Preface

The Expert Group on Public Finance, or ESO (Swedish acronym for "Expertgruppen för studier i offentlig ekonomi") is an ad hoc independent government commission attached to the Swedish Ministry of Finance. ESO was formed in 1981. Its main objective is to make sure that public resources are used more efficiently and to scrupulously evaluate public expenditure systems as well as economic effects of revenue collected. In recent years, however, the focus of ESO has become increasingly international and devoted to international comparisons such as benchmarking and analyses of different sectors concerning the consequences of Sweden joining the European Union. This report belongs to the latter category.

Firstly, however, a few words to clarify the status of the ESO Reports. ESO studies are normally carried out by academic researchers, individual civil servants, research institutions, and specialized agencies under contract to ESO. Our studies are defined as reports to and not by ESO; the views, findings, and suggestions are the exclusive responsibility of the authors; neither by ESO itself nor the Ministry of Finance.

The first stage of the process of enlarging the European Union is now drawing to a close, the perspective being that candidate countries should be able to join the European Union as of 2004. Much of the debate, particularly in the last phase of the negotiations, has focused on the costs of the enlargement during the first few years. Much energy has been devoted to issues concerning the costs of the support to agriculture in the new member states, structural support and budgetary compensations in order to facilitate the integration of the new members in the financial system before 2006 when the present Financial Perspective for the European Union expires.

ESO has issued this study as a contribution to a wider discussion, mainly by identifying some of the issues that must be tackled in the not so distant future. The work has been carried out, at the request of ESO, by *Bengt O. Karlsson*, M.Sc. from the

Stockholm School of Economics, a former head of the long-term economic surveys of the Swedish Ministry of Finance and later during many years Director of the industrial policies and strategies branch of the United Nations Industrial Development Organization (UNIDO) in Vienna.

In budgetary terms the brunt of the enlargement costs will fall in the period after 2006. The author finds that those costs are likely to be manageable and that the savings potential, also through relatively modest reforms of the agricultural and structural policies, is large. But he also shows that the present system of financing and allocating budgetary expenditure within the Union will lead to an even more uneven distribution of the financial burden after the enlargement than is presently the case. The main reason for this is the financial concessions given to a small number of contributors through successive decisions of the European Council. The study discusses some elements that could be included in a reformed financing system – an issue that should be tackled by the ongoing Convention on the Future of Europe as well as the Intergovernmental Conference.

The study claims that new inequalities between the member states will appear after the enlargement and the risk for an erosion of the Union is apparent. At the end of the study the author asks whether a political and economic entity that spans from Luxembourg (the country with the highest GDP/capita) or Sweden (the country with the highest rank in UNDP's Human Development index) to Albania or Moldova really can function. It will be up to the Intergovernmental Conference to show the political courage to take the necessary decisions, which must transgress national interests in order to ensure that the European unification process will lead to the conditions of peace and prosperity which no doubt were in the mind of the European leaders when the enlargement process started in 1993.

By issuing this study ESO hopes to have made a modest contribution to the discussion on the future of Europe.

Stockholm, October 2002

Leni Björklund
Chairman of ESO

Author's preface

The preparations for the enlargement of the European Union by 10 to 12 new members are nearing completion. It is expected that the final decision on membership will be taken at the meeting of the European Council in Copenhagen in December 2002. This would enable candidate countries to join as new members as of 2004.

The enlargement will have a profound influence on the European Union. This study tries to make a contribution to an understanding of some issues that need to be discussed and agreed on before the end of 2006 when the current financial framework for the EU expires. It does so mainly by investigating the long-term budgetary costs of integrating new members and the system for financing and allocating expenditure.

The author would like to thank the members of the secretariat of the Swedish Expert Group on Public Finance (ESO) for their support during the writing of the study. I am particularly grateful to the staff of the EU Division of the Budget Department of the Swedish Ministry of Finance for their cooperation, based on so much experience and knowledge of EU matters. (In view of our close cooperation I should perhaps state explicitly that conclusions, opinions and statements in this study in no way may be regarded as official Swedish positions). A special Reference Group within ESO consisting of Swedish and international independent experts has given valuable advice in the course of the work. Needless to say, all remaining errors and shortcomings are entirely my own responsibility.

The work on the study was finalized by August 31. Accordingly, it has not been possible to consider events, data or documents of a later date.

The most successful attempt to unify Europe prior to the EU was at its high point around the year 800 A.D. A great European author and Nobel Laureate wrote about the people of Europe at that time:

> *"Sur une feuille de tremble nul ne peut vivre en sécurité. Pourtant y vivent d'infimes créatures, ignorantes que leur pays est une feuille de tremble. Elle n'en constitue pas moins leur séjour, leur patrie dans un monde, le monde des feuilles de tremble*[1]*."*

Alas, the world of aspen leaves created by Charlemagne soon crumbled to pieces. Let us hope we do better this time!

Vienna and Stockholm, September 2002

Bengt O. Karlsson

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[1] (Quote from: Eyvind Johnson: Hans Nådes Tid. French translation *Le Temps de Sa Grâce*, Lausanne, 2000. With permission from Editions ESPRIT OUVERT.)

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Both GNP and GDP play an operational role in the context of the EU budget. Payments are partly calculated in relation to the GNP whereas the distribution of structural funds and the so-called 4 % cap are calculated on the GDP. Since there are no GNP data available for the candidate countries we have used GDP data instead. This explains the use of the designation "GNP/GDP" in text and tables.

Note 2

Unless otherwise specified all calculations of budgetary costs refer to appropriations for payments. The meaning and significance of this term is explained in several instances, notable in sections 5.1.2 and in section Terms used.

Note 3

All calculations, without exception, are carried out and expressed at constant prices, at the price level of 1999.

Note 4

Publications and documents from the European Commission and from the Council of the European Union are referred to as "EC" in the text. In the List of References those documents are listed in chronological order.

1 Summary

1.1 The study in a nutshell

The purpose of this study is twofold. The first purpose is to make quantitative estimates of the budgetary costs of the enlargement of the EU, estimates which assume on the one hand that no changes will be made to the present system for financing and allocating expenditure and on the other that the EU agricultural and/or structural policy will be reformed in the period after 2006 when the present long-term financial framework expires. The second purpose of the study is to look at the distribution of the financial net burdens between countries and groups of countries and try to identify areas where interests may diverge and future tensions appear. Such tensions are in most cases the result of structural deficiencies in the present system for financing and allocating expenditure but they will be aggravated when the Union grows from 15 to 25 or 27 members. The study presents some tentative proposals for how the system could be reformed in the direction of long-term sustainability.

The main finding of the study is that the significant share of the enlargement costs will come in the period after 2006, that is to say during a period which is not yet under active consideration by the responsible parties. Even then, however, the costs will be manageable and certainly within the framework that the EU member countries implicitly or explicitly must have taken into account when they decided in 1993 to start the enlargement process. In addition, reforms of agricultural and structural polices, which are badly required for the functioning of the market, its efficiency and competitiveness, will offer considerable scope for savings. Should the economic growth of the Union slow down considerably for a long period the picture would be different and more troubling.

The long-term risks for the successful integration of new member states and for the continued and intensified European integration will be of a different nature. There are already built-in weaknesses in the *financial system, which make the distribution of financial burdens unequal. The root of those problems is on the one hand an outdated system for estimating and distributing annual payments from the member countries and on the other hand the special financial advantages that were granted to the UK in 1984 and to Germany, Sweden, Austria and the Netherlands in 1999 (to be applied from 2002 onwards). The end result is that any increase in costs, for instance for the enlargement, will have a proportionally larger impact on other net payers but also on the cohesion countries in EU 15 and on the new member states. Already this calls for a thorough reform of the payments system.*

Other risk factors for the long-term sustainable development of the Union stem from the fact that economic and social gaps will increase dramatically after enlargement because of the massive differences between the old and the new member states. On the one hand this will call for more economic and financial resources to ensure cohesion within the Union, on the other hand it may slow down the integration process or make more advanced countries take advantage of the possibility for flexible integration, provided for in the Treaty of Nice. One conclusion reached in the study is that the enlargement process will give a boost to those who prefer future integration to take the form of more intergovernmental cooperation and a setback for those advocating a more federalist approach.

1.2 Purpose of the study

The first purpose of this study is to estimate, in quantitative terms, the budgetary cost of the enlargement of the European Union including the costs of alternatives to the present agricultural, structural and other polices. We will also make a cursory comparison between the costs of enlargement and the corresponding macroeconomic gains or losses.

The second purpose of the study is to identify possible future tensions and points of diverging interests between groups of countries and draw tentative conclusions as to reforms required to minimize those divergences. Our starting point will be that most of the reform requirements are already present in the Union but will be aggravated and inevitable once the enlargement process has taken its course.

1.3 The scenario analysis and macroeconomic effects

At the time of writing accession negotiations with 10 out of 12 candidate countries are drawing to a close. The goal is that a decision to accept those countries as new members of the Union as of 2004 will be taken by the European Council in Copenhagen in December 2002.

The Financial Perspective for the period 2000–2006 agreed by the European Council in Berlin 1999 provides for the necessary resources for financing the accession of 6 new member states as of the year 2002. This would have entailed costs during the period 2004 – 2006 amounting to 0.13 % of the GNP of EU 15. The European Commission has since presented a proposal for financing the inclusion not only of 6 but of 10 new member states and estimated the costs for this accession to 0.10 % of GNP of EU 15 during the period 2004 – 2006. The lower costs even include certain expenditure not foreseen in Berlin, first and foremost a certain amount of direct support to the agricultural sector of the new member states. This has been possible through the postponement of the accession from 2002 to 2004 since new members have a much lower capacity to absorb funds early in their membership and through an assumption of radically smaller financial requirements for interventions on the agricultural markets. In terms of total payments to the EU budget the present proposal would mean that EU 15 members would have to pay 1.11 % of their GNP in 2004 to finance the EU budget including the enlargement costs. By 2006 that figure would be 1.10 %. This can be compared with the corresponding figures from the financial perspective, which were 1.15 % and 1.13 % respectively. However, the enlargement costs do not include any provisions for possible budget compensation to new member states. Such compensation has been paid at previous enlargements of the Union. We can nevertheless draw the conclusion that the so-called Own Resources Ceiling of 1.27 % of GNP will not be threatened during this period.

For the period after 2006 this study uses a non-enlargement scenario as a benchmark against which to measure the cost impact of various enlargement alternatives. The benchmark scenario, which in no way must be seen as a policy option, is based on an assumption of freezing the expenditure in EU 15 at the level of 2006.

How will contributions and net positions of present and future member countries develop in various hypothetical enlargement scenarios?

The main enlargement scenario that we are testing is called the Least Resistance Scenario. We assume that there will be no reform of agricultural policy after 2006 and that the Commission's proposal for phasing in direct support payments to new member states to 100 % by 2013 is implemented. For structural operations we make the technical assumption that the same rules for allocation of funds will be applied to all member countries. Since this would imply drastic losses of structural funds for the present membership and in particular the cohesion countries (Greece, Spain, Portugal and Ireland) we have made a supplementary assumption that all EU 15 countries will continue to receive the same amounts as they did in 2006. We have also assumed that pre-accession support will continue to be paid, now mainly to Turkey but also to other prospective candidates. Finally, we have assumed that the whole margin between the expenditure in the Financial Perspective and the proposal by the Commission will be utilized for budgetary compensations and other unforeseen expenditure.

We can safely say that the assumptions behind the Least Resistance Scenario come close to a worst-case scenario (in budgetary terms). The outcome, in terms of enlargement costs, is that they would rise from 0.03 % of GNP of the enlarged Union in 2004 to 0.23 % in 2013. This would mean that the total payments to the budget would peak at around 1.12 % of GNP in 2007. Also the least Resistance Scenario would not pose a threat to the Own Resources Ceiling.

Sensitivity analysis shows that if the long-term volume growth in EU 15 were to slow down from 2.5 % to 1.5 % annually, the costs expressed as shares of GNP would increase radically. On the other hand if the accession were to be postponed or divided between several groups of countries the budgetary costs up to 2013 would become smaller.

What will be the budgetary impact of reform alternatives for the future agricultural and structural policy?

A reform of the agricultural policy of the EU, which were to take the form of a phasing down of direct support costs to 85 % of the present level by 2013, would mean that the enlargement costs (net) would reach 0.18 % of GNP of the enlarged Union by 2013 against 0.23 % in the Least Resistance Scenario. The strict application of same rules for all member states in the field of structural policy would produce even more drastic cost cuts: instead of the 0.23 %, enlargement costs (net) would amount only to 0.11 % of the GNP of the enlarged Union by 2013.

We believe that none of those alternatives is entirely realistic in the form we have estimated them. But the results indicate a considerable savings potential that could be exploited in negotiations and agreements.

Our calculations are by and large supported by evidence from other, similar, international studies. Studies that have taken an econometric approach, however, generally come out with higher cost estimates since they do not take full account of the change in expenditure trends achieved in Agenda 2000. All our estimates are based on an assumption that that trend change will be sustained up to 2013.

How do the additional budgetary costs relate to the macroeconomic impact of enlargement?

Other studies show that we can expect small, but significant positive macroeconomic effects in the present EU 15 countries (possibly with some exceptions) and very large ones in the new member states. Even in purely economic terms the enlargement would thus be a net gain for the European Union.

1.4 Burden sharing and need for reforms of the financial system

How will enlargement effect the distribution of the financial burden between member countries?

Sweden, Germany, the Netherlands and Austria are the largest net payers to the Union in relative terms (as share of GNP or per capita). Whereas our extrapolations show that the net position of those countries will continue to deteriorate they will benefit from a certain dampening effect, due to the financing arrangement agreed in Berlin 1999. The same is true, obviously, for the UK but not for a group of net payers consisting of France, Italy, Denmark and Finland, which increasingly will emerge as substantive net payers. (France is already a net payer.) New member states will benefit from very large inflows of budgetary funds and the net positions will improve dramatically for all countries, but particularly for the Baltic countries and for Romania and Bulgaria. There are three exceptions: Slovenia, Malta and Cyprus, which may even become net payers, at least in the beginning of their membership.

The inequities of the present system are made even clearer if we try to look at the countries' real ability to pay by using purchasing power parities (ppp) instead of GNP-data based on official exchange rates. By 2013 the net position of Germany, the Netherlands, Austria and Sweden would be –0.44 % of GNP in a ppp-based system compared to -0.56 % in the present system. The positive net positions of the cohesion countries and the new member states would be weakened.

How could the system for financing budgetary expenditure become more equitable and sustainable in the long term?

In order to eliminate or reduce the inequities of the present system we suggest a new system, based mainly on GNP-related payments and including a generalized net correction mechanism. We show that all countries, except the UK, would benefit from such a system, in which criteria would be much stricter than in the present system for the UK rebate but which would be applied to all countries that met certain pre-determined prerequisites. Such a system would also have the advantage that the payments measured as shares of GNP would be much more equitable between countries, all net payers would be treated on an equal footing and the new member states would not pay more than the present ones in terms of shares of GNP. An alternative, partial, reform could aim at bringing in an element of purchasing power parity measurements in the calculation of payments. Any proposal that may be forthcoming from the Commission in its review of the Own Resources System should, however, be considered on its own merits rather than prejudged from entrenched political or legalistic points-of-view.

1.5 An erosion of the union?

In the final chapter of the study we discuss the situation of the new member states from a different point of view. First we note that whereas the population of 12 candidate countries would constitute 22 % of the population of the enlarged EU, their contribution to the GNP, and thereby to the budget, would be only around 4 %. We see also that the income difference to the present EU countries is far greater than it has been in earlier enlargements. This is true whether we measure at official exchange rates or at purchasing power parities, it is true whether we compare with the EU 15 average or with the lowest ranked member country in EU 15. In 1999 the income level in Romania (at official exchange rates) was 7 % of the EU 15 average and 13 % of the level in Greece or Portugal. For a relatively wealthy and developed country as Poland the corresponding numbers were 18 % and 35 %. Figures for the island states and Slovenia are better and might be comparable to Portugal and Greece at the time for their accession, at least if we make the comparison at purchasing power parities. But generally the differences are enormous.

Looking at available index data for human development and international competitiveness there are some glimpses of light: some candidate countries may have latent human resources that not yet have had full impact on the potential GDP-level, others would seem to be in a good position to exploit the competitive advantage that their low level of income and costs would carry with them. But this is not a trend or a common characteristic for all candidates.

Other authors have pointed to the risk for an erosion of the Union through the enlargement. National interests and national exceptions may become more and more prevalent. The negotiations have created a plethora of special national exceptions from the common rules and certain inroads have been made into the basic freedoms for the movements of people, goods, service and capital. Certainly, these are to be temporary measures. The screening of the *acquis communautaire* focuses on the number of institutions and legislative and administrative measures that have been implemented. Whether the successful implementation of the acquis in this, formal, sense also has given the new members the possibility to keep pace with the European integration process remains to be seen. If this capacity is deficient and if other countries would like to forge ahead with the flexible integration provided for in the Treaty of Nice tension and gaps within the enlarged union may create problems of a much higher dignity than the ones related to the budgetary costs.

2 Introduction: Issues and methods

The first purpose of this study is to estimate, in quantitative terms, the cost of the enlargement of the European Union, that is to say the budgetary costs for the member states and for the Union itself. The costs of alternatives to the present agricultural, structural and other polices will also be analyzed.

Estimates will be made for each one of the present members of the EU as well as for future member states. The study will focus on the contributions to the EU budget and on the distribution of the financial burden between the member countries and the new member states, that is to say their contributions as well as the allocation of resources from the EU budget. We will also make a cursory comparison between the costs of enlargement and the corresponding macroeconomic gains or losses, both for the present and the new member states. These issues are covered by part 1 of the study.

Part 2 of the study is devoted to the second purpose, which is to identify possible future tensions and points of diverging interests between groups of countries and draw tentative conclusions as to reforms required to minimize those divergences. Our starting point will be that most of the reform requirements are already present in the Union but will be aggravated and inevitable once the enlargement process has taken its course.

The study will try to answer questions such as:

- How will the contributions and the net positions (contributions less allocations from the budget) of the present and future member countries develop in various hypothetical scenarios for the enlargement?

- What will be the budgetary impact of different alternatives for the future agricultural and structural policy and for possible concessions to new members concerning the payments of contributions?

- How do the additional budgetary costs relate to the macroeconomic impact of enlargement?
- What will be the impact on the distribution of the financial burden of the enlargement between member countries?
- Which reform elements can be identified for financing budgetary expenditure, which would contribute to a more equitable system, sustainable over the long term?

Our analysis of the first two questions will be a static one since we cannot consider the feedback effect from changing macroeconomic conditions due to the enlargement, for instance increased growth in the Union. Some results from other studies are, however, presented in section 4.3. The study does not at all go into the difficult and intricate issue of monetary cooperation and the common currency. Membership of the EMU, with its special criteria for eligibility, is foreseen for new member states.

The budgetary cost implications of the enlargement were already analyzed in the study *Priset för ett större EU – en ESO-rapport om EU: s utvidgning* published by the Swedish Expert Group on Public Finance in January 2001 (*Karlsson*, 2001). An extensive summary in English was included. Even though more information – at least concerning the period 2004 to 2006 – is now available, the main results and cost estimates for the different country groups are still valid and differ little from the ones presented here. The Swedish study also paid great attention to the distribution of the financial burden of the enlargement as well as to what is called below "An eroded union?" that is to say the fact that the nature and character of the Union is likely to change after the accession of a number of countries, with a gap in the level of the development, significantly larger that in earlier enlargements.

The estimates have been made by means of a model[2] based on MS Excel®, simulating the so-called Own Resources System of the EU and which allows an analysis of various policy alternatives, for

[2] The model is not an economic model, *stricto sensu*, since it consists of a large number of identities without any estimated behavioral functions. Even if the "model" is large and relatively complicated, it must be regarded mainly as an accounting device or "calculator". However, it appears that the terminological stringency in this respect has become rather blurred nowadays, which is why we take the liberty of using the term "model" in this study. Nevertheless, we define our approach as an "accountancy approach" in contrast to the econometric studies to which we will refer at a later stage.

instance concerning total costs, rebates for new members, the costs for the agricultural or the structural policy etc.

The allocation of funds from the EU-budget for various countries concerning agricultural and structural policy has been taken from working material available with the Swedish Ministry of Finance. The estimates of the macroeconomic impact of the enlargement are based on a review of a number of international studies. For details, the reader is referred to the list of references.

In addition to the questions listed above, there are other issues that merit a profound discussion. The Union will change profoundly after enlargement. The membership will almost double (from 15 to 27) and all of the new member states are in many respects very different from the present membership. This goes for the level of economic development and the economic structure but is true also in other ways. Most of the new members are very young democracies with a short experience of the market economy and the related economic, administrative and social policies. This may create difficulties for the continued integration, particularly if some member states would like to forge ahead, making use of the possibilities of flexible integration, provided by the Treaty of Nice. The fact that the new member states, even taken together, will be a very small share of the EU economy will facilitate the integration process – the enormous gap between most of the new member states and the present ones will make the process more difficult. These issues are discussed in the final chapter of the study.

Part 1. The road to enlargement

3 Towards a larger union

3.1 The framework

The enlargement of the European Union to embrace a number of previously socialist Eastern European countries, including parts of the former Soviet Union, is a historic occurrence and may well be a decisive step towards the unification of Europe.

This enlargement process started in 1993 when the European Council, at a meeting in Copenhagen, resolved that associated countries in Central and Eastern Europe could become full members of the EU if they so wished. Accession could take place as soon as a country fulfilled the political and economic requirements for membership. At present, accession negotiations are going on with 12 candidate countries, including the Mediterranean island states Cyprus and Malta. Turkey has also attained status of official candidate country but negotiations have not yet started. For 10 of the candidate countries negotiations are drawing to a close, the supposition being that the final decision on membership would be taken in Copenhagen in December 2002. It is a rational assumption that the number of EU members will have increased from 15 to 25 by 2004 or 2005 and to 27 before the end of the present decade.

At the outset, Eastern enlargement was strongly supported by most of the present member states. With time, attitudes have become more multifaceted among and within the member countries. After the Gothenburg Summit in June 2001 the enlargement again gained political momentum and although some stumbling blocks have appeared and negotiations on some of the major issues have not yet started at the time of writing, the enlargement remains the strongest political priority for the Union.
The motives of the present member states for supporting the enlargement of the union may be varied but the wish to create lasting peace and security on the European continent is without

doubt the all-embracing one. It seems to be a foregone conclusion that the political stability, a largely common currency and the creation of a huge market with few obstacles for the movement of people and productive resources also will bring economic advantages to the whole area. Geopolitical considerations, mainly the wish to firmly envelop the former socialist countries into the western sphere of interest, have also played a role. For instance, from the very beginning, the strong Scandinavian support for enlargement was created by concerns of such nature vis-à-vis the Baltic countries. As the potential threat from the Soviet Union and later Russia weakened, the support for enlargement is given within a broader framework.

