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**Agenda 2000 - Volume I - Communication :
FOR A STRONGER AND WIDER UNION**

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INTRODUCTION

The Madrid European Council in December 1995 reaffirmed that the necessary decisions for launching the accession negotiations with the countries applying for European Union membership would be taken within six months of the conclusion of the Intergovernmental Conference (IGC) and in the light of its outcome. It called on the Commission to submit as soon as possible after the IGC the opinions on the individual applications and to embark on the preparation of a composite paper on enlargement. It further asked the Commission to undertake a detailed analysis of the European Union's financing system in order to submit, immediately after the IGC, a communication on the future financial framework of the Union as from 31 December 1999, having regard to the prospect of enlargement.

The present Agenda 2000 communication, together with the opinions on each application for accession, constitutes the comprehensive Commission reply to these requests. It outlines in a single framework the broad perspectives for the development of the Union and its policies beyond the turn of the century, the horizontal issues related to enlargement, and the future financial framework beyond 2000 taking account of the prospect of an enlarged Union.

Enlargement plays a far greater role in Agenda 2000 than in any of the large financial packages of the past. The number of applicant countries and the differences between them are greater than ever before, and they will all be net recipients of Community funds. Moreover, both the policy reforms and the absorption of new members will have to be accommodated in a tight budgetary framework.

What has been achieved since the Single Act

Europe has undergone considerable changes in the space of a single decade. Two successive enlargements have raised the number of Member States to fifteen. Two major Treaty reforms - the Single Act and the Treaty on European Union - have radically modified the Union's institutional and political framework. And two comprehensive financial packages have redefined the objectives and means of integration that have accompanied these changes.

These developments contributed to a new dynamic of integration paralleled only by that of the early years of the Communities. The launching of the Single Market was instrumental to this process, as was the unprecedented effort of solidarity between Member States expressed in the rapid development of economic and social cohesion policies. The road to economic and monetary union (EMU), which was opened up by the Single Act and formally established in the Maastricht Treaty, further strengthened this development by encouraging greater economic stability and confidence.

This regained momentum in the history of European integration was based on both a strong and evolutive treaty framework and on sound and stable medium-term financial perspectives, coupled with an interinstitutional consensus on the need for budgetary discipline and moderation in the development of Union policies. In spite of the considerable expansion of Union action over the past decade, the Community budget has stayed well below the expenditure ceilings. In actual payments, the 1997 budget remains at 1.17% of GNP in comparison with a financial perspective ceiling of 1.23 % GNP.

But the historic acceleration of the pace of European integration in this past decade was also influenced by outside events. The end of the Cold War and the break-up of the Soviet Union opened up new horizons of international cooperation, and propelled the Union into a key role for promoting change and stability across Europe. This was notably the case through its support for German unification, and the major assistance effort for the countries of Central and Eastern Europe (CEEC). The 1993 Copenhagen European Council opened up the perspective of enlargement towards these countries. Subsequently, an ambitious strategy of pre-accession was launched at Essen.

Closer relations have also been established with the New Independent States emanating from the former Soviet Union and with the countries on the Southern and Eastern rim of the Mediterranean. Similarly, the breadth and strength of the Union's relations with the West-European partners and the United States was reflected in the establishment of the European Economic Area and the New Transatlantic Agenda. On the economic front, the Union played a decisive role in the successful conclusion of the Uruguay Round and the establishment of the World Trade Organization (WTO). It thus confirmed its stature as a key player in the context of growing globalisation.

But these genuine advances should not mask the difficulties encountered by the Union in recent years. These were first and foremost economic. After the strong economic performance at the end of the 1980s and early 1990s, when 9 million jobs were created, the subsequent downturn caused rising unemployment in the Union and made budgetary and structural reforms in the Member States more difficult to achieve. Nevertheless, considerable progress has been made since, not least as a result of the convergence programmes established under the Maastricht Treaty provisions to prepare for EMU. At Union level, policy coordination has been strengthened and new initiatives taken to make better use of the potential of Europe as a single economic entity. Although these actions contribute to giving the Union a better economic outlook now than it has had for many years, unemployment levels are still at an unacceptably high level.

The difficulties were also of a political and psychological nature. The debate on the ratification of the Maastricht Treaty revealed that the general public had not kept up with the accelerating pace of institutional change, in which they did not feel properly involved. The importance taken by the Union in daily news stood in contrast to the persistence or even aggravation of their own difficulties. Since the Union has become so important, people expect a lot of it. They want to be listened to and to be involved, they want answers to their concerns - be they unemployment, the environment, public health, the problems of drugs and crime or the instability near our borders.

The Treaty of Amsterdam

Before embarking on a crucial new stage in the history of Europe, it was necessary to modernise the Treaty in order to strengthen Citizen's Europe, improve the Union's capacity for external action and reform the institutional framework. Those were the stakes of the IGC which has just finished. The Treaty of Amsterdam made considerable progress on these fronts, but the institutional reforms were only partial and need to be completed before the forthcoming enlargements. The provisions on an area of freedom, security and justice and the integration of the Schengen Convention into the Treaty constitute a major step towards a Citizen's Europe. The incorporation of a Title on Employment translates the importance of the fight for employment in the Union into Treaty language. The changes to the social and environment provisions manifest the concern to build a Europe that is more human, closer to the citizen.

The new treaty improves the provisions on the common foreign and security policy (CFSP) and the coherence between it and external economic relations. The Union can now gradually enhance its presence and effectiveness on the international stage and develop an external policy which is commensurate with its potential and more in line with the expectations of the Europeans.

At the institutional level, the role of the European Parliament as co-legislator has been strengthened quite considerably by the extension of the codecision procedure and the simplification of procedures in general. The extension of qualified majority voting is more modest, even though important new areas of activity, such as research, will now be subject to majority decisions.

There is all the more reason, pending later reforms, to make full use of all the possibilities offered by the new Treaty as regards the changeover to qualified majority voting. This applies in particular to the measures concerning the area of freedom, security and justice, the common commercial policy and the CFSP.

The introduction of enhanced cooperation will also make it easier to take up the challenges of a broader and more heterogeneous Union.

The substantial strengthening of the status and powers of its President will raise the profile and efficiency of the Commission. At the same time, the internal reforms announced by the Commission and mentioned in a Declaration at the Conference will prepare the institution for the requirements of the 21st century.

Strengthening the institutions

The Treaty of Amsterdam is thus a new step on the road to the unification of Europe and allows to start the enlargement process. But that process must not get carried away. The euro must therefore be in place by 1 January 1999, as laid down in the Maastricht Treaty. Similarly, all the Union's policies must be developed and deepened in order to build a wider and stronger Europe.

Above all, the institutions and their functioning must be strengthened in good time, as foreseen by the Protocol on the future of the institutions annexed to the Treaty. Any delay in this respect would only serve to compromise the Union's effective enlargement.

The Commission therefore proposes that, as from now, a date be set for the reform regarding the weighting of votes in the Council which must accompany the reduction in the number of Commissioners to one per Member State prior to the first enlargement. Regardless of the likely date of that enlargement, the political decision on this reform should be taken well before 2000. However, this reform will not be sufficient to proceed with a substantial enlargement, as is also clear from Article 2 of the Protocol on the future of the institutions. The Commission therefore suggests that a new Intergovernmental Conference be convened as soon as possible after 2000 to produce a thorough reform of the provisions of the Treaty concerning the composition and functioning of the institutions. This would, in any event, have to involve the introduction of qualified majority voting across the board.

Enlarging the Union

Enlargement to include the countries of Central and Eastern Europe and Cyprus is a historic challenge for the Union. But it is also an opportunity - in terms of its security, its economy, its culture and its place in the world. The continent-wide application of the model of peaceful and voluntary integration among free nations is a guarantee of stability. The Union, with more than 100 million new citizens, will see enhanced trade and economic activity, and a new impetus for the development and integration of the European economy as a whole. Europe's cultural diversity will be a source of creativity and wealth. The accession of new Member States will enhance the Union's weight and influence internationally.

At the same time, the sheer number of applicants and the very large differences in economic and social development which they will bring with them, will present the Union with institutional and political challenges far greater than ever before. The Union population will potentially increase by more than a quarter to nearly 500 million, but total GDP would rise by barely 5%. Notwithstanding the enormous efforts undertaken by these countries, their integration into existing programmes and structures will be a very delicate task. The enlargement process will also require careful management in the Union's relations with other partners in Europe and beyond, in order to ensure that it contributes to the overall objectives of strengthening international security and cooperation.

The challenges ahead

With the help from a new Treaty, the support from a strong euro and a vast internal market and the driving force from the dynamics of enlargement, the Union should enter the next century in conditions which are better than those which it faces today. In this perspective, a reflection is needed on how longer term trends, both internal and external, will shape events and influence the ways in which it can hope to achieve its objectives.

This reflection must also address the question of how to develop the European model of society in the 21st century and how to best respond to the major *concerns of the citizens*. The primary of these concerns relates to the present unacceptably high rates of unemployment and social exclusion which tear at the very fabric of society. At the same time, growing threats to natural environment have become a major issue for all citizens. Similarly, drug abuse and organized crime are increasingly at the forefront of citizen's preoccupations.

The *demographic evolution* in the Union over the next 25 years will be quite dramatic : the number of people aged over 60 will grow by 37 million, whereas the working population will decrease by 13 million. This will put increasing strains on pensions and social protection systems, which will require a combination of reforms and strengthened economic performance in order to guarantee the sustainability of a high level of protection. At the same time, the shift in the age structure of the working population strengthens the need to increase the qualifications of young people and to offer the perspective of a full-length working life through continuous learning. Special attention must be given to the growing participation of women in the world of work and society and to changing family patterns.

New technologies develop at an ever increasing pace, and their implications are becoming more and more widespread. They will have a profound effect on all aspects of society. A special effort is required to exploit the new possibilities for the organisation of work they offer, allowing to combine flexibility with individual interests. Technological change can raise productivity by enhancing people's skills, improving tools and facilitating production processes. In areas where this combination is particularly successful, such as the information society, biotechnology or environmental technology, this evolution creates considerable opportunities for growth and jobs. To make full use of these possibilities, the necessary investments must be made in research, new equipment, the adaptation of management structures and the constant upgrading of human resources. Special attention should be given to make sure that technological progress benefits all sectors of the society.

The ongoing process of *restructuring of markets and enterprises*, fuelled by innovation, competition and international trade, has been accelerated by the creation of the Single Market. This process will entail the modernisation of manufacturing industry alongside the rapid growth in the services sector, which is particularly favourable to the development of small and medium-sized enterprises (SMEs). In this context, public services will need to adapt accordingly. The major challenge here is to balance the dynamic and social aspects of the restructuring process by combining flexibility for enterprises with security for individuals. While restructuring is both necessary and beneficial in overall terms, *labour market rigidities* and mismatches between skills and demand have made it difficult to take full advantage of its employment potential. This problem has been aggravated by the persistent low geographical mobility of people, both in the Member States and between them.

The Union will have to adjust to the *continued process of globalisation*. It is well placed to draw advantages from this process; its overall economic balance with the rest of the world is positive and has grown more so with market liberalisation. The external dimension of Community policies - on the environment or energy, for instance - will more than before become an integral component of its external relations. The Union will also have to adapt to the emergence of a *multi-polar world*. Its economic and geopolitical weight give it the possibility of becoming an important actor on the world stage. To that end, it will have to develop a coherent overall approach to its external relations.

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It is against this background that the Commission presents its Agenda 2000 communication which sets out to deal in a comprehensive manner with the future challenges of the Union.

The first part deals with the development of Union policies. Building on the new Treaty of Amsterdam, internal policies should set the conditions for sustainable growth and employment, put knowledge at the forefront, modernize employment systems and improve living conditions. Further reforms of structural policies and of the common agricultural policy (CAP) will deepen the commitment to economic and social cohesion as well as to agriculture and rural development while preparing the Union for enlargement. Finally, it addresses the question of how to achieve greater unity and effectiveness in the Unions external relations.

The second part addresses the challenge of enlargement. It draws the main conclusions and recommendations from the individual opinions on the applicant countries and gives the Commission's views on the launching of the accession process and on reinforcement of the pre-accession strategy. Volume II of this communication contains an analysis of the impact of enlargement on the Union's policies and a detailed presentation of the reinforced pre-accession strategy.

The third part provides the new financial framework for the period 2000-2006. It demonstrates that the twin objectives of deepening and enlarging the Union can be achieved within the 1.27 % GNP ceiling for own resources, thus ensuring continued budgetary discipline, and addresses the question of the future financing system.

Taken together, these elements offer a clear and coherent vision of the Union as it enters the 21st century.

PART ONE: THE POLICIES OF THE UNION

Beyond 2000

The Union's internal and external environment is in a state of rapid change. Europe must adapt, develop and reform. Even more than in the past it must concentrate on what is essential and focus its attention on areas where it can provide real added value. Through its right of initiative the Commission has a crucial role to play in reshaping the policies of the Union. At the same time it must rethink its action and improve its administrative, coordination and control capabilities. In a bigger and more diversified Europe, its role as defender of the common interest will be even more decisive than in the past. To succeed in this, it must reorganise and modernise its structures.

The development of *internal policies* is a first priority. This should be done in four directions: setting the conditions for sustainable, employment-intensive growth, putting knowledge and technology to the forefront, modernizing employment systems and improving living conditions.

The objectives of *cohesion* are clearly stated in the Treaty. Economic and social cohesion will become even more important in an enlarged, and therefore more diversified Union. The cohesion effort is an investment in our own future. The question is how to adapt the Union's instruments to the future and to the challenge of enlargement.

The 1992 reform of the *Common Agricultural Policy* has been highly successful. But the time has come to deepen the reform and to take further the movement towards world market prices coupled to direct income aids. Several reasons militate for such an approach : the risk of new market unbalances, the prospect of a new trade round, the aspiration towards a more environment-friendly and quality-oriented agriculture, and last but not least the prospect of enlargement. At the same time, there is a growing need for a fully fledged rural development policy.

In its *external relations*, the time has come for the Union to develop a fully operational foreign policy. The Amsterdam Treaty gives it more adequate instruments to develop the CFSP. The euro provides it with a unique opportunity to become one of the leading financial players. Enlargement will enhance its influence. There is a genuine call for Europe whose partnership and cooperation is sought after worldwide. The Union must respond positively, both because it has political and economic interests to defend and because it has a major contribution to bring to peace, democracy and the defence of human rights and values.

I. INTERNAL POLICIES

The successful passage to EMU and the full exploitation of the potential of the single market will enhance Europe as an economic entity, contributing to sustainable growth. Its competitiveness depends on dynamic enterprises and the skills and knowledge of its people. In order to turn growth into jobs, employment systems should be modernised. Beyond these economic goals, Europeans also want a cohesive and inclusive society based on solidarity, as well as a high quality of life, sound environment, freedom, security and justice. The internal policies of the Union should be more resolutely oriented towards meeting these objectives.

1. SETTING THE CONDITIONS FOR SUSTAINABLE GROWTH AND EMPLOYMENT

The process leading towards *Economic and Monetary Union* continues to be a major driving force for the Union. All the technical preparations are now in place to ensure that the euro will see the light of day on 1 January 1999. As a result of the enormous convergence efforts of the Member States, there is a good prospect that a large number of them will be ready for participation from the start. The move towards the euro will not only provide an anchor of stability, improve market efficiency and encourage investment. It will also open new possibilities for more effective *macroeconomic management* in Europe. The Amsterdam Resolution on Growth and Employment and the Stability and Growth Pact provide a favourable framework for economic growth and new job opportunities.

The *Single Market* can play a central role in furthering growth and employment, provided its potential is fully exploited. To this end, the Action Plan endorsed by the European Council of Amsterdam must be implemented in all its components. Making the rules more effective and removing all market distortions and sectoral obstacles will turn Europe into a dynamic and attractive market place. Moreover the Single Market must be there for the benefit of all citizens. The assets of the Single Market must be used to promote the Union's interests and presence internationally.

With further integration, the strict application by the Commission of *competition rules*, including close surveillance of state aids, becomes ever more important for the market operators and will enhance the overall economic performance of the Union. Rules will be made simpler and surveillance and enforcement structures will be modernised in partnership with Member States, with a view to decentralisation where possible. The Union should also press for more international cooperation in competition policy.

Given their proven potential for job creation, improving the operating conditions for *small and medium-sized enterprises* in the Single Market remains a high priority. This must be done by reducing administrative and regulatory red tape, stimulating new forms of cooperation between small and large companies and improving SME access to finance and capital. The projected new EIB lending facility will be of particular importance. Moreover, the Union should continue to fund actions aimed at improving the operating conditions of SMEs.

Following the inclusion of sustainable development as one of the Union's objectives into the Amsterdam treaty, progress must be made towards environmentally sustainable production and consumption patterns. The incorporation of the latest technological evolutions into environmental policy and the use of new instruments like market based incentives can actually enhance the competitiveness of European industry and services.

The continued development of the *Transeuropean networks* (TENs) will serve to enhance both sustainable development and the internal cohesion of the Union by tying regions closer together. This will need to be accompanied by a move towards sounder transport systems, drawing fully on new technology, to address the problems of congestion, pollution and climate change. TENs also have a particularly important role to play in creating new links with the Central and Eastern European candidate countries. It is precisely the trans-European nature of the benefits from these projects which justifies continued substantial contributions at the Union level towards their realisation.

Community funds can play a crucial role in getting TEN projects in transport, energy and telecommunications off the ground. The next financial period will see the main construction phase on many of the priority projects, involving higher overall spending than in the period 1994-99 during which the Community essentially financed preparatory works. Enlargement will extend the geographical coverage of the TENs, and consequently the financing needs. There is a range of sources of finance for TENs, including the Cohesion Fund, the European Regional Development Fund (ERDF) and the European Investment Bank/European Investment Fund (EIB/EIF). Effective coordination of these instruments, including development of public/private financing, is essential, but will not be sufficient to cover the identified needs in this sector. Additional funding must therefore be identified beyond present appropriations.

2. PUTTING KNOWLEDGE AT THE FOREFRONT

The key feature of today's world economy is a rapid shift towards globalisation and information and communication technologies. These technologies determine the global competitiveness of all economic sectors and foster the emergence of new immaterial goods.

In order to derive the maximum benefit from this process in terms of growth, competitiveness and employment, special attention must be paid to the development, dissemination and use of these immaterial goods. *Knowledge policies* - research, innovation, education and training - are therefore of decisive importance for the future of the Union.

In response to the challenges of technological development and innovation coming at a time when Europe's competitors are stepping up their efforts significantly, it is vital that the Community *research and technological development* effort be given new impetus. Community RTD must provide real added value in relation to national programmes. This is the main objective of the 5th framework programme, which will need to see its financial allocation increased above the level of the present programme. The Union must focus research activities on improving the competitiveness of the European economy, thereby promoting the creation of new jobs. It is particularly important that Europe should be able to transform scientific and technological breakthroughs into industrial and commercial successes. In this connection, innovation by small and medium-sized enterprises is a particularly important factor on which to build. The creation of innovative high-tech companies in Europe must be encouraged. The Union also has to improve on the dissemination of technology and the system of intellectual property rights for its discoveries.

Like research, *education and training* represent essential immaterial investments. The Union will go on giving priority to concrete initiatives to promote exchanges of young people, scientists and teachers along the lines of the Socrates, Leonardo da Vinci and Youth for Europe programmes. The success of schemes like the Erasmus programme should lead to new initiatives to promote transnational mobility for European citizens. An exchange programme for young apprentices should be developed rapidly. At the same time the European youth volunteer programme should be developed. The new generation of programmes would seek to encourage life-long training through innovative transnational projects and the exchange of good practice.

The *information society* holds major opportunities for Europe's competitiveness and its development must be promoted in areas such as electronic commerce and the audiovisual sector. But it has also become a formidable medium for education, training and culture. Familiarity with these new technologies must therefore be improved, in particular in schools.

3. MODERNISING EMPLOYMENT SYSTEMS

In order to draw the maximum benefit from growth and competitiveness for employment, *labour market and employment* policies must be modernised. Whereas the responsibility for these policies is largely national, the Union has provided a reference framework building on the process started in Essen and amplified in Amsterdam. It should fully exploit all the possibilities offered by the new employment title of the treaty such as pilot projects, exchange of best practices, benchmarking exercises and specific recommendations to Member States. In this way, a true coordination of national employment policies will take place involving all relevant actors and stimulating social dialogue. The aim must be maximum flexibility for the enterprises and maximum security for the individuals.

