Good Bye, Agenda 2000
Hello, Agenda 2003

Effects of the Berlin Summit on Own Resources, Expenditures and EU Net Balances

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Abstract

This paper describes the development of the negotiations from the birth of the Agenda 2000 proposals to the end of the Berlin European Council Summit and discusses the consequences of the outcome. The study shows to what extent net contributions to the EU budget and narrow national interests dominated the negotiations, at the expense of the original aims of the reforms (to prepare the Union for enlargement and for the next round of WTO negotiations), which were practically forgotten. This type of behaviour is by no means unique. On the contrary, it has been recurrent in the history of the EU. Estimates of future expenditures and own resources show that the Berlin European Council conclusions will prove to be far from satisfactory.

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1. Introduction

The Berlin Summit concluded with the suspicious outcome where every Head of State declared victory. The tone of the German Presidency was not so victorious declaring that Germany did not "win the lottery". There is reason for suspicion if, after long and arduous discussions to reform policies and reduce EU expenditure, member states declare their satisfaction on the result. Something must be amiss, if painful reforms appear not to hurt. In fact, after preliminary calculations and some political considerations, there are grounds to suspect that the reforms proposed are less than satisfactory.

This paper describes the development of the negotiations from the birth of the Agenda 2000 proposals to the end of the Berlin Summit and discusses the consequences of the outcome. The study shows to what extent net contributions to the EU budget and narrow national interests dominated the negotiations, at the expense of the original aims of the reforms (to prepare the Union for enlargement and for the next round of WTO negotiations), which were practically forgotten. This type of behaviour is by no means unique. On the contrary, it has been recurrent in the history of the EU. A comprehensive study on the development of the EU finances can be found in Laffan (1997). In fact, Laffan correctly predicted a confrontation over net balances for the negotiation of the financial framework 2000 to 2006.

2. The Birth of the Agenda 2000 proposals

The European Council Meeting in Madrid, December 1995, requested the European Commission to prepare an outlook for the development of the European Union. In July 1997 the European Commission presented the *Agenda 2000* (Commission, 1997a) in response. This document outlined a strategy to tackle the problems of the future, particularly the enlargement of the Union. It also included an assessment of the readiness to accede to the EU of the ten applicant countries from Central and Eastern Europe. This document was followed by detailed reform proposals for the Common Agricultural Policy (CAP) (Commission, 1998a), the Structural (Commission, 1998b) and Cohesion Funds (Commission 1998c, 1998d), the Instrument for Structural Policies for Pre-Accession (ISPA) (Commission, 1998e, 1998f) and a financial perspective for the Union with and without enlargement (Commission, 1998g).

The proposals of the Commission were wide-ranging and aimed, at least officially, at helping the Union to prepare for enlargement and to improve its negotiating position in the WTO talks. The most important proposals for agriculture and Structural and Cohesion Funds can be summarised as follows:

2.1 Agriculture

The proposals continued the reforms initiated in 1992 with the MacSharry reforms. The new proposals sought substantial cuts in the institutional prices for cereals, arable crops, beef and milk, compensated partially by direct payments to farmers. A "horizontal" regulation introduced cross-compliance with environmental conditions, modulation and an element of degressivity in the direct payments to farmers. It also revised points on the financing of agriculture and presented a system of support for rural development.

2.2 Structural Funds and Cohesion Funds

The size of the funds was increasing in real terms, following the rule agreed for the period 1994-99 that these should amount to 0.46 per cent of the EU's GNP. The regulations proposed to increase the concentration of the funds to smaller areas of the EU and to restrict the allocation to fewer objectives and initiative. Even excluding the amounts set for the acceding member states, the EU15 would spend 32 billion Euro more during the programming period. This was to ensure that more funds were available for better-targeted projects.

2.3 The financial framework

The financial framework for the EU15 (Commission, 1998h) presented an important real rise in the expenditures of the budget primarily caused mostly by the proposals to reform the CAP. This expenditure, combined with the expected and to some extent unpredictable extra costs of enlargement, worried the net contributors considerably. The financial framework was not breaching the ceiling of the EU budget at 1.27 per cent of GNP (although the reliability and accurateness of the Commission numbers have been often questioned), but it would have worsened the balances of the net contributors (or so the interested parties claimed). An estimate of the net balances in 2006 is compared with the year 1997[1] in Figure 1.[2]

Interestingly, the balances of Austria and Sweden do not deteriorate according to our estimates. On the contrary, they even improve slightly. This is due to the changes in the distribution of the CAP and the Structural Funds, as well as the fact that TOR[3] and VAT contributions were falling from 1997 to 1999. The estimates for 2006 use the 1999 TOR and VAT. The fall has affected the distribution of the contributions.

Given the margin of error in calculating the Structural Fund allocations and the expenditures for the CAP, the net balance estimates have to be taken with care. The 1997 budget itself is affected by the differences between appropriations and actual expenditures and the corrections to the UK rebate, which occurs with a two-year time lag.

From the beginning of the negotiations, four net contributors (Austria, Germany, the Netherlands and Sweden) began discussing their budgetary burden, which they regarded as 'excessive'. This movement culminated in a proposal by the Austrian Presidency to reform the own resources system in view to correct the 'excessive' net balances. The proposal was based on the Fontainebleau European Council of 1984, according to which 'any Member State sustaining a budgetary burden which is excessive in relation to its

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[1] 1997 is the most recent year with comprehensive data on the breakdown of expenditures.

[2] Technical details and assumptions used throughout the text can be found in Annex F. When comparing the budgetary balances, the special circumstances of the year 1997 have to be taken into account. The expenditures were considerably higher than the contributions due to the rollover from funds of the previous year. Furthermore, the UK's net contribution is small, because of the combination of a particularly high rebate combined with receipts of funds due to other factors such as the BSE crisis. Refunds for the definitive calculations of past rebates and exchange rate fluctuations caused the high rebate. All the details are explained in Commission (1998h).

[3] Traditional Own Resources: customs duties and agricultural levies

relative prosperity may benefit from a correction at the appropriate time' (European Council, 1984).

The Austrian Presidency offered as an option to introduce a generalised correction mechanism, which would work in a similar manner as the UK rebate. This proposal was strongly contested by Spain. It threatened to veto the final EU summit of the Austrian Presidency in Vienna unless the issue was withdrawn from the table. Fearing an inconclusive presidency, the Austrian government opted for the latter, probably in the knowledge that the German Presidency would take up the subject again.

3. The German Presidency

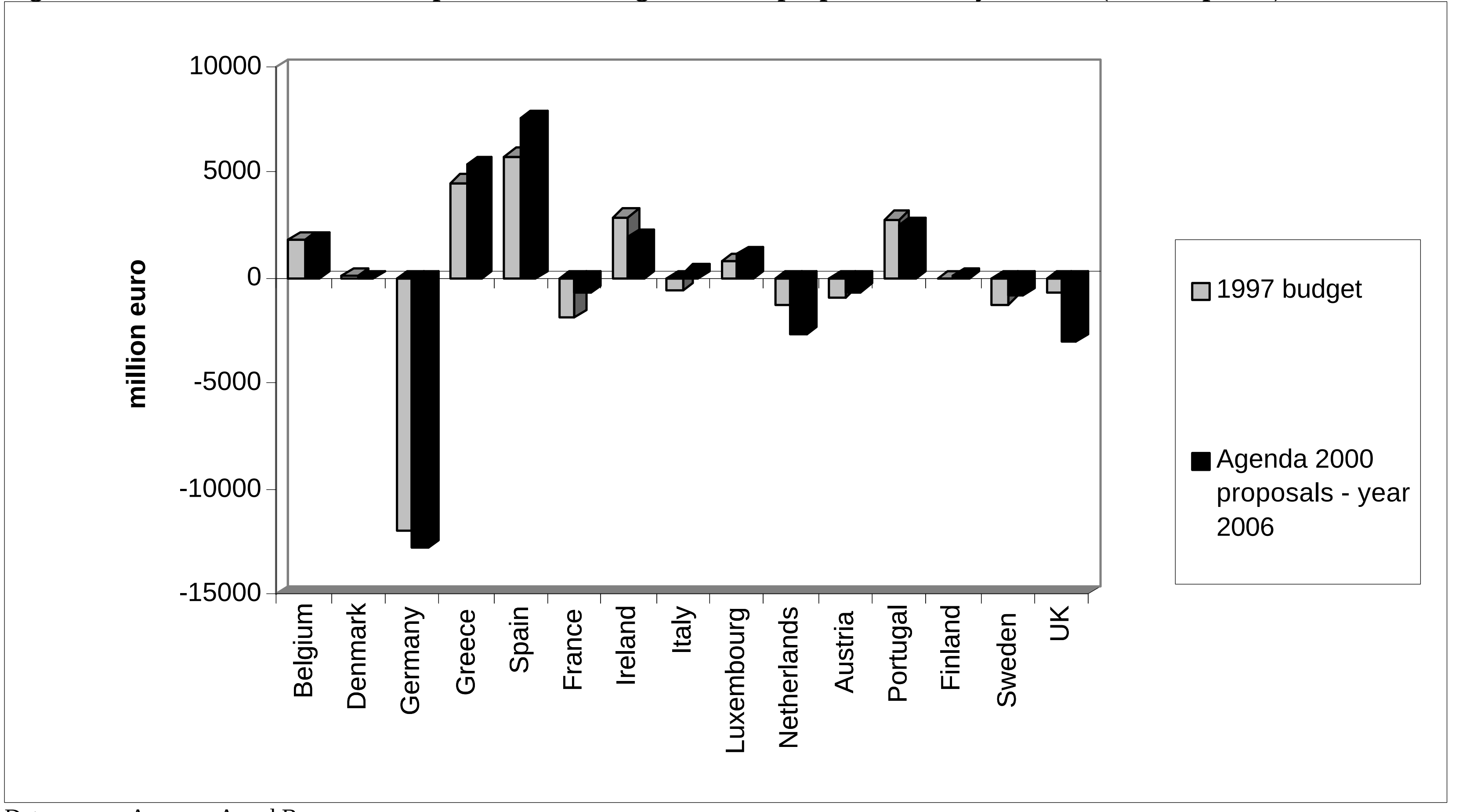
The Spanish reaction at the Vienna Summit did not deter Germany from presenting similar proposals for a budgetary rebate together with a number of other measures to reduce the EU budget burden. The measures discussed by the Presidency can be summarised as follows:

1. Change the budget own resources system by scrapping the VAT resource and only keep the TOR and GNP resources.
2. Introduce a correction mechanism for "excessive net contributions" for member states.
3. Renegotiate budget rebate of the UK.
4. Co-financing[4] of the direct payments to farmers.
5. Phase out Cohesion Funds for the member states, which have entered the single currency.
6. Reduce or limit the Structural Funds expenditures.
7. Introduce a ceiling to agricultural spending limiting spending to an annual average equal to the expenditure for 1999 (40.5 billion euro) for the period 2000 to 2006.

The mechanism to cut the net contributions to the Budget would follow a system similar to the one presented by Commission (1998h). Member states, which exceeded in their net contribution to the EU budget 0.3 per cent or 0.4 per cent of GNP, would be eligible for a rebate of 66 per cent of the sum over this level. This follows the rationale of the system for the UK rebate, with the exception that the UK's threshold is 0 per cent, which makes it valid for the whole net contribution.

