



COMMISSION OF THE EUROPEAN COMMUNITIES

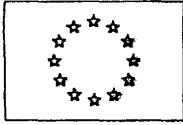
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**Interim report from the Commission
to the European Council on the effects on the policies
of the European Union of enlargement to the
associated countries of central and eastern Europe**

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INTRODUCTION

1. The Essen European Council in December 1994 requested the Commission "to submit as quickly as possible the detailed analysis desired by the Council on the effects of enlargement in the context of the Union's current policies and their future development." The European Council meeting in Cannes in June 1995 invited the Commission "to report back to its next meeting on progress in implementing the White Paper and on the studies and analyses requested at Essen". Progress in implementing the White Paper is covered in the Commission's separate report on the pre-accession strategy. The present report is an initial response to this request. It gives a broad indication of the overall effects of enlargement on the Union's principal common policies. Further work is needed to provide a more detailed analysis of these effects in particular sectors and this will be the subject of a subsequent report.

The prospective members

2. Europe agreements, which recognise the aim of membership of the Union, exist with ten countries Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia (in the latter case, an agreement has been initialled, but not yet signed). Six of these countries (Estonia, Hungary, Latvia, Poland, Romania, Slovakia) have made applications for membership of the Union, and others have announced their intention to do so. The Commission will give its opinions on these applications pursuant to article 0 of the Treaty. The present report is concerned with the effects of enlargement to the countries of central and eastern Europe. Basic data on the countries concerned are presented in the annex. It should be recalled that as far as that Malta and Cyprus are concerned, the Council has decided that these countries will be involved in the next phase of enlargement.

The Union's response

3. The European Council at Copenhagen in June 1993 agreed that:

"The associated countries in central and eastern Europe that so desire shall become members of the Union. Accession will take place as soon as a country is able to

assume the obligations of membership by satisfying the economic and political conditions. Membership requires:

- that the candidate country has achieved stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
- the existence of a functioning market economy, as well as the capacity to cope with competitive pressure and market forces within the Union;
- the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union.

The Union's capacity to absorb new members, while maintaining the momentum of European integration, is also an important consideration in the general interest of both the Union and the candidate countries."

4. Against this background, the Union has developed a comprehensive pre-accession strategy which is among its top priorities. The main features of this strategy include:
 - structured relations with the institutions of the Union;
 - development of the Europe agreements;
 - financial assistance under the PHARE programme;
 - preparation for integration into the Internal Market, following the White Paper.
5. Meanwhile, the institutional conditions for ensuring the proper functioning of the Union are to be created at the Intergovernmental Conference of 1996, which for that reason must take place before accession negotiations begin. Unless reforms are made in the functioning and decision-making of the institutions, enlargement could lead to paralysis and even disintegration. A satisfactory solution to this question is a prerequisite not only for opening accession negotiations, but for the successful realisation of enlargement.

The challenge of enlargement

6. Never before have so many countries wished to join the Union. Never before has the Union envisaged an extension of such importance, both in terms of dimension - it will add more than 100 million to its population of 370 million - and in terms of the different economic and social situations involved.
7. The extension of the Union is a political imperative and also a major opportunity. The analysis in this report suggests that enlargement is not only necessary, but - if it is well prepared and conducted - will strengthen peace, security and stability and bring a new dynamism to the European economy. In the short and medium term, the Union will need to make substantial efforts to ensure the satisfactory integration of the countries concerned. Substantial efforts will also be needed on the part of the associated countries. They have made considerable progress in the framework of the pre-accession strategy, but the situation differs significantly from country to country.

Time will be needed for them to catch up with the level of economic development in the Union and for certain countries to ensure political stability.

The timetable and modalities

8. The present report, which concerns the effects of enlargement on the Union's policies, cannot be viewed in isolation from considerations of how and when the accession of new members should be envisaged.
9. The timetable of enlargement must depend primarily on the progress of the applicant countries in conducting the political and economic reforms necessary to prepare for membership. Since each application must be considered on its merits, in the light of the conditions identified by the European Council, it would be premature at this stage to fix a calendar for accession or for negotiations with the central and eastern European countries.

In any event, negotiations with the applicant countries will not begin before the end of the IGC, which will have to provide the necessary institutional framework for enlargement. In the light of progress achieved by the countries concerned in the reform process and the pre-accession strategy, the Commission will pursue preparations of opinions on the applications received, in order to present the opinions shortly after the conclusion of the IGC.