The Community and its Member States will have to rethink a number of policies in order to achieve these aims: how to invest permanently in the skills of the existing work force; how to increase the participation rate by providing new forms of work organisation; how to encourage mobility; and how to anticipate and respond to restructuring by appropriately informing and consulting workers, improving their reintegration and stimulating entrepreneurship. The present social protection systems should be made more employment-friendly, unemployment schemes should be geared towards greater employability in the context of a move towards life-long learning. Furthermore, tax regimes should also provide the appropriate incentives towards job creation.

The *reform of pensions and health care systems* against the background of an ageing population presents the Member States and the Union with a particular challenge. It must be reconciled with the need for budgetary rectitude. Modernisation of protection systems must build on common analysis, coordination of policies and joint dialogue with the social partners. The Union will continue to serve as a forum for promoting better mutual understanding of long-term perspectives and for identifying common challenges. Where necessary, regulatory initiatives can provide a new common framework, in particular for pension funds in the euro financial area.

4. IMPROVING LIVING CONDITIONS

The overall growth and employment prospects in the coming decade are encouraging. At the same time, there could still be very different patterns of employment and social development within the Union, or within individual Member States. Special efforts will be required to ensure that the benefits of growth can be used to promote a more *cohesive and inclusive society*. Beyond the targeted use of structural funds and other Community instruments, the Union can play a supporting role by encouraging best practices and facilitating cooperation in the fight against social exclusion and all forms of discrimination.

Recent events have increased the sensitivity of Europeans as regard *public health*. There is an urgent need to draw the lessons from this situation, notably for improving food safety. As a matter of priority, a reflection is needed on the system of authorisations for the production and distribution of products with an impact on public health. In this context, Article 129 as complemented by the Amsterdam Treaty should be fully exploited. The Union should also defend its approach and high standards in this field at the international level in accordance with multilateral rules.

In order to be able to respond to *the environmental challenges* in an enlarged Union, a better implementation and enforcement of the environmental *acquis* must be ensured. Further efforts will have to be made towards integrating environmental considerations into the design and implementation of all relevant Community policies, thus responding to public demand for creating higher “quality of life”.

Globalization and increased economic integration imply that cost-effectiveness becomes a crucial determinant of sound environmental policy and so does an extended cooperation with the stake-holders, as successfully practised in the Auto/Oil Programme. This not only preserves and improves the situation within the Union, but also presents a way to achieve the objectives the Union is committed to in the follow-up of the Special Session of the United Nations General Assembly on the environment and sustainable development.

The right to move and settle freely is fundamental to the European citizen. The free movement of persons must however be accompanied by an adequate level of security and justice if it is to be seen as a genuine advantage by all. In Amsterdam, this twin requirement was written into the Treaty in the form of a progressive establishment of an area of freedom, security and justice. The integration of the Schengen cooperation into the Treaty amplifies the *acquis* in this area.

Migratory pressures on Europe will remain strong in the coming years and will, as in the past, have a strong impact on economic and social development. Europe will continue to attract people in need of international protection.

Crime, fraud, corruption, trafficking in human beings or smuggling of drugs and other illicit goods all call for clear common responses. With the new Treaty there is now scope for developing a comprehensive Union policy covering border control, immigration, asylum, the fight against crime in all its forms as well as judicial cooperation in civil and criminal matters. The Action Plan against Organised Crime agreed in Amsterdam bears witness as to the political determination to move forward immediately in this area of great interest to the European Citizen.

II. ECONOMIC AND SOCIAL COHESION

1. CONTINUING TO STRIVE FOR COHESION

Maintaining the political priority

Economic and social cohesion was introduced in the Single European Act, paving the way for the 1988 reform of the Structural Funds. The Treaty on European Union turned cohesion into one of the three pillars of the European construction alongside economic and monetary union and the Single Market. Finally, the Amsterdam Resolution on growth and employment enshrines the priority to be given to fighting unemployment.

There is no doubt that economic and social cohesion must remain a political priority. In fact, the prospect of enlargement to new countries with widely differing levels of development makes it still more essential. European solidarity will become more important than ever in achieving the major goal of reducing disparities in levels of development explicitly set by Article 130a. It makes a vital contribution to the stability of the Union and the promotion of a high level of employment. There is still a need to address the unequal abilities of the regions to generate sustainable development and their problems in adapting to new labour market conditions, which require a more forward-looking adaptation of the skills of working men and women. The Structural Funds should aim at fostering competitive development and sustainable and job-creating growth throughout the Union and the promotion of a skilled, trained and adaptable workforce.

Assuring financial solidarity

The European Council in Edinburgh decided that this solidarity should reach a significant proportion of the Union's GNP (0.46%) at the end of the current financial perspective.

The priority given to economic and social cohesion has been translated into comprehensive programmes implemented in partnership with Member States and regions, both for regions where development is lagging behind (Objectives 1 and 6), and for declining industrial areas (Objective 2) and rural areas (Objective 5(b)). A substantial effort is also being devoted to employment and industrial change (Objectives 3 and 4).

The first Cohesion Report drawn up under Article 130b of the Treaty showed the need for and relevance of the Community's structural support system and allowed for lessons to be learnt for the future. It also demonstrated that the Member States and regions which lag behind and are eligible under Objective 1 have made progress towards real convergence, not least as a result of assistance from the Structural Funds and the Cohesion Fund. However, despite significant successes, there is still much left to be done, particularly as regards employment: unemployment has not fallen significantly and is growing not only in many less-developed regions where disparities are widening but also in the more prosperous parts of the Union. The effort to support both the balanced development of the Union and the development of human resources throughout it will therefore have to continue over the next period of the financial perspective.

However, budgetary constraints will make it impossible to go beyond the effort made in terms of Union GNP in 1999 (0.46%). Nevertheless, with the extra resources generated by growth and a more efficient use of the resources available, it should be possible to finance both the development of structural policies in the Union of 15 and the gradual integration of new Member States from the moment of their accession.

Category 2 of the Community budget, covering structural operations, will therefore have to retain a privileged place in the budget. However, automatic and systematic rebudgeting in the framework of multi-annual programming is to be avoided.

An amount of ECU 275 billion (at 1997 prices) will be available for Structural operations (under both the Structural Funds and the Cohesion Fund) as compared with ECU 200 billion for 1993-99. On the basis of the assumptions made in Part Three of this communication, ECU 45 billion will be earmarked for the new Member States, including ECU 7 billion by way of pre-accession aid. The increase in transfers to the acceding countries will be gradual in line with their absorption capacity. At all events, total transfers from the Structural Funds and the Cohesion Fund to a present or future Member State should not exceed 4% of its GDP.

A better division of responsibilities

Making the Structural Funds more effective will require simplification of management and greater flexibility and decentralisation in implementation, in line with modern management principles and future staffing restrictions. In return, the Commission will require greater selectivity and rigour when priorities are defined at the outset. This is where the concept of partnership between the Commission and the Member States will have to be given a real meaning. The monitoring and evaluation systems will also have to be improved and checks made more efficient and rigorous.

2. GREATER CONCENTRATION

The Commission proposes to consolidate the budget effort of the Structural Funds over the period 2000-2006 at a level of ECU 210 billion for the 15 existing Member States. This means that over the new period average annual funding for the EU-15 will fall slightly from the 1999 level.

For reasons of visibility and efficiency, the present seven Objectives should be reduced to three: two regional Objectives and a horizontal Objective for human resources.

The percentage of the population of the Union of 15 covered by Objectives 1 and 2 should be reduced from 51% to 35%-40%. This figure will be smaller than the population covered by Article 92(3)(a) and (c), which should also be reduced from 1 January 2000. Furthermore, measures for the regions which will benefit from transitional (phasing out) support from the Structural Funds will have to comply with the competition rules on state aids.

A continuing high priority for Objective 1

The regions lagging behind in development which are eligible under Objective 1 and which face the most serious difficulties in terms of income, employment, the productive system and infrastructure, should enjoy the same priority as at present. It should be noted that their average level of unemployment is 60% higher than the Community average. In some regions, over one quarter of the labour force is unemployed.

That is why the total amount of the Structural Funds to be allocated to the Objective 1 regions should cover about two thirds of the Structural Funds available for the 15 Member States, a share comparable to the average for the current programming period.

In future, the threshold of a *per capita* GDP of 75% of the Community average should be applied strictly. Care should also be taken that there is complete congruence with the regions assisted by the Member States under Article 92(3)(a) of the Treaty. The efforts made following the 1993 revision of the Structural Funds regulations to achieve indicative financial allocations which are more objective, transparent and equitable should be continued. Using objective criteria broadly similar to those for the current period, only the eligible population, the gap between regional prosperity and the Community average, and national prosperity should be taken into account. Additional support would be granted to regions with a high level of unemployment.

For those regions currently eligible under Objective 1 but which will have passed the 75% threshold, phasing out of the relevant transfers over a transitional period will be required. The precise ways of achieving this will be defined at a later date. In view of their particular situation, the outermost regions covered by a new Treaty Article and Protocol will be treated as Objective 1 regions on an *ad hoc* basis. Similarly, the most northern regions with an extremely low population density which do not qualify for Objective 1 but which are at present eligible under Objective 6 should enjoy special arrangements.

As is presently the case, an integrated approach should be applied to the development of structurally backward regions. The success of efforts undertaken in partnership with the Member States depends on appropriate coordination of all the components of structural assistance, whether from the Regional Fund, the European Agriculture Guidance Fund (EAGGF - Guidance Section), the Social Fund or the Financial Instrument for Fisheries Guidance (FIFG). Each region will have to be looked at in terms both of specific needs and Community priorities. Programmes will be drawn up taking account as much as possible of the priorities voiced by the regions concerned. There will be special emphasis on improving competitiveness, which is vital if jobs are to be created and maintained. This will require support for measures to assist infrastructure, innovation, SMEs and human resources.

Redefining Objective 2 - economic and social restructuring

A new Objective 2 devoted to economic and social restructuring will bring together measures for other regions suffering from structural problems. These are areas undergoing economic change (in industry or services), declining rural areas, crisis-hit areas dependent on the fishing industry or urban areas in difficulty. All these areas are facing structural problems which take the form of economic restructuring problems, a high rate of unemployment or depopulation. A limited number of significant areas should be identified in order to facilitate an integrated strategy for economic diversification.

Almost one fifth of the population of the Union outside the Objective 1 regions lives in areas where the unemployment rate is above the Community average. Youth unemployment is still over 30%. In some urban areas, unemployment ranges from 30% to 50%.

Vigorous structural measures are required to foster diversification, restore economic dynamism and promote an active business culture. Such measures should help exploit the very high economic development potential of such areas, accompany restructuring and encourage the adjustments required. Particular attention will have to be paid to education and training and to access to new technologies to the extent that skills do not meet the requirements of a modern economy.

The new programmes to support the Objective 2 areas will favour economic diversification, including in regions heavily dependent on a single declining economic sector. This will require increased support for small and medium-sized enterprises and innovation as well as a greater emphasis on vocational training, local development potential, the protection of the environment and combating social exclusion, particularly in urban areas in difficulties. Investment in human resources, based on anticipation and on activating the labour market and on permanent training, should be increased in these areas undergoing changes. The development of rural areas should build better links between the countryside and local towns. This should facilitate the diversification of industrial, craft, cultural and service activities.

The Commission would like to see simpler, transparent and specific eligibility criteria developed for the various types of areas covered by the new Objective 2. Account will have to be taken of relevant socio-economic criteria, and in particular of the rate of unemployment, the levels of industrial employment, the level and development of activity in agriculture and in the fishing industry, and of the degree of social exclusion. In the interest of simplification, the different funds (ERDF, Social Fund, EAGGF Guidance Section, FIG) will be involved through a single programme per region. The use of Community criteria in the context of partnership with the Member States, and with due regard for their regional priorities, should result in geographical concentration on the areas most affected at Community level. This will lead to a zoning which is less scattered and as consistent as possible with the areas assisted by the Member States under Article 92(3)(c) of the Treaty.

The areas currently eligible under Objectives 2 and 5(b) which would no longer be eligible under the future selection criteria should enjoy limited financial support for a transitional period.

In addition to the aid provided under Objectives 1 and 2 of the structural policies for changes taking place in the fisheries sector, the FIG could support restructuring on the Union's coastline from category 1 of the financial perspective.

Developing a strategy for human resources: a new Objective 3

The development of human resources will be a key element both in the Objective 1 and 2 regions and elsewhere in the Union and should be implemented in a consistent way. A determined effort should be made to modernise labour markets in a way consonant with the multi-annual plans for employment and the new Title on employment introduced in the Treaty of Amsterdam. Priority should be given to access to employment, the development of life-long learning and the promotion of local employment initiatives, including territorial employment pacts.

A new Objective 3 will be introduced for regions not covered by Objectives 1 and 2. It will help the Member States to adapt and modernise their systems of education, training and employment. This is required both to make their economies competitive and for reasons related to safeguarding the European model of society. Education is, in fact, a powerful tool for social equity and inclusion.

The new Objective 3 will be based on a common European framework, but with sufficient flexibility so as to reflect a variety of systems, approaches and levels of development in the Member States. Strategy and funding should therefore be sufficiently flexible so as to be modulated as a function of Member State and the scale of intervention foreseen. The policy dialogue with Member States should ensure that Objective 3 programmes provide concentration within a realistic and effective range of measures and that monies are used in a way which both ensures consistency with the mainstream of national policies and also guarantees visibility of the Union contribution. Objective 3 will promote activity in four areas which will complement the guidelines developed as part of the European Employment Strategy:

- accompanying economic and social changes;
- lifelong education and training systems;
- active labour market policies to fight unemployment;
- combating social exclusion.

Reducing the number of Community Initiatives

There are at present 13 Community Initiatives, which have resulted in 400 programmes, as many as all the other structural measures put together. This is clearly excessive, particularly since the Initiatives often deal with the same topics as the main programmes.

Reform is obviously required to bring out more clearly the Community interest of the Initiatives and their innovative character. The Commission is therefore proposing to restrict them to three fields where the value added by the Community is most obvious:

- cross-border, trans-national and inter-regional cooperation to promote harmonious and balanced spatial planning;
- rural development;
- human resources, paying special attention to equal opportunities.

The schemes covered by other Initiatives will be incorporated in the programmes financed under the various Objectives. This will enable the share of the resources of the Structural Funds allocated to the Community Initiatives to be reduced to 5%.

Finally, innovative measures and pilot projects, which currently absorb 1% of the Structural Funds must be improved. Such an arrangement will make it possible to test innovative measures, to provide an interesting financial lever and to develop stronger partnerships. However, a scattering of means and the proliferation of mini-projects which are difficult to manage effectively and to monitor should be avoided at all costs. Consideration should therefore be given to concentrating on significant projects and making implementation simpler and more transparent.

3. THE FUTURE OF THE COHESION FUND

One of the major innovations of the Treaty of Maastricht was the decision to establish a Cohesion Fund “to provide a financial contribution to projects in the fields of environment and trans-European networks in the area of transport infrastructure.” (Article 130d).

Assistance from this Fund is subject to three conditions: it goes to those Member States whose *per capita* GNP is less than 90% of the Community average. It is aimed exclusively at projects concerned with the environment and transport and it is applicable only where a national programme leading to the fulfilment of the requirements of economic convergence referred to in Article 104c of the Treaty has been drawn up.

It is proposed that this fund be maintained in its present form; Member States whose *per capita* GNP is less than 90% and which take part in the third phase of EMU should remain eligible for assistance from the Fund. The latter’s national coverage enables Community support for the whole territory of the less prosperous Member States to be continued. Macroeconomic conditionality should continue to apply. For countries taking part in the third phase of EMU, this will require compliance with the Stability and Growth Pact and in particular the stability programmes. A review of eligibility under the criterion of *per capita* GNP being less than 90% of the Community average will be carried out half-way in the period.

It is proposed that the Fund should have available, for all its beneficiaries, a total of some ECU 3 billion per year.

4. STRUCTURAL SUPPORT FOR THE NEW MEMBER STATES

As soon as the next enlargement of the Union takes place, support from the Structural Funds and the Cohesion Fund should in theory apply to all the countries which join. There is ample reason for Community solidarity towards these new democracies, which have enormous development needs, particularly as regards infrastructure, including in the environmental field, the productive sectors and human resources.

To avoid major problems with regard to absorption, the level of annual aid should increase gradually, subject to the general limit of 4% of national GDP, which would apply to the Structural Funds and the Cohesion Fund together.

As a result, the resources under category 2 of the Community budget available for the new member states would be about ECU 45 billion for the Structural Funds and the Cohesion Fund. At the end of that period, the level of structural transfers to the new member states would represent approximately 30% of the total for category 2.

Pre-accession aid, to be drawn from the ECU 45 billion allocation for the new Member States, would be made available from the year 2000. This assistance, to be granted at a constant rate of ECU 1 billion per year, would initially be granted to all the applicant countries and would subsequently be focused on countries due to join the Union at a later stage. It would be primarily intended to help bring the applicant countries' infrastructures up to Community standards, particularly in the transport and environment fields, along the lines of existing Cohesion Fund transfers. It would also enable the countries concerned to become familiar with the procedures concerning structural operations.

5. ENHANCING COST-EFFECTIVENESS

The reduction of economic and social disparities depends not only on a real medium-term vision of territorial development and human resources supported by adequate resources, but also on a demanding and decentralised partnership to facilitate the preparation of integrated regional and social development strategies. This is the background against which the Union's structural instruments will be radically adapted to make them more effective through simplification, evaluation and auditing.

The reduction in the number of Objectives and Community Initiatives constitute a first step towards simplification. Other approaches, aiming at the simplification of operational procedures, should also be explored. There would be a single multi-annual programme for each region for Objectives 1 and 2. For the horizontal Objective 3, there would be a national programme or a set of regional programmes. This would substantially reduce the administrative burden while strengthening the integrated strategic approach to development and further building on the political dialogue between the Member States, the regions, the economic and social partners and the Commission concerning the effectiveness and the results of measures financed by the structural policies.

Simplifying the system for implementing the structural policies requires first of all a clear division of responsibilities between the national, regional and local authorities and the Commission. This division should be based on the following elements:

- The Commission and the national, regional and local authorities will identify in partnership the priorities for development and assistance in relation to verifiable targets.
- Management in the Member States and the regions will be decentralised, with special treatment of major projects. It will be facilitated by simpler financial management at both Commission level and that of the Member States. In return for decentralised management, the Member States and the regions will systematically have to account directly for the use made of the Structural Funds.
- To provide more stringent checks and verification of results, the Commission will ensure that the Member States have adequate systems for management, evaluation and auditing.

Finally, increased effectiveness could be backed up by a reserve, which should be substantial (at least 10%) and allocated only half-way in the period to regions with good performance in terms of results that are verifiable, including from the standpoint of budget implementation. It should be simple and transparent in application.

The multiplier effect of structural resources should be increased by greater use of other forms of assistance than grants (interest-rate subsidies, guarantees, venture capital holdings, other holdings) in order to better respond to economic needs and take better account of the returns from projects. This would also apply to infrastructure, including the trans-European networks. In this respect, greater cooperation between the EIB, the EIF and the Structural Funds appears to be an essential first step.

III. THE COMMON AGRICULTURAL POLICY

In December 1995, the Commission presented its Agricultural Strategy Paper to the Madrid European Council. This stressed the importance of improving the competitiveness of the European agricultural and agri-food sectors on internal and world markets, in the context of trade liberalisation and an expected growing world food demand. It highlighted the need for a further evolution of the CAP, by developing the approach successfully started by the 1992 reform. The Paper also outlined the need for an integrated rural policy which would accompany the reform process. Moreover, it called for a radical simplification of legislation at Union level and for a substantial decentralisation of policy implementation.

Later on, in November 1996, the First Cohesion Report argued in particular in favour of a more rational development of agricultural production, through a greater market orientation of prices and continuing structural adjustment. The Union should make a parallel effort to enhance the economic potential and the environmental value of rural areas and their capacity to provide sustainable jobs.

Building on these ideas, it is now time to formulate concrete proposals to reshape the common agricultural policy and prepare it for the next century.

1. THE ASSESSMENT OF THE REFORM PROCESS

Agricultural market policy

After the 1992 reform, there has been a considerable improvement of *market balances* and a decrease of public stocks in most of the reformed sectors. In the case of cereals, set-aside has helped to keep production under control, while the increased price competitiveness has allowed significant additional quantities to be used on the domestic market, mainly for animal feed. In the beef sector, the market situation evolved favourably and intervention stocks were diminishing rapidly until the outbreak of the BSE crisis in March 1996.

The general evolution of *agricultural income* per capita has been positive since the reform was implemented growing by + 4.5 % on yearly average between 1992 and 1996, with a diversity of situations according to Member States and farm orientations. The improvement of the market situation, the strong adaptation capacity of farmers, the agri-monetary context and, last but not least, the continuing decline in agricultural employment have contributed to this result. In the case of cereals the market prices improved much more than originally expected. This has led to an over-compensation of producers in the last few years. In the case of oilseeds, too, the observed market prices have been most of the time significantly higher than the reference price so that producers have benefited from the franchise in four years out of five.

