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The EU enlargement process: current state of play and stumbling blocks*

1 Progress at the accession negotiations

In keeping with the 'road map' to enlargement endorsed over a series of European Councils and ultimately confirmed at the European Council in Laeken, the Spanish Presidency (first six months of 2002) has the difficult task of bringing to a provisional close three chapters in the accession negotiations: *Agriculture*; *Regional policy*; and *Finance and budget*. These are the chapters which address the overwhelming majority of financial transfers to and from the EU budget. Ever since the Commission published its proposals on the financial aspects of enlargement, far less attention has been paid to those chapters that should have been closed under the Belgian Presidency, yet which still remain open to a varying degree in different countries (see Table 1). Only Slovenia did its homework properly and may now 'lean back and relax'.

The chapters that still require extensive negotiation are *Justice & home affairs* and *Competition*. In both cases, four of the eight CEEC candidates for entry in 2004 have still to negotiate the respective chapters. *Transport* is lagging behind where three candidate countries are concerned, while the *Taxation* and *Energy* chapters are still being negotiated with two countries. The remaining chapters (*Fisheries*, *Telecommunications*, *Culture & audiovisual*) are under negotiation with one candidate country each. Of the eight CEECs, Poland has the highest number of non-financial chapters still open (4), followed by Latvia and Slovakia (3 each).

2 Financing enlargement

The original financial framework was first elaborated in the document 'Agenda 2000' in 1997 and subsequently finalized in Berlin in 1999. The original scenario reckoned with six new members (the Czech Republic, Estonia, Hungary, Poland, Slovenia and Cyprus) and set their accession date for 2002. The working hypothesis for the two main enlargement parameters, date of accession and number of acceding countries, soon lost its relevance. That the first wave of accessions would have to be postponed became all too obvious as the pace of the negotiations was much slower than it should have been if the original target date was to be met. Moreover, according to the Copenhagen criteria the candidate countries were not found mature enough for full membership. (According to the

* This paper is based on a presentation the author gave to members of the Vienna Institute for International Economic Studies on 22 March 2002.

Table 1

**'State of play' in the EU accession negotiations for eight CEE candidates
applying to join the EU in 2004**

(As after the last negotiation meeting on 21 March 2002)

Chapter	Czech R.	Estonia	Hungary	Latvia	Lithuania	Poland	Slovakia	Slovenia
Justice & home affairs				O	O	O	O	
Competition	O		O			O	O	
Transport	O					O	O	
Taxation		O		O				
Energy		O			O			
Telecommunications				O				
Culture & audiovisual			O					
Fisheries						O		
Number of open, non-financial chapters	2	2	2	3	2	4	3	0
Agriculture	O	O	O	O	O	O	O	O
Regional policy	O	O	O	O	O	O	O	O
Finance & budget	O	O	O	O	O	O	O	O
Institutions	-	-	-	-	-	-	-	-
Total number of open/closed chapters	5/24	5/24	5/24	6/23	5/24	7/22	6/23	3/26

Legend: blank: provisionally closed chapter; O: open chapter, under discussion; - chapter not yet opened.

Source: www.euractiv.com

Commission's most recent evaluation published in the 2001 Regular Reports, all ten eastern candidate countries meet the political criteria of membership; all of them, except Bulgaria and Romania, are functioning market economies, yet none of them has the capacity to withstand competitive pressures and market forces within the enlarged Union.) As for the number of countries acceding up to and including 2006, the European Union first did away with the distinction between 'first-wave' and 'second-wave' candidate countries at the Helsinki Summit in December 1999. This opened up a window of opportunity for those six countries (Bulgaria, Latvia, Lithuania, Malta, Romania and Slovakia) that had not been considered potential candidates for accession prior to 2007. Except for Bulgaria and Romania, the former 'second wave' countries seized the opportunity and caught up with the former 'first wave' countries at the accession negotiations. Judging by the number of

chapters provisionally closed, Lithuania (24), Latvia (23) and Slovakia (23) are closer to EU membership than the former 'first wave' candidate Poland (22).¹

The Göteborg Summit in June 2001 confirmed that the EU regards 2004 as the target date for the first round of accessions. At the Laeken Summit in December 2001 it became clear that the EU now reckons with enlargement encompassing ten new members (the so-called 'big bang' solution that includes all the candidate countries, except Bulgaria and Romania).

The Commission realized that it had set itself a problematic assignment: enlargement in 2004 instead 2002; ten new members instead of six; and a predetermined, inflexible financial framework drawn up for a different enlargement scenario; as well as complete uncertainty concerning the future of the Common Agricultural Policy.

