EU Enlargement: How much it will cost and who will pay

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Introduction

The "cost of enlargement" and its distribution among Member States are the most sensitive and controversial issue in the enlargement exercise. Predictably the budgetary cost and, more precisely, the cost for the EU budget is at the center of the debate. Enlargement-related strains on the budget could upset delicate equilibria among Member States, while they would also have an impact on the future form of Community policies, and hence on the future shape of the Union. The debate is conditioned by the present general mood of budgetary discipline and austerity and, more specifically, by the revival of concerns about the "juste retour" (fair return), especially from Germany, the Netherlands, Austria, and Sweden.

This text presents an overview of the debate on the "cost of enlargement" and its distribution. It focuses on the proposals and estimates of the European Commission, as presented in the Agenda 2000 communication[1] and in the subsequent communication on the financial perspectives 2000-2006[2]. It also draws on the public and academic debate, both before and after the publication of Agenda 2000.

The first section addresses the issue of the overall economic impact of enlargement, while the second one presents and analyses the financial framework proposed by the Commission, as well as the reactions of other European institutions to it. Estimates on the investment needs of candidate countries are examined in a third section, in a "bottom up" approach to the cost of enlargement. The fourth and final section includes some concluding remarks.

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[*] *European Commission, DG 1A. The author was involved in the preparation of the enlargement volet of Agenda 2000, in particular of the "Impact Study". Views expressed in this paper are those of the author and do not in any ways engage the Commission. A summary of this paper was presented at the Chalki International Seminars, in September 1998.*

[1] *COM(97)2000 final*, 15-7-1997. The relevant sections are Parts II ("The Challenge of Enlargement") and III ("The New Financial Framework 2000-2006") in the main body of the communication, and the "Impact study" ("The Effects on the Union's Policies of Enlargement to the Applicant Countries of Central and Eastern Europe [Impact Study]") appended to it.

[2] *COM(1998)164 final*, 18-3-1998.

1. The overall economic impact of enlargement

An assessment of the economic cost of enlargement, as well as of the distribution of this cost among present Member States (as well as regions), should take into account the broader benefits and costs for the Union's economy which are expected to result from enlargement. This broader approach should on the whole rebalance the debate on budgetary costs, since the notion of benefits is by definition absent from the budgetary dimension[3]. However, while the broader assessment captures indeed the benefits from integration, it should also capture (in all but in extreme orthodox approaches) possible problems, which could be created by adjustment strains. Such strains would have a direct impact on the regional (and social) distribution of benefits and costs. In other words, assessing the broader economic impact should give a more optimistic picture of enlargement, but at the same time it should qualify simple arguments on the distribution of costs and benefits based on the "juste retour" principle.

1.1. Agenda 2000: the Impact Study

The European Councils of Essen and Madrid (December 1994 and 1995 respectively) requested the Commission to report on the expected impact of enlargement on the Union's policies. A number of conflicting aims were at the root of this request, reflecting the emerging positioning of member states on the enlargement issue. To some, the impact study would show the high cost of enlargement and would thus lend support either to a slowdown of the process or to an increase of own resources. To others, assessing the high cost of enlargement would favor a drastic reform of the costly policies, i.e. the CAP and the structural policies. To others still, the impact study would prove the significant overall benefits of enlargement, and would thus favor its acceleration.

The Commission submitted to the Madrid summit an Interim Report[4], while the final impact study was submitted in July 1997 as part of the Agenda 2000 package.

The Essen and Madrid mandates were to study the impact on "EU policies" and not on the EU itself. Meanwhile, on the (admittedly optimistic) assumption that EU policies reflect economic realities in the Union, the Commission decided to include in its study an assessment of the "overall economic impact" of enlargement, and also to include this dimension in the

[3] Indeed, when enlarging to poorer and more agricultural countries, the Union's budget can by definition only be burdened, the issue being by how much, and at whose expense. It should be reminded, however, that budgetary transfers (especially those from structural funds) generate demand that is often met by exports from countries that are net contributors to the EU budget. This is an additional reason for not limiting the "cost" assessments to a narrow budgetary dimension.

[4] *CSE(95)605*, 5-12-1995.

sections on the specific horizontal and sectoral policies of the Union[5]. The Commission did not venture, however, into a quantitative assessment: the "impact study" limits itself to a qualitative discussion of the issues related to the broader economic benefits and costs. This omission has been criticized as weakening the Commission's arguments in favor of enlargement, and in particular its rebuttal of the claims for "juste retour"[6].

According to the Commission's impact study, the main economic benefits to be expected from enlargement, are the classical ones generated by integration processes: expansion of the Single Market, strengthening of the Union's position in global markets, boosting of demand as a result of expected massive investment in the acceding countries as well as of their catching up with EU living standards. True, the acceding countries represent today a very small addition to the GDP of the existing EU (4% at current exchange rates and 11% at purchasing power standards). Nonetheless, the prospects of a growing market of around 110 mm people are obviously interesting.

At the same time, the Commission warns that, although integration with the candidate countries is already well advanced, through the implementation of the Europe Agreements for example, substantial sectoral and regional adjustment pressure is to be expected from the enlargement process[7]. Sensitive areas would include the labor market (though the Commission rejects some alarmist forecasts), some labor-intensive and other traditional sectors of industry, and some areas of transport. The Commission goes on to state that the regional distribution of costs and benefits from enlargement is difficult to assess, but rejects "inordinate pessimism" with regard to the impact on the less developed regions of the present Union[8]. Adjustment

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[5] For instance, the impact on regional policies would have to take into account possible regional strains resulting from the enlargement process, the impact on the common fisheries policy, possible effects of enlargement on the fishing industry of present and future member states, etc.

[6] The Nallet report to the French National Assembly considers that one of the main weaknesses of Agenda 2000 and of all EU documents on enlargement is the scarcity of macroeconomic assessments of the impact of enlargement on both present and future member states. The report even qualifies this absence as "curious" (*Nallet report*, p.19-20).

[7] It should be pointed out that the already advanced level of integration limits expected further strains but also further benefits.

[8] The lack of precision on regional and sectoral effects has been criticised:

⇒ "Agenda 2000 does not clarify the uncertainties surrounding the sectoral or regional impact of the increasing competition from industrial –and, in future, agricultural- products from the countries of Central and Eastern Europe and confines itself to outlining the possible effects" (From the Opinion of the Committee on External Economic Relations to the Oostlander-Baron Crespo report [*A4-368/97*] [draftsman: F.Moniz]).

⇒ The Nallet report states that the Commission limits itself to "common sense generalities" and that "more substantial and more precise information and studies" would be necessary, if we seriously want to shed light on the choices to be made (p.72).

⇒ For its part, the Economic and Social Committee Opinion states that "studies show that enlargement will produce the greatest economic and trade benefits in the most developed and the geographically closest countries" (CES, *1199/97*, pt.4.4.5).

It should be noted that uncertainty on the regional distribution of strains is an area of tension between countries bordering the CEECs (Austria, Germany), which fear the effects of strains are expected on the whole to be more important in acceding than in incumbent member states. Finally, a link is established between the economic benefits that will be reaped and the conditions under which enlargement will take place, i.e. the benefits will depend to a large extent on the degree that potential strains will be successfully addressed, which in its turn largely depends on adequate preparation of both acceding countries and the Union itself.

According to the Commission impact study, enlargement will not substantially alleviate the problems of the *less developed regions* in the present Union, it could also generate some adjustment pressure. Hence the necessity to maintain Community structural interventions. In *agriculture*, the positive effects of integration will be more profound, given the low degree of existing integration[9]. However, important adjustment strains are likely to be felt in acceding countries and to a lesser extent within the present Union. In any case, the effects of enlargement in this area will be highly dependent on the type of CAP that will be in force (*see below*).

It is interesting to note that, with few exceptions, the issue of the broader economic benefits and costs has not been very much on the agenda of the enlargement debate. This is understandable in the case of benefits, since these are as a rule diffuse; it is less so in the case of costs, where one would expect concerned sectoral and national or regional interests to be more vocal. The explanation could lie in the fact that those concerned (rightly) perceive that the strains to be expected from enlargement are as a rule only a small part of the broader challenge of an increased competitive environment, in which EMU and global competition are much more important elements.

The major exception to the above is free movement of workers, which is a highly sensitive issue, especially in Germany and Austria, as it nurtures fears about increased unemployment. In Austria, it is closely connected to the expected impact of enlargement on the border regions with future member states[10]. It is feared that the great wage differentials between bordering regions will generate massive flows of commuter migrants into Austria, and substantial industry delocalization towards neighboring regions of acceding states. In the public debate, these prospects have apparently overshadowed the obvious fact, that by its geographic position (and its history), Austria is likely to be among the major beneficiaries of the Eastern enlargement[11].

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proximity, and non-bordering cohesion countries (Portugal, Spain), which fear the effects of CEEC competition in labour-intensive products. Greece seems to lie on both sides of this controversy.

[9] The Europe Agreements do not provide for substantial integration in agricultural products.

[10] Austria is almost surrounded by four candidate states (Slovenia, Hungary, the Czech Republic and Slovakia), three of which (the first three) are among the so-called “ins”, i.e. those with which accession negotiations started in March 1998.

[11] The European Parliament has repeatedly voiced concern about the fate of border regions (Resolution of 4-12-97 on the *Oostlander* report, point 34, resolution of 18-6-1998 on the *Schroedter* report, point 10). See also the intervention of MEP Caligaris at the December 1997 debate (*Proceedings* 3/12/97).

1.2. Overall quantitative estimates

The problem with assessing quantitatively the overall economic impact of enlargement is that it is an almost impossible task, given the multitude of methodological problems, and the uncertainties, which prevail over the whole process. This is especially true, if the purpose is not to obtain an additional insight on the mechanisms and effects of an integration process (which is the standard academic rationale behind such exercises), but to use the results in very material and political arguments on burden sharing. The precedent of the Cechini report on the "cost of non-Europe"[12], shows that while the politics of the report and of its commissioning were commendable, the operational value of the result was more than questionable. This also explains, at least in part, why the Commission was reluctant to attempt such estimates in Agenda 2000.

