Agenda 2000:
financing and enlarging the European Union

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Introduction

In March 1998, the Social and Economic Council (SER) published an advisory report on Agenda 2000: the enlargement of the European Union and the financing arrangements for the period ahead. The SER drafted this report at its own initiative. The opinions expressed therein are held unanimously by its members.

The report outlines the SER's views on the new financial framework for 2000-2006 and on the enlargement of the Union by the accession of a number of Central and Eastern European countries and Cyprus. The report therefore also considers the European Commission's proposals to reform the European Structural Funds and the Common Agricultural Policy.

In the report, Agenda 2000 is viewed as a triple social and economic challenge for the Union, the challenges being:

- to ensure that the Economic and Monetary Union functions satisfactorily, and that it also fosters sustainable growth and employment;
- to enlarge the Union to the east;
- to tailor the Union's institutions and policy to changing circumstances, including enlargement.

The following summary of the SER's advisory report consists of three sections. The first section discusses the accession strategy for the Central and Eastern European countries. The second section provides an overall view of the role which the Community budget plays in the integration process and the Netherlands' stake in this process. The third section looks at the expenditure side of the Community budget, partly from the perspective of the Union's pending enlargement.

1. The accession strategy

When considering the enlargement of the Union, a strict distinction should be made between the accession criteria and the enlargement criteria, adopted during the European Council held in Copenhagen in June 1993. The accession criteria are the political and economic criteria on which candidate Member States will be judged when they apply for Union membership. The enlargement criteria are the requirements which the Union itself must meet to make enlargement possible; these involve institutional reform and reform of the Common Agricultural Policy (CAP) and the Structural Funds[1]. The relationship between the two sets of criteria is that, as soon as a candidate Member State satisfies the accession criteria, it should in fact be possible for enlargement to take place. It would be unwise to take the pressure to reform off the Union by using the enlargement criteria to postpone accession (thereby holding the candidate Member States hostage).

The European Commission has prepared detailed opinions in which it assesses the progress made by each of the candidate Member States in Central and Eastern Europe according to the 'Copenhagen criteria'. The Commission's conclusion is that accession negotiations may commence with five countries (besides Cyprus): Hungary, Poland, the Czech Republic, Estonia and Slovenia. Because these countries, as well as the other candidate Member States, still have a long road ahead of them before they qualify for accession, the European Commission has developed a reinforced pre-accession strategy in which it aims:

- to bring together all forms of assistance by the Union into a single framework: the 'Accession Partnerships', involving specific forms of cooperation with candidate Member States to prepare for accession;
- to increase the extent to which candidate Member States participate in Community programmes, so as to familiarise them with the Union's policies and procedures.

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[1] These policy adjustments and the relevant financial framework will be discussed in greater detail in the second and third sections of this summary.

In the SER's view, the adoption of the *acquis communautaire* by the candidate Member States is an important criteria for accession. The adoption of the *acquis* is a difficult, but necessary hurdle on the road to membership. At the same time, some thought must be given to the impact which the accession of the new Member States will have on the *acquis*, at any rate on its future development, since these countries will co-determine the common policy after accession.

The SER advocates preserving the *acquis* in its present form because it represents the Union's most important line of defence against weakening integration and offers the firmest basis for enlarging and deepening the Union further. In verifying the accession criteria, however, the Union must not apply criteria which go beyond the *acquis* and which could, in fact, be used to defer solving the enlargement problems indefinitely. It is therefore essential to consider carefully both the necessity and functionality of such additional accession criteria. In those cases where embodiment of the *acquis* is still too difficult, the answer must be sought in permitting temporary and restricted exceptions and not in permanent derogations (see also below).

In the opinions referred to above, the European Commission observed various policy, institutional and structural weaknesses which the candidate Member States will have to face in the years ahead. Viewed from a socio-economic perspective, these weaknesses can be found mainly in administrative and legal structures, physical infrastructure, social policy and industrial relations, environmental policy, nuclear safety and agriculture. According to the SER, any assistance provided in administrative, legal and social infrastructural matters would mainly involve the systematic transfer of know-how and a professional approach. The most pressing issue in terms of investing in the physical infrastructure and in nuclear safety and environmental management facilities will be the need for financial resources. In this light, SER views the stronger emphasis within PHARE on large-scale infrastructure projects as a positive step. The Union should concentrate on supporting infrastructure which facilitates cross-border traffic and transport, and on measures which will reduce cross-border environmental impact and the risk thereof.