3 The Commission's proposals – an overview

The proposed solution, which serves as an initial basis for discussion in an endeavour to arrive at a common position among all 15 EU members, was issued on 30 January 2002 in two separate documents². Summarizing the changes compared to the Berlin framework, it is clear that the new members have lost all claim to the transfers earmarked for the biennium 2002-2003. Compared to the projections approved in Berlin in 1999, the available resources proposed by the Commission for 2004-2006 are 6% less in terms of commitment appropriations and 19% less in terms of payment appropriations (see Table 2). Payment appropriations are usually lower than commitment appropriations on account of the time lag between the date of actual transfer and the date on which the commitment was first entered into. Transfers ultimately disbursed are even less; the numerous cases of unsuccessful applications for individual project funding, problems related to national co-financing and similar factors lead to disbursed payments being held back and total expenditures being less than those originally envisaged in the commitments. A portion of the payments is thus delayed. Although less of a problem for the incumbent countries which have been participating in programmes on a continuous basis, delaying the commencement of programmes and hence the disbursement of payments poses a problem for the new members who may well suffer deterioration of their net financial position - primarily in the first, but even in the second year of membership.

The new proposals have shortened the 'phasing-in' stage (except for direct payments in agriculture), reducing it from the five years originally envisaged to three. As in the original

¹ As at end of March 2002.

² Communication from the Commission, Information Note *Common Financial Framework 2004-2006 for the Accession Negotiations* SEC (2002) 102 final, Brussels, 30 January 2002.
Enlargement and Agriculture: Successfully integrating the new Member States into the CAP, Issues paper SEC (2002) 95 final, Brussels, 30 January 2002.

framework, new members will be entitled to full support from 2007 onwards, the difference being due to the fact that 2002 and 2003 no longer count as the first two years of the 'phasing-in' period. Although this is good news for the candidate countries, the philosophy behind it is debatable: the Commission originally proposed a longer 'phasing-in' period so as to grant new members an opportunity to improve their absorptive capacity which had been found insufficient and hence incapable of utilizing more transfers than those earmarked in the Berlin framework. The Commission has now reduced the proposed 'phasing-in' period by 40%. In its explanation, the Commission points to the experience acquired in pre-accession aid, in particular environmental and infrastructure projects under the ISPA instrument (the other aid line, the SAPARD agriculture programme, has suffered delays in most of the candidate countries and thus cannot be cited as a good example of improved absorptive capacity).

Table 2

**Financial framework for enlargement
2004-2006**

(EUR million, 1999 prices)

Scenario: Accession of ten new Member States in 2004	2004	2005	2006	2004-2006
COMMITMENT APPROPRIATIONS				
Agriculture	2048	3596	3933	
Structural operations	7067	8150	10350	
Internal policies	1176	1096	1071	
Administration	503	558	612	
Total commitment appropriations	10794	13400	15966	40160
<i>Total commitment appropriations (Berlin 1999 scenario)</i>	<i>11610</i>	<i>14200</i>	<i>16780</i>	<i>42590</i>
PAYMENT APPROPRIATIONS (Enlargement)				
	5686	10493	11840	28019
<i>Payment appropriations (Berlin 1999 scenario)</i>	<i>8890</i>	<i>11440</i>	<i>14220</i>	<i>34550</i>

Source: Communication from the Commission, Information Note Common Financial Framework 2004-2006 for the Accession Negotiations SEC (2002) 102 final, Brussels, 30.1.2002. p.10.

The progressive nature of the 'phasing-in' process has decreased significantly. In the Berlin framework eligible transfers for the new members were 2.6 times (commitment appropriations) and 3.4 times (payment appropriations) higher in the final year of the 'phasing-in' period than in the first year. In the new proposal, the respective transfers in the final year of the 'phasing-in' period are only about 50% and 40% higher than those in the first year. This means bad news for the former 'first wave' countries³; they will now receive

³ The Czech Republic, Estonia, Hungary, Poland and Slovenia.

transfers lower than those envisaged in the Berlin framework, on account of the greater number of recipient countries (10 instead of 6).⁴

4 Structural actions

In view of the shortened 'phasing-in' period and the probably fragile absorptive capacity of the candidate countries, the Commission has proposed a significant measure of relief for the new members. It proposes increasing the share of Cohesion Fund transfers to one third in all structure-related funding operations. That is substantially higher than the 18% share accorded to the beneficiaries under the current financial framework - the four Cohesion-countries: Greece, Ireland, Portugal and Spain. This change bears implications in terms of the budgetary burden imposed by the co-financing requirement attached to any EU transfer. The co-financing share of the EU in the case of transfers from the Cohesion Fund may be as high as 85%, whereas in the case of transfers from the Structural Funds to Objective 1 regions its co-financing share may not be higher than 80%.

The cap on amounts related to structural operations in any member country has been set at 4% of the GDP. None of the new members should have any reason to feel too anxious on that account: in the final year of the 'phasing-in' period (2006), transfers from the Structural Funds may amount to 2.5% of their GDP.

Is the proposed solution fair, in the sense that old and new members alike are treated on an equal footing? In 2006, per capita aid from the Structural Funds in the ten new member countries will amount to EUR 137. Under the current financial framework, the comparable figure for the four Cohesion-countries is EUR 231.⁵ In short, the new members' per capita support will be more than 40% less than that of the 'poorest' old EU members. This would seem to confirm the candidate countries' complaints about the EU meting out unequal treatment and applying double standards. However, if we take the relative significance of transfers from the Structural Funds, the situation is quite the reverse. The latter transfers make up only 1.6% of the Cohesion-countries' GDP whereas in 2006 they will account for no less than 2.5% of the new members' GDP. (These figures reflect the higher GDP of the Cohesion-countries relative to that of the candidates.) With substantially lower per capita transfers, the new members will benefit from a larger contribution to their economic development (one third higher in relative terms).