The actual timetable of enlargement will in effect depend primarily on the progress made by the individual countries in their preparation for membership. Clearly, if some applicant countries have made sufficient progress in preparing for membership, they should not be delayed because others have not reached the same level.

10. The modalities of enlargement - that is, the general conditions under which new members will take on the rights and obligations of membership - will be the object of negotiations with applicant countries. The basis for accession in future, as in the past, should be the *acquis* of the Union, as it exists at the time, subject to such adaptations or transitional arrangements as may be agreed in the accession negotiations. Such an approach is necessary to safeguard the principles of Article C of the Treaty, which provides that "the Union shall be served by a single institutional framework which shall ensure the consistency and continuity of the activities carried out in order to attain its objectives, while respecting and building upon the *acquis communautaire*".
11. At the same time, the issues raised by the next enlargement, not only for the acceding countries but also for existing members, will be such that transitional arrangements in some areas may be needed. Given the level of economic development in the associated countries, arrangements for accession are likely to differ from those negotiated during the Union's last enlargement.

The development of the Union's policies

12. The progressive integration of the countries of central and eastern Europe into the Union's political and economic framework has already commenced: it began with the Europe agreements and entered a new phase with the pre-accession strategy. The Union now expects and prepares for their accession. Consequently, in taking

decisions on the future development of its policies, it must from now on take account of the perspective of enlargement.

THE EFFECTS OF ENLARGEMENT

The political effects

13. The next enlargement, like all past enlargements, and like the creation of the original European Communities, concerns the basic objective defined in Article A of the Treaty as the "process of creating an ever-closer union among the peoples of Europe". Since the Union's fundamental aim is to promote peace, security and stability among Europeans, the effects of enlargement should first be judged on that criterion. Peace, security and stability are more difficult to quantify than the economic aspects, but they are vitally important for the countries of central and eastern Europe and for the existing members of the Union.
14. Democracy, the rule of law, the respect for human rights and the protection of minorities have been identified as requirements of membership. The prospect of accession, based on these preconditions, is already playing a positive role in the region, for example through the agreements for good relations between neighbours which form part of the Stability Pact. Nonetheless, the protection of minorities remains a delicate issue. Greater attention is also needed in some cases to constitutional checks and balances. Regional cooperation and integration are also highly desirable, both for economic reasons and as a political preparation for membership of the Union.
15. The accession of countries in central and eastern Europe, together with the reforms to be made by the IGC to the Common Foreign and Security Policy, will strengthen Europe's influence in world affairs.
16. Enlargement will increase opportunities for cooperation in justice and home affairs and strengthen the international effort against crime and drugs, which threaten the security of citizens throughout our continent.

The economic effects

17. With a combined population of 106 million and an area of 1.1 million square km, the CE-10 represent 29% of the population and 33% of the area of EU-15. It should be pointed out here that as far as other economic indicators are concerned, it is necessary to treat them with prudence in particular because of the unreliability of basic statistics as well as the size of the black economy. Bearing this in mind, it is estimated that their combined GDP represents less than 4% of the GDP of EU-15. In effect, they have an economic weight at present approximately equivalent to that of the Netherlands, although their population is seven times more numerous. Although their trade with the Union is increasing, it still represents less than 4% of the Union's trade with the rest of the world.
18. The economies of the CE-10 are engaged in a rapid process of reform and are showing good signs of recovery after a significant contraction in recent years. But

they are still very different in economic structure from most members of the Union. For example, agriculture's share of the work-force and output is high (7.8% of GDP and 26.7% of employment in CE-10, compared with 2.5% and 5.7% in EU-15) and the service sector is generally underdeveloped.