[4] Term used for the mechanism in which member states partially finance the direct payments to farmers.

Figure 1. Net balances in 1997 compared with the Agenda 2000 proposals in the year 2006 (at 1999 prices)

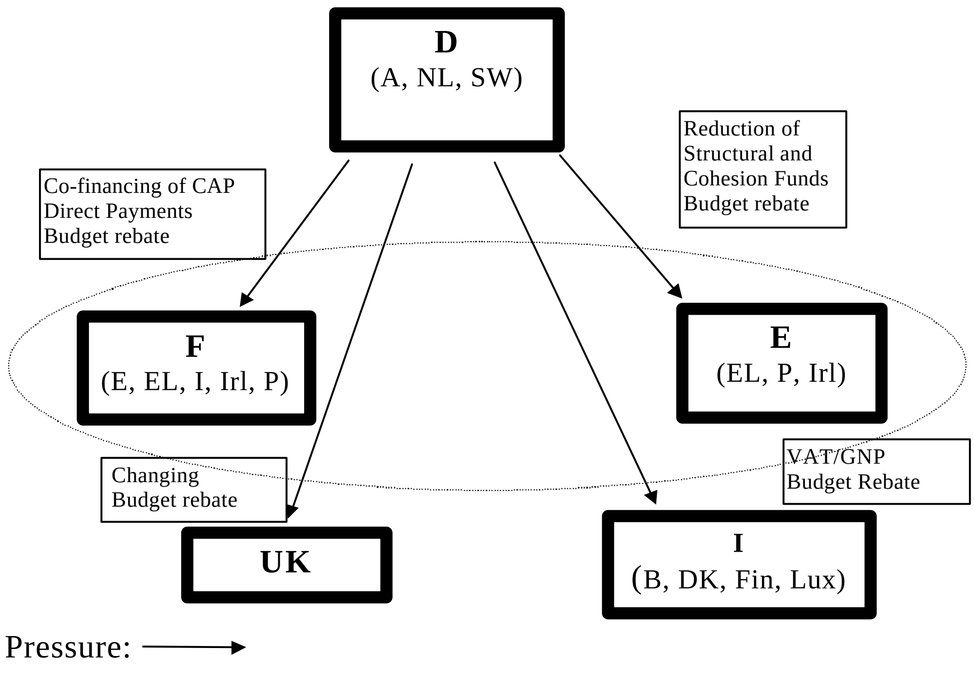


Data source: Annexes A and B

The German Presidency began the negotiating process with the principal aim of limiting EU expenditures and reducing the burden to the net contributors (i.e. including itself). In so doing the package of reforms demanded sacrifices of different kinds to the member states. The idea was to have all member states giving up benefits from the budget which can be contested as being too generous or unbalanced. These included the benefits from the Common Agricultural Policy for France, of which it is the main beneficiary. For the UK it required reducing the size of its budgetary rebate. The Cohesion countries had to give up some of the transfers to their economies in the form of Structural or Cohesion Funds. The presidency even mentioned abolishing the cohesion funds for those countries which became members of the Euro-zone. Finally, Italy was asked to accept a switch in the own resources mechanism of the EU budget from the VAT key to GNP, until now Italy was benefiting from VAT system. The measures would also have affected negatively other member states by a combination of the above measures.

It was possible to identify at that point a division in the Council in the form of five more or less stable coalitions led by Germany, France, Spain, Italy and the UK (see Figure 2). The loosest of all is the Italian coalition, which is more a group of countries affected negatively by the proposed changes in the own resources decision, rather than from changes in the CAP or Structural Funds. Italy was the most affected country of this group and most vociferous in a number of issues, therefore it is given the leading position.

Figure 2. Negotiating Positions: The German Proposals



Figures 3 demonstrates to what extent Germany could have benefited from the changes and the incidence on other member states. It describes the significance of each proposal for the net balances of the leaders of the groups (and the Netherlands) once these are implemented in full (i.e. year 2006).

The calculations of net balances of the German proposals assume the following:

- After the price reforms for the CAP, the level of co-financing in agriculture brings EAGGF expenditure down to 40.5 billion for the year 2006.
- Cohesion Funds are eliminated for Ireland, Spain and Portugal.
- Structural Funds are not cut but some areas lose their Objective 1 status.[5]
- The VAT resource is abolished and only TOR and GNP finance the budget. TOR is maintained at 1999 levels, as its future size is unknown.
- A constrained generalised correction mechanism is introduced, which reimburses 66 per cent of net contributions exceeding 0.3 per cent of national GNP. Members getting the rebate are, however, not exempt from participating in the reimbursement of rebates by other members, i.e. Germany has to contribute to the rebate of the Netherlands and vice versa. For technical details see Commission (1998h).
- The UK correction mechanism remains untouched. It was quite clear from the beginning of the process that not much was to be expected as a concession from the UK.

4. The First Round: Agriculture

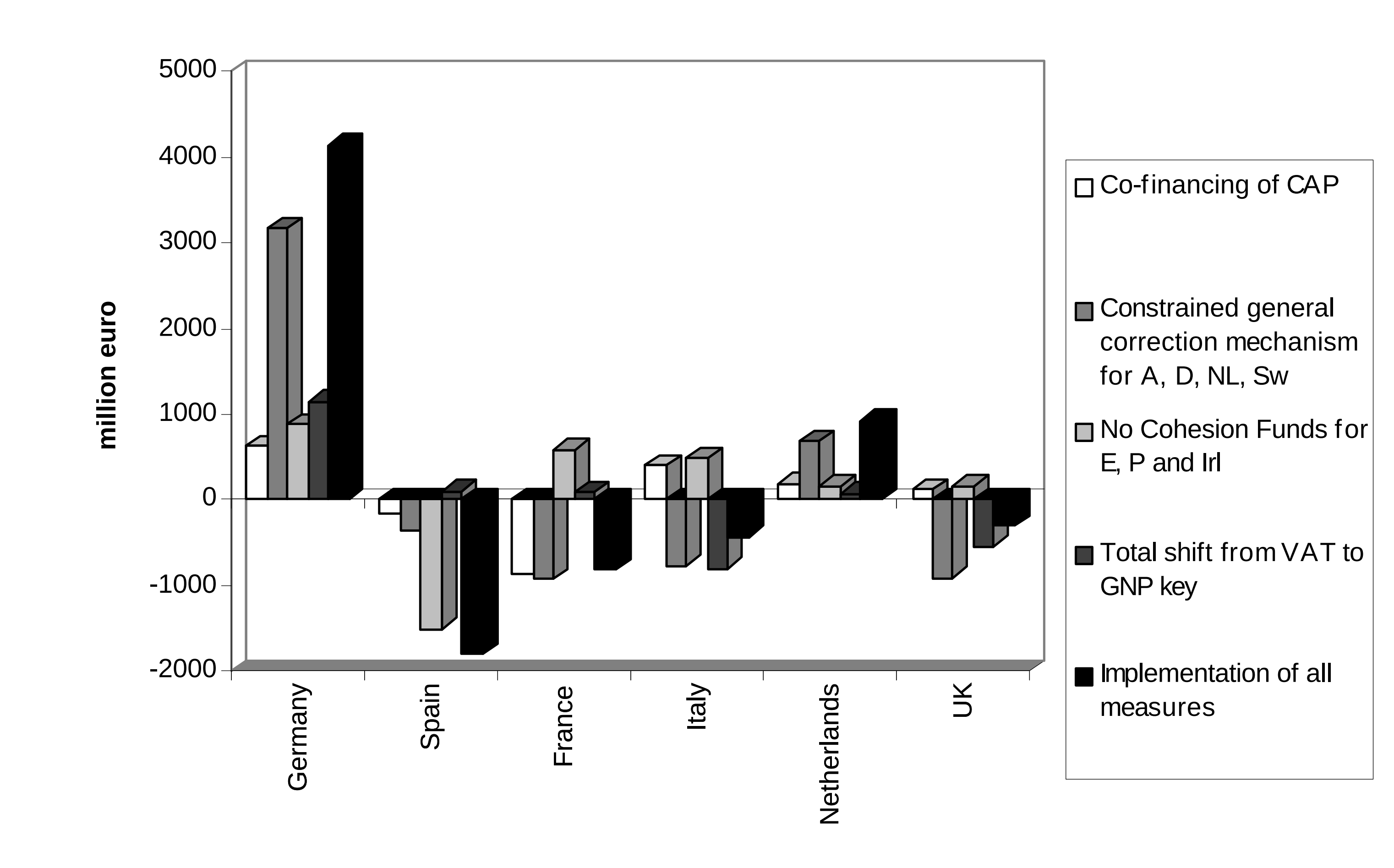
By putting the reform package of the CAP as the first item to be solved, the German presidency probably expected to have more influence on the outcome. The need for a positive conclusion of the Agenda 2000 should have pressurised the member states to accept a solution favoured by the Presidency. If this expectation were to be true, it backfired. The French took the opposite view. If the successful conclusions of the overall Agenda 2000 are of paramount importance for the EU and in particular for Germany, then France can just force through its own interests by simply not co-operating.

Figure 4 shows the coalitions during the initial stages of the negotiations. More formal coalitions are presented in the black boxes, agreements on particular issues across coalitions are connected by arrows. It is worth mentioning that the coalitions on agricultural policy differ of the alliances on an overall package. This is clear when comparing figures 4 and 5. This can have positive or negative effects during negotiations for a reform of the CAP. Positive, because the CAP comes under pressure from other interest groups, or negative, because agricultural reforms can lose importance inside a broader package.

It was immediately observable that the predominant view was against agricultural reforms. These were not considered urgent. The only countries calling for a radical reform were the UK, Sweden and Italy, forming the so-called 'London Group'. However, there was no clear common position. Italy's commitment to reform was particularly unstable due to its interest on a milk settlement. This and other similar weaknesses soon eroded the coalition. Other hidden agendas on the overall situation of the net contributions soon affected the UK’s and Sweden's resolve for a reform.

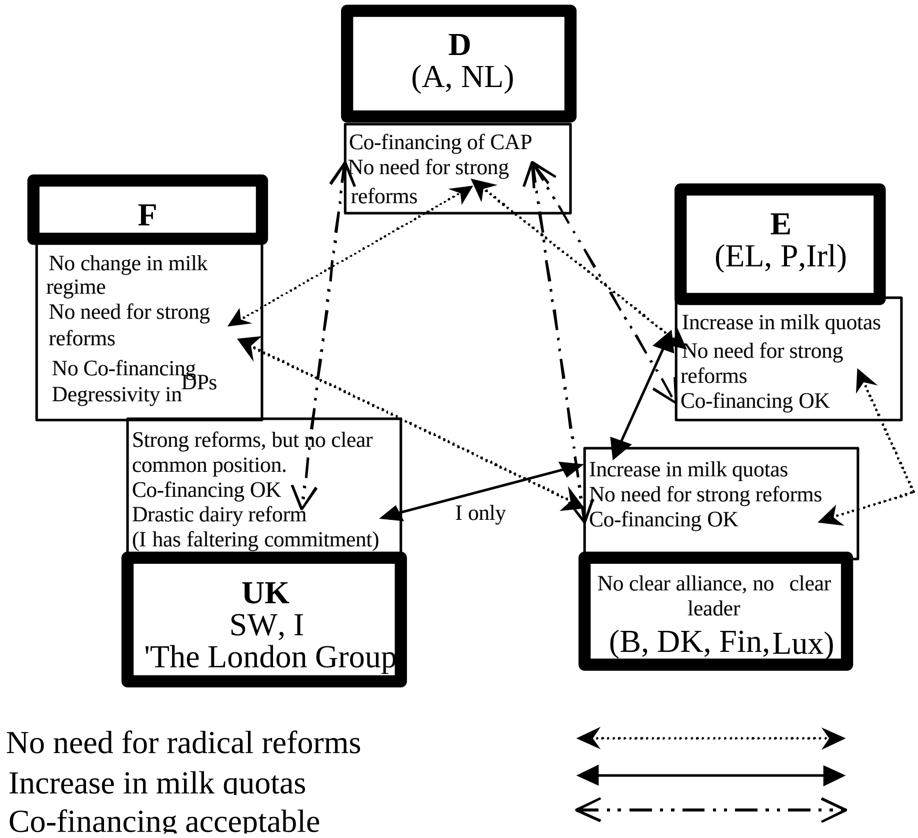
[5] See Annex F for the methodology used in the estimations.

