The European Union is set to incorporate five and possibly more Central and Eastern European countries in the next five years or so, with additional countries to follow. The new round of enlargement is unprecedented in sheer-number terms. Moreover, it will change the character of the united Europe significantly. The EU will cease being a »rich men’s club«: it will be much more heterogeneous economically and – at least statistically – poorer. Although we are convinced that eastern enlargement is a worthwhile endeavor, we also believe that at present the EU is not in a position to cope with the consequences. Neither the reform steps taken under Agenda 2000 nor the ones agreed to at the Nice summit of December 2000 suffice to make the Union fit for eastern enlargement. An Agenda 2007 is needed.

The reforms should also offer member states greater control over the choice of investment projects and should concentrate EU spending on fewer objectives and poorer member states. To avoid an endless political horse-trading on transfer payments, a clear and transparent mechanism for financial redistribution is needed. Agricultural-policy reforms should focus on further price liberalization, declining direct-income supports as well as national cofinancing.

The reform package should be accompanied by changes in the Union’s institutions that address the »leftovers« of Nice. The powers of the different levels of governance must be defined more precisely. The processes of EU decision making need to be further streamlined and rendered more transparent, democratic and effective. In the long run it will be necessary to reconstitute the European Union as a confederation of European states.

The Costs of Enlargement: Unsustainable Beyond 2006

In the 1990s a host of studies estimated the costs associated with eastern enlargement. Early studies by Baldwin (1994), Anderson and Tyers (1993) and Courchene et al. (1993) suggested that the estimated costs of CEEC accession would render an enlargement program prohibitive. Today the financial costs of the first accession round are calculated by different researchers to reach between 0.1 to 0.2 percent of the current EU-15’s GNP. As the EU’s economy grows, the percentage of this burden is expected to decline. The financial burden has to be set against the welfare gains brought about by economic integration. For two selected countries, Germany and Austria, net welfare gains derived from the first round of eastern enlargement have been estimated to be in the range of 0.5 to 0.8 percent (Keuschnigg and Kohler, 1999).

As far as contributions to the EU budget are concerned, Germany’s net burden would increase from 0.54 to 0.58 percent of its annual GDP. The net transfer receipts of Spain, Portugal, Greece and Ireland would fall from the current level of between one and four percent of GDP to between 0.3 and 0.8 percent (Quaisser et al., 2000). The new member states, in turn, can expect EU net transfers of up to four percent of their GDP.

* The authors would like to express their thanks to Michael Dauderstädt, Christian Dahlhaus, Heinrich Hick, Axel Hörhager, Werner Kirsch, Horst Günter Krenzler, Andreas Lillig, Rüdiger Leidner, Dietrich Lingenthal, Norbert Mühlberger, Franz Neueder, Alfred Pfäller, Burkhard Schmied and Manfred Wegner for their insightful comments.
However, the exact dates of accession and the actual number of countries entering in the various accession rounds are not etched in stone. Things can change. It is worth recalling that the European Council has already changed its plans for eastern enlargement. More Central and Eastern European countries have been invited to attend and participate in enlargement negotiations. Bringing in more than the proposed five countries would demand higher EU expenditures. On the other hand, the weight of the financial burden is expected to decline if enlargement is put off to a later date.

Our own estimates of the long-term costs of enlargement (see Table 1) are based on what we think is a realistic scenario. We assume that eastern enlargement will begin in 2004 with the accession of Poland, Hungary, the Czech Republic, Slovenia, Estonia and Malta, followed by a second group, consisting of Latvia, Lithuania, Slovakia and Cyprus, in 2006. Our assumption that Bulgaria and Romania will enter two years later, in 2008, may, however, be rather optimistic.¹

Enlargement costs for agriculture are calculated on the basis of model simulations that take into

1. Alternative scenarios also might be possible, like a group entry of all eight countries in 2005. This would cause less friction on such issues as border control. Cyprus also might be included in a first group if its political problems are solved.