19. Compared with EU-15, the CE-10 have much lower levels of economic development, as measured by their GDP in terms of purchasing power standards:
 - their average GDP per head is only about 30% of the EU average;
 - although the GDP per head of Slovenia is 50% of the EU average and that of the Czech Republic is more than 40%, those of Romania and Lithuania are less than 20%.
20. The extension of the Internal Market to 100 million more consumers can bring a new boost and dynamism to the European economy, and important gains will be made by the existing Member States as a result of the increased trade and economic activity induced by growth in the economies of the CE-10.
21. The main vehicles of integration in the region will continue to be trade and investment. The framework created by the Europe agreements, which provide access to markets for goods, services and capital, has encouraged a strong increase in trade and investment and will continue to do so in the coming years. Estimates of the potential trade effects suggest that, with continuing integration, trade between the CE-10 and EU-15 could increase in the long run by as much as three to five times compared with 1989. Already an important expansion of trade has taken place, with a doubling of EU imports and a tripling of EU exports since 1989. If the CE-10 successfully maintain the process of growth and convergence, significant trade imbalances with EU-15 should not occur. Regional economic cooperation between the CE-10 can also play an important role in developing trade between them and encouraging inward investment.
22. Good management of the accession process, both before and after enlargement, can ensure that the economic gains are obtained much more rapidly than if the CE-10 were to remain outside the Union. Moreover, experience with previous enlargements shows that the convergence process is generally faster once accession has taken place. However, the size of the present differences is such that, even in an optimistic scenario of growth, transition and integration, large gaps will remain at the time of accession and for a considerable period thereafter.
23. With the same reserve as mentioned in § 18, it is estimated that the average GDP per head of the CE-10 is now about 30% of the EU average. For it to reach even 50% of the EU average (the same relative level as Portugal had at the time of its accession) by the year 2001 would require them to sustain a growth differential with the Union of about 11% in the coming years, which is evidently unrealistic. Most assumptions concerning growth in the region and elsewhere in the world do not generate annual growth rates of more than 5% in the medium term for CE-10. A more probable scenario is that by 2000 some of them will have succeeded in sustaining accelerated growth and in approaching the level of the less favoured countries of EU-15, while others will still be struggling with reform and stabilisation;

even by 2005, many of them will still not have GDP per head much above 40% of the then EU average.

24. However, the economic problems of adjustment for the Union should not be exaggerated. Integration into the Union of the central and eastern European countries should not pose insuperable problems, given their economic weight, although specific aspects and sectors will need to be examined. It should be recalled, in this context, that previous accession arrangements did not result in displacement of jobs and inflow of labour in neighbouring Member States, as was feared at the time. On the contrary, migratory outflows from these countries diminished as a result of better prospects for employment and economic growth at home.
25. The main economic challenge is for the central and eastern European countries themselves, for they have to introduce the regulatory and administrative framework, manage the restructuring and reorientation of their economies and ensure stable macroeconomic development over a sustained period.

Principal questions

26. The main issues which emerge from a survey of the effects of enlargement on the Union's policies are:
 - (i) Thorough preparation is the key to successful enlargement. For this reason the Union attaches the highest importance to the preparations being made by the CE-10 as well as the pre-accession strategy and its reinforcement.
 - (ii) In many areas, even on a favourable hypothesis concerning the degree of preparation by the acceding countries, transitional arrangements will be needed to allow for progressive integration of the new members. To the extent that accession takes place at an early date, such arrangements are more likely to be needed.
 - (iii) In certain areas, particularly those with important budgetary implications (cohesion policy, agricultural policy), it is difficult to predict the *acquis* which the new members will take over and therefore to make valid financial estimates.

The need for preparation

27. The recent White Paper on the integration of the CE-10 into the Internal Market, which forms part of the pre-accession strategy being conducted by them with the assistance of the Union, illustrates the wide-ranging nature of the preparation which is needed. The preparation concerns not simply the introduction of legislation compatible with the Community system, but measures necessary for its effective implementation and enforcement.
28. This requires the development of administrative and organisational structures, in both the public and the private sector, to ensure the implementation of community rules in a uniform manner in the whole area of the enlarged Community. This implies a

permanent dialogue between the Commission and national administrative structures within the Treaty procedures designed to ensure the respect for Community law. Special attention should be given to the application of competition rules and the transparency of state aids. The associated countries will need to develop a judicial system giving citizens the full benefit of Community law.