The reform effects on the *environment* are mixed. Some positive elements can be identified: the more rational use of fertilisers and pesticides resulting from price decreases, the possible environmental benefits of set-aside (if well managed), incentives for a long-term improvement in the territorial distribution of livestock rearing. But there are also negative elements, mainly the encouragement given to irrigated crops through the regionalisation of direct payments to cereals, oilseeds and protein crops, as well as the relative advantage given to intensive livestock farming through lower feed prices and subsidising silage.

The reduction of price support and the introduction of direct payments have benefited *consumers* as part of the burden of agricultural support has shifted away from them. *Budgetary expenditure* is therefore significantly higher in the sectors concerned. It is also under better control since factors of uncertainty (world prices, dollar exchange rate, level of intervention stocks) that strongly affected its past evolution have become less determining. At the same time the shift to direct payments has made the support for farmers more transparent.

Rural development policy

Since almost two decades, attempts have been made to integrate agricultural structural policy into the wider economic and social context of rural areas. Experience gained shows how **rural diversification can be exploited in a flexible way as a necessary complement to farming.** Activities which had hitherto been marginal - the development and marketing of high-quality produce, rural tourism, investment projects linked with the environment or the region's culture, small and medium-sized enterprises - have been developed and opened up new perspectives.

The 1992 CAP reform stressed the environmental dimension of agriculture as the largest land user. Among the accompanying measures of the reform, the agri-environmental measures are of key importance and **have in general been welcomed by the public and well received by farmers.** However, the scale of support still provided through prices and crop specific payments (e.g. silage maize and flax) may discourage farmers from committing themselves to more extensive practices or dedicating land to environmental purposes.

On the whole, as a result of these different developments, rural policy in the Union still appears as a juxtaposition of agricultural market policy, structural policy and environmental policy with rather complex instruments and lacking overall coherence.

2. LONG-TERM OUTLOOK

According to the major forecasting institutes world-wide, the long term outlook for the main *agricultural markets* is favourable for exporting countries. Prospects for increased food consumption, mainly in developing countries, combined with the limited possibility of a proportionate growth in domestic production, are expected to boost world trade and sustain world prices over the next decade.

Two key factors influence *food demand*: population growth and rising incomes. The world population is expected to increase by more than 85 million people a year between 1995 and 2005. Moreover, growing urbanisation will influence the pattern of food consumption. The second factor determining increasing food demand is the favourable prospect for world incomes and economic growth, particularly in developing countries.

An increase in world *agricultural production* is expected over the next decade, but at a lower rate than in the past. In particular in many developing countries, the increase will be less than the growth in demand. This is firstly due to the limited availability of land, because of urbanisation and environmental constraints and, secondly, to a slowdown in the growth of yields. The development of genetic engineering, if well controlled, could enhance production but may raise questions of acceptability to consumers.

Almost all analysts expect generally *strong prices for agricultural commodities* up to 2006 and even beyond. Prices are projected to strengthen or remain strong for cereals, oilseeds, beef, poultrymeat, cheese, milk powder, but may weaken for pigmeat. However, price variability could increase in the future, as world stocks are expected to be relatively low compared to in the past.

Despite this favourable world context, the *agricultural commodities outlook* is not very promising at European level. Supposing that present policies continue, over the coming years a gap between Union and world prices will remain for many sectors. Taking into account current commitments under the Uruguay Round Agreement, in particular on export subsidies, non-exportable surpluses are likely to emerge after 2000, for the existing Union. A structural surplus was already projected for beef before it was made worse by the BSE crisis. Increasing problems may also appear for cereals, sugar, wine, olive oil, skimmed milk powder and some other dairy products, and the Union risks losing more and more of its share in expanding world markets.

New *multilateral trade negotiations* will start in 1999 as a follow-up to the Uruguay Round. Cutting border protection, reducing export subsidies and reshaping internal support towards more “decoupled” instruments will enhance the Union’s negotiating stance in the new Round. Another, increasingly sensitive, issue is the need to introduce environmental and social standards at international level and to take into account consumer concerns.

Eastward enlargement will add over a 100 million consumers, whose average purchasing power would however be only roughly one third of that of the current consumers in the Union. Agricultural area would be expanded by half and the agricultural labour force would at least double. The Central and Eastern European Countries have a serious need for structural improvement in their agriculture and up- and downstream sectors. Restructuring can be expected to reduce the labour absorption capacity of agriculture, implying a need for diversification of their rural economies.

If the CAP instruments, mainly support prices and direct payments, were applied at their present level by the Central and Eastern European Countries, particular problems would arise. Inordinate cash injections through direct payments would risk creating income disparities and social distortions in the rural areas of these countries. In addition, surpluses would increase, in particular for sugar, milk and meat, reinforcing the growing market imbalances predicted after 2000.

Consumer requirements from agriculture and the food industry are also evolving. Health, notably food safety, is the main one. Convenience (fast-food, ready-made meals and snacks) is becoming more and more important in the context of changing life-styles. But at the same time, typical, well-identified products, linked to specific areas or cultural values (traditional production methods, animal welfare, etc.) are increasingly sought after.

Rural trends in the Union show a sharp decline in the number of farms and in the number of people employed in agriculture. In terms of regional income and employment, agriculture (and forestry) no longer forms the main basis of the rural economy. It represents only 5.5 % of total employment on average, and in very few regions is its share higher than 20 %. The long term trend is a further drop in the number of farmers, at a rate of 2-3 % per year.

New activities and new sources of income are emerging on-farm and off-farm. Among those, the production of *renewable raw materials*, for non-food purposes in niche markets or the energy sector, can represent a new opportunity for agriculture and forestry and contribute to job creation in rural areas.

Society is increasingly conscious of the importance of the *natural environment* and of the environmental effects - both positive and negative - of human activity. Rural areas are in a unique position to respond to these concerns by maintaining and creating environmentally attractive living, working and recreational spaces. In this context, the concept of public payment for the protection of natural resources and the enhancement of the countryside is increasingly gaining acceptance and offers agriculture and forestry, as the main land users, both new challenges and fresh opportunities.

While the successive reforms have improved transparency and effectiveness, a number of inconsistencies and overlaps between different policies have developed. Too many programmes and measures can apply simultaneously in the same area under different policy headings, affecting consistency. There is an urgent need for a radical *simplification* of rules and a greater *decentralisation* of policy implementation, with more margin being left to Member States and regions. More decentralisation should not, however, lead to any renationalization of policies.

The CAP absorbs around 0.6 % of the Community's GDP. Considering both the declining share of agriculture in the economy and the increasing *budgetary constraints* many Member States are facing, this public support has to be fully justified. This means that the crucial role that agriculture plays, in producing high quality food, in maintaining a living countryside, in protecting landscapes and preserving cultural values, has to be clearly demonstrated. While the generalisation of direct payments to farmers after the 1992 CAP reform made financial support for agriculture more transparent, it also increased the need for it to be economically sound and socially acceptable.

3. POLICY OBJECTIVES FOR THE CAP

In order to help European agriculture take advantage of the expected positive world market developments, further reform of the CAP must *improve the competitiveness* of Union agriculture on both domestic and external markets. Lower prices will benefit consumers and leave more room for price differentiation in favour of high quality speciality products). Greater market orientation will facilitate the progressive integration of new Member States and will help prepare the Union for the next WTO Round. It will also help the Union to reinforce its position as a major world exporter.

Prices are, however, only one aspect of competitiveness. *Food safety and food quality* are at least as important. It is a fundamental obligation to guarantee the safety of food to consumers both within and outside the Union, and this must therefore be a top priority for the CAP. As far as possible it will continue to support quality products, which are often linked to specific geographical origins or specific production methods identifiable by consumers.

Complete reliability from the point of view of food safety, and continuous efforts to improve quality, will also determine the image of European products on domestic and international markets. Of growing importance in this area too are questions of the environmental friendliness of production methods, and animal welfare considerations. In all these respects, European farmers are able to offer quality products deserving to be known worldwide.

Ensuring a fair standard of living for the agricultural community and contributing to the stability of *farm incomes* remain key objectives of the CAP. In this context the questions of differentiation, redistribution of income support among farmers and the preservation of sustainable farming are gaining importance, not least from the point of view of social cohesion.

The integration of environmental goals into the CAP and the development of the role farmers can and should play in terms of management of natural resources and landscape conservation are another increasingly important objective for the CAP.

The creation of complementary or alternative *income and employment opportunities* for farmers and their families, on-farm and off-farm, remains a major aim for the future, as employment possibilities in agriculture itself fall away. Rural areas are multi-functional, and farmers should be encouraged to exploit all opportunities for rural entrepreneurs.

Last but not least, while recognizing the need of all rural areas for improving agricultural competitiveness and enhancing economic diversification, agricultural and rural policies have to contribute to *economic cohesion* within the Union.

4. NEW REFORMS

The Commission confirms the policy choice expressed in the “Agricultural Strategy Paper” of December 1995. It proposes deepening and extending the 1992 reform through further shifts from price support to direct payments, and developing a coherent rural policy to accompany this process. Direct payments will be set at an appropriate level while avoiding any overcompensation.

Crop sector: Cereals, Oilseeds and Protein crops

Over the coming years, the areas devoted to the cultivation of these crops and to set-aside are expected to stabilize at a level of about 53.5 million hectares. In the present policy framework, and supposing that the set-aside rate returns to its reference level of 17.5 %, the areas devoted to each of the three crops would also be relatively stable over time.

Cereals yields are forecast to resume their upward trend and production is therefore expected to rise from 201 million tons in 1996 to 214 million tons by 2005. Total consumption of cereals is also forecast to further increase, though at a slower rhythm, in response to the development of white meat production. Up to 2000, the situation is likely to remain relatively tight, in particular for wheat. From 2001 onwards, the current GATT commitments on subsidised exports become constraining for both wheat and coarse grains, leading to a rapid increase in intervention stocks (some 58 million tons by 2005).

Oilseed yields are expected to increase very modestly and the area cultivated is strictly limited by the outcome of the Uruguay Round Agreement. Production is expected to increase slightly, from 12.2 million tons in 1996 to 12.8 million tons in 2005. Trade deficits in oilseeds and oilseed meals would remain very substantial.

In theory, it would be possible to react to new cereals surpluses by increasing the compulsory set-aside rate. But this could then risk gradually increasing to over 20 %. Furthermore, the Union could well fail to benefit from the positive developments expected on the world market, since internal prices could be expected to remain above world prices. A more offensive strategy could simultaneously avoid the routine use of export subsidies, reinforce the competitiveness of cereals on the Single Market, overcome the Uruguay Round constraints for oilseeds and, last but not least, bring a good deal of simplification.

The Commission therefore proposes the following measures:

- The cereals intervention price is fixed in one step (2000) at a safety net level of 95.35 ECU/ton, (presently 119.19 ECU/ton);
- A non crop specific area payment is established at 66 ECU/ton (multiplied by the regional cereals reference yields of the 1992 reform); this payment will be lowered if the market prices are sustained at a higher level than currently foreseen;
- Set aside: the reference rate for compulsory set-aside is fixed at 0 %, voluntary set-aside is allowed, extraordinary set-aside is abolished; set-aside areas get the non crop specific payment;
- Silage cereals (mainly silage maize) are excluded from the regime;
- Special cases: for protein crops, a supplementary aid is established at a level of 6.5 ECU/ton in order to preserve their competitiveness with cereals; for durum wheat the present supplements are maintained.

As it already is the case in the beef and sheep sectors, the Commission will table a proposal enabling Member States to make the granting of direct payments for arable crops and set-aside conditional on the respect of environmental provisions, allowing them to be increasingly used to pursue environmental objectives.

Beef regime

Over the coming years, beef production will be influenced on the one hand by the short term measures adopted in 1996 (i.e. the calf processing and early marketing of veal calves schemes) and on the other by the elimination of adult cattle over 30 months in the UK from the food and feed chain. The first will be felt mainly in 1998 and 1999, whereas consequences of the second will continue until 2001. Beef consumption is expected to gradually recover from the 1996 shock and return to its long term (declining) trend.

These factors add to a cyclical downswing of production until 2000 and should lead to a substantial reduction in stocks over the next few years, from the levels built up during 1996 and 1997. After 2001 however, if the market policy remains unchanged, production would return to its full potential whereas consumption would continue its long term decline. Intervention stocks would tend to accumulate again (given the GATT limited export possibilities) and could reach some 1.5 million tons by 2005.

It is not acceptable in the long run to solve the problem of over-production in this sector by the slaughtering of young calves a few days after birth. Nor can the surplus problem be solved efficiently by pure supply management (quotas on animal numbers or on production), as this would present major administrative complications.

A more offensive strategy, on the other hand, could at the same time substantially reduce export refunds to traditional destinations, help develop new export outlets without subsidies and rebalance internal meat consumption to the benefit of beef. Moreover, it would reduce the incentive for higher carcass weights.

The Commission therefore proposes to gradually establish effective market support at a level of 1 950 ECU/ton (presently at 2 780 ECU/ton), over the period 2000-2002. It should be possible to stabilize market prices around or above this level through border protection, export measures and the introduction of a private storage regime, as already exists for pigmeat.

Single Market prices can be expected to remain higher than the new support price levels. In addition, as observed after the 1992 reform, farmers are likely to adjust their production systems and investment behaviour to save costs, and some input prices may well decrease. On the whole, the income loss farmers perceive due to the reform measures will probably be lower than a simple static analysis would indicate. Nevertheless there will be losses.

The Commission proposes to respond through direct income payments, gradually increasing and still paid per head of cattle and while avoiding overcompensation. In permanent regime, they would reach the following level (the present level is mentioned in brackets):

– Suckler cow (yearly payment)	215 ECU	(145 ECU)
– Male bovine bull (one payment)	368 ECU	(135 ECU)
steer (two payments)	232 ECU	(109 ECU)
– Dairy cow (yearly payment)	70 ECU	no premium

The different mechanisms governing headage payments and favouring extensification (the density factor, individual and regional ceilings) would be adapted in order to take into account the termination of the silage maize regime. At the same time, the Commission will reflect on how incentives to extensify production can be strengthened with a view to improving their effectiveness in relation to environmental objectives, without a major change in the global level of support.

Dairy regime

If milk quotas remain unchanged over the coming years, total milk production is forecast to decline slightly from 121.6 million tons in 1996 to 118.1 million tons in 2005, due to a small increase in milk fat content and adjustment of production to the quota level. Global milk demand (in whole milk equivalent) is expected to decline from 112.2 million tons in 1995 to 108.7 million tons in 2005. This is the net result of decreasing consumption of some dairy products, notably butter, and increasing demand for other products, such as cheese and fresh products. On-farm consumption (animal feed) should also drop in line with the expected decline in cattle numbers. The net surplus is likely to vary between 9.0 and 9.5 million tons of milk equivalent in the 1996-2005 period, with a tendency to increase by the end of the period.

Turning to the different milk products, which are all covered by GATT commitments, and supposing no policy changes, it appears that:

- further export growth in the *cheese* sector would appear to be constrained by GATT limitations on subsidized exports;
- intervention stocks of *skimmed milk powder* will tend to increase from 1998 onwards and reach some 200 000 tons in the first half of the next decade, as the GATT export commitments become binding;
- for *butter*, GATT export commitments give sufficient margin for subsidized exports, so that no accumulation of intervention stocks would necessarily be expected; it is however questionable whether real outlets exist on world markets for a quantity as large as the expected surplus of around 300 000 tons.

After an in-depth examination of the different options, the Commission discards radical solutions, such as drastic price cuts and rapid abolition of the quota system. Expected market developments do not justify such extreme measures. The Commission sees no strong reason for introducing fresh quota cuts either, since no major deterioration of the market balance is expected. Finally, the Commission also discards a double price - double quota system, which would raise serious questions of WTO compatibility, could be quite distortive, depending on how it were shaped and implemented, and would add to current administrative complexity and control problems.

However, dairy farmers should not be given the impression that the present system, with its intrinsic rigidities, can last for ever. The recent debate on long term prospects has revealed factors of uncertainty; in particular, the results of the next WTO Round could also affect the dairy sector.

The Commission therefore recommends a cautious approach at this stage. It proposes to:

- extend the quota regime up to 2006;
- improve flexibility and simplify the present common market organization;
- gradually decrease support prices, by an average of 10 % in total over the period;
- introduce a new yearly payment for dairy cows adjusted to average yield, at a level of 145 ECU.

Together with the new payment introduced for dairy cows in the beef context, the total dairy cow premium would be 215 ECU, equal to the suckler cow premium.

Mediterranean products

As a continuation of the 1992 reform process, the Commission presented in December 1996 a report on the *tobacco* regime to the Council and the Parliament. This report gives a positive assessment of the 1992 tobacco reform and proposes further strengthening the market orientation of the sector, while recognising the important economic role it plays in some rural areas. In February 1997, the Commission presented a report on the *olive oil* regime. It suggests as a possible option a further shift from price support to direct payments and a radical simplification of these payments. As soon as the necessary debates have taken place, the Commission will table detailed legislative proposals on these two sectors.

For *fruit and vegetables*, a major reform was adopted by the Council in July 1996: budgetary efforts were shifted from supporting prices to strengthening producer organisations and their competitiveness, and emphasis was placed on the structural adjustment of the sector and on its environmental dimension. The Commission will follow the implementation of this reform carefully.

For *wine*, a reform proposal has been pending at Council level since 1994. In view of the latest developments, and in particular the new context created in this sector by the Uruguay Round Agreement, the Commission intends to review the pending proposal and to table a fresh one as soon as the 1997 situation has been fully analysed. The new proposal would take into account the guidelines which have in the meantime been defined in the 1995 “Agricultural Strategy Paper”.

Differentiation and ceilings for direct payments

The Commission intends to propose the introduction of an individual ceiling covering all direct income payments granted under the Common Market Organisations. In addition, while excluding renationalization, Member States would be allowed to introduce differentiation criteria according to commonly agreed rules.

Rural policy

Over the coming decade, agriculture will have to adapt to further changes in market evolution, market policy and trade rules. These changes will not only affect agricultural markets, but also local economies in rural areas in general. Many of them are already confronted with acute economic development problems. Moreover, rural areas have increasingly important environmental and recreational functions to fulfil, and requirements linked to these functions may well imply additional adjustments for agriculture, as the main land user. Conversely the increasing importance of environmental and recreational needs will also offer new development opportunities from which farmers and their families should be able to benefit.

The Commission suggests that these developments should be encouraged and supported by a reorganisation of the existing rural policy instruments.

- Existing accompanying measures financed by the EAGGF, Guarantee Section (agri-environment scheme, afforestation, early retirement) will be supplemented by the Less Favoured Areas (LFA) scheme including its application in the regions lagging behind in their development (Objective 1 regions). All these measures will be applied horizontally and implemented in a decentralized way.

- For those rural areas which are located in regions eligible under Objective 1 of the Structural Funds, the current approach of integrated development programmes will be maintained, as described in the chapter on economic and social cohesion.
- In rural areas eligible under the new Objective 2, operations (formerly Objectives 5(a) and 5(b)) will be financed by the EAGGF Guarantee Section as accompanying measures. These measures will intervene together with the ERDF, the Social Fund and, where appropriate, the FIFG in the same programme within the Objective 2 region.
- In all rural areas outside Objective 1 and the new Objective 2, rural development measures to accompany and complement market policies will be co-financed by the EAGGF Guarantee Section. They will embrace all types of measures supporting structural adjustment and rural development as presently co-financed by the EAGGF Guidance Section. Included into the same legal framework as the present accompanying measures, they will be applied horizontally and implemented in a decentralized way at the appropriate level, at the initiative of Member States. **The same approach will apply to fishery coastal areas as far as the interventions of the FIFG are concerned.**

Agri-environmental policy

In the coming years, a prominent role will be given to *agri-environmental instruments* to support a sustainable development of rural areas and respond to society's increasing demand for environmental services. The measures aimed at maintaining and enhancing the quality of the environment shall be reinforced and extended.

With respect to better integrating the environment into the Common Market Organisations, the Commission will make a proposal enabling Member States to make direct payments conditional on the respect of environmental provisions.

A possibility which deserves further consideration is to take into account the considerable overlap between *LFA*s and *areas of high nature value*, and to gradually transform the related support scheme into a basic instrument to maintain and promote low-input farming systems. Such systems, because of specific geographic conditions or just as the result of centuries of traditional farming, often have a high landscape and nature value.