The Union should help all Central and Eastern European candidate Member States which are working constructively towards integration in the Union to proceed down the road to accession as quickly and effectively as possible. In socio-economic terms, that will require drafting a clear-cut accession strategy and making sufficient technical and financial aid available.
The SER believes that the five countries with which accession negotiations will actually commence have been chosen wisely. The actual starting date for the negotiations and the ultimate accession date can be determined on a case-by-case basis. A difference in the starting position, however, must not automatically lead to the candidate Member States crossing the finish line (i.e. acceding) at different times. An effort must be made to avoid dividing the candidate Member States into 'front runners' and 'laggers', a division which would cause some countries to become indolent and would only discourage others. There should be regularly scheduled checks on whether other candidate Member States have made sufficient progress towards embarking on accession negotiations.
It is in this connection that the SER would like to see much more credence given to the 'European Conference', which should offer a permanent and operational forum for the exchange of information and consultations on various aspects of Community policy, as an alternative to the existing structured dialogue. All countries associated with the Union which have applied for membership should be given access to this conference (including Turkey).

It is extremely important to select the right accession date; there is a promotional effect on the Member States and their citizens, and, as soon as they accede, the new Member States begin to participate in the Union's decision-making process, have access to the Court of Justice and qualify for the Union expenditure programmes. The accession date must reflect the right balance between the need to prepare socio-economic matters thoroughly and the political desirability of achieving integration at a relatively quick pace. While planning the accession process, the points of departure should be:

- to obligate the candidate Member States to take on the full *acquis*;
- to be aware that, realistically speaking, the new Member States will not be able to enforce all elements of the *acquis* in every single area of integration within the foreseeable future;
- to understand that possible exceptions to the *acquis* should be limited in time and scope to avoid the risk of disintegration.

Similar to the procedure which was followed when Spain and Portugal acceded, the pending enlargement of the Union will require transitional arrangements. However, exceptions to the *acquis* should only be permitted if absolutely necessary, i.e. because the relevant measure clearly cannot be implemented more quickly, and only for a specific, pre-determined period of time. The exceptions should also pose no threat to the proper functioning of the internal market, a requirement which involves, among other things, monitoring any instances of unfair competition. It is further essential that explicit reference is made to the temporary nature of the exceptions to the *acquis*, and that deadlines are specified to avoid undermining the existing *acquis*. Where the link to the internal market is less direct (e.g. certain environmental standards relating to production processes), longer periods of transition can be maintained on a selective basis. This will avoid a situation in which the cost of adjustment becomes excessive or in which the capital losses become exorbitant.

To encourage the new Member States, even after accession, to implement the entire *acquis*, the SER proposes linking privileges and obligations in a certain manner by incorporating a number of pre- and post-accession assessments and by having further action on the part of the Union depend in part on those assessments. One element would be the gradual introduction of the free movement of workers within an agreed period of time; another would be to improve access to the market for agricultural products.

Finally, the convergence of agricultural prices alone will require border checks to be carried out between the present internal market of fifteen Member States and the new Member States, for a certain period (four or five years) after accession. It is assumed that the first candidate Member States will accede around 2004-2005.

2. The Community budget

The SER believes that the internal market and the related Community policy are at the very core of European integration. The Community budget is one of the instruments which can be used to shape the ambitions of European integration. In many areas however – for example the completion and preservation of the internal market – the Union's policy makes little if any call on the Community budget because it is shaped mainly by regulation/deregulation and/or because it is the national exchequers which foot the bill. This also means that there is no explicit relationship between how much priority a particular policy objective is given and the size of the relevant Community budgetary item.

The European Commission's budgetary proposals in Agenda 2000, the Financial Perspectives, cover the period 2000-2006. The SER believes that it is well to have this period run up to and include the year 2006, as this will make it necessary to make full allowance for the accession of a number of Central and Eastern European countries. At the same time, in order to take a responsible decision on the Financial Perspectives up to and including the year 2006, the financial impact on the period thereafter will have to be considered as closely as possible. An effort must be made to avoid incorporating policy elements which will lead to considerable payment obligations only at a much later stage (*camel nose*).

Budgetary control

The European Commission has made a sensible move in proposing to maintain the own resources ceiling of 1.27% of the Union's GNP after the year 2000; the Union will be compelled to reconsider its spending and to act with greater efficiency. The SER would, however, like to remind the European Commission that the risk of financial setbacks still exists. For example, the Commission's assumption of an average 2.5% growth rate in the current Member States is high; given the average economic growth rate from 1981 to 1996, 2% is a more realistic assumption and more appropriate in a cautious scenario. If a slower rate of growth is assumed, the expenditure ceiling would also be lowered.

