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## REFLECTION ON THE FINANCIAL ISSUES IN THE ENLARGING EUROPEAN UNION\*

András Inotai\*\*

**ABSTRACT.** *Although access to EU financial resources is by far not the only objective of the new member countries, it is considered to be an important instrument to accelerate growth and economic modernization and support the catching up process to current EU levels. The article deals with the current structure, constraints and contradictions of the EU budget from 2000 to 2006, both from the background of global developments, intra-EU interests and the requirements of successful accession. Special attention is paid to the preparation of the new member countries to efficiently and quickly absorb available EU resources (both in agriculture and in the framework of structural and cohesion funds). It is pointed out that, although net resource flow will substantially fall short of that to the more developed but still net beneficiary present member countries, it could generate budgetary constraints in the new member countries, particularly in the first and decisive years of membership. The last chapter addresses some key issues, concerns and uncertainties of the volume and structure of the budget for the next period covering the years from 2007 to 2013. In addition, it outlines a proposal for creating a new objective within the coming budget to co-finance the cross-country and harmonized development of infrastructure of the new and still candidate member countries. In case of a high level of regional cooperation between East, Central and Southeastern European countries, this seems to be the most powerful argument to fundamentally change the pattern of distribution of the EU budget in favour of the less developed but rapidly developing new member countries.*

### 1. Introduction

It is evident, that the coming enlargement waves of the European Union in May 2004, most probably in 2007 and later at the beginning of the next decade, will not be free from conflicts of distribution or redistribution of financial resources. Certainly, the EU is much more than a „financial agency“. In its enlarged form, it is the world's largest trading group, a monetary union for twelve countries at the moment, a hopefully more influential political actor on the global scale and, last but not least, a community of values. All these elements do play a key role in the efforts of the Central, Eastern and

Southeastern European (CESE) countries to join the „club“. All of them are expected to create the necessary conditions of sustainable security and economic modernization. Still, they are often forgotten or pushed into the background once the budget of the EU has to be negotiated on. As if the above-mentioned factors were not much more decisive both in the context of additional development resources and of enhanced stability, even if the latter is difficult to be expressed in quantitative terms (in contrast, its lack becomes immediately visible in financial losses).

\* This presentation was delivered on: Summer Seminar „Preparation for EU Accession 2003“, held on 6-10 September 2003; „A La Fiesta Holiday Complex“, Bulgaria, it is contained in the book: „Summer Seminar for Young Public Servant from Southeastern Servants“; Sofia 2003.

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Why is then so much attention devoted to the national contribution to and the community-level redistribution of the EU budget? First, because this flow of money can be exactly measured, both on the side of net contributors and of net beneficiaries. Although membership in the EU has proved to be a clear net win-win game for all countries involved, narrow-minded approaches always tend to point to the net budgetary position of the individual countries. This, in turn, can largely influence the public opinion, particularly in periods of constrained or no economic growth, budgetary problems (as in Germany, France or Italy nowadays), or during negotiations on accession (as in the CESE countries). Second, the EU had been developing a wide set of financial transfers in the last decades based both on economic and political considerations of increasing growth in lagging behind regions of the integration and due to the principle of solidarity, a key European value. Third, the success story of some less developed member countries in the last 15 years cannot be decoupled from substantial financial support from the EU budget, even if it is well known that the efficient absorption and utilization of these resources needs much more than the availability of a certain volume of money.

Thus, it is no wonder that the CESE countries, being partly much „poorer“, at least in GDP per capita terms, than the less developed and net beneficiary present members, have put fundamental emphasis on the redistribution of EU resources. They did it because of their lower level of economic development and the decisive need to catch up in a relatively short time, but also by being aware of the equity- and

solidarity-based approach of the EU, as practiced in the past decades. Also, national negotiating teams had to prove to the domestic public in general, and to the political opposition in particular, that they could get out the best of the available options in the negotiation process. How important the latter was, despite much more important and long-standing impacts of membership, can be proved by the intra- and inter-country evaluation of this issue. In Hungary, for instance, the opposition accused the government that it did not negotiate correctly (as if the lion's share of negotiations had not been conducted by the present opposition). Various articles, even contributions by serious and professionally high-level experts, tried to compare the last-minute financial „achievements“ of Poland with those of the Czech Republic, Slovenia or Hungary.

It cannot be denied that the 2004 enlargement of the EU has an obvious financial constraint. Never before this problem has been as manifest as today. All decisions on enlargement were based on political motivations, since the EU is by far not just an economic or trading bloc, but a political entity as well. The problem is not with the politics-driven process of enlargement, but with the huge gap between political efforts, on the one hand, and their economic and financial costs, on the other. In the past, enlargements by less developed countries were immediately accompanied by creating new funds or by upgrading old ones, in order to support the integration and catching-up process of the new members. Currently, ten countries, most of them on a low level of GDP per capita, have been given the green light to enter the EU. However, the financial

conditions could not be created adequately, since the present budget covering the period between 2000 and 2006 has been approved in March 1999 in Berlin and provided little room for redistribution. As a result, at least until the end of 2006, the new member countries will have to get satisfied with a rather modest amount of EU resources and have to cope with a largely unequal situation, if compared to the amount of money more developed older members have been entitled with. In this context, two basic conflicts can be identified. The first relates to the remaining years of the current budgetary period (between May 2004 and December 2006), and raises the question to what extent the new member countries can experience the generally decisive first years of membership as a success story, considering the obvious financial constraints. The second covers the negotiations on the next budget expanding from 2007 to 2013. There is no doubt that there will be fierce struggle for a major redistribution of limited financial resources between old and new beneficiaries on the one hand, and between net contributors and net beneficiaries, on the other.

## **2. Basic facts about the EU budget**

It is important to be aware of the scope of „maneuvering capacity“ during the budgetary negotiations. First, according to the current rules of the game, the EU budget must not exceed 1.27 per cent of the member countries' GNP. At present, the annual budget amounts to about Euro 100 bn, or 1.07 per cent of the EU's GNP. Thus, there is some room for additional expenses of about almost 20 per cent or nearly Euro

20 bn. Moreover, with the accession of new countries the cumulated GNP of the EU will also be increasing. Finally, the budget is dependent on the growth rate in the EU, for a higher growth rate would automatically increase the volume of money available for the common budget, without challenging the ceiling of 1.27 per cent of GNP.

Second, no member country is allowed to get more than 4 per cent of its GDP, since the EU believes that this could be the upper limit of efficient absorption of community resources. In fact, one can dispute this issue, particularly in case of low-income but rapidly developing new member countries, that, in part, have been able to absorb a higher amount of GDP in form of foreign direct investments in the last years. Still, this amount seems to be sufficient for the coming seven-year budgetary period for at least three reasons. On the one hand, the 4 per cent includes resource flow from the structural, regional and cohesion funds and does not contain imbursements in the framework of the Common Agricultural Policy (CAP). On the other, the available EU resources (including CAP-related payments) amount to clearly less than 1 per cent of the acceding countries' GDP in the period between 2004 and 2006, in contrast with 1.25 to 3 per cent of GDP in the case of the current net beneficiaries of the EU. Finally, the two decade-long history of EU resources transferred to less developed member countries shows that the 4 per cent limit is satisfactory and can generate or support sizeable and sustainable economic growth.

Third, the built-in inflexibilities of the internal structure of the budget have to be mentioned. CAP-related payments account

for more than 40 per cent of the total budget. Even more importantly, this item has been fixed at the same high level for the period 2007 to 2013 as a result of a bilateral French-German agreement in October 2002. Structural and cohesion funds could reach a maximum of 40 to 45 per cent of the budgetary expenditures, since they are limited to 0.46 per cent of the EU's GNP. In addition, other community policy areas have to be financed as well, such as internal and external policies, administration and building up of reserves. Taking into account this structure, it is obvious that, disregarding enlargement(s) of the EU, the budget would need a fundamental restructuring away from agricultural support towards structural and cohesion funds, as well as to cover the rapidly increasing needs of financing new community policies (e.g. research and development, justice and home affairs, common foreign and security policy, etc.). Provided that the current internal structure of the budget will be maintained after 2007 as well, the „fight for redistribution“ will be mainly carried out within the individual items and only partially among the different items of the budget. No doubt, this would seriously limit the negotiating position of the new member countries. The agricultural „box“ seems to be untouchable, and the new member countries may reach an equitable treatment by 2010 only. In consequence, interest conflicts between the old and potential new beneficiaries will be concentrated on the redistribution of the structural and cohesion money. This „fight“ may be further exacerbated if, and this is no illusion, the EU will need more resources

for developing and supporting new areas of community policies, which have to be taken away from this item.

The other side of budgetary constraints can be identified in the structure of incomes. They consist of four elements: customs duties paid in at the common external tariff borders, levies on agricultural imports (both named as own resources), VAT-based payments and GNP-based payments of member countries. The first two issues, originally the basic pillar of the budget, have been showing a rapidly decreasing share of the income, due to extended free-trade and preferential-trade relations, WTO agreements, slow but still obvious agricultural liberalization. Thus, new elements of income have to be considered in order to ensure the financing of new tasks (mainly the support to backward regions and less developed countries). The current (and future) income sources should comply with two basic criteria: first, to satisfy the required volume of income, and, second, to create a system of equitable and just contribution to the budget by the individual member states. In this context, GNP-related payments seem to be better than VAT-based payments, since the latter roots in different VAT rates and different consumption patterns across member countries. In addition, both are growth-dependent, so that different growth rates of the member countries could result in different levels of budgetary contributions. Several ideas have been lifted to create a more equitable system of national contribution, such as environmental tax, a special and uniform EU tax, but none of them could be accepted as of today. At the same time, it is clear that sooner or later the EU budget

needs a new system of income if it wants to ensure a smooth financing of its main - old and new - targets. All the more, because, unlike national governments, the EU is not allowed to take credits from banks or financial institutions. Its annual and multi-annual budget has to be in equilibrium and no deficit, even temporary, is allowed. The regularly registered surplus will either be re-transferred to the national budgets or this money will not be paid in to the EU budget at all.

### 3. Enlargement and the 2000-2006 budget

The budget approved in Berlin in March 1999 with no participation of the new member countries at all, has already taken into account the fact of enlargement during the budgetary period. The main „framework conditions“ were the following:

- enlargement may happen in 2002, therefore, as a special new and sovereign item of the budget, financial means have to be secured for the period 2002 to 2006,
- the first wave of enlargement would include six countries only (Cyprus, Czech Republic, Estonia, Hungary, Poland, Slovenia),
- the new members would be excluded from the direct payment system of the CAP,
- their participation in the structural and cohesion funds would follow a phasing-in pattern (less money at the beginning and almost equal treatment with the current beneficiaries at the end of the budgetary period),
- a pre-accession fund has been set up for the whole budgetary period, with a

constant annual amount of Euro 3 bn, benefiting all candidate countries, as long as they are not members (the new entrants will automatically leave this scheme and enter the special item created for the new members).

Real life, however, developed differently:

- enlargement takes place May 1<sup>st</sup> 2004, so that a large part of the money earmarked for the new member countries as of 2002 could be „saved“.
- Further savings result from the fact that the phasing-in process in 2004 is based on 2002 and not 2004 figures of the budget,
- altogether ten countries will join, which required a 20 per cent increase of the „enlargement budget“, which had to be „generated“ from the savings mentioned above,
- also the new member countries will be entitled to participate in the direct payment system of the CAP, by starting at a 25 per cent level of payments guaranteed for current member country farmers, and by increasing this rate by 5 percentage points each subsequent year,
- the phasing-in principle has been maintained, but the volume available at the starting point has been reduced and the distribution between structural and cohesion fund resources has been shifted towards the latter,
- the annual amount of the pre-accession fund will be reduced, since, excepting Bulgaria and Romania, all beneficiaries will become part of the structural and cohesion fund framework as of May 2004.

In consequence, the Commission could

create a budget, which could be accepted by all countries, current and new members, as well as by net contributors and net beneficiaries. In addition, this „masterpiece“, the result of sometimes extremely short-sighted compromises and, at least in the context of the historical importance of enlargement(s) humiliating horse-trading, could observe the original and overall budgetary conditions, too. Still, most probably there was no other way to „successfully“ finish the negotiations. The acceding countries had to make their choice between (much) less EU resources for the first three years or left out of the first wave of enlargement and waiting (at least) until 2007. Since nobody expects that the financial conditions would be substantially better in 2007, particularly because a left-out (or opted-out) country excludes itself from being part of the official negotiations on the coming financial framework of 2007 to 2013, and staying outside would certainly be interpreted as a lost historical opportunity, the Commission's proposals were accepted. As usual in diplomatic negotiations, some latest-minute small changes could still be made. On the one hand, the EU agreed to add up to 30 per cent national support to the 25 per cent initial level of direct payments to farmers, and upgraded the money available for the establishment of the new Schengen borders. On the other, some candidate countries were successful in making internal shifts within the overall sum of available resources in order to present their hard negotiating position to the domestic public (Poland, partly the Czech Republic).