Nonetheless, it is interesting to take note of existing academic work. The state of the art in this area is probably provided by a 1997 Commission financed study by Baldwin, François and Portes[13]. The study uses a simulation model, which takes into account *allocation effects* -trade creation, trade diversion, and an additional "Single Market" effect (estimated as a reduction of trade costs by 10%)- and *accumulation effects*, reflected in changes of risk premiums for investment in the CEECs (estimated at 45 basis points). The resulting real income effect for the EU-15 is estimated at around ECU 11 bn annually, which roughly corresponds to 0.2% of EU-15 GDP. The real income effect for acceding countries[14] is much more important: in the static scenario (without changes in risk premiums) it is around ECU 2.5 bn, which however corresponds to 1.5% of their GDP; in the dynamic scenario, the effect is a spectacular ECU 30 bn, or around 19% of their GDP. Interestingly, the study concludes that other European regions not directly concerned by enlargement (EFTA and the former USSR) are also going to benefit from it.

The study also includes some "back-of-the-envelope" calculations on the distribution of the effects among incumbent member states. These show that the major beneficiaries will be Germany (34% of total EU-15 benefit), France (19%), and the UK (14%). Ireland, Greece and Portugal will hardly benefit at all; Portugal will even suffer a slight loss. A very rough calculation based on these results shows that, in relative terms, Sweden appears as the major beneficiary (0.3% of its GDP), most other member states lie around the EU-15 average (of 0.2%), while Italy joins the three above mentioned states in benefiting the least (or slightly losing, in the case of Portugal).

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[12] Report commissioned by the European Commission to assess the expected impact of the Single Market.

[13] R.Baldwin-J.François-R.Portes (1997).

[14] The three Baltic countries are not included in the calculations.

The main conclusions to be drawn from this study are comforting: the EU-15 is likely to gain as a whole (in fact by amounts comparable to expected additional budgetary expenditure -see the next section); no member state is actually going to lose (except for a marginal loss for Portugal), and in relative terms the distribution of profits is more or less even; acceding states will benefit much more, possibly even spectacularly; and neighboring regions are also going to benefit.

Needless to mention that the results of this exercise carry all the flaws inherent in its underlying assumptions and methodology. In particular, the study does not take into account the effects of adjustment strains, assuming full mobility of factors of production[15]. This is especially significant in the case of the acceding countries, where the expected major benefits will be the result of radical restructuring of whole sectors of industry. Indeed, if the authors published a sectoral breakdown of their results, it would appear that the benefits result from the practical disappearance of whole branches of industry (and the emergence of others). The implications of such changes, not least in budgetary terms, are certainly less comforting than the published results.

The “back-of-the-envelope” calculations on the distribution of the effects among incumbent member states suffer from an additional flaw: while they take account of the production structure of member states (for instance, countries with labor-intensive industries, are worse off than others with high-tech productions, etc.), they ignore the effect of geographic proximity with acceding states. This latter effect, however, has proven by experience to be by far the most important, though apart from benefits, also costs are affected by it.

A similar CEPR study which focuses on the enlargement effects for Austria, yields some interesting results: while it predictably estimates that the country has substantially to gain (0.6-0.8% of its GDP), indeed about as much as it gains from its own accession to the EU, it surprisingly concludes that enlargement would tend to favor the country’s labor-intensive rather than its skill-intensive industries. Once again, the classical assumptions of such models are there, including that of full inter-industry mobility of labor[16].

1.2. An indicator: developments in trade during the 1990s

A glance at the trade level between the EU and the CEECs as well as at its dynamics since 1989 can give us some clues on the integration potential and on its possible distribution among Member States.

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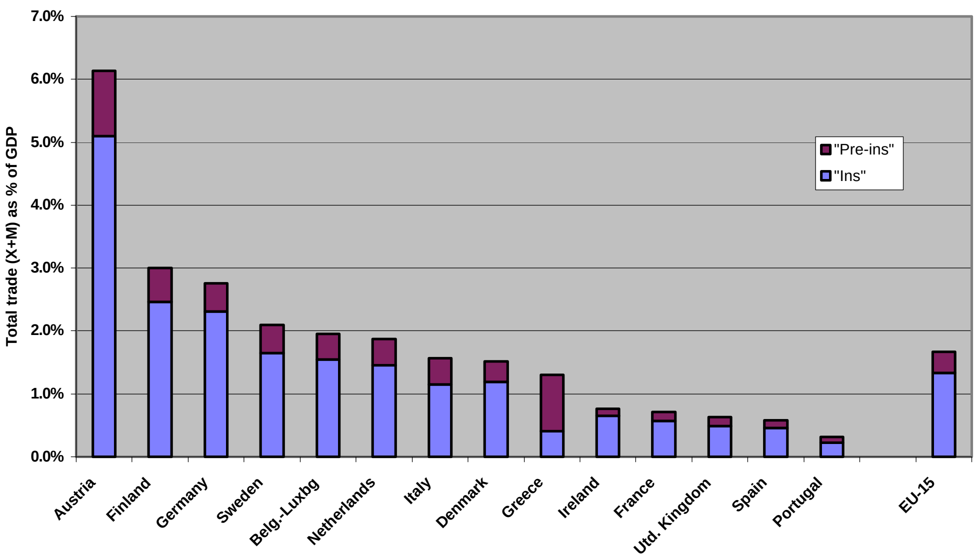
[15] Such effects are indirectly taken into account in the distribution among member-states, but not in the model itself, and the global estimates.
[16] Ch.Keuschnigg-W.Kohler (1998).

EU trade with candidate CEECs by Member State (Table 1)
Germany is by far the largest EU partner of the ten candidate CEECs with its share in total EU-15 trade with them reaching 43% in 1997. Italy follows (with 13%) before Austria (9%), France (7%), the UK (6%) and the Netherlands (5%). At the other end, Portugal answers for a meager 0.2% of EU trade and Ireland for 0.4%. The impressive weight of Germany, but also the substantial share of Austria, a small Member State, are the main conclusions from this picture.

Chart 1 **EU-15 TRADE WITH CANDIDATE CEEC'S 1997: IMPORTANCE FOR MEMBER STATES**

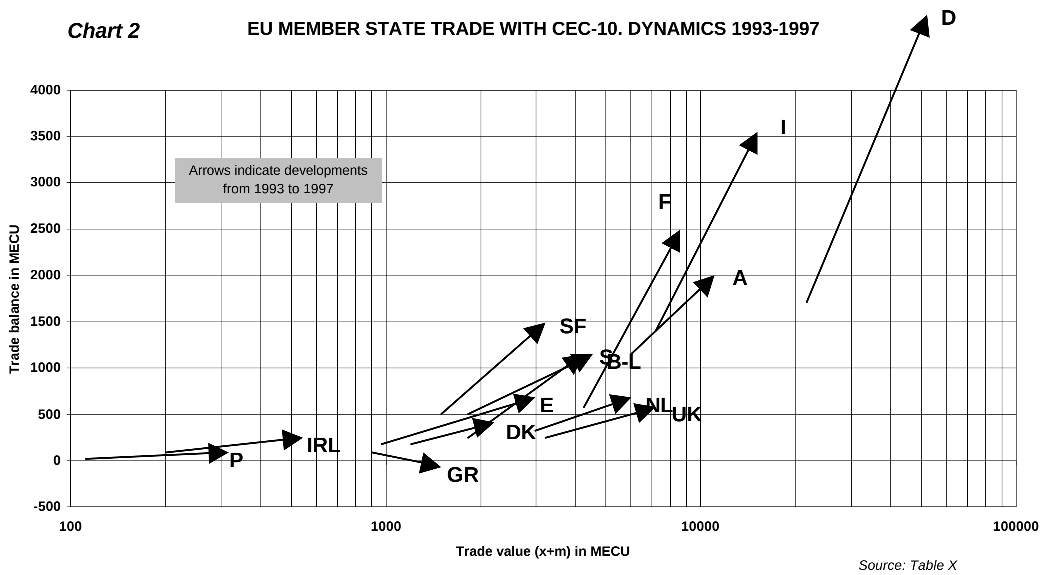


Importance of the CEECs to EU Member States (Chart 1 and Table 1)
Despite the dynamism of EU-CEEC trade (see below), in 1997 trade dependence of the EU on its eastern partners was on the whole still quite small: total trade (exports+imports) with the ten candidate countries represented 3.5% of EU-15 trade with the world (and around 10% of its extra-EU trade) and just 1.7% of its aggregate GDP. What is interesting, however, is the picture by Member State: Austria is by far the most dependent, with a trade/GDP ratio of above 6%, while three other countries follow in the 2-3% range: Finland, Germany and Sweden. An intermediate group in the 1-2% range is formed by Belgium-Luxembourg, the Netherlands, Italy, Denmark and Greece, while Ireland, France, the United Kingdom, Spain and Portugal occupy the last places with rates below 1% (just 0.3% for Portugal). In the case of all Member States, but Greece, the “ins” answer for the bulk of trade with the candidate countries. Not surprisingly, geographic proximity seems to be highly correlated with trade dependence[17].

[17] Of course, trade in goods gives only a partial picture of economic dependence, and it can be assumed that the position of the UK and Ireland would improve, if account were taken of trade in services and investment.

Trade growth in the 1990s (Chart 2 and Table 2)
EU trade with the candidate CEECs has been increasing spectacularly in the nineties. On the whole, it almost tripled in ECU terms from 1989 to 1997. All Member States have participated in this development, with increases ranging from 5-6 times (Spain, Belgium-Luxembourg) to 2-2.5 times (Germany, Finland) [18]. This growth reflects the impact of both the EU-CEEC integration process (Europe Agreements, liberalization measures before the EAs), and the systemic changes in the CEECs, which lead to a substantial opening of their economies to the world.