The expenditure ceilings for specific categories and for the overall budget are important tools for enforcing budgetary discipline. These ceilings should force the Union to consider its priorities very carefully. Through stricter financial management, and thanks to the relatively favourable economic conditions, actual Union spending has increased less over the past few years than what is allowed for by the expenditure ceilings in the current Financial Perspectives. The budgetary scope which has resulted is very welcome, considering the two operations which will initially place an extra burden on the budget, i.e. the progressive reform of the CAP and the accession of several Central and Eastern European countries. One serious risk is that a slow rate of growth in the Union and in the global economy will be combined with low agricultural prices and a depreciated dollar, putting upward pressure on the agricultural budget. In such an event, a second margin is available in the multi-annual budget, i.e. under the agricultural guideline.
Essentially, any setbacks related to enlargement can only arise in the agricultural budget, because this includes open-ended schemes. The size of any resulting setbacks depends largely on the future design of the CAP and will be limited by the GATT/WTO agreements on the subsidised export of agricultural products. The remaining extra budgetary expenditure associated with enlargement, for example as drawn from the Structural Funds, can be properly budgeted ahead of time and is subject to a separate political decision-making process (see also section three).

Sharing the financial burden
In the political debate on the Community budget, much energy is being spent discussing how the financial burden is to be shared between the Member States. The Dutch Cabinet believes that the current burden-sharing arrangement is not commensurate with relative prosperity. While the Netherlands is willing to accept that it is a net contributor to the Union, it objects to its relative share of the net financial burden in the Community budget.

The British Government was the first to put the Community's budgetary imbalances on the agenda. A 1984 agreement provided for a specific rebate mechanism for the United Kingdom. The SER has regularly spoken out against maintaining the rebate for the United Kingdom as well as against the one-sided emphasis on the net financial position (the balance between the resources transferred by a Member State to the Union and the Union's expenditure on that Member State). Because the Community budget has, in the first place, an allocative function, it is not really possible to judge the fairness of a certain *net* sharing of the burden without analysing each underlying expenditure and income category separately.

The *expenditure* should be assessed primarily on the basis of subsidiarity (is Union action desirable?), effectiveness (are there economies of scale and cross-border external effects?) and efficiency (which Union action will provide the most efficient way of achieving the result?). Additionally, the scheme should be designed in such a way that the distribution of Union resources between the Member States is compatible with the aims of the scheme (fairness). In the case of the Structural Funds, this fairness implies a certain re-distribution from 'rich' to 'poor'. With respect to CAP spending, however, it is in fact impossible to determine what a fair distribution between the Member States means, not only because of the peculiarities of the separate market intervention mechanisms, but also because of the primary focus on individual producers. In the case of other expenditure from the Community budget, an equitable distribution is not the primary motivation behind the policy decisions.

With a view to sharing of burden fairly, the *revenue side* of the Community budget should be guided by the ability-to-pay principle. The best measure of the ability to pay is to calculate the (nominal) GNP in ECUs at the current exchange rates. The present procedure is otherwise: in addition to contributions based on the GNP key, VAT resources and the traditional own resources (customs duties and agricultural and sugar levies) are part of the Union's revenues.

On the revenue side of the budget, there is much to be said for converting entirely to GNP resources (possibly with a certain degree of progressiveness) while doing away with the VAT resource and the British rebate. An alternative to eliminating the United Kingdom's rebate mechanism would be to embed this scheme in a general system setting net limits on the national contributions. This would ensure that the revenue side of the Community budget does not give rise to feelings of inequitable treatment and to rebate mechanisms. The problem however, is that no new Own Resources decision is required as long as the own resources ceiling of 1.27% of the Union's GNP is not exceeded.

During the next period, then, it will be mainly the expenditure side which offers the best opening for improving the net financial position. The SER recommends to insist on greater efficiency, a sharper cost-benefit analysis of spending programs, the introduction of forms of financial renationalisation, and forceful measures against fraud. This will help to achieve a lower spending level.

3. The expenditure side of the Community budget

The European Commission proposes to allow spending to rise over the next period from ECU 81.6 billion in 1997 to ECU 111.4 billion in 2006 (in 1997 prices). That is 1.22 percent of the Union's GNP, keeping expenditure below the own resources ceiling (1.27 percent of the Union's GNP). Spending on agriculture and on structural operations (the Structural Funds and Cohesion Fund) are and will remain the Union's biggest expenses. Spending on agriculture will increase by well over ten percent from ECU 40.5 billion in 1997 to ECU 45.6 billion in 2006, while spending on structural operations will rise from ECU 26.6 to ECU 42.8 billion, an increase of approximately two-thirds.