<table>
<thead>
<tr>
<th>Years</th>
<th>2004</th>
<th>2006</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total appropriations for commitments (in millions of euros)</td>
<td>108,317</td>
<td>116,951</td>
<td>129,133</td>
</tr>
<tr>
<td>Costs of enlargement</td>
<td>12,637</td>
<td>22,400</td>
<td>34,071</td>
</tr>
<tr>
<td>Preaccession aid²</td>
<td>3,260</td>
<td>3,259</td>
<td>3,259</td>
</tr>
<tr>
<td>Financial margin of the EU, as percent of EU’s GNP</td>
<td>0.13</td>
<td>0.12</td>
<td>0.06</td>
</tr>
<tr>
<td>Ceiling on resources, as percent of EU’s GNP</td>
<td>1.27</td>
<td>1.27</td>
<td>1.27</td>
</tr>
<tr>
<td>Share of total agricultural expenditures, as percent of EU’s GNP (2000 = 0.32%)</td>
<td>0.50</td>
<td>0.50</td>
<td>0.48</td>
</tr>
<tr>
<td>Total expenditures for structural policy, as percent of EU’s GNP (2000 = 0.41 %)</td>
<td>0.42</td>
<td>0.44</td>
<td>0.48</td>
</tr>
<tr>
<td>Expansion costs as percent of GDP</td>
<td>0.17</td>
<td>0.25</td>
<td>0.35</td>
</tr>
<tr>
<td>Enlargement costs as percent of total EU spending (appropriations for commitments)</td>
<td>14.68</td>
<td>21.9</td>
<td>28.91</td>
</tr>
</tbody>
</table>

¹. Assumes that Poland, Hungary, Czech Republic, Slovenia, Estonia and Malta will enter the EU in 2004; Latvia, Lithuania, Slovakia and Cyprus in 2006; Romania and Bulgaria in 2008. All amounts refer to appropriations for commitments. Usually costs are calculated in appropriations for payments, as they represent the real flow of money. Normally these amounts are a bit lower because there is a time lag between when the commitments are made and when the money is actually paid. Because of data problems we were only able to calculate in appropriations for commitments.

². We assume that the remaining preaccession aid will be used for Turkey and the Balkan countries.

Sources: European Commission and authors’ calculations.
account costs of market intervention, including direct payments to farmers (see Frohberg, 2001). They will increase, adjusted to our enlargement scenario and expressed in 2001 prices, from three billion euros in 2004 to 10.4 billion in 2008 (with direct payments increasing from 1.3 to 7.3 billion euros). Structural funds are estimated to reach an established ceiling of four percent of the accession countries’ gross output (Agenda 2000 assumed only three percent). Structural funds and direct payments will be phased in and reach their maximum levels for the first and second rounds of enlargement in fiscal year 2007. They will increase from 8.2 to 21.3 billion euros in 2008, when we assume that Bulgaria and Romania will enter the EU. Other costs are calculated as they will be incurred. For Romania and Bulgaria enlargement costs start in fiscal year 2008, but already the full amount is considered in order to facilitate the calculations. Table 1 presents projected costs over time.

Our calculations suggest that the EU would spend about nine billion euros less in the time span from 2000 to 2006 than it itself has calculated, mainly because the enlargement will start later than the EU assumed. However, the money saved cannot be used automatically for covering costs in the coming years because the budget is based on the principle of annual accounting. If we compare the costs in 2006, the year with the largest amount of payments during the time span 2000–2006, then in our scenario enlargement costs are five billion euros higher than Agenda 2000 estimated (see Table 1).

But the real problems are liable to come up in the financial period starting in fiscal year 2007. Calculations here have to consider a broad range of uncertainties. For example, it is difficult to predict the results of accession negotiations, especially in the field of compensation payments for farmers in the new member countries. It is also hard to imagine what the EU’s agricultural and structural policies will be like after 2006. Additional funds for structural changes in agriculture and rural development might have to be made available for the accession countries. In the long run, although a »phasing-in« policy for compensation payments to eastern farmers would lower EU expenses, the new member states cannot be denied their due agricultural compensation payments (or, in the future, income-support payments) and structural funds.