The strong will from almost all quarters to see a rapid enlargement of the Union cannot, however, hide a large number of worries, threats and misgivings, less from individual member states than from groups, regions or sectors within some of the member countries. The year 2002 will show us whether any of those misgivings will transform into real stumbling blocks on the road to enlargement. Another factor of uncertainty appears to be the public opinion in some of the candidate countries: if opinion polls give any indication at all, the outcome of the referenda that will be held is by no means certain.[3]

Even without enlargement there would be many fundamental issues, which need to be tackled by the European Union over the next few years such as policy reforms (mainly in the fields of agriculture and structural support), institutional reforms and reform of the system of financing the budget of the Union. A special convention on the future of Europe is presently working and will present its findings and proposal by June 2003. An Intergovernmental Conference will be convened later in 2003 or in 2004 to take the necessary decisions on the future of the European Union.

The enlargement process, which includes negotiations, accession of new members, implementation of transitional arrangements and continued negotiations with remaining, and possibly new, candidate countries, coincides with this period of necessary reform and change in the Union. In the midst of it all, a new long-term financial framework will have to be negotiated and agreed before the present one expires after 2006.

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[3] Another uncertainty factor is that the Treaty of Nice, which is a prerequisite for the enlargement, has been rejected by Ireland in a referendum. A scond referendum on the issue will be held in October 2002.

It is easy to see that all those issues, including the integration of a large number of new member states, are closely interrelated. Yet, so high is the priority of the enlargement, that it has been, and still is, an unbreakable taboo for the Commission as well as for member states and candidate countries to link the enlargement negotiations to the reform issues. A few attempts to link enlargement and the future of the common agricultural policy have quickly been quenched. One practical, and perhaps intended, consequence of this de-linking is that most candidate countries will have a full voice in the decision process on the future of the Union in their capacity as member states. This includes, of course, the future agricultural and structural policy.

We can thus begin to discern a perspective where the most critical and difficult issues, particularly the financial ones, will loom large in a period which is not yet under active consideration, at least not explicitly, by the responsible parties. We will show in this study that the budgetary costs of enlargement will become significant only after 2006 but we will also argue that the absorption of those costs is not the most important risk for the future development of the Union and of European integration.

3.2 The process

As mentioned above, the enlargement process was initiated in 1993 by a decision of the European Council. The accession should take place as soon as a candidate country met the required economic and political conditions.

The European Council established at the time what became known as the Copenhagen criteria for the fulfillment of the economic and political conditions of membership. Those criteria are mainly that the candidate countries must have stable institutions, which will guarantee democracy, law, human rights and protection of minorities, a functioning market economy that they can compete within the Union and have the ability to meet the obligations of membership. The latter includes an obligation to participate in the political, economic and monetary union. Furthermore, criteria were established for the administrative and institutional structures and for the acceptance of the EU legislation. In order to become members the candidate countries must accept the so-called *acquis communautaire,* that is to say the common system of rules and regulations that has been built up by the Union in the form of treaties, legislation, international agreements etc. This refers mainly to what can be called the basic law of the EU, that is to say the treaties of Rome, Maastricht and Amsterdam.

At its meeting in Luxembourg in December 1997, the European Council decided to start negotiation with Cyprus, the Czech Republic, Estonia, Hungary, Poland and Slovenia. At a subsequent meeting in Helsinki in December 1999 the Council further decided to start negotiations with Bulgaria, Latvia, Lithuania, Malta, Romania and Slovakia. At the same time Turkey was recognized as an official candidate country.

It would be taking things too far to go into the details of the negotiation process and the initial screening, the objective of which is to establish to what extent the candidates meet the criteria for membership. The enlargement pages at the website of the Commission[4] give a detailed account of the negotiations and the screening. The enlargement strategy paper (*EC, 13 November 2001*) gives an overview of the situation of the negotiations, in total and for each candidate country as well as the Commission's proposed time plan for the continued work. The negotiations focus on how and when the candidate countries should introduce the *acquis communautaire*. The candidate countries often request transitional arrangements, which, however, in the view of the Union, must be of a temporary character. At the time of writing, negotiations have started concerning what is regarded as the most critical chapters namely agricultural policy, regional and structural policy and financing.

At its meeting in Gothenburg on 14 June 2001, the European Council set the objective that those candidate countries which were ready should participate as EU Members in the European Parliament elections of 2004, and should be able to conclude the accession negotiations by the end of 2002. *(EC, 13 November 2001*).

The basic principles for the conclusion of the negotiations for entry are, according to the Commission's strategy paper, that each country should be assessed on its own merits and that countries that started negotiations later than others should have the possibility to catch up. For those reasons it is now often assumed that 10 candidate countries will join the Union by 2004. Bulgaria and Romania are slated for a later time of accession. This will be

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[4] Many of the documents that are referred to in this study are available on the World Wide Web. See "Selected www links", below.

the main assumption in this study but one alternative scenario will also be explored.

3.3 Enlargement, yes, but who will pay?

The enlargement will require considerable financial resources. The level of income in the candidate countries is far below that of the present member countries. It is clear that new members will be entitled to considerable amounts as support to their agricultural sector as well as structural support. At the same time, their ability to contribute to the common budget is relatively low.

At present 9 out of the 15 member states of the EU are net contributors or net payers, that is to say they make larger contributions to the EU budget than the amounts that are allocated to them from the same budget.[5] In addition to the presently largest net payers the importance of some other member states as net payers will grow considerably during the period under study. As we will see, it is quite possible that at least one additional net payer will emerge from the candidate countries.

Present and emerging net payers will have to finance the largest part of the costs of enlargement. In the negotiations of Agenda 2000 net payers were quite successful in achieving a reorientation of the budget development in a more restrictive direction than before. Through this reorientation financial room for the enlargement was created. There are several factors at play, however, which may, in the future, exercise an upward pressure on their payments. Present net receivers are not likely to sacrifice their financial benefits easily and may demand compensation for any concession they have to make. Much budgetary authority has been transferred from the Council of Ministers to the European Parliament, which, by tradition, tends to take a more expansionary approach to the budget. One of the richest member countries, the United Kingdom, will continue to contribute a disproportionally low share of the budget and other net payers may demand the same kind of discount that was granted to Germany, the Netherlands, Sweden and Austria in 1999 by the Berlin Council. It may also become necessary to grant new members some kind of phasing in of their membership payments until the inflow of funds from the

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[5] Applying the so-called accounting definition. This is discussed at length in chapter 7 and appendix 1.

EU budget has picked up. Any such concession will have to be financed by the present membership.

Even if the enlargement of the Union has a very high political priority, the goal of budget restrictivity and the necessity to incur direct as well as indirect costs for accommodating new members are obviously conflicting. The question is how serious this conflict of goals will turn out to be, particularly for the net payers, and what the consequences will be for their budgetary contributions. One of the aims of the present study is to illustrate this in quantitative terms.

The financial, or budgetary, contributions must, however, also be weighed against the macroeconomic gains that will result from an enlargement of the Union. There is probably a consensus that those gains will be considerable for the new member countries but what will be the impact on the present membership? Results from some international studies of this issue will be contrasted with our own estimates of the budgetary cost in section 4.3.

The purpose of the enlargement is not, however, to create macroeconomic gains for the members of the Union. The political and social importance of the peace project that is the European Union can hardly be measured in quantitative terms. To leave the Central and Eastern European countries outside the Union would create considerable costs for the Union, both in budgetary and in macroeconomic terms. An unfavorable political, social or economic development in all or some of the present candidate countries could generate costs in monetary, human and political terms, which would be many times greater than the estimated budgetary costs of the enlargement. A "non-enlargement" scenario is therefore not a politically relevant alternative.

Against the background of the estimates of budgetary costs in this study as well as the calculations of macroeconomic impact of enlargement made by others, it may well be worth asking whether there are other kinds of difficulties connected with the enlargement than those that are manifest in terms of economic costs and benefits. This is done in the last chapter of the study.

4 A larger union: costs and resources

4.1 What will the enlargement cost?

The present chapter will deal with enlargement costs over the period 2004–2006 which is the one currently considered by the Commission and the member states and during which an enlargement from 15 to perhaps 25 member states is expected to take place. This period is covered by the budgetary and financial framework of the European Union, the so-called Financial Perspective agreed by the European Council in Berlin 1999 (*EC, 1999*) and finally established through the Interinstitutional Agreement. The Financial Perspective includes resources for the expected enlargement of the Union. Although the number – let alone the names – of new member states were never explicitly specified, the estimates were based on a so-called technical assumption that a group of six candidate countries would join the Union as new member states by 2002. Those countries were assumed to be Cyprus, the Czech Republic, Estonia, Hungary, Poland and Slovenia.

The development, as usual, took a different turn than originally assumed. It was not possible, and perhaps not even desirable, to finalize negotiations in sufficient time for new members to be accepted already 2002. On the other hand, four additional candidates succeeded in accelerating their adoption of the *acquis communautaire* to such an extent that they could be considered on equal footing with the first group. Those countries were Latvia, Lithuania, Malta and Slovakia.

Without formally abandoning the so-called *regatta* approach, according to which the progress towards accession of each individual country should be evaluated on its own merits and not in relation to the position of other candidates, the Union is now bracing itself for a so-called *big bang* solution, previously disdainfully rejected by candidates and member states alike.

The proposal for a Common Financial Framework for Negotiations

In January 2002 the Commission presented an information note on a Common Financial Framework for the Negotiations 2004–2006 (*EC 30.1.2002, ref 9*). The highlights of the proposal (in the following called CFF) as well as of the enlargement costs according to the Financial Perspective, agreed in Berlin 1999, are presented in table 1.

We note that despite the fact that enlargement costs are now included for 10 countries instead of the 6 that were foreseen in Berlin, payments for the period 2004 – 2006 are estimated at 0.10 % of GNP in EU 15 instead of the 0.13 % of the Financial Perspective. It has been argued, however, that the comparison should not be made with the calendar years 2004 – 2006 but with the first three years of accession. Taken at face value, the costs of 0.10 % of GNP estimated by the CFF should then be compared with a Berlin cost estimate of 0.08 % of the GNP of EU 15 (not shown in the table). The additional cost of 0.02 % of GNP (or an absolute amount of 8.2 billion Euro)[6] would represent the cost of the additional four countries as well as of additional measures that were not foreseen in Berlin. The most important of the latter is the inclusion of a certain amount of direct support to the agricultural sector in new member states.

However, the issue of various possible comparisons with the Berlin agreement is a purely academic one by now. The discussion has instead come to focus on issues like:

- Will the proposed resources be enough to ensure an equal treatment of new and old member states, in particular with respect to the critical issue of direct income support to the agricultural sector?
- Will it be necessary to alleviate the budgetary situation in new members states, given that they will have a low capacity to absorb support from the Union at the beginning of their membership but will have to render full contributions to the EU budget immediately upon accession?

[6] Unless otherwise specified all absolute amounts in this study are given in 1999 prices in order to secure consistency with the Financial Perspective, the CFF and various international studies. To obtain current (2002) prices an increase of around 5 % could be applied as a rule of thumb.

At the time of writing those questions are the object of an intensive political discussion with candidate countries vehemently protesting that they should have the right to the same level of agricultural support as EU 15 more or less immediately, the Commission insisting on a "take it or leave it" attitude and at least some of the present EU net payers arguing that the proposed framework would imply an undue increase in the financial burden. There are arguments for, and certainly very much against, all those standpoints.

Table 1. **Resources earmarked for enlargement according to the Financial Perspective and the Common Financial Framework.**
Percentage share of the GNP of EU 15

	2002	2003	2004	2005	2006	Total	
						2002-2006	2004-2006
Resources earmarked in The Financial Perspecitive 2000–2006 (for 6 countries)							
Commitments	0.08	0.11	0.13	0.16	0.18	0.13	0.16
Payments	0.05	0.08	0.10	0.13	0.15	0.10	0.13
Resources proposed in The Common Financial Framework, Jan 2002 (for 10 countries)							
Commitments			0.12	0.15	0.17		0.15
Payments			0.06	0.12	0.13		0.10

Source: *The Financial Perspective (EC, 1999), the Common Financial Framework (EC, 30.1.2002 ref 9).*

Note: *The table shows the resources in terms of both commitments and payments. Those terms are explained in the List of Terms. In a simplified way commitments are what member states have promised to pay in a certain financial year, payments what they expect to be really paying. Normally payments follow commitments with a certain time lag.*

As can be seen already from table 1, the proposed framework would entail a considerably higher level of commitments over the period 2004–2006 than the level of payments. Indeed, the sum of the commitments would amount to 0.15 % of the GNP of EU 15 whereas the payments would amount to 0.10 %. While we will not at this stage launch a technical analysis of the difference between commitments and payments, we would only point out that the normal ratio between the two parameters for the present EU 15 is close to 100 % for ongoing projects. That the ratio of payments to commitments is considerably lower for programs in the new member states is largely the effect of a lack of absorptive capacity of the newcomers. Despite the introduction of the *acquis* and the pre-accession support, the institutional capacity is missing and probably also the required ability of co-financing, particularly concerning regional and structural policy, Nevertheless, this capacity will increase with time and the commitments made will have to be honored, at some undetermined time after 2006.

We may conclude that the proposed CFF adds considerably less to the EU budget than was foreseen in Berlin even though 10 countries are now considered and some unforeseen direct support payments to agriculture in new member states have been added. This budgetary space has been created

- by the delay of the enlargement (starting 2004 instead of 2002)
- by budgeting direct support payments only as of 2005 (since claims would be based on production in 2004)
- by assuming that a significantly lower amount than in the Berlin estimates will be required for agricultural market interventions

The last point depends on an assumption of rising world market prices on agricultural products, which would require less intervention on behalf of the European farmers. Agricultural expenditure is so-called obligatory expenditure, that is to say the amounts that result from the determining variables (for instance world market prices) must be paid out, irrespective of what was budgeted. The precision of the cost estimates is therefore crucial when assessing the costs of the enlargement. The price expectations are based on an assumption of a change in the long-term development of falling world market prices, due to a sustained economic growth particularly in developing countries and countries in transition.[7] (*EC, July 2001)*

[7] The Comission actually now estimates that the cost for market interventions on behalf of new member states would be smaller than half of the amounts included for that purpose in Agenda 2002. The new estimate is less than a third of the amount calculated by the reputed Agricultural Economics Research Institute in the Hague, the Netherlands in April 2001 (*Silvis et al., 2001*). The Dutch study was, before the proposal by the Commission, the standard material used in estimates of the agricultural enlargement costs 2004–2006.

Table 2. **Total budgetary costs (payments) of the EU 2000–2006 according to official estimates by the Commission.**
Percentage shares of the GNP of EU 15

	2000	2001	2002	2003	2004	2005	2006
1 Expenditure for EU 15 and external expenditure							
According to FP	1.13	1.12	1.13	1.11	1.05	1.00	0.97
Acc. to outcome and annual budgets	0.98	1.03	0.93	1.02			
2 Expenditure for the enlargement							
According to FP			0.05	0.08	0.10	0.13	0.16
Acc. to CFF					0.06	0.11	0.13
3 Total expenditure (=total payments to the EU budget)							
According to FP	1.13	1.12	1.18	1.19	1.15	1.13	1.13
Acc. to outcome, budget and CFF	0.98	1.03	0.93	1.02.	1.11	1.11	1.10

Source: *EU budgets 2001 and 2001, the Financial Perspective (EC, 1999) and CFF (EC, 30.1.2002, ref 9).*

Table 2 summarizes the official estimates of the enlargement costs 2004–2006 as well as the total payments to the EU budget. As we can see the payments share of the GNP of EU 15 would never exceed 1.11 % which might be compared with the maximum permissible value of payments, which amounts to 1.27 % of GNP. Even with enlargement this so-called Own Resources Ceiling[8] would not be threatened, at any rate not during the period 2004 - 2006. Another noteworthy feature in table 2 is that for the whole period 2000–2002 the actual or budgeted expenditure lies considerably lower than the provisions in the Financial Perspective.

4.2 Financing the enlargement costs

In principle, the financing of the total budgetary costs of the EU, including enlargement costs, should be borne loyally and equitably by all EU member states. (*EC 1998*). However, the UK rebate and the financing advantage from 2002 onwards granted in Berlin 1999 to Germany, Sweden, the Netherlands and Austria represent serious deviations from this principle.

The contributions to the EU budget are regulated by the so-called Own Resources System, which is the implementation of the

[8] The meaning and implications of this ceiling are further discussed in footnote 27 below.

Own Resources Decision, taken in consensus by the member states. The system is utterly complicated as a result of political considerations and a general unwillingness by the member countries to modify earlier decisions.[9] The fact that the system is so complicated may be one reason why earlier studies of the financing of the EU budgets have preferred to work with simplified assumptions of how the financing system works.[10] Depending on the purpose of the study such a simplification may be more or less important: when the focus is on the financial burden sharing it will, however, be necessary to look at the details of the financing system. The present study uses a model, which in detail replicates the Own Resources System of the EU in the form it is implemented from the beginning of 2002.

We may make our calculations with a model faithfully representing the financing system of the EU but we mercifully abstain from describing the details of the system. The reader is referred to *EC, 1998* for an excellent explanation and evaluation of the system and how it has developed and to *EC, 7.10.2000* for details on the new decision, which is being implemented as of 2002.

We recall that the financial resources of the EU are of three types: traditional own resources (mainly custom duties; around 17 % of the total resources in the year 2000), VAT-based resources (approximately 40 %) and GNP-based resources (approximately 43 %).

Despite the fact that both the VAT-based and the GNP-based payments are charged to the members by means of uniform percentage shares, the relative burden of payments is unevenly distributed between the member states. There are various reasons for this. One reason is that some member states (particularly the Netherlands and Belgium) pay more than other countries in

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[9] One frequently meets the conception that the obscure dealings of some bureaucracy in Brussels, probably the Commission, unnecessarily complicate and confuse the system of contributions. In our opinion this is not at all the case since the "bureaucrats" would much prefer to apply a simple and transparent own resources system. Practically all attempts to simplify the system have so far failed because of the stubborn insistence of the member states to retain acquired exceptions and advantageous special modifications and preferably also to introduce new ones to their own benefit. To the extent that a country succeeds in this endeavor it finds it difficult to object to wishes of other members for similar tidbits. One of the more grotesque examples is the *mode de calcul* of the UK rebate. Another one is that the special financing rebate that four countries will enjoy as of 2002 must, due to the insistence of one member state, be explicitly calculated in the budget by means of two different methods although elementary arithmetic tells us that the end results will be indentical.

[10] This is, for instance, the case in *Quaisser and Hall (2002)*, which may otherwise be the only other study so far that takes into account the CFF proposed by the Commission.

custom duties.[11] Another reason is that the size of the VAT-base varies considerably between countries.[12] The main reason why the relative burden of financing varies between countries is, however, related to the British rebate (officially: *The UK budgetary compensation*.) This rebate, introduced in 1984, is of a considerable financial advantage for the UK.[13] At the meeting of the European Council in Berlin 1999 it was explicitly decided that this rebate would be applied also to the enlargement costs. Another decision from Berlin was that the four largest net payers (in relative terms), Germany, Sweden, the Netherlands and Austria, should have to pay only 25 % of their normal shares of the UK rebate as of 2002.

All those rebates and discounts will have to be paid for by the other member states including the new ones. This has as a consequence that the relative contributions to the EU-budget, e.g. in relation to the GNP, of the new member states will be considerably larger than the ones of the UK and the four other discounted countries. This is shown in table 3.

The fact the distribution of the financing responsibility is uneven is a structural deficiency of the payment system and as such not a direct consequence of the enlargement. But it means that also the burden of enlargement costs will be unevenly distributed.

[11] See Appendix 1 for a discussion of those issues, sometimes labled as *the Rotterdam effect*.

[12] This is also one of the reasons why it has not been possible to simplify the system and base the whole contribution on GNP. Certain countries, for instance Italy, would have to pay more after such a reform.

[13] Due to a number of coinciding circumstances the size of the rebate even made the UK a net receiver of budgetary funds in the year 2001. (*EC, Allocation of 2001 EU operating expenditure by member state, September 2002.)*

Table 3. Financing the EU Budget by different groups of countries.
Percentages

		Payments to the EU budget		
		As shares of GNP of each country group		Percentage distribution
		2002	2006	2006
Berlin net payers	Germany, Sweden, Austria, the Netherlands	1.12	1.04	33.2
Net payers without rebate	France, Italy, Denmark, Finland	1.18	1.10	35.2
UK	UK	0.79	0.75	12.0
Cohesion countries	Ireland, Spain, Portugal, Greece	1.21	1.11	11.7
EU adm. countries	Belgium, Luxembourg	1.19	1.10	3.3
New member states	10 new members	..	1.11	4.6
Total	*EU 15 and 25 resp.*	*1.10*	*1.02*	*100*

Source: *EU budget 2002 and own estimates.*

4.4 The macroeconomic impact

Commentators widely agree that the enlargement of the Union will bring about macroeconomic advantages to all or most countries of the enlarged Union. There is also a consensus that there will be large positive effects on the new member states and relatively small ones on the present EU 15 members. Among the latter, countries that are geographically close to the new members generally stand to gain the most whereas a few countries which might be in direct competition with the new member states could even risk making some macroeconomic loss as a result of the enlargement.[14]

Positive effects would mainly come from the enlargement of the inner market and increased mobility of the factors of production. This would lead to increased growth, higher incomes and employment and – maybe – lower prices because of increased competition. But the positive effects may be distributed in an uneven fashion. Enterprises within the present EU 15 will be subject to increased competition from new member states with

[14] See *Karlsson, 2001 Ch. 8*, for a review and assessment of studies of the macroeconomic impact of enlargement available by the end of 2000. *Quaisser and Hall, 2002*, contains an updated and systematized list.

lower costs and wages. Member states with a large share of branches where labor costs still have a decisive influence on competitive advantages might lose out when industry in the new member states gain improved access to the EU-market. We might expect this to become a problem for present member states at the lower end of the income scale, measured for instance as GNP per capita. An econometric study by *Egger et al., 2001* on the competitive strength of Southern and Eastern Europe respectively finds that final goods imports from the two country groups are largely complementary, whereas import of intermediate goods is largely substitutive. *Egger et al.* also find that even a marginal rise in unit labor costs in the South increases substitution, that is to say has a negative impact on competitivity.

In the assessment of available studies made in *Karlsson, 2001*, only Portugal would effectively stand to lose whereas the impact on Greece and Ireland might be neutral. Countries like Spain and Italy on the other hand would be clear winners and so would the Netherlands.

Newer studies, mainly *Breuss, 2001* slightly modify the picture referred to above. Breuss compares two periods 2005–2006 and 2008–2010. Whereas all present member states[15] would make a small but significant gain in GDP during the first period, this gain would be partly lost during the second period. Some illustrative data from Breuss' study are presented in table 4.

[15] Greece and Luxembourg are not included in the study referred to.