The baseline scenario has, however, remained unchanged. The ten new countries will get a gross volume of EU resources of about Euro 40 bn for within the

present budgetary period. In turn, they will have to contribute to the EU budget without any phasing-in pattern, which means that, from the very beginning, they will provide the full amount of their annual contribution (two-thirds of it in 2004, due to accession in May). As a result, the net EU resource transfer will decrease to Euro 25 bn for this period. According to the Commission, about Euro 10 to 15 bn will in fact be used until the end of 2006, part of which contains funds still provided or to be provided from the pre-accession fund. In consequence, the net EU financial support will hardly exceed Euro 10 bn, or Euro 300 mn per month, considering 32 months of membership until the end of 2006. This is about 0.03 per cent of the EU's GDP or 3 per cent of the annual EU budget (in fact, due to the phasing-in process, the amount will be much less in 2004 and higher than 3 per cent in 2006).

Unfortunately, much less attention was devoted to some more important changes in the conditions of availability of EU resources.

First, all new entrants will become full members of the CAP. Both media and experts were complaining about the 25 per cent initial level of direct income support for the acceding countries, despite the fact that two years ago, no support at all was viable, and that this amount, which is the only (almost) automatic resource flow from the EU budget (it does not need projects, long bureaucratic procedures, etc.), is even in its present form higher than any support the new countries' agriculture has experienced any time earlier from the national budget. Two not less important elements of membership in the CAP have been roughly ignored. On the one hand,

membership in the CAP means that the EU countries have to stop immediately subsidizing agricultural exports to the new member countries. This will definitely increase the competitiveness of domestic farmers in their own domestic market. On the other, all new member countries will fully benefit from the export subsidization scheme of the CAP towards third countries. In other words, Polish or Hungarian agricultural exports to Russia or Ukraine will be treated in equal terms with French, Dutch or Danish exports to third countries and benefit from these subsidies.

Second, with the exception of Prague and Bratislava regions (being the Hungarian decision still uncertain about Budapest), all NUT-2 level regions of the acceding countries will automatically benefit from the structural funds, since they fall into the category of „Objective 1“ of regional policy (per capita GDP levels lower than 75 per cent of the EU average). Those regions having a higher income per capita, will benefit from the resources allocated to Objective 2 (depressed regions) and Objective 3 (human resource development). The basic rule is that those areas included in Objective 1 cannot participate in other „Objectives“. In addition, the availability of EU funds is conditioned on two basic criteria. First, projects have to be conceived, submitted and implemented on the regional level, which needs a well-established regional structure within the given nation-state. Second, projects have to be co-financed from national sources (central budget, local authorities, private capital) with a contribution between 25 and 50 per cent of the total sum of the undertaking.

Third, access to the Cohesion Fund has to be mentioned. In this case, the resources

will immediately flow to the national budget, and the co-financing need amounts to 10 to 20 per cent only. In order to increase the starting level of absorption capacity of the new members (which is not only the fundamental interest of these countries but of the EU as well, provided everybody would like to have a successfully enlarging integration), the Commission shifted the balance between structural and cohesion funds towards the latter. There were two evident reasons for it. On the one hand, the money to be made available through the Cohesion Fund can be reached through an existing (although not always sufficiently developed in EU-terms) national institutional framework. On the other, the co-financing requirement from the national budget is lower. Partly for the same reason, part of the agricultural support can be used for rural development, with a national co-financing of 20 per cent).

#### **4. Preparation of the acceding countries for receiving EU resources**

Discussion about and fighting for more EU resources in general, and a more equitable distribution of available funds in particular, are understandable endeavours of each of the new member states. Unfortunately, first of all in the final stage of negotiations, much less interest was given to two key issues which will fundamentally influence the experience with the EU and the EU resources in the first three years of membership: (a) the impact of membership on the budgetary situation in the acceding country, and (b) the domestic preparation for absorbing the available funds as quickly and as efficiently as possible.

(a) The Commission has several times stated that no new member country shall get into a financially weaker (worse) situation than it was in the last year before membership, in which, on paper at least, EU-related financial flows were a one-way street. Namely, the candidate countries benefited from the pre-accession money divided into PHARE, SAPARD and ISPA and were supposed to learn the rules of the game of the EU well before they would become members. On the other hand, however, national budgets had to finance heavily both the legal accommodation process to comply with EU rules partly before ending the negotiations, partly at the moment of accession in May 2004, and the building of institutions required to have access to potential EU funds following accession. These EU-related expenditures have amounted to Euro 1.5 to 2 bn annually in Hungary, or almost ten times the pre-accession resources coming from the EU. One can, of course, argue, that large part of such steps would have been necessary even without the perspective of membership, most probably, however, at a different speed and with different sequencing of priorities. The above sum is only important to indicate that preparation for accession or enlargement is not a one-sided effort of the EU, but a real challenge for the candidates as well. The lion's share of the financial „burden“ is, as evident in the case of all countries wishing to join a club, to be taken by the candidate.

Still, the first years of membership represent a real challenge to (most of) the budget of the acceding countries.

First, the net flow of financial resources from the EU budget will follow a phasing-in schedule, meaning that the balance

between contribution to the EU budget and flows from it will be „improving“ from one year to the next. The net financial situation of the first year will be hardly better than that of 2003, and most resources to be taken will keep on originating from the pre-accession funds that finance previously started projects. In the case of Hungary, the net position is expected to be about Euro 200 mn in 2004, Euro 500 mn in 2005 and Euro 800 mn in 2006.

Second, delays in preparing for the EU, both in legal and institutional terms, will continue requiring additional money from the national budget. Moreover, new tasks arising from membership, will also ask for additional financing after May 2004.

Third, co-financing, although at easier conditions as originally expected or used to be provided in the pre-accession framework, will need substantial national resources and press almost all countries for a major and rapid restructuring of the budget, at least on the expenditure side, with immediate social consequences. (If necessary, also the income side has to be tackled upon, mainly meaning higher taxes and increasing other income items.) Another big slice is the co-financing of the payment scheme to farmers, which can go as much as 30 per cent of the EU standard. No question that, whatever the budgetary situation of a given country, the parliamentary opposition (and, maybe, also extra-parliamentarian lobbies) will press the acting government to provide the maximum amount of money in order to improve its position in a social and economic sector relevant for the coming elections. (See, in this context, the decades-long French experience.)

Fourth, transitory but disturbing liquidity gaps are likely to appear. They stem from

two main sources. On the one hand, direct payment to the farmers has to be anticipated from the national budget in 2004, while EU transfers will occur in 2005 only, once the necessary data on the area cultivated and the output reached will be available. Second, the financing of projects supported by the structural and cohesion funds will need additional temporary resources from the national budget, due to the general rules of EU-financing. At the initial stage, part of the EU money will be available, but in the next phase(s), national contribution has to be made use of. Part of the EU contribution will only be paid after finishing the project, so that in-between accounts have to be paid by the national budget. In several stages of the project's „life cycle“, the national contribution would largely exceed the share of national co-financing, while the „balance“ will only be restored some time after concluding the project and approving all accounts. Companies participating in such projects can hardly have a financial background that would allow them to wait for payments for months or even years.

Fifth, joining the EU is, in an obligatory form, accompanied by preparing for membership in the Economic and Monetary Union (EMU). Unlike Great Britain, Denmark (and partly Sweden), no new member country was acknowledged the right of opting-out. Thus, sooner or later, they will have to become part of the EMU and, from the beginning of EU membership, share the main economic policy goals of the EU, including a resolute policy approach towards meeting the Maastricht criteria.

Such a situation, even disregarding the current budgetary imbalances in the leading acceding countries (Czech Republic,

Hungary, Poland, Slovakia), could easily lead to a „crunch“ with unknown political and economic consequences. To avoid such a situation, the EU and each of the new member countries have to develop utmost responsibility. A disciplined budgetary policy and a flexible EU behaviour should form the two sides of this approach.

(b) The fact that money from EU sources will be modest in the first years of accession, must not be used as an excuse to lower-than-expected growth or not-fulfilling expectations of membership. Just the opposite, the quick and efficient use of each euro has to become the cornerstone of development policies. In order to reach this goal, three conditions have to be fulfilled:

- high-level preparation of projects to be financed, ready for application on the first day after accession,
- functioning institutions to qualify for and absorb EU funds,
- availability of co-financing resources from the very beginning.

The fulfillment of the first criteria is rooted in the new member country's microeconomic development. Of course, it cannot be revealed if the institutional framework is missing or is inadequate to EU rules. A good case in point was the delayed setting up of the SAPARD agency in Hungary. Once, however, it started to function (in the autumn of 2002), the rate of successful applications for EU funds was about 40 per cent as compared to the 11 per cent average of other candidate countries which could establish this agency much earlier. Therefore, the real absorption capacity of the individual countries is very difficult to be forecast. It is, however clear that all three conditions have to be fulfilled and support each other mutually.

Provided that all or most available EU resources can be efficiently used, development gaps among differently developed regions within a new member country are likely to widen, at least temporarily. This can be attributed to the differences in the starting level of absorption capacity. More developed, better endowed regions (both in human capital, physical infrastructure, institutions, social environment, etc.) used to be more successful in absorbing additional resources than less developed ones. It is a key task of the government's regional policy to support both the spillover impacts originating in the developed region and the absorption capacity of the less developed area in order to create a sustainable process based on genuine and autonomous development. In this respect, the EU itself has an ambiguous trajectory. While most less developed countries could catch up after membership (excepting Greece until recently), regional differences within the catching-up countries remained almost unchanged. It does not mean that backward regions were not able to develop, but they were not able to have a better development record than the most prosperous regions of the given country. (Without any support, most probably, the gap would have been much wider, with serious social and domestic political implications.)

### **5. What does the next budget promise?**

Negotiations on the EU budget covering the period between 2007 and 2013 are expected to be even harsher than previous ones. This is partly due to the fact that, instead of two, there will be three (or just

four) main players. First, the net contributors who are not ready to pay more into the community budget. Just the opposite, they would like to reduce their payments. Second, the old net beneficiaries who are unlikely to give up their previous and generous position. Third, the new members who would like to get a justified and equal-footing treatment, since they are (much) poorer than the present beneficiaries of the resources. And, finally, one has to take into account the financial needs of additional entrants by 2007, on an even lower GDP per capita level (Bulgaria and Romania, perhaps Croatia, too). Partly, the „fighting“ for redistribution will be brutal because of the already mentioned inflexibilities of the EU budget concerning the ceiling of 1.27 per cent of GNP of the member countries and the built-in structural problems hindering adequate and future-oriented redistribution (CAP as the, literally, holy cow of the EU).

The starting situation can be made even more difficult if the Spanish veto about the future form of the structural funds of the EU were accepted (at least until 2013 or even for the period after 2013). Similarly, preliminary negotiations on the main pillars of the budget from 2007 to 2013 that have already started behind closed doors and without the new members, could create an atmosphere characterized by lack of confidence, mutual fears and general uncertainty. It is clear that the new budget has to be approved by the member countries and the European Parliament in the spring of 2006 the latest. There is no reason why to anticipate some rounds of negotiations before May 1<sup>st</sup> of 2004, when the new members would become full parties of the negotiations. Any preliminary

talk with their exclusion, whatever its subject, could undermine confidence and give room to justified or unjustified speculations. If the new member countries were faced with a budget plan for 2007 to 2013, in which the mentioned inflexibilities would be further increased and the still available manoeuvring room for restructuring would be curtailed, it would be very difficult to have a successful enlargement. The new entrants must be given full right to attend these talks and try to make a more equitable balance of resource distribution. Due to their (relatively) limited bargaining power, to their lack of experience and, as in the past, to the disunity in the process or at the final stage of negotiations, a wonder must be produced to have a substantially differently structured budget, with clear priority to be given to the new and poorer member countries.