For the purpose of estimating the EU-15’s financial obligations after 2007, we assume average GNP growth rates of 2.5 percent for the EU-15 and four percent for Central and Eastern Europe. We also assume that Romania and Bulgaria will enter in 2008 and will start to receive their structural funds at a ceiling of four percent of their GNP. Our calculations thus render enlargement costs of about 34 billion euros for 2008 (see column three in Table 2). That corresponds to 0.35 percent of the EU’s GNP. If Croatia is included (which is not totally unrealistic), costs would increase to about 36 billion euros in 2008 (0.37 percent of the EU’s GNP). Our estimates imply that the welfare gains of eastern enlargement, which – according to a host of econometric models – do not exceed 0.2 percent of the EU-15’s GNP, would be lower than the costs.

In combination with additional burdens falling on the EU budget (such as the financial fallout from the recent BSE crisis, the costs of the EU engagement in the Balkans and a general upward trend in foreign- and defense-policy expenditures), eastern enlargement well might prove incompatible with the EU spending ceiling established at the Edinburgh Summit in December 1992. But it is unlikely that the net contributors to the EU budget will agree to increase this ceiling in the future. Therefore, before 2007, when the new financial plan is to begin, reforms in the agricultural and structural policies of the EU seem unavoidable. This is all the more urgent as the Republic of Yugoslavia, Albania and Turkey, with its population of 80 million, also might enter the Union between 2007 and 2013.

In the past, the agricultural and structural policies of the EU were shaped more by political bargaining than by rational decision making. Each enlargement made these policies more subject to political pressures and consequently more expensive. This was especially obvious when the southern countries of Greece, Portugal and Spain joined the European Community. Now that spending limits are being approached, the EU needs new policies to deal effectively with the challenges of eastern enlargement.

2. We used the market-intervention cost estimates of the Institute in Göttingen, which are about two billion euros higher than those of the Institute in Halle.
Decision Making: Out of Tune with a Larger Union

The changes in EU decision-making procedures established at the Nice Summit of December 2000 (for example, extended majority voting) constitute the minimum of what will be required for managing the first round of eastern enlargement before 2006. But they are inadequate for the years to follow. The voting power of the various member countries will be utterly incommensurate with their net contributions to the EU budget. In addition, the move toward 25 or more EU members will reduce dramatically the possibility of reaching the qualified majorities needed for making important decisions. Hence a political paralysis is a real danger in the enlarged Union (Kirsch, 2001; Baldwin et al., 2000).

If we consider an enlarged EU with up to 27 members by 2008, contributor countries would account for 63 percent of the EU’s population and 81 percent of its budget. However, according to the Banzhaf Index (which estimates the relative voting power wielded by different parties engaged in various types of decisions), the Nice Summit would give this group only a 45.5 percent voting power. The discrepancy between contribution and voting power is especially pronounced in the case of the biggest net contributors to the budget. Although a qualified majority of votes (71.42 percent) and a single majority of states is needed to make important EU decisions, the relatively large weight of net-receiver countries could result in their earmarking higher levels of funding for themselves (see Table 2).

Agricultural Policy: Terminate Price Support

There is a broad consensus that the EU’s Common Agricultural Policy (CAP) is too costly and leads to a highly inefficient allocation of resources. Close to 50 percent of the EU budget goes into the CAP. The policy of subsidizing agricultural prices encourages overproduction. The surpluses are

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**Table 2:** Member Countries’ Relative Importance and Voting Power in an EU-27 of 2008 (in percent of EU total)