Figure 3. Possible effects of German proposals on net balances for selected countries



Data: Annex A. Own estimation.
Technical details - Annex F

Figure 4. Initial Coalitions for CAP reform negotiations



Serious negotiations began with the reform proposals for the agricultural sector. From the beginning, an impasse was formed by France and Germany. France could not accept co-financing of the direct payments for the CAP, which to an extent was accepted by most other member states. This measure was unpalatable for the farmers in France, who claimed that this would be a move towards discrimination in the future among producers of different member states. Furthermore, France would have to spend more of its own state funds to finance the direct payments for its large agricultural sector.

Farmers (and in particular the vociferous French farmers) were probably also worried that this move would speed up the process of reform, reducing the size of the direct payments. Common policies are generally believed to be more resistant to change. There is a large amount of literature which supports the idea that the Council of the EU has the tendency to keep common policies untouched, which at national level would not survive (a good review of the effects on decision making in the Council of Ministers can be found in Hayes-Renshaw and Wallace, 1997).[6]

However, France accepted to a degree that the expenditures for agriculture were increasing too much with the reform proposals by the Commission. It therefore proposed

[6] Other recommended readings: Scharpf (1988) discusses in more detail how the Council of Agricultural Ministers fosters the *status-quo* for the CAP. Ten years later the situation has not changed much. Webber (1998, 1999) describes the relationship between France and Germany and the influence of this in negotiating the CAP and other issues.

to reduce the size of the price cuts for cereals and beef, to abandon the milk reforms and to introduce a gradual fall of the direct payments by a certain percentage every year for larger farms, the so called "degressive payments".

Germany could not accept the gradual reductions in direct payments. It was here that the German intentions became obvious. It was proposing co-financing instead. This system would replace partially the direct payments to farmers from the budget with direct handouts from the national budget. This measure was able to kill two problems at once. One would have been to reduce the politically controversial transfers to the European budget, which would have then been replaced with less transparent national transfers. The second would have been a reduction in the transfers through the CAP of funds from the net contributors to the net beneficiaries of the direct payments policy. Co-financing was important for Germany because it guaranteed the farmers from East Germany, who are under an extreme financial strain, the full amount of direct payments. Germany demonstrated little interest in radical reforms and was indirectly trying to use the Presidency as a tool to generate a reform, which would serve well its national interests. It also regarded quite favourably calls by various members to reduce the size of reforms. Soon Germany offered then a highly diluted proposal after bilateral negotiations with France, which demonstrates that it did not regard substantial agricultural reforms as necessary.

This was generally considered a exaggeratedly weak proposal, and was also strongly contested by the 'London group'. The negotiations stalled again. At this stage, the German Presidency made a final move and proposed a package, which was similar to the original Commission proposals. However, it reduced overall expenditure for the period until 2006 by delaying the introduction of the milk reforms and introducing transition periods for the remaining reforms. Interestingly, yearly expenditure at the end of the period from 2006 onwards would have reached practically identical levels to the Commission estimates for the original Agenda 2000 package. It is worth noting the deletion of Article 6 of the horizontal measures, which stipulates a degressive element for payments over a certain amount. This article was affecting negatively East German farmers. In the end, the option to reduce direct payments by a certain percentage every year was kept open, but not agreed upon. The negotiations on the CAP conclude with a non-voted “agreement”. The Agricultural Council *de facto* left the situation unsolved and open to change in the Berlin Summit, partly because there was no time to further delay the issue. The Presidency's claim that an agreement was reached was clearly not shared by France and some other member states, which hinted that all was open for negotiation in Berlin.

5. The Berlin Summit

The long and arduous bargaining on the agricultural package had delayed any meaningful negotiations on other items for the Berlin Summit. In fact, by reducing agricultural expenditure only cosmetically, it was politically easier for Spain and the UK not to co-operate much on the issues of Structural Fund reforms and the rebate. Both were not ready to accept big changes in their interests now that France and Germany had not given up any significant point on the CAP. Figure 5 describes the initial negotiating positions at the Summit.

Again five positions were observable. The first consisted in the coalition of Germany, Austria, the Netherlands and Sweden. This was the group of member states claiming that their net contributions are excessive. The second group was formed by the Cohesion countries and headed by Spain, defending their benefits trough the Structural and Cohesion Funds. France held the third position and was determined to reopen the agricultural chapter. The UK entrenched itself to defend the UK rebate, and the last group consisted on the member states with less clear preferences. Italy is at a leading position in the picture, because of interests to secure an even higher milk quota for itself.

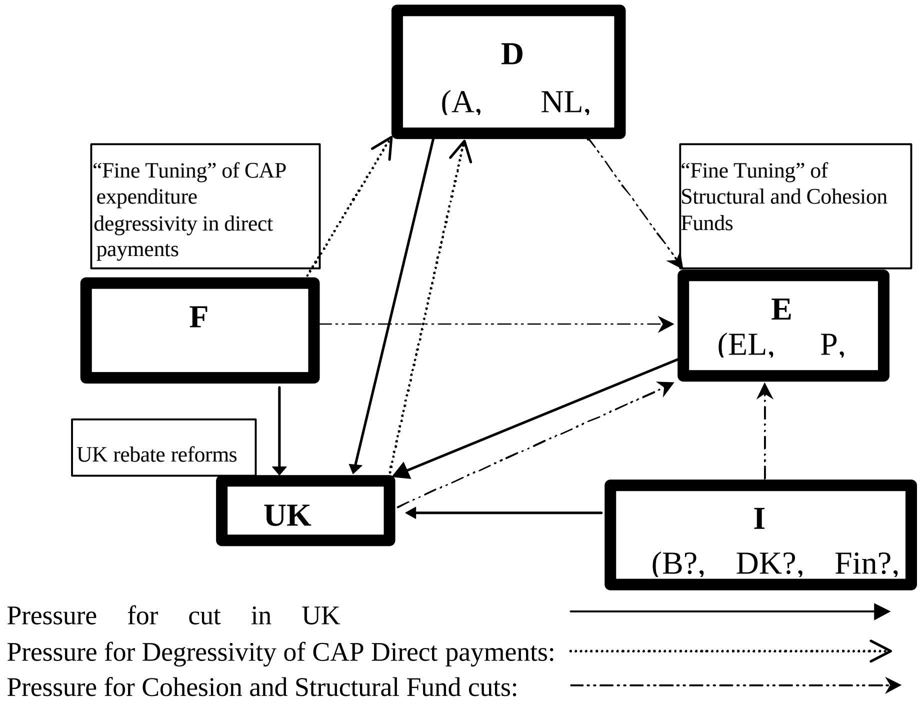
As a consequence of the above constellation, the Summit's agenda looked more like a set of proposed "fine tunings" than an radical change of the Unions' policies. Small changes here and there were possible allowing a conclusion of the negotiations. A fundamental change in the Union's policies was already out of sight.

- <u>Agriculture</u>: "Fine Tuning" consisted in insisting on limits to direct payments, through modulation (ceilings on what farmers can get) or using a system of degressive direct payments.
- <u>Structural Funds</u>: "Fine tuning" consisted in a conservative reduction in Structural and Cohesion Funds (scrapping the Cohesion Funds was out of question). Some compensation for Ireland and Portugal was to be expected to cushion the negative impacts for due to the losses caused planned changes of the Objective 1 criteria of the Structural Funds.
- <u>Financing (Budget rebates):</u> "Fine tuning" here consisted of technical adjustments to the financing of the UK rebate and some compromises on the treatment of future enlargement costs. Those expenditures to the CEECs before accession, which are external to the Union and excluded from the rebate, should not be included in the rebate calculation after enlargement.
  The constrained general correction mechanism for net balances disappeared from the programme.
- <u>Financing (own resources)</u>: The shift from the VAT to GNP key was expected to go through, mainly because until then it had not been contested seriously on any particular occasion.

5.1 Change in the CAP reforms

Agricultural reforms were cut down considerably in the last minute under French insistence. Price cuts for cereals were reduced (and consequently also the size of the direct payments) and the mechanism to cut direct payments yearly was abandoned. Milk reforms were postponed until 2005, while the milk quotas were increased for various member states. This quota increase was particularly important to appease Italy, which was very concerned over the size of its quota allocation. Declarations of historical reforms in agriculture followed, announcing that the new CAP would successfully reduce expenditures in agriculture.

Figure 5. Initial negotiating positions: Berlin Summit



The reduction in expenditures is, however, more fictitious than real. The new 'reformed' CAP is less expensive then in the original Agenda 2000 proposals because of the reduction and postponement of reforms. Ironically, once most of the reform delays are over, the budget expenditures for agriculture in 2006 approximate in our estimates the originally planned levels in the Commission's financial framework. The expense would reach similar levels after 2006, but without the same depth of reform. The problem of the CAP has simply been shifted to the next generation.

The behaviour of the 'London group' is a clear sign of the low priority the CAP reform has in the list of national interests. For Italy, the calls for a fundamental reform of the CAP were mainly a search for a solution to its problems with the dairy quota. As soon as the quota was increased for Italy to an acceptable level, Italy lost any interest of a fundamental reform. It did not even seem very affected by the fact that the actual reform of the milk regime was postponed and that the lack of reform coupled with an increase in the quotas runs counter to the logic of economic efficiency, enlargement or WTO.

As far as the UK is concerned, reforms of the CAP and Structural Funds were not really the major priority in the national agenda. The main worry was to maintain untouched the budget rebate for the EU. Indeed, without the distortions in the economic impact of the CAP the rebate is indefensible. The popular perception of the UK rebate is not related to the distribution of the CAP or the Structural Funds, but to the national sport of fighting the "Continent" initiated by Baroness Thatcher. The inability to bargain with the rebate also reduces the capacity of the UK government to negotiate on reforms on the expenditure side.

Sweden was also interested in finding a domestically 'sellable' outcome to the summit, and a special budget rebate suited the government fine, despite the distortions such rebate systems introduce at EU level. Once such an interesting system was granted, Sweden apparently lost its appetite for reform.