29. In addition to preparation for adoption of the *acquis* in different areas, it is desirable for the prospective members to manage their economic and monetary situation in such a way as to ensure stable economic development over a period of time. The reforms and restructuring which are part of their transition to the market system should be conducted in such a way that, at the time of accession, their economies can withstand the effects of membership. They should also strengthen their commitment to stabilisation in view of their participation in Economic and Monetary Union. Even if they do not fix irrevocably their exchange rates on accession, they will still need to respect their obligations as non-participating Member States in economic and monetary relations with other members.
30. For its part, the Union should continue to assist the CE-10 in their preparation for accession, notably through PHARE.
31. Concerning agriculture, the Commission has (in its separate report on agricultural strategy in relation to the associated countries) suggested a number of measures including improved access to the market of EU-15 and modernisation programmes for the farm and food sector in the CE-10.
32. Concerning policies for cohesion, a preparation of the associated countries for their application is also necessary. With the multi-annual PHARE programmes, including infrastructural investment and enterprise support, the CE-10 are gaining some experience in intervention fields covered by the Community structural funds. In addition, the link between INTERREG and PHARE in cross-border co-operation will not only promote the transfer of know-how, but also help future Member States to co-operate actively with present ones in the field of regional policy. Beyond this, there are other elements which could facilitate the smooth application of cohesion policy after enlargement; this is the reason why it is important to begin preparatory work on national regional policy in CE-10 with each of the countries concerned.
33. In other areas, too, the Union is working with the CE-10 to prepare for accession. Priority fields include environment, transport, competition, energy, trade policy, business cooperation and social policy, as well as the CFSP and justice and home affairs.

Specific measures on accession

34. Even if rapid progress is made with the preparation for accession, transitional periods will need to be included in the accession arrangements.
35. The adoption of the Union's rules in full by new members may pose problems for economic, social and budgetary reasons, notably in areas such as agriculture, the free movement of workers, the free movement of capital and the financial services sector, energy, transport, environment, social policy and consumer protection.

In a subsequent report, the Commission will keep the Council informed of the results of its analyses of the impact of enlargement in such areas.

36. It is not possible at this stage to prejudge the nature or length of transitional arrangements, which would be the object of accession negotiations and would depend on the actual situation of the applicant countries at the time. In preceding enlargements, satisfactory transitional measures were devised to facilitate the harmonious integration of acceding countries into the Union's policies; and as new members, they have participated in the development of those policies. This basic approach should remain valid for the next enlargement. It would permit specific arrangements for new members, in duly justified cases, for a period of time necessary to ensure full integration.
37. Such an approach should not, however, become a pretext for permanent derogations. Enlargement must not lead to "à la carte" membership or "second-class" treatment. A new member is expected to take on both the rights and the obligations of membership and to accept the basic objectives of the Union and its policies as laid down in the Treaty. Nor should applicant countries suppose that the possibility of obtaining such transitional arrangements in accession negotiations reduces the need for them to prepare fully for membership. In fact, accession negotiations imply that the candidate can implement most of the basic rules on accession and the other rules within a definite period of time.

Cohesion policy

38. The strengthening of economic and social cohesion is a fundamental objective of the European Union, as set out in article B of the Treaty. The financial perspectives and the regulations for the Structural Funds and the Cohesion Funds concern the period up to 1999, when they are to be re-examined. The report which the Commission will make in 1996, in accordance with Article 130B of the Treaty, will provide a basis for that review. At present it is difficult to predict the Union's future policy for cohesion or its financial implications, even for the existing Union; as regards the enlarged Union, theoretical estimates based on extrapolation of present arrangements cannot be a valid basis.
39. Cohesion policy must be made more effective, particularly in the perspective of enlargement, and the future review will need to cover all aspects of the policy so as to develop principles for its conduct in the period following 1999. A smooth and acceptable reform of cohesion policies will need to be progressive and will therefore take time.
40. At this stage, in advance of the review, it is possible to indicate only preliminary orientations for the development of cohesion policy in the context of enlargement.
41. The general application of the cohesion policy throughout the Union should be maintained, even if there is a need for concentration. The cohesion countries should benefit from a guarantee of continued solidarity, whose application should, however, take account of the success achieved in economic and social cohesion. Support for

least-favoured regions should continue to be the main preoccupation. The Union should also manifest its solidarity with disadvantaged regions and people in richer Member States. In the framework of the Structural Funds, Community initiatives, which can adjust flexibly to changing priorities, should be reinforced. During a time when most member states are going through a process of rigorous budget management in order to fulfil or to maintain the Maastricht criteria, the Community should also provide a clear signal that it shapes its policies in a way that the principle of budget discipline is concretely respected.