Chart 2 **EU MEMBER STATE TRADE WITH CEC-10. DYNAMICS 1993-1997**



Source: Table X

A comparison can also be made between 1993 and 1997, since this would allow us to include trade with all ten candidate countries and to capture more distinctly the effects of the Europe Agreements[19]. EU-15 trade with the CEC-10 more than doubled (+120% in ECU) between 1993 and 1997, and important increases are recorded by all Member States. The highest growth rates are those of Portugal, Spain, Ireland, Belgium-Luxembourg and Sweden, and the lowest ones (but still quite high) those of Greece, Austria and Denmark. A trend for the countries with the lowest trade volumes to catch up can be observed.

Trade balance (*Chart 2 and Table 2)*
The trade balance and its evolution are often seen as a measure of the “profitability” of a bilateral relationship. This of course reflects a mercantilist approach; nevertheless, since such arguments do influence public opinion and

[18] The three Baltic states and Slovenia are not included in these calculations, since there are no reliable figures for 1989. The comparison is made for EU-15, i.e. by including Sweden, Finland and Austria, as well as East Germany in 1989.
[19] This is only partly correct, since the trade volet of the EAs went into effect in early 1992 for the Visegrad countries, and later than 1993 for most other candidates. Also, the effects of systemic changes are being felt even after the completion of trade liberalisation (which occurred before 1993).

policy making, it is worth examining this dimension in EU trade with the candidate countries.

In 1997, the EU ran a surplus of around ECU 20 bn in its trade with the ten candidate CEECs, and its export import ratio was 139%. This represented an increase of more than ECU 13 bn since 1993, when the X/M ratio was 127%. In 1997, all Member States, but Greece, ran surpluses with the CEC-10; also, their balances had improved since 1993 in all cases but Greece; so had the X/M ratio in most cases (the exceptions being Greece and Austria[20]).

The conclusions from this overview are that in recent years trade has been very dynamic, and that EU exports are substantially higher and have grown more than EU imports. This picture is valid for practically all Member States (with the exception of Greece with respect to the trade balance). The increasing EU surplus, up to a point natural under present conditions, contradicts fears that integration with the CEECs would lead to a unilateral "invasion" of cheap eastern products in EU markets. At the same time, it could be argued that a large part of the potential trade integration has already taken place, and that consequently, further benefits (and strains) on the road to enlargement could be limited. However, empirical and historical evidence suggests that an important integration potential is still untapped, since the free trade zone is still incomplete (agriculture, possibility of contingency measures, import liberalization by CEECs), while there is additional integration potential from a free trade zone to a Single Market (and, eventually, EMU) status. The expected continued fast growth of candidate country economies is another factor conducive to increased trade.

2. The budgetary dimension

2.1. The issues and early estimates

The logic for an assessment of the budgetary implications of enlargement is relatively simple. Acceding countries are much poorer and on average much more agricultural than the present Member States. Moreover, they are likely to remain so for the foreseeable future, despite expected faster growth and agricultural reforms.

⇒ Average per capita GDP in the ten applicant countries was at around 15% of the average EU-15 level in 1997, and that in the five "ins"[21] at around 19%. Expressed in purchasing power standards (which are the basis for calculation of eligibility to structural and cohesion fund support), the respective figures were 40% and 45%[22]. By the year 2006 the average for

[20] In the case of Austria, however, the surplus in absolute terms had almost doubled from 1.1 to 2.0 bn ECU.

[21] The Czech Republic, Estonia, Hungary, Poland and Slovenia.

[22] Data taken or calculated from Eurostat, *Statistics in focus, Economy and finance*, 1998/28. These are new data compared to those published by the Commission in Agenda 2000.

the CEC-10 is still expected to lie at around 56% of the EU-15 average, and that of the five “ins” at 65% (in PPS)[23].

⇒ Agricultural employment for its part was on average 22% of total employment for the ten applicants and 18% for the five “ins” in 1995, compared to an average 5.3% for the EU-15; and although one might expect a considerable narrowing of this gap in the coming years, there is no doubt that by 2006 the new member states will on average still be considerably more agricultural than the EU-15.

The above means that while the new member states will contribute to own resources only modestly, under presently valid rules they will largely benefit from the structural and cohesion funds as well as from the CAP. In the case of the structural funds, it is expected that the quasi-totality of the territory of the new member states will be eligible for Objective 1 support (regions with a per capita GDP of less than 75% of the EU average)[24], while all acceding states will be eligible for the Cohesion Fund (per capita GDP of less than 90% of the EU average).

Before the publication of Agenda 2000, government and academic sources produced a large number of estimates on the budgetary cost of enlargement. As a rule, these estimates are based on the assumption that existing policies would remain unchanged and would be fully applied to acceding countries. *Table 3* presents a representative sample of such estimates concerning the two main expenditure items, the CAP and structural policies (including the cohesion fund). As can been seen, they vary widely and are not easily comparable since they do not cover the same set of countries. Nevertheless, with few exceptions they conclude that the budgetary cost of enlargement is very high. On the basis of these estimates, an overall annual net cost of *80-90 BECU* for the ten candidate countries is easily attainable, and indeed was often mentioned[25]. These sums correspond to 1.2-1.3% of EU GDP and would imply a practical *doubling* of the Community budget.

The high estimates for structural aids result from the assumption that acceding states would receive the same per capita amounts as a benchmark Objective 1 incumbent member state (usually Greece). This was apparently the basis for a Commission estimate of 38 BECU, which leaked to the press in late 1995[26].

Calculations on the CAP cost are more complicated, and hence varied more widely. The higher estimates were based on the pre-Marrakech situation, and do not take into account new WTO obligations, which limit potential EU

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[23] Assuming Commission forecasts for GDP growth, constant population for the CEECs, and 1990-96 recorded population growth rates for EU-15.

[24] Possible exceptions could be the regions of Prague and Bratislava, and, less probably, those of Budapest and Warsaw.

[25] 87 BECU according to the French Minister for European Affairs (in *Europe* No 6328, as quoted by V.Barta-S.Richter (1996)). 83 BECU in S.Walldén (1995).

[26] *El País* 12-10-1995. The Commission subsequently denied the figure.

subsidies, nor the recent trend of higher world prices for key agricultural commodities. Indeed, in some cases there is also an estimate of the impact of large subsidized exports on world prices (which would result in additional export subsidies). In this respect, the higher estimates could be discarded.

A clear conclusion that could be drawn from these "early" estimates was that, despite very big uncertainties, the direct budgetary cost of enlargement to the ten candidate countries, on the assumption of unchanged policies and their full application to acceding states, would be very high, indeed not sustainable under conditions of financial austerity. Even the Commission's alleged estimates, totaled annual sums of around 50 BECU, i.e. an almost 60% increase in expenditure.

2.2. Agenda 2000: "squaring the circle"

In its Agenda 2000 the Commission accomplishes what many have called "*la quadrature du cercle*". It proposes a financial framework for enlargement which (a) is compatible with keeping the ceiling of own resources constant as a proportion of EU GDP, at 1.27%, and expenditure for structural operations at 0.46% of EU GDP; (b) maintains on the whole existing levels of support to the present member states and in particular to the less developed ones; and (c) maintains a single conceptual framework for the Community policies, rejecting –at least formally- a differentiation between new and old member states.

2.2.1. The "cost of enlargement"....

The financial framework proposed by the Commission (*Table 4*) foresees that the additional cost for enlargement during the 2000-2006 period will be ECU *80 bn* (in constant 1999 prices). This sum breaks down into:

- ECU 22 bn for pre-accession aid and ECU 58 bn for the new member states;
- ECU 16 bn for agriculture (incl. 3.6 bn in pre-accession aid), ECU 47 bn for structural operations (incl. 7.2 bn in pre-accession from the proposed new "Structural Pre-Accession Instrument") and ECU 17 bn for other policies (including 10.9 bn of Phare funding for pre-accession).

Enlargement-related expenditure would thus represent around *10%* of the total proposed budget; in agricultural expenditure it would represent 5% and in structural operations 16%.

Given the fact that enlargement-related expenditure will undergo a phasing-in process, it is pertinent to examine the expected level of expenditure in the final year *2006*. At that date the Commission proposal would bring total enlargement-related expenditure to ECU *20 bn* out of a total budget of ECU 122 bn, or 16%. Structural aids for enlargement would total ECU 13.1 bn or 30% of the total EU budget for structural operations, and agricultural expenditure would reach ECU 3.9 bn, or 7% of total CAP expenditure.

In terms of GDP, the thus estimated "cost of enlargement" for the period 2000-2006 amounts to 0.13% of the EU-15 GDP, while for the year 2006 this cost will amount to 0.21% of the enlarged Union's GDP.
The figure of 20 BECU (for the final year 2006) compares favorably to practically all the estimates that had previously been advanced (see *section 2.1*).

2.2.2. ...and "who will pay for it"

Logically, any additional budgetary expenditure has to be financed either by an increase in revenues or by a decrease in present expenditure, or by a combination of the two.
By keeping the ceiling of own resources constant as a percentage of Union GDP, the Commission foresees an increase in revenues proportional to EU GDP growth. This growth should generate additional resources of around 73 BECU (in constant 1999 prices) for the period 2000-2006, which is pretty close to the estimated "cost of enlargement". For the year 2006, additional resources from EU-15 growth could be 18.7 BECU as against 19.9 BECU of "enlargement costs" and 16.2 BECU of "net costs", i.e. after subtracting new members' possible contribution to own resources. This would mean that enlargement could be wholly financed by EU-15 growth. Meanwhile, the Commission does not propose to fully exhaust the 1,27% ceiling in own resources, since it wishes to keep sufficient margins for possible additional expenditure, in particular in relation to enlargement[27]. Hence, in reality, part of the enlargement costs will be financed by cuts in EU-15 expenditure[28].