5.2 Reform of the own resources

Own resources were modified to correct ‘excessive’ net contributions (as well as to reduce ‘unfair’ benefits). In order to achieve this, reductions of the VAT call rate to 75 per cent by 2002 and to 50 per cent by 2004 were scheduled. For traditional own resources, the percentage retained as the share of so-called collection costs will be increased from 10 to 25 per cent. The system of financing of the UK rebate by the remaining 14 member states has been altered in an ad-hoc fashion, reducing the contribution towards the rebate for Germany, the Netherlands, Austria and Sweden to 25 per cent of the unadjusted amount. The UK rebate itself has remained practically untouched.

Despite the apparent achievement to limit expenditure, it has to be noted that the reforms in agriculture are less expensive budgetarily because the reforms themselves were substantially diluted. It also seems paradoxical that when the Union is expanding its influence in the international arena (e.g. in the Balkans) the amount scheduled for external action has been revised downwards.

6. The effect of the Berlin Conclusions on own resources

After the unconvincing end of the Berlin Summit, it is the opinion of the authors that the survival of the conclusions until 2006 is not possible. In particular, this is expected to be true at least for decisions on the own resources and the expenditure allocation for enlargement. The analysis that follows will elucidate the reasons for such an opinion. The analysis will show the effects of the reform on the net balances after the full implementation of the reforms, i.e. 2006 (except for milk which will still be in the transition period of implementation). These figures exclude the enlargement costs. The costs of enlargement will be discussed later.

According to estimates the overall expenditure for the EU15 in 2006 will reach 92.8 billion euro (Annex B, Table B.3.2), close to but higher than the estimate presented in the Presidency Conclusions of 90.3 billion euro. This is a saving from the estimate of 102.5 billion euro for 2006 under the original Agenda 2000 Commission proposal (Annex B, Table B.2.2). Our estimates show savings for this year of 9.7 billion euro.

This has been achieved in a number of ways such as reducing planned expenditure on agriculture, structural and cohesion funds as well as internal policies and external action. The net balances for the year 2006 after all the Berlin changes are compared in Figure 6 to the original Commission proposals and the 1997 budget. The estimated changes to the Agenda 2000 in the Berlin Summit can be found in Annex C - Table C.1.
The changes in net budgetary contributions are the effect of two separate reforms, one on the expenditure side and the other on the own resources system. Figure 7 isolates effects of reforms on the own resources system after the changes on the expenditure side.

The effect on net contributions is quite clear, the net contribution reduction by approximately 2.7 billion euro for Germany is affected strongly by the reduction in the overall expenditure. The own resources reform in itself only brings 1,3 billion euro as saving.[7]

We can see some other interesting developments in Figure 7. The shift from the TOR and VAT keys to GNP strongly benefits Germany and the Netherlands. Italy is as expected the main loser from the changes, increasing its net contribution by 865 million euro, 574 from the VAT to GNP change and 291 as contribution to the UK rebate. For the UK the loss amounts to 270 million euro. This is after deducing the UK advantage[8] from the rebate. Without this reduction, the UK would benefit from the changes and reduce its net contribution by 84 million euro. This assumes, however, that the UK will not contribute to the rebate of its own rebate to Austria, Germany, the Netherlands and Sweden. This is not clear in the Berlin Conclusions.

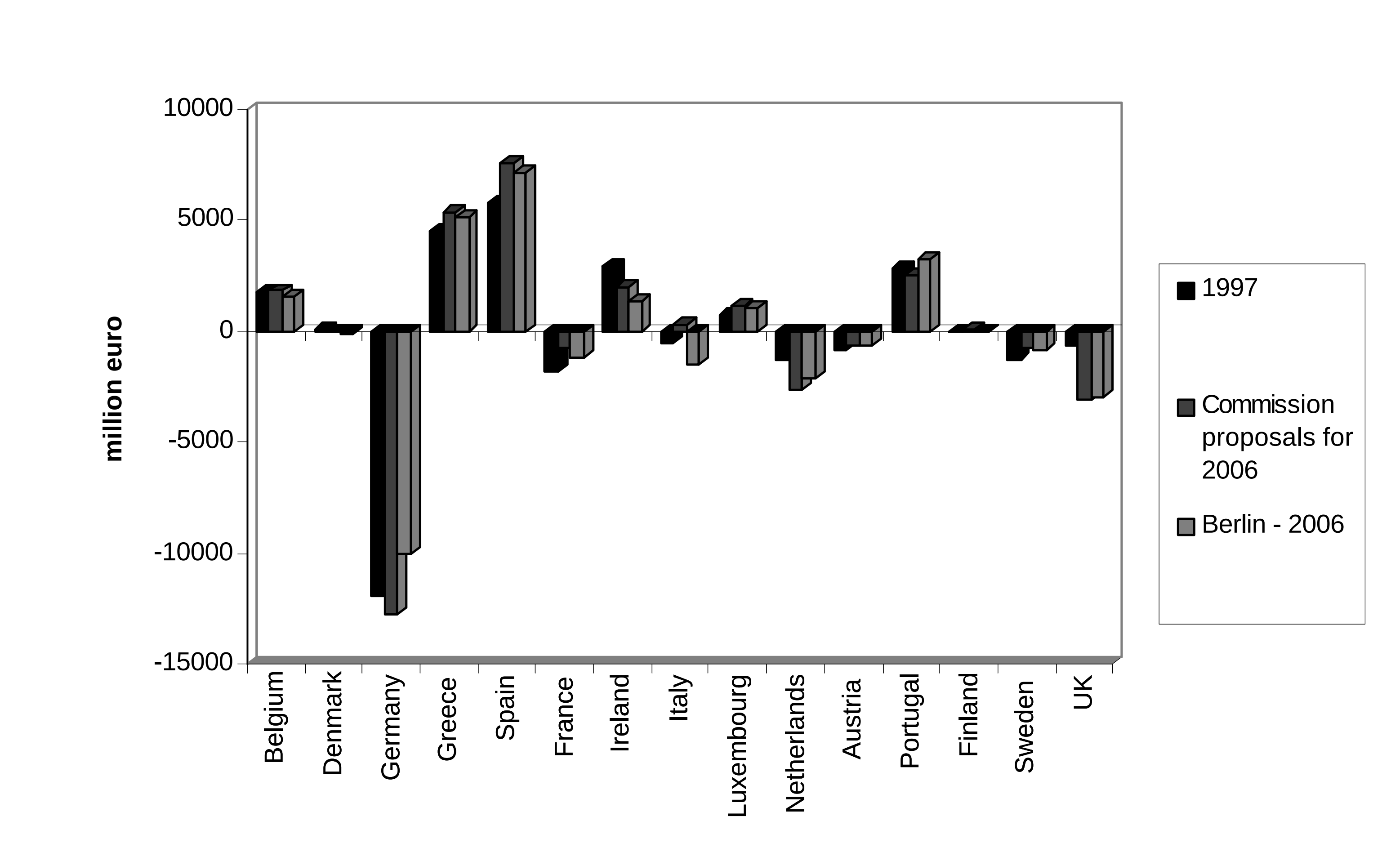
One question that is now interesting to clarify is to what extent the new balances have improved the relationship between the ability to pay and the net contributions. Figures 8a and 8b give an answer. This figures shows the relationship between GNP per capita and net contributions for the years 1997 and 2006.[9]

[7] It has to be noted that the reduction in the contribution to the UK rebate calculated here is not for the previous year 2001 (as specified in the Berlin Conclusions), but for 2002 for mathematical convenience.

[8] This follows the Berlin Conclusions text; "In accordance with the principles reflected in the conclusions of the 1988 Brussels and 1992 Edinburgh European Councils, its amount shall not include windfall gains from changes to the financing system. So technical adjustments in the new Own Resources Decision will, as before, neutralise windfall gains resulting from the progressive reduction of the VAT reserve and now from the increase in the percentage of Traditional Own Resources retained by Member States to cover their collection costs." This has been taken into account for the estimates in 2006. However, as Annex F explains the UK advantage pre 1998 is not properly modelled in, due to its complexity.

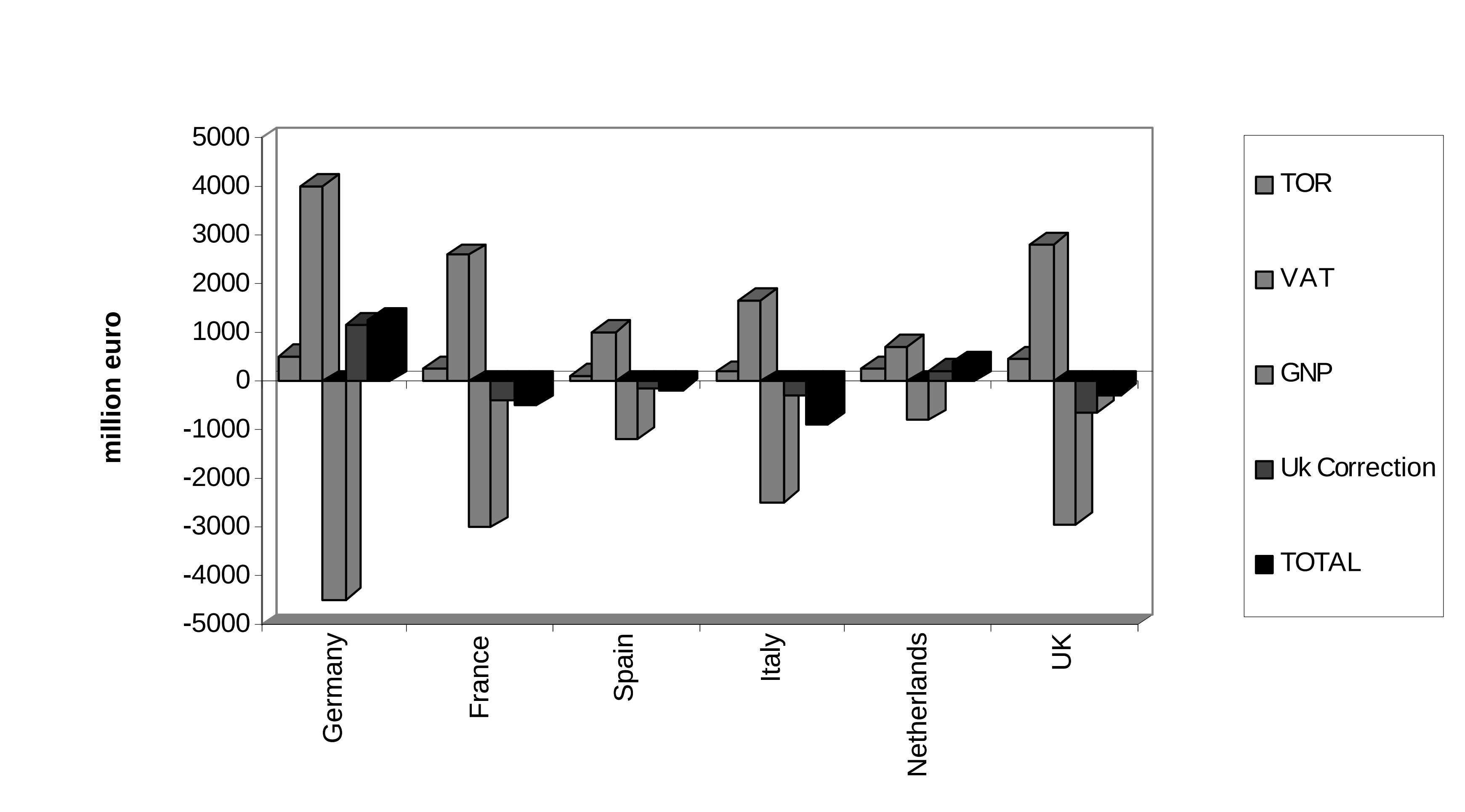
[9] GNP per capita is assumed to grow 2% per year from 1999 to 2006.