⁴ That notwithstanding, neither in the Berlin framework nor in its current proposal did the Commission allocate transfers by country.

⁵ Calculation by the Commission, in *Communication from the Commission, Information Note Common Financial Framework 2004-2006 for the Accession Negotiations* SEC (2002) 102 final, Brussels, 30 January 2002, p. 6.

5 Agriculture

Direct payments, production quotas and rural development were the top issues addressed by the Commission as it paved the way for the candidate countries' full integration into the Union's highly complex Common Agricultural Policy (CAP).

Table 3

Financial framework for the enlargement in agriculture

A: Commitments	(EUR million – 1999 prices)		
	2004	2005	2006
Total direct payment	-	1173	1418
Market expenditure	516	749	734
Rural development	1502	1674	1781
TOTAL	2048	3596	3933
B: Payments	(EUR million – 1999 prices)		
	2004	2005	2006
Total direct payment	-	1173	1418
Market expenditure	516	749	734
Rural development	748	1187	1730
TOTAL	1264	3109	3882

Source: *Enlargement and Agriculture: Successfully integrating the new Member States into the CAP*, Issues paper SEC (2002) 95 final, Brussels, 30 January 2002, p. 24.

Direct payments

In the Berlin scenario no mention was made of direct payments to the new members, thus leaving open the issue whether the new members would receive transfers through this channel within the financial framework for 2000-2006 or later. The candidate countries' position was unequivocal: they insisted on being fully integrated into the CAP, including direct payments from the first year of membership onwards.

The Commission had to strike a balance between the financial constraints posed by the Berlin scenario and the stance adopted by the candidate countries. Furthermore, it had to find a proper way of lending support to the agricultural sector in the candidate countries given their existing ownership and production structures, the important role played by subsistence and semi-subsistence farming and its role as a safety net for the rural population, as well as their absorptive capacity. The Commission considered it important to enhance structural modernization, as opposed to conserving non-competitive agricultural activities through relatively high direct payments.

The solution proposed is based on a 10-year transition period: 2004-2013. In the final year of that period, farmers in the new member countries would be entitled to the same amount of direct payments as farmers in the old member countries, assuming that direct payments, if at all, are still an integral part of the CAP which will most likely have undergone reform by that date.

The system would be fixed in the first three years (2004 to 2006) at 25%, 30% and 35% of the level paid to present members. The pace of further increases is an open question which only comes up for discussion in the next financial framework: 2007-2013. On average, direct payments will have to be increased by 9.3 percentage points each year over the seven years remaining, if the new member countries are to reach the level currently enjoyed by the old members.

Inevitably, commitments are but one side of the coin; real payments are dependent in a broader sense on the absorptive capacity of the recipient. This is especially true in the case of the direct payments, the regulation of which is very complicated and where there is every danger of farmers in the new member countries making mistakes when applying for this support for the first time. Available resources would be low as a consequence, whereas the costs associated with administering relatively small amounts would be high.

Table 4

Direct payments, by main sector

	(EUR million – 1999 prices)			
	2004	2005	2006	2004-2006
Arable crops	-	861	1014	1875
Beef	-	254	299	553
Dairy	-	-	38	38
Tobacco	-	34	40	74
Other	-	24	27	51
TOTAL	-	1173	1418	2591

Source: *Enlargement and Agriculture: Successfully integrating the new Member States into the CAP*, Issues paper SEC (2002) 95 final, Brussels, 30 January 2002, p. 25. and own calculations.

In order to avoid this occurring, the EU proposes a simplified approach for the first three years of membership (two possible renewals of one year each). On the basis of the total sum earmarked for direct aid, an average area payment would be calculated for each new member. All types of agricultural land (agricultural area in use) would be eligible for payment. The minimum area eligible would be 0.3 ha, thus granting smallholders access to funds. There would be no obligation to produce, yet the land should be maintained in such a way as to protect the environment.

Since properly functioning implementation structures are of vital importance to direct payments, the simplified option as such may not slow down progress in that area. If at the end of the simplified option, the Commission finds that the management and control structures do not function properly, the simplified direct payment approach would none the less continue, but the increase due according to the ten-year transition period scenario would be frozen at the then prevailing level, until such time as the requisite progress in the institutional environment has been achieved.

It is important to mention that the Commission would allow the new members to extend direct payments from their own, national sources over and above payments disbursed by the EU, if comparable pre-accession national subsidies were higher than post-accession direct payments under the CAP framework. A pragmatic approach, it will undoubtedly help the new members to alleviate the pains of being integrated into the CAP. Although somewhat philosophical, one question is worth raising. If the low initial level of direct payments from the CAP was regarded as the key to the modernization of agriculture in the new member states and served as a justification for the 25% starting level, why are supplementary subsidies from national budgets permitted? Applying the logic of the Commission's own argument, they would jeopardize any desirable modernization of the agricultural sector in those very same member states.