The proposed financial perspectives foresee a practically constant level of overall expenditure for the EU-15. In other words, it would appear that, according to the Commission proposals, overall transfers to the EU-15 will not suffer at all from the planned enlargement (though net transfers to beneficiaries will somewhat diminish given the increase in the absolute value of their contributions to own resources). Agricultural expenses are scheduled to rise by 13% as a result of further CAP reform, while other non-structural expenditure will also increase by 10%. Structural expenditure for its part will decrease by 19% between 1999 and 2006, from 39 to 31.4 BECU[29].

As mentioned above, structural policy transfers to the EU-15 will diminish. Given the policy of maintaining total structural transfers constant at 0.46% of EU GDP, it can be estimated that present beneficiaries will finance around a quarter of the similar transfers to acceding and candidate countries, while the

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[27] Additional margins are foreseen under the agricultural guideline.

[28] In practice, calculations are complicated by the fact that the 1,27% ceiling concerns appropriations for commitments, while the figures presented here are appropriations for payment. Since however the latter exceed the former, it can be concluded that growth-generated financial margins are even greater when compared to enlargement-related expenditure expressed in appropriation for payment.

[29] The 1999 figure for structural expenditure is inflated by "adaptations passées". Without these, the figure would be 35.7 BECU (which also corresponds to the 0.46% of EU GDP ceiling) and the planned decrease by 2006 would be limited to 12%.

remaining three quarters will be financed by GDP growth. If we take the final year 2006, the proportion is closer to one over two thirds. On the other hand, structural policy transfers to Objective 1 regions will diminish by less (by an estimated 5% between 1999 and 2006 according to our own very rough calculations). If we consider only those Objective 1 regions which are likely to remain such throughout the period (i.e. which will not be phased out), there could actually be an 8% increase in total (and a 7% increase in per capita) support[30].

In other words, the proposed concentration of the structural assistance effort in the present EU will more than compensate for the new enlargement-related transfers, thus allowing for *increased* support to the most disadvantaged regions within the present EU. These regions will probably include the whole of Greece, the whole of Portugal except the Lisbon area, the five new German Länder and all of the present Objective 1 regions of Spain, except Valencia. "Losers", apart from the already mentioned regions of Lisbon and Valencia, would include the whole of the Republic of Ireland, and a number of regions in Italy (Puglia, Sardegna), France (Valenciennois, Corse), the UK (N.Ireland, Highlands[31]), Belgium (Hainault), and the Netherlands (Flevoland).

Finally, the question is often raised whether the "costs of enlargement" will be at the expense of assistance granted to other third countries. The Commission proposal foresees a 20% increase in such payments between 1999 and 2006 (from 5 to 6 BECU), though a small drop is planned for the first year. In terms of EU-15 GDP, the 2006 figure will remain unchanged with respect to 1999 (at 0.065%). It can thus be concluded that third countries will not "pay for enlargement", though it is a matter of opinion whether the proposed increase is sufficient, given the increasing involvement of the Union in world affairs[32].

2.3. Methodology and Assumptions of Agenda 2000

Obviously the Agenda 2000 "miracle" was achieved through a number of assumptions on political, economic and policy developments, many of which have been contested by interested and concerned actors and observers. Moreover, the coherence of the exercise is ensured by the adoption of a "top down" or residual methodology in the planning of transfers to candidate and

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[30] The assumptions for these very rough calculations are (a) Cohesion Fund support to Spain is distributed evenly between Objective 1 and other regions (proportionally to population), (b) Cohesion Fund payments will continue to the same countries throughout the period (a proposed mid-term review could modify this situation), (c) populations are considered constant in the new members, while they grow at an average rate of 0.3% in Objective 1 regions (calculation based on national growth rates for 1990-96), (d) Structural Fund payments to Objective 1 regions for 2000-2006 estimated at 2/3 of total, (e) Structural Fund payments to Objective 1 regions for 1999 at same proportions as for the whole period 1994-1999, (f) linear phasing-out (and phasing-in) for regions which will reach (or fall below) the 75% threshold. These regions have been provisionally identified by a Commission official, as reported in R. Martin (1998), p.107.

[31] In the case of the UK, South Yorkshire is expected to acquire Objective 1 status.

[32] The overall *economic* impact of enlargement on third countries is, of course, another issue, but there seems to be a consensus that this impact will on the whole be positive.

acceding states: those result from the difference between own resources and the planned expenditure for the EU-15, and not from an estimate on the needs of these states[33].

The main underlying principles and assumptions of Agenda 2000 are the following:

2.3.1. The "sacrosanct principles": unchanged own resource and structural expenditure ceilings

Agenda 2000 has as its starting point the inviolable character of two ceilings that were decided at the Edinburgh summit of 1991: own resources will not exceed 1.27% of the EU GDP, and payments for structural policies will not exceed 0.46% of EU GDP. Thus, unlike during previous periods (and enlargements), resources and structural expenditure will remain constant in relative terms. Of course, under assumptions of positive growth rates, both posts will grow in absolute terms, and this increase is intended to finance at least in part the enlargement. The imperative of the two ceilings reflects the present mood in the Union and rising demands of Member States that are net contributors for a "fair return". The Commission proposals foresee important margins even below the 1,27% ceiling, and indeed, projected expenditure is substantially below this ceiling, in line with the observed trend during the current financial perspective.

2.3.2. The CAP and the Structural Policies will be reformed as proposed

In the Commission's analysis, enlargement is sustainable only if accompanied by the proposed policy reforms. This is obvious in the case of the Structural Policies, where the reform is intended to finance around one fourth of the cost of enlargement for 2000-2006 and around one third of it in 2006 (*see below*). In the case of the CAP it is less evident, since the proposed reform will actually increase the overall expenditure even to present member states[34]. However, further CAP reform is indispensable in the Commission calculations, because it will contribute to reduce the price gap for farm products between the CAP and the acceding states. The impact of remaining price gaps after accession, first of all on production levels (and hence surpluses) in the acceding states, but also on a number of other variables (unemployment, inflation, production in EU-15) is one of the main elements of uncertainty in the Agenda 2000 exercise. If these gaps were to remain very large, budgetary and other problems could become very serious.

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[33] "We have the feeling that what you present to us is not a sum, it is a residual. It is not a sum of credits, reflecting needs, it is a difference between two orders of magnitude on which you have no command: on the one hand, of contributions that must not move, on the other hand of expenditure in favour of the 15 Member States that was incompressible. Between these two there is a residual, and it is within this residual that the candidates to the EU are invited to make their happiness" (MEP Bourlanges, *Proceedings* 3/12/97).

[34] It has been estimated that the "Agenda 200" reforms would result in annual savings of 3.7 BECU in market expenditure, which would be over-compensated by 7.8 BECU of additional direct aid, and 2 BECU of additional accompanying measures, the net result being an increased cost of 6.1 BECU (*Colom I Naval* report, *A4-331/97*, pt.30). The new Commission proposals on financial perspectives would slightly modify this figure, probably upwards for the additional net cost.

Linkage with the enlargement project is clearly the Commission's powerful leverage to achieve the proposed policy reforms. Predictably, member states and interests, which oppose these reforms, contest various elements of the Agenda 2000 puzzle, including the 1,27% ceiling and the enlargement timetable. While it is true that Agenda 2000 provides for important margins, it is also true that, were the policy reforms which will be eventually agreed to be more costly than the Commission's proposals, the sustainability of the enlargement process would be endangered, given also the high degree of uncertainty on other parameters of the exercise.

2.3.3. Average annual growth rate until 2006 will be 2.5% for the EU-15 and 4% for the acceding states

These forecasts are central to the Commission calculations since most of the additional cost for enlargement is expected to be financed by EU growth.

The Commission forecasts for EU-15 have been criticized as being too optimistic[35], while it has also been suggested that in any case they comport a high degree of uncertainty. It has been pointed out that the past record for EU-15 is substantially below the Commission forecast[36]. The Commission insists that its forecasts are realistic, but also argues that its financial perspective is viable even under very pessimistic scenarios with an average growth rate of 1.5%[37].

2.3.4. Timing of enlargement and "first wave" versus "second wave" countries: differentiation

It is assumed that enlargement will take place in 2002 with five countries - the Czech Republic, Estonia, Hungary, Poland and Slovenia (plus Cyprus). No further accessions are expected before 2007. Agenda 2000 underlines that this is just a working hypothesis since the EU position is that each candidate country will join on its own merits, and hence neither the dates nor the sequence of accessions is decided.

It is easy to figure out that, were the time schedule of accessions to be accelerated, the proposed financial framework would fall apart. Likewise, the pledge to keep the negotiation timetable open for additional candidate

[35] The growth rate of new member states weighs very little in the financial perspectives, and the Commission forecast should anyway not be considered excessive, if one takes into account recent performance.

[36] There is however a controversy over how much lower this record is. The Commission has presented the Council a working paper, which mentions 2-2.1% as the average growth rate over the current period (presumably 1993-1997). In Parliament, Colom I Naval, the Committee on Budgets rapporteur, mentioned 1.5% for the years 1991-96 (*Proceedings*, 3/12/97). Obviously the two figures concern different periods. According to our calculations (linear regression method, EUROSTAT data) the respective figures for 1991-96 and 1993-97 are 1.6% and 2.0%.

[37] This claim is presented in the above mentioned Commission working paper. For his part, Colom I Naval, maintains that if the growth rate fell below 2%, "the edifice of the Commission [...] would collapse" (*Proceedings*, 3/12/97).

countries is heavily constrained, and would seem credible only in the case of small countries[38].