<table>
<thead>
<tr>
<th>Groups of Countries*</th>
<th>Population</th>
<th>GDP</th>
<th>Budget</th>
<th>Votes (Nice)</th>
<th>Votes (Banzhaf)</th>
</tr>
</thead>
<tbody>
<tr>
<td>High Net Players</td>
<td>23.9</td>
<td>32.3</td>
<td>33.6</td>
<td>17.9</td>
<td>17.9</td>
</tr>
<tr>
<td>Medium Net Players</td>
<td>38.6</td>
<td>49.1</td>
<td>46.6</td>
<td>29.3</td>
<td>27.6</td>
</tr>
<tr>
<td>Medium Net Receivers (EU-15)</td>
<td>13.3</td>
<td>11.9</td>
<td>12.6</td>
<td>16.8</td>
<td>17.0</td>
</tr>
<tr>
<td>High Net Receivers (EU-15)</td>
<td>2.3</td>
<td>1.6</td>
<td>1.8</td>
<td>4.6</td>
<td>5.0</td>
</tr>
<tr>
<td>Medium Net Receivers (accession countries)</td>
<td>4.4</td>
<td>1.4</td>
<td>1.5</td>
<td>9.9</td>
<td>10.6</td>
</tr>
<tr>
<td>High Net Receivers (accession countries)</td>
<td>17.5</td>
<td>3.7</td>
<td>3.8</td>
<td>21.5</td>
<td>21.9</td>
</tr>
</tbody>
</table>

* High net payers contribute more than 0.3 percent of their GNP. They include Germany, the Netherlands, Sweden and Austria. Medium net payers contribute up to 0.3 percent. They include Denmark, France, Italy, Finland and the United Kingdom. Medium net receivers from the EU-15 receive up to three percent of their GNP. They include Belgium, Spain, Ireland and Portugal. High net receivers from the EU-15 receive more than three percent of their GNP. They include Greece and Luxembourg. Medium net receivers from the accession countries, including Cyprus, the Czech Republic, Latvia, Malta, Slovenia and Slovakia, will receive up to three percent of their GNP. High-net-receiver accession countries, including Poland, Estonia, Hungary, Bulgaria, Lithuania and Romania, will receive more than three percent of their GNP.

Sources: Eurostat; Kirsch (2001); authors’ calculations.
either destroyed or sold on the world market at dumping prices, which in turn cause endless trade frictions. In addition, quotas are set for sugar and set-aside programs established for farmland. Highly intensive agricultural production requires copious amounts of fertilizers and pesticides – to the detriment of rural flora, fauna and soil as well as rivers. CAP price subsidies tend to benefit large-scale producers most of all. They keep marginal farmers in production but provide them with only low incomes.

In spite of its gross and well-known deficiencies, the CAP has proven remarkably resistant against any attempts at reform (see Michael Ehrke’s contribution to this issue of International Politics and Society). Although Agenda 2000 has reduced price supports and put more emphasis on direct income supports for farmers, major market distortions were not abolished.

Further reforms should aim at market prices for agricultural products. They should delink payments to farmers from their productive capacity, make them declining payments and introduce national cofinancing for farm-income support. If such reforms were made in the near future – and then were executed consistently without giving in to political pressure – the EU would be able to integrate eastern agriculture into its income-support system. The EU then should extend financial assistance to the new member countries to promote structural change in agriculture and rural development. This would make much more sense than keeping marginal farmers in production (see, for example, Schrader, 2000).

Altogether, there is no lack of coherent concepts for improving EU agricultural policy (for a synopsis of different reform concepts, see von Urff, 1997). What has been lacking so far is the political will to implement them. But now several political factors exist that work in favor of CAP reforms. For one, France may recognize that it will become a substantial net payer when enlargement costs exceed the calculated margin. In addition, negotiations within the World Trade Organization may put pressure on the EU to enact deeper agricultural reforms (see Anderson, 2000). Finally, after the elections in 2002, France and Germany would be free to work together to overcome the reform blockade they have formed during the last decades.

As long as reforms are not tackled seriously, the CAP promises to remain a source of conflict among the EU’s existing 15 member states. One of the problems associated with current negotiations is that it is not clear which sort of CAP will exist when the new members enter the EU. Also, once they are part of the EU, Central and Eastern European countries might prefer not to promote agricultural reforms at home but rather to live off the CAP’s largesse.