Table 4. **Macroeconomic impact of EU enlargement. Total increase of GDP by 2006 and 2010.**
Cumulative percentages

	Sum of effects from trade, internal markets and budget costs by:		Sum of effects from factor movements by:	
	2006	2010	2006	2010
Belgium	0.36	0.48	-0.03	-0.23
Denmark	0.41	0.15	-0.05	-0.26
Germany	0.64	0.37	-0.01	0.11
Spain	0.34	0.19	-0.07	-0.36
France	0.18	0.35	-0.07	-0.24
Ireland	0.56	0.84	-0.09	-0.45
Italy	0.51	0.62	-0.02	-0.12
Netherlands	0.74	0.44	-0.03	-0.29
Austria	0.79	0.79	0.04	-0.13
Portugal	0.67	0.05	-0.04	-0.26
Finland	0.57	0.61	-0.04	-0.31
Sweden	0.69	0.07	0.01	-0.18
United Kingdom	0.21	0.11	0.02	0.03

Source: *Breuss, 2001.*

The estimated GNP impact is very small for the EU 15 countries. The data in table 4, are cumulative figures, that is to say the column for 2010 shows the *whole* GNP-increase due to enlargement from 2004 onwards.[16]

The model calculations by *Breuss* indicate positive effects from the development of trade and the internal market for all EU 15 countries also after deduction of the negative effects stemming from the budgetary costs. The study is based on a World Global Equilibrium Model. (Even so, only 3 new member states are explicitly treated as well as Eastern Europe as a bloc. Also the assumed time profile of enlargement is slightly different from the one we use in our study.) The model tries to take into account all theoretical effects of the economic integration, including effects of movements of capital and labor. In general the effects of labor migration would be positive for the EU 15 countries, in particular for Austria and Germany. On the other hand, an exogenous assumption that an investment boom in the new member states

[16] In principle it would be permissible to add for each year the figures for trade effects and effects of factor movements. We have abstained from this since we assess that the estimated impact of factor movements is much more uncertain than the impact of trade etc. We draw this conclusion mainly from the results of similar studies referred to in the text.

would lead to increased interest rates results in mainly negative effects from capital flows in the EU 15 countries. It should be mentioned that *Baldwin et al., 1997* do not find such a negative effect despite the fact that the estimated increase in foreign investment in the new member states would be very high. Other studies (see for instance *Quaisser, 2000* for a review) show important GDP-gains for Denmark, Spain and Sweden. A study by the Netherlands Bureau for Economic Policy Analysis *(Lejour et al., 2001*) shows considerably larger impacts on the new member states but very insignificant effects on the present member states.

We abstain from detailed comments on other similar studies since broadly speaking they concur, always with some exceptions. We can mention, for example, the studies by *Dicke and Foders, 2000* as well as by *Vaittanen, 2000*, which find no positive macroeconomic impacts on the EU 15 countries of the enlargement but only a net financial loss. The main explanation for these deviating results is that in those studies the positive trade effects are assumed to be discounted already. This is certainly a problem. We recall that the so-called European agreements between the candidate countries and the EU 15 came into force 1993–1998 with the aim of establishing

> *"free trade in industrial products over a gradual, transition period, although the EU opens its markets more quickly than the associated country. As a result, industrial products from the associated countries have had virtually free access to the EU since the beginning of 1995, with restrictions in only a few sectors, such as agriculture and textiles….. In addition to the liberalisation of trade, the Europe Agreements also contain provisions regarding the free movement of services, payments and capital in respect of trade and investments, and the free movement of workers. When establishing and operating in the territory of the other party, enterprises must receive treatment not less favourable than national enterprises.[17]"*

Opinions differ on the extent to which the integration effects have already been discounted in the general liberalization process. Apart from the asymmetry referred to in the quote from the

[17] Quote from the web site of the European Commission. See below, Selected www links: *European agreements.*

Commission[18] there are also important exceptions from the agreements, for instance for agricultural products and textiles. In *Karlsson, 2001* we ventured the guess that at least half of the macroeconomic impacts had already been accounted for. The study by *Breuss, 2001*, includes in the results only the macroeconomic effects that are yet to come.

In table 5 we have estimated how the total macroeconomic impact on 13 countries in EU 15 is distributed and also compared each country's gain with its share of the total EU budget.[19] We can also compare that estimate with that of *Baldwin et al., 1997*.

Table 5. **Comparison between macroeconomic gains and shares of budget of EU 15 countries by 2007.**
Percentage distribution between countries

	Share of GNP-gains		Share of payments to EU
	Derived from Breuss	Derived from Baldwin	
Germany	41.7	33.8	25.2
Italy	19.2	8.5	14.9
UK	11.6	14.1	12.9
Netherlands	6.0	4.6	5.0
Austria	5.2	2.6	2.5
Sweden	3.5	3.9	2.9
France	2.8	19.3	18.9
Belgium	2.6	2.6	3.2
Finland	2.5	1.4	1.7
Spain	2.3	7.0	8.0
Ireland	1.6	0.3	1.3
Portugal	1.0	-0.4	1.5
Denmark	0.0	1.9	2.2
EU 15, total	*100*	*100*	*100*

Source: *Derived from Breuss, 2001 and Baldwin et al., 1997. Own estimates of payments..*

If we follow *Breuss, 2001*, we see that in particular Germany, Italy, the Netherlands, Austria and Sweden would benefit from much larger GNP gains than what would correspond to their share of the financing responsibility whereas France and Spain would make smaller gains. *Baldwin et al., 1997*, on the other hand makes a more

[18] The EU eliminated tariffs on imports under the European agreement from 1997. The new member states will reach that state only by 2002.
[19] Obviously it is not permitted to ”net” the shares of GDP gains and of payments. The macroeconomic gains have already been reduced with a negative item caused by enlargement costs. But the table shows, in a sense, the degree of ”fairness” in the distribution of macroeconomic gains.

optimistic assessment of those countries but a less optimistic one for Italy.

There are not many studies available of the macroeconomic impact of enlargement in new member states. Commentators agree, however, that the gains will be substantial.

We will see later in our various scenario estimates that the net allocations of EU expenditure to new member states (with the possible exception of Slovenia, Malta and Cyprus) will be very considerable. The inflow would be greatest for the Baltic countries and for Bulgaria and Romania where it would reach 6 % or more of the GNP. For the four Visegrad[20] countries the inflow would be somewhat lower but would still approach 4 % towards the end of the period we are studying. We can safely assume that this will have a very strong positive impact on the GDP of those countries.

There are some econometric estimates of the impact on the economies of the new member states. Already *Baldwin et al., 1997*, estimated an income effect of more than 18 % in seven candidate countries, largely due to increases in foreign investment. *Breuss, 2001*, finds a positive impact on GDP (average 2008–2010) of 5.65 % for the Czech Republic, 8.02 % for Poland and 8.4 % for Hungary. For Eastern Europe as a whole (which, however, includes also Russia, the Ukraine and others) he finds a positive effect of 3.07 %. Here also the investment effects are important but less so than the gains from expanded trade.

For one dissenting voice we may quote from a news item from the official Czech news agency that a study assigned by the Slovak Academy of Science will apparently show *"an unemployment rate of up to 30 %, a "price shock" and further burden for the deficit-running public finance" for Slovakia.*[21]

A word must be said about the island states Malta and Cyprus and about Slovenia. Those are the candidate countries with the highest level of income. At the same time they are countries where the agricultural sector plays a smaller role relative to other candidate counties. Their geographical smallness also disqualifies them to a large extent from receiving large amounts of support

[20] Poland, Hungary, The Czech Republic and Slovakia. Visegrad (also transcribed as Vysegrad) is a city in nothern Hungary and was in medieval times the seat of Hungarian kings. At a meeting in 1335 a cooperation pact was struck in Visegrad between Bohemia, Hungary and Poland. Well aware of the historical significance, the presidents Havel and Walesa and Prime Minister Antall launched the present cooperation pact in 1991. After the split Slovakia joined as a fourth member.

[21] In another study under the auspices of IIASA, Fidrmuc and Fidrmuc, 2000, estimate a positive lift of the Slovak economy of at least 5 % by 2010 in the case of early accession.

from structural or cohesion funds. The end result is that they might end up as net contributors to the Union, at least in the beginning of their membership until the flow of funds picks up. It should be stressed that in addition to a possible budgetary compensation, the criteria for distribution of structural support could still be subject to negotiations. The results of our estimates are mainly a consequence of our applying the rules of the present system to the new member countries as well.

5 Post 2006: Time to pay the bill!

The resources earmarked for enlargement costs 2002–2006, as well as the proposed CFF, were presented in chapter 4. In this chapter we will present a number of extrapolations for the period 2007 – 2013 under the general assumption that there will be no major reforms of the present system for payments and allocations of expenditure to member states. In chapter 6 we will make similar extrapolations but then under the assumption of various reforms of the main policy areas. That chapter will also summarize and recap the results of the cost estimates so far.

Chapters 4 to 6 focus on the payments (contributions) to the expanded EU-budget, whereas the allocation of expenditure and the budgetary balance or net position of the various country groups will be discussed in chapters 7 and 8.

Unless otherwise specified, it is assumed in all these scenarios that 10 candidate countries will become members as of 2004 and that Bulgaria and Romania will join in 2007. Turkey is not considered in this study, except insofar that it is assumed that the EU budget will continue to include pre-accession support after 2006, which would then partly be allocated to Turkey. Except for a brief mentioning in chapter 9, we are also not considering the accession of further countries, such as Croatia, FYROM, other Balkan countries or Moldova.

The period 2007–2013 has been chosen as a likely period for a new Financial Perspective. The present period covers the years 2000–2006. There is, however, nothing in the EU statutes that stipulates that the Financial Period should cover a seven-year period. This issue might possibly be regulated at the forthcoming Intergovernmental Conference (IGC).

5.1 A non-enlargement scenario as benchmark

All comparisons will be benchmarked against a non-enlargement scenario in which it is assumed that there will be no additional member states during the whole period up to 2013. It cannot be emphasized strongly enough that this non-enlargement scenario only serves to provide a benchmark for measuring the budgetary costs of the enlargement. It is not a political option. For one thing negotiations and preparations have already progressed to such an extent that it would be practically impossible to bring them to a halt. A collapse of the enlargement process at this – or a later- stage would be a European disaster of cataclysmic proportions and would call the very existence and purpose of the Union into question.

A less dramatic, but also important, consideration is that the present Financial Perspective has tailored the expenditure for EU 15 in such a way as to make it possible to accommodate the enlargement (by 6 countries). Had enlargement not been an option in the 1999 negotiations, it is highly likely that the budgetary costs for covering the present membership would have been considerably higher than is now the case.

Nevertheless, the non-enlargement estimate can function as a convenient yardstick against which we may compare the costs of different scenarios.

5.1.1 The characteristics of the benchmark scenario

The benchmark scenario is presented in appendix table 2. Overall, it is characterized by strong budget discipline, basically freezing the expenditure levels for EU 15 at the 2006 level, which is practically the same as the level in 2000. Since GNP is assumed to increase at a steady rate (2.5 % annually for the present EU 15 members, 4 % annually for new member states, measured in 1999 prices) this implies that the share of the EU-budget in GNP will successively fall. In addition, the present Financial Perspective expenditure is assumed to increase between 2000 and 2003 and then fall rather rapidly towards the 2006 levels. No such “hump” has been assumed for 2007–2013. This means that the cumulated sum of expenditure over the seven-year period will be lower in the benchmark scenario than in the present Financial Perspective.

There are some fundamental assumptions, which will influence the comparison with all other scenarios.

The cost for *agricultural policy* after 2006 has been estimated under the assumption that the present system for CAP will remain in force but that the total agricultural expenditure will remain at the level of 2006.

For *structural operations* it has also been assumed in the benchmark scenario that expenditure and distribution on member states will be frozen at the level of 2006 for all EU 15 countries. The same assumption has been made for *Internal policy* and *Administrative expenditure*. As far *External expenditure*, which includes pre-accession support, is concerned we have assumed the same level as the one achieved by 2006. This implies that pre-accession support would continue even after the accession of 12 new member states but now be directed towards other candidate countries, mainly Turkey.

5.1.2 The relation between payments and expenditure

The issue of the ratio between the level of payments and the level of commitments has already been mentioned above (se section 3.1). The present study concentrates on the level of payments, since that is the parameter, which determines contributions, net positions and so on. For EU 15 the difference between commitments and payments is normally trivial over the long run, whereas it will have a significant impact in the new member states. As far as EU 15 is concerned we will therefore limit ourselves to noting that the level of payments has been calculated with the help of the overall ratio of payments to commitments in the Financial Perspective. When determining that ratio agriculture, payments towards reserves and administrative expenditure have been excluded since it is assumed that for those categories commitments and payments are entirely synonymous.

In contrast to EU 15 the difference between the level of payments and the level of commitments becomes very important for the new member states. We can regard commitments for direct income support to agriculture as identical to payments but for all other categories of expenditure there will be a considerable lag in payments in relation to the commitments made, mainly due to lacking absorptive capacity in the new member states and the time needed to start new programs. This has to do on the one hand with the deficient institutional structure in the recipient countries and on the other with the complicated planning and approval procedure for many EU programs. This has been amply demonstrated by the difficulties the candidate countries are experiencing in benefiting from the pre-accession support programs. In 2001, for instance, only about 60 % of the resources set aside for pre-accession support were actually used. For EU 15 only around 70 % of the funds budgeted for structural support were used.[22]

The CFF contains figure for both commitments and payments for the years 2004–2006. The implied ratios are very much lower than the one for EU 15. For the period after 2006 we have, wherever relevant, extrapolated the ratios of CFF in such a way that they would reach the same level as for EU 15 in 2009 for countries joining in 2004 and in 2012 for those joining in 2007.

5.2 A Least Resistance scenario

5.2.1 Assumptions

We have labeled the first enlargement scenario to be explored "the Least Resistance scenario." Like all enlargement scenarios it is based on the CFF for the period 2004–2006. No reform of CAP is assumed and the phasing in period of direct income support to agriculture in new member states that is proposed in the CFF is applied, which means that by 2013 all member countries will enjoy 100 % of the present system of direct income support. Bulgaria and Romania, however, will only have reached 70 % of the full level of direct support by the year 2013.

The assumptions for structural operations are a bit more involved. Obviously in a "Least Resistance" scenario (which might also be termed "Business as usual") we would start by assuming that there would be no reform of the present system. But if structural funds in an enlarged union were allocated following the same rules as those in force by 2006, many of the present member states would lose large parts of their structural support. As a matter

[22] This underutilization led to a giant surplus on the EU annual budget for 2001 (around 15 %), which will be repaid to the contributors.

of fact, the total costs of structural operations in the enlarged EU would become lower than at present because many EU 15 countries would no longer be eligible for certain funds while at the same time those funds could not be fully allocated to new members. This is because the majority of the new member states would reach the ceiling of 4 % of GDP that is imposed as a maximum for structural funds, well before the end of the period under consideration. In order to avoid those peculiar consequences we have assumed in the Least Resistance Scenario that structural support to the countries of EU 15 will be frozen at the levels reached by 2006. This means that none of the present EU 15 member states would lose structural or cohesion fund support as a consequence of enlargement. This assumption is certainly somewhat extreme and will be relaxed in one of the reform scenarios in chapter 6.

Expenditure on internal policy has also been frozen at the 2006 level. For new member states the figures of CFF have been used and distributed in relation to their GDP. The same has been done for administrative expenditure with the important difference that all additional administrative expenditure has been allocated to EU 15, that is to say mainly to Belgium and Luxembourg.

In this scenario the same assumptions have been made as in the benchmark scenario with respect to pre-accession support.

For the period 2004 to 2006 in the Least Resistance Scenario, we have assumed that the whole difference between funds earmarked for enlargement in the Financial Perspective and the expenditure according to the CFF will be used for budgetary compensations to new member states as well as for unforeseen expenditure. The Commission has proposed that compensation should be paid to new member states in relation to changes in their financial net position before and after accession.

5.2.2 Results of the Least Resistance Scenario

The results are presented in table 6 in the form of enlargement costs as shares of GNP. Absolute amounts are shown in appendix table 3.

As we can see the enlargement will have a cost impact corresponding to 0.03 % of the GNP of the expanded EU in 2004, rising to 0.23 % in 2013. For reasons that will be further explained in forthcoming sections, the impact is marginally lower on EU 15 and on present net payers. Since new member states do not pay anything towards the EU budget before their accession, the impact will be equal to their total payments as a share of GNP.

The estimated total payments as a share of GNP for all countries are shown in table 9. It is clear that in no way is the 1.27 % ceiling for own resources threatened by a development such as the one assumed in this scenario.

Table 6. **Enlargement costs in a Least Resistance Scenario.** Percentage shares of GNP/GDP

	2004	2006	2007	2010	2013
Berlin net payers (D, NL, A, SE)	0.03	0.09	0.17	0.21	0.23
Net payers without rebate (DK, F, I, Fin)	0.02	0.08	0.16	0.20	0.22
Sum	*0.02*	*0.08*	*0.16*	*0.20*	*0.22*
UK	0.03	0.09	0.17	0.21	0.22
All net payers	*0.02*	*0.09*	*0.16*	*0.20*	*0.22*
Cohesion countries (Gr, Irl, E, P)	0.02	0.08	0.16	0.20	0.22
EU adm countries (B, Lx)	0.02	0.08	0.16	0.20	0.22
EU 15 total	*0.02*	*0.08*	*0.16*	*0.20*	*0.22*
Baltic countries (EE, L, Lit)	1.11	1.13	1.20	1.19	1.15
Visegrad countries (Pl, H, CZ, Sl)	1.11	1.13	1.20	1.19	1.15
Slovenia	1.11	1.13	1.20	1.19	1.15
Island states (C, M)	1.11	1.13	1.20	1.19	1.15
Bulgaria and Romania	0.00	0.00	1.20	1.19	1.15
New MS total	*1.11*	*1.13*	*1.20*	*1.19*	*1.15*
EU enlarged	*0.03*	*0.09*	*0.17*	*0.21*	*0.23*

Source: *Own estimates.*

5.2.3 The importance of growth

In all scenarios it has been assumed that the GNP of all EU 15 countries will grow by 2.5 % annually (in volume terms) after 2003 and that the GNP of all new member states will grow by 4 % annually, thus taking some step towards convergence. Some sort of standard assumption is obviously necessary since it would be a futile task to try to make individual growth forecasts for a large number of countries over this long period.[23] The assumptions that have been made lie in all likelihood around the average capacity growth of the member countries. The various scenarios are all based on an assumed growth rate of budgetary expenditure that falls well below the one assumed for the GNP. The payments to the budget, therefore, will by necessity fall over time when expressed as a share of GNP.

In order to show the importance of the growth assumptions, a variation of the Least Resistance Scenario was carried out in which growth rates were lowered to 1.5 % annually for EU 15. The growth rate for new member states was maintained at 4 % annually.

We note that the change of growth assumptions has a significant impact on the enlargement costs expressed as a share of the GNP and mainly towards the end of the period studied. In 2013, for example, the enlargement costs would amount to 0.30 % of the GNP of the enlarged Union with the lower growth assumption against 0.23 % with the standard assumption.

It must be stressed that these estimates must be considered mainly as a mechanical sensitivity analysis. It is difficult to envisage why and how the lower long-term growth would come about, let alone what consequences it would have for the development of the Union, its budget and finances. Nevertheless, the results serve as a pointer to the fact that the actual GNP-growth will have a significant impact on the way in which we look at the enlargement costs in the longer run. Those numbers are presented in table 7.

Table 7. **Enlargement costs in the Least Resistance Scenario with different growth assumptions.**
Percentage share of GNP of the enlarged EU

	2004	2006	2007	2010	2013
Standard growth	0.03	0.09	0.17	0.21	0.23
Slower growth	0.03	0.09	0.18	0.25	0.30

Source: *Own estimates (Least Resistance Scenario).*

[23] *Dresdner Bank, 2001*, makes courageous assumptions of growth rates in the individual candidate countries for the period 2001–2010. Numbers vary between an annual growth of 3.5 % (Romania) and 5.5 % (Estonia) with an average for 12 countries of 4.6 %, compared to 2.5 % in EU 15. The assumption of an average volume growth of 2.5 % for all EU 15 countries is the one used in the Financial Perspective and in most studies of the costs of enlargement – see for instance *Quaisser and Hall, 2002, p. 34.*

5.2.4 The importance of the time profile of accession

The importance of the timing of the accession will be illustrated in another variation on the Least Resistance Scenario. Without basing ourselves on any deeper political analysis we will assume that certain changes in the present roadmap to enlargement will appear. We will thereby assume that there will be no enlargement in 2004, that the Czech Republic, Estonia, Hungary, Slovenia and Malta will join in 2005, that the accession of Cyprus, Poland, Latvia, Lithuania and Slovakia will be delayed until 2007 and that Bulgaria and Romania will join only in 2009.[24] The impact on costs of such a time profile for accession is contrasted with the one of the original Least Resistance Scenario in table 8.

What happens if enlargement gets delayed and/or split up in several country groups is obviously that the payments of the enlargement costs will be postponed. In the variation presented in table 8, the total cumulative budgetary costs of enlargement would become about 25 % lower over the period 2004–2013 under the assumed profile than when the standard assumption is used.

Even if such a cost reduction might have some attraction from a budgetary point of view, it must be remembered that there would be severe political and maybe social costs of a delayed enlargement in which some countries would become members before others. This scenario variation must only be regarded as a sensitivity analysis of the calculations presented in our study. This being said, a ratcheting of enlargement could have a significant budgetary impact. This was seen already in table 2 where the actual EU budget costs are hovering just above and considerably below 1 % of GNP and might jump to 1.11 % the first year of accession, if budgetary costs were to reach the levels included in the Financial Perspective and the CFF respectively.

[24] As already stated there is no deeper political analysis behind this assumed pattern of accession but neither is it entirely without foundation, as the reflecting reader will understand. This *might* happen.

Table 8. **Enlargement costs in the Least Resistance Scenario with different time profiles for accession.**
Percentage share of GNP

	2004	2006	2007	2010	2013
Standard Time Profile	0.03	0.09	0.17	0.21	0.23
Alternative Time Profile	0.01	0.03	0.08	0.17	0.20

Source: *Own estimates (Least Resistance Scenario)*

Note: *Standard time profile: 10 countries accede in 2004, 2 countries in 2007. Alternative time profile: 5 countries accede in 2005, 5 countries in 2007 and 2 countries in 2009 (see text for further explanation). The amounts for pre-accession support have not been adjusted.*

5.2.5 Budgetary compensation to new member states

Upon membership every country also becomes part of the so-called Own Resources System.[25] One of the cornerstones of the system was supposed to be equity among the member states. In other words all members should contribute to an equal degree to the financing of the budget for the Union. All redistribution of financial resources should be made on the expenditure side.

The above has led to the apprehension that new member states might be in a worse financial position after joining the EU than before since they will have to pay their full contribution to the EU budget from the very outset of their membership. Their net position will depend on the amounts of expenditure allocated to them and on their capacity to absorb or make use of available funds, particularly at the beginning of their membership, which may be weak. The Commission has proposed that budgetary compensations be paid to new members in order to avoid that that accession would have a negative impact on their budgetary position. For technical reasons such compensation must be given in the form of lump sum payments rather than as rebates on the payments.[26]

At all previous enlargements a financial compensation has been given to the new members, with various motivations. At the most recent enlargement Austria, Finland and Sweden were granted four-year lump sum payments decreasing from 1.5 billion Euro in 1995 to 0.7 billions in 1996, 0.2 billion in 1997 and 0.1 billion in

[25] See *EC*, *1998*, for a detailed description and assessment of the system.
[26] A rebate would require an amendment of the Own Resources Decision, theoretically possible but in real life absolutely out of question.