Structural expenditure

With an eye on the absorption capacity, the European Commission proposes that total transfers from the Structural Funds and Cohesion Fund should not exceed a ceiling of 4 percent of the recipient Member State's GDP. It also proposes pegging the total financing for structural operations, including those for the new Member States, at the 1999 level of 0.46 percent of the Union's GNP. This would provide a total of ECU 275 billion for the 2000-2006 period (at 1997 prices).

The European Commission wishes to streamline and concentrate the Structural Funds by reducing the number of objectives from seven to three and by restricting the Community Initiatives to three fields. The Commission also proposes taking steps to spend the financial resources more efficiently.

The SER agrees with the financial limitations and the Commission's Structural Funds proposals. In order to ensure full integration of the candidate Member States, however, the SER would prefer the European Union to set sharper priorities for the structural aid by limiting the regional objectives to the problem regions in the less prosperous Member States alone, and not, as the Commission proposes, to the problem regions in all Member States.

The Financial Perspectives give the impression that the annual ECU 2.9 billion from the Cohesion Fund is reserved exclusively for the current Member States. Given the focus of this Fund and the high level of aid (80-85 percent), the SER believes that the Cohesion Fund would be an excellent channel for assisting candidate Member States both prior to and after accession. There is not a single reasonable argument in favour of excluding the candidate Member States. They will satisfy the Cohesion Fund eligibility criterion by a wide margin (i.e. that the per capita national income is less than 90 percent of the Union average).

One item missing in Agenda 2000 is a proposal on the size of the Union's contribution percentages for the Structural Funds. The SER recommends lowering these percentages for the current Member States to a maximum of 50 percent for the less prosperous Member States and 25 percent for the more prosperous ones.

Agricultural expenditure

With respect to the CAP, the European Commission proposes deepening and extending the 1992 reform through further shifts from price support to direct income payments and by developing a coherent rural policy. The Commission would like to lower the institutional prices for cereal, beef and milk. It also proposes introducing individual ceilings on all direct income payments and allowing the Member States to differentiate payments according to commonly agreed rules, while excluding renationalisation.

The SER has already argued in favour of progressive reform of the CAP by gradually lowering the structural price support mechanisms and by using (mainly) compensatory direct income payments for a number of years[2]. The European Commission's proposals follow this line of action and should therefore, in the SER's opinion, essentially be supported. Regarding the individual ceiling on all direct income payments, the SER's views are grounded in the idea that the size of the direct income payment – combined with income from sales – should provide

[2] See the SER's advisory report *Reform of the Common Agricultural Policy*, publication no. 96/09E.

suitable compensation for the production factors (labour, land and capital) on farms engaged in efficient, sustainable and safe production.

The SER does not back the European Commission's proposals for a coherent rural policy. Rural policy essentially comes down to regional and general socio-economic policy and is better left to the Member States themselves. It is going too far to burden agricultural policy with such objectives as maintaining a living countryside.

The SER also disagrees with the Commission's idea of pursuing *cross compliance* with respect to nature and environmental management, with the Member States making the direct payments conditional on compliance with environmental provisions. The SER opposes this strategy because it turns the nature management function of agriculture into a derivative of the economic function, and because this approach can only reward extensification of production. The SER advises making (agricultural) nature and landscape management into a separate pillar of the CAP, and recommends developing a specific set of instruments for nature management.

The European Commission has done well to be cautious about financial renationalisation, as it is the unity of the internal market which is at stake. However, an in-depth analysis may throw light on the possibility of partial financial renationalisation of policy. The determining factors for financial renationalisation should be the possibility of achieving efficiency gains, increasing the effectiveness of policy and making the system less susceptible to fraud. Financial renationalisation makes it possible to tailor the amount of income support to local circumstances and views on what a reasonable income is. Financial renationalisation can also facilitate the accession of the candidate Member States to the CAP. The SER advises enforcing strict requirements in this regard: the unity of the internal agricultural market must not be undermined and unfair competition must be effectively ruled out.

Finally, the SER feels it is time to reconsider the agricultural guideline during the coming period and to tailor it to the degree to which financial renationalisation takes place vis-à-vis rural policy and nature management, as well as the degree to which price support has been and will be replaced by nominal constant or decreasing income compensation.

External expenditure

Regarding external policy, the European Commission warns that devoting large amounts of money and effort over an extended period of time to the environmental problems of new members could have an inward-looking effect on Community policies, leaving the Member States with fewer resources and energy to shoulder the wider burden of promoting sustainable development on a global scale. The further along the process of integration is, the more the Union will be expected to make a recognizable contribution to tackling global issues. If it is to finance such operations, the Union will have to look beyond the financial items which now fall under external policy matters.