Moreover, *targeted agri-environmental measures* should be reinforced and encouraged through increased budgetary resources and, where necessary, higher co-financing rates. Most relevant are services which call for an extra effort by farmers, such as organic farming, maintenance of semi-natural habitats, traditional orchards or hedgerows, continuation of alpine cattle keeping, upkeep of wetlands. A high level of commitment is also needed where actions result in a significant loss of yield, for instance due to the establishment of buffer strips along rivers or field margins.

IV. THE UNION IN THE WORLD

It is imperative that Europe steps up its activities in the external relations field. The European project will remain credible only if it responds to the growing calls from its citizens for greater unity and more effective ways of building and defending peace, stability and prosperity on the European continent and throughout the world.

The Member States of the Union have many *common interests*. The Union must increase its influence in world affairs, promote values such as peace and security, democracy and human rights, provide aid for the least developed countries, defend its social model, and establish its presence on the world markets. In addition to maintaining the territorial integrity of the Union, Member States must combine their forces to combat organized crime, terrorism and the proliferation of nuclear, bacteriological and chemical weapons, prevent major damage to the environment and ensure sustainable growth with an optimum use of world resources.

Collective action by the European Union is an ever increasing necessity if these interests are to be defended, if full advantage is to be taken of the benefits of globalization and if the constraints it imposes are to be faced successfully. Europe's partners, beginning with the applicant countries, expect it to carry out fully its responsibilities.

The enlargement of the European Union will affect not only the destiny of the Europeans, the Member States and the applicant countries. Through its international implications, enlargement will have an impact far beyond the new frontiers of an enlarged Europe because it will increase Europe's weight in the world, give Europe new neighbours and form Europe into an area of unity and stability. The geopolitical impact of the enlargement process was already underlined in the Madrid European Council conclusions concerning "The Political Agenda for Europe".

1. A STABLE EUROPE THAT IS OPEN TO THE WORLD

Over the last four decades and in line with the basic intentions of Europe's founders, the Member States have developed between them a real Community of security within which it is inconceivable that there would be the slightest threat of recourse to force as a means of settling disputes. The challenge is now to extend that basic achievement of the European project to new Member States. The enlargement of the European Union must therefore aim to make an additional stabilizing impact complementary to that made by the enlargement of NATO. This stability should facilitate the gradual definition of a common defence policy that could lead to a common defence, in accordance with Article J.7 of the Amsterdam Treaty.

An enlarged Union will have more direct frontiers with Russia as well as frontiers with Ukraine, Belarus and Moldova. It will enjoy direct access to the Black Sea which will lead to intensified contacts with the countries of the Caucasus and Central Asia. An enlarged Union will also surround the Kaliningrad oblast, which is part of Russia, and will contain several hundred thousand ethnic Russians, living mainly in Estonia and Latvia. It will be important for the enlarged Union to deepen its relationship with Russia, Ukraine and the other NIS on the basis of the Partnership and Cooperation Agreements (PCAs). Among the Union's new neighbouring countries will be those of the Balkan region. Stability through cooperation in this region will be all the more important for the enlarged Union.

The Union will have to continue and step up its policy of providing support for democracy, and assisting the reform process and the transition to the market-economy system, which constitute long-term guarantees of security and stability. There is likely to be an increase in trade flows, a rise in energy and raw material imports from CIS countries, an expansion of transport networks and increased cooperation on environmental protection. Moreover, these developments could lead to changes in the content and geographical organization of Community programmes such as Tacis in order to take account of new geopolitical circumstances.

Active measures will have to be taken to reinforce links between the Union and its Mediterranean partners. The stable development of the southern Mediterranean rim is a challenge of ever increasing proportions. The potential of the Barcelona process will have to be fully exploited to that end. The Union will also have to maintain an increased presence in the Middle East as one of the main promoters of peace in that region. Enlargement should therefore lead to an intensification of economic and commercial relations between the European Union and its southern partners, based on the pursuit of reciprocal interests.

Development cooperation constitutes the third major element of the Union's external action. The Union's development assistance and its efforts to reduce poverty and inequalities around the world are closely linked to the search for peace and stability, the need for better management of global risks and interdependence, and the promotion of a sound development path. As part of the new partnership arrangements which will have to be established between the European Union and the ACP countries, whose political and economic situations differ, the question of the inclusion of development cooperation in the Community budget will have to be examined.

The Union should also intensify its relations with the United States, with the implementation of the New Transatlantic Agenda agreed in Madrid in December 1995. Asia and Latin America are also among the regions which should be given particular attention.

2. A STRONG AND COHERENT EUROPE

The enlarged Europe will have richer but inevitably more complex relations with the rest of the world. In order to be more effective and more present, in order to prepare as much as possible to exercise wider responsibilities and in order to assume its role on the international scene, Europe will have to reinforce its political decision-making capacity and ensure consistency in all of its actions.

Making the European Union a global actor

It is in the interests of the European Union to exercise political responsibility commensurate with its economic power. The interdependence of modern economies and the increased importance of transnational factors mean that an active and effective foreign policy cannot be limited to the more traditional aspects of international relations. This applies in particular to the Union, characterized by its strong economic dimension. Ultimately, a common foreign and security policy can become reality only if the Member States accept, in terms of working methods and in substance, that progressively an *integrated approach to external relations* must be built.

This integrated approach will make it possible to support a common political will with the instruments of the CFSP, those of commercial policy, development aid or other common policies and the operational capacity of the Western European Union to carry out tasks recently included in the Treaty. It should also strengthen the complementarity, which is currently inadequate, between the activities of the Union and those of the Member States.

The provisions of the new Treaty for designing and implementing the common foreign and security policy will make it possible to strengthen the overall cohesion and continuity of external action. The Council and the Commission will have to cooperate closely to that end. It will of course be essential to resort more frequently to a qualified majority for the Union to be able to take rapid, specific action.

The European Union will increasingly have to acquire the capacity to take foreign-policy decisions involving the use of military resources. This is essential if the Union's external action is to be credible. It will therefore be necessary to strengthen the operational resources of the WEU, both in order to carry out the new tasks laid down in the Treaty of Amsterdam and with a view to the WEU becoming increasingly integrated in the development of the European Union itself.

Maintaining the commercial power of the Union

The international environment must not be seen as a threat to the Union, but rather as a positive challenge and development factor. The EU, the biggest trader on the world stage, has a strong interest in consolidating the new WTO structures and in *promoting further international trade liberalisation* beyond that which is already programmed. The alternative to a multilateral approach is likely to be a risk of less advantageous conditions of access and competition. It is also essential that the dismantling of trade barriers be accompanied by the development of competition policy principles within the WTO framework.

Taking account of the new forms of international trade, it will be necessary to make full use of the new opportunities offered by Article 113, as amended by the Treaty of Amsterdam, for conducting *international commercial negotiations* in the field of services and intellectual property. In this way, the enlarged Union will be able to act more decisively and more cohesively in international organizations such as the WTO or the OECD.

Ensuring complementarity between internal and external policies

The *advent of the euro* will give Europe a key role to play in economic and monetary matters. During the next eighteen months, it will therefore be necessary to define the relationship with international financial institutions and the arrangements for external representation in this field.

The *external potential of the Single Market* should be developed. Both the strength and the experience of the Internal Market can be used to promote the Union's interests and presence internationally, for example in the area of aeronautics and satellites. Another example is greater European assertiveness in international standard-setting, but the potential extends into many other areas, including financial services, intellectual property and competition policy.

Greater care will have to be taken to ensure coherence and complementarity between the internal and external dimensions in Union policy. *Energy policy* provides a good example of such a consolidated approach, where the achievement of market integration will provide the essential basis for the diversification and flexibility of energy supplies as well as reinforcing the competitiveness of European enterprises in this field. A careful coordination of external energy policy will also contribute simultaneously to enhanced supply security and the achievement of international environmental objectives.

Better integration is equally necessary for other internal policies of the Union, for example in the field of research, in order to promote the Union's international interests.

Handling transnational issues which are at stake

The process of globalization, from which the Union has benefited so much, also exposes it to both economic and political risks in the international arena, such as the consequences of demographic imbalances, failures in governance and environmental mismanagement. These must be handled resolutely with the Union's international partners in multilateral fora.

The increasing importance of threats to the environment, like global climate change, is already high on the international agenda. The Union has, on various occasions, confirmed its leading role in this field, where it is particularly well placed for taking the leadership in international negotiations in order to reconcile conflicting interests.

The proliferation of drug trafficking and organised crime also requires coherent and concerted action at the international level. This should be developed in close cooperation with the Union's main partners and with the countries most afflicted by these phenomena, focusing on preventive action in a multilateral framework as well as on measures aimed at eliminating the social and economic sources of these scourges of society.

Increasing the visibility and adapting the procedures for the Community's external assistance

External action should become more *visible*. The Community and its Member States finance half of the international development assistance effort, in particular through the comprehensive partnership embedded in the Lomé Convention. They are responsible for well over half of the humanitarian aid distributed throughout the world. They provide one third of total aid to the Middle East, including half the assistance granted to the Palestinian Territories, nearly 60% of international aid to Russia and the republics of the former Soviet Union, and 40% of the reconstruction in Bosnia-Herzegovina. These figures, often unknown, show that the Union is the most important provider of international aid - a situation which should be consolidated by enlargement.

The reality of Europe's presence will have to be explained and enhanced in order to increase the margins of manoeuvre in the common foreign policy.

Strengthening decision-making capacity, and the efforts which may be required in order to increase the speed with which action can be taken, will be decisive in improving the impact of the Union's external assistance programmes.

The effectiveness of Community instruments in the external sphere is currently limited by slow, complex internal procedures. A reflection should be undertaken on how to overcome these constraints where rapid action by the Union is required. In addition, here as elsewhere, it will be appropriate to limit as much as possible the spread of financing over too many small-scale measures. It will also be necessary to promote closer *coordination of Community programmes and national action by Member States*.

Where the Union's external financial action is concerned, it will be necessary to foster the synergy between the Community instruments and those of institutions such as the EBRD or the IMF, as part of a balanced financial burden sharing.

Given the prospects for economic growth, the maintenance of *financial resources* in terms of percentage of GNP will make it possible to ensure that Europe has a strong presence at world level.

V. AN EFFICIENT COMMISSION AT THE SERVICE OF EUROPEAN CITIZENS

Armed with its right of initiative, the Commission must remain a dynamic force for renewal, including in the new domains opened up by the Amsterdam Treaty. Nevertheless, the legislative activity of the Union will be less intense than in the past. Implementation and enforcement of existing legislation will need to have the highest priority. Greater decentralisation will require closer monitoring on the ground. More generally, the Commission will have an enhanced role in the promotion of cooperation, the launching of partnership and network activities as well as an effective coordination. Managing a high level of integration will require a thorough *re-evaluation of the Commission's executive and management functions* and a change in its administrative culture.

Budgetary constraints will remain tight, with an inevitable impact on spending policies and the management of human and financial resources. With increased competition for limited funds, there will be a need to *identify more clearly the core functions* on which the Commission should concentrate. The relevance of policies, structures and procedures should be examined critically in a screening process preceding decisions on funding programmes and allocating resources to their management. It is imperative to make more efficient and effective use of available resources.

In this context, the quality of available human resources and use of their full potential are crucial. A European public service operating on the basis of the three principles of competence, independence and permanence must therefore be preserved; it must nevertheless be capable of adapting and modernizing in order to take up the ever-evolving challenges of European integration and of a profoundly changing world.

Therefore, the Commission has already initiated a far-reaching programme of reform of its administration in the Sound and Efficient Management (SEM 2000) and Modernisation of Administration and Personnel policy (MAP 2000) initiatives. This will involve a review of its structures, modernisation of the management and a streamlining of procedures. *Decentralisation, rationalisation and simplification* are key words for such an undertaking. It will be necessary to determine for each policy area the appropriate balance between core policy and control functions, which need to be retained within the Commission, and executive functions which are more effectively administered at a level closer to the end users.

Consideration should be given to the appropriate size of programmes and projects supported financially by the Community to ensure that the programmes deliver a clear added value at European level and that the required administrative resources are not excessive. Administrative functions can sometimes be carried out by executive agencies reporting to the Commission, by administrations in Member States in partnership with the Commission or even by non-governmental organisations or other private sector organisations on a contract basis. In some areas, new network management structures involving both Community and national levels may be appropriate. In all cases, however, a clear policy framework will have to be established.

Ultimately, the Commission depends on the competence and motivation of its staff to be able to respond effectively to the demands of the integration process. More emphasis should therefore be put on the upgrading of skills and competence in order to take full advantage of synergies created in the reform of structures and to enhance flexibility in view of the new challenges ahead.

In recent years the Commission has had to take on a growing number of new tasks, resulting in successive reorganisations which have often had to be carried out hastily and without adequate preparation. Now that a new phase in European unification is beginning and that the shape of Europe in the 21st century is emerging more clearly, the time has come to embark on a thorough review of the organization and operation of the Commission beyond the year 2000. It was along these lines that the Commission defined its position in its recent contribution to the IGC, in which it announced that it would be regrouping and redefining tasks, including those of its Vice-Presidents. It also announced that it would undertake a corresponding restructuring of its departments. By strengthening the status and powers of the Commission President, the Amsterdam Treaty has introduced a reform sought by the Commission which will heighten the effectiveness and profile of the Commission as a body. In a declaration annexed to the Final Act of the Amsterdam Treaty, the Member States have taken note of the Commission's intention to prepare the above mentioned reorganisation in time for the new Commission due to take office in the year 2000.

The Council must also play its part, e.g. by reducing the number of different compositions in which it meets and by assigning to the General Affairs Council its true overall coordinating role.

PART TWO: THE CHALLENGE OF ENLARGEMENT

This part of the Agenda 2000 communication is the composite paper on enlargement which the Commission was invited to prepare by the Madrid European Council. Its aim is to explain the way in which the Commission has examined the different applications for accession and the main questions they raise, as well as the timetable for opening negotiations which appears most realistic. It draws the main conclusions and recommendations from the opinions and presents the Commission's views on launching the process of accession negotiations. It also tackles the horizontal questions linked to enlargement as well as the practical arrangements for the initial phase of the negotiations and the reinforcement of the pre-accession strategy as a whole.

These conclusions and recommendations are based on the criteria adopted by the European Council when it met in Copenhagen in June 1993:

“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, and*
- [has] the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union.”*

I. ASSESSMENT ON THE BASIS OF THE ACCESSION CRITERIA

At the request of the Council, the Commission has prepared opinions on each application for membership. Its assessment draws on numerous sources of information, taking as a starting point the replies to questionnaires sent to each of the applicant countries in April 1996. Bilateral meetings were held with each of the applicant countries, which were given an opportunity to provide any further information concerning their preparations for accession by the end of May 1997.

The Commission also took into account assessments made by the Member States, particularly with respect to the political criteria for membership established by the Copenhagen European Council. The European Parliament's reports and resolutions, and the work of various international organisations, non-governmental organisations and other bodies were also used by the Commission.

The Commission also considered the progress made under the bilateral agreements which are the main element in the Union's relations with the applicant countries. Europe (Association) Agreements, which cover economic cooperation, trade and political dialogue have entered into force with six of the applicant countries. For Estonia, Latvia and Lithuania, the agreements need to be ratified by all Member States before they come into force. In the case of Slovenia, the Slovenian Parliament still has to ratify the agreement.

The Commission's task was unprecedented because the Copenhagen criteria are broad in political and economic terms and go beyond the *acquis communautaire* (for example, assessing administrative and judicial capacity), and because the *acquis* itself has expanded considerably since previous enlargements. The *acquis* of the Union now includes the common foreign and security policy and justice and home affairs, as well as the objectives and the progressive realisation of political, economic and monetary union.

The Commission not only gives a picture of the situation in 1997 and of the applicants' progress in recent years. It has also made an analysis of expected progress over the medium term, as far as the economic criteria and the countries' ability to implement the *acquis* are concerned. In making this forward assessment, the Commission has taken into account trends in policies and programmes for progressively implementing the *acquis* under way in the applicant country. The Commission has also anticipated the future development of the Union's policies, particularly in certain fields such as the environment, the Single Market and the information society where the *acquis* is evolving rapidly.

With regard to the political criteria for membership, the Commission considers that an assessment could be conducted only on the basis of elements of the present situation which it has been able to verify and confirm. The effective functioning of democracy is a primordial question in assessing the application of a country for membership of the Union. The Amsterdam Treaty has enshrined in Article F a constitutional principle that "The Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms and the rule of law". Accordingly the Intergovernmental Conference has decided to modify Article O to make the respect of Article F an explicit condition for membership.

The Commission considers therefore that the respect of the political conditions defined by the European Council in Copenhagen by an applicant country is a necessary, but not a sufficient, condition for opening accession negotiations.

1. POLITICAL CRITERIA

The Copenhagen European Council indicated that “*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*”.

In order to evaluate the extent to which applicants meet this condition for membership, the Commission, in each opinion, went beyond a formal description of political institutions, and the relations among them, to assess how democracy actually works in practice, in terms of a series of detailed criteria. It examined how various rights and freedoms, such as the freedom of expression, are exercised, through, for example, the role of political parties, non-governmental organisations and the media.

Democracy and the rule of law

Countries wishing to become members of the Union are expected not just to subscribe to the principles of democracy and the rule of law but actually to put them into practice in daily life.

On the whole, the applicant countries’ constitutions guarantee democratic freedoms, including political pluralism, the freedom of expression and the freedom of religion. They have set up democratic institutions and independent judicial and constitutional authorities, which permit different state authorities to function normally, have held free and fair elections, permitting the alternation of different political parties in power and, in general, recognise the role of the opposition.

Some of the applicant countries - beyond the normal cycle of elections - do not have stability of institutions enabling the public authorities to function properly and democracy to be consolidated. All the applicant countries have flaws in the rule of law which they need to put right. There is a lack of suitably qualified judges and guarantees of their independence. Police forces are poorly paid and require better training and discipline. The autonomy of local government also requires a firmer legal basis in several cases.

Romania did not experience a genuine change of government until the June 1997 elections. The political system has long been characterized by the persistence of practices inherited from the communist system, with too much government interference in the media and the judicial system. The changes that have taken place in the wake of the election of a new president and a new government majority have altered the situation of the country considerably: it has thus improved the functioning and stability of its institutions. The reform of the secret police services and the judicial system has been completed very quickly.

The changes that have taken place this year in *Bulgaria* and the reforms announced by the government should also enable it to achieve decisive progress in terms of democracy and the rule of law and the stability of its institutions.

In *Slovakia* there is still a gap between the letter of constitutional texts and political practice. The Commission is concerned that the rule of law and democracy are not yet sufficiently deeply rooted. This would require a greater openness to opposing views, the proper functioning of state institutions and the respect for their individual roles in the constitutional order. A democracy cannot be considered stable if the respective rights and obligations of institutions such as the presidency, the constitutional court or the central referendum commission can be put into question by the government itself and if the legitimate role of the opposition in parliamentary committees is not accepted.

The failure of the May 1997 referendum on NATO membership and on the direct election of the president, unsuccessful attempts by the government to reform the penal code, with a view to limiting the freedom of expression, the efforts to block an enquiry into the activities of the secret services and various forms of pressure exerted by the government on officials and cultural bodies, are symptomatic of the instability of the country's institutions.

Human rights

Respect for fundamental rights is in principle guaranteed in most of the applicant countries. All have acceded to the Council of Europe's Convention for the Protection of Human Rights and Fundamental Freedoms and the Protocol allowing citizens to take cases to the European Court of Human Rights.

Romania inherited from the Communist regime a system which placed many children in state institutions in conditions which violate conventions on children's rights. This concerns more than a hundred thousand orphans. However, the former legislative provisions dating from 1972 have been abrogated and the basis for reforms, founded on direct support to families, established.

Freedom of expression and of association is assured in all applicant countries but the independence of radio and television needs to be strengthened in some cases.

Respect for minorities

Many of the applicant countries have minority populations, whose satisfactory integration into society is a condition for democratic stability. Minorities account for 44% of the population in Latvia (where 34% are Russian), 38% in Estonia (30% Russian), 20% in Lithuania (9% Russian, 7% Polish), 18% in Slovakia (11% Hungarian, 5% Roma), 14% in Bulgaria (9% Turks, 5% Roma) and 13% in Romania (8% Hungarian, 4% Roma).

A number of texts governing the protection of national minorities have been adopted by the Council of Europe, in particular the Framework Convention for the Protection of National Minorities and recommendation 1201 adopted by the Parliamentary Assembly of the Council of Europe in 1993. The latter, though not binding, recommends that collective rights be recognised, while the Framework Convention safeguards the individual rights of persons belonging to minority groups. Bulgaria has not yet signed the Framework Convention; the Czech Republic, Latvia, Lithuania, Poland and Slovenia are among the countries that have not yet ratified it.