Figure 6. Comparing net balances: 1997 vs. the original Agenda 2000 proposals and the Berlin outcome for the year 2006 (at 1999 prices)



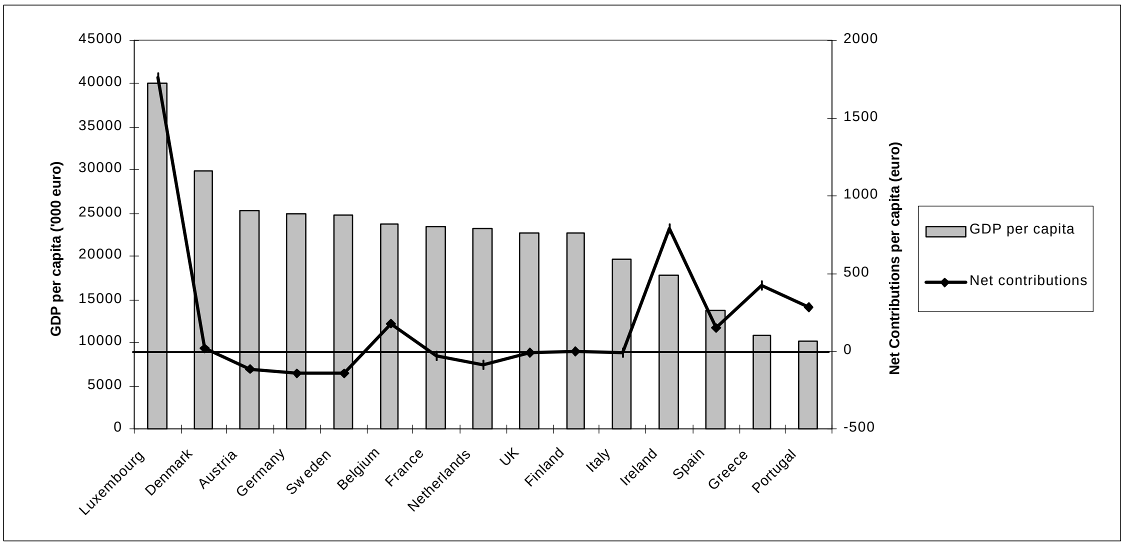
Data Source: Annex B - Table B.1.

Figure 7. Breakdown of effects in changes of the own resources decision



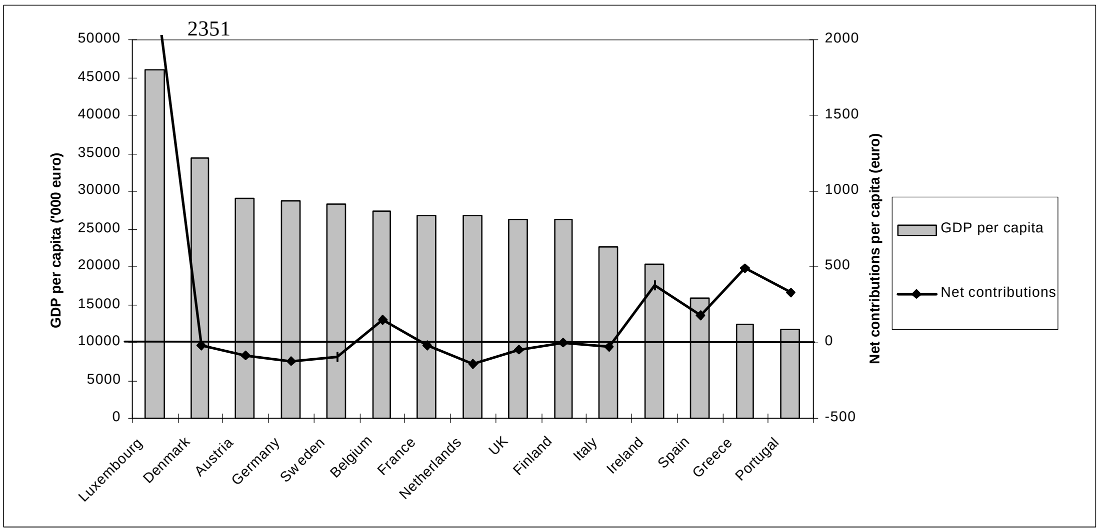
Data: Annex D - Table D.1

Figures 8a. Relationship between net contributions per capita and GNP per capita, 1997



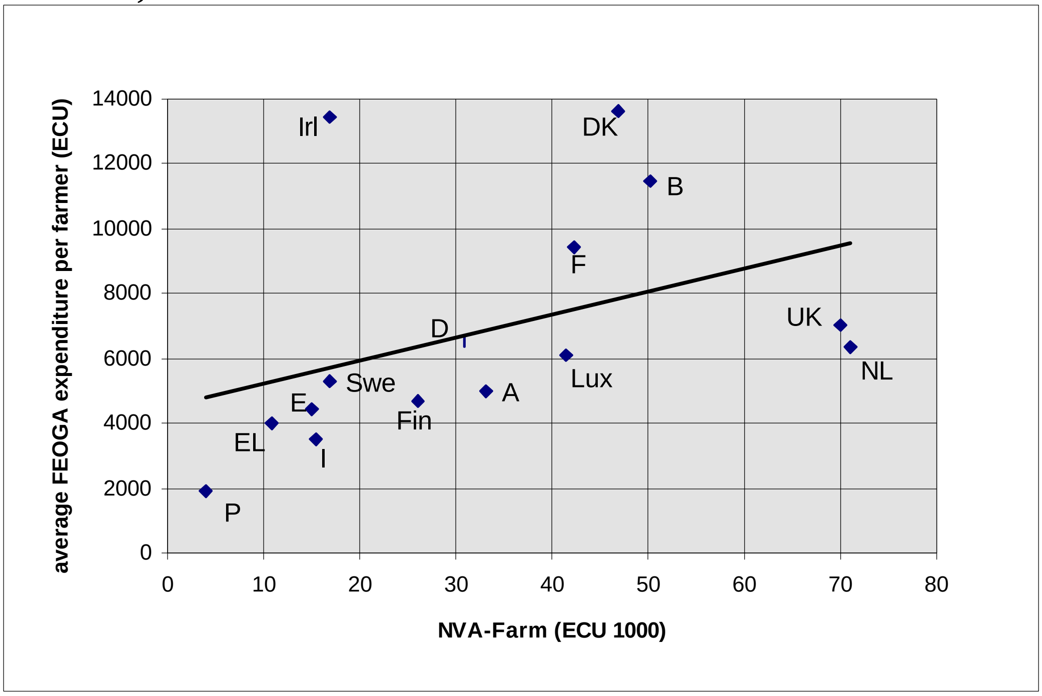
Data: Annex E

Figures 8a. Relationship between net contributions per capita and GNP per capita, 2006



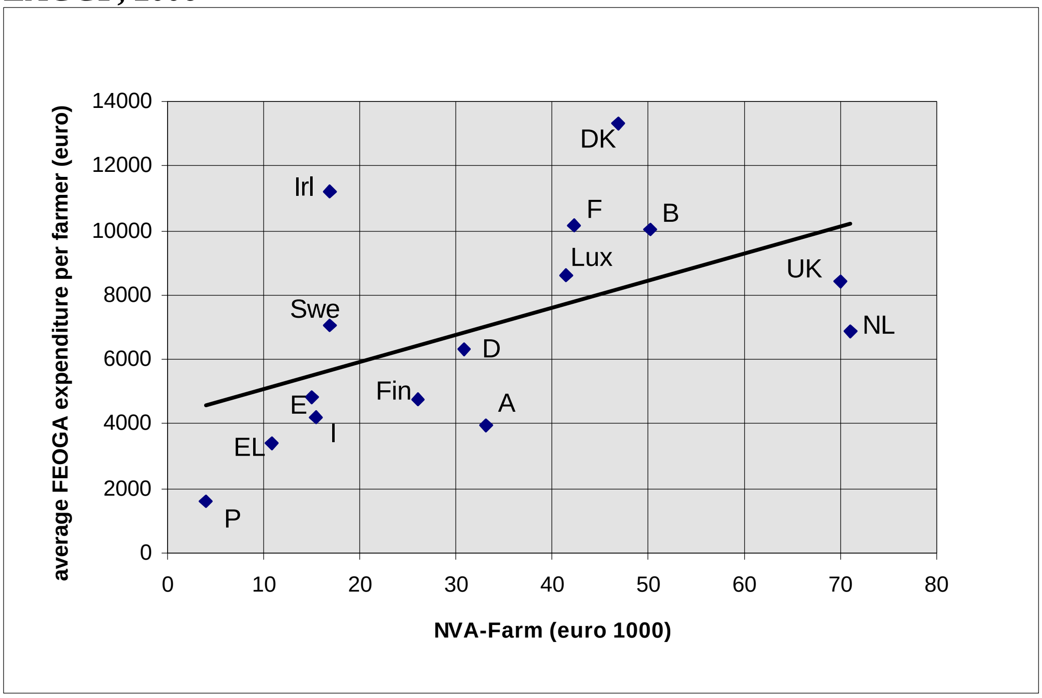
Data: Annex E

Figure 9a. Average Farm Net Value Added compared to per farmer receipts from EAGGF[10], 1996



Data source: Court of Auditors (1997)

Figure 9b. Average Farm Net Value Added compared to per farmer receipts from EAGGF, 2006



Source: Own calculations

[10] European Agricultural Guidance and Guarantee Fund

The ability to pay is assumed to be based on GNP per capita. Not everybody does necessarily consider this as an acceptable method. Commission (1998h) discusses various interpretations. Putting aside differences of purchasing power due to price differences, a proper functioning EU budget following the solidarity and convergence criteria, should show a negative linear relationship between net balances and GNP per head. The relationship is there, but relatively weak. The changes agreed in Berlin do not seem to change much the picture although some improvements have been achieved. The strongest change is due to the Irish position, which actually seems an improvement in fairness.

The outcome is leaving a lot of budgetary distortions, mainly due to the perverse distribution effects of agricultural policies. These are very visible for Belgium, Denmark, France and Ireland[11]. The relationship of income per farmer to CAP receipts is extremely regressive in nature and clearly one of the main causes of the distortions. Figures 9a and 9b shows the regressive nature of the policies. In 1996 the relationship between NVA (Net Value Added) per farm was positively correlated with income per farmer! As the reforms have not changed the nature of the policies, this relationship was hardly affected. Different proposals to induce some kind of degressivity to direct payments to farmers have failed to be agreed. Only a voluntary introduction of degressive measures by the governments of the member states is permitted. The application and impact of these has yet to be seen. However, the redistribution of the funds deduced from the direct payments to farmers would be redirected for other related measures within the member state, thus not changing at all the relationship depicted in Figures 9a and 9b.