Distribution of resources between the present and future Member States

The European Commission believes that support from the Structural Funds should “in theory” apply to all the countries that join the Union. A sum of ECU 45 billion has been earmarked for the candidate Member States for the 2000-2006 period. During this period, there will be a gradual reduction in the amount of aid received by the present Member States from the Structural Funds, with the support going instead to the new Member States. Nevertheless, in the Commission's proposals, far and away the largest share of the total sum, i.e. ECU 275 billion, made available during this period will go the present Member States: ECU 210 billion from the Structural Funds and a further ECU 20 billion from the Cohesion Fund. As stated, the SER has been struck by the fact that no provision has been made in Agenda 2000 for transfers to the new Member States from the Cohesion Fund.

The question is whether the European Commission's proposed distribution of resources between the present and future Member States makes sufficient provision for the fact that the new Member States will require major structural support and that it is important to speed up their integration into the internal market and reduce the transitional periods. The candidate Member States undeniably need much more support than do the present 15 Member States, but because their per capita national income is lower, they will reach the limits of their absorption capacity sooner. Assuming an absorption capacity of 4 percent of national income, it can be estimated that maximum transfers to the five new Member States will reach well over ECU 20 billion by the year 2006. In the SER's view, it may be reasonable to wait a few years after the anticipated accession date before posting this ceiling to the multi-annual budget.

Regarding agricultural expenditure, the question is to what extent the European Commission's proposals will lead to timely convergence between the agricultural regimes in the present Union and those in the candidate Member States. It is true that there are better ways to help the new Member States build up their agricultural production and processing structure than by furnishing direct income payments to primary producers. There is also no reason to give farmers in the candidate Member States compensatory income support: after all, their sale prices will not fall, and may even rise after accession.
At first, then, it will be entirely justified to distinguish between the farmers in the present Member States and those in the new Member States. That distinction can only be maintained for a few years, however, and will certainly have to be eliminated once a single agricultural market becomes reality and border checks have ceased (from about 2008-2010); it will be virtually impossible then to treat farmers who cultivate the same products and who are subject to the same market intervention rules differently by paying only those in the old fifteen Member States income support.
That does not, incidentally, alter the fact that initially, the new Member States should preferably use the agricultural aid to reinforce the agricultural structure. However, the SER questions whether the ECU 2.1 billion that the European Commission has reserved for specific accompanying rural measures will be sufficient to support the kind of restructuring which is needed to ensure proper integration of the

agricultural markets. The SER recommends setting aside more resources to support restructuring and modernisation.

The distribution of resources from the Community budget for the 2000-2006 period reflects a certain shift in precedence away from the present Member States and towards the new ones. The SER is, however, left with the impression that too much emphasis is still being placed on what are considered 'acquired privileges'. In the SER's opinion, finding an efficient and effective response to future challenges, including the enlargement of the Union, will require an even greater shift. The Union could make much more of an effort to clear the path to accession, within the limits of the candidate Member States' absorption capacity. The SER hence advocates a more consistent shift in priorities within the Structural Funds and Cohesion Fund, by:

- focusing the Structural Funds exclusively on the less prosperous Member States;
- not allowing Member States which no longer receive transfers a period of 'withdrawal';
- applying the 4% absorption capacity limit to all Member States;
- reducing the Union contribution percentages, and;
- allowing the new Member States access to the Cohesion Fund.

In other words, the SER proposes allocating fewer resources to the current Member States from the Structural Funds and Cohesion Fund than does the European Commission. This is illustrated in the following table which implies transferring an extra sum of ECU 8 billion from the current Member States to the candidate Member States.

Distribution of resources earmarked for structural reinforcement between the current and future Member States (in billion ECU, 1997 prices)

	EC in 2000	EC in 2006	SER in 2006
Union of the 15:			
Structural Funds	31.3	27.3	21
Cohesion Fund	2.9	2.9	1½
New Member States:	.	11.6	15
Structural	.	.	1½

Funds Cohesion Fund Agriculture*	.	2.1	3½
Pre-accession: Structural Funds Other categories	1 2	1 2	4 2
Total: Structural Funds Cohesion Fund Other categories	*37.2* 32.3 2.9 2	*46.9* 39.9 2.9 4.1	*48½* 40 3 5½

* Expenditure on accompanying agricultural measures which are budgeted under the agricultural guideline.