At Luxembourg, the Commission proposal for accession negotiations to be opened with the five countries mentioned above (plus Cyprus) was approved. Although the decision concerns the *opening* of negotiations, it is undoubtedly in line with the idea of differentiated accessions, and thus conforms to the Agenda 2000 working hypothesis. Concerning the realism of the accession *timetable* used as a hypothesis, a number of high-ranking politicians of Member States, including President Chirac and Chancellor Kohl, have repeatedly suggested early dates (e.g. 2000) for the first accessions. Meanwhile, the present mood in the Union is that even 2002 is a rather optimistic date[39]. It should be noted that the enlargement timetable is likely to be affected by the so-called 4th Copenhagen criterion, i.e. the capacity of the Union to absorb new members while maintaining the momentum of European integration. In this respect, enlargement could be delayed by complications in the institutional reforms.

The Agenda 2000 proposals imply that the five countries which have been selected for the opening of negotiations will receive 63 BECU during 2000-2006, while the remaining five countries will receive 19 BECU; in per capita terms the corresponding average yearly figures are 141 and 61 ECU (*Chart 3* and *Table 5*). If we take the final year 2006, transfers to the five "ins" will be 16.8 BECU or 268 ECU per capita, while those to the five "pre-ins" a mere 3.1 BECU or 73 ECU per capita[40]. This means that in 2006 per capita transfers to the "pre-ins" will be 3.7 times less than to the "ins"[41]. This difference is in a sense natural, since countries joining the Union will of course enjoy the advantages of Member States. It is also true that transfers to the "pre-ins" will also increase sharply (from around ECU 0.5 bn in 1999, to a yearly ECU 1.2 bn in 2000-2001, and ECU 3 bn in 2002-2006). Nevertheless, criticisms have been voiced that such a large differential in assistance between "ins" and "pre-ins" will hardly contribute to keep the "pre-ins" on track, all the more so since they are already as a whole considerably less developed than the "ins" [42].

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[38] Strictly speaking, the Union pledge concerns the opening and not the conclusion of accession negotiations; however, the obvious meaning of this flexibility is that candidate countries that perform well could join faster, even if they have now been excluded from formal negotiations.

[39] Gil Robles, speaker of the European Parliament, recently qualified the entrance dates of 2000 or 2001-2002 "more a dream than a reality" (*AFP*, 15/5/98).

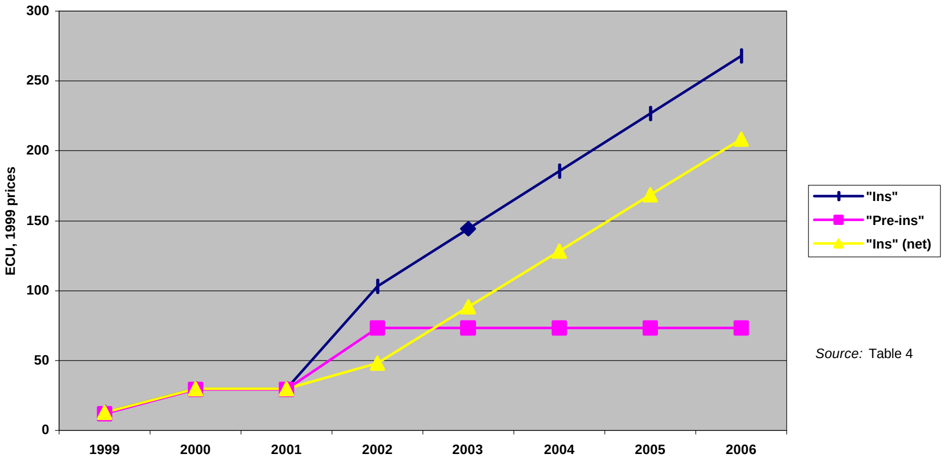
[40] We assume unchanged populations, which is an improvement with respect to the 1990-96 record.

[41] The ratio for net transfers will be somewhat lower, since as of accession, the "ins" will have to contribute to the Community budget. Assuming that contributions of new member states will not be phased-in, net transfers to the "ins" in 2006 will be 13 BECU, or 208 ECU per capita, which is 2.9 times the projected per capita transfers to the "pre-ins".

[42] See for instance the *Nallet report*, p.94-95. Responding to such criticism, the Commission decided to re-allocate a small amount of Phare funds (50 MECU) for the years 1998-99 to a so-called "catch up" facility ear-marked for the "pre-ins".

Chart 3

"AGENDA 2000": PER CAPITA TRANSFERS TO "INS" AND "PRE-INS" 1999-2006

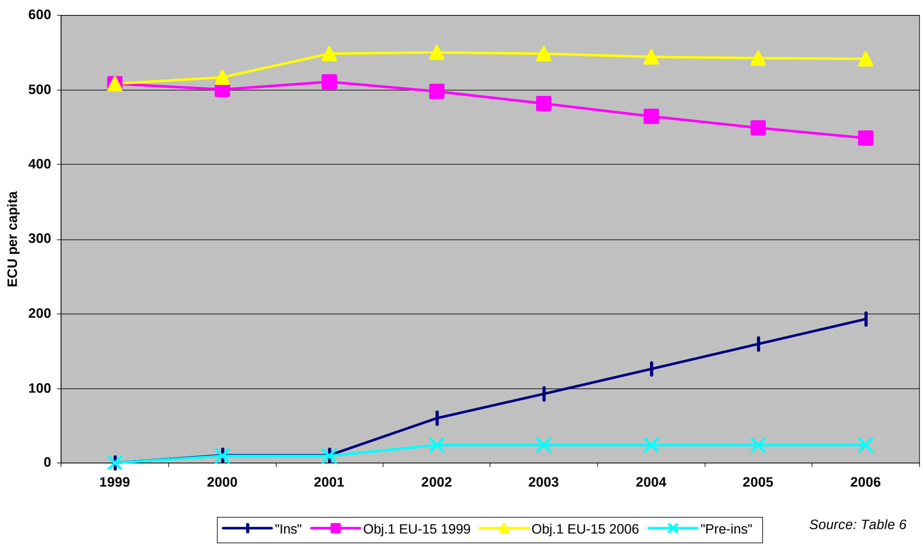


Source: Table 4

2.3.5. Structural fund transfers to acceding countries: phasing in and 4% ceiling, reflecting assumed absorptive capacity

The Commission proposes that structural transfers to the new members will be phased in (from 3.8 BECU in 2002 to 12.1 BECU in 2006). This was the usual practice also in previous enlargements and is justifiable with respect to the absorptive capacity and the learning-in process in the new member states. Meanwhile, the amounts to be allocated to new member states at the end of the transition period in 2006 are still at slightly more than one third of the per capita levels of the amounts which will go to Objective 1 regions in the old member states (193 as against 542 ECU) (*Chart 4* and *Table 6*). The Commission justifies this difference by the limited absorptive capacity of the new member states. Indeed, a key element of the proposed reform is that structural transfers will not exceed 4% of the GDP of any member state since this is judged to be a fair measure of their absorptive capacity. The 4% ceiling applies to both old and new member states, but given the lower per capita GDP of the acceding states, it implies much lower per capita transfers to the latter.

Chart 4 **PROJECTED STRUCTURAL TRANSFERS 1999-2006**



Source: Table 6

The idea of a 4% ceiling has met with widespread approval in the Union, since it is the key which will allow old beneficiaries to continue receiving high amounts of aid, without this leading to an increase of the 0.46% ceiling for structural operations. However, it would appear that it is one of the less well founded elements in the Agenda 2000 puzzle:

- In the first place, while the issue of absorptive capacity is certainly a real one, even for present member states[43], empirical evidence on the absorption problems for the Structural Funds is not very strong and does not seem to allow for determining an upper quantitative limit above which transfers can no longer foster catching up. It has been suggested that the figure 4% is arbitrary, and there is no real reason why it could not be 5%, 7% (or 2% for that matter). The only apparent justification for its adoption is that it slightly exceeds the expected rates for present member states. It has also been pointed out that *net* transfers from the Federal Republic of Germany to the new Länder during the period 1991-96 have averaged at 39% of the latter's GDP, while in 1991 they reached 52%[44]. Although the two situations are not strictly comparable (and the figures for the ex-GDR correspond to all transfers, not just to structural ones), the gap between the respective percentages is still impressive, and can only cast serious doubt on the absolute and objective character of the 4% ceiling[45].

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[43] This capacity is limited by inadequate administrations as well as by constraints on the required co-financing from national sources.
[44] Data from OECD, Economic Surveys, *Germany*, September 1997.
[45] The Nallet report uses the example of the New German Länder to question the sufficiency of the means put at the disposal of the acceding states: "Even if one takes into account the considerable differences between the two integration experiences, can the Commission reasonably propose to allocate 76.1 BECU over eight years (1999-2006) to integrate 110 million inhabitants, [...], when the Federal Republic of Germany has not yet succeeded in

- In the second place, it has been suggested that the philosophy implicit in the 4% ceiling is particularly problematic. Indeed, such a ceiling implies that richer countries would get more per capita assistance than poorer ones, while in the pursuance of the objective of social and economic cohesion one would expect the exact opposite to happen[46].

2.3.6. Farmers in acceding countries will not enjoy direct income subsidies

Direct income subsidies to EU farmers were originally intended to compensate for drops in income resulting from the 1992 CAP reform; in practice they have been maintained, even when (as is the case for cereals) incomes did not actually drop, because of higher world market prices.

In the case of farmers in acceding countries, no decrease in their income or of institutional prices is foreseen; on the contrary, income is expected to rise substantially as a result of higher CAP prices. The Commission therefore proposes that for a transitional period (which, however, extends at least until 2006) they will not receive direct income subsidies, but that a part of the amounts, which is thus saved, will be ear-marked for rural development and structural reform in the agricultural sector of the acceding countries.

The amount saved by not paying direct income subsidies to acceding member states is relatively important, probably around 4 BECU by 2006 *(Table 7)*. The Commission proposes to grant in 2006 2.1 BECU for specific accompanying measures, but this should represent an increment of around 1.3 BECU with respect to “normal” accompanying measures in a status quo scenario. Thus, the amount saved is around 2.7 BECU, and acceding countries will receive only around one third of what they would be “entitled” to.