The recent BSE crisis provides a unique opportunity to reform the CAP, because the agricultural lobby is under attack as never before. Political pressure by consumers is increasing (see Ehrke in this edition of International Politics and Society). Important steps could be introduced during the review of agricultural policy planned for 2002 and 2003. Still, a breakthrough seems unrealistic because of the forthcoming elections in France and Germany. Besides, it is not at all clear that a majority of EU governments will support further liberalization of the CAP as demanded by Britain and Sweden. Recent discussions in Germany on a new agricultural policy focus on improved food quality and environmental protection – not on liberalization.

We expect that the outcome of the 2002 and 2003 meetings will be that the CAP will take environmental externals more seriously. The danger is that this might lead to a set of policies that spell yet more bureaucratic regulation. As a consequence, European agriculture might fail to improve its international competitiveness, thus assuring that the financial burden to the EU budget remains large. In addition, it is far from clear that bureaucratic regulations concerning ecological farming would lead to better environmental results than would less-intensive forms of conventional agriculture.

An area where there is a chance to push ahead with reforms involves the so-called »second pillar« of the CAP, which is dedicated to rural development and cofinanced by national governments. It could well be extended. Although this would burden national budgets, it would offer relief to the EU’s net payers if cofinancing becomes mandatory rather than optional, as it is now.
Structural Policy: Promote Income Convergence Between East and West

From a strictly economic standpoint EU regional policy should concentrate on funding the production of public goods in geographic locations. Additional projects would be justified if an adjustment process connected with the EU’s common market is facilitated by transitional transfers. The latter also would help to mitigate whatever social tensions might arise. If markets fail and negative externalities emerge, then public-sector interventions would prove rational (see Mallossek, 1999).

In the light of these arguments, it does not seem justified that the EU assigns nearly 35 percent of its budget to structural funds. However, the thrust of EU policy goes well beyond such economic arguments. In fact, its structural policy is designed as a form of redistribution policy among richer and poorer member states. The name »cohesion fund« clearly betrays the overriding political purpose of the transfers. To date, a large amount of the various »structural« funds was given to Ireland and the southern countries of Greece, Portugal and Spain. But richer member states also received a sizeable share.

Once established, financial redistribution has a strong tendency to be subject to political horse-trading and to persist over time even if its original purpose is outdated (Ireland is a good example). During former enlargements of the EU, this sort of misallocation of funds could be shouldered readily by the prosperous member states. Not so with eastern enlargement. There will be a major redirection of financial flows.

The most important structural-policy instrument is »objective-one« funding, which goes to regions with a per-capita GDP (measured in purchasing-power parity) below 75 percent of the EU average. As this average experiences a sizeable decline with eastern enlargement, about 27 regions with approximately 49 million inhabitants will lose their transfers because their regional GDP levels will rise above the 75-percent line. On the other hand, the number of inhabitants below this line would increase from 71 to 174 million. This is about 36 percent of the enlarged EU’s population. If the Union accepted Spain’s recent proposal to retain the existing structural and cohesion policy in the enlarged EU, expenditures would increase to an exorbitant amount. Moreover, the less-developed new member states would get much less per-capita funding than the old cohesion countries. Clearly, this is not recommendable. It is now time that the EU members, both rich and poor, redirect their assistance to the accession countries.

There is another point to be stressed. Fulfilling the goal of the Union’s structural policy – to overcome income disparities between EU regions – will be harder to achieve. This is especially true if we consider regional disparity as a phenomenon that inevitably occurs in economic development promoted by economic forces. Therefore, as an enlarged EU will change from its present character as a rich men’s club to a heterogeneous organization with a large West-East development gap, structural policy should give up supporting less-developed regions. Instead, it should concentrate on promoting the convergence of member countries. Regional policy should be left to the competence of the individual member states, while the reshaped structural and cohesion funds are allocated toward poorer member countries.

That is to say, the reforms should give member states greater control over the choice of investment projects. But to avoid misuse, EU-wide standards for the allocation of funds should be designed and administered consistently. The Commission, with its tendency to become overloaded by administrative details, should be freed from the ex-ante selection of projects and should instead concentrate on ex-post evaluations. If a misuse of money is proved, sanctions could be implemented (i.e., a country could be penalized by being allocated less money for the next financial period). A larger part of allocated funds should be given in the form of preferential credits and within the framework of international banking institutions, such as the European Investment Bank or the European Bank for Reconstruction and Development.