Direct payments were originally designed to secure income levels for farming households that corresponded to other segments of society. That direct payments to farming households in the new member countries should start at a low level is quite justified since, it was argued, granting them 100% support would push farmers' incomes in those far above those in other segments of society. Household incomes, however, are only one side of the coin. Contrary to industrial products where free trade practices have been pursued for years has been applying by the EU and the candidate countries alike, trade in agricultural and food products trade remains regulated, despite major concessions. Only after enlargement will free trade come in force, derestricting competition between incumbent farmers and farmers in the new member states. In this respect, for all the difference in agricultural input and output prices between the Union and the applicant countries, the major difference in direct payments will seriously distort competition - to the detriment of farmers in the new member countries. Limited competition and different subsidies on the one hand, free trade and equal subsidies on the other, are both viable solutions. Free trade in tandem with markedly different levels of direct payments would appear to be unfeasible.

Production quotas

In most cases, agriculture plays a more important economic role in the eastern candidate-countries than in the present member countries. Setting production quotas and identifying

other supply management instruments (such as arable crops base areas) take on especial importance for the former.

In the case of earlier enlargements, this task was not as difficult as it is for the eastern candidate countries, where the proper reference periods for setting the quotas are fiercely discussed. The reason for this lies in agriculture having been especially hard hit by the transformation to a market economy and output levels are far below those recorded in the last few years of Communist rule. The candidate-countries would like to see the high pre-transition levels taken as a reference; however, the EU insists on referring to output levels in the period 1995-1999, where applicable. The Commission emphasizes that this should not be taken as a rule, but rather as a general time frame, permitting deviations when justified (viz. exceptional conditions such as natural disasters or significant market disruptions.)

The Commission had to cope with the difficulties caused by missing, incomplete or incomparable agricultural data. In only six of the twelve candidate countries has it been possible to conduct a harmonized agricultural census according to Eurostat criteria, as a central element of the agricultural statistics, yet the results are still not available for all of them. Cyprus, Lithuania, Malta and Poland will only carry out the survey this year and next, while the findings will not be available until 2003 and 2004. That notwithstanding, the Commission proposed a set of quotas for all important commodities or supply management instruments. As illustrated in Table 4, arable crops enjoy the highest share (72%) in total direct payments earmarked for the new member-countries.

Tables 5 shows the degree of variance between the candidate countries' requests and the Commission's proposals. Concerning the establishment of a base area for arable crops, the deviation of the proposed from the required base area is less than 5% in four countries (Hungary, Lithuania, Poland and Slovakia); in Slovakia the Commission even offers more than the candidate country requires. The Czech Republic's claim is 7.5% higher than the proposed area. Cyprus, Estonia, Latvia and Slovenia are cases of extreme deviation, 30-40%. In the case of Estonia and Latvia the reason for the difference is that both countries wish to include large areas of agricultural land which are currently lying fallow. The Commission, however, established that the land had not lain fallow under a statutory scheme and thus rejected the request.

With respect to the reference yields for arable crops, the Commission selected the median three years in the period 1994/1995-1998/1999 as an appropriate reference period. The variance between the proposed and requested values is larger than in the case of the base-area values. Except for the Czech Republic, the difference is substantial; in the three Baltic countries quite astonishingly so. That may be explained by the fact that the Baltic

agriculture was hard hit by the transitional recession, while output levels dropped dramatically compared to pre-transition levels.

Table 5

Production quotas: the Commission's proposal as a percentage of the candidate countries' request

(candidate's request = 100)

Countries	Arable crops		Milk	Beef sector: slaughter premium per unit slaughtered animals	
	base area	reference yields		adult	calves
Czech Rep.	92.5	99.5	80.8	80.2	137.1
Estonia	59.6	50.6	62.5	75.5	92.9
Hungary	97.3	84.5	69.5	66.0	66.0
Latvia	64.4	56.5	40.8	85.7	71.0
Lithuania	98.6	64.9	64.8	109.7	84.2
Poland	99.6	82.0	79.1 to 64.6	100.7	118.1
Slovakia	102.0	83.4	76.6	78.5	104.7
Slovenia	62.8	86.8	66.7	76.8	243.7

Source: Own calculations based on the data published in: Enlargement and Agriculture: Successfully integrating the new Member States into the CAP. Issues paper SEC (2002) 95 final, Brussels, 30.1.2002.

In the beef and the dairy sectors, both of which have a significant bearing on the CAP, the imponderables are relatively large owing to a lack of exact statistical comparability in some of the candidate countries. Partly on account of this, the Commission proposals and candidate country requests differ to a considerable extent. In the dairy sector, the milk production quotas proposed by the Commission are to a large extent lower than those requested by the candidates. Even the smallest discrepancy is close on 20% (Czech Republic); Latvia, however, would get less than half the quota it requested. Where the slaughter premium in the beef sector is concerned, the picture seems to be better for a few countries; that, however, is only one facet of a broader context. For example, the quotas requested by Poland are lower than those proposed by the Commission for both adult animals and calves, whereas in the case of another support channel, the special beef premium, the Polish quota is but 39% of the quota proposed by the Commission.