Certainly, the guidelines of the new seven-year budget will be different from those of the current budget. This comes both from the much larger number of poorer countries and regions, and the new priorities of the enlarging EU that should be financed from Community resources. Proposals to throw out the CAP as such of the EU budget (see the Sapir Report to the President of the Commission this summer), should be forgotten, not because they are not justified, but because of the political obstacles to implement them. Other ideas, according to which the structural and cohesion funds did not provide incentives to economic growth and modernization in the less developed countries, therefore they have to be completely remodeled or renationalized, are even more dangerous and politically counterproductive. It is

simply not true that the EU resources did not contribute, and in some cases to a large extent, to the catching-up process of Ireland, Portugal and Spain. If it were the case, it would hardly be understandable, why these countries are still fighting for each Euro and against any idea to change the status quo they had been enjoying over two decades or more.

Until now, the Commission did not present any clear guidelines concerning the future of the budget, including the priority objectives valid for the structural and cohesion funds. Nevertheless, internal discussions are under way and various versions have been aired in the last months. It would, however, be too early and less professional to enter this area of speculation. It is much more important to insist on the following issues:

- the equal-footing situation in the CAP payments has to be created as soon as possible (and, in this respect, any kind of reform is acceptable, even a full renationalization of the agricultural policies, provided that all member countries do it at the same time and at the same speed),
- the special treatment of the areas with GDP per capita below the 75 per cent level of the EU average (whether this average is calculated on the basis of the current members or the lower figures of the new entrants are taken into account as well) has to be preserved. Phasing-in and phasing-out schemes are acceptable, however, they should be as short as possible in order to achieve equitable status soon after 2007,
- new community policies require more financing and the new members are

rightly advised to support them, partly because they will be the above-average beneficiaries of such policies (e.g. justice and home affairs, but also common foreign policy), partly because in this way they can contribute to the reshaping of the EU and to an enhanced role of the European integration in global affairs. Any future-oriented change is expected to favour the new member countries which have revealed a high level of economic, institutional and social flexibility in the last decade, in contrast to „sleeping Western Europe“, - last but not least, new priority objectives have to be formulated by the Commission in order to ensure more equitable distribution of resources and exclude or at least limit any kind of „national blackmailing“.

It does not matter how justified the last requirement is. There is a chance to let it accepted by the other member countries only if the new members can elaborate, take and keep a strictly common position from the very beginning until the end of negotiations on the coming budget. More importantly, they have to agree on a common priority which cannot be declined by the current member countries. It is not difficult to identify this common objective, since each of the eight Central and Eastern European country (plus the next entrants of South Eastern Europe) is less developed than the current beneficiaries of the EU. Therefore, they have to get a preferential treatment. The question is, where these preferences should be allocated and to what extent they will be able to create a geographic restructuring of available financial resources.

By far the most viable approach is the introduction of a new overarching regional objective, based on the fact that the new members constitute the geographic core of Europe and all of them have common continental borders. In contrast, all previous enlargements in general, and those by less developed countries in particular, have included „peripheral“ countries in geographic terms. Therefore, it was natural to support national economies, even if intra-state regions were the beneficiaries. Moreover, the cohesion fund became completely operational on the national levels. This approach should have limited validity in the case of Central and Eastern (and South Eastern) Europe. The quick catching-up of the whole region, based on political stability and economic modernization, is crucially dependent on the quality of physical and human infrastructure of the respective countries. The geographic cohesiveness of the region and the pivotal role of infrastructure development argue for a special regional fund that would finance common projects from the Baltics to the Black Sea and the Adriatic. The positive results are more than evident. First, national prestige projects, several times financed by EU resources, would give way to multi-country regional projects. Second, all countries not involved into the first wave of „Eastern“ enlargement, should participate in these projects (if necessary, with the pre-accession funds assigned to them). This would have a very transparent political and psychological message to the societies that they are not „forgotten“. Just the opposite, they could become part of all-European projects well before they may reach institutionalized membership in the EU. Third, more developed infrastructure would support economic activities and create new

business opportunities both for domestic and for international capital. (It is a well-known fact that the geographic map of the expansion of foreign investors largely overlaps the map of physical infrastructure of the given country.) Fourth, cooperative willingness and solidarity between and among the CESE countries could be enhanced.

Only such a new objective would be able to manage a major redistribution of the EU budget towards the less developed new member countries. And only if negotiations on the future of the budget start with the identification of new objectives there is a real chance of getting rid of horse-trade-like blackmailing about every Euro 1 mn. If the new member countries start negotiating on sums and amounts of money, no major change can be realistically expected, since the discussion will center on and end up in an unholy contraposition or even agreement between Germany and Spain.

Evidently, the above described approach takes into account that EU resources to be devoted directly to national development plans would be reduced, since part of these plans will be implemented on a supra-regional level. It goes without saying, that for supra-regional projects new institutions are necessary, or, even better, Brussels could become the coordinating agency, in cooperation with

national authorities which are supposed to work closely together as well.

Finally, the success of such an approach crucially depends on the willingness of the participating CESE countries. There is no doubt at all, that all countries of the region share the priority objective of developing their physical infrastructure and creating or improving cross-border contacts. However, they have to share this approach from the very beginning till the end of negotiations and resist any kind of „distorting“ offers and pressures, whether they come from some EU member countries, from transnational companies or, most probably, from their own domestic lobbies. It is difficult to assess the probability of success of this effort, since no official statement has been made as of yet, and the author does not have any information whether such an approach would have been seriously discussed among the acceding countries. Nevertheless, it is obvious that the likelihood of success fundamentally depends on the formulation of a common development objective by all new entrants (plus the members of the next wave of enlargement), as well as the firm representation of this project during the official negotiations on the future structure of the EU budget.

## AGRICULTURE, THE STRUCTURAL FUNDS AND THE BUDGET AFTER ENLARGEMENT

Jim Rollo\*

**ABSTRACT.** *The purpose of this article\*\* is to examine how the legacy of the, often bruising, negotiations at Copenhagen and subsequently over agriculture will affect the political economy of the European Union and specifically the challenges facing the CAP, the Structural Funds in the next decade. The EU Budget for the remainder of the 2000-2006 Framework was fixed by the EU-15 at the Brussels Summit of October 2002 (European Council, 2002b) and is very unlikely to change. That is why the first real battle over resources engaging the new members will turn out to be the Financial Framework post 2006. This article will discuss the general context, before examining agriculture policy and structural funds after Copenhagen summit and finally the implications for the next Financial Framework.*

In 1993, Richard Baldwin, one of the most prolific and original economists working on European integration, declared that the Central and Eastern European countries are too poor and too agricultural ever to be members of the EU. The point of this comment is that if money is the lifeblood of the Union then eastern enlargement was unaffordable. As was seen at the Copenhagen Summit in December 2002 (European Council, 2002a), which settled the next enlargement of the EU, when finally the Council got to the money they engaged in real negotiations. How the negotiated outcomes on agriculture, the Structural Funds and the EU Budget will affect the future political economy of the Union is one of the major challenges from the 2004 enlargement.

The initial attempt to deal with the

challenges thrown out by Baldwin's statement by the EU Commission was the document Agenda 2000 (European Commission 1998). This was intended to show how policy needed to change if EU enlargement was to be 'affordable' in the context of the 2000-2006 Financial Framework, which would set out the EU budgetary strategy for that period. The report and the Commission proposals for 2000-2006 were considered at the Berlin Council in March 1999 (European Council 1999). There the Commission's proposals were substantially altered under pressure from Finance Ministers anxious to limit the growth of the Budget and the French President who single-handedly destroyed the Commission proposals on agriculture. The latter effectively vetoed or reduced the price cuts put forward in Agenda 2000. The

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Commission obtained a mandate for a mid-term review of the CAP (a review resisted by France and for which it said there was no legal basis) proposed for 2003 and completed at the end of June 2003 after marathon negotiations. Following Berlin the shape of the enlargement assumed in Agenda 2000 changed. The number of countries increased from 6 to 10 and the date of accession was delayed from 2002 to mid 2004. These two factors required a further consideration of the budgetary framework by the EU-15, which took place at the Brussels European Council in October 2002 (European Council, 2002b) where heads of government agreed on the shape of the budgetary offer to be made to the candidates in Copenhagen the following December.

The purpose of this article is to examine how the legacy of the, often bruising, negotiations at Copenhagen and subsequently over agriculture will affect the political economy of the European Union and specifically the challenges facing the CAP, the Structural Funds in the next decade. The EU Budget for the remainder of the 2000-2006 Framework was fixed by the EU 15 at the Brussels Summit of October 2002 (European Council, 2002b) and is very unlikely to change. That is why the first real battle over resources engaging the new members will turn out to be the Financial Framework post 2006.

First of all, this article will discuss the general context, before examining agriculture policy and structural funds after Copenhagen summit and finally the implications for the next Financial Framework.

## The Context

Structural Budget deficits are a feature of the members of the euro zone core. This has put the Stability and Growth Pact of EMU under great pressure, and while many think this pact is theoretically unnecessary, it is crucial for EMU credibility. This pact declares that each country should aim for the budget balance in medium term and the budget deficit should not exceed the 3% of the GDP. France and Germany are both above those strict criteria of deficit levels and Italy is struggling to remain within them against a background of weak growth. Even for those euro zone members not in structural deficit the need to aim for budget balance under the Pact forces them to look for revenue (or cut expenditure) where they can. As a result EU members are effectively short of tax revenue. And when it comes to reducing deficits the EU budget is politically a free hit. Net recipients from the Budget effectively tax foreigners and foreigners cannot vote and thus have no impact on domestic politics. Equally the net payers to the Budget look to cut their net contributions. This, above all, is German strategy but interestingly now even the Netherlands, once seen as a champion of *Communitaire* policies and an opponent of *juste retour*, tries to do the same. The Dutch Prime Minister and the Dutch finance minister sound exactly like Margaret Thatcher at the beginning of the 1980s, they want their money back, as do German finance ministers. The existing net recipients obviously look to sustain their position. The Spanish, the Greeks, the Portuguese, the Irish and even the Germans, for their new *Länder* in the East, all want to still hold onto their structural

funds money. And France threatens the veto in defence of its receipts from the Common Agricultural Policy.

### **Agricultural Reform and the mid term review**

It is perhaps best to begin with agricultural reform. After the customs union and competition policy it is the oldest common policy, and an icon of European integration to many down the years. It affects the daily lives of all EU citizens because as consumers they are concerned by the price of food. It affects taxpayers because it represents between 40 and 50% of the European budget. In total it raises costs to taxpayers and consumers by more than € 100bn a year (OECD 2002).

In 1999, as part of fixing budget for the period of the 2000-2006 budget, the Commission proposed a reform of the agriculture policy. This reform of agricultural policy was slowed and almost stopped by the intervention of President Chirac at the Berlin Summit. But the Commission claimed and have got a mid-term review, which allowed them to return to the issue in 2003. The French at first denied that the mid term review was mandated by Berlin and at the Thessalonica summit in June 2003 (European Council, 2003) threatened to veto on going negotiations despite this being a qualified majority issue. So what was so threatening about the Commission proposals?

First the Commission proposed (European Commission, 2003a) further support price cuts for all products but sugar. Second the Commission proposed that direct payments to farmers should be production neutral, 'decoupled' in the jargon, meaning that they give no incentive to producers to produce particular products although clearly the

intention is to allow farmers to remain on the land and producing more than under a pure market. Rather support would be for farming in general and linked to total past receipts from the CAP: farmers would receive a single payment each year. Third the intention would be to favour small producers over big producers. The first € 5000 of any payment would be given in total. Above € 5000 it was proposed they be subject to reductions of 1% in 2006 rising to 6% pa by year 2011. Fourth, the receipts from this so-called modulation will be used to generate funds for a policy of rural development (sometimes called pillar two and de facto a form of agricultural structural funds). Finally the Commission proposed that to qualify for decoupled payments, producers should have to pursue environmental standards, food safety standards and animal health standards above the minimum required by EU law. This 'cross-compliance' would require the setting up of an advisory service to help farmers qualify and inspection to check.

By reducing price support and decoupling income subsidies from production the Commission attempted to move agriculture policy away from a purely productionist based policy to a social income based one. In terms of the American debate on social welfare of the 1980s and 1990s they proposed moving away from 'workfare' towards the 'welfare'. Farmers dislike it intensely since it explicitly puts them on the same footing as social security recipients rather than important members of the productive economy.

What is also interesting about this package is that despite proposed cuts in domestic support prices which would bring them close to world market levels and hence reduce the need for export subsidies,

the Commission made no explicit proposals for cuts in frontier protection. Tariffs at the frontier would still exclude imports (outside the limited tariff quotas negotiated in the Uruguay Round of trade negotiations). In reality it is the exclusion of imports that pushes up agricultural prices in the EU and it is actually where the most of farmers' support comes from, rather than from the budget or market intervention.