In Romania, the Hungarian minority is represented in Parliament by 25 deputies and 11 senators and in the government by 2 ministers. It is also represented in local authorities and benefits from the right to education in Hungarian in primary and secondary schools and from the right to use Hungarian in contacts with the administration and the judiciary.

In Slovakia, however, where such rights are in principle recognised, the Hungarian minority faces a number of problems in exercising its rights. Following the adoption of the law on the national language and in the absence of a law on the use of minority languages, the exercise of several of the Hungarian minority's rights have been put into question. Certain recent developments with regard to cuts in cultural subsidies and changes in administrative sub-divisions of the country give cause for concern.

Non-citizens constitute 28% of the population in Latvia and 25% in Estonia. There is no evidence that these minorities are subject to discrimination except for problems of access to certain professions in Latvia. But the rate of naturalisation of non-citizens has been slow in both countries and it should be accelerated to ensure the integration of non-citizen minorities into society.

Except for the situation of the Roma minority in a number of applicants, which gives cause for concern, the integration of minorities in their societies is, in general, satisfactory.

Minority problems, if unresolved, could affect democratic stability or lead to disputes with neighbouring countries. It is therefore in the interest of the Union and of the applicant countries that satisfactory progress in integrating minority populations be achieved before the accession process is completed, using all opportunities offered in this context.

Conclusion

Even though progress has still to be made in a number of applicant countries as regards actually practising democracy and protecting minorities, only one applicant State - Slovakia - does not satisfy the political conditions laid down by the European Council in Copenhagen.

2. ECONOMIC CRITERIA

The Copenhagen European Council indicated that, in the economic area, membership requires *“the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union”*.

The applicant countries have made considerable progress in the transition to a market economy, including with privatisation and liberalisation, although their economic situations vary considerably. For all of them, the break-up of the CMEA, the former communist trading bloc, and the beginning of market reforms implied a major initial shock. However, for some this was aggravated by severe disequilibrium at the outset, while others inherited comparatively stable conditions and higher standards of living. Moreover, half the applicant countries needed to create the institutions of a new state while at the same time conducting a fundamental overhaul of their economies.

Reform has taken a different course from country to country. In some, reform has benefited from wider support and policy has proved relatively constant even when governments changed. Although almost all applicants have progressed substantially in recent years, often with high growth rates, several still find themselves in fragile economic conditions. There have also been some reversals with the introduction of administrative forms of control, e.g. on prices or imports.

The average GDP per inhabitant of the applicant countries is only about one-third of the Union's. Some applicants, and by no means always those with the lowest income per head, have achieved annual GDP growth of 5-7% in recent years, while others have lagged behind, for a variety of reasons. Some have achieved a high degree of price stability and are close to budget balance, while others face large and/or rising trade deficits, resulting from imports of capital equipment as well as consumer goods. In general, structural reform still has a long way to go, particularly as regards the banking and financial systems, and as regards social security. Most applicants still need to restructure large state-owned industries, which dominate local economies and are very hard to reform for both social and economic reasons.

None of the applicants fully meets the two economic conditions of Copenhagen today, although some should be able to do so a few years from now.

The existence of a functioning market economy

The first economic criterion identified by the Copenhagen European Council is the existence of a functioning market economy.

This requires a number of conditions to be met which are analysed in each opinion, namely that:

- equilibrium between demand and supply is established by the free interplay of market forces; prices, as well as trade, are liberalised;
- significant barriers to market entry (establishment of new firms) and exit (bankruptcies) are absent;
- the legal system, including the regulation of property rights, is in place; laws and contracts can be enforced;
- macroeconomic stability has been achieved including adequate price stability and sustainable public finances and external accounts;
- broad consensus about the essentials of economic policy;
- the financial sector is sufficiently well-developed to channel savings towards productive investment.

The opinions assess each applicant in the light of these conditions. The Commission finds that five of them (the Czech Republic, Estonia, Hungary, Poland and Slovenia) can be considered functioning market economies, even if in all these cases some important features, such as capital markets, still need to mature and develop further. A sixth applicant (Slovakia) comes very close in terms of legislation and systemic features, but lacks transparency in implementation.

The other applicants have made substantial progress, especially in recent times, and should be able to meet this first economic criterion early in the next century. For these countries, the main challenge now is to strengthen the implementation of their legal and institutional reforms, and in some cases to avert the risk of further macroeconomic instability.

The capacity to withstand competitive pressure and market forces within the Union

The second economic criterion is the capacity to withstand competitive pressure and market forces within the Union. This will require a minimum level of competitiveness in the main parts of the economies of the applicant countries.

The necessary evaluation is more difficult than for the first criterion. On the one hand, a comprehensive view needs to be taken including a considerable number of factors and on the other hand, an assessment of future developments needs to be made. A key question is whether firms have the necessary capacity to adapt, and whether their environment supports further adaptation. The elements to be taken into account include:

- the existence of a functioning market economy, with a sufficient degree of macroeconomic stability for economic agents to make decisions in a climate of stability and predictability;
- a sufficient amount, at an appropriate cost, of human and physical capital, including infrastructure (energy supply, telecommunication, transport, etc.), education and research, and future developments in this field;
- the extent to which government policy and legislation influence competitiveness through trade policy, competition policy, state aids, support for SMEs, etc.;
- the degree and the pace of trade integration a country achieves with the Union before enlargement.. This applies both to the volume and the nature of goods already traded with member states;
- the proportion of small firms, partly because small firms tend to benefit more from improved market access, and partly because a dominance of large firms could indicate a greater reluctance to adjust.

The analysis carried out by the Commission services in the opinions led to the following overall picture :

- trade integration in most countries and Foreign Direct Investment (FDI) in some countries have progressed substantially. However, in some countries, there has been reversal from initial trade liberalisation, mainly for macroeconomic reasons;
- the functioning of capital markets and competition rules is improving everywhere, but generally still far from satisfactory;
- the state of infrastructure remains poor;
- wage levels are still well below Union levels;
- privatisation has progressed at different rates and the process remains to be completed.

A major difficulty in assessing the applicants according to the second criterion is its forward-looking nature. Although all the countries have opened up to foreign trade substantially, entering the Single Market (including harmonised VAT, public procurement, banking insurance, etc.) will take them considerably further along the road of integration. In particular, they will need to be able to produce products conforming to European technical requirements which will be helped by taking over the *acquis*, creating the necessary institutional structures and making them work, and appropriate standardisation activity. How they will perform with regard to this criterion therefore remains difficult to predict. In the meantime, further progress in implementing the measures indicated in the 1995 White Paper on the Single Market will remain both an essential method of preparation and an approximate yardstick for the applicants' degree of preparedness.

In support of the applicants' domestic policy efforts, continued external support will be required from Phare, and the International financial institutions (IFIs). After accession, the structural funds will take over the leading role in this regard.

While keeping in mind the difficulties inherent in such an assessment, the Commission finds that two countries (Hungary and Poland) should satisfy the second criterion in the medium term, provided they stay on their current course. Three others (the Czech Republic, Slovakia and Slovenia) should be in the same position on condition that they strengthen their efforts and avoid policy reversals. Because Estonia has modernized and radically liberalized its economy, it comes close to this last group, but its large external imbalance is a cause for concern. Latvia, Lithuania and Romania have made great strides recently, but will require further consolidation of their efforts. Bulgaria is shedding the difficult legacy of the past; it has made considerable progress very recently and is on course to join the others during the next decade.

Conclusion

For the two criteria taken together, therefore, Hungary and Poland come closest to meeting them, while the Czech Republic and Slovenia are not far behind. Estonia meets the first criterion, but has some progress to make to meet the second criterion of capacity to withstand competitive pressure. Slovakia meets the second criterion but cannot yet be fully regarded as a functioning market economy.

3. OTHER OBLIGATIONS OF MEMBERSHIP

The Copenhagen European Council concluded that membership requires “*the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union*”.

The aims of political, economic and monetary union

In applying for membership, the countries of central and eastern Europe accepted the objectives of the Treaty on European Union, including political, economic and monetary union.

As regards the common foreign and security policy, the applicants have demonstrated, through political dialogue and concrete action, their will to contribute to effective action by the Union. In its opinions, the Commission’s assessment is that they could fulfil the obligations of membership in this field.

With respect to the aim of economic and monetary union, it is unlikely that the applicants will be able to join the euro area immediately upon accession. Indeed, further progress in structural reform will be necessary before they will be able to maintain sufficient macroeconomic stability in the long run. However, new member states will have to adopt the *acquis* of Stage 2 of EMU. This implies central bank independence, coordination of economic policies (national convergence programmes, multilateral surveillance, excessive deficit procedure, ...), and adherence to the relevant provisions of the stability and growth pact. New member states will forego any direct central bank financing of public sector deficits as well as privileged access of public authorities to financial institutions. They shall have completed the liberalisation of capital movements. Also, they are expected to participate in an exchange rate mechanism and avoid excessive exchange rate changes.

Adoption of the *acquis*

The adoption and implementation of the *acquis* upon accession is a difficult challenge for the applicants to meet and considerable additional efforts need to be made. This is a far greater challenge than in earlier enlargements. In the last enlargement, the new members, as participants in the EEA with highly developed economies, had already taken on large parts of the *acquis*. This is not the case with present applicants. Moreover, Community legislation has expanded considerably. Certain policies which were limited at that time, today consist of an impressive set of principles and obligations. New obligations have arisen regarding the Single Market, CFSP, EMU, and justice and home affairs.

As in previous enlargements, the European Council has ruled out any idea of a partial adoption of the *acquis*. The Commission's observations on this question in the context of the accession of Spain and Portugal are relevant to the forthcoming enlargement. "A partial adoption of the *acquis* without solving the underlying problem, whose solution would merely be postponed, could create new difficulties which would be even more considerable. If one or the other party obtained such an exception, it is clear that this would not be without compensation. Little by little, a process would begin, going beyond the principle that problems of integration can be gradually solved by transitional measures which would considerably dilute the *acquis* as a whole. In addition, the problem would arise of the institutions' capacity to take decisions on policies which would no longer be common".

The capacity to take on the obligations of membership, which include the whole range of policies and measures that constitute the *acquis* of the Union, can be judged, to some extent, by the applicant countries' record in implementing existing commitments.

Firstly, their performance in carrying out obligations under the Europe agreement, or other contractual agreements with the Union, for example, in trade policy and the approximation of legislation, provides some indication of their capacity to implement the *acquis*. In most cases, however, the agreements do not stipulate precise targets, but only that countries should endeavour to ensure that their legislation gradually becomes compatible with the Union's. There are however specific provisions on rules for state aids and competition.

Secondly, the 1995 White Paper on the Single Market set out the key elements of the *acquis* to be adopted in each sector. However, none of the applicants has yet been able to transpose a large proportion of Community laws on the Single Market into national legislation and a major effort is needed before accession, according to a precise timetable and monitoring procedure.

Thirdly, there is the *acquis* in areas not covered or only partly covered by the White Paper, that includes many other important areas of the Union's activity such as agriculture, environment, energy, transport and social policy.

The progressive adoption of the *acquis* in these different areas in this three stage framework is a task which the applicant countries need to complete as far as possible before accession. Their progress so far is uneven, taking into account the trends shown by the following indicators considered by the Commission in each opinion:

- a) the obligations set out in the Europe Agreement, particularly those relating to the right of establishment, national treatment, free circulation of goods, intellectual property and public procurement;

- b) the progress in transposition and effective implementation of the measures set out in the White Paper, particularly key Single Market directives in areas such as taxation, public procurement and banking;
- c) the progressive transposition and implementation of the other parts of the *acquis*. In this area, the situation varies considerably among the applicant countries. For most of the countries, significant and far-reaching adaptations will be needed in the fields of environment, energy, agriculture, industry, telecommunications, transport, social affairs, customs administration and justice and home affairs. The assessment in this area is therefore more prospective than in the other areas.

From this, and taking the applicants in the order of their applications for membership, it emerges that :

- Hungary is making satisfactory progress with regard to all three main criteria, suggesting that it should be in a position to adopt the main parts of the *acquis* in the medium term; particular progress should be made in the area of environment, customs, control and energy.
- Poland, despite its comprehensive strategy has run into problems with regard to (a) (trade disputes) but its record on (b) is satisfactory; concerning (c), current efforts need to be stepped up in areas where progress is lagging (such as agriculture, environment and transport); if that is done, Poland should be in a position to adopt the main part of the *acquis* in the medium term.
- Romania, despite the efforts it is making on (a) has not yet implemented key parts of (b) and (c) and will not be in a position to take on the obligations of the *acquis* in the medium term.
- Slovakia is well advanced with respect to (b) and (c) but some problems remain for (a). Provided current efforts are significantly stepped up, Slovakia should be in a position to adopt the main part of the *acquis* in the medium term, even if further work is required in certain sectors, particularly for the environment.
- Latvia has anticipated important obligations of the Europe Agreements but very substantial efforts are needed on (b) and (c) to adopt the main part of the *acquis* in the medium term.
- Estonia has anticipated important obligations of the Europe Agreements but substantial efforts are needed for (b) and (c) to adopt the main part of the *acquis* in the medium term.
- Lithuania has anticipated important obligations of the Europe Agreements but very substantial efforts are required on (b) and (c) to adopt the main part of the *acquis* in the medium term.

- Bulgaria has made satisfactory progress on (a) but not with respect to (b) and (c) and will not be in a position to take on the obligations of the *acquis* in the medium term.
- The Czech Republic has run into problems with (a), but is making satisfactory progress with regard to (b); concerning (c), current efforts need to be continued; if that is done the Czech Republic should be in a position to adopt the main part of the *acquis* in the medium term. Particular efforts will be required in sectors such as agriculture, environment and energy.
- Slovenia, as a result of delays in the signature and ratification of the Europe Agreements, is considerably behind with regard to (a). In addition, (b) and (c) are unsatisfactory and no national programme has been drawn up on the implementation of the *acquis*. Considerable efforts will have to be made by Slovenia to adopt the *acquis*, including the Single Market (indirect taxation).

Administrative and judicial capacity to apply the *acquis*

The applicant countries' administrative and judicial capacity is of crucial importance for the adoption, implementation and enforcement of the *acquis* and for the efficient use of financial support in particular from the structural funds. It is vital that Union legislation be transposed into national law. But this is not sufficient to ensure its correct application. It is equally important for the applicants' administrations to be modernised so that they can implement and enforce the *acquis*. This will often require new administrative structures as well as properly trained and remunerated administrators. The applicants' judicial systems must be capable of ensuring that the law is enforced. This requires the retraining and in some cases, the replacement of judges, to ensure that courts are able to operate effectively in cases involving Community law. It is important that these countries' courts should be able, from accession, to apply the principles of Community law, such as primacy over national law or the direct effect of some legislation. It is also essential for these courts to have a sufficient number of judges trained in Community law in order to make use of the preliminary ruling procedure in Article 177 and to ensure effective cooperation with the Court of Justice of the European Communities.

Yet in many cases the applicants still lack the structures needed to apply new regulations, for example on environmental and technical inspections, banking supervision, public accounts and statistics. There are also widespread problems of corruption which are now being tackled by most governments of the applicant countries.

Each opinion sets out the national administrations, and the supervisory bodies, with the number of employees who will be in charge of implementing the *acquis*. The general situation gives rise to considerable concern. The efforts undertaken are beginning to bring results in Hungary, Poland, Estonia, Lithuania and the Czech Republic.

Each of the applicant countries should be asked to introduce a timetable for reinforcing institutions, administrations and judicial systems responsible for applying the *acquis* as part of the pre-accession strategy with the aid of Phare. Training for this purpose is one of Phare's two priorities. 30% of Phare's resources could be used to finance exchanges and the long-term detachment of experts from the member states to the applicant countries in the framework of twinning programmes. This training of specialists in the application of the Community *acquis* should be accompanied by measures to ensure that the staff trained remain in the public service for a number of years.

Conclusion

In the light of the main trends observed in the candidate countries, it emerges that if current efforts are reinforced, Hungary, Poland and the Czech Republic should be able in the medium term to take on the major part of the *acquis* and to establish the administrative structure to apply it, while Slovakia, Estonia, Latvia, Lithuania and Slovenia would be able to do so only if there is a considerable and sustained increase in their efforts.

II. THE PRINCIPAL QUESTIONS ON THE WAY TO ENLARGEMENT (IMPACT STUDY)

The Essen European Council asked the Commission to conduct a "detailed analysis of the effects of enlargement in the context of the Union's current policies and their future development". The Commission prepared an interim report for the Madrid European Council, drawing attention to the advantages of enlargement in terms of peace and security as well as economic growth and development in Europe as a whole. It identified certain areas in which enlargement would have a marked impact on Union policies. In response to the European Council's request, this analysis has been pursued in greater depth with particular reference to the common agricultural policy and structural policies.

The results of this work (see volume II of COM 2000) confirm that Union enlargement to some 25 countries and 475 million inhabitants will bring considerable political and economic advantages, and will further Union policies if certain conditions are met.

Enlargement will, however, bring greater heterogeneity to the Union and some sectoral and regional adjustment problems will result. These could limit the benefits of enlargement and make more difficult the further development of the *acquis* unless adequate preparations are made.

It is vital to use the pre-accession period to the full to ensure that the applicants make adequate preparations for membership. This will require substantial investment in sectors such as the environment, transport, energy, industrial restructuring, agricultural infrastructure and rural society. The funds needed will have to come from public and private sources in the applicant countries themselves, the Union and other providers of foreign capital. Standards among the applicant countries are generally low in the social sphere, in particular in the areas of public health, unemployment and health and safety at work. Too slow an adaptation of their standards could undermine the unitary character of the *acquis* and possibly distort the operation of the single market. Supporting the process of adaptation will be necessary in the reinforced pre-accession strategy.

1. AGRICULTURE

In most of the candidate countries currently important price gaps (in the sense of lower prices than in the EU) exist for the main commodities. In the crop sector these vary from around 10-30% for cereals, oilseeds and protein crops to 40-50% for sugarbeet (although for sugar the price gap is generally somewhat smaller) and in the livestock sector from 30-40% for milk and dairy products to 35-45% for beef. For the cereals based meats (pigmeat and poultry) price differences are relatively small. For certain fruit and vegetables important price differences exist (e.g. up to 80% for tomatoes). A further increase in producer prices in these countries can be expected from here towards the middle of the next period of financial perspectives, which will somewhat reduce, but not eliminate the price gaps.

By then, the gaps for cereals and beef may have largely disappeared if the proposed reforms are carried out. For sugar and dairy and certain fruit and vegetables price gaps in the order of 20 to 30% or higher can still be expected to exist in the medium term. For the sugar and dairy processing industry in these countries overnight price alignment (i.e. full integration into CAP from day one) would imply an important hike in their raw material price, while at the same time facing the full competitive pressure from the Single Market. Introduction of quotas would counteract the tendency to increase sugarbeet and milk production under influence of the higher producer prices. Domestic demand could be expected to be negatively affected, increasing sugar and dairy surpluses in these countries. For certain fruit and vegetables, immediate integration in the CAP would provoke market imbalances.

The primary sector in candidate countries, with a relatively large average size of holdings, in particular in the arable crop sector, would face relatively few problems in integrating into the CAP market and price policy. In the livestock sector such integration will take longer, in view of the capital investments, restructuring and the reorganisation of management still needed. In some candidate countries agricultural structures are weaker due to the much smaller average farm size.

In the downstream sectors, including the first processing stage, large efforts in restructuring and modernisation remain necessary in all countries, although those countries with relatively large foreign investment in the food processing industry would seem to be more advanced. Adjustment pressure on the CEEC food industry when entering the Single Market is expected to be large, in particular in those industries faced with increases in raw material prices and in those countries with a weak primary sector.

The weakness of their farm sector and agri-food industry and the foreseeable price differentials make it necessary to envisage for most of the applicant countries a transition period that could vary in length according to the country concerned. Such a transition period would make it possible to cushion the shock of price adjustment to the extent necessary and would avoid exposing the applicant countries' processing industry to excessive competition. In all events, there would be no need during this period to provide direct income support such as that resulting from the 1992 CAP reform. On the other hand, the applicant countries should be able to receive aid for developing their agricultural and processing structures in order to gradually prepare them for full integration into the common agricultural market.

2. COHESION POLICY

The continued commitment to economic and social cohesion which results from the first part of this communication implies that new member states as of accession will progressively - and in line with their absorption capacity - benefit from the co-financing under the Union's structural policies. Towards the end of the next period of financial perspectives (2000 - 2006) it would thus be possible that financial transfers from the structural policies would be comparable to those attributed to Union Member States lagging behind in their development.