7. Assessing the completeness of the agricultural reforms

This reform was supposed to have paved the way for a smooth enlargement to the CEECs and to give the EU a strong position in the WTO negotiations. Do these reforms really fulfil these requirements? Unfortunately the answer is no. They help, of course, but they have not tackled some of the most problematic and controversial issues. One may argue the contrary, claiming that the main problem was intervention price levels in the agricultural sector and that these have been cut. Prices are without a doubt an important, but not the only, element; direct payments to farmers involve a large number of problems that have not been really solved in the negotiations. Also worrying is the postponement of the milk reform. The timetable for reforms brings the quota system well into the years after the expected first wave of enlargement. The quota regime will bring not only technical difficulties for accession, but will introduce some paradoxes that are presented below. As for whether the price reductions are adequate, future developments in the world market will decide for the EU if the cut was enough.[12]

7.1 Direct Payments and the problems with enlargement

The EU's reform is based on the weakly founded assumption that enlargement will not entail making any direct payments to the new members. This assumption has its origins in

[11] Luxembourg has an extreme positive relationship with the highest receipts per capita and the highest income per capita. However, this is due to the size of the country and the high administrative expenditures of the EU in the operation of its institutions. A similar, but smaller effect is found in Belgium's net balance.

[12] For a discussion on this issue, see Brenton and Núñez Ferrer (2000).

the White Paper published in the Madrid EU summit in 1995. This declaration was based on the argument that the Central and Eastern European Countries did not suffer from the cuts caused by the MacSharry reforms and they therefore have no grounds to expect the payments. The real reason, however, is budgetary. Extending the payments to the CEECs would increase the EU expenditures on the CAP considerably, a development which is not welcomed by a number of member states. Since the new members have low GNPs, their contribution to the budget will be very limited, shifting the burden to the present 15 members.

Although there is some logic in the argument about the CEECs not being members when intervention prices were cut, it is far from satisfactory. First, a new farmer in the EU would be entitled to the payments despite the fact that he/she was not farming at the time of the reforms. Furthermore, the farmers of Eastern Germany are entitled to all direct payments, while their prices increased during the period of the MacSharry reforms. Austria, Sweden and Finland are also benefiting from direct payments despite the fact that these countries were not in the EU at the time of the introduction of the reforms of 1992. Second, excluding the CEEC farmers from the direct payments would entail an automatic increase in the regressivity of the policy, i.e. the direct payments will be going to the richer western farmers. Third, there is the question of the single market: it seems inconsistent to pay subsidies to farmers in some regions and not in others; this is discrimination. There is another argument being voiced: since GDP capita in the new member states is low, direct payments at EU level would increase the income of farmers disproportionally and cause unacceptable distortions in income distribution. This is a good argument, but unfortunately the payments in the EU are not linked to GDP per capita. Some members such as Greece, Portugal and Spain have similar incomes per capita as some of the applicant countries, so why should their payments not be also adjusted? For all these reasons, there are no valid arguments for excluding the future CEEC members from these benefits.

While it is true that the EU15 should not deny the direct payments to the new members, it can offer to give the funds in a more efficient way during a transition period for rural and structural development purposes, a sort of addition of the SAPARD[13] after accession. Once the transition period is over, the new member should be treated equally. The proper solution is to reform in the meantime the direct payment system of the EU15 to avoid an exacerbation of the present misallocation of CAP resources.

The latest speeches by Commissioner Fishler and some press commentaries, also point out that the Commission is aware that just denying the present system of direct payments to the CEECs is not politically acceptable. A formal solution to the problem has not yet been proposed.

It has to be noted that reforming the direct payment levels and distribution after accession of the first group of six applicants (including Cyprus) would be very difficult, as the ministers of the CEECs will be sitting at the Council, increasing number of decision-makers to 21. This situation should be avoided.

[13] The new Community aid programme directed exclusively for agriculture and rural development projects. It substitutes the PHARE-EU programmes for agriculture.

7.2 The milk question

The milk reform has been postponed again, now until 2005. What will this mean? First and foremost it reduces the expenditures of the CAP for the period until 2005. The reform would have been costly. This is another sign that most of the “reform savings” have been created by reforming less and by postponing the implementation. The milk quota reform is now, however, scheduled for a year after the expected entry of the first CEECs to the EU. This has the unfortunate implication that CEECs may have to adopt the quotas and then participate in the negotiation of a reform of the regime. The failure to abolish quotas before enlargement, or even only reduce them may become very costly. If the CEECs implement the quota system and guarantee high prices for the milk producers, the EU will find itself in a dilemma when reducing prices. The farmers of the CEECs will claim with reason the direct payments, thus reinforcing the argument above. There will be no getting round the compensation problem. For an enlarged Union, Brenton and Núñez Ferrer (1999) predict a compensation payment between 6 billion (50 per cent compensation) to 12 billion euro (full compensation). It seems also irrational to introduce a complicated policy like the milk quota regime in the new member states to then subsequently abolish it. Apart from these problems, the highly fragmented farm structure in some of the member states and in particular Poland will make the imposition of quotas a technical nightmare.

8. WTO

There is little doubt that the problems linked to export subsidies have been reduced considerably. The extent to which the problem has been eliminated depends primarily on the movements in world market prices. At the moment In any case the pressures caused on the value of export subsidies and quantity limits by GATT have receded considerably. The main problem now remains the status of the direct payments and their position in the “blue box”,[1] which excludes them from the Aggregate Measure of Support (AMS) limits imposed by GATT. It is of extreme importance for the EU to keep these payments excluded from the AMS limits or the Union would breach by far the barriers to subsidies negotiated in the Uruguay Round of the GATT talks. Unfortunately, the nature of the direct payments is not completely decoupled from production, and the Agenda 2000 reforms do not solve this problem, regardless of any claims to the contrary. The Commission hopes that by having the same payment per ton for oilseeds, cereals and the set aside area, the decoupling is high enough. The problem is that other WTO members including the US do not share this view. With the passage of the FAIR Act in 1996, the US has decoupled payments to the extent that it is possible for farmers to change the agricultural activities on their land without restrictions[1] (with very limited exceptions). The payments remain constant and based only on the past activity on the area. This level of decoupling is not reached with the Agenda 2000 reforms. In light of the present strain in the EU-US relationship today, the likelihood that the EU direct payments “blue box” position will be challenged is high. The are indications that the Cairns group of countries is also preparing such a challenge. As the AMS commitments would be breached by far if the direct payments are included, something more should have been done to resolve this issue. A more extensive analysis of the problems of enlargement and WTO for EU agriculture can be found in Brenton and Núñez Ferrer (1999).

9. EU budget expenditure and enlargement

It was claimed by the heads of state that the Berlin Summit made the necessary changes to pave the way for accession. The margin available in the projected 2006 budget seems to be able to accommodate even the extension of the direct payments for agriculture to the CEECs. The total margin after accession is of 17.096 billion Euro, i.e. 0.18 per cent of EU GNP.[1] In a recent calculation of the effects of the CAP on the applicant countries (excluding Cyprus) and the EU budget using the Agenda 2000 proposals, the cost of enlargement including the direct payments to farmers would increase the estimated costs of enlargement by 6 to 7 billion Euro (Münch, 1999). Therefore there is no apparent problem with the ceiling.

The issue however does not stop at this level. 2006 is a year in which the acceding countries are still on a transition period. In fact, the Structural Fund payments would still too low if compared to the present members. The new members are all eligible to have all their national territory under Objective 1 of the Structural Funds. Taking the reasonable assumption that the receipts from the Structural Funds per capita will rise to the same levels as in other low income regions of the EU, the results are striking. Using for simplicity Greece as a benchmark, the planned average yearly expenditure for Objectives 1 to 3 of the Structural Funds in Greece is 2,99 billion euro (without including other community initiatives not in the Objectives). This is equivalent to 285 euro per capita. The population in the first wave of acceding CEECs is of 66 million. If the transfers per capita reached 285 euro, the increase in the Structural Funds would reach nearly 19 billion euro, up to 7 billion more than in the 2006 projected levels. Thus the final bill for the budget of the five CEECs could easily reach over 30 billion euro if combined to the direct payments (*not including any milk reform*).

There is a final concern left. The new members would contribute 3-4 billion euro to the budget due to their very low GNP levels. The result could easily mean for the EU15 budget contributions an increase by 6 - 12 billion euro after 2006, of which nearly a third would fall on Germany. The rebates for net contributors, so arduously negotiated in Berlin, would be swamped by this.

It is reasonable to expect a new round of discussions on these issues during the present financial framework given also the "unexpected" rise in expenses for external action (e.g. Kosovo).

11. Conclusions and Recommendations

All the arguments presented above point to the conclusion that the Berlin Summit reforms, despite moving in the right direction, fell far short of solving the problems of net contributions, the WTO, enlargement and the rationality of agricultural policy. The EU is driving straight into a collision course with enlargement and the WTO, overshadowed by increasing conflicts on the EU budget distribution based on the unhealthy argument of the *juste retour*.

The EU shows clear signs of incoherence in the distribution of expenditures and the own resources system. A disaggregation of the expenditures of the EU per member state shows the Common Agricultural Policy as the centrepiece of the imbalances. However, instead of addressing the problem directly and efficiently, EU member states have preferred to introduce complicated and theoretically questionable "rebate systems". The new ingenious "rebate on the rebate" for example has no clear theoretical foundations, shifting the burden of the budget to poorer regions.

Therefore, new reforms in the EU should be negotiated before enlargement. A failure to redress these shortcomings before enlargement would require reforms with 21 members or more taking part in decision-making with a new set of policy preferences and disputes. Changes in an enlarged European Union with countries undergoing difficult periods of economic reform can only be more difficult, risking further aggravation of the situation. Furthermore, larger Union with obscure and unclear expenditure systems, corrected by even more obscure and blurred rebate systems, will reduce the citizens' confidence in EU institutions.

For this reason, it is urgent to reform the Common Agricultural Policy and the own resources system. A negotiation of these issues should not wait for the next financial framework for 2006 to 2012, but should rather be an <u>Agenda 2003</u>. The negotiation should occur <u>before</u> the accession of the new member states. As the Union expands further and specially with poorer regions, the proper functioning of the EU budget is of paramount importance.

Reforming the Common Agricultural Policy
The following reform package is proposed:

1) The present system of direct payments based on the principle of price compensation, should be <u>decoupled</u> from production, <u>phased out</u> and <u>not be available</u> to <u>any</u> farmers which enter the market <u>after this reform</u>. This eliminates the problem of eligibility with farmers in the CEECs.
2) The support system should be replaced by decoupled payments. Production decisions and set aside areas should be based on market conditions and be of a voluntary nature. This would bring the EU direct payments <u>in line with WTO 'green box'</u> rules.
3) These decoupled payments should be <u>"Green payments"</u> linked to the application of improved environmental farming techniques.
4) A <u>greater share</u> of the Common Agricultural Policy budget should be directed to <u>rural development</u> programmes. Farming is not the only activity in rural areas. On the contrary, it is the lack of other services and activities, which fosters the depopulation and degradation of rural areas. Problems the CAP should officially be addressing.
5) Except for the compensatory payments, which are phased out, <u>all funds</u> should be available for the CEECs after accession.
6) <u>Export subsidies should be abolished</u>.
7) The <u>milk reforms should be speeded up</u> and the quota system should be abolished to avoid introducing the present system to countries such as Poland. Introducing quotas in Poland would be a technical nightmare and detrimental to the sector's restructuring. This would be very disruptive. The reform of the direct payment system could potentially free enough budgetary resources for <u>time-limited</u> compensatory payments, which should also be <u>phased out</u>.