In terms of political economy France and Ireland, with support from Spain, Italy and some others, were the most resistant to this package; Germany is mainly interested in budget cost but there is a very big electoral interest in the food safety and the environmental issues backed by an agriculture minister from the Green Party. Finally, the United Kingdom though generally supportive of the package, was against any penalization of the biggest farmers and worried about budget costs as are the Dutch and Scandinavians who are also generally supportive of the Commission.

The key coalition remained France and Germany. They agreed ahead of the Brussels European Council of October 2002 that the agricultural budget should be frozen until 2013 and that was duly agreed by the Union at Brussels. This meets some German objectives by at least limiting the room for increased budget burdens. Ahead of the first Agriculture Council in June 2003 they also agreed at head of government level that the degree of price cuts and the proportion of production covered by decoupling should be less than proposed by the Commission. And indeed that is what happened at the final negotiations overnight on 25/26 June 2003 (DEFRA, 2003).

First the degree of potential decoupling was reduced from 100% to 75% for arable

(60% for Durum wheat) and between 75% and 0% for beef and sheep subsidies. This all on a voluntary basis and could be introduced as soon as 2005 or delayed until 2007. So some member states could be 100% decoupled for all eligible products as soon as 2005 while others could be between 75% and 0% decoupled depending on product and would not have to introduce any decoupling before 2007.

On prices the proposed cut in cereals prices of 5% has been rescinded although some technical adjustments to seasonal prices may cut overall price support a little across the year. The cut in butter prices proposed in Agenda 2000 for the year 2000 is reduced from 35.8% to 25% and will not be introduced until 2005. The milk production quota increase also proposed in Agenda 2000 for the year 2000 has been delayed another year to 2006 and additional increases of 2% have been dropped.

Modulation is introduced but beginning at 3% in 2005 and rising to 5% by 2007. This is a year earlier than originally proposed by the Commission and at higher levels until 2011. This will generate significantly higher funds for the second pillar policies in the years before 2011 than originally proposed. This may help both new members and the amount of support that can be transferred from the 'blue box' to the 'green box' in the early years of any WTO agreement - see below.

All in all while decoupling has been introduced it is in a differential and weakened way (notably for beef and sheep) and proposed price cuts or production quota increases have been significantly reduced in arable and dairy. And sugar remains untouched.

## The WTO dimension

The Doha Development Agenda has set up an agenda for agricultural negotiations which focus on three main areas reducing trade distorting subsidies and market support (broadly consistent with support price cuts and decoupling), cutting export subsidies and the increased market access for basic agricultural products, the latter mainly aimed at the developing countries.

The mid term review only deals with a part of that. The agreed outcome does offer some decoupling of production from support, which potentially reduces the trade distorting potential of the CAP. It thus seems to offer something to a WTO round.

Most notably it will allow the EU to move a large proportion of its total support from the 'blue box' (trade distorting but allowed for the moment) to the 'green box' of permitted, non-trade-distorting subsidy.

There are problems however. The impact on export subsidy of decoupling is unclear but is likely to fall short of the complete abolition demanded by the US, the Cairns Group of agricultural exporters and major developing countries like India and China. EU Tariffs remain prohibitive. The tariff level on grain into the EU is in excess of 200%. By comparison the average tariff on manufactures into the EU is currently 3%, even on textiles and apparel, which are heavily protected, the average tariff is around 25%. So starting from 200% a very large cut is necessary if any imports (outside the small quotas allowed at reduced tariffs and which are currently not even filled) are to take place. Hence there is very little in the Commission Package that yet significantly contributes to the development objectives of the Doha Round.

## The Enlargement Dimension

So where does the enlargement fit to all this? The Copenhagen summit left the new member states with no more than 25% of direct payments (those payments now to be decoupled) commonly financed by the EU budget when they join in 2004. That will rise to 100% by 2013 (the end of the next budgetary period). This is yet another part of a process of fixing the 2007-2013 financial framework along an important dimension before the new members join the EU.

And the budgetary pressures of enlargement on new members are quite significant (Spokeviciute (2003), Mayhew (2003)). If, as negotiated, they top up these direct payments from their own budget, it is a serious budgetary problem. There do exist budgetary constraints in almost all new members. Add to that the fact that the costs of just adopting the *acquis communautaire* will require another 5-9% on existing expenditure. Under these pressures they will find it hard to meet the excessive deficits procedures of the EU let alone meet the Maastricht criteria for membership of EMU or the Stability and Growth pact. All of which could put their future accession to EMU in danger.

The new member states have big agricultural populations, many on small, quasi-subsistence holdings, but seem to have poor rural infrastructure. The increased spending under the new second pillar of the CAP may help them. On the other hand with so many very small holdings and weak bureaucracy they may find it hard to take advantage of the rural development funds or to meet the cross compliance standards necessary to qualify for direct payments.

If that turns out to be true, the combination of, at best, less than 100% receipt of direct payments until 2013 and the possibility that many of their producers might in any case fail the cross compliance test and receive nothing may make them resistant to any reduction in border protection as main source of support to their farmers. They may increase the protectionist voice in the Agriculture Council after May 2004 when they formally join and make a successful completion of the Doha Round by the end of 2004 more difficult.

More generally they are likely as a group to look to re-open the Copenhagen deal on direct payments (they have, just, a blocking majority on the Treaty of Nice voting allocations in the Council). They may also look for more direct budget support for rural infrastructure after 2006 particularly if they make no progress on direct payments. That will throw them into direct conflict with the agreed limits on the agricultural budget and the EU-15 who will lose receipts from the direct payments if the budget ceiling is breached under the financial discipline mechanism agreed in Luxembourg.

### **Structural Funds**

The term Structural Funds is normally taken to mean the Regional and Social Funds but here will include the Cohesion Funds. This section will discuss them as a whole even though there are important differences in their operation. There are two problems facing the Funds.

First, the net contributors to the structural funds may start to lose interest and the willingness to pay. There is a discussion going on about whether net

contributors should only put in their net contributions and receive no receipts from the Regional Funds. The British finance minister for example has proposed repatriating regional policy spending in Britain and only paying the net contribution to Brussels (Guardian, 7 March 2003). That is, Regional Fund payments to British regions would come from London not Brussels. Such an approach would undercut any political support for the regional policy in Great Britain among regional or local politicians.

Second, the current recipients want to maintain their position (eastern Länder, Spain, Greece, Portugal, Mezzogiorno). Even rich Ireland, whose GDP per head is now around 120% of the EU-15 average (EU Commission 2003b, table 1) compared with the Regional Fund cut-off of 75% and who might be thought of as a large relative net contributor wants to keep the money. Ireland was a single region for the purposes of the regional policy until the last revision of regional boundaries. Then magically it became two regions. One, including Dublin and with a GDP per head over 100% of EU-25 GDP per head and the other close to the limit of 75% of EU GDP (EU Commission 2003b, map 1). This is one illustration of the political economy of the structural funds at work.

The new members were offered full access to the structural funds at Copenhagen but with a cap on their receipts of 4% of GDP as proposed in Agenda 2000. They may have difficulty reaching this cap soon (or at all) because of complex rules for planning and implementing projects, lack of administrative capacity to absorb and fully exploit these funds or lack of matching

funds which amount to one third to 45% of the total cost.

So once members they may look for simpler disbursement rules and lower rate for co-financing. If they don't make the 4% cap, financing the structural funds budget might be relatively straight forward. But if they reach it early and consistently then the impact on structural funds spending could be over € 25Bn by 2013.

On questions of political economy, first there is an upper limit on spending of 0.46% GDP (European Commission 1998b, section B and Inter-institutional agreement between the Council the Commission and European Parliament, 1999). Second unanimity is required for approval of structural funds budgets and is likely to remain so at least until after 2013 even if the proposed EU constitution is adopted as drafted by the Convention on the Future of Europe. Thus everyone has a veto. The net contributors, the current recipients and the new members will have to find a consensus, which creates a very difficult political economy.

### **The Budget**

The enlargement package agreed at Copenhagen is mean and that may poison the new members' attitude in future negotiations. It is not just less than in Agenda 2000 (agreed by the Commission in 1998) it is even less than was agreed in March 1999 at the Berlin Council, where they cut back the Agenda 2000 proposals. The Berlin 2000-2006 budget was designed for six new members joining the EU in 2002 not ten joining in mid 2004. This saved considerable funds since the 4 extra countries were small while the time period of membership was reduced by more than

half from 4 years to 18 months.

Thus the net contributors sewed up the Budget until 2006 first at Berlin in 1999 and again in Brussels in 2003. The total budget is barely more than 1% of GDP. In real terms it has fallen back from the levels proposed in Agenda 2000 and at Berlin. Against that background the financial framework post 2006 is the real battlefield post enlargement. This is also a battleground where unanimity is required so everyone is condemned to reach a consensus.

First some context, the upper limit on the budget is set by the so-called 'Own Resources' (or budget income) ceiling, which is set at 1.24% of EU GDP. The Own Resources ceiling is not on the table since current expenditure is nowhere near the limit and the net payers have a veto. The EU budget is not allowed to borrow, so if its income is limited so is expenditure.

And the EU-15 has already limited the room for manoeuvre of the Commission and the net recipients. As noted above the agriculture budget is frozen by the financial discipline mechanism agreed at Luxembourg in June 2003. Second as noted above the structural funds are limited at 0.46% of EU GDP and have been since the 1993-1999 Financial Framework and this could only be changed by agreement among the Commission, the Council and the European Parliament. And the actual level and distribution of the structural funds budget is also a matter of unanimity. So change there is going to be hard to make.

Other constraints will also affect the negotiation. Romania and Bulgaria have been given very strong commitments on EU membership by 2007 in the Thessalonica European Council Conclusions of 20 June 2003 (European Council 2003). Turkey was

given the target of opening negotiations at the end of 2004 in the Copenhagen Council conclusions. Croatia has just applied for the candidature and Macedonia is on the verge of applying. So we have another five countries and Turkey above all, which want to join the European Union and which could do so during the period of 2007-2013. Money for them will need to be part of the budgetary planning procedure. Turkey in particular is likely to weigh heavily on the minds of Finance ministers because of its size (total population at 70 million only 10 million less than the 10 new members and much poorer and much more agricultural than the new members).

And other policies are on the increase and budgets are under pressure. Most notably security both internal and external. The Justice and Home Affairs agenda is likely to be at least partially Communitised after the next Intergovernmental conference in 2004 which could lead to some common financing particularly of guarding external borders. The costs of stabilising and preparing the Western Balkans for possible and eventual EU membership will along with programmes for the 'near abroad of Ukraine, Belarus and Russia as well as North Africa and the Middle East all speak to a hugely expanding foreign policy budget. Even if not part of the EU budget increased defence cooperation could lead to downward pressure on the EU budget envelope. And the Lisbon agenda, which has the aim of making the EU the most technologically advanced, high productivity economy in the world by 2010 also demands increased expenditure on Union R&D budgets. So the budget is under the wider pressures than just agriculture and the structural funds.

### **Political Economy of the Budget after the Enlargement of 2004**

How is the political economy of this going to work out? It might be possible to carry out some complex game theoretic modelling but that is not the intention here. Instead three somewhat stereotyped scenarios will be set out to give a sense of the possible range of outcomes.

#### **A new 'Club Med'?**

All the net recipients gang up together to expand the budget, in particular the so-called „Club Med“, which includes Italy, Spain, Greece and Portugal and Ireland (although Ireland starts phasing out of the Cohesion Fund from 2004 onwards), expands to include the new members. The aim would be to unfreeze the Agricultural budget and perhaps to raise the share of the structural funds and in consequence raise the budget closer to the own resources ceiling.

This might be done with the support of the Commission who write the initial Framework and perhaps their members of the European Parliament, which could threaten not to sign the Inter-institutional Agreement on the Framework.

Each country has a veto, but more importantly as a group they do have a substantial blocking minority (186 votes see Annex). This might allow them to threaten the net payers on issues which are important to the net payers as a group or individually and which are subject to Qualified Majority Voting (QMV). Equally however the net payers also constitute a fairly, if less, robust blocking minority of 99. The outcome will therefore depend on which group is most prone to defections as a result of side payments or threats.

## 'Club Med' vs. 'new kids on the block'?

This becomes a spoils fight between the new members and the existing cohesion states (plus Italy or perhaps France defending its take from the CAP budget) both of which groups have blocking minority in the Council. This is driven by an essentially frozen budget on agriculture and the upper limit on the structural funds plus the Germans and other net payers trying to drive in wedges to split the net recipients. The key targets of the new members are likely to be more money for direct payments and pillar two from the agricultural budget and easier disbursement rules for the structural funds. As we have seen in the past the Spanish, in particular, are extremely adept at political infighting in the Council and have been very successful. They have also kept very close to Germany when they can and that long-term relationship could still serve them well in any budget wars.