It is of utmost importance to familiarise the applicant countries with the structural policies' principles and procedures in order to prepare them before accession for the progressive introduction of Union structural policies. To this effect - in the context of the enhanced pre-accession strategy - applicant countries should benefit from pre-accession assistance to prepare themselves.

It should also be pointed out that the high level of co-financing by the Cohesion Fund (85%) should permit from the outset of accession and given the existence of a convergence programme, financing of important projects in such sectors as environment and trans-European networks which are crucial to their integration into the Union.

3. IMPLEMENTING THE SINGLE MARKET

A fully operating Single Market is of crucial importance to the new member States as it offers potential for growth and jobs. Hence the importance of applying in advance of accession all the elements of the White Paper on the Single Market, through a specific procedure. Only then a full application of a Single Market without border controls is conceivable.

Possible difficulties related to trade in agricultural products or to free movement of workers and of persons in general should not prevent the full implementation by the candidate countries of the measures foreseen in the White Paper related to the abolition of border controls.

4. IMPLEMENTING ENVIRONMENTAL STANDARDS

Environment is a major challenge for enlargement: while the adoption of the Union's environmental rules and standards is essential, none of the candidate countries can be expected to comply fully with the *acquis* in the near future, given their present environmental problems and the need for massive investments.

These problems are far more severe than those faced by present Member States. The persistence of a gap between levels of environmental protection in present and new members would distort the functioning of the Single Market and could lead to a protectionist reaction. This situation would affect the Union's capability to develop its environmental policy.

Nonetheless, effective compliance with Union environmental standards would necessitate, apart from important legislative and administrative efforts, massive investment in the ten applicant countries. Such levels of investment would appear unsustainable for national budgets even in the long term. The Union will not be in a position to cover the resulting financing gap by the time of enlargement. Investment for the adoption of the *acquis*, however, is one of the priorities of the reinforced pre-accession strategy, and forms the basis of the reorientation of Phare.

This apparent impasse can be tackled through a two-fold approach:

- In partnership with the Union, realistic national long-term strategies for gradual effective alignment should be drawn up and start being implemented in all applicant countries before accession, in particular for tackling water and air pollution. These strategies should identify key priority areas and objectives to be fulfilled by the dates of accession as well as timetables for further full compliance; ensuing obligations should be incorporated in the accession treaties. All new investments should comply with the *acquis*.
- Important domestic and foreign financial resources, in particular from the private sector, will have to be mobilised in support of these strategies. The Union will be able to make only a partial contribution.

5. TRANSPORT

Very important investment in the applicants' transport infrastructure will have to be made, to avoid bottlenecks resulting from increasing flows and to allow for the full benefits of integration to be reaped. Development of transport infrastructure is also likely to be a high priority for the applicant countries themselves. Investment needs in transport infrastructure will be very high and an important part will have to be financed from sources other than national budgets. Substantial support will be needed from the Union for TEN-related corridors.

Full adaptation to Union safety and other technical norms will be necessary for a smooth enlargement. On the whole, operators should be able to bear the cost of gradual adaptation involving substantial renewal of fleets. However, specific measures might be needed, mainly in the railway sector, to encourage a favourable modal development in line with the orientations of the Common Transport Policy, and to address the consequences of restructuring.

6. NUCLEAR SAFETY

The nuclear industry accounts for 30% of electricity-generation in the applicant countries, on average, and as much as 80% in some countries. Most of the power stations were built using Soviet technology and do not meet international safety standards.

The solution is not simply to close them down, as they do not all pose the same risk and the cost of obtaining alternative energy supplies would be extremely high. Several of the applicant countries have already begun constructing new nuclear power plants, which they consider the least expensive way of meeting growth-led energy demand and of achieving independence in the energy sector.

The Union must protect the life and health of its present and future citizens. This implies that the applicants should co-operate fully in efforts to bring their levels of nuclear safety up to international standards, in accordance with the approach of the G7 since 1992. This implies that:

- Where western-designed nuclear plants are in use (Romania and Slovenia), developments should be monitored to ensure that operations comply with the appropriate safety standards. Technical assistance can be provided if necessary.

- Where the safety of Soviet-designed nuclear power stations, which are in operation or under construction, can be upgraded to meet international safety standards, modernisation programmes should be fully implemented over a period of 7-10 years. (This applies to Dukovany and Temelin in the Czech Republic, Paks in Hungary, and certain units at Bohunice and Mochovce in Slovakia and at Kozloduy in Bulgaria.)
- The timetables agreed by the governments concerned, subject to certain conditions, for the closure of non-upgradeable units must be respected. (This applies to Bohunice in Slovakia, Ignalina in Lithuania and certain units at Kozloduy in Bulgaria.)
- Meanwhile, the urgent improvements called for by international experts should be carried out.

The plant closure commitments given by Bulgaria and Lithuania in return for loans granted by the EBRD/Nuclear Safety Account were subject to certain conditions. The Nuclear Safety Account Agreement entered into in 1993 by Bulgaria provided for the closure of the four units concerned at Kozloduy as soon as other duly specified energy sources became available. The necessary work was to be completed by the end of 1998; this timing having slipped, it is now thought that units 1 and 2 could be closed in 2001 and units 3 and 4 in 2001/2002. The Nuclear Safety Account Agreement concluded in 1994 with Lithuania for the closure of two units at Ignalina provided for the first to close in 1998 and the second in 2002; however, their operation could be extended until 2004 and 2008 at the latest if certain criteria were fulfilled.

Slovakia has not taken on any international commitments concerning the closure of the two reactors concerned at Bohunice, but the government adopted a resolution in 1994 whereby these reactors would be closed down by the year 2000 at the latest if the two new units under construction at Mochovce have in the meantime entered into commercial operation.

Agreement should be reached as soon as possible between the institutions providing financial support and each of the countries concerned on the earliest practical date for the closure of the nuclear power stations in question and a support programme to make their closure possible. These programmes should be prepared by the EBRD, together with PHARE, EURATOM and the World Bank, which should co-ordinate closely.

Such co-ordination should be extended to all assistance and modernisation operations. Given the amounts in question (some 4-5 billion ecus for the main operations over ten years), the Union will be able to make only a partial contribution.

The Union should co-operate closely with the safety authorities of the countries concerned to create a climate favourable to nuclear safety, and should support their independence vis-à-vis the political authorities.

7. FREEDOM, SECURITY AND JUSTICE

Justice and Home Affairs became part of the Union's agenda with the entry into force of the Treaty of Maastricht. The Treaty of Amsterdam transfers some of these areas into Community competence and reinforces cooperation in the residual third pillar areas. It moreover integrates the Schengen agreements into the Treaty on the European Union. All applicant countries are to a varying degree confronted with the challenges of the fight against organised crime, terrorism, trafficking in women and drugs.

The control of external frontiers and respect for international norms in fields such as asylum, visas and immigration brings an added dimension. The geographical situation of some of the applicants exposes them to risks of importing problems from their neighbours.

The impact of these factors on the present Union is already apparent. But the enlargement of the Union provides an opportunity to address more effectively common problems in these fields which affect both the present Union and the applicants.

Some applicant countries began determined reforms in this area early on. Others have experienced delays notably due to changes in government. Overall, their achievements both in legal terms and in practical implementation varies considerably. However the lack of trained and experienced manpower is a common feature.

In these fields institution building in the pre-accession period will also be of utmost importance.

8. BORDER DISPUTES

Enlargement should not mean importing border conflicts. The prospect of accession acts as a powerful incentive for the states concerned to settle any border disputes. The Stability Pact promoted by the Union between May 1994 and March 1995 has also been influential in this regard. Today several disputes, of low intensity, among applicants remain to be resolved.

The dispute between Hungary and Slovakia over the dam on the Danube is before the International Court of Justice, while the question of the maritime frontier between Lithuania and Latvia is in the process of being settled. Some of the applicant countries also have unresolved disputes with third countries. The Commission considers that, before accession, applicants should make every effort to resolve any outstanding border dispute among themselves or involving third countries. Failing this they should agree that the dispute be referred to the International Court of Justice.

In any event, all candidate countries should therefore, before accession negotiations are completed, commit themselves to submit unconditionally to compulsory jurisdiction, including advance ruling of the International Court of Justice in any present or future disputes of this nature, as Hungary and Slovakia have already done in the abovementioned disagreement.

9. APPLYING COMMUNITY RULES IN ADVANCE OF ACCESSION

The applicant countries must abide by commitments they have made in the framework of the WTO and the OECD. But there have been a number of disputes between the Union and certain applicant countries, in cases where the latter have put international rules, such as the most favoured nation clause or certain trade arrangements, above the provisions of the Europe Agreements and their future obligations as member states. Such an approach is contrary to the spirit of gradual adoption of the *acquis communautaire*. Stepping up the pre-accession strategy should therefore include finding solutions to these problems.

The application before accession of certain Community rules on competition and state aid is also needed. This implies that the Commission should be asked to approve or, in any event, be consulted on national decisions by the authorities in the applicant countries.

III. A STRATEGY FOR ENLARGEMENT

Negotiations will define the terms and conditions on which each of the applicant countries accede to the Union. As in the past, the basis for accession will be the *acquis* of the Union as it exists at the time of enlargement. While transition periods of definite and reasonable duration may be necessary in certain justified cases, the objective of the Union should be that the new members apply the *acquis* on accession.

This will ensure a balance of rights and obligations. The new members should accept the basic obligations on accession, otherwise their right to participate fully in the decision-making process may be put in question. The Union should not envisage any kind of second-class membership or opt-outs. Good preparation for membership, on the part of all the applicant countries, is therefore of fundamental importance. The actual timetable for accession will depend primarily on the progress made by individual countries in adopting, implementing and enforcing the *acquis*. This should continue, and be accelerated, in parallel with accession negotiations.

A successful strategy for enlargement thus needs to combine:

- negotiations, based on the principle that the *acquis* will be applied on accession.
- a reinforced pre-accession strategy, for all applicant countries, designed to ensure that they take on as much as possible of the *acquis* in advance of membership.

1. ACCESSION NEGOTIATIONS

Principles

The position to be presented by the Union to the applicant countries with which negotiations are opened should be based on the following principles:

- new members will take on the rights and obligations of membership on the basis of the *acquis* as it exists at the time of accession;
- they will be expected to apply, implement and enforce the *acquis* upon accession; in particular, the measures necessary for the extension of the Single Market should be applied immediately;
- transition measures - but not derogations - may be agreed in the course of negotiations, in duly justified cases; they should ensure the progressive integration of the new members into the Union within a limited period of time;
- during the accession negotiations, the applicants' progress in adopting the *acquis* and in other preparations for membership will be regularly reviewed on the basis of reports from the Commission.

The negotiations will begin with the screening of secondary legislation by the Commission and each of the applicant countries with which negotiations have been opened. This preliminary stage will identify the main problem areas for subsequent negotiation.

In the last accession negotiations, which took place with particularly well-prepared applicant countries, difficulties occurred in the conduct of four separate, but parallel, accession conferences of an intergovernmental nature. The Union's arrangements for the future accession negotiations will need to take full account of the complexity of the matters involved, the degree of preparation of the applicant countries, and the need for overall coherence with the reinforced pre-accession strategy.

Transition Periods

In its interim report on enlargement to the Madrid European Council, the Commission indicated that the basis for accession is the *acquis* of the Union, as it exists at the time, but that transitional arrangements may be needed in some areas such as agriculture and free movement of persons. Any transition periods should, however, be limited both in scope and duration.

2. REINFORCING THE PRE-ACCESSION STRATEGY

At the request of the Dublin European Council, the Commission is proposing the reinforcement of the pre-accession strategy for all CEEC applicant countries, whatever the stage they have reached in the transition process. This will enable assistance to be directed towards the specific needs of each applicant, with a view to the negotiations, in a coherent overall approach. In this way, the Union will be able to provide support for overcoming particular problems identified in the opinions, without the need for long transition periods which would put into question the *acquis* and the economic and social cohesion of the Union as a whole.

The reinforced pre-accession strategy outlined below has two main objectives. First, to bring together the different forms of support provided by the Union within a single framework, the Accession Partnerships, and to work together with the applicants, within this framework, on the basis of a clearly defined programme to prepare for membership, involving commitments by the applicants to particular priorities and to a calendar for carrying them out; secondly, to familiarise the applicants with Union policies and procedures, through the possibility of their participation in Community programmes.

The existing pre-accession strategy is founded on the Europe Agreements, the White Paper on the Single Market, the structured dialogue and Phare.

In the light of the intensity of contacts between the Union and the applicants during the coming phase of the accession process, in the framework of the negotiations, the Europe Agreements and the Accession Partnerships, the present structured dialogue no longer appears appropriate.

Most accession-related issues of principal concern to the Union and the applicants will be discussed bilaterally. In the event that accession-related issues of a horizontal nature arise which could advantageously be taken up in a multilateral framework, an ad hoc dialogue could be arranged for this purpose by the Presidency and the Commission with the ten Central and Eastern European countries. This approach should enable the dialogue to focus on such issues with a minimum of formality.

Pre-accession aid

In addition to Phare (ECU 1.5 billion per year), the pre-accession aid to be granted to the applicant CEECs from the year 2000 will consist of two elements:

- aid for agricultural development amounting to ECU 500 million a year;
- structural aid amounting to ECU 1 billion. This aid would be directed mainly towards aligning these applicant countries on Community infrastructure standards, particularly - and by analogy with the assistance currently provided under the Cohesion Fund - in the transport and environmental spheres. It would also familiarize these countries with the arrangements for implementing structural measures.

Accession Partnerships

The new instrument of the Accession Partnership will be the key feature of the reinforced strategy and will mobilise all forms of assistance to the applicant countries in central and eastern Europe within a single framework for the implementation of national programmes to prepare them for membership of the Union.

Accession Partnerships would involve:

- precise commitments on the part of the applicant country, relating in particular to democracy, macro-economic stabilisation and nuclear safety, as well as a national programme for the adoption of the Community *acquis* within a precise timetable, focusing on the priority areas identified in each opinion;
- mobilisation of all resources available to the Community for preparing the applicant countries for accession. This means first and foremost the Phare programme but also any new forms of assistance that the Community could provide in the context of future financial perspectives. Other resources could be mobilised from international financial institutions for work on standards and the development of SMEs. Phare could be used as a catalyst for cofinancing operations with the EIB, the EBRD and the World Bank with whom the Commission will conclude framework agreements. Given the enormous requirements, in particular in the field of environment and transport, the Commission suggests that around 70 % of the Phare funds be used for investment.

The programme for adopting the *acquis* would be drawn up with the Commission in partnership with each of the applicant countries. The priorities set should initially correspond to the sectors identified as deficient in the opinions. Work towards the objectives would be covered by an indicative timetable. The granting of assistance - on the basis of annual financing agreements - will be conditional on achieving these objectives and on progress made. Implementation of the programme would thus depend on strict "accession conditionality" based on suitable evaluation mechanisms and a continuous dialogue with the Commission.

The Commission would regularly report on progress to the European Council. The first report will be submitted at the end of 1998 and then on an annual basis thereafter. The progress of the applicant countries in fulfilling the targets set out in each individual Accession Partnership will serve as the basis of the reports. When an applicant country is judged to have fulfilled the necessary conditions to enter into accession negotiations and has not already done so, the Commission will forward a recommendation to the Council that accession negotiations should be launched.

Each Accession Partnership will take the form of a Commission decision to be taken after consulting the applicant country concerned and with due regard to the opinions of the management committees involved in administering assistance which has hitherto been granted from a range of different sources.

Preparation of the Accession Partnerships will begin in the second half of 1997.

Participation in Community programmes and mechanisms to apply the *acquis*

As the applicant countries progressively adopt the *acquis* in preparation for membership, they should be given an opportunity to participate in Community programmes.

This is provided for in the Europe Agreements and does not raise problems of principle. As these programmes encompass most Community policies, covering education, training, research, culture, environment, SMEs and the Single Market, they will provide a useful preparation for accession in familiarising the applicant countries and their citizens with the Union's policies and working methods.

The problem is to make this participation effective for all programmes. It will be necessary, depending on the budgetary resources of each country, to permit the Phare programme to cofinance the applicant countries' participation in the programmes beyond the 10% assistance limit laid down by the European Council in Essen.

The gradual integration of the Central and Eastern European countries into the different programmes will enable their representatives to become more familiar with Community legislation and proceedings and to take advantage of Member States' experience in areas such as public procurement, the right of residence and VAT. Nevertheless, this does not imply giving decision-making power to countries which are not yet members of the Union.

The involvement of certain Community agencies or bodies will also help better prepare the adoption of the *acquis*. More frequent contacts within these bodies will enable certain problems to be resolved at a technical level. A special effort will be made to familiarize the applicants with Community agencies, such as the Medicines Evaluation and the Environment Agency, the European Statistical Office (Eurostat), and the Veterinary and Phytosanitary Office, and with certification and standardisation bodies.

IV. CYPRUS

In July 1993 the Commission delivered a favourable opinion on Cyprus's application for membership. The European Council subsequently reaffirmed on several occasions, most recently at Florence in June 1996, that accession negotiations with Cyprus should start six months after the conclusion of the IGC.

1. ECONOMIC DEVELOPMENT

In its 1993 opinion the Commission noted the Republic of Cyprus's advanced level of development and economic dynamism. This still holds good with full employment (2.5% jobless rate), moderate inflation (3%) and public debt standing at 53% of GNP in 1996. The southern part of the island should not encounter any major problems in adopting the *acquis communautaire* or in coping with competition inside the EU. However, there is a need to align regulations and practices in the financial sector more fully with those which apply in the Union and to reinforce co-operation and controls in all areas of justice and home affairs.

In northern Cyprus the trends observed by the Commission in 1993 remain unchanged. Average income per capita is about ECU 3 600 per annum, one third of that of the southern part of the island. The economy is becoming increasingly dependent on the public sector, which ultimately means financial transfers from Turkey. Investments remain low despite its human and natural resources.

2. PROSPECTS FOR A POLITICAL SETTLEMENT

The 1993 Opinion noted the continuing division of Cyprus. Efforts since then, chiefly under UN auspices, to work towards a political settlement, in accordance with various UN proposals, have not achieved much progress. The UN conducted intensive contacts with the leaders of the two communities during the first half of 1997 which have now led to face to face talks between them under UN auspices. There is a chance to make progress before the Presidential elections due in Cyprus in February 1998.

The shape of a settlement, establishing a bicomunal and bizonal federation, is well established, and supported by the Union. A number of options for constitutional and territorial arrangements to implement it have been explored, and the beginnings of a possible consensus have sometimes been discernible. But there has not hitherto been sufficient incentive for the two communities to reach agreement.

The Union is determined to play a positive role in bringing about a just and lasting settlement in accordance with the relevant United Nations Resolutions. The status quo which is at odds with international law, threatens the stability of the island, the region and has implications for the security of Europe as a whole. The Union cannot, and does not wish to, interfere in the institutional arrangements to be agreed between the parties. But it is available to advise on the compatibility of such arrangements with the *acquis* of the Union. The prospect of accession, whose political and economic advantages are now becoming clear to Turkish Cypriots as well as to Greek Cypriots, can in itself provide such an incentive.

3. RELATIONS WITH THE EUROPEAN UNION

The timetable agreed for accession negotiations to start with Cyprus means that they could start before a political settlement is reached. The Union shares the view expressed by the UN Secretary General, that the decision to open negotiations should be seen as a positive development which could promote the search for a political settlement.

Negotiations on accession would be facilitated if sufficient progress is made between the parties in contacts this year under the auspices of the United Nations to allow representatives of the Turkish Cypriot community to be involved in the accession process. Agreement on a political settlement would permit a faster conclusion to the negotiations. If progress towards a settlement is not made before the negotiations are due to begin, they should be opened with the government of the Republic of Cyprus, as the only authority recognised by international law.

V. THE EUROPEAN CONFERENCE

Enlargement is a long-term process affecting the whole of Europe. The Member States of the Union and all those European countries aspiring to membership and linked to it through an association agreement should be brought together in a single forum.

The European Conference would provide an opportunity for consultations on a broad range of issues arising in the areas of the Common Foreign and Security Policy and Justice and Home Affairs.

With regard to the CFSP, the conference would provide a framework for dialogue on international problems of common concern, such as relations with Russia, Ukraine and other CIS countries and European security. The conference would enable participating countries to be involved more closely in the preparation and implementation of joint actions, declarations and demarches. This would contribute to the overall weight and coherence of decisions and actions taken under the CFSP.

In the field of Justice and Home Affairs, the Union and the other participants in the conference share many concerns in areas including the fight against organised crime, terrorism, corruption, drug trafficking, illegal arms sales, money laundering and illegal immigration. The European Conference would facilitate cooperation between national authorities, including police and judicial officials, and cooperation with Europol.