Rural development

The Commission proposes that the experience gained in pre-accession aid programmes under the heading SAPARD should basically help the new members to achieve a smooth landing in the rural development programmes. In the last three years of the current financial framework, the objective will be to create a flexible instrument, building on SAPARD and adapted to the needs of the new members.

One means of reducing the budgetary burden of co-financing on the new members will be to raise the EU co-financing rate to 80% in a large proportion of their rural development activities.

The Commission has devised various forms of special assistance for semi-subsistence farms, which produce for their own consumption, yet sell the larger part of their output. Many of these farms display commercial potential. However, after accession marketing these farms' output will be subject to competitive pressure from products supplied by larger subsidized farms in their own countries and in other EU member states. The Commission proposes providing aid to semi-subsistence farms at a flat rate; the maximum flat rate would be EUR 750. This payment will be conditional on the farm submitting a business plan confirming its economic viability. This temporary income support is conceived as a contribution to restructuring the farms by alleviating bottlenecks in household incomes during the period of reorganization.

Experience of the SAPARD programme

As mentioned above, the programmes within the framework of the rural development programme for the new members have been conceived as building on the experience the candidate countries gained with the SAPARD pre-accession aid programme. Hitherto, however, that experience has been rather negative. Two years after the programme was officially launched, only five of the ten CEEC candidate countries have been given the go-ahead by the Commission to start implementing the programme. Moreover, by the end of 2001 not even those countries had seen any disbursement of the first payments. The Czech Republic, Poland, Hungary, Slovakia and Romania failed to meet the prerequisites for starting the programme. Surprisingly, Bulgaria otherwise known as the 'rear light' was the first of the candidate countries to secure the Commission's approval on 15 May 2001. Bulgaria's case goes to show that for all the other problems associated with the accession process, once the necessary staff and expertise are available, the responsible officials are genuinely committed and the process enjoys political support, the pre-conditions can be met.

The main problem with SAPARD is that it is the Union's first foreign aid programme to be fully decentralized, with the authorities in the recipient countries being responsible for its effective implementation. The national institutions involved must be accredited by the Commission, and fulfilment of the conditions set calls for enormous effort. The Commission has to be 100% convinced that the financial support disbursed will be properly managed.

The delays suffered in the SAPARD programme must be seen as intimations of the difficulties that may lie ahead once the Commission starts implementing its rural development programme for the new member countries. In this respect the Commission's

intention to attach greater importance to the rural development programmes than to direct payments may prove counterproductive, since the requirements governing the disbursement of direct payments are less stringent (as long as the simplified approach is adopted). Should the problems besetting the SAPARD programmes re-occur in the rural development programmes, there is a certain danger that in the early years of membership the new members will receive only a fragment of the support committed.

6 Net financial position of the new members in the first three years of membership

Estimating the new members' possible net financial position after accession is no mean task. No generally accepted methodology for calculating the net financial position exists, despite the extreme importance of the issue and the prominence it is accorded in discussions about the real burdens on net paying members. A milestone in these discussions was the 'UK rebate': compensation granted to the UK for its large contribution to the joint budget agreed upon in 1984. Margaret Thatcher was able to secure the rebate because calculations incontrovertibly showed that while it paid relatively high contributions on account of the tariffs levied on agricultural imports from third countries and the country's relatively high VAT base (two items in the multi-component scheme for budgetary contributions), the UK received relatively few agricultural subsidies from the joint budget. The UK was thus at a distinct disadvantage compared to other member states at a similar stage of economic development.⁶

According to an official document released by the Commission, budgetary balances can be defined in 30 to 40 'perfectly defensible' ways.⁷ The results of calculations based on different definitions can diverge substantially for smaller member states and may distort year-to-year comparisons. If calculating budgetary balances over the few past years has proven so controversial, the estimates of future net financial positions must be viewed in a similar light: at best, they can only be rough approximations. Despite the obvious limitations of such estimates, it is essential to obtain some impression of the possible range of the new member countries' net financial positions in the post-accession period. The section below attempts to assess that range.

The estimate is based on: the budgeted expenditures as published in the Commission's Information Note; the new members' projected contribution outlined in a Commission press release; and the author's own assessment of the expected success/failure rate with

⁶ See detailed analysis in Manfred Claus Lödl (2002), 'Das EU-Budget und die öffentliche Haushalte in Österreich', in Gerhard Steger (ed.), *Öffentliche Haushalte in Österreich*, Verlag Österreich, Vienna, p. 190.

⁷ *Financing the European Union*, Commission Report on the Operation of the Own Resources System, Annex 3, p. 5, DG XIX, Brussels, 7 October 1998.

respect to the EU resources available. The items of importance to the estimate are as follows:

A COMMITMENT APPROPRIATIONS

Resources available in a given year for supporting EU co-financed projects. Actual expenditures on individual projects need not necessarily start or end in that year.

B PAYMENT APPROPRIATIONS

Spending earmarked in the given year for ongoing EU co-financed projects.

C TRANSFERS DISBURSED

The value thereof depends on the success/failure rate of applications for EU co-financed projects.⁸

D CONTRIBUTIONS FROM OWN RESOURCES

Contributions by individual member countries to the EU budget according to a multi-component scheme. A member state's share in total unused resources from payment appropriations in the previous year reduces that member state's contribution to the EU budget in the current year.