1998.[27] This is approximately equal to the presently suggested amounts of 0.8 billions annually for 3 years (*EC 30.1.2002, ref 9*). Our estimates show that such an amount would correspond to a cost increase of approximately 0.01 % of GNP per year over the three years. In the context of long-term costs of enlargement this must be considered as a *quantité négligeable* although this is not so, obviously, in the negotiations of the annual budgets for the period in question.

5.2.6 Summary of the impact on costs of enlargement without policy reforms

It might be useful at this particular juncture to make a comparison of the total enlargement costs between the Financial Perspective, the Benchmark Scenario and the least Resistance Scenario and the variations that we have made. The results are shown in table 9. When comparing with the Financial Perspective we must remember that the assumed time profile for enlargement in the FP differed from the one now envisaged and also that the GNP-numbers have been revised since the FP was drawn up in 1999. We note in particular the following:

1. The estimates of the enlargement costs 2004–2006 are significantly lower in the Least Resistance Scenario than in the Financial Perspective in spite of the fact that they cover 10 countries instead of 6. The estimates of the Least Resistance Scenario are based on the CFF.

2. When related to the GNP of the enlarged EU the total payments, including the costs of enlargement, appear considerably lower, both for the present EU 15 and for the enlarged Union as a whole, than when related to the GNP of EU 15 only. (The latter was the case in tables 1 and 2 above.)

The last point may seem self-evident but is worth emphasizing. Sometimes, particularly in the political discussion, the total cost of the enlargement is often related to the GNP of EU 15 only. Total costs measured in this way may reach almost 0.30 % of GNP by

[27] See *EC, 1999*, p. 8, footnote3.

the end of the period studied. This could lead the casual observer to believe that the so called Own Resources Ceiling of 1.27 % of GNP might be threatened by the enlargement, particularly if even more pessimistic assumptions about the costs than the one we have used are made.[28]

The reason why we are sometimes misled is that we tend to neglect the increase in the GNP of the Union brought about by the new membership as well as the contributions to the EU budget coming from those countries. It is true that those increases are relatively small but, as we will demonstrate later, they nevertheless have a significant effect on the burden sharing within the Union.[29] Table 9 shows us that enlargement costs would reach no higher than 0.23 % by the end of the period when related to the GNP of all countries that will have to share the financial burden.

Concerning total payments to the EU budget, after enlargement, the Low Growth Scenario shows the highest costs in relation to GNP but even those numbers are a far cry away from the Own Resource Ceiling of 1.27 % of GNP.

[28] The Own Resources Decision stipulates that the EU may never charge more than 1.27 % of the GNP of the Union as so-called Own Resources (contributions or payments). This decision will be applied to a new system of National Accounts (ESA 95) in which the overall GNP-levels have been revised upwards. In order to prevent this statistical revision from affecting the Own Resources, the ceiling has been lowered to 1.24 % (of GNI). Since we use the material from Agenda 2000 and the Financial Perspective 2000–2006 in this study we maintain the old ESA system and the Resource Ceiling of 1.27 % (of GNP). Another matter, of real financial significance, is that the present membership always tries to maintain a budgetary margin to the Own Resources Ceiling of 0.15–0.18 % of GNP and that, in addition, the budgeted resources are never fully utilized. The 1.27 % ceiling is therefore, at best, a theoretical concept but not a suitable instrument for resource allocation. Again, several commentators tend to treat the margin between the actual budget and the ceiling as an available resource, which could be used for many a wonderful thing.

[29] See section 7.3 below.

Table 9. **Enlargement costs and total payments after enlargement in various scenarios.**
Percentage shares of the GNP of the enlarged EU

	2002	2004	2006	2007	2010	2013
1 Enlargement costs						
In the Financial Perspective	0.01	0.06	0.12			
Estimates in the Least Resistance Scenario						
Standard assumptions		0.03	0.09	0.17	0.21	0.23
Low Growth		0.03	0.09	0.18	0.25	0.30
Alternative Time Profile		0.01	0.03	0.08	0.17	0.20
2 Total payments to the EU budget						
In the Financial Perspective	1.14	1.11	1.09			
Estimates in the Least Resistance Scenario						
Standard assumptions	1.10	1.03	1.05	1.12	1.09	1.04
Low Growth	1.10	1.03	1.05	1.13	1.13	1.11
Alternative Time Profile	1.10	1.00	0.98	1.03	1.05	1.02

Source: *The Financial Perspective 2000–2006 (EC, 1999). Own estimates.*

Note: *See text for explanations of low growth and alternative time profile assumptions.*

6 Enlargement costs in reform scenarios

6.1 Cutting costs through policy reforms

This section will analyze the budgetary impact of a couple of scenarios where the development is assumed to take directions other than those in the "Least Resistance Scenario." Possible reforms of the common agricultural policy and the structural policy are the most important alternatives. It is important to understand, however, that it is not the aim of the present study to undertake any in-depth analysis of those or other policy areas and to suggest possible or likely reforms. Such issues have already been thoroughly examined by a number of researchers and institutions and we would have very little to add. We have, nevertheless, a general idea of what certain reform alternatives or risk scenarios could look like and it is our task to try to estimate the impact of such alternatives on the budgetary costs of the Union, their distribution between member countries and, later in the study, their impact on the net position or budgetary balance of various country groups. We will start with what is perhaps the most difficult and controversial policy area, the so-called Common Agricultural Policy (CAP).

6.1.1 A less expensive agricultural policy

The common agricultural policy (CAP) covers around 46 % of the total EU budget. Historically, CAP was designed with a food security aim but has developed into a mechanism for supporting agricultural prices, thereby securing the income levels of the farmers. Protectionist measures and market interventions leading to a price level more or less constantly above world market prices led to overproduction and the notorious "mountains" or "lakes" of various agricultural produce emerged. The European consumers, at the same time, were prevented from enjoying the lower food prices through the protectionist measures. This became an untenable situation and in 1992 a reform was carried out, bringing the EU market intervention prices somewhat closer to, but still above, the world market prices. Since this inevitably meant falling income for European farmers, a compensatory system of direct support was introduced with its own rules and stipulations, often connected with an undertaking to lay land fallow.[30] With time, environmental requirements and a special rural development support were introduced.

It is difficult today to find anyone defending the CAP except those directly benefiting financially or politically from the system. In addition it contains certain features that are not compatible with the WTO rules. The Agenda 2000 negotiations offered an unprecedented possibility to assess the system and agree on the necessary reforms in view of the impending enlargement. However, the agreements of Berlin were not even half-hearted. Certain reductions in the intervention prices were agreed on but they were to a large extent compensated by increases of the direct income support. The postponement of the CAP reform has accordingly created one of the biggest stumbling blocks in the enlargement negotiations.[31]

The proposed payment of direct income support to farmers in new candidate countries is the most critical issue. In the financial perspective 2000–2006, drawn up as part of Agenda 2000, no such payments were included. The main argument may have been that they would have distorting effects on the markets but also that direct support payments were a compensation for falling prices on agricultural products. Since, as a rule, the price level in the candidate countries is lower than within EU 15, farmers would suffer no loss due to this factor and hence there would be no need to pay compensation. The candidate countries have not accepted this argument and both the Commission (as stated in its Medium

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[30] The technique to lower intervention prices and increase direct payments is often referred to as shifting the costs from the consumer to the taxpayer, which should have some interesting domestic income distribution effects.

[31] For an excellent analysis of what really happened in Berlin see *Schwaag Serger, 2001*, which also is an interesting case study of decision-making in the EU. One author quoted (*op.cit.* p. 159) states: "*…a group of political leaders…proved to be less reform-inclined than their own farm ministers, with their intrinsic tendency to protect agriculture.*" The generally accepted negative assessment of the CAP decision in Agenda 2000 could be contrasted with a quote from Agricultural Commissioner Fischler's home page: "*Agenda 2000 has been one of the most ambitious and wide-ranging reform programmes of the common agricultural policy yet. By putting forward a new approach to farm policy, it equips our rural economies to face the challenges that lie ahead.*" This is a great example of what in Mr. Fischler's mother tongue is called *Zweckopimismus.*

Term Review (*EC, 2002, ref 13*) and, in reality, most of the members of EU 15 have tacitly agreed that nowadays the direct payments are rather a way of generally propping up the agricultural sector. The issue is to what extent and for how long that policy is sustainable.

The CFF foresees a gradual phasing in of direct support payments to the new member states in such a way that they would receive direct support payments to a level of 25 % in 2004, 30 % in 2005 and 35 % in 2006 of the present system. Making a remarkable departure from the rule not to discuss the development after 2006, the CFF goes on to propose that by 2013 the new member states would reach 100 % of "the support level then applicable." (*EC, 30.1.2002, ref 9, and EC, 30.1.2002, ref 10.*)

The CFF has been received with a mixture of pain and indignation by the candidate countries, which feel that the proposal would brand them as second-class members. Some of the EU 15 countries, notably the UK, the Netherlands and Sweden, oppose the proposal out of concern for their net payer status and since they are generally opposed to support payments. The Commission has taken a rather firm "take it or leave it" attitude. Commissioner Fischler writes, for instance, on his home page that full direct support payments would be counterproductive and have negative effects on production and restructuring and lead to income disparities and social distortions.

Chances of a thorough reform[32] of the agricultural policy would seem to be remote. *Schwaag Serger, 2000*, analyzes in a convincing way why this is so. France, in particular, plays a key role. Not only is France the major net beneficiary of CAP but the policy also seems to have a solid ideological foundation and be regarded as a major pillar of the European cooperation. (*op. cit. page 70 et passim*). *Quaisser and Hall, 2002*, believe that "*France might be willing to promote a CAP reform if offered a medium-term phasing-out scheme*" and that after the elections in 2002 France and Germany would be in a position to work together to overcome blockades to reform. We reserve our opinion on this matter but note that the recent elections in France have hardly facilitated political concessions from the side of the French Government.

[32] For the sake of simplicity we are only discussing a reduction of the direct income support payments. There are also a number of other measures for reforming the CAP that would be required, for instance, with respect to production quotas. Many also favor an increased emphasis on rural development measures, which have a strong environmental component.

In order to illustrate the budgetary impact of a possible reform of direct support payments we have estimated a scenario in which payments will be reduced to 85 % of their present level by 2013, through continuous phasing out of payments to the present EU 15. We assume this phasing out to start after 2006. It would correspond to an annual decrease of 3.14 %. We retain the proposal of the Commission of *phasing in* direct support payments in such a way that the new member states would receive 100 % of the possible support in 2013. That level, however, would now be 20 % lower than what the present system would give. In that way all member countries (with a temporary exception of Bulgaria and Romania) would receive equal treatment by that year.

Since we are addressing here one of the biggest budgetary items of the Union, even relatively modest savings, such as 15 % over a 7-year period, will have significant impacts. We estimate the total sum of direct support payments to EU 15 by 2013 to approximately 30 billion Euro (at 1999 prices) and to the new member states at slightly less than 7 billion Euro. A 15 % saving on direct support to EU 15 would correspond to approximately 0.05 % of GNP of the enlarged Union, an important quantity in this context.

Table 10. **Impact of a reduction of agricultural expenditure on enlargement costs.**
Percentage share of GNP of the enlarged union

Net cost of enlargement:	2007	2010	2013
Without agricultural reform	0.17	0.21	0.23
With 3.14 % annual reduction of direct support costs 2007–2013	0.16	0.18	0.18

Source*: Own estimates.*

Note*: In this table we use the term "net cost of enlargement" since the reduction of costs would come from a cut in the agricultural expenditure allocated to EU 15 whereas the enlargement costs proper would be the same as in the standard alternative.*

This policy alternative would seem very attractive from a budgetary point of view but its possibilities of being implemented are very much in doubt. *Schwaag Serger, 2001*, gives a full review of the various proposals made before Berlin and the negotiation games. At one point an annual degressivity of direct support payments of 3 % was a serious possibility but disappeared in the final cutting of the deal. In a very simplified way of looking at matters, countries that are net payers to the EU budget would be in favor of partial renationalization of the agricultural policy and/or degressivity of direct support payments. But the issue is complicated, among other things by the relative importance of the agricultural sector and the share of the agricultural budget, which is allocated back to the member countries. France receives around 22 % of the EU budget of EU 15 and Germany around 14 %. The relation between the GNP-shares is almost the opposite. So although both countries are net payers to the EU budget it will obviously not be an easy task to convince France with budget savings arguments.[33]

In July 2002, the Commission presented its mid-term review of the agricultural policy. (*EC, 2002, ref 13*). Contrary to expectations, the review contained relatively far-reaching proposal for the future agricultural policy. The principle of degressivity was not accepted as such but the review contained a proposal of decoupling direct support from agricultural production and also a reduction in the amount of direct support and a corresponding increase in funds for rural development. The proposal got a mixed reception. Some net payers welcomed it but cautiously since there would be no reduction in total costs. Others, notably France, rejected the proposal in harsh terms.

Since the proposal in the mid-term review would not entail any reduction (or increase) in the total costs for agricultural policy but only a redistribution between the various types of payments, we have not further analyzed its budgetary consequences. Should the proposal be accepted in principle it is possible, however, that the proposed shift from conventional agricultural policy towards a rural development policy might in the future permit savings on the structural operations budget rather than on the agricultural budget.

[33] France at one point of time accepted the degressivity principle during the Agenda 2000 negotiating but insisted that the savings would be used for rual development policy instead. (*Schwaag Serger, 2001, page 115 et passim*.) *Quaisser and Hall, 2002,* argue that the agricultural net position of France may suffer sufficiently from the access of new member states into the system that it might be willing to promote a CAP reform (*op. cit. p.48*). We cannot see this.

6.1.2 Structural policy: same rules for all?

The heading Structural Operation covers around 33 % of total EU 15 expenditure in the Financial Perspective 2000–2006 whereas agricultural expenditure corresponds to approximately 46 %. If we were to transfer the expenditure for rural development, which is basically of a structural operations character, the former policy area would cover 38 % of the resources of the Union against 41 % for agriculture. The two policy areas would thus be of the same magnitude.

The functioning and impact of the structural policy of the EU has been the object of a number of evaluations and assessments. The latest assessment from the side of the Commission is *EC 30.1. 2002, ref 11*, which, among other things, presents the proposed criteria for structural support to the new member states during the years 2004–2006. The Commission is, however, well aware of the fact that the critical period is the one after 2006. It therefore promises to make concrete proposals for the future of the cohesion policy in its Third Cohesion Report, which is expected in November 2003.

Even if a reform of the structural policy of the Union would be due under all circumstances, it is clear that the enlargement of the Union will fundamentally impact the regional cohesion within the Union. The accession of 10–12 new member states, all with a level of income far below the average of the present Union and with huge regional disparities, will, on the surface, make the Union much more unequal than before. Statistically, most of the poorest regions of the present EU 15 will suddenly emerge above the average Union level of income. This opens up a host of questions and issues relating to the future structural and cohesion policy of the Union.

In addition to the issues raised by the enlargement there are many other question marks surrounding the regional and cohesion policy of the EU. A "meta-evaluation" of the structural and cohesion policy was published at the end of 2000 in *Tarschys, 2000*.[34] A review of the studies and evaluations made, leads the author to the conclusion that the structural and cohesion policy of the Union has been quite successful – but unfortunately not in terms of achieving its proper goals of reducing regional inequality

[34] The study contains an extensive summary in English.

but rather in terms of other or subsidiary goals such as facilitating the integration process, strengthening sectoral polices and the institutional development. Broadly speaking this is because the structural and cohesion funds have functioned as a pool of money that could be deployed in order to remove political obstacles on the road to integration. Expressed in a cruder fashion: to buy out countries that otherwise would refuse to participate in the one or the other reform process.

Leading politicians have raised the question whether the future regional and cohesion policy should not be exclusively directed towards the poorest member states, in other words the present candidate countries. A negotiated share of the EU budget should be set aside for this purpose and distributed following certain criteria to the poorest member states. Those criteria could be either of a national or a regional nature and the use of funds could be controlled either at the national or the Union level.

Those proposals unfortunately meet with strong objections since there are a number of the present EU 15 member states that happily enjoy the benefits of the present regional policy. Apart from the present so-called cohesion countries (Spain, Portugal, Greece and Ireland), countries like Germany (the eastern *Länder*), the UK (*highlands and islands*), France (*départements d'outre-mer*) and Sweden and Finland (*arctic regions*) dip into the pot.[35] Informal estimates show that with a reform of the system enough budgetary savings could be made to compensate for possible losses in those countries.[36] Alternatively, regional criteria could be set in such a way as to include the neediest of those regions, for instance Eastern Germany.

Another problem with a reform along such lines is that the present regional policy is the only visible and strong link between regions in the member countries and the administration in Brussels.[37] The availability of EU support for local projects has without doubt contributed significantly towards creating a positive grass root attitude towards the Union and the European

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[35] The Netherlands is one of the very few countries which do not benefit from the regional development policy of the Union. In jest (?) a representative of the Dutch Government suggested to the author that a below-the-sea-level criterion should be introduced unless the policy was reformed. This would be only marginally more peculiar than some of the present criteria for obtaining structural support.

[36] Informal communication to the author from the Ministry of Finance in one of the countries concerned.

[37] This is convincingly demonstrated in the report from the Cohesion Forum in Brussels, May 2001, attended by 1 800 delegates from national and regional authorities and interest groups. (See *EC, 30.1.2002, ref 11*) for further reference.

cooperation in contrast to the archetypal prejudice against the "bureaucracy in Brussels." It is obviously dangerous to rely on anecdotal evidence but when traveling through the countryside of any member country an observer is likely to be impressed by the number of small signs with the European emblem and some variation of the text "supported by the EU."

Another way of approaching reform of the structural and cohesion policy would be to advocate "same rules for all" after the accession of new member states. A negotiated proportion of the EU budget should be set aside for regional and structural policy. All member states would be eligible and the distribution should follow the same criteria as at present (possibly in a somewhat simplified fashion). Attractive – and fair – as this idea may seem the above-mentioned statistical effect would, however, result in most of the present EU 15 members losing their structural support with particularly heavy losses for the present cohesion countries.

In this study we have assumed that the same-rules-for-all option will prevail. At the same time we admit that the present beneficiaries of the structural policy are not going to accept this without receiving compensation. In most of the scenarios presented above we have therefore assumed that the present EU 15 will receive a 100 % compensation for their loss in a same-rules-for-all system. Obviously, this is a somewhat extreme assumption. We show therefore, in table 11, what would happen if "same rules for all" were applied strictly.

As we can see from the table the principle of same-rules-for-all would cut a considerable part of the costs of structural operations and of enlargement costs as a whole. There should be, accordingly, a sufficient margin for successful negotiations between the two extremes: full compensation to EU 15 and same rules for all.

Another issue relating to structural operations policy concerns the so-called 4 % cap on structural support. In Agenda 2000 it was decided that income from the structural funds and the cohesion fund should not exceed 4 % of the national GDP. This rule does not come into force in any of the present member states. By following the present support system, the Baltic countries would hit that ceiling before 2006 and all new member states except Cyprus, the Czech Republic, Hungary, Malta and Slovenia would reach the 4 % ceiling in the period after 2006. This is one of the reasons why structural operations costs for enlargement would not be exceedingly expensive. Certainly, voices have been raised for abolishing the 4 % cap on income from structural expenditure but the resistance from net payers is strong and unanimous on this point. There is however another good reason not to relax this limitation: without the capping the net positions of the new member states would reach unrealistic values of 8 to 10 % for the Baltic countries and much higher for Bulgaria and Romania. Three of the four Visegrad countries would still not reach the 4 % ceiling and only Poland would attain a net position in 2013 of between 4 and 5 %, which might or might not be considered as manageable. Already there are justified concerns about the absorptive capacity of the new member states, that is to say their ability to utilize the funds put at their disposal from the Union budget. Partly this is due to the extremely complicated planning and programming procedure for utilizing structural support allocations but mainly the requirements of co-financing and institutional capacity in the receiving countries constitute severe bottlenecks, particularly at the regional and local level. Even very advanced member states, such as Sweden, have difficulties in utilizing their structural support funds to the full. Our conclusion is that only one country, Poland, could have a legitimate interest in discussing the 4 % cap on structural operations and even that is a doubtful case.

Table 11. **Impact of different alternatives for structural operations policy on enlargement costs.**
Percentage share of GNP/GDP

Net cost of enlargement	2004	2006	2007	2010	2013
With full compensation to EU 15	0.03	0.09	0.17	0.21	0.23
With the same rules for all	0.03	0.09	0.04	0.08	0.11
Same rule for all but no 4 % cap on structural funds	0.04	0.11	0.17	0.20	0.20

Source: *Own estimates.*

Note: *In this table we use the term "net cost of enlargement" since the reduction of costs would come from a reduction of structural operations expenditure allocated to EU 15 whereas the enlargement costs proper would be the same as in the standard alternative.*

Our same-rules-for-all scenario is based on an assumption that an amount equal to 0.45 % of the GNP of EU 27 would be set aside for structural operations policy in the period 2007–2013. This is the amount set aside for that purpose by the Berlin Council in 1999 for the year 2006.[38] The estimated structural expenditure in this scenario would, however, only amount to slightly more than 0.30 % of the GNP. Even our Least Resistance scenario implies total cost for the structural policy to slightly above 0.40 % of GNP in EU 27 during the period.

6.2 Summary of the cost estimates

6.2.1 A recap of our scenarios

It is now high time to sum up the various cost estimates described in the sections above and in chapter 5. Table 12 summarizes the impact of the enlargement expressed as percentages of GNP or GDP of the enlarged Union. In the Least Resistance Scenario, which includes no CAP reform and no reduction of structural support to EU 15, the costs would go from 0.03 % of GNP/GDP of the enlarged Union in 2004 to 0.23 % in 2013. We see also that either of the two reform alternatives, a modest reduction of direct support payments or application of the same rules for structural funds for all member countries, would reduce those costs in a very significant manner. Even if we take away the 4 % cap on structural funds, total costs would be somewhat lower than in the Least Resistance Scenario.

A phasing out of direct support payments obviously would create a huge potential for budgetary savings. Here, as in other contexts, a lot of caution is required: we have not at all gone into the problems of what kind of national policies that might be required or permitted in order to support the agricultural sector or backward regions. A heavy restructuring of the agricultural sector in Europe would have social costs, which must be covered by

[38] As quoted in EC, 30.1.2002, ref. 11. What was agreed was, however, the absolute amount of support, not the share of GNP. This share as such can therefore not be considered part of the *acquis.* The Commission quotes, nevertheless, studies by independent research institutes claiming that 0.50 – 0.65 % of GDP should be set aside for community structural and cohesion policy. Maybe, but it is difficult to reconcile such claims with the absorptive capacity of the receiving countries. The formulation and execution of policy would have to be fully redefined in order to put even larger funds than at present to use.

national policy measures. It is likely, nevertheless, that such measures could be made more efficient than the present system.