### **New Members vs Candidates**

The new members, despite warm words now, may find it difficult to welcome the budgetary consequences of Bulgarian and Romanian accession in 2007 right at the beginning of the Framework period, let alone the possibility of Turkish accession during it. There are 8 million Bulgarians and 23 million Romanians, which is roughly equivalent to another Poland or half the size of the current enlargement (and 70 million Turks would double that again). The impact on the distribution of receipts on agriculture and structural funds could be substantial particularly if key elements of the Budget are frozen. This

might encourage the new members to a strategy of delay on the next enlargement not least because pre-accession aid is outside agriculture and the Structural Funds budgets and thus outside any ceilings. This might lead to a policy of delay.

### **Conclusions**

The political economy of the EU budget is going to be very messy after enlargement. It is too early to tell how it will work out but not too early to start thinking about the issue. In terms of the big choices confronting the EU:

- The Doha Round may suffer as new members look to domestic market support and market access barriers to sustain farm incomes in the absence of any new money for them before the end of 2004
- Future agricultural reform is likely to be slowed by enlargement unless new members are given more cash after 2006.
- The structural funds seem unlikely to expand and if net payers lose interest and distance themselves from them politically then deals may be hard to strike in the next Financial Framework.
- The Financial Framework is an uncertain battleground, but the need for unanimity suggests stasis unless there are some levers external to the budgetary negotiation available to the demanders/net recipients. One of the most important issues to focus on may be whether there is any sign of blocking minority coalitions emerging among the new member states or among the net recipients as a group.
- The next enlargement may also suffer. Bulgaria and Romania may

join the European Union later than the promised 2007. And Turkey may be in the waiting room until the Greek calends.

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## Annex

### Blocking Minorities in the enlarged EU

Votes in the Council	
<i>THE WEIGHTING OF VOTES IN THE COUNCIL</i>	
<i>Members of the Council Weighted votes</i>	
<i>Germany</i>	29
<i>United Kingdom</i>	29
<i>France</i>	29
<i>Italy</i>	29
<i>Spain</i>	27
<i>Poland</i>	27
<i>Romania</i>	14
<i>Netherlands</i>	13
<i>Greece</i>	12

<i>Czech Republic</i>	12	<i>condition is shown not to have been met,</i>
<i>Belgium</i>	12	<i>the decision in question shall not be</i>
<i>Hungary</i>	12	<i>adopted.</i>
<i>Portugal</i>	12	Extract from Nice Treaty Declaration on
<i>Sweden</i>	10	Enlargement, Official Journal, En 10.03.2001.
<i>Bulgaria</i>	10	page C81/82
<i>Austria</i>	10	<a href="http://europa.eu.int/eur-lex/en/treaties/dat/nice_treaty_en.pdf">http://europa.eu.int/eur-</a>
<i>Slovakia</i>	7	<a href="http://europa.eu.int/eur-lex/en/treaties/dat/nice_treaty_en.pdf">lex/en/treaties/dat/nice_treaty_en.pdf</a>
<i>Denmark</i>	7	
<i>Finland</i>	7	
<i>Ireland</i>	7	
<i>Lithuania</i>	7	
<i>Latvia</i>	4	
<i>Slovenia</i>	4	
<i>Estonia</i>	4	
<i>Cyprus</i>	4	
<i>Luxembourg</i>	4	
<i>Malta</i>	3	
<i>Total</i>	345	

*Acts of the Council shall require for their adoption at least 258 votes in favour, cast by a majority of members, where this Treaty requires them to be adopted on a proposal from the Commission. In other cases, for their adoption acts of the Council shall require at least 258 votes in favour cast by at least two-thirds of the members. When a decision is to be adopted by the Council by a qualified majority, a member of the Council may request verification that the Member States constituting the qualified majority represent at least 62 % of the total population of the Union. If that*

### **Calculating a blocking Minority**

A maximum size of a blocking majority in a Union of 27 is thus 88 votes ((345-258)+1). This is 25.50725% of the total votes in the Council. Total votes in a Union of 25 is 322 (345 minus Bulgaria (10) and Romania (13)). So a blocking minority in a Union of 25 is 82 votes (322 \*0 .2550725). The ten new members have 99 votes which is comfortably a blocking minority and can lose up to 17 votes in defections but Poland must remain in any coalition.

The Cohesion states Spain, Ireland, Greece, and Portugal (58 votes in total) can only muster a blocking minority if they can include Italy (defending the mezzogiorno) or France (defending the CAP) in any coalition.

Net payers, taken to be Germany, UK, Netherlands, Sweden, Austria, Finland, have 98 votes and hence a blocking majority that can be sustained against the defection of the Netherlands, or Finland, plus one of Sweden or Austria.

## THE CHOICE OF THE EXCHANGE RATE REGIMES OF THE EUROPEAN UNION ACCESSION COUNTRIES INFLUENCED BY THE WORLD CURRENCY CONSOLIDATION

Marin Frâncu<sup>1</sup>

*ABSTRACT.\* The pressure of the currency consolidation increased in the years 1990 as the world currency system became obviously too complicated and too costly. There are too many national currencies that generate artificial barriers and avoidable transaction costs, both for the domestic economies and for the world economy. The high costs and great vulnerability of the national currencies determined the financial and economic business of small open economies to move into the major currencies of the world. The world needs fewer national currencies, but does it need fewer central banks too? Or it needs central banks capable to pursuit sound monetary policies? What kind of institutional arrangements and international financial architecture are most suitable for the prospective environment of a greatly reduced multiplicity of currencies? A regional currency consolidation may be a good answer but a regional currency union is a better answer. Though, until membership of the Euro zone, what kind of the exchange rate regime is more suitable for Romania and other European Union accession countries? The hard peg regimes seem not to be a good solution. The best solution lays probable between managed floating regimes and intermediate regimes. This may be because emerging markets have both „fear of floating“ and „fear of fixing“. But there is no ideal exchange rate regime „to suit everybody“. Once the exchange rate regime chosen, it evolves in time. So is the case with the exchange rate benchmarks for the national currency.*

### 1. Fewer is better

The currency consolidation is a unification process of too many national money standards of the world. **The world currency consolidation means the official national currencies merging into one world currency.** This idea is not new. A world currency, the „bancor“, was advanced by John Maynard Keynes at the Bretton Woods conference in 1944, but not accepted. Even today it has a few advocates and mostly as a

desirable endpoint in the long run. Between them a Nobel laureate, Robert Mundell a supporter of a single world currency. At the other end, another Nobel laureate, Milton Friedman is a supporter of widespread flexible exchange rate regimes and an opponent to one world currency<sup>2</sup>. More accepted is the proposal **that national currencies to consolidate within regional blocs** that have close trading and investment linkages, thus making them more economically and politically sustainable<sup>3</sup>.

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\*This article was written in July 2003.

<sup>2</sup> See the debate of the two famous economists in: Friedman, M. and Mundell, R. A. „One World, one Money?“, Policy Options - Options Politiques 22(4) p. 10-30 May 2001 Canada.

<sup>3</sup> See George M. von Furstenberg „One Region, One Money: Implications of Regional Currency Consolidation for Financial Services“ Fordham University New York, Washington, D.C., 29 September 2001.

National currencies in a region would be merged into one currency to gain economies of scale and a market credibility that would come from an independent regional central bank, free from short-term political interference. Some observers find that, at global level, *„from an economic point of view, it would be preferable to retain ... three or four currencies“*<sup>4</sup>. They take into consideration, at least, **the dollar, the euro and the yen.**

Global liberalization, regional economic integration, and a lengthening list of financial, e-commerce, and other activities eroded the monopoly of small currencies in their home market. Their **national currencies have been exposed to international competition** and have to struggle for survival. Small national currencies continued viability is threatened. There is greater urgency for their government policy to decide whether to hang on to a financially small and purely domestic currency in which less and less business can be conducted cost-effectively or to merge it into some form of currency consolidation or regional monetary union.

Among the three *major currencies* of the world, the U. S. dollar, the euro and the yen, there is probable **no better alternative to floating rate regime.** On the contrary, inside regional economic unions of the world have grown the pressure to take new steps to assure irrevocable fixed exchange rates. For the *smaller countries* in each region, the questions raised by financial liberalization are quite different. For them, maintaining separate volatile currencies became less desirable when exchange rates, instead of being serviceable shock absorbers, became a

growing source of shocks to the domestic economy and its finance. Abrupt changes in nominal and real exchange rates that reverse themselves only after a currency crisis can drastically change competitive conditions between the members and of members with outsiders.

Such changes disturb rather than equilibrate trade relations. The desire to avoid such upsets by using a single currency inside economically integrated regions has contributed to a mutual insurance interest in European Economic and Monetary Union. Nevertheless, the adoption of euro owed more to the political logic of shared governance and a common anti-inflationary resolve than overwhelming pressures in financial markets. This may explain a part of the slow progress in the direction of a common regional currency in other great regions of the world, in the Americas with NAFTA and Mercosur, in East Asia or in Southern Africa.

## 2. Many options on the road towards the regional European currency

*The euro is the first great success of a regional currency consolidation* with a large potential in the international finance. More than *50 countries* outside the Euro area currently have an exchange rate regime involving an external anchor in which euro plays a role<sup>5</sup>. **Romania** needs to overcome many problems to get through the stages required for the euro monetary union. The problems range from standardizing the macro and micro economic policies and adjusting the

4 Kenneth Rogoff „Why not a global currency?“ January 8, 2001 Economics Department, Littauer Center, Harvard University, Cambridge MA.

5 European Central Bank, Annual Report 2001, Frankfurt am Main, Germany.

business cycle in line with the business cycle of the Euro zone to putting on track the role and the functions of the national central bank according to the Euro system standards. Romania has to prepare to join the Exchange Rate Mechanism II (ERM II) and to meet the convergence criteria for euro zone. It must very seriously get prepared in a shorter period of time for the advantage of entering in the euro economic and monetary union and also for losing inter alia its national monetary policy and capital markets.

Within the European Union, **Economic and Monetary Union (EMU)** is the process whereby the economic and monetary policies of the member states of the Union are being harmonized with a view to the introduction of a single currency. It was the subject of one of the two Intergovernmental Conferences held in December 1990. The Treaty provides that EMU is to be achieved in *three stages*:

- First stage (1 July 1990 to 31 December 1993): free movement of capital between member states, closer coordination of economic policies and closer cooperation between central banks;
- Second stage (1 January 1994 to 31 December 1998): convergence of the economic and monetary policies of the member states (to ensure stability of prices and sound public finances);
- Third stage (from 1 January 1999): establishment of a European Central Bank, fixing of exchange rates and introduction of a single currency.

Eleven member states participated to the third stage of EMU that began on 1 January 1999. Two years later, on 1 January 2001 Greece joined them. Three

member states have not adopted the single currency: **Denmark, Sweden, and the United Kingdom.**

To ensure that the sustainable convergence required for the achievement of economic and monetary union comes about, the Treaty sets **five convergence criteria**, which must be met by each member state before it can take part in the third stage of EMU. The Commission and the European Central Bank (ECB) draw up reports to check whether the criteria are being met. The criteria are:

- the ratio of government fiscal deficit to gross domestic product must not exceed 3%;
- the ratio of government debt to gross domestic product must not exceed 60%;
- there must be a sustainable degree of domestic price stability and an average inflation rate, observed over a period of one year before the examination, which does not exceed by more than 1.5 percentage points that of the three best performing member states in terms of price stability;
- there must be a long-term nominal interest rate which does not exceed by more than 2 percentage points that of the three best performing member states in terms of price stability;
- the normal fluctuation margin provided for by the exchange-rate mechanism (ERM II) on the European monetary system must have been observed without severe tensions for at least the last two years before the examination.

The convergence criteria, then, are meant

to ensure that economic development within EMU is balanced and does not give rise to any tensions between the member states. It must also be remembered that the criteria related to government deficit and government debt must continue to be met after the start of the third stage of EMU (1 January 1999). A stability pact with this end in view was adopted at the Amsterdam European Council in June 1997; the other three criteria are substituted by the unique monetary policy decided by the European Central Bank.

**Romania** and the other accession countries must meet the conditions of all three stages, as the initial 11 member states, and the convergence criteria. But which is the best approach for the national exchange rate regimes to go through these three stages since in the last two years the candidate currency has to stay in a band of fluctuation close to the euro? Does it mean that an intermediate exchange-rate regime is the best choice?