Economic arguments corroborate the Commission position of not paying direct income subsidies: the consequences of a spectacular increase in agricultural income in the acceding countries could be very serious – increase in the price of agricultural land with negative impact on restructuring, increase in food prices, with broader economic consequences. Also the redistribute effects of such payments could be questioned, since farmers would be relatively well off with CAP prices anyway, while the structure of the sector in acceding countries would imply that transfers would probably mainly benefit large firms and landowners living in cities instead of active farmers.[47]

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attaining its goals to integrate 16 million inhabitants after injecting the equivalent of 450 BECU over seven years?” (p.86). At the same time, however, the Nallet report approves the 4% ceiling: ”It is incontestable that the absorption capacities of aids by the economies and administrative systems of these states are limited, and it seems reasonable, under the reservation of more advanced investigations, to fix the maximum level of aid at 4% of GDP, as proposed by the Commission” (p.45).

[46] This point is mentioned in the Committee of Regional Policy opinion to the *Oostlander-Baron Crespo* report (*A4-368/97*).

[47] The Commission’s Directorate General II produced a study with detailed argumentation in this sense, CEC (1996).

At the same time, however, non-payment of direct income subsidies will further contribute to a situation where new member states will receive smaller transfers per capita and per farmer to new member states. Indeed, some rough estimates (*Table 8*) indicate that by 2006, agricultural transfers per capita to the new member states will be at 40% of the level of transfers to the EU-15, while transfers per farmer could be somewhere between 15% and 20%[48]. The effect on economic and social cohesion of such large differences could of course be considerable[49]. Meanwhile, it should also be noted that, were the farmers of the new member states to receive the same per capita sums as their colleagues of EU-15, additional expenditure could well be of the order of 15-20 BECU in 2006. Also transfers of the order of 7-8000 ECU per farmer would significantly exceed expected average per capita GDP in new member states for that same year[50].

2.3.7. Assumptions on the market driven element of CAP expenditure

The underlying assumptions are obviously crucial for the estimates of market-driven CAP cost. These assumptions include projections of world prices for the main agricultural commodities as well as of EU production. Concerning the development of world prices, the Commission projections are apparently based on the state-of-the art; however, no analysis of the sensitivity of agricultural expenditure to changes in world prices has been published, which means that the Commission has chosen not to elaborate (at least publicly) on the possible budgetary consequences of an overvaluation of world prices[51]. Obviously, were the Commission assumptions to prove too optimistic, the agricultural guideline could fall under pressure, while complications would also arise with respect to the Union's international obligations within the framework of the WTO.

For payments to new member states, an additional key parameter is the price elasticity of supply for agricultural output in these countries. This elasticity is assumed to be low due to structural obstacles to modernization and, hence, to productivity increases in these countries. In other words, it is assumed that price increases resulting from the implementation of the CAP will not result in substantial production increases. Until now, this assumption has proved correct; indeed in Agenda 2000, the Commission had to revise its production

[48] The wide range in the latter estimate is due to uncertainties about the evolution of agricultural employment. We have used two scenarios, one of radical reform, where agricultural employment in the new member states is halved, while it drops by 20% in the EU-15 during the 1995-2006 period, and another with more moderate reforms where the respective drops in agricultural employment are 25% and 10%.

[49] This aspect is taken up in the conclusions of the DG II study mentioned above: "The economic arguments leave, however, a political counter-argument unanswered. Would it be possible to defend a policy which transfers important cash subsidies to farmers in the rich EU countries, but not to farmers in the poorer CEECs?" (CEC(1996), p.16).

[50] Of course, the main reason for the lower transfers is lower productivity, and different product-mix of production.

[51] In its Opinion, the Economic and Social Committee notes this "budgetary optimism" and adds that it "nevertheless would like to know whether pessimistic hypotheses would jeopardise the EU's capacity to keep within the agricultural guideline" (CES *1396/97*, pt.5.4).

estimates downward with respect to estimates dating from 1995. Nevertheless, it could be argued that in the next years, this trend will be reversed, especially since we are talking about the "ins", i.e. those of the candidate countries which are relatively advanced in the transition process. Estimates presented by the Spanish delegation at the Council give a considerably higher figure for market measures (2.6 as against 1.2 BECU)[52].

On the other hand, it should be noted that the element of uncertainty in payments to new member states affects only part of the proposed total expenditure, around 1.2 BECU or a little more than one third[53], and in fact only the part of this sum which concerns products that are not subject to quotas. Also, an important margin is foreseen under the agricultural guideline (around 5 BECU or 11% of total projected expenditure in 2006).

2.4. Reactions of other European institutions to Agenda 2000

We now propose to briefly describe reactions by the Council, Parliament and the Economic and Social Committee to the Agenda 2000 proposals related to the assessment of the cost of enlargement and to its financing.

2.4.1. Council

No conclusions have been reached so far[54] by the Council on issues related to the financing of enlargement. At the Luxembourg summit the focus was on the launching of the enlargement process and the crucial issues were the formula for the start of negotiations, as well as the place of Turkey. Concerning other aspects of Agenda 2000, the European Council decided that the Commission proposals were "an appropriate working basis for further negotiations", while it also stressed that "the imperative of budgetary discipline and efficient expenditure must prevail at the Union level just as it prevails at the level of the Member States".

However, both before and after Luxembourg, the Council discussed at various levels the other aspects of Agenda 2000[55]. In these discussions, there was lack of agreement on most key issues, which is not surprising, given the early phase of the negotiation process. Disagreements predictably focus on policy reforms and own resources, i.e. on those items, which have a direct financial impact on the Member States. In more detail:

- A majority of Member States seem to agree with the *1.27% ceiling* in own resources; however, there are disagreements in both directions: some Member States insist that this should be a ceiling, that it should be kept even beyond 2006, and that margins beneath it should be larger than

[52] Delegacion.... (1997).
[53] The other 2/3 would be earmarked for rural development.
[54] This section covers developments up to July 1998.
[55] Summaries of the state of play in these debates can be found in the reports by the presidencies to the Luxembourg European Council ("on the enlargement of the Union and Agenda 2000") (December 1997) and to the Cardiff European Council ("Agenda 2000 Progress Report") (June 1998).

those proposed by the Commission. Others maintain that 1.27% is insufficient to finance enlargement, and that it anyway should be an objective, not a ceiling. None of the four major Member States would accept an increase in the 1,27% figure.

- Concerning the *CAP*, a consensus of fourteen (with Spain disagreeing) had been reached before Luxembourg on some principles contained in Agenda 2000, including the need and general direction of further reform. However, more detailed discussions during the first part of 1998 showed that there is very little agreement on the content of the reform, and at moments tones went quite high and public.
- On the reform of *structural policies*, there is disagreement similar to the one on own resources, concerning the 0.46% ceiling; there are also divergent views on the basis of calculating a "consolidated level of structural effort" (should the comparison be made with the final year 1999 or with the substantially lower average 1994-99 level?). Another subject of discord is the proposed continuation of cohesion fund payments to countries joining the euro-zone (subject to a mid-term review).

Budget-related proposals concerning the candidate countries received much less attention. Spain questioned the Commission estimates on the cost of extending the CAP to new member states. A number of Member States deemed that the distribution of structural assistance between pre-accession aid and aid to new members was unfair, since one would expect such aid to be attributed according to needs, with the poorer countries receiving proportionally the greater aid

2.4.2. Parliament

During the second half of 1997, Parliament displayed an unprecedented activity in analyzing and debating Agenda 2000. The end-result of this work was two resolutions adopted at the December session, on Agenda 2000 and on the financial perspectives. The Committees on Foreign Affairs, and Budgets, which also included opinions from the other Committees, based these resolutions on voluminous reports[56]. Two additional resolutions on "Agenda 2000 and Economic and Social Cohesion" and on "Agenda 2000 and CAP reform" were adopted in June 1998, on the basis of reports by the Committees on Regional Policy and Agriculture and Rural Development, respectively[57].

Concerning the financing of enlargement, Parliament's resolutions voice a number of criticisms of the Commission's proposals:

- The approach by which the 1,27% ceiling in own resources is "sacrosanct" is deemed "inadequate for such an ambitious project". Setting such a ceiling today is "premature" and "may cause genuine problems". The current system of own resources (which the Commission does not propose

[56] *A4-368/97* (*Oostlander-Baron Crespo*) and *A4-331/97* (*Colom I Naval*).
[57] *A4-210/98* (*Schroedter*) and *A4-219/98* (*Cunha*).

to change) “is likely to be a constraint on the funding of a successful enlargement”.

- The 2.5% growth forecast “could be an overestimate which may give rise to false hopes regarding the possibility of initiating such a momentous historic process without incurring extra cost”.
- Given the numerous uncertainties, the new financial framework should provide for “a revision clause dealing both with expenditure limits, resources and policies in the event that the Commission’s assumptions prove not to be on target”[58]. An automatic revision is suggested “once one or more applicant countries sign the accession to the Union and, likewise, if appropriate reforms of the agricultural and structural policies are not realized or if the estimated rate of growth is not attained”.
- The “need to reform certain agricultural policy and Structural Fund mechanisms” is acknowledged, but risks could be created “by a policy reform dictated solely by the need to marshal resources in the absence of any political perspective or vision”. “It is important that the financial repercussions of enlargement should not undermine the principles of solidarity and economic and social cohesion within the Union”. Concerning the CAP, the proposed price cuts are judged to be “excessive”.

A careful reading of the resolutions would show that despite the above points, Parliament’s main operational objective is the introduction of the revision clause. Indeed, the following remarks can be made:

⇒ The 1,27% ceiling is considered premature, its “sacrosanct” character is condemned, but it is not rejected per se. As Colom I Naval put it, “we accept the financial content of the Commission communication as a point of departure”[59]. What is feared is that the Commission’s assumptions fail to materialize hence the demand for a revision clause. One can conclude, that were these assumptions to materialize, Parliament would probably not object.