As mentioned in the text above, we have seen that budgetary compensations to new member states for a couple of years would have a very small impact on total enlargement costs. A delay in the enlargement process, such as the one outlined in section 5.4.4 above would obviously shift the costs forward in time. Table 12 shows us that, in the example we have used, enlargement costs would go from 0.01 % of GNP of the enlarged Union in 2004 to 0.20 % in 2013. Whereas this might bring about some short-term budget relief it could carry with it political and macroeconomic costs that would outweigh by far the short-term gains.

Table 12. **Summary of enlargement costs in different scenarios.** Percentage shares of GNP/GDP

	2004	2006	2007	2010	2013
Least Resistance	0.03	0.09	0.17	0.21	0.23
Degressivity of direct support	0.03	0.09	0.16	0.18	0.18
Same rules for all in structural operations	0.03	0.09	0.04	0.08	0.11
Same rules but no cap on structural operation	0.04	0.11	0.17	0.20	0.20
Low growth in EU 15	0.03	0.09	0.18	0.25	0.30
Delayed and group-wise enlargement	0.01	0.03	0.08	0.17	0.20

Source: *Own estimates.*

Another observation that can be made from table 12 is that a slowdown in growth in the EU 15 area after 2006 would have a significant effect on costs when expressed as a share of GNP/GDP. We are, however, in doubt as to whether those growth assumptions would be consistent with the assumptions of expenditure development. A growth rate of 1.5 % annually would probably be well below capacity growth in EU 15 and hence would indicate a permanent state of underutilization of resources, which would probably not be compatible with implementing the ambitious project of integrating 12 new member states. It is meaningless to speculate on the kind of policy actions that might become necessary in such a situation – this would obviously also depend on the underlying causes of the slow growth. The indicated scenario should be seen only as a mechanical sensitivity analysis. Nevertheless, there is one important lesson to be learned: accommodation of the costs related to enlargement will require a long-term steady economic growth, always very close to the path of full capacity utilization.

Table 13 summarizes the results expressed as total payments of various country groups in some of the key scenarios. We note that even in the lax Least Resistance scenario the payment quotas for the different country groups would have maximum value of between 0.82 % (UK) and 1.20 % of GNP/GDP (new member states). This corresponds to a value of slightly above 1.10 % of GNP/GDP of the enlarged union (not shown in the table).

Table 13. **Total payments to the EU budget in different enlargement scenarios.**
Percentage shares of GNP/GDP

	2002	2004	2006	2007	2010	2013
Least Resistance scenario						
Net payers (except UK)	1.16	1.07	1.10	1.17	1.14	1.10
UK	0.79	0.75	0.75	0.82	0.74	0.70
EU 15 total	1.10	1.02	1.03	1.11	1.08	1.04
New member states	0.00	1.11	1.13	1.20	1.19	1.15
Same rules for all in structural operations						
Net payers (except UK)	1.16	1.07	1.10	1.04	1.01	0.97
UK	0.79	0.75	0.75	0.69	0.69	0.65
EU 15 total	1.10	1.02	1.04	0.98	0.96	0.92
New member states	0.00	1.11	1.13	1.08	1.05	1.01
Low growth in EU 15						
Net payers (except UK)	1.16	1.07	1.10	1.18	1.19	1.17
UK	0.79	0.75	0.75	0.82	0.77	0.75
EU 15 total	1.10	1.04	1.04	1.12	1.12	1.11
New member states	0.00	1.13	1.13	1.22	1.24	1.22

Source: *Own estimates.*

But we also see that there are great disparities between the country groups. The very low share of the UK stands out. On the other hand the shares of the new member states are higher than for the net payers. Although this is not shown in the table the same would be true for the cohesion countries of the present EU 15. The reason behind this anomaly is that the payment share of EU 15 is significantly reduced by the UK rebate and the discount on payments granted four other countries.

A fuller presentation of the scenario results is given in Appendix 2, tables 2–6.

6.2.2 What other studies say

A number of studies of the costs of enlargement have been published since the beginning of the 1990's. It is, however, not so easy to compare the results of those studies with each other or with our own results since methods and assumptions vary considerably. The time profile of the accession has generally been identical with the one foreseen in the Financial Perspective, that is to say with 6 countries acceding in 2002 and with a supplementary assumption of 4 or 6 countries acceding in 2007. We have seen in section 5.2.4 above and in table 9 that the time profile for accession can have a very significant impact on the distribution of costs over time. Since we now assume a big bang enlargement with 10 countries by 2004 most earlier estimates show higher costs than our study for the period 2002–2006 but often come to similar results over the longer time perspective, that is to say by 2013.[39]

A recent study by *Quaisser and Hall, 2002*, takes into account both the likely change in time profile for access as well as the proposed Common Financial Framework for the period *2004–2006 (EC, 30.1.2002, ref 9)*. The outcome is very similar to ours except that the cost estimates for 2008 appear to be substantially higher than ours at 1.20 % of GNP against our 1.11.[40] The discrepancy is explained by the fact that it is the result of an econometric estimate for agriculture and an assumption about full use of the 4 % ceiling for structural operations.

As already pointed out in *Karlsson, 2001*, econometric studies of the enlargement costs generally tend to indicate higher costs than the accounting approach we are using for our estimates. The reason for this seems to be that those studies are based on implicit or explicit relations between the development of expenditure and economic structure or voting behavior in the European Council.[41]

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[39] For reviews and summaries of earlier studies of enlargement costs see mainly *Karlsson, 2002*, *Baldwin et al., 1997*, *Stankovsky et al., 1998 and Quaisser et al., 2000.*
[40] *Quaisser and Hall*, *2002*, p. 32 et passim.
[41] See for instance *Baldwin et al., 1997*.

Whereas this is an excellent way of analyzing and explaining what has happened so far, the forecasting ability of such methods is of course less certain. We have followed another approach and taken as a given starting point that the Financial Perspective agreed on in Berlin indicates a permanent (or at least semi-permanent) change of trends in the expenditure development of the Union. This was largely due to the insistence of a number of important net payers. We believe that this trend change will prevail during the period up to 2013.

This assumption may of course turn out to be wrong. *Quaisser and Hall, 2002*, show that after enlargement countries which contribute around 80 % of the budget would have only around 60 % of the votes in the Council after the Nice agreements. Net recipients, contributing 20 % to the budget, would have almost 40 % of the votes. The authors assess the risks for a future "*explosion in costs*"[42] as rather high. This assessment is based mainly on an assumption of an accelerating growth in the new member states which would raise the 4 % cap for structural funds in absolute amounts plus an assumption that new member states would be able to make full use of all structural funds available to them from the very beginning. We are not fully convinced of this, given what we know about the absorptive capacity of the candidate countries. Normally accelerating growth would also mean less need for support to backward regions.

6.3 Is there a worse scenario?

The estimates above and tables 12 and 13 have probably left the impression that the enlargement costs, also in the perspective of the period up to 2013, are within the limits that member countries must have reckoned with when the enlargement project started to take form. Although we reject the 1.27 % ceiling as a policy parameter it is an agreed maximum, which will hardly be threatened, even in the more pessimistic alternatives. But what would a real "worst case" scenario look like? We recall that even in the Least Resistance Scenario above we have included full direct support payments to agriculture in new member states after a phasing in period suggested by the Commission. We have not assumed any reform of the present system. Furthermore, we have assumed that all EU 15 countries would receive full compensation

[42] *Quaisser and Hall, 2002*, p. 35.

for the losses of structural support funds that they would suffer if a same-rules-for all-system were introduced. In a sense the Least Resistance scenario could also be regarded as a Worst Case scenario.

Without losing all internal consistency it might be possible to tighten the screws one or more additional turns. The opposition to the phasing in proposal from the candidate countries is very strong. We could therefore envisage a solution where full direct support was paid as early as of 2007. In other scenarios we have not included any increase in administrative costs or internal policy after 2006, knowing well that those are the favorite areas of budget negotiators.[43] We could therefore add an increase in those items, perhaps at the same rate as the one foreseen for the period 2000–2006 in the Financial Perspective. We further assume a 5 % increase in the policy area "External Expenditure".

Of all those assumptions only the increase in direct support payments to new member states from 2007 onwards has a significant effect on total costs. Since Bulgaria and Romania would be entitled to very high support payments in an un-reformed system, it is particularly the payments during the first years of their membership (say 2007–2010) that would be affected. The payments by the large net payers excl. the UK would reach a maximum of 1.22 % of GNP (against 1.17 % in the Least Resistance Scenario) and for EU 15 the quota would reach a maximum of 1.15 % (against 1.11 in the standard scenario). The Own Resources Ceiling would in no way be impaired and by 2013 the difference between this scenario and others would be minimal.

It would of course be possible to relax simultaneously further constraints imposed on the previous calculations, for example by not using the 4 % cap on structural expenditure and assuming a lower growth rate in EU 15 and by assuming falling instead of rising world market prices for agricultural products. We fear that our accounting approach to the issue of enlargement costs would break down if new assumptions along those lines were introduced. Such an analysis would no doubt require a dynamic econometric analysis of a general equilibrium character.

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[43] Sometimes unwisely, as we will argue below, since some of the net payers enjoy a substantial net inflow of funds from the policy area "internal policy." But we must refer to the timeless example of the bicycle shed and the nuclear reactor in *Parkinson's Law (Parkinson, 1958*) corroborating the thesis that *"the time spent on any item of the agenda will be in inverse proportion in the sum involved" (op.cit., p.63)*.

It is, of course, possible that there could be new initiatives in an enlarged union to increase rather than to restrict the community activities and the budget. Cost intensive common policy actions in the fields of for example energy and environment but possibly also in areas such as crime prevention, defense and general security and maybe, in a more positive vein, in information infrastructure, education or advanced research are fully possible. This might lead to a considerable expansion of the EU budget but would then be the result of explicit policy decisions, mostly taken in consensus. As such they would fall outside the scope of this study which focuses on issues that are either already included in the existing system or will appear in the future as a consequence thereof.

Part 2. Equity in a large union

7 Sharing the financial burden

7.1 The issue of budgetary imbalances

In table 3 we have already shown how the payments for the EU-budget will be distributed, in total and for the enlargement in particular, between various country groups. We have stressed that the basic idea of equity in burden sharing has become severely distorted by the UK rebate and the discount relating to Germany, Sweden, the Netherlands and Austria but also because of variations in the VAT-base and in the payments of customs duties etc. This has led to an uneven distribution of payments, which can be seen when studying the payments as a share of the GNP (table 3), which is estimated to vary between 0.75 % (UK) and 1.11 % (most countries not enjoying any discount) in 2006.

When assessing the relative financial plights of the member countries there is another fundamental aspect to take into account, namely the budgetary balance or, as we will call it in this study, the (budgetary) net position. Except for the external expenditure the whole EU budget is spent within the Union, that is to say allocated to the individual member countries. The biggest policy areas, agricultural policy and structural operations, have their own set of rules for distributing the funds. There are special rules also for the category Internal policy. Even the administrative expenditure benefits the member countries and particularly the countries where the central administration is located, that is to say Belgium and Luxembourg.[44]

It is possible to calculate the difference between payments and allocated expenditure for each member country, in order to

[44] At the time of writing, EU institutions are located to all EU 15 countries except Sweden and Finland. All countries have, however, a EU-representation office. Meetings are also held in all member countries, particularly in the country holding the rotating Presidency of the Council. In addition some of the travel costs for participation in official meetings in Brussels are paid from the EU budget. Accordingly, all member countries benefit, albeit to a modest extent, from the EU administrative expenditure.

determine a budget balance or net position. Without supplementing assumptions the sum of those net positions would not be equal to 0 since around 10 % of the budget is spent as external expenditure (of which preaccession aid is one important part).

The net position is an analytically doubtful concept of very little macroeconomic relevance. It is also difficult to calculate since parts of the expenditure are not allocated via public sector budgets but go directly to institutions, organizations, enterprises or individuals in the form of research grants, consultancy fees, procurement payments and so on. A large part of the funds allocated back to the member countries requires national co-financing. In a macroeconomic cost-benefit analysis the opportunity costs of both the payments of contributions and the national co-financing must be considered, as well as several other factors.[45]

In the past, the European Commission has argued forcefully that the net position cannot be a correct measure of the economic, social and welfare benefits gained from a EU membership (*EC, 1998, ch. 2 et passim*). We share this opinion fully. At the same time, we have to accept that, unfortunately, the net position has become an official concept in the Union. At the meeting of the European Council in Fontainebleau in 1984 all countries with significant budgetary imbalances "*in relation to their relative level of prosperity*" were granted a possibility of achieving an adjustment. This was, however, mainly an alibi action for granting the UK its considerable rebate on its payments. No other country has so far obtained a similar advantage.[46]

It is possible to define the net position in several different ways. The only official definition available is, however, the one used for determining the UK rebate. For the purposes of this study we will therefore use the so-called *UK rebate balance* definition. *EC, 1998*, gives a detailed description of this definition and of how the UK rebate balance is calculated. This is also touched upon in Appendix 1, which further shows that the choice of definition far from being just a theoretical quibble has some very real political and financial implications. Right now we will confine ourselves to mentioning that the chosen definition evens out the external expenditure in such a way that the sum of the net positions becomes 0 and that

[45] We will argue in section 8.2 that it might even be against the interest of a net payer to try to increase its share of the allocated expenditure.
[46] Except that Germany, as the largest net payer, had a small rebate on its share of financing the UK rebate, which may have been the precedent for the decision in Berlin 1999 to grant 4 countries a similar, but larger, discount.

for each country custom duties are taken into account only in relation to its share of VAT- and GNP-based payments. A further disadvantage with the UK rebate definition is that total payments less total allocated expenditure will not be equal to the net position as the reader will find in several of our tables.[47]

It is interesting to note that in connection with the enlargement negotiations the Commission seems to have abandoned, at least temporarily, its objections to the use of net positions as a political concept and its earlier insistence on using the UK rebate definition. The Commission has proposed that budgetary compensations should be paid to new member countries if their net position would be less advantageous after than before accession and that this be defined as the cash difference between payments and funds received.[48]

After this somewhat longwinded introduction we will start by giving a picture of the burden sharing among the present EU 15 member states. Thereafter we will analyze how the various enlargement scenarios, elaborated in previous chapters, will affect the distribution of the financial burden.

7.2 Burden sharing in EU 15

The actual situation in 2000 is set out in table 14. The table shows clearly the dominating position of Germany as a contributor and as a net payer. We can also see that four countries, Germany, France, Italy and the UK pay almost 70 % of the EU budget, a share that will change only marginally when the Union is enlarged. The same countries receive together somewhat more than 50 % of the allocated expenditure. Nine out of the fifteen members are net payers. Of the net receivers, Spain receives most funds in absolute numbers, followed by Greece.

The strong positive net positions of Belgium and Luxembourg are the results of the allocation of the administrative costs of the EU. They constitute, nevertheless, real positive contributions to the economies of those two countries.[49]

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[47] The author feels a certain need to apologize for these technicalities. But, to quote the American columnist Dave Barry; ”*I am not making this up!*”

[48] In other words the accounting definition otherwise advocated by large net payers such as the Netherlands and Sweden. Appendix 1 shows why.

[49] The multiplier effects on the domestic economy are probably smaller in Luxembourg than i Belgium because of a higher import leakage.

To understand the sharing of the financial burden we have to look at the net position in relation to the GNP and, maybe, in relation to the population of the country. Three net payers stand out: Germany, the Netherlands and Sweden with negative shares of –0.43 to – 0.50 % of GNP. A second group consisting of Austria, the UK and France have negative net positions ranking from –0.08 to – 0.27 % of GNP. Among the net receivers Greece, Ireland and Portugal stand out while the net position of Spain was only 0.88 % of its GNP. Also when measured per capita Sweden, Germany and the Netherlands have by far the highest negative net positions.

We should remember that the actual size of the net position also depends on the definition that is used. Appendix 1 shows that with alternative definitions the net positions cold be very different, particularly for the Netherlands (more negative) and for Belgium and Luxembourg (much more positive).

For the future, and in particular in the perspective of the enlargement of the union, present members cannot expect any increase in allocated expenditure from the EU budget. Since at the same time total costs and thereby payments will increase at least to some extent, the net positions of present members will deteriorate to a varying degree. Countries like Denmark, France, Italy, Austria and maybe Finland will find themselves in the position of significant net payers. (France and Austria are already net payers but their importance as such will increase.) The traditional main net payers Germany, the Netherlands and Sweden will see their share of the financial burden further increase. At the same time present net receivers risk seeing the financial inflows shrink, in particular if there would be reforms of the agricultural and, above all, the structural policy of the Union. Those are the political realities that are likely to determine the positioning in the upcoming debate on policy reform and the own resources system. Since the enlargement process by and large is welcomed and accepted by all countries the political infighting relating to the financing of the enlarged Union is likely to happen between various groups of the present EU 15 rather than between old and new member states. The latter may in some cases gain a strategic influence when deciding with which group to side.

Table 14. **Financial burden sharing in EU 15 in the year 2000.**
Percentage shares and Euro per capita, 1999 prices

	Percentage share of EU 15			Net position	
	Total payments	Total receipts	GNP	As share of GNP	Euro per capita
Belgium	3.9	5.6	3.0	0.85	199
Denmark	1.9	2.1	2.1	0.12	39
Germany	24.8	13.4	24.5	-0.45	-111
Greece	1.5	7.2	1.5	3.47	414
Spain	7.3	14.2	7.0	0.88	127
France	16.5	16.1	17.0	-0.08	-19
Ireland	1.2	3.4	1.0	1.99	447
Italy	12.5	14.1	13.7	0.07	14
Luxembourg	0.2	1.2	0.2	4.09	1 687
Netherlands	6.2	2.9	4.8	-0.43	-106
Austria	2.4	1.8	2.4	-0.27	-66
Portugal	1.4	4.2	1.3	1.95	212
Finland	1.4	1.8	1.5	0.19	45
Sweden	3.0	1.6	2.8	-0.50	-131
United Kingdom	15.8	10.2	17.0	-0.26	-61
EU 15	*100.0*	*100.0*	*100.0*		

Source: *Payments and receipts: Allocation of 2000 EU operating expenditure by Member State (EC, September 2001). GNP: Eurostat, European Economy and own extrapolation. Population: UN Population Division (data refer to 2000).*

7.3 The share of new member states in the financial burden

The new member states will make a small, but significant, contribution to the EU budget. Although the 12 candidate countries will constitute approximately 23 % of the population of the enlarged Union, they will contribute only about 4 % to the GNP measured at market prices. Roughly speaking, this means that the new member states will contribute around 4 % of the total budget of the Union. It is often forgotten in the discussions that that percentage will be applied to *the whole budget* of the Union (estimated to approximately 110 billion Euro in 2007) and not only to the enlargement costs (estimated to amount to slightly less than 20 billion Euro by 2007). The total payments from new candidates will amount to approximately 5.3 billion Euro. This is of course their contribution to the *total* EU-budget but seen in relation to the enlargement costs it is more than ¼.

The financial burden of the four Berlin net payers, for instance, would be reduced by approximately 1.7 percentage points (mainly attributable to Germany) because of the enlargement and that of the UK with more than 0.8 percentage points. This obviously contributes towards alleviating the burden of additional cost for enlargement.

As can be seen in table 15 and in chart 2 the net positions for the new member states are expected to develop in a very positive manner. We have to emphasize strongly that this is on the assumption that the absorptive capacity of the new member states will develop in the way that is foreseen by the Commission in the proposed CFF and extrapolated by us (see section 5.1.2 above). That assumption is based among other things on the hope that the preaccession support will achieve its goals in preparing the candidate countries for full membership.

There is a large degree of uncertainty surrounding the absorptive capacity of the new member states. Commentators have sometimes expressed concerns that some new member states might end up as net payers because of lacking absorptive capacity. Slovakia and Poland have been mentioned.[50] We have had no other option in this study but to rely on the data presented by the Commission.

If some member states should prove to be unable to absorb the available funds, the outcome would be on the one hand that their net position would deteriorate since all member states would have to participate in the Own Resource System from the first day of their membership and on the other hand that the total financing requirements of the EU would be reduced. Depending on the timing this could be a budgeted reduction or take the form of a repayment of funds one year after the underutilization. (In 2001 about 15 billion Euro out of the budget total of almost 100 billion Euro was not used. That sum was credited to the member countries in the budget for 2002, which made the Own Resource quota fall to 0.93 % of GNP for that year. According to the Financial Perspective the quota should have been 1.13 % for that year not counting any enlargement costs.)[51]

There is at least one additional aspect to consider relating to the budget compensation of the new member states. In the CFF the Commission has proposed that that new members be paid a budgetary compensation in order to prevent their financial

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[50] See for instance an article in "Die Presse" (Vienna) May 14, 2002 where EU staff responsible for the preaccession programmes in Poland expresses very pessimistic opinions.
[51] This is the number for which a ceiling of 1.27 % has been set.

situation from deteriorating vis-à-vis the EU after accession. This could be the case if their net position would be lower than the sum of pre-accession aid enjoyed before accession. The Commission assumes that this will be the case in some instances, but does not provide any detailed information. (*EC, 30.1.2001, ref 9, p 8*). In the information note the Commission estimates that there would be a "margin" of about 800 millions of Euro available each year 2004 – 2006. A considerable share of this would be used for budgetary compensation to some of the new member states.

It is not easy to estimate the net positions of the new member states for the critical years 2003 and 2006, respectively. We know, of course, from the Financial Perspective (*EC, 1999*) the amount of funds earmarked for pre-assistance support. We also know the budgeted amounts for the various pre-accession instruments for each one of the new member states. (*EC, 2002, ref 12*). But when it comes to comparing the net positions between two calendar years, the timing of the pre-accession payments becomes critical and we know very little about that. It is reasonable to assume that the absorption capacity of the new member states is very low at the beginning of their membership, something that is also borne out by the implied ratios payments/commitments in the Financial Perspective. The Commission has described the principles they have used in their internal estimates in a technical note. Although no amounts are given, it is clear that those principles imply a very high absorption capacity.

Our own estimates indicate that the need for budgetary compensation according to the criteria suggested by the Commission is marginal and at any rate very far from the annual 800 million of Euro, originally indicated by the Commission in its information note on the CFF.

In our scenarios we have, nevertheless, included the full use of the 800 million margin as defined by the Commission and which we have distributed on all new member states in relation to their GDP shares.

7.4 Changes in the burden sharing in different scenarios

In table 15 we present the resulting net positions in 2013 as a percentage of GNP/GDP for three of the main scenarios that we calculated.

We note that in both the reform scenarios the present cohesion countries would lose whereas other EU 15 members would gain. Another interesting observation is that in the degressivity scenario Slovenia and the island states would be better off than in the Least Resistance Scenario whereas other new member states would be worse off. The reason is, obviously, that the degressivity would reduce the payments of those countries more than it would reduce the allocation of support payments, in other words the same pattern as for the net payers of EU 15.