8) The sugar policy should be reformed; there is no need to maintain the excessively high price levels presently in operation. Compensation payments as set out in point 2 could be introduced.

This set of changes fits the original objectives of the Common Agricultural Policy better than the present system and is in line with the newest ideas of multifunctionality and the European model of agriculture.

The speed and shape of the introduction of the reforms is discussed further below.

The own resources system

The own resources system along should revised the following lines:

1) Eliminating all rebate systems. This can go hand in hand with the changes in the distortions on the expenditure side. The agricultural policy changes should reduce the imbalances and therefore invalidate the arguments for rebates. The overall budget expenditure on agriculture also should fall as the funds are distributed on more clearly defined and better-targeted objectives.
2) It is recommended to move to a budget based solely on customs duties/levies and GNP keys. The elimination of the VAT resource should be completed. This would also further facilitate the elimination of budget rebates.

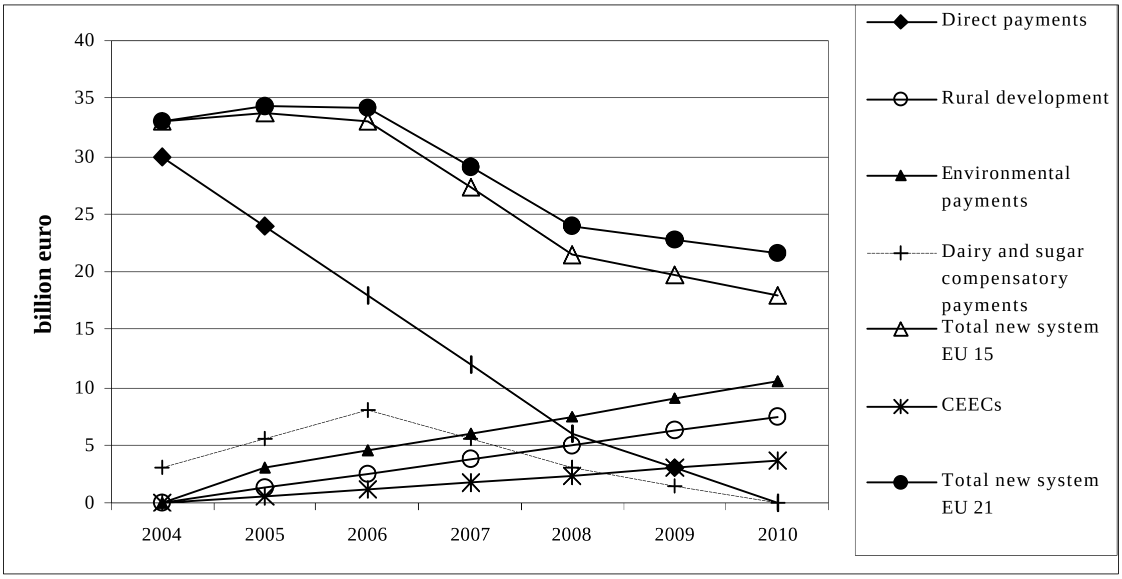
Enlargement and reform converge

The proposals above mean making clear a missing element in the EU's present strategy and introducing a double transition and convergence policy. A transition period in agriculture is introduced in the CEECs, for them to adapt to the CAP policies, which are themselves changing over the same transition period. Policies on both sides should converge on a common denominator, for example by 2010. By this date, the EU should have completed all of the above-mentioned changes, including changes in own resources.

The own resources reforms should be introduced without delay. The rebate systems can be phased out in parallel with the reforms in the agricultural policy, and are abolished before the end of the transition periods for the CEECs.

For agriculture, Figure 10 below describes a possible accession strategy with a six-year transition period. The phasing out of compensatory payments should go hand in hand with the increase in funds in other support measures, which should also be available in the new member states. The CEECs would receive therefore not only equal treatment, but would introduce a reformed agricultural support system simultaneously with the EU.

Figure 10. Adapting the EU direct payments to Enlargement – a transition system



Note: The Figure includes only the direct payments and their replacement other forms of support.

The direct payments of the CAP would be phased out completely from 2004 to 2010, as would export subsidies (not shown in the figure), and reforms of the dairy and sugar regimes would see the scrapping of quota systems. There would be compensating measures, with permanent environmental payments and rural development aids, and transitional aids to the milk and sugar sector. Under this scenario, the net budgetary saving would amount to more than 12 billion euro, in addition to which there would be the abolition of export subsidies (about 6 billion euro in recent years). These savings leave ample room for manoeuvre for the subsequent further enlargements.

The CEECs' receipts from the budget through the new agricultural support system would amount to approximately 3.5 to 4 billion euro, compared to 6 or 7 billion under the full introduction of the present direct payments.

The recommended measures would prevent an otherwise inevitable WTO-enlargement-budget crisis of major proportions.

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Annex A. Possible effects of German proposals to EU net balances

Table A.1 Possible effects of original German proposals to EU net balances - own estimates

	Co-financing of CAP	Constrained general correction mechanism for A, D, NL, SW	No Cohesion Funds for E, P and Irl	Total shift from VAT to GNP key	Implementation of all measures
Belgium	122	-165	103	-110	3
Denmark	-119	-107	67	-70	-194
Germany	625	3160	869	1143	4141
Greece	-36	-78	-582	32	-638
Spain	-151	-366	-1511	99	-1812
France	-859	-936	585	84	-825
Ireland	-269	-45	28	29	-243
Italy	405	-771	482	-805	-442
Luxembourg	10	-12	7	-3	6
Netherlands	190	672	155	71	923
Austria	8	-139	87	63	63
Portugal	-36	-68	-587	52	-618
Finland	-28	-80	50	-41	-72
Sweden	25	-150	94	3	19
UK	112	-916	153	-545	-312

Annex B. Actual and estimated expenditures and contributions

Table B.1.1 1997 own resources (at 1999 prices)

1997	**TOR**	**VAT**	**GNP**	**UK correction**	**TOTAL**
Belgium	1091	944	955	102	**3092**
Denmark	300	641	560	65	**1567**
Germany	3571	10414	7575	514	**22074**
Greece	170	575	433	48	**1226**
Spain	657	2680	2018	228	**5584**
France	1613	6536	4987	582	**13719**
Ireland	234	261	198	22	**715**
Italy	1166	3587	3814	450	**9017**
Luxembourg	23	86	62	7	**178**
Netherlands	1798	1749	1335	151	**5033**
Austria	265	1077	768	86	**2196**
Portugal	161	552	367	41	**1121**
Finland	150	488	419	47	**1105**
Sweden	378	1129	825	89	**2420**
UK	3167	5020	3660	-2558	**9289**
Total	**14745**	**35739**	**27977**	**-126**	**78335**

Table B.1.2 Expenditures 1997 (at 1999 prices)

	Agriculture	**Structural**	**Cohesion**	**other internal**	**TOTAL**
Belgium	1023	372	0	2819	**4215**
Denmark	1286	176	0	176	**1638**
Germany	6012	3783	0	894	**10689**
Greece	2841	2154	596	183	**5774**
Spain	4792	5575	1059	334	**11760**
France	9519	2560	0	828	**12906**
Ireland	2116	1040	221	123	**3500**
Italy	5296	3012	0	645	**8953**
Luxembourg	24	21	0	888	**932**
Netherlands	1828	438	0	398	**2665**
Austria	896	379	0	168	**1443**
Portugal	683	2521	539	209	**3953**
Finland	594	395	0	174	**1163**
Sweden	777	240	0	228	**1245**
UK	4577	2007	0	833	**7417**
Total EU (1)	**42265**	**24673**	**2415**	**8901**	**78254**
				non EU	**5435**
Total					**83689**

(1) Only expenditures inside the EU

Table B.2.1 Estimated own resources in the year 2006 for the Commission proposal (1999 prices)

	TOR	**VAT**	**GNP**	**UK correction**	**TOTAL**
Belgium	1133	790	1757	202	**3881**
Denmark	290	516	1143	131	**2081**
Germany	3219	8080	14825	1703	**27826**
Greece	166	456	826	95	**1542**
Spain	705	2096	3898	448	**7146**
France	1547	5194	9973	1145	**17860**
Ireland	221	273	478	55	**1027**
Italy	1202	3402	8211	943	**13758**
Luxembourg	14	61	125	14	**213**
Netherlands	1589	1428	2648	304	**5968**
Austria	276	820	1479	170	**2745**
Portugal	166	425	729	84	**1404**
Finland	124	395	850	98	**1467**
Sweden	387	820	1595	183	**2986**
UK	2791	5619	9764	-5574	**12600**
Total	**13829**	**30374**	**58301**	**0**	**102504**

Table B.2.2 Estimated expenditures for the year 2006, Commission proposals (1999 prices)

	Agriculture & rural dev.	**Structural**	**Cohesion**	**other internal**	**TOTAL**
Belgium	1062	308		4086	**5455**
Denmark	1476	146		255	**1878**
Germany	7647	4001		1296	**12944**
Greece	3107	2796	630	265	**6798**
Spain	5765	6191	1740	484	**14180**
France	11861	2638		1200	**15699**
Ireland	1833	889		179	**2900**
Italy	6415	5510		935	**12860**
Luxembourg	41	21		1287	**1349**
Netherlands	1774	546		577	**2897**
Austria	1228	402		244	**1873**
Portugal	960	1935	630	303	**3829**
Finland	859	320		253	**1431**
Sweden	1046	585		330	**1962**
UK	4810	2140		1207	**8158**
Total EU	**49884**	**28430**	**3000**	**12900**	**94214**
				non EU	**8290**
Total					**102504**

Table B.3.1 Estimated own resources for the year 2006, Berlin outcome (1999 prices)

	TOR	VAT	GNP	UK Correction	TOTAL
Belgium	944	395	1992	240	**3571**
Denmark	242	258	1297	156	**1953**
Germany	2682	4040	16814	326	**23863**
Greece	138	228	937	113	**1415**
Spain	587	1048	4421	532	**6588**
France	1289	2597	11311	1361	**16559**
Ireland	184	137	542	65	**928**
Italy	1002	1701	9313	1121	**13136**
Luxembourg	12	30	141	17	**200**
Netherlands	1324	714	3003	58	**5099**
Austria	230	410	1677	33	**2350**
Portugal	138	213	827	100	**1277**
Finland	104	197	964	116	**1381**
Sweden	322	410	1810	35	**2577**
UK	2326	2810	11074	-4273	**11937**
Total	**11524**	**15187**	**66123**	**0**	**92834**

Table B.3.2 Estimated expenditures for the year 2006, Berlin outcome (1999 prices)