The Conference would meet each year at the level of Heads of State or Government and the President of the Commission and, where necessary, ministerial level.

VI. RELATIONS WITH TURKEY

Turkey's eligibility for EU membership, first raised in the 1964 Ankara Association Agreement, was reiterated in the Commission's 1989 opinion on Turkey's 1987 application for membership. On 29 April 1997 the EU-Turkey Association Council reaffirmed Turkey's eligibility and confirmed that Turkey will be judged by the same objective standards and criteria as other applicants.

The entry into force of the customs union on 31 December 1995 marked a major step forward in relations between the EU and Turkey. The customs union is working satisfactorily and provides a sound basis for the further development of relations between the EU and Turkey. However, political circumstances have not so far allowed for the pursuit of financial co-operation and political dialogue, as agreed when the customs union decision was taken on 5 March 1995.

The *Turkish economy* has grown rapidly in the last ten years. Following the entry into force of the customs union total EU-Turkey trade has increased from 22 Becu in 1995 to an estimated 27 Becu in 1996 (with an estimated EU surplus of 9 Becu). The customs union has demonstrated the *Turkish economy's* ability to cope with the competitive challenge of free trade in manufactured goods, as well as the trade, competition, and intellectual property components of the *acquis communautaire*. However, macroeconomic instability continues to give cause for concern. Over the past decade, Turkey has been unable to break the cycle of inflation, public spending deficits and currency depreciation. The structural causes of macroeconomic instability need to be tackled e.g. by improving the efficiency of tax collection, restructuring and privatizing public sector enterprises, reforming the social security system and reviewing public expenditure. Efforts are also needed to bring about economic and social cohesion, to modernize agriculture and to focus more on investment in infrastructure and human capital.

In political terms Turkey has a government and parliament resulting from multi-party, democratic elections and an administration capable of framing and applying legislation compatible with the *acquis communautaire*. Despite political recognition of the need for improvement and certain recent legislative changes, Turkey's record on upholding the rights of the individual and freedom of expression falls well short of standards in the EU. In combating terrorism in the south east, Turkey needs to exercise restraint, to make greater efforts to uphold the rule of law and human rights and to find a civil and not a military solution. Persistent cases of torture, disappearances and extra-judicial executions, notwithstanding repeated official statements of the government's commitment to ending such practices, put into question the extent to which the authorities are able to monitor and control the activities of the security forces.

Recent developments in the administration and the education system, while intended to strengthen secularism, nonetheless underline the particular role of the military in Turkish society. The National Security Council has a special role under the Constitution in the formulation and implementation of national security policy and the Council of Ministers is required to give priority to its decisions. There are ambiguities in the Turkish legal system with regard to civilian political control of the military.

The further pursuit of democratization in Turkey should be accompanied by a firm commitment to resolve a number of problems in the region. As was pointed out at the EC-Turkey Association Council on 29 April 1997, tensions in the Aegean can be overcome only through the settlement of the issues between Greece and Turkey in accordance with international law, including means such as the International Court of Justice, as well as through good neighbourly relations and the rejection of the threat or use of force in accordance with the UN Charter. Moreover Turkey should contribute actively to a just and lasting settlement of the Cyprus question in accordance with the relevant United Nations resolutions.

The EU should continue to support Turkey's efforts to resolve its problems and to forge closer links with the EU. The Association Agreement and the customs union provide the foundations for building an increasingly close political and economic relationship which should evolve in parallel with the democratization process inside Turkey, progress towards lasting good-neighbourly relations towards Greece and the achievement of a just and lasting settlement in Cyprus.

A number of proposals designed to take the relationship forward are set out in the Commission's communication to the Council on the future development of relations with Turkey (COM(97) 394). As requested by the Council on 24 March 1997, they aim to take the relationship beyond the customs union in the light of the decisions of the April 1997 Association Council.

Several of the proposals put forward by the Commission will require funding from the Community budget. Without it most of these proposals cannot be implemented. The Commission considers that the special financial regulation designed to accompany the customs union should be adopted as soon as possible. It also notes that MEDA is available for financial co-operation with Turkey and trusts that the conditions will be established for the full use of this instrument.

VII. FINAL RECOMMENDATIONS

1. The Commission invites the Council to endorse the approach to the challenge of enlargement set out in this communication.

Enlargement, as the Amsterdam European Council indicated, is an inclusive process embracing all of the applicant countries. The overall process includes the opening of accession negotiations with individual countries, according to the stage which each has reached in satisfying the basic conditions of membership and in preparing for accession; and an accompanying framework which consists of the reinforcement of the pre-accession strategy for countries of Central and Eastern Europe, as well as the creation of a multilateral forum of cooperation in the form of a European Conference.

2. As regards the opening of accession negotiations, the European Council has already concluded that they should commence with Cyprus six months after the end of the Intergovernmental Conference.

3. Concerning the countries of Central and Eastern Europe, the Commission has now presented in its Opinions an objective analysis, in the light of the criteria laid down by the Copenhagen European Council. The Commission considers that none of them fully satisfy all the criteria at the present time. However, nine countries satisfy the political conditions, while certain countries have made sufficient progress towards satisfying the economic conditions and those related to the other obligations of membership.

In the light of its analysis, and in accordance with their respective merits, the Commission considers that Hungary, Poland, Estonia, the Czech Republic and Slovenia could be in a position to satisfy all the conditions of membership in the medium term if they maintain and strongly sustain their efforts of preparation.

The Commission underlines that a decision to open accession negotiations simultaneously with the countries mentioned does not imply that negotiations will be concluded simultaneously. The timing of the conclusions of accession negotiations will depend in large part on the accomplishment of the further efforts required from each applicant country in the respective opinions.

4. On this basis, the Commission recommends the Council to open negotiations with the following countries (listed in chronological order of their accession requests):

Hungary

Hungary presents the characteristics of a democracy, with stable institutions guaranteeing the rule of law, human rights, and respect for and protection of minorities. It can be regarded as a functioning market economy, and should be able to cope with competitive pressure and market forces within the Union in the medium term. It would be capable in the medium term of taking on the *acquis*, particularly of the Single Market, provided that it continues its efforts of transposition and implementation. However, particular efforts will be needed in the fields of environment, customs and energy. Further reforms will also be necessary for the country to have the structures to apply and enforce the *acquis*.

Poland

Poland presents the characteristics of a democracy, with stable institutions guaranteeing the rule of law, human rights and respect for and protection of minorities. It can be regarded as a functioning market economy, and should be able to cope with competitive pressure and market forces within the Union in the medium term. It should be able in the medium term to participate fully in the Single Market, provided that it continues its efforts on transposition of the *acquis*, and intensifies work on its implementation.

However, particular effort and investment will be needed to meet the *acquis* in sectors such as agriculture, environment and transport. Further administrative reform will also be indispensable if Poland is to have the structures to apply and enforce the *acquis* effectively.

Estonia

Estonia presents the characteristics of a democracy, with stable institutions guaranteeing the rule of law, human rights and respect for and protection of minorities. However, measures need to be taken to accelerate the naturalisation of Russian-speaking non-citizens, to enable them to become better integrated into Estonian society. It can be regarded as a functioning market economy, and should be able to make the progress necessary to cope with competitive pressure and market forces within the Union in the medium term. Estonia has made considerable progress in transposing and implementing the *acquis* relating particularly to the Single Market. With further effort it should become able to participate fully in the single market in the medium term. Particular efforts, including investment, will be needed to apply the *acquis* fully in sectors such as environment. Strengthening of the administrative structure will also be indispensable if Estonia is to have the structures to apply and enforce the *acquis* effectively.

Czech Republic

The Czech Republic presents the characteristics of a democracy, with stable institutions guaranteeing the rule of law, human rights and respect for and protection of minorities. It can be regarded as a functioning market economy, and should be able to cope with competitive pressure and market forces within the Union in the medium term. It should be capable in the medium term of applying fully the *acquis* relating to the Single Market, provided that it continues its efforts on transposition and intensifies work on its implementation. However, particular efforts, including investment, will be needed to meet the *acquis* in sectors such as agriculture, environment and energy. Further administrative reform will also be indispensable if the Czech Republic is to have the structures to apply and enforce the *acquis* fully.

Slovenia

Slovenia presents the characteristics of a democracy, with stable institutions guaranteeing the rule of law, human rights, and respect for and protection of minorities. It can be regarded as a functioning market economy, and should be able to cope with competitive pressure and market forces within the Union in the medium term. However, considerable efforts will be needed to take over the *acquis*, particularly for the effective application of the Single Market. Important progress will be needed in the fields of environment employment and social affairs and energy. Further reforms will also be indispensable for Slovenia to equip itself with administrative structures to apply the *acquis* effectively.

Slovenia has not yet ratified the Europe Agreement, although its government has committed itself to obtaining the necessary modification of the Constitution and ratification of the Agreement as soon as possible; such action on the part of Slovenia should be considered a precondition for the opening of accession negotiations.

4. As regards the reinforcement of the pre-accession strategy, the Union is firmly committed to working with each of the PECO applicant countries, notably through the Accession Partnerships, to overcome the difficulties which they face in preparation for membership, and which are identified in the Opinions. The Commission will report regularly to the European Council on the progress made. The first report will be submitted at the end of 1998 and then on an annual basis thereafter. The progress of the applicant countries in fulfilling the targets set out in each individual Accession Partnership will serve as the basis of the reports. When an applicant country is judged to have fulfilled the necessary conditions to enter into accession negotiations and has not already done so, the Commission will forward a recommendation to the Council that accession negotiations should be launched.
5. In place of the existing structured dialogue, multilateral meetings with the applicant countries of Central and Eastern Europe could be arranged by the Presidency and the Commission to discuss accession-related issues other than those arising in the individual accession negotiations.
6. The overall framework should be completed by the creation of a European Conference, to address issues related to cooperation in the fields of Common Foreign and Security Policy, and Justice and Home Affairs; the Conference would comprise the Member States of the Union and all those European countries aspiring to membership and linked to it through an association agreement.

PART THREE:THE NEW FINANCIAL FRAMEWORK (2000-2006)

I. WHAT IS AT STAKE

Since 1988 the Community budget has been contained within a medium-term financial framework accepted jointly by the Council, Parliament and the Commission. Subject to a guaranteed ceiling of own resources, this arrangement has produced a steady evolution in the broad categories of expenditure in accordance with the priorities set for the development of Community policies. The rules and procedures which were also laid down by interinstitutional agreement have undoubtedly helped to ensure more trouble-free annual budgetary procedures.

This financial framework system has demonstrated its worth in political, economic and budgetary circumstances which have after all undergone far-reaching changes over the past decade. It is the Commission's strong opinion that this arrangement must be continued.

The new financial framework to be laid down for the period immediately after 1999 will have to provide coherent coverage, within reasonable budget limits, for the development of Community policies and the impact of the Union taking in new members, along the lines set out in this communication.

An assessment needs also to be made of whether the current financing system should be amended, in particular to take account of likely changes in budgetary circumstances.

The new financial framework will have to satisfy three major concerns. It must:

- cover a sufficiently long period of time;
- be capable of financing essential requirements;
- ensure the sound management of public finances.

The Commission is assuming that there will be a first wave of accessions towards the middle of the period covered by the new financial perspective (2000-2006).

1. COVERING AN ADEQUATE PERIOD

The period covered by the new financial framework must be long enough to cater for:

- the likely impact of changes to certain Community policies;
- the impact of the first enlargement and the subsequent transitional arrangements for the countries concerned;
- the development of pre-accession aid for all the applicant countries.

The period to be covered is therefore 2000-2006.

2. FINANCING ESSENTIAL REQUIREMENTS

The reform of the common agricultural policy to make it more consumer-friendly will, in the first instance, entail additional expenditure. However, given the content of the proposed reform, these costs should be relatively low and the level of agricultural expenditure should be stabilized.

The existing fifteen Member States will continue to give priority to cohesion with greater thematic, geographical and financial concentration of aid. There will also be efforts to improve efficiency through simplification of the implementation of aid, improved division of responsibilities and systematic evaluation of results.

Other Union priorities whose financial implications will have to be accommodated in the new framework are:

- the development of a number of internal policies intended to serve priority objectives shared by all the Member States and where there is an obvious added value;
- giving the Union a higher profile on the world stage, by continuing cooperation with third countries, economic and financial development aid and humanitarian aid;
- financing a modernized Community administration where human resource and financial costs will be kept under control.

The new accessions will entail substantial extra costs for the existing fifteen members. However, enlargement is likely to take place in stages. Prior to this, pre-accession aid will be stepped up to support the necessary adjustment processes in the applicant countries and to spread them over time.

3. SOUND MANAGEMENT OF PUBLIC FINANCES

Public finances will have to be kept on a tight rein in all the Member States in order to consolidate sound growth. The same applies to the Community budget.

This budgetary discipline is not incompatible with the considerable challenges that will have to be met by the new financial perspective.

There are various indications that it should be possible to cover the development of priority measures to be financed from the Community budget over the period 2000-2006 without raising the own resources ceiling from its level of 1.27 % of GNP.

- The 1999 budget should be adopted well beneath the 1.27% ceiling, leaving a fairly substantial margin right from the beginning of the period.
- With economic growth forecast to be running at 2.5% a year for the period 2000-2006 for the existing fifteen Member States and at 4% a year between now and 2006 for the applicant countries, if the own resources ceiling is maintained at its 1999 level in terms of GNP, by the end of the period there would be potential additional resources slightly in excess of ECU 20 billion (1997 prices).
- Disregarding pre-accession aid and on the basis of the working assumptions used, the initial round of accessions would not begin to have any budgetary impact until about 2002-2003. In any case, transitional arrangements will be in force, particularly as regards the common agricultural policy, through the rest of the period covered by the financial perspective. Allocations to the new members for structural measures will only increase gradually.

II. DEVELOPMENT OF EXPENDITURE

Expenditure needs have been estimated on the basis of the expenditure classification used in the current financial framework under the following six major categories:

- The common agricultural policy, expenditure on which is limited by the agricultural guideline
- Structural actions
- Other internal policies
- External action
- Administrative expenditure
- Reserves (monetary reserve and reserves for emergency aid and loan guarantees)

Where appropriate, requirements have been broken down into those needed for the existing fifteen Member States, pre-accession aid and expenditure following the accession of new Member States.

1. AGRICULTURAL EXPENDITURE

Maintaining the current method of calculating the agricultural guideline would not pose any difficulty in covering identified agricultural expenditure needs.

Expenditure under the reformed agricultural policy for the existing fifteen Member States would cover:

- market intervention measures and export refunds; following the reform (which is to bring Community prices closer to prices on the world market) these costs should fall by about ECU 3.7 billion (1.4 billion for cereals, 1.2 billion for beef and 0.9 billion for milk products) by the year 2006 compared with what they would be if there were no reform;
- direct compensatory aid; here the reform will entail additional expenditure of about ECU 7.7 billion by the same date (1.7 billion for cereals, 4.1 billion for beef, 3.0 billion for milk products and a saving of 1.0 billion as a result of direct payments for silage maize being abolished);
- existing accompanying measures (agri-environment, afforestation, early retirement); about ECU 2.8 billion a year plus the new rural development accompanying measures and the horizontal measures in the fisheries sector (FIFG), costing from 1.9 to 2.0 billion a year over the period, which are to be taken over by the EAGGF Guarantee section; on that occasion a proposal will be made for the appropriate adjustments to the EAGGF financial regulations.

At the same time, agricultural expenditure for the applicant countries would comprise:

- Pre-accession aid, currently estimated at about ECU 500 million a year, for modernizing farms and agri-foodstuff distribution channels in the applicant countries. Following the first accessions, the total amount allocated for this aid would remain the same, meaning that each of the countries not due to join until later would receive more.
- Expenditure relating to the accession of the new Member States to market organization measures (estimated at between 1.1 and 1.4 billion a year), enhanced accompanying measures and special modernization aid following on from the pre-accession measures (an additional amount rising from 0.6 to 2.5 billion over the period from the time of accession).

Application of the guideline as it stands would leave a margin that would grow from 2003 onwards, to reach a very substantial amount by the end of the period.

There are in any case good reasons for leaving a large margin in order to cover market uncertainties and to enable the reform of the common agricultural policy to continue before the end of the period covered by the financial perspective. In addition, it should be made feasible in due course to put an end to transitional arrangements for new Member States. The Commission nevertheless finds, irrespective of the accession effect (ECU 1.3 billion to ECU 1.4 billion), that it is not the right moment to review the way the guideline is calculated now, but that the issue should be reviewed in about 2005.

2. STRUCTURAL EXPENDITURE

Financing for structural operations, including those for the new Member States, would be maintained, in relative terms, at the 1999 level, namely 0.46% of the Union's GNP. The total allocation for the period 2000-2006 would therefore be ECU 275 billion at constant 1997 prices.

Of this amount, ECU 210 billion would be allocated to the Structural Funds proper for measures in the existing fifteen Member States in line with the changes proposed above:

- about two thirds would be allocated for measures in Objective 1 regions, including the transitional schemes for regions above the 75% threshold in terms of GDP per inhabitant, which would be gradually phased out of the Objective 1 arrangements;
- the remainder, for measures under other objectives, would slightly decrease over the period at the same time as concentrating greater funds on a smaller target population; this would be done without prejudice to the new rural development accompanying measures which are now included in the agricultural guideline.

Generally speaking, and in particular in areas where Community aid is to be appreciably reduced, ways will have to be developed to get the best leverage from operations funded by the Community budget by using public-private partnerships as well as combining subsidy arrangements, loans and venture capital contributions.

The new Member States would receive a total allocation of some ECU 45 billion, to be phased in over the period and accounting for about 30% of the total allocation for structural measures by the end of the period.

Pre-accession aid, to be drawn from the ECU 45 billion allocation for the new Member States, would be made available from the year 2000. This assistance, to be granted at a constant rate of ECU 1 billion per year, would initially be granted to all the applicant countries and would subsequently be focused on countries due to join the Union at a later stage. It would be primarily intended to help bring the applicant countries' infrastructures up to Community standards, particularly in the transport and environment fields, along the lines of existing Structural Fund operations.

The allocation for the Cohesion Fund will be ECU 20 billion. A review of eligibility under the criterion of *per capita* GNP being lower than 90% of the Community average will be carried out half-way in the period.

3. OTHER CATEGORIES OF EXPENDITURE

The proposed figures for agricultural and structural expenditure and for the own resources ceiling are determined by reference to the growth in Community GNP, which must also be the benchmark for determining the development of other types of expenditure.

The 1999 budget should leave significant margins below the ceilings in categories 3 to 5. The ceilings could then be maintained in real terms at the same level in 2000 and would not need to be increased until after that date.

The growth in expenditure under categories 3 to 5 from 2000 onwards must be looked at in the light of the specific features of the measures concerned and their future development, as well as in the light of enlargement, which will affect expenditure on different policies in different ways.

Internal policies

The development of internal policies over the period covered by the next financial perspective will have to satisfy two considerations, both designed to enhance the effectiveness of measures taken at Community level. First, the resources available for internal policies will have to be targeted so that they are not wasted on measures that are unlikely to have a significant impact. At the same time, allocations may be increased faster than GNP growth for certain programmes, which have been given priority because of the value-added they derive from Community-level action, for example in terms of growth, employment and the development and dissemination of new technologies. This would essentially mean the trans-European networks, research, education and training, the introduction of environment-friendly technologies and measures to support SMEs.

Regardless of enlargement, redirecting internal policies in this way would in overall terms mean raising the category 3 ceiling slightly more than the rise in the GNP of the fifteen Member States.

The effect of enlargement will vary from programme to programme. Although increases in line with the new countries' GNP would be appropriate for a good number of programmes, requirements may be greater in certain areas. This will be the case for policies where the population or the language concerned are more relevant as criteria than GNP (education and training, culture, information, etc.). The development of the trans-European networks will also necessarily have a different dimension in an enlarged Union. In addition, all the programmes that contribute to the proper functioning of the Single Market, and which are at the heart of Community action (such as statistics, standardization, administrative cooperation and controls in agriculture and fisheries) are also likely to be substantially affected by enlargement. Prior to enlargement the Phare programme will finance the applicant countries' participation in certain internal policies, including the research and technological development programme, as part of the pre-accession aid, but once they have joined, this funding will have to come from within category 3 for the new Member States.

This means that the increase in the allocations for internal policies following enlargement will have to be more than just in proportion to the new members' GNP. The increase will not only have to finance measures in the new Member States, but must also enable the Union to cope efficiently with a broader and less homogeneous whole without crowding out operations in the existing Member States.

The upshot of this is that the ceiling under category 3 will have to rise more rapidly than the GNP of the enlarged Community after the first accessions.