Table 15. **Net positions 2013 as a share of GNP/GDP in 3 different scenarios.**
Percentage shares of GNP/GDP

	Least Resistance Scenario	Degressivity in direct support	Same rules for all in structural operations
Berlin net payers (D, NL, A, SE)	-0.56	-0.54	-0.48
Net payers without rebate (Dk, F, I, Fin)	-0.38	-0.38	-0.29
Sum	*-0.47*	*-0.46*	*-0.38*
UK	-0.26	-0.25	-0.22
All net payers	*-0.43*	*-0.42*	*-0.35*
Cohesion countries (Gr, Irl, E, P)	1.09	1.04	0.38
EU adm ctrs (B, Lx)	0.84	0.87	0.99
EU 15 total	*-0.22*	*-0.21*	*-0.23*
Baltic (EE, L, Lit)	5.30	5.14	5.44
Visegrad (Pl, H, CZ, Sl)	3.78	3.67	3.92
Slovenia	0.15	0.15	0.29
Island states (C, M)	0.15	0.17	0.29
BU + RO	6.58	6.45	6.72
New MS total	*3.89*	*3.79*	*4.03*
EU enlarged	*0.00*	*0.00*	*0.00*

Source: *Own estimates.*

The development over time of the net positions in the Least Resistance Scenario as a share of GNP/GDP is illustrated in charts 1 and 2. Chart 1 shows the development of the present net payers in EU 15. We have underlined above that the inflows of funds (allocation of EU expenditure) will hardly be influenced by the enlargement in the no reform scenario. Changes in net positions are therefore only effected by changes in payments. Chart 1 reveals that while the net position for the net payers that do not enjoy any discount (France, Italy, Denmark and Finland) will deteriorate all through the period, the decline in the net position of the UK as well as of the Berlin net payers (Germany, the Netherlands, Sweden and Austria) would stop by 2008–2009 and then not get any worse. This shift in burden sharing is brought about by the development of the UK rebate. As the EU expenditure grows and the UK share of allocated expenditure falls (since the whole expenditure increase is allocated to new member states) the UK rebate increases. The Berlin net payers have to cover only a small part of this cost.

Chart 2 shows the corresponding development among the net receivers. The positive net position of the cohesion countries and of Belgium and Luxembourg will show a steady decline for the same reason as described above. The net position of Bulgaria, Romania and the Baltic countries will reach numbers that approach or transgress the borders of realism. The net position of the Visegrad countries would reach a plateau around 2009.

The precarious position of the island states and of Slovenia was touched upon above and is clearly illustrated by the chart. The precision of the assumptions that have been made will determine if the curve for the net position in reality will be just above or just below 0 but it is clear that the advantages of membership for those countries do not lie in a bounteous inflow of EU budget funds.

That the net position for new member states as a whole lies a bit below the 4 % limit depends on the fact that the Czech Republic and Hungary (as well as Slovenia, Malta and Cyprus) do not reach the 4 % cap on structural funds as well as on that fact that each member state will have to pay well above 1 % in budget contributions.

Chart 1 Net positions of Net Payers in the Least Resistance Scenario 2002 - 2013

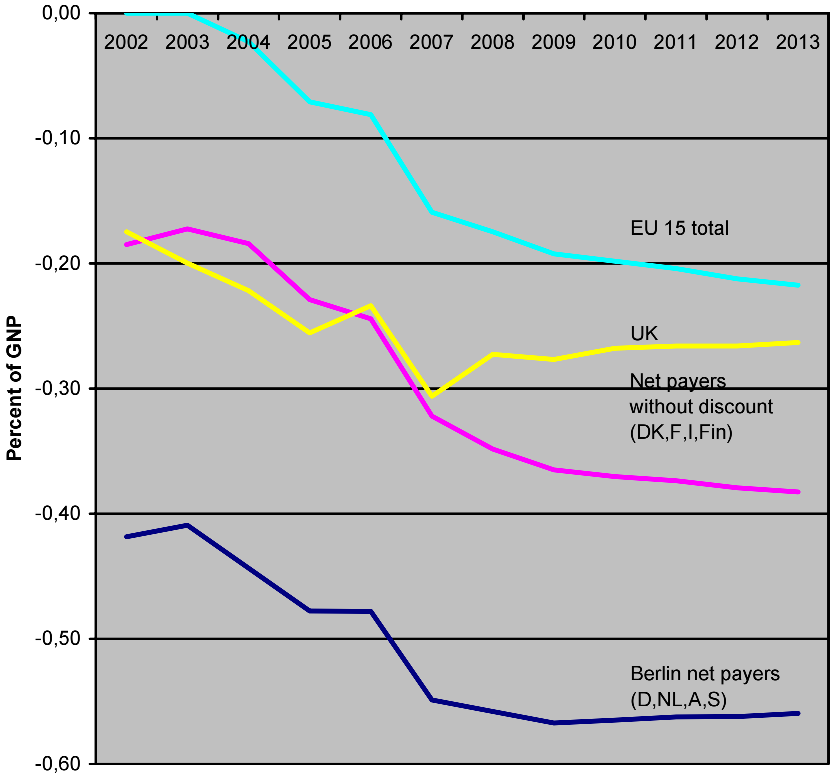
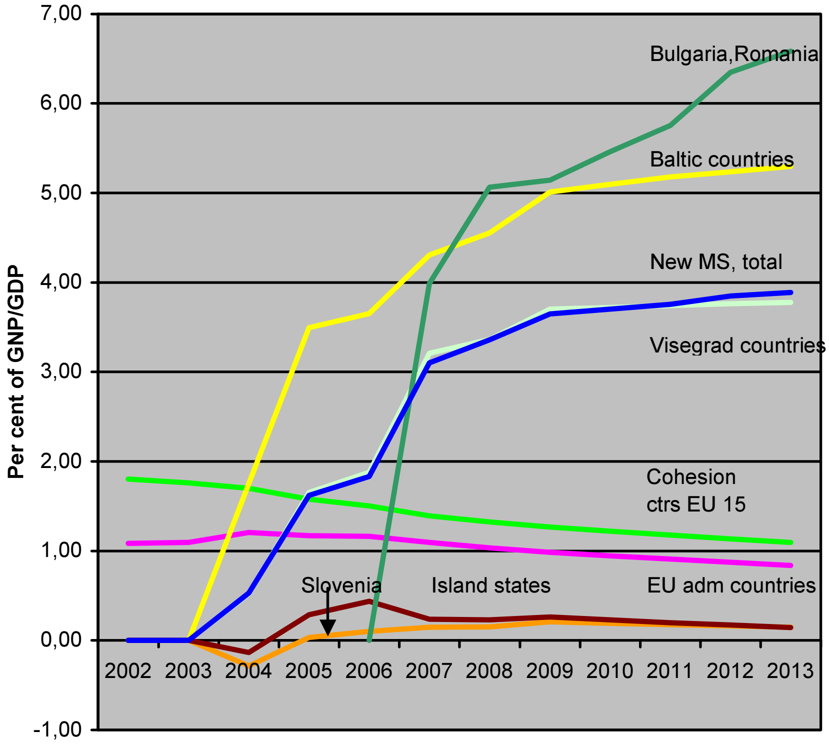


Chart 2 Net positions of Net Receivers 2002 - 2013 in the Least Resistance Scenario



Source: Own estimates.

8 Burden sharing – reform issues

8.1 The UK rebate

We have several times above demonstrated the distorting impact of the UK rebate on the equity of financing and on the burden sharing. For obvious reasons every attempt to discuss this issue has failed. In the course of Agenda 2000 negotiations and at the meeting of the European Council in Berlin 1999 the UK rebate was reaffirmed in no uncertain terms and explicitly extended also to the enlargement costs. In order to pacify the four largest net payers, which had been trying hard to introduce some limitation on their net payments, it was agreed that those countries would only have to pay 25 % of their "normal" share of the UK rebate as of 2002.[52]

The reasons for the UK rebate have ceased to exist since long (*EC, 1998, p. 25 et passim*). The rebate was granted in 1984, at a time when CAP represented about 70 % of the EU budget. England has a relatively small agricultural sector and had, at the time, a relatively low level of prosperity. Its budgetary imbalance, before the rebate, was the largest in the community.

At present there are four countries with the same as or larger imbalance than the UK (Germany, Sweden, the Netherlands and Austria). The structure of the EU budget is now entirely different and will become even more so as enlargement expenditure grows. Member states, which do not pay their full share, are not participating in an equitable fashion in the financing of new expenditure areas, for instance enlargement.

The European Council in Fontainebleau in 1984 decided, *"that any member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the*

[52] In the subsequent negotiations on the promulgation of the own resources decisions there was ample opportunity to haggle over the meaning of the word "normal". In the end the concept was defined as the share that the four countries would have paid had they not been granted a financing relief! At the insistence of one member country the reduced share, nevertheless, has to be explicitly computed in two different ways, both obviously giving the same results, as elementary arithmetic will show.

appropriate time."[53] In the Agenda 2000 negotiations the four countries mentioned above indicated that they considered their negative budgetary position as "excessive" in relation to their "relative prosperity" according to the Fontainebleau agreement. They proposed substituting a general *net correction mechanism* (here called NCM) for the UK rebate, which should automatically be applied to any country that met certain criteria. The solution that was found in Berlin was the one described above. Chart 1 and tables show that financially this was a good solution for the benefiting countries.

At present there are 5 out of 15 member states, which do not participate with their full share in financing the EU budget, including the enlargement costs. At the same time there is a group of present or future net payers without any rebate (France, Italy, Denmark and Finland) which, according to our estimates, will face a deteriorating net position (Chart 1, table 15) which will approach – 0.4 % of GNP a by the end of the period under study. Present cohesion countries, as well as new member states, will pay a larger share towards the budget in relation to their GNP than the UK and the Berlin four. (This can be seen also in table 3 above).

Although none of the candidate countries seems to have objected to this financing pattern it is perhaps doubtful how long the present system will be accepted without major political conflicts. The possibilities for a united front were greater before Berlin than now since the willingness of the Berlin four to reform probably is weaker than before.[54] Our model estimates show, nevertheless, that *all countries except the UK would benefit from the introduction of a generalized net correction mechanism* to replace the UK-specific rebate.[55]

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[53] The Conclusions of the Presidency as quoted in *EC, 1998*.

[54] See *Pelkmans et al., 2000*, and its references (p.139) for some explicit statements about the supposedly diminished reform willingness of the four countries.

[55] In this rather schematic example, also Austria might be a marginal case depending on which parameter values that are chosen.

Table 16. **Net positions 2013 under a generalized net correction system.**
Percentage shares of GNP

	2013 Least Resistance Scenario Net position as a share of GNP			
	Present system	With a generalized Net Correction Mechanism		
Limit for deploying NCM (net pos as share of GNP)		*-0.40*	*-0.50*	*-0.50*
Rebate on net position above deployment limit		*50%*	*50%*	*66%*
Belgium	0.59	0.61	0.66	0.65
Denmark	-0.36	-0.34	-0.29	-0.30
Germany	-0.57	-0.47	-0.52	-0.52
Greece	2.43	2.45	2.50	2.49
Spain	0.73	0.75	0.80	0.79
France	-0.40	-0.38	-0.33	-0.34
Ireland	0.68	0.70	0.75	0.74
Italy	-0.37	-0.35	-0.30	-0.31
Luxembourg	4.00	4.02	4.07	4.06
Netherlands	-0.58	-0.48	-0.53	-0.52
Austria	-0.46	-0.42	-0.47	-0.48
Portugal	1.79	1.81	1.86	1.85
Finland	-0.32	-0.30	-0.25	-0.26
Sweden	-0.56	-0.47	-0.52	-0.51
United Kingdom	-0.26	-0.50	-0.55	-0.54
EU 15	*-0.22*	*-0.22*	*-0.22*	*-0.22*
New Member States	*3.89*	*3.91*	*3.96*	*3.95*

Note: *The numbers in the column headings indicate the ceiling which would deploy the NCR and the discount rate, respectively.*

The NCM would work so that it would deploy whenever a country reached a net position of a pre-determined size, for example -0.4 % of GNP. That country would then receive a discount *on the excess amount* also of a pre-determined size, say 50 %.

Those conditions for a NCM are considerably less generous than the ones that determine the UK rebate, which, in principle, is applied on the very first euro of a negative net position. There would still not be any absolute limit for the net positions of any country, but they would grow slower when getting larger than, say, – 0.40 %.

Table 16 shows this. Even the UK would be better off than in a system where all countries paid their "normal" share. In such a system the UK would have a net position of – 0.61 % compared to – 0.50 in the examples we have given. The present system would reduce the UK net position to – 0.26.

The improvement for each of 26 countries of the enlarged EU would not be large. Nevertheless, it would be a more equitable system, applicable to all member states and without special favors to individual members.

Despite the outcome of various calculations that can be made, possibilities to change the present system are dubious for obvious, political, reasons. *Dresdner Bank, 2001*, does not include any UK-rebate in their estimates of the distribution of the financing of the enlargement costs *"since a political decision on its future handling has not yet been made."*[56] Maybe so, but it is not likely to be taken soon given, for instance, concerns not to irritate the British public opinion, at least not before a referendum on the EMU.

8.2 Reforms of the Own Resources System

In the conclusions from the European Council in Berlin the Commission was requested to undertake a review of the functioning of the Own Resources System. The Commission has announced that this review can be expected in 2003. It is too early to speculate what kind of proposals may be made. *EC, 1998*, makes some analyses and proposals that might well be taken up again. That study makes for instance a review of possible new resources such as a CO_2 tax, an increased emphasis on VAT-based resources, excise duties on tobacco, alcohol etc. but also a corporate income tax, a personal income tax or a withholding tax on interest income and the somewhat curious idea of a tax on ECB seigniorage.[57] Each proposal is analyzed against a number of criteria.

The political support for an "EU-tax" might be at a low ebb at the time of writing. Rightly or wrongly (probably wrongly) member countries fear that such a tax would strengthen the

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[56] *Op.cit. p.31*. Our translation.

[57] The seigniorage is, roughly speaking, the profit of the central banks and, in this case, the ECB. This profit is generated as interest yield on bonds and other assets held by the central bank as counterpart to the monetary base, which it creates itself. Part of this profit is delivered to the reasury and has been of great help to some countries in achieving the established balance criteria for the government finances. Only when entering the government budget does the seignorage have an influence on the real economy. It can be mentioned that the funds financing the Swedish so-called Nobel Prize for Economics (should be: *The Bank of Sweden Prize in Economic Sciences in Memory of Alfred Nobel*) were originally drawn from the seigniorage of the Swedish Riksbank on the occasion of the Tercentenary of the Bank.

supranational features of the Union and threaten the democratic sovereignty of the citizens over their taxes. Theoretical niceties apart, we find it difficult to see any difference between a straightforward EU taxation and the present system. Also under the present system countries have to pay whatever results from the budget process and their possibilities to influence this are strictly limited to their influence on the expenditure development. An EU-tax could be collected and administered by the national tax administrations in the same way as the present contribution payments. We are nevertheless happy to abstain from entering this minefield in advance of possible proposals from the Commission.

A much simpler reform, which has been discussed time and again, would be to substitute the present system with a simpler one, based purely on GNP-based payments. (The so-called traditional own resources would probably still be retained, mainly for theoretical and ideological reasons – it would be against the principle of the economic union to have individual countries keep the revenue from custom duties.) In practice there has been a stepwise movement towards such a system through reforms limiting the VAT-based resource in 1988, 1994 and 1999 (with effect from 2002). As mentioned in section 4.2 above, the VAT-resource covered 41 % of the total resources in 2001. 2006 the share of the VAT-based resource is expected to have fallen to less than 15 % of the total resources.

The collection of the VAT-based resource and above all the auditing process is fraught with enormous complexities and administrative costs. Despite the auditing system it is also one of the areas where fraud and improper handling of funds is frequent. From those points of view there would be much to gain from the introduction of a pure GNP-based system.

Table 17 shows the differences between the estimated payments 2013 according to the present Own Resources System and a clean GNP-based system (however including Traditional Own Resources). The differences are so small that they would practically disappear if we presented them as GNP-shares. In order to illustrate the issue we are therefore showing the absolute amounts.

Table 17. Total payments 2013 in a GNP-based payments system.
Millions of euro, 1999 prices

	Present system	GNP-based system	Difference
Belgium	3 754	3 774	19
Denmark	2 566	2 620	53
Germany	28 734	28 599	-135
Greece	2 086	2 075	-11
Spain	9 193	9 144	-49
France	21 865	21 749	-116
Ireland	1 460	1 452	-8
Italy	17 228	17 516	288
Luxembourg	299	298	-2
Netherlands	5 672	5 645	-27
Austria	2 854	2 841	-13
Portugal	1 692	1 683	-9
Finland	1 915	1 926	10
Sweden	3 294	3 333	39
United Kingdom	13 509	13 506	-3
EU 15	*116 121*	*116 159*	*38*

Sources: *Own estimates.*

Germany and France would benefit from a switch to a purely GNP-based system whereas Italy would be the big loser. For other countries the difference is insignificant. Technically four other countries would have to pay slightly more in a GNP-based system but it is likely that the administrative and bureaucratic savings as well as a more transparent handling of EU funds would outweigh this nominal loss with the possible exceptions of Denmark and Sweden.

It has not been possible to include the new member states in this example since there are no data available concerning the VAT-base in those countries. Some of the candidate countries have not yet, or only recently, introduced a Value Added Tax, this in order to conform with the *acquis communautaire*. It would have been good to reform the system before the accession of new member states but this has not proved possible.

8.3 What is relative prosperity?

The Fontainebleau agreement gives countries the possibility to enjoy a correction for budgetary imbalances if their burden is "excessive" in relation to their "relative prosperity." But how should the level of prosperity be measured? Differences in price levels between countries and fluctuating exchange rates make a comparison of the level of income per head a very uncertain business. International organizations, including the Commission and EUROSTAT regularly calculate *purchasing power parities* (ppp) to be used for international comparisons. The theory behind the ppp-estimates is clear, the practical implementation full of difficulties and traps. Both the GNP at market prices computed at official exchange rates, and ppp play an operational role in the context of the EU budget. The payments to the budget are largely determined by the GNP at exchange rates whereas for instance the distribution of structural funds is partly influenced by the ppp-calculations.[58]

This is not the place to go into the intricacies of estimating ppp. When measuring relative prosperity the ppp-measure should be, at least theoretically, the preferred measure. If we would imagine a system based entirely on payments based on GNP but measured at purchasing power parities, the impact would be to shift the burden of financing from the richer to the poorer countries. The reason would be that the GNP-measure at official exchange rates overstates the relative prosperity of the first group in relation to the other. We may illustrate this in table 18.

[58] The eligibility of regions for Objective 1 support is calculated in ppp-terms.

Table 18. **Payments and net positions 2013 in a system based on purchasing power parities.**
Least Resistance Scenario. Percentage distribution and share of GNP

	Distr. of payments		Net position share GNP	
	In the normal system	In a ppp-based system	In the normal system	In a ppp-based system
Berlin net payers (D, NL, A, SE)	32.9	28.8	-0.56	-0.44
Net payers without rebate (DK, F, I, Fin)	35.3	32.1	-0.38	-0.27
Sum	*68.2*	*60.9*	*-0.47*	*-0.35*
UK	11.0	10.3	-0.26	-0.24
All net payers	*79.2*	*71.2*	*-0.43*	*-0.33*
Cohesion countries (Gr, Irl, E, P)	11.7	13.2	1.09	0.72
EU adm ctrs (B, Lx)	3.3	3.2	0.84	0.81
EU 15 total	*94.2*	*87.6*	*-0.22*	*-0.14*
Baltic (EE, L, Lit)	0.3	0.7	5.30	1.58
Visegrad (Pl, H, CZ, Sl)	4.2	8.5	3.78	1.16
Slovenia	0.3	0.4	0.15	-0.19
Island states (C, M)	0.2	0.3	0.15	-0.22
BU + RO	0.7	2.5	6.58	1.03
New MS total	*5.8*	*12.4*	*3.89*	*1.08*
EU enlarged	*100.0*	*100.0*	*0.00*	*0.00*

Source: *Own estimates based on UNDP/World Bank data.*

In a pure ppp-based system the payment share of the new member states would more than double that of the present system, mainly to the benefit of the net payer group. We note that the net positions of the four Berlin net payers would improve from – 0.56 to – 0.44 % of GNP and that the net positions for the new member states would be sharply reduced as a consequence both of increased payments and a considerably larger GNP to which the net receipts is related. For the UK there is no significant difference which shows, once again, the stabilizing impact of the UK rebate on the payment responsibilities of that country.

Both OECD/Eurostat and the World Bank compute ppp-data. The Eurostat data are not so easily available which is why we have used data from the World Bank from 1999 when comparing relative prosperity. Among the EU 15-countries Ireland, Belgium and the Netherlands are ranked considerably higher when using ppp-data than when using exchange rate data, Finland and Sweden considerably lower. The rankings of Sweden differ most of all countries: while ranked as number 2 in GNP/capita calculated at official exchange rates its ranking is only number 9 when ppp-data are used.

8.4 Partial re-nationalization of EU policy areas?

We have discussed, in chapter 6, the important reform requirements concerning CAP and the structural policy. The aim of those reforms are to achieve more efficient and adequate policies for supporting agriculture, to even out income differences between regions and countries and to reduce the budgetary costs of the Union. There are also other reform proposals, which aim directly at the *distribution* of the financial burden. Those have to do with so-called *re-nationalization* of agricultural and/or structural policy.

The question of whether a policy area should be the responsibility of the community or the national level is connected with the principle of subsidiarity. This principle says that higher levels of public authority should be involved only when their intervention is deemed necessary for achieving objectives that would be out of reach for lower levels. (*Grevi, 2001, p.4*). According to this principle the Maastricht Treaty states: "*In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States.*" Meanwhile the Nice Treaty on the future of the Union asks for further clarity on "*how to establish and monitor a more precise delimitation of competencies between the European Union and the Member States, reflecting the principle of subsidiarity*".[59]

The 2002–2004 Convention on the Future of Europe is trying to tackle those issues. The development of an inventory or catalogue of competencies has been one idea but even this has apparently turned out to be too much for some of the more devoted proponents of intergovernmentalism.[60]

There is another, more practical aspect, of whether a policy area should be in the hands of the Union or the national governments.

[59] All quotes from *Grevi, 2001*.
[60] One government representative believes that if such a catalogue had existed earlier the EU would not have been able to deal with environmental issues, which were not predominant in the sixties. (*Dagens Nyheter, Stockholm, 02 05 30*).

To understand this we start by looking at table 19. This time data are taken from statistics from the Commission rather than from our own estimates.

A rule of thumb might be that the larger the gap between the share of payment and the share of allocated expenditure, the more interested a country would be in partial or complete re-nationalization. Obviously, the reduction of contribution payments that a re-nationalization measure would bring would not result in a full net gain for the countries since part of the expenditure that used to go via Brussels now will have to be provided through the national budget. But the funds would only go to support of domestic agriculture or regional policy. (The required arguments for this stance could always be provided by a suitable interpretation of the principle of subsidiarity!) It is relatively easy to see that likely proponents for a re-nationalization of structural policy might be for instance Denmark, Germany, France, the Netherlands and Sweden while Italy, Finland and the cohesion countries would oppose such a move. Germany, the Netherlands, Sweden and the UK may feel strongly about re-nationalizing part of the CAP while Finland, France and Denmark would be negatively inclined. (At least in the case of CAP this is also more or less the way in which the real front lines are defined!)