⇒ Parliament approves the principles of the proposed reform of the Structural Funds, and there is even a qualified support for the proposed CAP reform.

⇒ Parliament agrees that “the CAP in its current form should not be extended to the new members”. On the issue of the 4% ceiling in structural assistance it keeps silent, but its Committee on Regional Policy has expressed two contradictory opinions, the last one being agreement with the Commission. In other words, Parliament explicitly or implicitly acquiesces with the Commission proposals concerning the amounts to be allocated for enlargement. While it criticizes the approach by which the Commission “has not really estimated the future Community policy requirements” both for the EU-15 and for applicant countries, it does not determine that these requirements are higher.

[58] Such a revision clause was qualified a “conditio sine qua non” by the rapporteur Colom I Naval. (*Proceedings* 3/12/97).
[59] *Proceedings* 3/12/1997.

Of course, as usual in Parliament practice, criticism voiced in the reports and opinions of parliamentary Committees is as a rule more outspoken than that of the resolutions[60].

2.4.3. The Economic and Social Committee

During the run up to the Luxembourg summit, the *Economic and Social Committee* adopted three opinions: on enlargement, on Agenda 2000, and on the agricultural aspects of Agenda 2000[61]. The Committee's opinions are broadly supportive of the Commission proposals, in particular with respect to the CAP. Concerning cohesion, it states that "before accepting the Commission's proposals", it will seek "reassurance that these proposals will not reverse progress on economic and social cohesion within the EU". The Committee expresses doubts as to whether the proposed financing of the applicant countries through the structural funds and the CAP will suffice to cover those countries' needs. At the same time, however, it explicitly supports the 4% ceiling for structural support, and it implicitly accepts non-payment of direct income subsidies to the acceding countries.

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[60] Here is a sample of such criticism:
"Do the financial resources required for enlargement exist, or will the ceiling need to be revised? The probable reply is no: it would appear extremely difficult to cope successfully with the impact of accession of 11 countries [....], unless the appropriate financial efforts are made. Existing and new policies will require an ever-greater volume of resources, without which they cannot possibly be effective. Whatever the case, there is good reason to anticipate that the ceiling will be revised when accession takes place. [...]. Despite its financial vigour, which is matched only by the lack of imagination which it showed when drawing Agenda 2000, the Commission would appear to have adopted an approach of static optimism unlikely to stand the test of time. Agenda 2000 is an interesting, accurate document, but one which lacks the vision required to sketch out the Europe of the future, together with that form of dynamic vision required to understand how the Union and its policies will change once enlargement has taken place" (Baron Crespo, *A4-368/97*).
"Unlike the Delors I and II packages, in which the Commission acted as the driving force behind Community ambitions, this time the Commission has tailored its ambitions to the budget stringency required by transition to the third phase of EMU. In this context, it would be a real 'budget miracle' if the Union could guarantee that the cost of enlargement, the new technological and training requirements entailed by globalisation and the Union's ever greater external responsibilities in the sphere of development aid [...] could be financed within the limit of 1.27% [...]" (Muniz, Opinion of the REX committee to the *Oostlander-Baron Crespo* report, *A4-368/97*).
"The fundamental point about all of these documents is that the Commission has not proposed that the own resources ceiling be raised [...] [R]ather than being the outcome of a process, the ceiling has become a give *a priori*. Keeping the ceiling at 1.27% of GNP might well diminish the impact of the challenge and straight-jacket the Union, thus putting an end to hopes for the development of the new policies laid down by the Treaties". (Colom I Naval, *A4-331/97*).

[61] CES *1197/97*, 29-10-97, CES *1199/97*, 30-10-97 and CES *1396/97*, 10-12-97.

3. The "bottom up" approach: accession-related investment needs in candidate countries

3.1. The Agenda 2000 approach

As mentioned above, the Agenda 2000 proposals for the financing of enlargement are essentially a "top-down" exercise. Thus, what Agenda 2000 in fact says is that enlargement will "cost" as much as "we" (i.e. the present Member States) decide it can be allowed to cost. The Commission proposal does not attempt to reconcile the available margin with an estimate on the expected financial needs of candidate countries, or, more precisely, with an estimate on the financial gap resulting from such needs, which the Union would be called to finance.

At the same time, Agenda 2000 repeatedly stresses that investment needs in applicant countries are enormous, and stresses the importance of such investment for the adaptation of these countries to the "acquis communautaire"[62]. The "impact study" singles out environment, health and safety at work, nuclear safety, energy security, stock obligations, public health, restructuring, and upgrading of certain sectors (polluting industries, nuclear plants, transport and fishing fleets, energy companies, etc.) as the most costly elements for the adoption of the acquis. However, Agenda 2000 does not include any figures on the needs, with the sole exception of nuclear safety (*see below*).

3.2. Methodological problems of quantifying investment needs

Assessing the accession-related investment needs for applicant countries is an extremely complex exercise, first and foremost in terms of methodology. Key issues in this respect are the following:

- *Scope*: In a narrow interpretation of the notion "accession-related" only costs related to adoption of specific *acquis* requirements (e.g. environmental norms, oil stock requirements, etc.) should be included in the estimates. In a broader interpretation, investment necessary to ensure the "normal functioning" of the enlarged Union (including the Single Market) should be added: investment in transport, energy and telecommunication networks, necessary to ensure a minimum "acceptable" level for acceding countries, cost of restructuring sectors of the economy, including accompanying social measures, etc. Finally, one could also imagine to include all investment necessary for the "catch up" process, in a way similar to the one used for Objective 1 regions of the present EU.
- *Additionality*: One could opt to include only those investments, which would not have been made without the prospect of accession. Obviously, this approach, while logically pertinent, would be extremely difficult to implement, given the difficulty of defining what a "normal" level of investment would have been without accession. Besides, in a perspective

[62] Adoption of the "full acquis" by applicant countries is a cornerstone of the Commission position on enlargement.

of applying the Community cohesion policies what is relevant is the total necessary effort.

- *Public or total costs:* An approach that would include costs to be borne by the private sector and households is relevant if one investigates the macro-economic sustainability of the effort. If, however, the focus is on the budgetary aspect, what should be estimated is rather the gaps which would justify public support (public investment and direct support to households and the private sector).
- *Time horizon*: The time horizon of investment is not cost-neutral, obviously in terms of annual burden, but also in terms of total amounts.

To sum up, there is no single set of accepted criteria for calculating accession-related investment needs of candidate countries, and estimates could vary widely, according to the assumptions made.

3.3. Quantitative estimates

Although in Agenda 2000 the Commission avoided to produce estimates on investment needs in candidate countries, it did publish subsequently a number of sectoral estimates, which give a broad idea of the orders of magnitude involved:

- *Environment –120 BECU*: The estimate is based on a study prepared for the Commission, which reviewed all existing work in this area and produced a "best estimate"[63]. Water and air pollution would each account for around 40% of the estimated cost, the remaining 20% going to waste management; other areas (e.g. chemicals, noise, nature and forest preservation) have not been taken into account. Around 55% of the total cost concerns the "ins", with Poland accounting for the lion's share (35 BECU). Two World Bank studies on Poland and Slovakia produce comparable results, though substantially lower in the case of Poland (26 BECU)[64].
- *Transport –90 BECU*: The estimate is based on the work of the so-called TINA group (Transport Investment Need Assessment), financed by the Commission. It covers the cost of completing a transport network in the ten candidate countries, which would comprise 18,000 km of roads, 20,000 km of railway lines, 38 airports, 13 seaports and 49 river ports. The bulk of the investment (around four fifths) concerns roads and railways. The estimate has a time horizon up to 2015[65]. Additional transport-related costs would result from the necessary renewal of air and road fleets and other acquis-related expenditure; these would, however, be relatively low compared to those for the networks, especially if a sufficient time margin were allowed for fleet renewal.
- *Steel sector restructuring –10 bn $*: The estimate was published in a recent Commission Communication and is based on existing studies. It covers modernization of plants, but also costs related to regional and

[63] EDC Ltd., *Compliance Costing for Approximation of EU environmental legislation in the CEEC*, Dublin, May 1997, mentioned in *COM(98)294 final*, 20-5-98.
[64] World Bank, Country Economic Memoranda Poland and Slovakia, 1997.
[65] Press conference by Commissioner N.Kinnock, 24-6-1998 (*IP/98/565*).

social aspects of the process over the period 1996-2002. Around 200-250.000 jobs are expected to be lost[66].

- *Nuclear safety –4-5 BECU*: The estimate is made in Agenda 2000 and concerns costs for upgrading of Soviet-type reactors and decommissioning of "non-upgradeable" plants[67], over 10 years.

The above estimates cover only part of the expected accession-related investment needs, though the sectors of environment and transport would seem to be among the most costly. Other sectors and areas, with substantial costs would include:

⇒ *Energy*: Building of oil stock reserves in accordance with EU requirements, modernization of refineries, upgrading of electric and gas networks, restructuring of the solid fuel sector, and of energy sector companies, adaptation to energy efficiency norms. These needs could well sum up to some tens of BECU.

⇒ *Agriculture:* Adaptation of the private sector and of national administrations to internal market acquis, including phyto-sanitary and veterinary rules; and adaptation of administrations to CAP management. These needs could well be of the order of 20 BECU. In addition, the cost of necessary restructuring of the agricultural sector as a result of accession, could be one of the most costly elements of the total package.

⇒ *Industry*: Restructuring of branches (in addition to the steel sector), as a result of accession-related competitive pressure.

⇒ *Telecommunication*: Modernization of networks.

⇒ *Social policy*: Adaptation of various sectors to EU safety at work rules and related necessary restructuring.

⇒ *Consumer policy*: Restructuring necessary for abidance to consumer protection rules.