Romania's approach to the regional currency is a *common debate for all emerging- market economies*, including here also the transition countries, focusing on the type of the **exchange rate regimes**. In broad lines the exchange rate regimes, excluding multilateral regimes, may be divided in **two large categories**: „corner regimes“ and intermediate regimes<sup>6</sup>.

**II. „Corner regimes“** comprise:

- hard peg regimes consisting of
  - a. currency board arrangements;
  - b. the unilateral official adoption of a foreign currency e.g. dollarisation, euroisation or other currency substitution.
- Floating rate regimes consisting of

independent floats and managed floats. In the former interventions are to smooth only the market movements and in the latter to influence only the direction of the change of the exchange rate.

**II. Intermediate regimes** (or soft peg regimes) are those under which the authorities aim to achieve a pre-announced or undeclared exchange rate target. This type comprises peg to other currencies or basket of currencies, crawling pegs, and bands of fluctuations.

### 3. The offensive of the advice for the corner regimes

Emerging market economies are frequently advised to adopt a „corner“ exchange rate regime (in reference to floating rate and hard peg regimes at either end of the continuum of exchange rate regimes) in order to resolve the tensions resulting from these economies integrating into regional or global economy and finance. This advice takes into consideration that the crises in the late 1990s mostly affected countries with intermediate regimes (or „soft peg“ regimes defined by default as the remainder from corner regimes). More over, the currency competition pressure means, first of all, at least theoretically, more national currencies pegged by major currencies of the world. More recently, because of stricter requirements imposed by hard peg regimes are considered acceptable only for a very limited number of countries, floating rate regimes (independent floats and managed floats) have been advocated over hard peg regimes, giving rise to double bias against

<sup>6</sup> See „Exchange Rate Regimes for Emerging Market Economies“, European Central Bank, Monthly Bulletin February 2003, Frankfurt am Main, Germany.

intermediate regimes. But also the floating regimes are very demanding and, in its pure form, suit only a few emerging countries.

In fact, **the most appropriate exchange rate regime for a country depends on the characteristics of that country.** The theory of „optimal currency areas“ considered important capital mobility, the inflation rate differential with major trading partners, the rise of the economy and its degree of openness, the geographic and product diversification of trade, labor mobility, the degree of synchronization of business cycle and the stage of economic development. Another strand of the literature considered that *the nature of shocks* (source, frequency and severity) was the major variable in regime choice.

A common, though not universal, conclusion is that floating rate regimes minimize the economic costs of shocks for the domestic economy and the global system. Support for this conclusion is theoretically derived from the „inconsistent quartet“ which is the impossibility of having simultaneously openness to trade in goods and services, unrestricted capital flows, autonomy of monetary policy and a fixed exchange rate. Practically, **for small countries, a floating rate regime raises the negative impact of the shocks** because it requires at least a very sound domestic financial system.

The trend towards increasing economic openness has heightened the importance of the exchange rate regime in the price formation mechanism. For small, open economies, the variability of the exchange rate is of greater concern than for the large more closed economies.

Of the *additional criteria* identified as relevant to regime choice the most

pertinent include the degree of regional economic (cyclical and structural convergence) and institutional integration, the depth of financial and foreign exchange markets and the level of international reserves.

Where present, *regional co-operation* may significantly alter the cost-benefit considerations in regime choice and affect the modalities of regime shifts.

In order to prepare for *the membership of the exchange rate mechanism* (ERM II) of the EMU, some European Union accession countries are moving through various types of regimes with ultimate shift being the adoption of the single currency. **Romania** has started with a fixed exchange rate regime and moved gradually from an intermediate (soft peg) regime to a managed floating regime. Now the national currency has a **managed floating exchange rate** against a basket composed 60% of euro and 40% of U.S. dollar. **Bulgaria** has started also with a fixed exchange rate regime and moved gradually from an intermediate (soft peg) regime *to a currency board pegged to euro*. At the other end, only **Poland** has adopted *an independent floating exchange rate*, but with two anchors for its monetary policy, one internal and the other an external one.

*Regional integration and co-operation* is an issue which confronts other regions such as **East Asia, North and South America** and **Southern Africa**, where the desire to stabilize intra-regional exchange rates to foster trade and capital flows may necessitate reducing volatility and uncertainty in exchange rate movements between integrating countries. Such an objective **is theoretically more comparable to some form of fixed rate**

**regime than a freely floating regime.** This makes the choice of an exchange rate regime even harder. The considerations behind regime choice show that, since economies differ widely and evolve through time, no single exchange rate regime will be suitable for all countries until it enters into a monetary union.

The evolution of the **policy framework** of a country is an *interactive process*: while the exchange-rate regime must be tailored to suit the other policies, it will in turn influence them. This two-way, dynamic interaction is significant on two counts. First, no exchange rate regime per se constitutes an intrinsic guarantee for macroeconomic and financial stability.

Second, the exchange rate regimes have a disciplining effect on other policies. The degree of this disciplining effect is determined by both the choice of **an external or internal anchor for monetary policy** and by the degree of the **control of capital flows**. With an **external anchor**, under hard peg regimes and, to a lesser extent, under the intermediate regimes, the country seeks to import credibility at the cost of restricting its degree of monetary policy freedom. By contrast, under floating rate arrangements, the commitment to the **internal anchor** forms the basis for policy discipline and determines the credibility of the regime. This latter credibility relies on the *high quality of domestic institutional and operational requirements*. Such requirements apply first to monetary policy and its transmission mechanism (e.g. central bank independence, accountability and transparency, and domestic capital market deepening) but also to the other components of the

domestic policy framework (e. g. fiscal and financial policy). **The majority of accession countries** to EU chose to prepare for the ERM II membership with an **internal anchor**. Only a few choose a regime with an **external anchor** e.g. **Estonia, Lithuania and Bulgaria**.

#### **4. Some benefits and costs of the different type of exchange rate regimes. The currency consolidation through adoption of a hard peg regime may be not a good solution.**

Each exchange rate regime type has advantages and major costs and implies certain factors pending to stability. In general, the advantages of **the fixed rate regimes** refer, firstly, to reducing transaction costs and exchange rate risks and real volatility, which in turn encourage trade and investment and, secondly, to providing an external anchor.

Under *currency board arrangements*, monetary authorities pledge to sell foreign currency for domestic currency on demand at a fixed rate, and back the domestic currency entirely with foreign currency for this purpose. *Official dollarisation* (or *euroisation*) does not permit a mismatch in the currency denomination of assets and liabilities in the public, banking, corporate or household sector, thereby eliminating the risk of a related run on banks. On this count, currency substitution does not require the same degree of strength of the banking sector that is necessary under currency board. But, the official currency substitution requires the political willingness *inter alia* to abandon the domestic currency, and concomitantly the

seigniorage revenues, which are not insignificant (may be estimated at 3% of GDP).

Another big problem both for the currency board and currency substitutions is *the absence of the domestic monetary policy*. Since hard pegs involve a commitment to an unadjustable exchange rate, the authorities must give up of monetary policy autonomy and pursue appropriate fiscal, structural and financial policies to currency adopted. This requires tough fiscal and financial discipline, price flexibility and the availability of an adequate level of international foreign reserve to operate effectively, since the exchange rate cannot be used as a shock absorber. Under hard peg regimes, the domestic economy seems to be left without any protection, *exposed to all kind of shocks*.

These regimes are employed by countries where the capabilities to conduct an alternative exchange rate or domestically anchored monetary policy are impaired by institutional and operational constrains. At present, in the world there are fewer countries willing the *official currency substitution* with dollars or euros (e.g. **Panama, El Salvador and Ecuador**) or to pursuit *currency boards* (e.g. **Hong Kong, Estonia, Lithuania and Bulgaria**).

It should be added that, although *no European Union accession country chose an official currency substitution* (e.g. dollarisation or euroisation), **all are registering an involuntary currency substitution**. The degree to which the financial system is *de facto* dollarized (or euroized) depends largely on relative volatility of the inflation rate (more

volatility makes foreign currency deposits less risky) and of the real exchange rate (more volatility makes foreign currency deposits less risky in terms of domestic prices).

In all kinds of fixed rate regimes, since the exchange rate cannot be used as a shock absorber, *wages and prices must bear directly the burden of adjustment*. Given that, in principle, *the central bank is not in the position to play the role of lender of last resort*, the authorities cannot support any individual institution or the banking sector in a systemic crisis. As a result, a *precondition* for the adoption of a hard peg regime is the existence of a sound domestic financial sector, which partially may be offset by a significant presence of foreign banks, a sound economic policy and a continuity of financial foreign inflow into domestic market. The success of a fixed rate regime depends widely on the country characteristics.

Even within the same type of exchange rate regime the *conditions are very different*. For instance, **Argentina's** currency board arrangement had little in common with **Hong Kong's** currency board arrangement. On the other hand, a currency board arrangement *that pegs unnaturally* to a currency from outside the country's major trading region is prone to stress. **Singapore's** shift in 1967 to the U.S. dollar-based currency board, from a sterling-based one, though precipitated by the desire to disassociate from the sharp pound's devaluation from 2,8 to 2,4 dollars per pound, was appropriate to its trade and finance as well. Singapore broadened its exchange rate reference further a few years later when it made the transition to managed floating.

By contrast, **Lithuania's** insistence on maintaining a dollar-based currency board in what is rapidly becoming a sea of euros has been costly and the economy fell into a recession as long as the strength of the dollar against euro persisted up to 2002. Then, Lithuania switched to euro-based peg on 2 February 2002, but unlucky again because the euro begun to appreciate sharply thereafter. In general, **currency boards** established in distant outposts far away from the „peg country“ and its currency area, however, **represent a false start from the point of view of currency consolidation.**

Even a currency board with the dominant currency next door may often not survive for long when its financial system is exposed to direct competition from its more experienced neighbor. *The strength of trade and financial relations of countries in the vicinity of the euro zone makes the almost complete financial integration and interest rate convergence that is available upon formally adopting the euro more attractive than stay in a half-way house of a currency board.* Hence not only for **Central and East European countries** but also for every emerging country **if currency consolidation** is to be allowed, some form of **monetary union is the best way** to achieve it. Of course, different kinds of monetary union have different kinds of advantages and costs. The multilateral and co-managed euro zone is just one of them.

Unlike hard pegs, **floating exchange rate regimes** permit the pursuit of an *autonomous monetary policy* to absorb the external shocks. On the *advantages*, first, such a policy is consistent with the prioritization of domestic objectives, as

may be inflation. Second, with no implicit exchange rate guarantee, the scope for moral hazard is reduced. Third, exchange rate flexibility should allow for smoother and gradual adjustment to external shocks than intermediate regimes and hard pegs. Forth, floating regimes are relatively less crisis-prone. They are better able to cope with abrupt capital flow reversal.

On *downside*, first, it should be noted that the monetary policy of a small country is either illusory or undesirable in certain cases (a country subject to spillover effects from other economy, for example). Optimal currency area theory suggests that small, open economies *may be better off being part of a larger monetary area* rather than having their own independent currency. Second, owing in part to the difficulty of many emerging markets in issuing debt in domestic currencies, foreign currency indebtedness is *vulnerable* to downward pressure in foreign exchange market and the flexibility of the exchange rate is of no advantage.

Third, an internal monetary anchor, absolutely needed, is problematical in the form of a *money target* because of instability of money demand and underdeveloped domestic capital market. *Inflation targeting is a more viable choice*, but is not enough. It implies *specific requirements*, central bank independence and transparency, a high quality of monetary policy transmission mechanism and a developed domestic financial system, insofar as financial variables are used to measure market expectations.

Because, in emerging markets, some elements of the inflation target framework are lacking, it tends to be complemented to some degree of *exchange rate targeting*.

That means a *dual pursuit of an internal and external anchor for the monetary policy*, recently and successfully experienced in some countries like **Israel, Chile, Mexico and Brazil**.

The analyses of **intermediate regimes**, particularly those with a *pre-announced exchange rate target*, first, suggest that careful management of the exchange rate is necessary to secure credibility and minimize vulnerability to crisis.

Second, under the *intermediate regimes with conventional fixed-rate*, because of the „inconsistent quartet“ of free trade, a fixed exchange rate, unrestricted capital flows and the autonomy of monetary policy, the monetary policy has little room for maneuver and is subordinated to maintain the exchange rate. In effect, this means *adopting the monetary policy of the anchor currency country*, which can cause economic strain if the two countries' *business cycles* are not synchronized.

This is the case also with some candidate countries preparing for the *euro zone*. In countries pursuing a disinflation policy, the positive interest rate differential maintained to reduce inflation induces capital inflows, which must be sterilized in the foreign exchange market, and this can be costly (estimated at 1% of GDP per annum).