We have also included here the interesting policy area "Internal policies". This area covers items such as training, youth, culture, energy, environment, consumer protection, internal market and research and development. The first thing we notice is the extremely strong position of Belgium and Luxembourg. We hypothesize that the presence of the EU central institutions benefits those countries not only through the allocation of administrative expenditure but also through easier access to the internal policy funds. (A detailed breakdown shows that Belgium retains this strong position in all the sub-areas of internal policy.) But the relatively strong positions of Denmark, the Netherlands, Finland and Sweden are also striking. This is mirrored in the comparatively weak positions of the big countries and – strangely enough – of Austria.

Table 19. **The relation between member countries shares of allocated expenditure and of payments in 2000.**

	Agriculture	Structural operations	Internal policy
Belgium	0.80	0.47	4.07
Denmark	1.68	0.26	1.84
Germany	0.55	0.54	0.62
Greece	4.00	6.31	2.19
Spain	1.79	2.43	0.75
France	1.25	0.51	0.74
Ireland	3.50	2.50	1.42
Italy	0.95	1.43	0.85
Luxembourg	0.50	0.00	7.50
Netherlands	0.69	0.33	1.17
Austria	1.00	0.36	0.84
Portugal	1.07	5.80	2.47
Finland	1.20	1.33	1.47
Sweden	0.65	0.26	1.03
United Kingdom	0.68	0.73	1.00
EU 15	*1.00*	*1.00*	*1.00*

Source: *Own estimates based on EC, September 2001.*

Note: *The numbers in the table are calculated as each country´s share of the allocated expenditure in the policy area divided by its share of payments to the EU budget. The number 4.07 for Internal policy in Belgium, for instance, indicates that Belgium´s share of the allocations of internal policy funds is more than 4 times larger than its share of payments to the EU budget.*

Since the whole area "Internal policy" in 2000 only amounted to 6.5 % of total allocated expenditure we are not talking of any large amounts of money. But it is interesting to note that this policy area where funds are largely directed towards institutions, enterprises, organizations or local government the distribution pattern is entirely different from other policy areas. Net payers, which are strong in this area, should be interested in moving resources from structural operations to internal policy. *Tarschys, 2000*, has shown that most of the success stories of structural operations are in areas that could as well have been placed under "Internal policy". The Commission's guidelines for the structural policy 2000 – 2006 emphasize, among other things, environmental policy, equality between men and women, energy, information technology, research and development, tourism, culture and services. A transfer from one policy area to the other with accompanying change in the system of distribution of funds might open up interesting possibilities for some of the present high net payers as well as for some of the emerging ones.

We can take this reasoning one step further and point out that a reversal – or perhaps rather a reinterpretation – of the subsidiarity principle in the form of transferring more policy areas from the national budgets to the Union might be to the benefit of certain member states. Environmental policy and defense policy might be such areas.

We will end this section by pointing out that a net payer policy aiming at maximizing the return flow of allocated expenditure may turn out to be very counterproductive. If a country is a very strong net payer in one area it will almost certainly be preferable to sacrifice the inflow of funds for the benefit of reforms, reduction or renationalization of the policy area. In the field of structural policy we can easily identify some such cases. Table 19 shows that efforts of countries such as Denmark, the Netherlands, Austria and Sweden to increase or even maintain their structural support would be counterproductive if it meant jeopardizing the possibilities of reform, particularly in the same-rules-for all direction. Even France and Germany might be in this category.[61]

8.5 Towards a more equitable burden sharing in a larger EU

In this section we will make a somewhat subjective assessment of the results of the analysis made earlier in this chapter. This assessment will be formulated as policy recommendations.

The present system for sharing financing responsibility and for allocating expenditure from the EU budget is a motley quilt with seams that threaten to burst when it should cover 27 member states of the most varying character. In the perspective of the enlargement, the aim must be to create a system of financing and allocating expenditure that is sustainable in the long run, regarded as fair by all participants and robust enough in face of external shocks.

The present Own Resources System creates inequalities in the responsibility for financing the EU-budget and those inequalities will grow as the agreed costs for the enlargement of the Union pick up. At the root of those problems is the present system of rebates in which five countries have been granted financing advantages of which the UK rebate is the major one and also the cause of the others. This system should be abolished.

[61] But see section 6.1.2 above on the links between Brussels and the regions.

The aim must be to ensure that all countries pay an equitable share and that, in particular, that new member states would no longer pay more than the richest countries in relative terms. All net payers should also enjoy equal treatment and those that have only lately emerged as net payers, or perhaps will do so in the future, should not be treated differently from the classical net contributors.

The problem nevertheless remains that there is no upper limit for payment obligations and, in practice, no lower limit for negative net positions for a group of 6 – 9 countries out of 27 members. Even the 1.27 % (or now: 1.24 % of GNI)[62] is not sacrosanct. As the voting share of the net receivers in the Council gets bigger, as more decisions are taken by qualified majority and as more budgetary power is transferred to the European Parliament, the upward pressure on expenditure is likely to grow. Of course, any one country will still have the formal possibility to veto budgetary decisions. But political pressure, blocking minorities by net receivers and tactical alliances between net receivers and the one or other net contributor may make it difficult or impossible for small countries with net payer status to prevent drastic expansion of expenditure. Some kind of automatic stabilizer could alleviate those risks. A generalized net correction mechanism would probably be the most appropriate instrument. Its parameters can be negotiated and no *absolute* limit of the payment responsibility would be involved. All member states would be eligible as soon as they meet the pre-established criteria.

A generalized net correction mechanism may also help net payers, in particular small countries that are important contributors such as the Netherlands, Austria and the Nordic countries, to abstain from ill-considered measures for increasing their share of allocated expenditure, particularly in the structural operations area. Generally speaking, greatest care should be exercised when trying to correct the burden sharing through changes in the allocation of expenditure. Proper policy reform in the area of CAP and structural operations is probably greatly preferable to partial re-nationalization. Such a policy reform might include a pruning and slimming of the structural support policy to a proper cohesion

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[62] For an explanation of how this has been calculated see document *COM (2001) 801 final*, available online in the Eurolex datase or, in a more cursory way, in *document COM (2002) 86 final: Communication from the Commission to the Council and the European Parliament – Adaptation of the ceiling of own resources and of the ceiling for appropriations for commitments following the entry into force of Decision 2000/597/EC, Euratom (COM (2001) 801 final of 28.12.2001.*

policy (perhaps directed at the national level) and a transfer of other viable parts to the Internal policy area.[63] Such measures, while improving the efficiency of the regional policy, particularly for the new member states, may be to the benefit of the net payers. They may also be able to identify areas, which could be transferred from the national to the Union budget, thereby easing the pressure on national budgets while at the same time improving their net positions. However, since this would be a zero-sum game for the participating countries it may not be so easy too achieve.

An alternative to a generalized net correction mechanism might be to introduce elements from purchasing power parity measurements of the level of prosperity when determining the base for payment responsibility. However, the methodology for ppp-calculations is probably not yet well enough established to play such an important role. In addition, it might not be advisable to charge new member states with a higher payment share during the transition period to full integration in the Union, even if that would better reflect their real economic strength. The ppp-estimates of GDP per capita must be an element to consider nevertheless in assessing any proposal for reform of the payment system.

Failing more radical reforms, the present VAT-based contributions should be replaced by a GNP-based system in order to increase transparency and reduce costs and improper handling of funds.

There could be a political price to pay for a reform that would abolish the system of rebates. That price would probably take the form of delaying or hindering the expansion of the EMU to cover all countries of the Union, particularly the UK and its followers. Before letting such considerations stop a reform a very careful analysis should be made of the long-term costs and benefits, not only in terms of budgetary costs and advantages of monetary cooperation, but also in term of solidarity and equity which may be more important in the long run for the sustainability of the Union.

Any forthcoming proposal from the Commission on a possible taxation at the Union level should be carefully considered on its own merits and not rejected offhand as an infringement upon national sovereignty. Depending on the nature of such proposal, it may not be very different in real terms from the present system in

[63] See *Tarschys, 2000*, for examples of such areas.

terms of national sovereignty but possibly more effective and equitable.

9 An eroded union?

9.1 The candidate countries are small with a very low level of income

The budgetary costs of the planned enlargement of the EU should certainly not be underestimated. As we have indicated above there might be risks for an uncontrolled expansion of expenditure in the agricultural as well as in the structural operations field if there are no significant reforms of those policy areas. The increased number of net receivers and new, potentially budget expansionary, coalitions in the Council cannot be excluded.

Nevertheless, the overall impression of our estimates is that the enlargement costs, also in the time perspective of the next Financial Perspective, would be possible to absorb and to manage by the net payers, particularly when considering the likely macroeconomic gains of the expansion. The enlargement should not in the first instance be regarded as a budgetary or macroeconomic issue but there is every reason to consider whether it might raise other problems than those that can be measured in Euro.

We know that this is the case. Already in section 8.2 above, we have discussed the necessity to reform the Own Resources System in order to prevent increasing inequality among members, which would lead to tensions not only between net payers and receivers but also between different groups of net payers. The necessity of reforms of the agricultural as well as the structural policy has also been discussed and is already a hot topic on the international agenda.

Nevertheless, we might say that those problems exist already today. The enlargement may aggravate them but they are certainly not caused by the need to accommodate new members states. There are, on the other hand, other problems that are directly related to the enlargement, for example the inadequacy of the institutional structures and the increasing administrative costs (such as the future language regime!).

It might be useful to put the enlargement in a wider perspective. As illustrated in table 20, the candidate countries – the prospective new member states – are very small compared to the present Union. True, they would represent about 22 % of the population of the enlarged EU but only slightly more than 4 % of the GDP or, when measured at ppp, around 10 %. Two of the prospective new member states, Poland and Romania, would contribute almost 60 % of the population and as much as 40 or 50 % of GDP of the new member states depending on whether the calculation is made at official exchange rates or using ppp.

The small size of the candidate countries could be seen as a positive factor from the point of view of the ability of the union to absorb new members. But the difference between the candidates and the present members is almost breathtaking when we look, for instance, at the income levels. This is illustrated in table 21. The island states have a GDP/capita that is higher than the lowest value of EU 15 (Portugal) and even Slovenia slightly exceeds that value, but only when GDP is measured at ppp. However, at official exchange rates, which is the measure that will determine the contributions of the new members to the EU budget even Slovenia is only at a level of 88 % of the lowest value in EU 15 (Greece). All candidate countries together have a GDP/capita of 16 % of the average of EU 15. Seven out of the 12 countries have a GDP/capita below 20 % of the EU 15 average!

Table 20. **Share of the candidate countries in an enlarged EU.**
Percentage shares based on 1999 data

	Population	GDP at official exchange rates	GDP at ppp
10 countries as a share of EU 25	16.6	3.7	8.1
12 countries as a share of EU 27	21.9	4.2	9.9
Poland as a share of 12 new member states	36.6	31.1	35.7
Romania as a share of 12 new member states	21.3	9.0	14.9

Source: *Derived from UNDP, Human Development Report 2001.*

Tabell 21. **GDP per capita in candidate countries in relation to EU 15.**
Index numbers, 1999 data

	Average EU 15 = 100		Lowest value in EU 15 = 100	
	At official exchange rates	At ppp estimates	At official exchange rates	At ppp estimates
Bulgaria	7	23	14	34
Cyprus	49	82	99	118
Czech Republic	23	59	45	85
Estonia	16	39	33	56
Hungary	21	52	43	75
Lithuania	13	30	25	43
Latvia	11	29	23	41
Malta	51	86	103	124
Poland	18	38	35	55
Romania	7	27	13	39
Slovenia	44	71	88	103
Slovakia	16	48	32	69
New MS total	*16*	*39*	*31*	*57*

Source: *UNDP Human Development Report 2001.*

Disregarding for a moment the island states, Slovenia is the richest candidate country and has a GDP/capita of 44 % of the average of EU 15. Obviously, if we look at the ppp data instead this picture would be somewhat modified but not to an extent that would change the rather dismal picture.[64]

This situation cannot be compared with previous enlargements of the Union. At their time of accession, Ireland had a GNP/capita reaching 58 % of the average of the countries that now make up EU 15. For Spain the corresponding number was 56 %, for Greece 33 % and for Portugal 31 %. Only Cyprus, Malta and Slovenia are presently in a situation similar to the one of Portugal at the time of accession.[65]

[64] Figures in *the Strategy Report 2001 (EC, November 2001)* are marginally *lower* than those estimated by us!
[65] In 1999 Ireland was *above* the average of EU 15, Spain at around 76 % and Greece and Portugal slightly over 50 %.

9.2 Are the candidate countries more developed than national account numbers seem to indicate?

Is it possible that it is mainly with respect to the degree of economic development that the candidate countries are severely lagging behind present member states? Two well-known composite indicators of the degree of the development may give us some insight into this, namely the Human Development Index from UNDP (*UN, 2001*) and the World Competitiveness Scoreboard from the International Institute for Management Development (IMD) in Lausanne, Switzerland (*IMD, 2002*). Both indices are published annually.

The UNDP index measures not only economic development but also a number of factors relating to life expectancy, health and education. Comparable data are available for more than 150 countries of the world. In order to make correct comparisons we have adjusted the UNDP data slightly. We consider only the countries with the 100 highest HDI-rankings in 1999 and only included those where data for both GDP at official exchange rates and ppp-data are available. The present members of EU 15 rank between nr 4 (Sweden) and 28 (Portugal) and the 12 candidate countries between 25 (Cyprus), 29 (Slovenia) and 58 (Romania) for the HDI-index.[66] This can be compared with the ranking according to GDP/capita at ppp where the present membership lies between 6 (Ireland) and 35 (Greece) and for the candidate countries between 28 (Cyprus), 33 (Slovenia) and 74 (Bulgaria). All candidate countries rank higher in HDI than in GDP at ppp, but so do 8 of the present membership. Significantly higher HDI-rankings are found for Bulgaria, Latvia, Lithuania and Poland. We might hypothesize that in those countries there could exist some latent reserves of human resources, which so far have not influenced the GDP/capita and which might facilitate the general integration process.

The same picture is emerging if we compare the differences between the ranking of the candidate countries and Greece, the present EU member with the lowest HDI-ranking. Most candidate countries have the same distance to Greece in all 3 indicators

[66] The first three countries in 2001 were Norway, Australia and Canada.

except the four mentioned countries where the difference in HDI is clearly smaller.

We can make a cautious comparison of the development of the HDI over time: since 1995 there seems to have been significant improvement in the HDI rankings of Poland, Hungary and Latvia.[67]

The evidence from this material is not too clear. Nevertheless we have been able to identify a small number of candidate countries where the gap to the present EU in terms of human resources might be smaller than the gap in income. If true this should facilitate the integration and catching-up process. But it is not a common trend among all candidates.

Trade between the candidate countries and EU 15 has increased impressively after the fall of the old system. However, the exports from the EU have increased much faster than the imports and large trade deficits have been created in most candidate countries. We will not go into an analysis of the real economic impact of this imbalance or of the fact that most candidate countries have an industrial and export structure that is different from the EU 15. We have already in section 4.3 referred to a study (*Egger et al., 2001*), which discusses the competitive strength of Eastern and Southern Europe, respectively. A study by A. Smith, University of London, (*Smith, 2000*), undertakes a detailed review of the revealed comparative advantages. The study finds that in particular that the industry of Latvia, Lithuania, Bulgaria and Romania would not be competitive on the European market and threatened by high costs of restructuring. We note that three of those countries are among those that we have identified above as countries with possible latent human resources capacities. We should not speculate too far on a possible connection – taken at face value one could perhaps say that this would facilitate a necessary restructuring process.

The assessment of the Commission is found in the Strategy Report (*EC, November 2001*). With respect to the requirement of being able to meet the competitive pressure the Commission concludes:

[67] When making thoses comparison adjustments have been made for the different number of countries included in 1995 and 1999, respectively.

> *"The Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia are functioning market economies. There are substantial economic differences among these countries, but provided they continue with, and in some cases reinforce, a number of differing measures detailed in each Regular Report, they should be able to cope with competitive pressure and market forces within the Union in the near term. "*

Nevertheless this assessment is qualified by a long and distressing list of improvements that need to be made by the candidate countries in all the central areas of the economy.

We can sidelight the by necessity somewhat optimistic assessment of the Commission by looking at some data from the *World Competitiveness Yearbook (IMD, 2002)*. This yearbook, which is compiled by the International Institute for Management Development in Lausanne, Switzerland, contains a competitiveness "scoreboard" where the participating countries are ranked according to a large number of factors. Competitiveness is given a very broad, and deep, definition where unit labor cost is only one part. Other factors are openness, governance, finance, infrastructure, technology, quality of the labor force, institutions etc. The estimates are based on very detailed studies of enterprises in each of the participating countries.

The scoreboard shows, for instance, that of the EU 15 countries only Finland, the Netherlands and Ireland have a higher ranking of competitiveness than of GDP/capita. All other EU members have a lower ranking which is exactly what we would expect since the comparison now is made with highly productive countries with relatively low average income such as the Republic of Korea, the Philippines, Singapore, Taiwan etc. Accordingly, it is remarkable that the three mentioned EU countries apparently have been able to compensate their cost disadvantage, measured as GDP/capita, with other factors that influence competitiveness positively. We would now expect – indeed hope for- the candidate countries to translate their very low level of GDP/capita into a high competitiveness ranking. Data are available only for 6 of the candidate countries (Estonia, Hungary, Czech Republic, Poland, Slovakia and Slovenia) and in all those cases the country ranking with respect to competitiveness is indeed higher than the ranking according to GDP/capita. In so far as we can draw any conclusion from these indications, it would be that the competitiveness scoreboard, at least for these 6 countries, would tend to support the positive assessment of the Commission.[68]

9.3 The invisible problems

When the European Union has been enlarged from 15 to 27 member countries, its GNP per capita will have fallen by approximately 20 %. Most of the new member countries will be at a level of economic development far below the present membership. The gaps between the richest and poorest members will be larger than it has ever been, even at the time of the so-called southern enlargement. There may be some mitigating factors in the form of human resources and competitiveness based on low costs but evidence here is unclear and, at any rate, confined only to some countries.

The picture that we just have drawn is based on factors that can relatively easy be quantified and measured. The most important prerequisite for membership, the adoption and implementation of the *acquis communautaire*, concerns, on the other hand, factors that to a large extent are non-quantifiable. The question is whether there are any reasons to expect that the difference between the old and the new member countries would be smaller in those areas than in the more tangible ones?

We have to modify the statement above to some extent. The screening of the *acquis* focuses on the legislation that has been implemented, the institutions that have been built up etc. Those factors can, of course, in a sense be *measured* and accounted for and this is also done in the strategy reports, albeit largely on the basis of information from the candidate countries themselves. The intrinsic quality and the efficiency of the administrative and institutional adjustment can, on the other hand, hardly be assessed through the screening process. We might recall that the problems in the candidate countries (and in the Soviet Union) under the old system hardly were caused by the fact that the number of governmental institutions was too small or that comprehensive legislation was missing.

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[68] This result is different from the one found two years ago in *Karlsson, 2001*, and more positive for the candidate countries. One caveat: participation in the surveys and the scoreboard is voluntary and tends to include mainly countries that expect a good showing!

Pelkmans et al., 2000, point to the risk of erosion of the interior market and that the enlargement might lead to member states becoming less disciplined and putting more emphasis on national preferences and exceptions from the common framework. The system of sanctions that exists could then easily collapse. With detailed statistics of breaches or unsatisfactory implementation of the *acquis communautaire* the authors try to show that such a process of erosion is already under way and likely will be reinforced by the accession of the central European countries *"where traditions of legalism, rather than equivalence to achieve the objectives of law, are so prevalent."*[69]

In their most recent Strategy Paper (*EC, November 2001*) the Commission talks in optimistic wordings of the progress made in the candidate countries and which has been observed through the screening process. The presentation of detailed results, country by country, partly gives a different impression. Even in the most advanced candidate countries serious problems remain and in many cases little progress seems to have been made in comparison to previous reports. Deficiencies in human rights and treatment of minorities, trafficking and persistent corruption seem to be particularly serious problems. But even at the economic level the Commission finds that not all candidate countries have succeeded to come closer to the EU and that economic inequalities within the countries have increased. In the Report 2000 it is explicitly stated that the privatization process has facilitated the creation of a new economic elite, stemming from the previous *nomenclatura*.[70]

Long transition arrangement for the free movement of labor has in principle already been agreed on. The negotiations are likely to bring about further exceptions, border controls and transitional arrangement as, for instance, in agriculture for veterinary and phytosanitary reasons. Every exception, every special clause, every obstacle for the "four freedoms"[71] will contribute to an erosion of the Union.

The circumstances that have been discussed above should of course not detract from the remarkable economic, social and political progress that has been achieved in most candidate countries since the system change. The Commission rightly underlines that most countries fully meet the Copenhagen criteria, that most have a functioning market economy and that the political

[69] *Pelkmans et al., 2000, p.68*

[70] *EC, November 2001, chapter III, section 2 a.*

[71] Free movement for people, capital, goods and services.

stability in Europe has increased significantly. As we have already pointed out, trade between Eastern and Western Europe has shown a very dynamic development after the change of economic system. Most candidate countries have shown an impressive economic growth, albeit from the very low level caused by the implosion of the system of central planning. We agree, nevertheless, with *Pelkmans et al., 2000*, on the risk for an erosion of the union. We believe that this risk is particularly large in areas where the visible manifestation of the implementation of the *acquis communautaire* mainly is of an institutional or administrative character or perhaps in the form of illusive indicators, the impact of which cannot really be screened at all. Examples of such chapters are, for instance, chapter 24 Justice and Home Affairs, which covers border control, illegal migration, drugs trafficking and money laundering, organized crime, police and judicial co-operation, data protection and the mutual recognition of court judgments and chapter 23 Consumers and Health Protection. Even in such down to earth areas as for instance chapter 29 Financial and budgetary provisions progress (or the lack of it) is sometimes measured in such ephemeral terms as "capacity to calculate" or "administrative capacity to collect and transfer" financial resources. Generally speaking, the reading of the country reports is a sobering experience. There is a large difference in tone between the more lofty overview reports such as for instance the Strategy Paper (*EC, November 2001*) and the regular country reports.[72]

One of the basic principles of the approach to enlargement has been that all members of the enlarged union must be treated equally, after negotiated transition periods, which were to be kept as short as possible. This is also one of the reasons why the Commission and the present membership have insisted so strictly on the full adoption of the *acquis communautaire* in the candidate countries. (This includes membership in the EMU although, of course, every member state will have to meet also the special criteria established for the monetary cooperation before becoming full members.) Although there is likely to be a lot of lip service to the principle of not having any second-class members of the Union also in the future, the reality might look different. As we have seen, the possibilities for at least some of the new members to keep pace with the European integration process are rather doubtful. At the same time, countries that are anxious to forge ahead with increased

[72] Most easily available on the www under http://europa.eu.int/comm/enlargement/report2001/index.htm

integration in certain areas, have created the concept of so-called *flexible integration*, that is to say increased voluntary cooperation between a group of countries (to which anyone that wishes would have access). This concept is embodied in the Nice treaty. It seems likely that this dichotomy will lead to a considerable differentiation in the degree of cooperation. Such a development – and indeed the enlargement as a whole – would also be a boost to those forces that want to see the future of EU as a deepened and broadened intergovernmental cooperation and a setback for those that favor a more "federalist" approach.