From the above partial estimates and gaps, it can be concluded that total accession-related (in a rather broad sense) investment needs of the candidate countries could well be of the order of some hundred BECU. With the help of "back-of-the-envelope" calculations, we can reach the following conclusions:

- Assuming this investment is spread over a 10-year period, except for environment-related investment which would last 20 years, annual needs would amount on average to 23 BECU in a (low) scenario of 300 BECU total cost, and to 43 BECU in a (high) scenario of 500 BECU. In terms of the ten candidate countries' GDP (1996-2006), this would correspond to 6% and 11% respectively, which are quite considerable but probably not prohibitive rates at the macroeconomic level. These, however, are average figures for the ten countries, and a breakdown would probably show that the effort is sustainable for the most developed countries, but hardly so for the less developed ones.

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[66] *COM(98)220 final*, 7-4-1998.

[67] Agenda 2000 determines that such plants are Units 1-4 of Kozloduy (Bulgaria), Ignalina (Lithuania), and Units 1-2 of Bohunice (Slovakia). It should be noted that all these units are situated in countries that are "pre-ins".

- Expected total transfers from the EU to the ten countries during the period 1996-2006 account for 37% (low scenario) or 20% (high scenario) of the needed sums for that same period. If we take, however, the final year 2006, the proposed transfers could cover up to 90% (low scenario) or 50% (high scenario) of the needed sums. Given the lack of balance between "ins" and "pre-ins", it can be concluded, that the situation for the former in 2006 would be highly satisfactory, while for the latter the transfers would be negligible with respect to needs.

In other words, on the basis of these very rough estimates, it would appear that the necessary accession-related investment effort is very important for all applicant countries, but probably hardly sustainable without massive external assistance for the less developed ones. Planned EU assistance would probably be sufficient for the countries that will accede, *after* the phasing-in period (account taken of other sources of financing, including national co-financing), but hardly so for the other countries.

4. Final remarks

We can now sum up and conclude with the following remarks:

1. As is the case with all integration processes, the question of the "cost of enlargement" cannot be answered correctly by an approach that limits itself to the EU budgetary dimension. Broader economic benefits and costs must be taken into account. In addition, one would also have to include the "economic peace dividend", not least on the national budgets of Member States. For, as stressed by the European Parliament, "the budgetary costs of enlargement are but a fraction of the economic peace dividend gained after the Cold War and [...] investing in enlargement sustains this peace dividend"[68]. On the whole, it is difficult to imagine, in other than worst case scenarios, that the net economic (apart from the political) effect of enlargement will not be positive.

2. An assessment of the broader economic impact (and hence also of the "cost") of enlargement, as well as of its distribution, must take into account the possible adjustment strains, and the way these are addressed. An orthodox approach that would ignore the impact of such strains would fail to capture both the real effects of enlargement and the rationale behind the positions of the main actors.

3. The Commission proposals on the financial framework of enlargement and thus on enlargement itself are fundamentally conditioned by financial and political constraints reflecting the present prevailing climate among the Member States. As underlined in the Nallet report, "the primacy of financial concerns is legitimate, since it is clearly desired by the Council, and the Commission text conforms to that orientation"[69]. While it is probably true that "one cannot find in Agenda 2000 an attempt to define the European political project to which we would invite the CEECs to

[68] Parliament resolution on the *Oostlander-Baron Crespo* report, 4/12/97, pt.32. See also G.Denton in A.Inotai-K.Vida (1998), p.55 on the "economic gains from projecting security".
[69] *Nallet report*, p.12.

associate themselves"[70], it would be clearly unjust to hold the Commission responsible for the lack of such a project. Realism is the key notion of Agenda 2000, though one could possibly regret a certain timidity in highlighting the shortcomings of the dominant mood[71].

4. The answer to the question "who will pay" for enlargement is probably that, according to the Commission proposals, it is the applicant countries who will mostly "pay", in particular those which have not been included in the opening of negotiations last spring (the "pre-ins"). Not surprisingly, this result reflects the negotiating power of the parties involved in these decisions, and the fact that one of the concerned parties is (still) absent[72]. In more detail:

   ⇒ Present net contributors to the EU budget will "pay" very little, since their contribution is even programmed to diminish in relative terms, while their receipts will probably somewhat diminish. Meanwhile, most of them are likely to be major beneficiaries of enlargement.

   ⇒ Present net beneficiaries will also apparently "pay" only little for enlargement, and their contribution will mainly come from those regions which have achieved important progress in terms of catching up, and could thus be expected to gradually draw less from structural funds, even independently of enlargement. On the other hand, regions in the present EU, which are still lagging will probably see an increase in their receipts from the EU budget.

   ⇒ The proposed further reform of the CAP is dictated by the prospect of WTO negotiations, much more than by the prospect of enlargement. In budgetary terms it will lead to an increase in transfers to the present beneficiaries. The impact on agricultural income in the EU-15 and on its distribution has little to do with enlargement.

   ⇒ The countries which are expected to join the Union during the next financial perspective, will be receiving much smaller amounts than present less favored member States, also at the end of the "phasing in" period. Still, the amounts they will be receiving by 2006 are quite important, even when compared to their needs. However, the timing of the support (back-loaded) will not contribute to the proclaimed goal of favoring their adaptation as much as possible prior to accession or

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[70] Ibid. p.11.

[71] "We have the feeling that in this issue the Commission has offered us not a "trompe l'oeil", far from that, but a document that reflects constraints much more than choices. We do not accuse it for that. We understand that it acts under constraints and that it was confronted with some that said: I do not want to pay more, I want to pay less; with others who said: don't touch upon my structural funds; and with still others who affirmed: beware of my agricultural guideline. [....]" (MEP Bourlanges, *Proceedings* 3/12/97)

[72] "There are three interests to reconcile in the new financial framework: those of the net contributors within the EU 15; of the net recipients within the EU 15; and those of the new MSs. Two of the interests are inside the Union, and have substantial power to affect the outcome. The third interest, is outside, and will have to accept what is given. Battle lines are already drawn up" (G.Denton in A.Inotai-K.Vida (1998), p.48).

during short transition periods after accession. Thus the financial proposals would tend to favor long transition periods[73].

⇒ Planned support to the "pre-ins" is small both in terms of their estimated needs and in terms of the support extended to the "ins". This would imply that the task of keeping these countries "on track", i.e. on a course which converges with accession, will not be easy, and that a very substantial effort would have to be made after 2006, if these countries are to join the Union in the visible future. The problems would seem particularly serious in the case of the larger of these countries.

5. The fact that the proposed budgetary effect of enlargement does not seriously burden neither the net contributors nor the net beneficiaries in the present Union, should facilitate a compromise, more or less along the lines of the Commission proposals, despite present rhetoric from all sides. Evidently, such a compromise will be easier if the overall economic climate improves, and more painful if the opposite occurs in the coming years.

6. The technical coherence of the Commission proposals has not been seriously questioned. At this level, the key issue is the one of the multitude of uncertainties, which weighs on the exercise. These uncertainties include the expected growth rate, possible strains resulting from enlargement in both incumbent and acceding members, the possible impact of EMU, factors influencing the timetable of enlargement, etc. Evidently, were the net effect of these factors to be substantially "negative" (from the viewpoint of budgetary burden), the proposed framework would not be viable, despite the existence of important margins in the Commission proposals[74]. It is true that the proposals do not appear to take account of possible additional economic, regional and social strains resulting from EMU and enlargement, but then its "optimism" is related to expected positive overall effects of EMU, which do not seem unreasonable. Also, Agenda 2000 is rather optimistic on the enlargement timetable for the "ins", and this should provide for an additional safety valve.

7. Nonetheless, even if the enlargement process proposed by the Commission under the existing constraints would seem to be technically viable and politically feasible in the sense that it could obtain a consensus from Member States, the proposed scheme has two important long-term implications, which in my view are the (high) price the Union could have to pay for its present "malaise":

⇒ The ambitious enlargement project is curtailed, both in time, but mainly in geographic scope. The prospect of an inclusive enlargement, especially in

[73] A.Inotai argues that this distribution in time of resources could result in "heavy costs of integration for both sides" (in A.Inotai-K.Vida (1998), p.94).

[74] In such a case it has been pointed out that the probable outcome would be the slowing down of the enlargement process. In particular the "conditionality" of enlargement on the Union's economic performance has been criticised as "an unprecedented discrimination of the Eastern applicants vis-à-vis earlier candidates for membership" (S.Richter in A.Inotai-K.Vida (1998), p.66).

Southeastern Europe, seems distant; and debates about the European prospects of Turkey have more than a touch of irreality, when confined to the issues of human rights and relations with Greece. The strategic, security and geo-political implications of all this for the future role of Europe should not be underestimated.

⇒ Viability of the present financial proposals is achieved at the expense of the philosophy that underlies basic Community policies. In the case of structural policies, the 4% ceiling would seem to run counter to their main rationale, which is the pursuance of the goal of economic and social cohesion. Structural transfers would appear to result more from acquired rights and negotiating power than from the implementation of policy principles. The long term implications of this are obvious: high tensions for the post-2006 period can be expected, when new member states will participate in the decision making, while the very principles of the cohesion policies will be weakened. The European model based, *inter alia*, on the principle of solidarity would suffer. Likewise, one cannot imagine that the proposed differentiation in direct income subsidies to farmers would survive the participation of new member states in the decision-making. Pressure would thus grow for the curtailment or abolishment of such payments[75]. While such a development might anyway seem sensible, its implications for rural development and cohesion could be important and would have to be explicitly addressed.

In conclusion, one would hope that in the coming years, a successful EMU will revitalize the impetus of European integration, in terms of political integration, institutional reform and policy development. This would hopefully allow the present realistic approach to enlargement to be transformed into a more ambitious project, in line with a broader vision of the role of Europe in the world.

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[75] This is clearly suggested in the quoted Commission (DG II) study: "To solve this problem, reflection on the future of CAP would be necessary. It may imply redefining the role of direct payments" (CEC [1996], p.16).

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