External action

From the beginning of the next period, the Community should pay special attention to the development of pre-accession aid, one of the objectives of which, in addition to the measures under categories 1 and 2, is to help finance the applicant countries' participation in Community programmes, including research programmes. After the first accessions, the total amount of this aid should remain stable at ECU 1.5 billion and be concentrated exclusively on the countries due to join at a later date.

As regards other external action by the Union, in contrast with what was done for the last enlargement, there will be no increase based on the new countries' GNP, since the acceding countries will have been in receipt of external aid prior to accession.

For the whole period 2000-2006 the ceiling for category 4 should therefore on average rise in step with the GNP of the existing fifteen Member States. In this way, the Community will be able to develop its international cooperation, in particular with its closest neighbours, such as the former Soviet republics, the former Yugoslavia, Albania, the Mediterranean countries and Turkey. It will also be in a position to step up its humanitarian aid, given the primary responsibility it has acquired in this area. This assumes, however, that no large increases in Community financing for the common foreign and security policy will be required in the coming years.

Administrative expenditure

The Commission's efforts to modernize the way it operates should make it possible to keep any increases in administrative expenditure within tight limits. The ceiling for category 5 may therefore rise more slowly than the fifteen Member States' GNP, if all the institutions apply the same budgetary discipline. This allocation will have to cover items such as buildings programmes already under way and pension commitments which will rise by about ECU 250 million over the period.

In contrast, enlargement will involve an increase in costs proportionately larger than the increase in GNP provided by the new Member States. The institutions will have to be equipped to work in new languages, to assume a bigger role in a more diverse Community and to accommodate nationals from the new Member States.

The Commission, nonetheless, feels that if the entry of the new Member States into the various institutions is made a sufficiently gradual process and is accompanied by the necessary rationalization measures, the overall administrative expenditure ceiling, after taking enlargement into account, may increase more slowly than the GNP of the enlarged Community over the whole period 2000-2006. This would make it possible to reduce the relative cost of running the Community institutions.

Overall development of categories 3 to 5

The guidelines proposed above point to different developments for the three different categories. However, between 2000 and 2006, the overall rise in these headings taken together should be slightly below that of the GNP of the enlarged Community.

4. RESERVES

The monetary reserve, which was set up in 1988, and the guarantee and emergency aid reserves set up in 1993 have, by and large, operated effectively.

It should, however, be possible to reduce the reserves during the coming period:

- ♦ The phasing-out of the *monetary reserve* by 2003 should be possible in view of the reform of the common agricultural policy, which is supposed to bring Community prices for several major products into line with world market prices, thereby significantly reducing the Community budget's vulnerability to fluctuations in the dollar.
- ♦ The *emergency aid reserve* could be cut back to ECU 200 million. This reserve has been systematically used to supplement allocations available for external action and this runs counter to proper budgetary discipline. The relevant items under category 4 should be given bigger allocations and the emergency aid reserve should be restored to its original role as a reserve to be mobilized to deal with situations that were genuinely unforeseeable when the budget was drawn up.

5. PROPOSED REFERENCE FRAMEWORK

The figures for the broad categories of expenditure (in terms of commitments) at 1997 prices produce a 17% increase between 1999 and 2006 in total appropriations for commitments, which is less than the growth in GNP (24% according to forecasts for the same period, taking account of the first wave of accessions). However, because the increase in total commitments will be lower than in the preceding period, the increase in payments would be more marked (20,5%) and the appropriations for commitments/appropriations for payments ratio would tend to fall in relation to what was used for drawing up the current financial perspective.

A significant margin would, nonetheless, remain available beneath an own resources ceiling maintained at 1.27% of Union GNP. This would most likely be more than sufficient to cover requirements should economic growth turn out lower than forecast. There are in any case good reasons for leaving such a margin:

- The integration of the applicant countries will not have been completed by the end of the next period. It would therefore be wise to leave some resources available to cover the end of the transitional arrangements for the first wave of new countries and the subsequent accessions.

- Political circumstances permitting, the issue of including the EDF in the budget may come up again in 2005, even though this would not have a significant impact on the appropriations for payments required until some time later.

III. THE FINANCING ARRANGEMENTS

Over the period covered by the next financial perspective, it is possible to face the challenges posed by the necessary reforms of some of the most important Community policies and those deriving from a first wave of accessions without exceeding the existing own resources ceiling (1.27% of GNP). As a result, there are no technical or legal reasons which impose a modification of the decision at the basis of the financing arrangements. The current own resources decision will remain in force as long as it is not modified by a new one.

The question of the opportunity of proposing a modification of the current financing arrangements rests therefore on an assessment of their current and expected performance. This assessment will have to take into account the fact that a modification of the own resources decision would require unanimity among the Member States and ratification by national parliaments.

1. THE FUNCTIONING OF THE SYSTEM

As demanded by Article 10 of the own resources decision, the Commission will present in the course of 1998 a full report on the functioning of the own resources system covering also the mechanism used to reduce the contribution of the United Kingdom and the possibility to introduce a new own resource. It is, however, already possible, even at this stage, to draw some broad conclusions.

The current arrangements have provided the Union with *an adequate amount of financial resources* and look likely to do so for the period covered by the next financial perspective. The margin available under the own resources ceiling has never been fully utilised. This has been due to various factors such as systematic underspending, e.g. in the agricultural area, and delays in carrying out commitments, e.g. in structural spending. Since 1997 the reduction in the increase in expenditure, measured as a percentage of GNP, has been the result of cautious budgetary decisions, in line with the budgetary consolidation efforts of the Member States,. These trends, combined with the increases in the own resource ceiling for the years 1997-99, are creating a margin which will help to accommodate a first wave of accessions.

The last modification of the own resources decision, whose effect has started being felt from 1995 onwards, has made the system more equitable by bringing national contributions more in line with the shares in GNP. The weight of the VAT resource, whose yield is poorly correlated with contributive capacity, is being reduced. Whereas in 1992 the VAT resource still represented 61.6 % of the total resources put at the disposal of the Union, in 1996 this share was down to 51 % and is expected to drop to about 33 % by 1999. The increase in the relative share of the GNP contribution, however, has been less rapid than anticipated as actual Union spending (and contributions) is increasing less than what is allowed by the own resources ceiling and less than what had been anticipated in 1992. While some improvement in the "fairness" of the financing system has already taken place, the largest part is still to come.

The share of the Community budget financed by the so called "traditional own resources" (custom duties and agricultural levies) has also continued to decline. In 1992 these resources still represented 22 % of total receipts, but in 1999 they are expected to drop below 15 %.

2. THE INTRODUCTION OF A NEW OWN RESOURCE?

The trend described in the previous paragraph often prompts the demand for the introduction of a new own resource to increase the percentage of tax-based own resources. The VAT and GNP contributions are perceived by Member States as transfers from the national exchequers and not as real own resources of the Community.

However, the introduction of new own resources still presents technical and, above all, institutional obstacles. One important consideration is that the fiscal autonomy of the Union would not be significantly enhanced by an increase in the share of financing provided by tax-based own resources. As long as the residual financing of the budget is covered by a "complementary" resource activating transfers from the national exchequers, any increase in Community spending would still translate in a corresponding increase in own resources payments. A real modification would be brought about only by the passage to a situation where the whole of the Community budget would be financed by autonomous fiscal resources. However, this would represent a significant institutional development that would have little chance of being countenanced by all Member States in the present phase of the integration process.

In addition, the introduction of any new resource is likely to make the system less equitable as the yield pattern of the new resource by Member State is unlikely to correspond to the GNP shares and require the introduction of an equalisation mechanism that would adjust national contributions to make them correspond to the GNP shares. While this mechanism would make the system more equitable, it would also raise the question of whether it would not be more cost-effective to switch to a system entirely based on GNP contributions.

Indeed, a strong case could be made for replacing the VAT resource. Its weak link with contributive capacity has already led to the decision to reduce its importance. Furthermore, in the countries where the harmonised base is capped, the resource is already effectively a GNP resource since its base is a conventional "50% of GNP". A good case could also be made for replacing traditional own resources with GNP contributions. As the importance of traditional own resources for the financing of the Community budget decreases, the balance between their advantages and disadvantages as a source of Community finance shifts towards the latter. In particular, their collection and recovery procedures are very complicated, exposed to fraud and very costly in terms of controls. This would not mean that the Union could ignore the effective collection of customs duties by Member States since these duties constitute an instrument of Union trade policy, but would modify substantially the perspective of its involvement in this complex area.

On the whole, the considerations presented in this section do not suggest the existence of a strong case for a rapid modification of the present arrangements.

3. MAIN TRENDS TO 2006

A first wave of accessions will affect the budgetary positions of all the present Member States, reducing the positive balances of net beneficiaries and increasing the negative ones of the others. The applicant countries have levels of prosperity significantly below those of the Union and will have therefore a strong claim to substantial amounts of Structural Fund payments. In addition, the experience of the enlargement to Spain and Portugal suggests that long transition periods for the "own resources" payments of the applicant countries might be introduced.

Future expenditure flows in the Union will also be influenced by the necessary reforms of the main policies. The common agricultural policy will be modified along the lines of the previous reform and the changes will affect essentially the same products. The new reform will therefore affect the budgetary positions of the Member States along the pattern of the previous one. However, its effects on the budgetary positions might be smaller as income losses will only be partially offset by increases in direct aids.

structural Fund spending in the new Member States will be financed through a combination of greater concentration of spending in the present Member States (which may supply about one third of the amounts needed) and of use of the margins created by economic growth (the other two thirds). However, the regions which will remain classified as “objective 1” and which experience high rates of unemployment will benefit from higher per capita transfers.

Internal policies will focus more on some key themes such as research and development efforts and the support of the completion of the trans-European networks. This concentration will be accompanied by stronger emphasis on selection criteria such as excellency and Community interest. This should lead to a more balanced distribution of expenditure among Member States.

Whereas the future budgetary trends for the United Kingdom are no more difficult to forecast than those for the other Member States, a considerable amount of uncertainty surrounds its future position in terms of relative prosperity, which is one of the factors at the base of the rebate granted to this country. Producing a projection of the relative prosperity of the United Kingdom to the year 2006 depends on forecasting, over a period of nine years, the rates of economic growth and of inflation of all Member States and the relative trend of the pound sterling if the United Kingdom decided not to join EMU. In a Union of 15 members, it is likely that in 2006 the relative prosperity of the United Kingdom would still be below the average of the Union. The accession of four or five of the applicant countries, however, might change this tentative conclusion.

At the time of the enlargement, it will be necessary to adapt the definition of the expenditure on which the calculation of the rebate is based to avoid an unjustified increase in its amount due to purely statistical changes. This is made necessary by the fact that with enlargement some expenditure flows directed to the new Member States, which are now considered “external expenditure” and therefore do not enter into the calculation, will be replaced by payments under internal policies, which enter into the calculation.

4. THE FUTURE FINANCING SYSTEM

National contributions to the Union budget have become more proportional to GNP shares, thus improving the degree of fairness of the current financing system. Community expenditure has been increasingly directed at achieving cohesion goals, which has implied a substantial amount of redistribution. Even if relative positions have developed in line with what had been expected at the time of the negotiation of the present own resources decision, in some cases the combination of these trends and of low returns from agricultural expenditure has resulted in budgetary positions which are perceived as excessive net financial burdens.

The next enlargement, which will take place during the period covered by the next financial perspective, will inevitably provoke a deterioration in the budgetary positions of all the current Member States. This cannot come as a surprise and should not give rise to claims for compensation.

However, over the same period, the maintenance of the current financing arrangements and the effects of the reform of the main Community policies are not expected to lead to major changes in the relative budgetary positions of the Member States.

The uncertainties surrounding the future relative prosperity situation of the United Kingdom, however, lead the Commission to propose postponing a re-examination of the rebate mechanism until immediately after the first enlargement.

At that moment, it will be possible to proceed to an assessment of the situation on the basis of more reliable data. If the relative prosperity of this country were to be above the Union's average, it would be appropriate to review the current arrangements and to foresee a gradual reduction of the current rebate.

The review might be extended to the financing of the budgetary rebate. If the data were to show that the effects of the reform of the common agricultural policy were significantly different from those expected and that they were leading to unjustifiable budgetary positions it might be conceivable to adjust its financing key. A first step in this direction was taken already in Fontainebleau when it was decided that Germany would pay two thirds of the amount resulting from the standard GNP key.

If and when the Union were to require an increase in its financial resources beyond the present 1.27% of GNP ceiling, a more fundamental reform might be considered. In such a case, it might become possible to re-examine the whole structure of the system of own resources. If, in addition, the budgetary positions were to be significantly affected by the increase in expenditure or by the reform of the structure of financing, it could be appropriate to envisage the introduction of a generalised system of corrections, which would also address the problems of the United Kingdom, aimed at smoothing further deteriorations of the largest budgetary imbalances.

ANNEX TO PART 3: TABLES AND CHART

Table 1: Overview of the new financial framework 2000-2006. 1997 prices.

Table 2: Category 1: Agricultural expenditure. Current prices.

Table 3: Category 2: Expenditure on structural operations. 1997 prices.

Table 4: Pre-accession aid and expenditure connected with the accession of new Member States. 1997 prices.

Chart: Expenditure in categories 3 (Other internal policies), 4 (External action) and 5 (Administration). 1997 prices.

Main assumptions (Tables 1 to 4 and Chart)

- *1999: Current financial perspective. 1997 prices. Based on May 1997 economic forecasts.*
- *Real GNP growth after 1998: average of 2.5% per year for all current Member States; average of 4% per year for applicant countries.*
- *Implicit GNP deflator in ECU after 1998 (for calculation of agricultural guideline at current prices): average of 2% per year.*
- *Technical working assumption that five central or east European countries and Cyprus will join in 2002.*

Table 5: Own resources ceilings and effective budgetary resources (1993-1999).

Table 6: Percentage shares in the financing of the Union and in total GNP (1992, 1996 and 1999).

Table 5

Own Resources ceiling and effective budgetary resources

	1993	1994	1995	1996	1997	1998	1999
Ceiling as a % of GNP	1.20	1.20	1.21	1.22	1.24	1.26	1.27
Total resources (% of GNP)	1.11	1.12	1.15	1.17	1.17	1.15	1.15
Unused margin	0.09	0.08	0.06	0.05	0.07	0.11	0.12

1993-1997: Budget; 1998: draft budget presented by the Commission; 1999: projections based on an extrapolation of the 1998 budgetary orientations

Table 6

Percentage shares in the financing of the Union and in total GNP

	1992		1996		1999	
	Budget	GNP	Budget	GNP	Budget	GNP
B	4.0	3.1	3.9	3.1	3.8	3.0
DK	1.8	1.9	1.9	2.0	2.0	2.0
D	30.2	28.2	29.4	27.4	27.7	26.2
GR	1.3	1.4	1.5	1.5	1.6	1.6
E	8.6	8.2	6.3	6.8	6.7	6.7
F	18.7	18.6	17.5	18.1	17.5	17.5
IRL	0.8	0.7	0.9	0.7	1.0	0.8
I	14.7	17.0	12.5	14.1	13.4	14.3
L	0.2	0.2	0.2	0.2	0.2	0.2
NL	6.3	4.6	6.2	4.6	5.9	4.6
A	--	--	2.7	2.6	2.6	2.5
P	1.5	1.3	1.3	1.2	1.4	1.3
FIN	--	--	1.4	1.4	1.4	1.4
S	--	--	2.6	2.9	2.9	2.8
UK	11.9	14.8	11.6	13.4	11.9	15.1

Table 1

Overview of the new financial framework 2000-2006

1997 prices

ECU billion - 1997 prices - Appropriations for commitments	1999	2000	2001	2002	2003	2004	2005	2006
AGRICULTURE (guideline)	43,3	44,1	45,0	46,1	47,0	48,0	49,0	50,0
STRUCTURAL OPERATIONS	36,1	35,2	36,0	38,8	39,8	40,7	41,7	42,8
<i>of which past adjustments</i>	<i>1,8</i>							
INTERNAL POLICIES	6,1	6,1	6,4	7,3	7,5	7,7	7,9	8,1
EXTERNAL ACTION	6,6	6,6	6,8	7,0	7,1	7,3	7,5	7,6
ADMINISTRATION	4,5	4,5	4,6	5,1	5,2	5,3	5,4	5,5
RESERVES	1,2	1,0	1,0	0,8	0,5	0,5	0,5	0,5
APPROPRIATIONS FOR COMMITMENTS - TOTAL	97,8	97,5	99,8	105,1	107,1	109,5	112,0	114,5
APPROPRIATIONS FOR PAYMENTS - TOTAL	92,5	94,1	96,6	101,1	103,9	106,5	108,9	111,4
Appropriation for payments (as percentage of GNP)	1,25%	1,24%	1,24%	1,22%	1,22%	1,22%	1,22%	1,22%
Margin	0,02%	0,03%	0,03%	0,05%	0,05%	0,05%	0,05%	0,05%
Own resources ceiling	1,27%	1,27%	1,27%	1,27%	1,27%	1,27%	1,27%	1,27%

Internal policies if growth at same rate as total GNP	6,132	6,285	6,442	6,856	7,031	7,211	7,395	7,584
External action if growth at same rate as total GNP	6,596	6,761	6,930	7,375	7,563	7,756	7,955	8,158
Administration if growth at same rate as total GNP	4,535	4,648	4,765	5,070	5,200	5,333	5,469	5,609
INTERNAL POLICIES	6,132	6,132	6,442	7,303	7,493	7,687	7,886	8,089
EXTERNAL ACTION	6,596	6,596	6,796	6,955	7,119	7,287	7,461	7,640
ADMINISTRATION	4,535	4,535	4,617	5,060	5,185	5,322	5,410	5,500

Table 2

Heading 1: Agricultural expenditure

Current prices

ECU billion	1999	2000	2001	2002	2003	2004	2005	2006
Guideline (current prices) (*)	45,0	46,7	48,5	50,6	52,6	54,7	56,9	59,2
Agricultural expenditure (current prices)		44,0	45,9	49,7	52,1	53,2	53,9	54,5
Community of fifteen								
Reformed CAP	41,7	41,6	43,4	45,4	47,3	47,9	47,9	47,9
New rural development accompanying measures and horizontal fisheries measures		1,9	2,0	2,0	2,0	2,0	2,1	2,1
New Member States								
CAP (market measures)		0,0	0,0	1,1	1,2	1,2	1,3	1,4
Specific rural development accompanying measures		0,0	0,0	0,6	1,0	1,5	2,0	2,5
Pre-accession aid (**)		0,5	0,5	0,6	0,6	0,6	0,6	0,6
Margin		2,7	2,6	0,9	0,5	1,5	3,0	4,7

(*) Assumed 2% deflator per year from 1999 to 2006.

(**) Equal to ECU 500 million at constant 1997 prices.

Table 3

Heading 2: Expenditure on structural operations

1997 prices

ECU billion (1997 prices)	1999	2000	2001	2002	2003	2004	2005	2006
Community of fifteen								
Structural Funds	31,4	31,3	32,1	31,3	30,3	29,2	28,2	27,3
Cohesion Fund	2,9	2,9	2,9	2,9	2,9	2,9	2,9	2,9
New Member States (*)		0,0	0,0	3,6	5,6	7,6	9,6	11,6
Pre-accession aid		1,0	1,0	1,0	1,0	1,0	1,0	1,0
TOTAL	34,3	35,2	36,0	38,8	39,8	40,7	41,7	42,8

(*) Including participation in the Cohesion Fund

Table 4

Pre-accession aid and expenditure connected with the accession of new Member States

1997 prices

ECU billion - 1997 prices	1999	2000	2001	2002	2003	2004	2005	2006
TOTAL PRE-ACCESSION AID	1,3	3,0	3,0	3,0	3,0	3,0	3,0	3,0
Heading 1		0,5	0,5	0,5	0,5	0,5	0,5	0,5
Heading 2		1,0	1,0	1,0	1,0	1,0	1,0	1,0
Heading 4 (*)	1,3	1,5	1,5	1,5	1,5	1,5	1,5	1,5
Other applicant countries (**)	0,5	1,2	1,2	3,0	3,0	3,0	3,0	3,0
New Member States (**)	0,8	1,8	1,8					
Amounts for the new Member States				5,8	8,2	10,8	13,3	15,7
Heading (***)				1,5	1,9	2,4	2,9	3,3
Heading 2				3,6	5,6	7,6	9,6	11,6
Heading 3				0,7	0,7	0,8	0,8	0,8

(*) The 1999 amount is intended as a guide.

(**) The breakdown for 1999 to 2001 is purely indicative.

(***) Figures converted to 1997 prices for purposes of comparison. Only the estimates in current prices are relevant.