Third, rising capital flows accompanying capital account liberalization make *intermediate regimes vulnerable to crises* of the East Asian type of late 1990s. To the extent that economic agents feel protected by implicit exchange rate guarantee, this may foster *moral hazard*. In the event of a crisis, *costs may be high* and are incurred whether the exchange rate is defended or abandoned.

## 5. Romania's exchange rate benchmarks in a dual target of the monetary policy

The exchange rate is currently the main intermediate target of Romania's monetary policy. Since early 1999 the central bank, i.e. the National Bank of Romania (NBR) has generally pursued a dual target of **gradual disinflation** on one hand and of sustainable external position by using the **exchange rate as a soft nominal anchor** on the other hand. NBR shifted the emphasis between „soft“ and „anchor“ as dictated by the relative importance of the two sides of the target at each particular moment.

Although this framework proved later good, it didn't work all the time due to inconsistencies in the monetary policy that is shared between NBR and ministry of finance. It has performed relatively well, especially since late 2001, when fiscal and wage policies got largely harmonized with a tight monetary policy in pursuing the stabilization objectives of internal and external equilibrium. Thus, inflation fell from 55 percent at the end of 1999 to about 15 percent in mid-2003 while the current account deficit has been sustainable and gross international reserves have steadily accumulated.

As in many emerging countries, in Romania **domestic prices and exchange rate move together**. Since central bank plans to adopt **fully fledged inflation target by the end of 2004** quantifying how much of and how fast the exchange rate depreciation turns into inflation has become very important for formulating monetary policy decision.

During 1997-2002, the **exchange rate**

**pass-through** to both consumer and producer prices has been relatively large and fast, ranging between 60-70 percent for producer prices and 30-40 percent for consumer prices, depending of the choice of the exchange rate benchmark. Most of this effect has been felt after 12-15 months<sup>7</sup>. Romania's relying on exchange rate for disinflation has **apparently had no alternative** since such a lag of time is considered too short for monetary policy to affect inflation via the interest rate or the credit channel.

The choice of an exchange rate benchmark for targeting could be an important policy issue for Romania if it turns out that **the pass-through differs between the benchmarks**. Historically, the NBR has used the exchange rate against the U.S. dollar (Lei/US\$) for the targeting of the monetary policy.

However, as preparing the transition to the European regional currency and after switching to targeting a 60/40 Euro/US\$ basket in June 2002, the NBR is considering **the use of the exchange rate against the euro (Lei/Euro) as its intermediate target in the near future**. The exchange rate of the Leu in terms of the basket (60/40 Euro/US\$) is currently very close to the nominal effective exchange rate, as the bulk of Romania's foreign trade is conducted either in euro or U.S. dollars. The flows in euro account for more than 60 percent of exports and more than 50 percent of imports.

Until recently the pass-through from Lei/U.S. dollar exchange rate used to be larger, if not faster than the pass-through from the Lei/Euro one, with the basket

understandable in between. This difference may be explained by **the higher weight of U.S. dollar pricing in Romania's imports of intermediate inputs**. Intermediate inputs constitute a large part, about 60 percent of the overall Romanian imports. While the trade flows in U.S. dollars is estimated at about one third of total trade, it is exceeding 50 percent in imports of intermediate inputs.

In a high-inflation environment, domestic price setting reflects expectations about future exchange rate dynamics as a proxy for expected inflation. At current lower levels of inflation (and especially when it falls to single digits), the **signaling role of the exchange rate for future inflation declines** and therefore this channel of pass-through decreases in significance. Given the Romania's economic profile, as long as the exchange rate is the nominal anchor, the dollar should be represented in the targeted benchmark.

The contribution of estimated Lei/US\$ exchange rate shocks to domestic inflation turns sharply negative in mid-2002, as a result of NBR adopting the 60/40 Euro/US\$ basket as a targeted benchmark. With steadily appreciation of the euro throughout 2002 and thereafter, the Lei/US\$ exchange rate trend moved from upward sloping to a flat line.

This policy change, which amounted to effective monetary tightening, may be responsible for the significant over-performance of inflation in 2002 (an outcome of 18 percent versus a target of 22 percent).

7 Nicolay Guerguiev, "Exchange Rate Pass-Through in Romania", June 2003, International Monetary Fund, European I Department, Working Paper WP/03/130.

## 6. The shift from preponderance of intermediate regimes to floating regimes

In emerging market countries there is a *distinction* between *de jure* regimes (declared to the **International Monetary Fond**) and *de facto* regimes. Over a half of all declared regimes are not actually pursued. This discrepancy can be explained, to a large extend, by emerging market countries „fear of floating“ and, to a lesser extend, „fear of fixing“.

„Fear of floating“ is the fear that a falling exchange rate will raise inflation and/or cause a large rise in debt denominated in/or indexed to a foreign currency. „Fear of fixing“ is a dual fear. It is the fear of becoming the target of a speculative attack if a peg to a given exchange rate is declared. It is also the fear that, for relatively closed economies operating a fixed rate regime, a sudden stop in foreign capital inflows will necessitate a very large real depreciation of the exchange rate. This depreciation is needed to restore a viable external position and it implies a degree of prices and wages flexibility which is both difficult to achieve and politically unacceptable.

Also the *distinction between various type* of corner and intermediate regimes pursued is not clear. For instance, at the flexible end of corner regimes, the motive of managed floating is to influence the direction of change in the exchange rate; the motive of independent floating is to reduce volatility. But, these motives can be identified, if at all, only after intervention.

In general, the analyses in emerging countries suggested that *intermediate rate*

*regimes are currently the second most popular type of regimes, behind the floating rate regimes*, but well ahead of hard peg regimes. This compared with the observation that in the year 1990 almost four-fifths of emerging-market economies pursued intermediate regimes.

Nevertheless, claims of growing preference for corner regimes after the Asian crisis of late 1990s are exaggerated. Of the emerging market countries exited intermediate regimes, more than half adopted another form of intermediate regime rather than corner regimes.

*Shifts to a floating rate regime* could not be described as a free choice but are rather favored by a lack of credible alternatives. The number of emerging countries with *de facto independent floating rate regimes is rather limited*. Also only a *small number of countries have pursued hard pegs* for any significant period of time (e.g. **Panama, Hong Kong and Estonia**), while the bad experience in **Argentina** showed how demanding are the conditions to sustain a currency board.

At the opposite end, experiences in countries like **Brazil** and **Poland** with independent floats are too recent as to draw firm conclusions. For emerging-market economies the floating regimes are very demanding because of institutional and operational requirements needed to operate this type of policy framework in a credible manner. For this reason, the floating regimes in emerging countries *are mostly managed floating regimes*.

Since economic and financial conditions vary widely across countries, **there is no ideal exchange rate regime for all countries, no for any country all the time**. Consequently, EU accession

countries should *pay attention to the full range of regimes* available and make a choice in accordance with their own particular situation. They *must take into account* the degree of monetary policy autonomy, desirable and feasible, the degree of capital account liberalization and financial stability, the pattern of trade and financial linkages and the road map of regional integration. An exchange rate regime is not an end in itself, but a means to macroeconomic stability and sound and sustainable growth.

## POLITICA FISCAL-BUGETARĂ DIN PERSPECTIVA PROCESULUI DE INTEGRARE EUROPEANĂ

Dorin Măntescu\*

**ABSTRACT.** 2003 was the best year in a transition decade from the point of view of the macroeconomic performance. Also, the structural reforms were consistent, wage policy was cautious and the first IMF agreement was concluded from the point of view of the implementation. However, notwithstanding the progress, Romania is still confronted with substantial structural problems in energy, railways and mining sectors. Furthermore, the large share of the total population that lives in the rural areas and the situation of the pension system represent additional major structural constraints that we currently face. The speed up of these reforms will require additional public expenditures. Additional public resources need to be channeled also in health, education, infrastructure and institutional reform areas. The level of public expenditures in Romania was around 32,7 percent of GDP in 2002 compared to over 45 percent in the other more advanced candidate countries and EU member states. There are two reasons for this lower expenditure level as percent of GDP: the lower level of public revenues as percent of GDP and the lower level of budget deficit. Given the additional expenditure needs, Romania should do the best effort to increase public revenues by improving tax collection, enlarging the tax base and cutting social security tax rates. Also given the lower levels of the budget deficit and public debt from a comparative perspective, Romania should increase the budget deficit. Taking into account that the larger public sector deficit is composed from the consolidated budget deficit and the arrears and losses in the public enterprises, an increase of the budget deficit accompanied by a larger decrease of the arrears and losses in the public owned enterprises will allow the reduction of the overall excess aggregate demand. This will help us to maintain the disinflationary tendency that our economy knew in the last several years while benefitting of additional public expenditures.

Decada precedentă a fost o perioadă caracterizată de deficite fiscale foarte mari și de o creștere continuă a nivelului datoriei publice în multe din țările puternic industrializate. A fost de asemenea o perioadă în care au devenit tot mai intense preocupările că aceste stocuri ale datoriei publice raportate la Produsul Intern Brut au un caracter nesustenabil. În plus, Tratatul de la Maastricht a cerut țărilor participante îndeplinirea unui număr de criterii fiscale, printre acestea cele mai importante fiind cele cu privire la deficitul bugetar (care nu trebuia să depășească 3 la sută din Produsul Intern Brut) și stocul de datorie publică (care avea de asemenea un plafon

de 60 la sută din Produsul Intern Brut).

Cu toate că această lucrare se adresează țărilor în tranziție, are o aplicabilitate mult mai largă. Multe dintre țările în curs de dezvoltare și avansate din punct de vedere economic se confruntă cu probleme similare concretizate în eforturile de rectificare a dezechilibrelor economice ce au ca sursă politicile fiscale laxe, redefinirea rolului statului în economie, creșterea transparenței activităților guvernamentale și implementarea unor programe menite să stimuleze dezvoltarea sectorului privat prin creșterea productivității.

Majoritatea țărilor aflate în tranziție au făcut progrese substanțiale în ceea ce

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privește atingerea unor poziții fiscale rezonabile, 16 din 26 de țări propunându-și să realizeze deficite bugetare de mai puțin de trei procente în 1999. Cu toate acestea încetinirea ritmului de creștere economică internațională începând cu cea de-a doua jumătate a anului 2000 a condus la o depreciere a poziției fiscale reflectate în creșterea deficitelor bugetare ca urmare a reducerii veniturilor bugetare.

Este un lucru deja evident că țările care au implementat politici fiscale restrictive în perioada timpurie a tranziției au reluat procesul de creștere economică mult mai devreme și au experimentat o creștere economică mult mai ridicată ulterior decât țările care au menținut poziții fiscale caracterizate de deficite bugetare nesustenabile și niveluri ale cheltuielilor bugetare ridicate.

România s-a remarcat față de țările mai avansate în procesul de tranziție prin menținerea unui nivel scăzut al datoriei publice și prin diminuarea continuă a deficitului bugetar ca raport în Produsul Intern Brut. Cu toate acestea nu a fost scutită de riscul intrării în incapacitate de plată în anul 1999 în condițiile în care lipsa de credibilitate externă nu a permis accesarea piețelor financiare internaționale, iar maturitatea de refinanțare pe piața internă a fost relativ scăzută conducând la o acumulare substanțială a scadențelor de refinanțat pe termen scurt.

### **Deficitele quasi-fiscale-cauze și implicații**

Ignorarea situației sectorului guvernamental în ansamblu și concentrarea atenției numai asupra nivelului deficitului bugetar în sens restrâns poate crea o percepție greșită a poziției sectorului fiscal. În multe dintre țările care s-au confruntat cu crize economice severe, existența unui

deficit bugetar efectiv redus nu a reprezentat o garanție pentru investitori. Existența unor activități publice neînregistrate din punct de vedere contabil asociate cu activități quasi-fiscale a mărit gradul de vulnerabilitate financiară a economiilor respective și a subminat încrederea investitorilor.

Reducerea cheltuielilor cu subvențiile a reprezentat una dintre modalitățile principale de reducere a nivelului deficitului bugetar în economiile în tranziție. În condițiile în care ritmul reformelor structurale nu a fost suficient de ridicat, întreprinderile cu probleme au acumulat arierate ca o formă de rezistență și de supraviețuire. Aceste comportamente au fost amplificate și de numeroasele scutiri și reeșalonări acordate la datoriile întreprinderilor față de bugetele de stat. Hazardul moral rezultat a condus la o creștere a stocului datoriei întreprinderilor private profitabile subminând astfel însăși credibilitatea de ansamblu a sistemului fiscal.