E NET FINANCIAL POSITION = C – D

In estimating the net financial position the following assumptions were made:

The date of accession is 2004; the number of acceding countries is 10. (All candidate countries, except Bulgaria and Romania).

As for contributions from own resources, the Commission's working hypothesis is based on a figure of up to EUR 5.5 billion in each of the first three years of membership. The Information Note refers to possible budgetary compensation so as to avoid new member states ending up in a worse net budgetary position than in the year prior to enlargement. To that end, new members may receive budgetary compensation not in excess of

⁸ 'The inability to absorb the funds may arise from incomplete planning, overoptimistic setting of targets or insufficient feasibility-implementation studies. It may be also due to: the existing inadequate institutional framework, to management weaknesses or to public resistance in the implementation of certain projects. Also it may arise from unfulfilled co-financing requirements stemming either from fiscal problems in the case of the national budget or difficulties in mobilizing private funds.' Sarantis E.G. Lolos (2001), 'The Macroeconomic Effect of EU Structural Transfers on the Cohesion Countries and Lessons for the CEECs', Interim Report IR-01 – 044 /October, IIASA, pp. 7-8.

EUR 816 million in 2004, EUR 800 million in 2005 and EUR 814 million in 2006. The estimate operates on the assumption that: annual budgetary compensation will be set at the upper limit indicated - EUR 5.5 billion⁹; and new members will be awarded the maximum compensation available.

According to the author's optimistic scenario, the new members will be able to obtain 75% of the resources available (payment appropriations) in the form of disbursed transfers throughout the three-year period. According to his pessimistic scenario, however, the rate would be a mere 30%. The pessimistic scenario is based on Poland's disappointing experiences with pre-accession aid. In 2001 Poland managed to secure only 28% of the resources theoretically available.¹⁰ The optimistic scenario is derived from information contained in the Commission's Second Cohesion Report.¹¹ According to Table A 35 of that report 72% of the resources available in the period 1994-1999 were in fact paid from the Structural Funds (Objective 1, 2, 3, and 4) for the (unweighted) average of the 15 EU members. As for the Cohesion Funds, the project implementation rate in the last year of the financial framework (1999) ranged from 85% (Portugal, the best performer) to 65% (Greece, the weakest performer). Although project implementation and related payments were extended up until December 2001, it did not change the final balance of the six-year financial framework. Another factor should also be considered: for incumbent countries, extensions from a previous financial framework create a financial buffer for the first two years of the subsequent financial framework – an opportunity that the new members will not be able to avail themselves of. (Extending transfers related to pre-accession aid may, however, serve as a similar buffer for new members.) Based on figures in the experienced member states, an assumption of 75% for actual disbursements for new, inexperienced member states can be regarded as optimistic.

As mentioned earlier, unspent resources are not lost completely; they are redistributed among the member states according to their original share in total contributions to the EU budget and their contributions from own resources are reduced by that amount the following year. It is estimated that 5% of the ten new members' unspent resources would be deducted from their own resource contributions the following year.

⁹ 'Commission offers a fair and solid approach for financing EU enlargement', *EU Institutions Press Releases* IP/02/170 30 January 2002.

¹⁰ According to *Interfax Poland* in 2001 Poland absorbed EUR 316 million of the EUR 1.22 billion available (*Világgazdaság*, 25 February 2002).

¹¹ Second Report on Economic and Social Cohesion, Statistical Annex, Table A.35 EUROPA Regional Policy Info regio http://europa.eu.int/comm/r...ces/docoffic/official/reports/p31_en.htm

Table 6

Financial framework for enlargement 2004-2006

Assumption: Accession of ten new member states in 2004

(EUR million, 1999 prices)

	2004	2005	2006
1. COMMITMENT APPROPRIATIONS	10794	13400	15966
2. PAYMENT APPROPRIATIONS	5686	10493	11840
3. TRANSFERS DISBURSED (Author's estimate)			
3.1 Optimistic scenario (75% of payment appropriations)	4265	7870	8880
3.2 Pessimistic scenario (30% of payment appropriations)	1706	3148	3552
4. CONTRIBUTIONS FROM OWN RESOURCES			
4.1 Commission estimation "full"	5500	5500	5500
4.2 = 4.1 reduced by EUR 816 in 2004; 800 in 2005; 814 in 2006	4684	4700	4686
4.3 (Author's estimate based on scenario 3.1 for disbursed transfers)*	4684	4629	4555
4.4 (Author's estimate based on scenario 3.2 for disbursed transfers)*	4684	4501	4319
5. NET POSITION (Author's estimate)			
Optimistic scenario: 3.1 less 4.3	-419	3241	4325
Pessimistic scenario: 3.2 less 4.4	-2978	-1353	-767
(Outgoing pre-accession aid transfers?）**	(1100)	-	-
Optimistic scenario in % of new members' GDP	-0.11	0.82	1.06
Pessimistic scenario in % of new members' GDP	-0.77	-0.34	-0.19
(Outgoing pre-accession aid transfers?）**	(0.29)	-	-

Notes: * 5% of undisbursed payment appropriations in any given year may diminish payments to the EU budget in the next year. (5% is the approximate share of the new member countries in members' total contributions to the EU budget.) Data for payments to the EU budget in the table are adjusted by estimated undisbursed payment appropriations for the new members, but they do not include the respective share in possible unused resources from payment appropriations for the EU 15. Please see Annex table for background calculations to this table.