42. While the objective should be full application of cohesion policy to new Member States, transitional arrangements after accession will be necessary to integrate them gradually into the policy and its financial aspects. In the application of the policy, the economic effectiveness of transfers must also be assured. Experience suggests that volumes of assistance which are high in relation to the recipients' GDP are difficult to use effectively, and can even distort their economic structure. In the case of new Member States, this aspect may be aggravated by problems of administrative systems, absorptive capacity, and the need for national co-financing. These considerations will need to be taken into account in the context of enlargement.

Agricultural policy

43. In the agricultural sector, the Community has embarked on important reforms to make the policy more market-oriented, taking account also of international commitments in the Uruguay Round. These reforms, which are already having their effects, will by 2000 have resulted in changes which are difficult to predict. Predictions of the development of agriculture in the CE-10 over the medium term are equally uncertain. Moreover, a new negotiation of the international commitments is expected to commence around 2000.
44. A status quo projection of agricultural expenditure may be made on the basis of existing EC agricultural prices and rules, assuming some recovery of agricultural production in the CE-10 by 2000; a substantial increase by then is improbable because of the structural situation and problems of their agriculture. The expenditure resulting from enlargement to include the CE-10 is explained in more detail in the Commission's separate report on agricultural strategy in relation to the associated countries.
45. In any case, the Commission considers that, independently of enlargement, to maintain the status quo would not be desirable. It would be preferable to develop further the approach already inherent in the 1992 reforms. That implies reduced reliance on price support, more emphasis on environmental and social considerations, and the development of an integrated rural policy. In the context of enlargement, this strategy would facilitate the integration of the CE-10 and allow greater emphasis to be placed on programmes for structural improvement and rural development which would be more appropriate to their needs. It would avoid the risk of distortion of their economies resulting from higher price levels.

Final remarks

46. No precise estimate can be given of the overall budgetary effects of enlargement, in particular given uncertainties about the development of the Union's policies and about the future economic situation in Europe. Nevertheless, preliminary analyses do suggest that budgetary efforts will have to be made by the Union to ensure the integration of the new members into its policies. A number of considerations will influence the budgetary effects. These include: the Union's future economic growth, the economic benefits of enlargement, the overall economic weight of the associated countries, the fact that all are unlikely to join at the same time, which will delay the budgetary effects, and the possibility of transitional measures.
47. This report has identified a number of broad areas in which enlargement will have a significant impact on Union policies and their development. It has drawn attention to the benefits which enlargement will bring in terms of peace and security as well as economic growth and development throughout Europe. The Commission will continue the analyses which are underway and provide a subsequent report on the **outcome of its work.**

Annex

CENTRAL EUROPEAN COUNTRIES

BASIC DATA

	<u>Population</u>	<u>Area</u>	<u>Gross Domestic Product</u>			<u>Agriculture</u>	
	(millions)	(million hectares)	(billion ECU)	(ECU per head) PPS	% of EU	(% of GDP)	(% of employment)
Poland	38.4	31.3	81.8	5029	31.5	6.3	25.6
Hungary	10.3	9.3	35.2	5720	35.8	6.4	10.1
Czech Rep.	10.3	7.9	30.8	6738	42.2	3.3	5.6
Slovakia	5.3	4.9	10.6	5365	33.6	5.8	8.4
Slovenia	2.0	2.0	11.3	8076	50.5	4.9	10.7
Romania	22.8	23.8	27.1	2669	15.7	20.2	35.2
Bulgaria	8.5	11.1	8.6	5280	33.0	10.0	21.2
Lithuania	3.7	6.5	2.9	2828	17.7	11.0	22.4
Latvia	2.6	6.5	2.9	4593	28.7	10.6	18.4
Estonia	1.5	4.5	1.9	6136	38.4	10.4	8.2
CE-10	105.5	107.7	213.0	4776	29.9	7.8	26.7
EU-15	369.9	323.4	6187.0	15984	100	2.5	5.7

Source: DG II, DG VI

Year: 1993 (except column 3 which is 1994)

Comment: The data on GDP per head are expressed in terms of purchasing power standards, and are derived from World Bank estimates. These are the most widely used internationally comparable estimates, but in the case of the Central European countries are subject to more than the usual margin of error.