It would be an important charge for the Convention on the Future of Europe to propose ways and means to prevent a future erosion of the Union as well as ways and means to overcome tensions created by a different willingness or capability of member states to forge ahead with European integration. Finally, it will be up to the Intergovernmental Conference, foreseen for 2004, to show the political courage to take the necessary decisions. Policy reform, institutional reform and a long-term political vision that transgresses national interests will be of vital necessity. If not, the grandiose project of European unification may end up in no more than the creation of a super-EFTA, an easy victim of global and regional political shocks and the whims and vagaries of external economic forces.

We have not, in this study, discussed other prospective candidate countries. (Turkey is already an official candidate country.) In case of a successful enlargement it would be difficult, and certainly not desirable, to leave out countries like Croatia, FYROM, Serbia/Montenegro, Albania and Moldova once they would meet the Copenhagen criteria. Can a political and economic entity that spans from Luxembourg (highest GDP/capita) or Sweden (highest HDI-ranking) to Albania really function? The next five to ten years will give us an indication of how far the limits and borders of the European Union can be extended and not only in the geographical sense.

Appendix 1: Net positions and ability to pay

To the extent possible this study uses the same definition and methods as the EC in the study *Agenda 2000 Financing the European Union, 1998* (*EC, 1998*) to which the reader is referred for detailed explanations. This has been done in order to facilitate international comparison, particularly with estimates by the EC. More precisely, we have used the concept of the so-called "UK rebate balance" (*EC, 1998, p. 69*.) Since this is the preferred definition in the above-mentioned report we will refer to it henceforth as the "ORR definition" or the "ORR method" where "ORR" stands for the Own Resources Report.) Alternative choices would have been "the operational balance" or "the accounting balance".

The choice of definition has some important implications, particularly when it comes to assessing the payments and net positions.[73] The following observations should be made in this context:

The ORR method does not count the traditional own resources (TOR), i.e. mainly custom duties, as "national contributions" to the EU budget. The reason for this is that importers may utilize ports in other countries while the country at the border collects the custom duties. The TOR that are included in the ORR balance are therefore not the actual amount that a country collects and delivers to the EU budget but an imputed amount, calculated as the total TOR of the Union multiplied by the share of each country of the total VAT- and GNP-based payments. (*EC, 1998, p.44*).

[73] When calculating *ex post* budget balances, these difficulties are compounded by the need to choose between cash or accrual data.

This method is not undisputed. Some countries, notably the Netherlands, claim that the custom duties collected should be seen as a return on national investment in infrastructure, e.g. in ports. They should therefore be considered as a national contribution to the EU budget. This is an example of "regional arbitrariness" of a tax and in this context sometimes called "The Rotterdam Effect". The EC refers to studies showing that 27 % of the custom duties levied in the Netherlands and 31 % of those levied in Antwerp are related to final consumption of goods in other member countries. (*EC 1998, p. 44; Verbeke et al. March 1998*). However, the Dutch side has pointed out that the 73 % of the customs duties that would represent a burden to the Dutch economy, would still lead to a Dutch share of all EU TOR that is at least twice the normal one.

We know very little about the distribution of TOR in an enlarged Union. We have assumed that each new MS collects TOR in the same relation to its GNP as the EU 15 average.

A certain amount of the EU budget cannot be allocated to its member countries because it is spent outside the Union. We are talking about less than 10 % of the budget that goes to external expenditure, including pre-accession aid to candidate countries. Total payments and total allocated expenditure for the Union are therefore not equal which means that the sums of the net positions for the member countries will be negative. In order to avoid this, the ORR method uses an imputed net position for each country, calculated as the difference between its share of payments and its share of allocated expenditure, multiplied by the sum of total EU expenditure. In this way the net positions, or budget balances, will always add to 0.

In our view the use of the "accounting balance" definition would give a better view of the real financial burden sharing among the EU member states. With this definition, TOR payments are considered as paid by the country that transfers them to the EU budget. The total EU expenditure, including external expenditure, is taken into account. The payments that are required to finance the external expenditure (e.g. pre-accession expenditure) of the EU obviously increase the financial burden of member states and reduce their net positions. The ORR says, however, that showing a negative net position of the EU could result *"in Member States claiming to have transferred to other partners financial resources that* *have left the EU" (EC 1998, p 68)*, a somewhat contrived argument, in our opinion.

Despite the arguments in favor of the accounting definition, the "UK rebate balance" - the ORR definition - has been used in this study, mainly to facilitate comparisons with other studies, notably from the EC.

The table below shows the impact of using different methods on some countries, which are mainly influenced by the choice of definition. The ORR method underestimates, for instance the Dutch net position by more than 0.2 % of GNP and the German and Swedish ones by 0.04 à 0.05 % of GNP. It must be remembered, however, that it is only the net position that is under- or overestimated; the budgetary payments (as well as the allocated expenditure) are not affected by this difference in definitions.

The concept of "operational balance" is of little interest to most countries – it has been advanced mainly by countries to which a large share of administrative expenditure is allocated. With that definition, payments are considerably reduced whereas allocated expenditure is affected only marginally, except for Belgium and Luxembourg. This definition is doubly disadvantageous for large net payers: not only do their contributions seem to diminish relative to the countries which host the EU administration but their net positions are calculated on a lower level of EU expenditure than in other definitions and hence less negative than in reality. Belgium succeeded to achieve that the Commission must show this concept *"for presentational purposes"* (see, for instance, *EC, September 2001*) but we cannot see that the concept has any analytical or operational (*sic!*) value.

As pointed out above, the concept of "accounting balance" would give a more accurate picture of the burden sharing within the Union. That definition is therefore of particular interest to those countries that have an over proportional share of TOR. This is illustrated in the following table.

Appendix table 1. **Net positions in 2013 calculated with different definitions.**
Shares of GNP in the Least Resistance Scenario

Definition of budgetary balance	Bel-gium	Germany	The Netherlands	UK	Sweden	EU 15
"ORR"	0.59	-0.57	-0.58	-0.26	-0.56	-0.22
"Accounting"	0.35	-0.62	-0.80	-0.35	-0.60	-0.28
"Operational/ORR"	-0.41	-0.55	-0.54	-0.25	-0.51	-0.22

From the numbers in the table, it is easy to understand why these rather technical issues attract a certain amount of interest in the negotiations between the EU members.

Appendix 2: Additional tables

Source material for scenario calculations:

The Financial Perspective 2000–2006 (*EC, 1999*)

The Common Financial Framework for Negotiations (*EC, 30.1.2001, ref 9*). All enlargement scenarios use those figures for 2004–2006.

Own extrapolations for the period 2007–2013 as described in the text for each scenario.

Distribution of allocated expenditure by countries:
Agriculture: Material from the Swedish Ministry of Agriculture
Structural funds: Material from the Swedish Business Development Agency (NUTEK)
Other expenditure: Own assumptions as described in the text

Purchasing power parities: UNDP (*UN, 2001*) and the World Bank (*UN, 2002, ref 16*).

Population data: United Nations Population Division (*UN, 2002, ref 15*).

Competitiveness indicators: The World Competitiveness Yearbook 2002, International Institute for Management Development (*IMD, 2002*).

Appendix table 2. **The benchmark scenario (no enlargement), commitments and payments.**
Millions of euro, 1999 prices

	2000	2002	2004	2006	post-2006
Commitments					
Agriculture	40 920	43 900	41 084	42 932	43 788
Structural operations	32 045	30 872	29 602	29 205	29 205
Internal policy	5 930	6 150	6 370	6 600	6 600
Administration	4 560	4 700	4 900	5 100	5 100
Pre-accession support	3 120	3 120	3 120	3 120	3 120
Other expenditure	5 450	5 220	4 990	5 010	5 010
Total	*92 025*	*93 962*	*90 066*	*91 967*	*92 823*
Ratio payments/commitments[1]	**0.95**	**1.01**	**1.00**	**0.98**	**0.99**
Payments:					
Agriculture	40 920	43 900	41 084	42 932	43 788
Structural operations	30 343	31 055	29 721	28 507	28 772
Internal policy	5 615	6 186	6 396	6 442	6 502
Administration	4 560	4 700	4 900	5 100	5 100
Pre-accession support	2 954	3 138	3 133	3 045	3 074
Other expenditure	5 208	5 247	5 008	4 900	4 942
Total	*89 600*	*94 227*	*90 241*	*90 926*	*92 177*
Total paym. as % of GNP	**1.09**	**1.11**	**1.01**	**0.97**	**0.89**

[1] Excluding agriculture, reserves and administration.

Sources: *The Financial Perspective 2000–2006 (EC, 1999). Input from Swedish sources.*

Appendix table 3. **Enlargement costs by country group in a Least Resistance Scenario.**
Millions of euro, 1999 prices

	2004	2006	2007	2010	2013
Berlin net payers (D, NL, A, SE)	853	2 802	5 501	7 330	8 626
Net payers without rebate (DK, F, I, Fin)	657	2 540	5 258	7 047	8 405
Sum	*1 510*	*5 342*	*10 759*	*14 376*	*17 031*
UK	442	1 510	2 798	3 675	4 168
All net payers	*1 952*	*6 852*	*13 557*	*18 051*	*21 200*
Cohesion countries (Gr, Irl, E, P)	222	841	1 732	2 319	2 763
EU adm ctrs (B, Lx)	61	236	489	655	781
EU 15 total	*2 235*	*7 930*	*15 778*	*21 026*	*24 744*
Baltic (EE, L, Lit)	286	316	350	390	422
Visegrad countries (Pl, H, CZ, Sl)	3 543	3 923	4 343	4 840	5 235
Slovenia	267	296	327	365	394
Island states (C, M)	164	182	202	225	243
BU + RO	0	0	734	818	885
New MS total	*4 260*	*4 717*	*5 956*	*6 637*	*7 180*
EU enlarged	*6 495*	*12 646*	*21 734*	*27 663*	*31 923*

Source*: Own estimates.*

Appendix table 4. **Total payments to the EU budget by country group in a Least Resistance Scenario.**
Millions of euro, 1999 prices

	2004	2006	2007	2010	2013
Berlin net payers (D, NL, A, SE)	31 888	34 141	37 275	39 221	40 554
Net payers without rebate (DK, F, I, Fin)	33 828	36 390	39 563	42 100	43 575
Sum	*65 716*	*70 530*	*76 839*	*81 321*	*84 129*
UK	11 591	12 079	13 531	13 232	13 509
All net payers	*77 307*	*82 610*	*90 370*	*94 553*	*97 637*
Cohesion countries (Gr, Irl, E, P)	11 221	12 061	13 105	13 934	14 430
EU adm ctrs (B, Lx)	3 148	3 386	3 681	3 916	4 054
EU 15 total	*91 676*	*98 056*	*107 155*	*112 403*	*116 121*
Baltic (EE, L, Lit)	286	316	350	390	422
Visegrad countries (Pl, H, CZ, Sl)	3 543	3 923	4 343	4 840	5 235
Slovenia	267	296	327	365	394
Island states (C, M)	164	182	202	225	243
BU + RO	0	0	734	818	885
New MS total	*4 260*	*4 717*	*5 956*	*6 637*	*7 180*
EU enlarged	*95 936*	*102 773*	*113 111*	*119 040*	*123 300*

Source: *Own estimates.*

Appendix table 5. **Net positions by country group in a Least Resistance Scenario.**
Millions of euro, 1999 prices. UK rebate definition

	2004	2006	2007	2010	2013
Berlin net payers (D, NL, A, SE)	-13 536	-15 325	-18 038	-19 990	-21 328
Net payers without rebate (DK, F, I, Fin)	-5 658	-7 885	-10 660	-13 201	-14 682
Sum	*-19 194*	*-23 210*	*-28 699*	*-33 191*	*-36 010*
UK	-3 413	-3 779	-5 076	-4 780	-5 059
All net payers	*-22 607*	*-26 990*	*-33 774*	*-37 971*	*-41 069*
Cohesion countries (Gr, Irl, E, P)	17 122	15 877	15 076	14 246	13 748
EU adm ctrs (B, Lx)	3 444	3 485	3 366	3 130	2 992
EU 15 total	*-2 041*	*-7 627*	*-15 332*	*-20 596*	*-24 329*
Baltic (EE, L, Lit)	453	1 021	1 251	1 666	1 949
Visegrad countries (Pl, H, CZ, Sl)	1 676	6 510	11 572	15 086	17 223
Slovenia	-69	27	40	58	51
Island states (C, M)	-20	70	40	43	31
BU + RO	0	0	2 429	3 743	5 075
New MS total	*2 041*	*7 627*	*15 332*	*20 596*	*24 329*
EU enlarged	*0*	*0*	*0*	*0*	*0*

Source*: Own estimates.*

Appendix table 6. **Distribution of payments and receipts in EU 15 in 2006 including enlargement costs.** Millions of euro, 1999 prices

	Absolute amounts, millions of euro				Euro per capita
	Total payments before UK rebate	Financing of UK-rebate	Allocated expenditure	Net position	Net position
Belgium	2 889	247	5 368	2 433	233
Denmark	1 969	171	1 561	-442	-83
Germany	23 852	340	11 574	-10 962	-134
Greece	1 608	136	6 357	4 725	445
Spain	7 085	598	14 419	7 227	181
France	16 853	1 423	12 863	-4 242	-72
Ireland	1 125	95	2 201	1 059	279
Italy	13 229	1 146	10 502	-2 954	-51
Luxembourg	231	19	1 286	1 052	2 407
Netherlands	4 708	67	2 160	-2 288	-144
Austria	2 369	34	1 424	-815	-101
Portugal	1 304	110	4 189	2 865	286
Finland	1 473	126	1 250	-247	-48
Sweden	2 730	40	1 321	-1 260	-142
United Kingdom	17 001	-4 922	7 119	-3 779	-64

Source: *Own estimates.*

Note*: See text on why net position is not equal to payments less receipts. Per capita positions estimated on population 2000.*

Terms used

Absorptive capacity: The capacity of a member country to make effective use of funds made available to it from the EU budget. The absorptive capacity will depend among other things on a country's ability to plan ahead, its institutional capacity for plan implementation and its financial capacity for providing required national co-financing.

Acquis communautaire: The EU system of rules, regulations and laws, which must be applied by all member countries, including new ones.

Agenda 2000: Action program for the period 2000 – 2006, agreed by the European Council in Berlin, 1999 and later finalized in the Interinstitutional Agreement. Agenda 2000 contains among other things the Financial Perspective for this period.

Allocated expenditure: The part of the EU budget (approx. 90 %) that flows back to the member states in the form of agricultural support, structural funds etc. Non-allocated expenditure are funds paid outside the Union, e.g. as pre-accession support to candidate countries or support to third countries.

Big bang: An enlargement strategy where a large number of candidate countries becomes members at the same time. Presently a big bang accession with 10 countries is expected for 2004.

Candidate countries: 13 countries recognized as official candidates for EU membership through a decision by the European Council at meetings in Luxembourg (1997) and Helsinki (1999). Those countries are the 12 countries with which negotiations are ongoing in 2002 plus Turkey. Other potential member countries are not considered as candidate countries in this context.

CAP: The Common Agricultural Policy

CFF: The Common Financial Framework for Negotiations. Proposal from the Commission in January 2002 for financing the enlargement 2004 – 2006.

Commitment appropriations: Appropriations in the EU budget or the Financial Perspective, showing the maximum amount that can be used for an item of expenditure during the budget year or later years.

Convention on the Future of Europe: A specially convened forum for discussing the future of Europe consisting of representatives from governments and the European Parliament. Candidate countries as well as the Civil Society are also represented. The Convention is expected to produce its report in 2003.

Council of the European Union: a.k.a. Council of Ministers or Ministerial Council. The decision-making organ of the EU, which convenes at the ministerial level in different constellations depending on the subject. The General Affairs Council (GAC) where the member countries are represented by their Ministers of Foreign Affairs has a central and coordinating role in the enlargement negotiations. Other constellations of the Council are, for instance, the Agriculture Council and the Economic and Financial Affairs Council (ECOFIN). Not to be confused with the Council of Europe, a different international organization with a broader membership than the EU.

ECB: The European Central Bank in Frankfurt a/M, Germany.

EU 15: The 15 countries that are members of the EU in 2002.

European Agreements: Agreements between the EU and a number of East European countries on the successive abolition of customs and other barriers to trade. Through the implementation of the European agreements much of the positive trade impact of enlargement on the economies of EU 15 and on candidate countries has been discounted already.

European Commission: The 20 commissioners nominated by the member countries for a period of 5 years. The Commission oversees the implementation of agreements and decisions. It has the exclusive right to take initiatives for new legislation.

European Council: The highest policy-making instance of the EU consisting of Heads of State and/or Governments (not to confuse with the Council of Europe; see above).

Financial Perspective: The long-term financial framework for the EU. The present F.P. covers the period 2000 – 2006 and was agreed in Berlin 1999.

FYROM: The Former Yugoslav Republic of Macedonia – the officially recognized designation of that country!

GNI: Gross National Income. A concept replacing the Gross National Product (GNP) as basis for important parts of the Own Resource System.

IGC: The Intergovernmental Conference, technically already in session, but expected to take new, far-reaching, decisions on the future of the Union in 1994.

IIASA: The International Institute for Advanced Systems Analysis, Laxenburg, Austria

Interinstitutional agreement (IIA): Binding agreements between the Parliament, the Council and the Commission on budgetary discipline and the improvement of the budgetary procedure, including the Financial Perspective.

Mode de calcul: The agreed method for calculating the UK rebate.

Net payer: Country, which pays more into the EU budget than the amounts of budget expenditure allocated to it.

Net position: The difference between the payments to the EU budget of a country and the budget expenditure that is allocated back to that country. See appendix 1 for further explanations.

Net receiver: Country, which receives larger allocations of expenditure from the EU budget than its contributions to the budget.

Own Resources System: The system for financing the EU budget.

Payment appropriations: Appropriations in the EU budget or the Financial Perspective, showing the amounts that are planned to be paid during a certain year. Payments can be the results of commitments made the same year or earlier.

PPP: Purchasing Power Parities. Gross National Product or Gross National Income data adjusted for differences in purchasing power between countries. Data calculated by the UN, the World Bank, OECD and Eurostat

Pre-accession support: Financial support given to the candidate countries before their accession to EU. Because of lag in payments a part of this support will also be paid in the years immediately following accession.

Regatta: An enlargement strategy where each candidate country becomes a member upon finalization of its negotiation without regard to the status of other candidate countries. Previously the preferred strategy, now in reality abolished.

UNDP: United Nations Development Programme – the UN agency responsible for assistance to third world countries and countries with economies in transition. UNDP publishes each year the Human Development Report, an attempt to give a comprehensive review of the development of human resources and conditions in the member countries.

Country abbreviations used in certain tables

B	Belgium
DK	Denmark
D	Germany
Gr	Greece
E	Spain
F	France
Irl	Ireland
I	Italy
Lx	Luxembourg
NL	the Netherlands
A	Austria
P	Portugal
Fin	Finland
SE	Sweden
UK	the United Kingdom
BU	Bulgaria
C	Cyprus
CZ	Czech Republic
EE	Estonia
H	Hungary
Lit	Lithuania
L	Latvia
M	Malta
Pl	Poland
RO	Romania
n.a.	Slovenia
Sl	Slovakia

Selected www links

Basic EU treaties and agreements

Basic treaties of the European Union:
http://europa.eu.int/eur-lex/en/treaties/dat/treaties_en.pdf

The Europe Agreements:
http://europa.eu.int/comm/enlargement/pas/europe_agr.htm

New Own Resources Decision:
http://europa.eu.int/comm/budget/furtherinfo/index_en.htm#financing

The UK rebate (Method for calculation):
http://europa.eu.int/comm/budget/furtherinfo/index_en.htm#financing

The European Commission

Home page:
http://europa.eu.int/comm/index_en.htm

DG enlargement:
http://europa.eu.int/comm/dgs/enlargement/index_en.htm

Financial Perspective:
http://europa.eu.int/comm/employment_social/esf2000/budget/financial_framework/en.pdf

The Own Resources System:
http://europa.eu.int/comm/budget/pdf/agenda2000/finue1998/en/en.pdf

Enlargement Strategy Paper:
http://europa.eu.int/comm/enlargement/report2001/index.htm

Common Financial Framework for Negotiations (CFF):
http://europa.eu.int/comm/enlargement/docs/index.htm

Mid-term review agriculture:
http://europa.eu.int/comm/agriculture/mtr/index_en.htm

Allocated expenditure 2000:
http://europa.eu.int/comm/budget/agenda2000/reports_en.htm

The Convention on the Future of Europe:
http://europa.eu.int/futurum/congov_en.htm

The Council of the European Commission

The Council:
http://ue.eu.int/en/Info/eurocouncil/index.htm

Some other studies, reports and basic data

(Note: Many of the reports and documents referred to in this study are available on the www. The list of links below contains a selection of sites with good overviews and further links.)

Priset för ett större EU (Karlsson 2001):
http://www.regeringen.se/info_rosenbad/departement/finans/eso/

Studies on enlargement assigned by the Commission:
http://europa.eu.int/comm/budget/financing/enlargement_en.htm

The Preparity Project (Austria):
http://preparity.wsr.ac.at/

The Countdown Project (Vienna Institute for Comparative Economic Studies):
http://wiiwsv.wsr.ac.at/Countdown/f_searc.html

The Human Development Reports;
http://hdr.undp.org/

World Competitiveness Yearbook:
http://www01.imd.ch/wcy/

History of the enlargement process and briefing material:
ttp://www.bankaustria.com/index.html(Under tab “Research)

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International Institute for Management Development (IMD), Lausanne, Switzerland

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United Nations and other international organizations

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List of ESO Reports in English

The Expert Group on Public Finance (ESO) is a Government commission at the Swedish Ministry of Finance. The expert group was established in 1981. All reports since 1993 include a summary (or at least an abstract) in English. A list of all reports published since 1982 and English summaries, when available, can be found at www. regeringen.se/eso. Paper copies can be ordered from the secretariat (+ 46 8 405 1518 or + 46 8 405 1588).

What Price Enlargement? – implications of an expanded EU by Bengt O. Karlsson (Ds 2002:52)

The School's Need for Resources – a report on the importance of small Classes by Alan B. Krueger & Mikael Lindahl (Ds 2002:12)

Looking ahead through the Rear-View Mirror – Swedish stabilisation policy as a learning process 1970-1995 by Lars Jonung

Social Security in Sweden – how to reform the system – Jan Bröms, Ingemar Eriksson, Inga Persson and Göran Schubert

Productivity Trends in the Public Sector in Sweden by Richard Murray

The Mobility of Capital – the Swedish tax and expenditure structure in an integrated Europe by Krister Andersson

Social Security in Sweden and other European Countries – three essays by Sven E. Olsson, Hans Hansen and Ingemar Eriksson