	Agriculture & rural dev.	Structural	Cohesion	other internal	TOTAL
Belgium	1042	269,352		3579	**4890,6**
Denmark	1356	109,313		223	**1688,3**
Germany	6616	4084,24		1135	**11835**
Greece	2671	3026,75	527,1	232	**6457,1**
Spain	5128	6233,2	1455,8	424	**13242**
France	10922	2133,52		1051	**14106**
Ireland	1636	454,643		157	**2247,4**
Italy	5640	4122,3		819	**10581**
Luxembourg	34	11,703		1127	**1173,4**
Netherlands	1692	388,248		506	**2585,4**
Austria	1073	215,54		213	**1501,8**
Portugal	862	2747,78	527,1	266	**4402,3**
Finland	768	267,537		221	**1256,5**
Sweden	916	318,26		289	**1523,8**
UK	4318	2277,6		1058	**7652,9**
Total EU	**44674**	**26660**	**2510**	**11300**	**85144**
				non EU	**7690**
Total					**92834**

Annex C. Berlin outcome vs. original Agenda 2000

Table C.1 Changes in expenditures and receipts, Berlin budget compared with Commission proposals for 2006

	TOR change	VAT change	GNP change	UK rebate change	Agriculture & rural development[a]	Structural Funds	Cohesion funds	Total
Belgium	189	395	-236	-38	-20	-38	0	**252**
Denmark	48	258	-153	-25	-121	-37	0	**-29**
Germany	536	4040	-1989	1376	-1031	83	0	**3016**
Greece	28	228	-111	-18	-436	231	-103	**-181**
Spain	117	1048	-523	-84	-637	42	-284	**-321**
France	258	2597	-1338	-216	-939	-505	0	**-143**
Ireland	37	137	-64	-10	-196	-434	0	**-532**
Italy	200	1701	-1102	-178	-775	-1388	0	**-1541**
Luxembourg	2	30	-17	-3	-7	-10	0	**-3**
Netherlands	265	714	-355	246	-82	-158	0	**629**
Austria	46	410	-198	137	-155	-186	0	**54**
Portugal	28	213	-98	-16	-99	812	-103	**737**
Finland	21	197	-114	-18	-91	-53	0	**-58**
Sweden	64	410	-214	148	-130	-267	0	**12**
UK	465	2810	-1310	-1302	-493	137	0	**308**
Total	**2305**	**15187**	**-7822**	**0**	**-5210**	**-1770**	**-490**	**2200**[b]

a) Assumptions concerning the increase in the resources available for rural development and its distribution affect the outcome.
b) Fall in the budget for administrative expenditure and internal action, and fall in resources for external action, which do come up in the contributions but not in the expenditure side of the EU15.

Annex D. Own resources and net balances after Berlin

Table D.1 Effect of changes in the own resources decision on net balances for the 2006 Berlin budget

	TOR	**VAT**	**GNP**	**UK Correction**	**TOTAL**
Belgium	189	388	-527	-62	**-13**
Denmark	48	272	-343	-41	**-64**
Germany	536	4039	-4448	1168	**1295**
Greece	28	240	-248	-29	**-10**
Spain	117	1034	-1169	-138	**-156**
France	258	2596	-2992	-353	**-492**
Ireland	37	129	-143	-17	**6**
Italy	200	1689	-2464	-291	**-865**
Luxembourg	2	40	-37	-4	**0**
Netherlands	265	726	-794	209	**405**
Austria	46	415	-444	116	**134**
Portugal	28	201	-219	-26	**-16**
Finland	21	192	-255	-30	**-72**
Sweden	64	406	-479	126	**118**
UK[a]	465	2821	-2930	-627	**-270**
Total	**2305**	**15187**	**-17492**	**0**	**0**

a) The UK advantage caused by the change from TOR and VAT to GNP of 356 million euro has been deducted from the rebate.

Annex E. Relationship between net contributions per capita and GNP per capita

Table E.1. Relationship between net contributions per capita and GNP per capita, years 1997 and 2006

1997

	GNP per capita euro ('000)	Net contributions per capita
Luxembourg	40012	1767
Denmark	29837	18
Austria	25222	-112
Germany	24950	-145
Sweden	24717	-139
Belgium	23812	175
France	23390	-31
Netherlands	23305	-82
UK	22815	-12
Finland	22801	0
Italy	19735	-10
Ireland	17768	796
Spain	13734	147
Greece	10786	427
Portugal	10221	282

2006

	GNP per capita euro ('000)	Net contributions per capita
Luxembourg	45961	2351
Denmark	34273	-21
Austria	28972	-81
Germany	28660	-123
Sweden	28392	-94
Belgium	27352	152
France	26868	-19
Netherlands	26771	-139
UK	26207	-51
Finland	26192	-2
Italy	22670	-26
Ireland	20410	378
Spain	15776	182
Greece	12389	490
Portugal	11740	326

Sources: European Commission (1998c) for 1997 figures and own calculations for 2006.

Annex F. Technical aspects and assumptions used in the calculations of net balances

The estimations on budget expenditures and own resources are the result of two models created by J. Núñez Ferrer. The first model estimates expenditures for agriculture. The second model estimates the expenditures for structural funds and uses the results from the agricultural model to estimate the total EU budget expenditure. The same model then calculates the contributions of each member state to the EU budget, following closely the own resources system as described by Commission (1998h).

The system used to calculate different scenarios and the final results following the decision in the Berlin European Council is as follows. A base scenario is constructed, which simulates the budgetary expenditures and the contributions of each member state in the hypothetical case that the Agenda 2000 proposals were accepted and implemented in full. All differences between this scenario and any other agreements in the Council, hypothetical or real, are simulated by changing the parameters in the models.

I. Base scenario

Agriculture

The agricultural model analyses the effects on the budget of changes in the CAP for cereals, oilseeds, beef and dairy, as these are the main items of reform. The proposals and the final decision of the Agenda 2000 reforms for Agriculture specify for each member state the number of hectares, heads of cattle and tons of milk, which will be eligible for direct payments. Together with the average regional base yields for oilseeds and cereals, the model calculates what the expenditure on direct payments would be, if the member states claim all their allocated limits.

Expenditures on other items are assumed to be equal to the 1997 figures Commission (1998i) for all remaining products (set at 1999 prices). For cereals and beef no export refunds or storage costs are included. As the national maximum allowed support claims have not been usually used in full, this partially counterbalances any excessive fund allocations by the model. For dairy, the difference between the Commission predictions (Commission, 1998a) and the calculations of the expenditure on direct payments for milk are assumed to be expenditures for other costs and export refunds. The difference is distributed among the member states according to their corresponding 1997 share in the expenditures.

Structural Funds

For the Agenda 2000 initial proposals, the structural funds model allocates the funds using the following criteria:

1. The structural funds budget line in the proposals has to be fully utilised in 2006.
2. It uses the expenditure on Structural funds for 1997 (at 1999 prices) as a base for estimation as follows.

- New Objective 1: Regions which have crossed the 75 per cent of the average EU GDP per capita have been removed from the areas eligible for Objective 1 support. The average yearly expenditure for these regions between 1995 and 1999 has been deduced from the 1997 expenditure. The funds have been redistributed among the member states according to the share of Objective 1 allocations in the member states, assuming that the global expenditure on Objective 1 does not fall. The expenditures on Objective 6 have been added to Objective 1.

- New Objective 2: Objectives 2 and 5b have been added together.
- New Objective 3: Objectives 3 and 5a have been added together

After these operations 4,5 billion euro were not allocated (excluding pre accession aid, which is treated as external expenditure). These funds have been redistributed among the member states according to their shares in total receipts under the structural funds.

Cohesion Funds

The 3 billion euro programmed in the financial framework for 2006 have been distributed as follows:

- No funds for Ireland.
- The distribution among the remaining 3 countries Greece, Portugal and Spain use 1997 shares as base. These were 18 per cent for Greece, 55 per cent for Spain and 18 per cent for Portugal. Assuming a similar distribution, their shares have been increased by 3% each to cover the exit of Ireland.

Own Resources

The methodology used follows the rules of the calculation of budget balances including the UK budgetary rebate as presented in Commission (1998h). The UK rebate has been calculated using few simplifications, but trying to stay as close to the actual mechanism as possible. The methodology is as follows:

- TOR and VAT are the same as estimated for 1999 by the Commission (1998h) throughout the simulations.
- The UK rebate is equal to 66% of its budgetary imbalance. This imbalance is calculated by multiplying the difference between the UK's average of the sum of the percentage shares in VAT and GNP payments and its share in allocated expenditure times allocated expenditure. In the actual rebate only the share in VAT is used, using the old pre–1988 contributions system as a calculation tool and then deducing the UK advantage after the 1988 reforms, which have introduced GNP as a resource. The calculations in the present paper try to evade complications by using the average of the sum of shares in VAT and GNP contributions. The Commission (1998h) also does not use the UK advantage in their simulations to avoid unnecessary complications.
- The rebate used is for the net contributions of the year analysed. The actual two year time lag in the budgetary procedures is eliminated for mathematical simplicity.

Other costs

Other costs constitute the sum of internal policies and administration budgeted. Costs for external action are added to the EU15 expenditures separately.

II. Simulations

Six hypothetical policy scenarios and the actual outcome of the Berlin European Summit have been performed:

1. Introduction of co-finance for agricultural policy
2. Elimination of the Cohesion Fund
3. Introduction of a constrained generalised correction mechanism
4. Elimination of the VAT key in the own resources
5. All of the above changes together
6. Implementation of the Berlin European Council Conclusions

The changes are described in Table F.1.

Table F.1. Simulation scenarios, changes with respect to base scenario

Scenario	Agricultural Policy	Structural and Cohesion Funds	Own resources	Other costs
Co-financing in Agriculture	Co-financing is introduced for direct payments and rural development funds. 25 per cent for arable crops, beef and dairy and 30 per cent for rural development. This allowed agricultural expenditure to approximate the 1999 budget expenditure on agriculture.	No change	No change	No change
Elimination of the Cohesion Fund	No change	Cohesion Fund set to 0	No change	No change
Introduction of a constrained generalised correction mechanism	No change	No change	All member states for which the net contributions exceed the threshold of 0,3% of their GNP are eligible for a 66% reduction in their net contribution above this threshold. Member states do not pay for their own rebate, but have to contribute for the rebate of any other member state. The UK rebate remains unchanged.	No change

Elimination of the VAT key in the own resources	No change	No change	The VAT contributions fall to 0. The loss in contributions is redistributed according to shares in EU GNP. The UK rebate is calculated by multiplying the difference between the percentage share in GNP payments and its share in allocated expenditure. The UK advantage of 532 m euro is deducted from the rebate.	No change
All changes	All changes in the cells above	All changes in the cells above	All changes in the cells above. The UK advantage is affected by all other changes and has not been taken into account for simplicity.	No change
Berlin Council conclusions	The expenditures for the CAP are recalculated using the final agreed lower direct payments per hectare. The expenditures for the dairy policy also follow the new direct payments regime and adapts the refunds and storage expenditures in accordance with the new budget line in the financial perspective.	The Structural Funds are allocated according to average yearly allocations following the distribution of the funds as published by the Commission (1999). The Cohesion Funds are allocated with the same shares as in the base scenario, but using the budgetary outlay agreed in Berlin.	The amount retained as collection costs by the member states form TOR increases from 10% to 25%. VAT is cut by 50%. In both cases, the base scenario figures are used as reference. The UK advantage is taken into account and deducted from the rebate. Contribution towards the UK rebate cut for Germany, the Netherlands, Austria and Sweden to 25 per cent. Remaining member states (excluding the UK) make up for the rebate according to their GNP share.	The amounts for administrative expenditures and internal action are changed according to the financial perspective agreed in Berlin. External action is also amended accordingly.