** The figure corresponds to about one third of the EUR 3120 million pre-accession aid available to the candidate countries in any one year.

Source: Communication from the Commission, Information Note Common Financial Framework 2004-2006 for the Accession Negotiations SEC (2002) 102 final, Brussels, 30.1.2002, p. 10 and 'Commission offers a fair and solid approach for financing EU enlargement', Press Release by the Commission, 30 January 2002. Own calculations are based on data from the above-mentioned documents.

The outcome of the above computation shows that according to both the optimistic and pessimistic scenarios, the first year of membership will most likely see the new members assuming a net contributor position. Transfers disbursed should make up more than 82% of the payment appropriations needed to arrive at a balanced net financial position in the first year of membership. In both the optimistic and pessimistic scenarios, the estimated net financial position will improve considerably in the second and third years of membership. However, according to the pessimistic scenario, new members may still remain net contributors to the EU budget in the third year.

The relative significance of the net financial position measured as a percentage of the new members' GDP is surprisingly low. It is less than 1% each year according to both scenarios, except in the optimistic scenario for 2006 when it amounts to 1.06%. Should the new members be able to absorb 100% of the payment appropriations earmarked for the first year, the (positive) net financial position would only amount to 0.26% of their aggregate GDP in the first year of membership. By way of comparison, the estimated annual net FDI inflow to this group of countries over the same period will amount to about 4% of their aggregate GDP.¹² The current account position of the respective countries may change from one year to the next to a much larger extent than the sum of all EU-related transfers. Poland's current account deficit in terms of its GDP changed by 2.3 percentage points in the period 2000-2001 (from -6.3 to -4.0), while that of Slovakia shifted by 3.9 percentage points (-3.7 to -7.6).

Table 6 shows that a possible prolongation of the outgoing pre-accession aid transfers may substantially improve the first year's balance. Nevertheless, pre-accession aid is not part of the financial framework for enlargement; its possible role will have to be addressed separately.

By way of comparison, the Cohesion Countries enjoyed much better net financial positions in the period 1995-2000 than those the new members will enjoy in the first three years of the post-accession period.

¹² Estimate by G. Hunya, FDI expert attached to the WIW.

Table 7

**Net financial position of selected EU members in 1995-2000,
as % of GDP**

Net financial position 1995-2000			
	Worst	Best	
Greece	3.22	4.35	
Ireland	1.83	4.56	
Portugal	1.93	3.23	
Spain	0.86	1.72	
1995 (First year in the EU)			
	Worst	Best	
Austria	-0.50	-0.20	-0.50
Finland	-0.22	0.17	-0.13
Sweden	-0.60	-0.35	-0.43

Source: 'Kommissionsbericht über die Aufteilung der operativen EU-Ausgaben 2000 nach Mitgliedsstaaten', September 2001, quoted in M. C. Lödl (2002), 'Das EU-Budget und die öffentliche Haushalte in Österreich', in Gerhard Steger (ed.), *Öffentliche Haushalte in Österreich*, Verlag Österreich, Vienna, p. 202.

The information note issued by the Commission emphasizes that high priority has been given to ensuring that the new member states will not be financially worse off after accession. Table 8 compares the financial positions of the new members in the final year before and the first year after accession, assuming that 100% of the pre-accession aid commitments in 2003 and 100% of the payment appropriations in 2004 will in fact be disbursed. The maximum possible reduction of own resource contributions was taken into consideration. Indicators in Table 8 show that the Commission's aim of averting a deterioration of the net financial position cannot be achieved under the conditions projected for financing enlargement: the net financial position of the 10 new members may well deteriorate by more than EUR 1 billion immediately upon accession compared to their position in the final year prior to their joining the EU.

Table 8

**Estimated net financial position of the new members
one year before and in the first year of enlargement**

New members: transfers from and to the EU budget	2003	2004
(+) Pre-accession aid, commitments* (estimated)	2200	-
(+) Payment appropriations	-	5686
(-) Own resources contributions (with max. reduction)	-	4684
Net position (estimated)	2200	1002

Note: *Excluding Bulgaria and Romania.

7 Concluding comments

Undoubtedly under the given circumstances, the Commission had no opportunity to elaborate a proposal that would satisfy both the new candidate countries and the old EU members, while simultaneously ensuring that integration into the highly complicated redistribution system of the EU would ensue in a manner that promotes the rapid modernization of the late entrants. Hence, the critical remarks coming from all sides do not necessarily mean that the proposals are bad or unfeasible.

The figures set in the Berlin scenario seem to be the touchstone of the whole financing package, and certainly only for the period 2004-2006. There can be no doubt that the candidate countries will insist on participating in all aspects of the next financial framework: 2007-2013.