3. Besides the regional-policy instruments, the so-called cohesion funds (established in 1993) have a similar objective. Cohesion funds (ten percent of all funds for structural-policy expenditures) are paid to countries whose per-capita GNP levels fall below the 90-percent line. Cohesion funds are used by member countries to help promote transnational networks and environmental projects.
The funds should be distributed among member states according to their national GDP per capita, measured in terms of purchasing-power parity. We suggest that the maximum amount of funds should be fixed in advance, and presented as an absolute sum or specified percentage of either the EU budget or total EU GDP. In support of eastern enlargement, EU structural policy should concentrate on the lowest-income countries among the new member states. Such a concentration is justified by the fact that the adjustment costs connected with structural change are much higher for the accession countries than for the existing EU members.

**A Road Map to Agenda 2007**

Many problems would be solved if the EU shifts to some kind of confederation of states. However, a united Europe cannot be built following an idealistic blueprint, and no single European sum-

mit can be expected to bring the breakthrough. European integration is “path dependent.” Sol-ving step by step the various problems that arise in the wake of eastern enlargement is as important as discussing the final shape of the EU. Table 3 presents a possible road map toward Agenda 2007.

Already the accession negotiations in 2001 and 2002 should not only establish the terms of reference under which the new member states will enter the Union but also determine how the old member states will be affected by the enlargement. After the elections in many European countries, especially France and Germany, a realistic chance exists that the EU’s mid-term review of agricultural policy will launch major reforms. WTO negotiations in succeeding years will press for further reforms, which will allow the EU to incorporate Central and Eastern European countries under equal terms. With respect to structural policy, some kind of provisional deal, based on the principle of burden sharing, has to be made – especially with Spain – in order to finish the accession negotiations suc-

### Table 3:
**A Road Map to Agenda 2007**

<table>
<thead>
<tr>
<th>Year(s)</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001–2002</td>
<td>Negotiations over eastern enlargement</td>
</tr>
<tr>
<td>2002</td>
<td>Elections in many European countries, among them France and Germany</td>
</tr>
<tr>
<td>End of 2002; beginning of 2003</td>
<td>Mid-term review of agricultural policy</td>
</tr>
<tr>
<td>End of 2002; beginning of 2003</td>
<td>End of the negotiations over enlargement, important decisions on the terms of entry for the first round of accession countries</td>
</tr>
<tr>
<td>2003</td>
<td>Checking of cohesion-funds criteria (Ireland probably will be excluded from funding)</td>
</tr>
<tr>
<td>2003</td>
<td>Intensive negotiations in the WTO round on agriculture and other conflicting issues</td>
</tr>
<tr>
<td>2004 or 2005</td>
<td>First accession countries will enter the European Union</td>
</tr>
<tr>
<td>2004</td>
<td>Intergovernmental conference on the European Union’s decision-making structures</td>
</tr>
<tr>
<td>Our proposal: 2006</td>
<td>New intergovernmental conference: Agenda 2007, on the financial perspective for the years 2007–2013 and further institutional and policy reforms</td>
</tr>
</tbody>
</table>
cessfully by the end of 2002 or 2003. Net payers, especially Germany and Austria, might dig in their heels if they are forced to give up their priority of a rapid enlargement and their demand on transitional periods for the free movement of labor.

The next important step is the Intergovernmental Conference (ICG) already planned for 2004. It should clarify the distribution of powers among the different levels of governance in the EU. The conference could serve as an opportunity to delegate responsibilities for agricultural and structural policies to member states. Negotiations on Agenda 2007 probably will start already in 2005 and should be finished in 2006. The agenda should not only address the financial perspective of the years 2007 to 2013 but also a new design of EU policies. In addition, it should initiate the process of introducing major reforms in EU institutions, which should lead to more efficient, transparent and legitimate decision making.

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