The segment addressing structural activities seems to be acceptable – even to the candidate countries. For the period beyond 2006, the 4% cap (ratio to GDP) on structure-related transfers guarantees that costs will not explode in this context. One can only raise a question as to the rationality of the argument behind the 'phasing-in' of the transfers from the Structural Funds: if on account of their limited absorptive capacity the new members can utilize the transfers committed from one unit to a lesser degree than the incumbent countries, why is that a reason to allocate them fewer resources, as though they had a greater absorptive capacity? Given their weak absorptive capacity, they will merely derive a lesser amount of disbursed payments from the lesser amount of committed transfers. It would have been more straightforward to argue that additional funding is not available for those three years.

In agriculture-related financing direct payments is a really difficult issue. Although the CAP in itself is anything but a system enhancing efficiency and competitiveness, it is impossible to be in the European Union without being part of the CAP. Therein lies the problem with the Commission's proposal: 'phasing-in' direct payments per se may well be justified by the arguments enlisted by the Commission, but 'phasing-in' direct payments *and* immediately exposing the farmers in the candidate countries to unbridled competition in the single market dominated by EU farmers enjoying full-scale (100%) subsidies poses a challenge that the newcomers cannot meet. In this respect, a major revision of the proposal seems inevitable.

The solutions proposed by the Commission to facilitate a 'soft landing' in the CAP in other respects are to be welcomed, e.g. lower co-financing requirements for the new members in rural development projects or a special form of assistance for self-subsistence farmers. Probably the only way for the candidates to obtain a more advantageous set of accession conditions in the field of agriculture will be to secure further concessions in areas where it does not involve the old members in more expenditure. Better co-financing requirements

are typical devices; they relieve the burden on the new members without increasing that on the incumbents.

The net financial position is one of the most important issues of EU membership. Nevertheless, it is unjustified to interpret the net financial position as the balance of overall costs and benefits of membership in the European Union. The consequences of being integrated into the single market may yield benefits or disadvantages that match the impact of financial transfers, not to mention the political and security aspects and the pressure to modernize the institutional and legal system following acceptance of the *acquis communautaire*.¹³ The net financial position merely reflects the primary effects of transfers; their secondary effects remain concealed.¹⁴ Possible non-enlargement would entail considerable costs for the 10 applicant countries in terms of the opportunities they would lose of achieving higher GDP growth rates.¹⁵

As mentioned above, the macro-economic significance of the new members' net financial position is small. The impact of a possible negative balance of transfers (or prospects of a negative balance prior to accession) from and to the EU is primarily political, providing arguments for populists opposed to accession and eventually leading to a profound disappointment among the people in the countries concerned. The outcome may be a rejection of the accession treaties following the referenda in the candidate countries or a serious political crisis after accession.

The possible solution may come either from within the proposed financial framework or without. Rearranging things so as to increase transfers in the first year of membership and decrease them in the second and third years may well create a buffer for the first year, leaving the total balance for the period 2004-2006 unchanged. A solution from without may be to use the resources set aside for the pre-accession aid as yet unspent or to extend those programmes already up and running in the year prior to accession. In any case, the problem of the net financial position in the first three years of membership, but in the first year in particular, calls for careful analysis and a comprehensive action plan that goes beyond the efforts undertaken hitherto.

With regard to the critical responses to the Commission's proposals from both the EU 15 and the candidate countries, it is questionable whether the incumbent countries will be able to elaborate a joint position this spring or whether the financial chapters can be finalized with the candidate countries as foreseen in the 'road map'. Elections in France and

¹³ Jorgen Mortensen and Sándor Richter (2000), 'Measurement of Costs and Benefits of Accession to the European Union for Selected Countries in Central and Eastern Europe', *WIIW Research Reports*, No. 263, Vienna.

¹⁴ Lödl, op.cit.

¹⁵ Fritz Breuss, 'Kosten der Nicht -Erweiterung der EU für Österreich', WIFO study commissioned by Wirtschaftskammer Österreich, March 2002.

Germany may delay the process. Under those circumstances, the dual target comprising accession by 2004 and incorporation of ten new members would seem over-ambitious. 2005 seems the more likely accession date. It must be pointed out that it is in the elemental interests of the candidate countries that they be able to participate in the elaboration of the European Union's financial framework for the period 2007-2013: a precondition for this being accession by 2005 at the latest.

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ANNEX

ANNEX Table 1

Calculations for the estimation of selected positions in Table 6

(EUR million, 1999 prices)

6. PAYMENT APPROPRIATIONS less TRANSFERS DISBURSED	2004	2005	2006
6.1 = 2 - 3.1 (Scenario A)	1421	2623	2960
6.1.1 (5% of 6.1)	71	131	148
6.2 = 2 - 3.2 (Scenario B)	3980	7345	8288
6.2.1 (5% of 6.2)	199	367	414
4. CONTRIBUTIONS FROM OWN RESOURCES (Author's estimate)			
4.3 = (4.2 less 6.1.1/2004 in 2005 and 6.1.1/2005 in 2006)	4684	4629	4555
4.4 = (4.2 less 6.2.1/2004 in 2005 and 6.2.1/2005 in 2006)	4684	4501	4319
7. AGGREGATE GDP OF THE TEN NEW MEMBERS (Author's estimate)	384 883	397 521	409 752