O atenție din ce în ce mai mare a fost acordată arieratelor din economiile în tranziție, datorită în principal:

- naturii și amplitudinii fenomenului în aceste economii, arieratele agregate nete reflectând puterea structurii de a-și conserva ineficiența și de asemenea existența unei structuri instituționale slab structurate;
- consecințelor macroeconomice nefavorabile ca urmare a menținerii unui nivel al cererii agregate excesive cu impact negativ asupra deficitului de cont curent și al inflației;
- costul de oportunitate al resurselor bugetare necolectate și consecințele negative reflectate prin menținerea unor cheltuieli bugetare scăzute în domenii sensibile cum ar fi educația, sănătatea sau infrastructura cu efect negativ asupra

rateri de creștere economică potențială.

Existența unor deficite quasi-fiscale mari a fost una din cauzele principale a declanșării crizelor valutare manifestate pe plan internațional. Vulnerabilitatea la o criză valutară este amplificată nu numai de existența unui deficit bugetar ridicat dar și de manifestarea unor deficite quasi-fiscale substanțiale. Migrarea capitalurilor poate fi amplificată în condițiile în care percepția investitorilor se schimbă în urma obținerii unor noi informații cu privire la depășirea unui nivel critic al obligațiilor bugetare nete sau ca urmare a predispoziției guvernului de a extrage venituri din inflație mai degrabă decât de a se angaja la măsuri de asanare fiscală necesare corectării dezechilibrelor.

Asemenea măsuri sunt relativ dificil de luat într-o societate democratică supusă la presiunile inevitabile asociate ciclului electoral și depind într-o măsură considerabilă și de calitatea aranjamentelor instituționale existente. Chiar dacă sunt fezabile din punct de vedere politic asemenea ajustări rapide a sectorului fiscal necesită modificări discreționare ale taxelor și reduceri ale cheltuielilor cu investițiile publice în condițiile în care celelalte cheltuieli au o rigiditate mai ridicată. În orice caz, ajustarea sectorului fiscal necesară corectării dezechilibrelor are un efect prociclic agravând în acest fel impactul negativ al migrării capitalurilor asupra creșterii economice. De asemenea acest tip de ajustări discreționare au un efect negativ în sensul diminuării ritmului reformelor structurale de ansamblu.

În acest context credibilitatea politicilor macroeconomice este esențială, iar deciziile investitorilor pot fi influențate prin anunțarea unor schimbări majore de politică economică. Semnalarea unor astfel de schimbări va avea

un efect sustenabil asupra așteptărilor atâta timp cât sunt urmate de măsuri concrete din punct de vedere al reformelor structurale și care să fie implementate de-a lungul unui orizont de timp mediu.

Un beneficiu major al strategiei de semnalare a schimbărilor de politică economică în condiții de credibilitate este reprezentat de marja de manevră suplimentară oferită de intervalul de timp mai îndelungat și de creșterea probabilității apariției unor efecte anticiclice. Într-un cuvânt, în loc ca ajustarea să se realizeze prin înghețarea salariilor, reducerea investițiilor, or implementarea altor măsuri de restricționare a cererii agregate s-ar putea realiza prin măsuri de reformă durabile, de genul disponibilizărilor de personal redundant, substituirea unor subvenții alocate nediferențiat și îmbunătățirea ariei de adresare, ori lărgirea bazei de impozitare.

Aceste măsuri nu pot fi implementate decât în cadrul unui program de ajustare promovat pe termen mediu. Potențialul evitării crizelor și îmbunătățirii stabilității prețurilor și cursului de schimb poate fi crescut prin adoptarea unor reguli de politică fiscală stabile și predictibile. Astfel, adoptarea unor limite ale deficitului bugetar sau ale datoriei publice care să limiteze gradul de discreție al guvernelor succesive poate conduce la obținerea unor beneficii majore. În principal aceste beneficii includ o scădere a premiului de risc reflectat într-o scădere a ratelor dobânzilor cu efect pozitiv în sensul reducerii cheltuielilor cu serviciul datoriei publice și accelerarea procesului de creștere economică.

### **Deficitul bugetar**

Nivelul maxim al deficitului bugetar conform criteriilor de la Maastricht este de 3 la sută din Produsul Intern Brut. Acest

obiectiv este stabilit prin Tratatul de bază al Comunității Europene și este obligatoriu atât pentru țările membre actuale cât și pentru noii membri la momentul adoptării monedei euro. În plus țările membre ale zonei euro trebuie să respecte prevederile Pactului de Stabilitate și Creștere care implică atingerea pe termen mediu a unei poziții echilibrate sau chiar existența unui surplus a deficitului bugetar ajustat ciclic. Aderarea la obiectivul unor poziții bugetare caracterizate de existența unui deficit bugetar ajustat ciclic echilibrat sau în surplus va permite țărilor membre să facă față fluctuațiilor ciclice normale fără a depăși nivelul de referință de 3 la sută din produsul intern brut al deficitului bugetar.

România a avut stabilit pentru 2003 un obiectiv al deficitului bugetar de 2,65 la sută din produsul intern brut. Acest nivel este relativ redus atât din perspectiva criteriului privind deficitul bugetar stabilit prin Tratatul de bază al Comunității Europene cât și dintr-o perspectivă comparată cu celelalte țări mai avansate din punct de vedere al procesului de tranziție. Astfel, conform proiecțiilor guvernamentale, Cehia are ca obiectiv atingerea unui deficit bugetar de 6 la sută din produsul intern brut în 2003, Ungaria are 4,5 la sută din produsul intern brut iar Polonia are 3,7 la sută din produsul intern brut. Reducerea mult mai pronunțată a deficitului bugetar efectiv în România comparativ cu celelalte state candidate s-a datorat necesității diminuării ratei inflației în condițiile în care deficitul cvasi-fiscal s-a menținut la niveluri ridicate ca urmare a ritmului mai scăzut dintr-o perspectivă comparată al reformelor structurale. Astfel deficitul cvasi-fiscal din sectorul energetic a fost de aproape 2,7 la sută din produsul intern brut în anul 2002. Chiar dacă s-au

făcut progrese considerabile în reducerea acestuia față de anul 2000 când acest deficit s-a cifrat la aproximativ 4,9 la sută din produsul intern brut, nivelul înregistrat în anul 2002 este încă foarte mare și necesită o diminuare suplimentară.

Ținând cont că avem deja un nivel redus al veniturilor publice ca raport în produsul intern brut, o scădere suplimentară a deficitului bugetar în 2004 fără o îmbunătățire sensibilă a ratei colectării va conduce la o reducere a cheltuielilor publice cu consecințe negative asupra infrastructurii instituționale, umane și de capital a țării.

În consecință cred că efortul de ajustare suplimentar necesar susținerii procesului de scădere a inflației la un nivel sub 10 la sută începând cu 2004 trebuie făcut într-o măsură din ce în ce mai mare de către sectorul real prin îmbunătățirea disciplinei salariale și financiare, reducerea pierderilor și îmbunătățirea performanțelor economice la nivel microeconomic.

România are la ora actuală următoarele trei probleme majore: sistemul de pensii, ineficiența structurală a marilor întreprinderi de stat și pierderile acumulate în domeniul utilităților, și existența unui sector agricol supradimensionat.

- 1) Restructurarea marilor întreprinderi de stat și a utilităților va implica costuri substanțiale pentru bugetul public. Aceste întreprinderi au reușit în ultimii ani să relaxeze în mod constant constrângerile bugetare prin neplata datoriilor către bugetul general consolidat al statului și prin neplata datoriilor față de utilități. În acest context se impune întărirea constrângerilor bugetare și accelerarea procesului de restructurare și privatizare la nivel microeconomic. În

cazul întreprinderilor mari care implică existența unor externalități semnificative, guvernul va trebui să suporte costuri relativ ridicate pe termen scurt asociate procesului de restructurare. Aceste costuri vor fi predominant asociate cu plata ajutoarelor de șomaj și a salariilor compensatorii cu scopul asigurării protecției sociale a forței de muncă disponibilizate. De asemenea, o parte din costuri vor fi asociate și cu lichidarea unor societăți, conservarea unor active sau ecologizarea și protecția mediului înconjurător. Eliberarea resurselor de capital și de forță de muncă și realocarea lor către sectoare profitabile și cu productivitate mai ridicată va conduce la obținerea cu siguranță a unor beneficii consistente pe termen mediu și lung. La ora actuală, România are probleme substanțiale în sectorul energetic și minier. În plus, există un număr relativ ridicat de întreprinderi mari de stat fără șanse de privatizare care vor trebui lichidate.

2) Gradul de mărime diferit al sectorului agricol nu a avut până acum o influență directă asupra ratei de creștere economică și asupra vitezei procesului de convergență reală a diferitelor țări angajate în procesul de tranziție. Legătura între mărimea inițială a sectorului agricol, viteza procesului de ajustare structurală și gradul de dezvoltare economică în ansamblu s-a dovedit nesistematic în a doua jumătate a anilor '90. Cu toate acestea, dintr-o perspectivă a dezvoltării economice pe termen mediu și lung, nivelurile diferite ale sectorului agricol pot reprezenta surse potențiale de creștere ale productivității și de accelerare a procesului de convergență reală. Spre exemplu, România are aproximativ 43 la sută din forța de muncă situată în mediul rural și cu toate acestea sectorul agricol a contribuit cu numai 13 la sută la realizarea produsului intern brut în anul 2000.

Țara	Valoarea adăugată (% din PIB)		Angajare (% din total forța de muncă)	
	1996	2000	1996	2000
Bulgaria	15,4	14,5	10,1	8,3
Cehia	4,8	3,9	6,1	5,1
Polonia	6,4	3,3	22,1	18,8
<b>România</b>	<b>20,1</b>	<b>12,6</b>	<b>38</b>	<b>42,8</b>
Ungaria	6,6	4,8	8,3	6,5
Estonia	8,4	6,3	10,1	7,4
Slovacia	4,4	4,5	10,2	9,9

Sursa: Comisia Europeană

Se observă că România este singura țară unde ponderea ocupării în agricultură a avut o tendință crescătoare până în anul 2000. Chiar dacă ponderea populației care trăiește

prezent. Sistemul este responsabil pentru o mare parte din cheltuielile bugetului consolidat, având o medie de 7,2% din PIB între anii 1995 și 2001.

Tabel. Performanțele financiare a sistemului de pensii, 1995-2001 (% din PIB)

	Venituri	Pensii de stat	Pensii agricole	Beneficii pe termen scurt	Altele	Excedent/Deficit
1995	6,1	5,9	0,4	0,4	0,1	-0,8
1996	5,8	5,8	0,5	0,4	0,1	-1,1
1997	5,0	5,2	0,6	0,4	0,1	-1,3
1998	5,5	5,9	0,6	0,5	0,1	-1,6
1999	6,0	6,1	0,5	0,5	0,1	-1,2
2000	6,8	6,4	0,5	0,5	0,1	-0,8
2001	6,6	6,1	0,5	0,4	0,2	-0,6

#### Sursa: Programul Economic de Preaderare, 2002

în mediul rural a scăzut la aproximativ 35 la sută în 2003, România are încă un nivel extrem de ridicat, iar realocarea acestei forțe de muncă va necesita creșterea resurselor publice și private cu scopul creșterii investițiilor și creării unor noi locuri de muncă alternative cu o productivitate mai ridicată. În acest context corelarea resurselor (atât publice cât și europene) și prioritizarea investițiilor în infrastructura locală de apă, canalizare, drumuri, distribuție de gaze și telecomunicații devine esențială cu scopul creării condițiilor necesare dezvoltării întreprinderilor mici și mijlocii care să absoarbă această forță de muncă. În plus, trebuie subliniată și necesitatea alocării unor resurse suplimentare în domeniul sănătății și educației în mediul rural care să conducă la o îmbunătățire a calității factorului uman.

### 3) Sistemul de pensii

Sistemul de pensii în România asistă aproximativ 6,2 milioane de beneficiari în

Unul dintre motivele principale ale creșterii deficitelor sistemului de pensii a fost creșterea rapidă a numărului de beneficiari în perioada timpurie a anilor '90. Între anii 1990 și 2002 numărul beneficiarilor sistemului public de pensii a crescut de la 3,4 la 6,2 milioane.

În același timp numărul contribuabililor la sistemul de pensii a scăzut de la 8,2 milioane în 1989 la 6,2 milioane în 1995 această tendință menținându-se în continuare în 2000 când numărul contribuabililor a fost de numai 4,5 milioane.

Creșterea numărului de pensionari asociată cu descreșterea numărului de contribuabili a condus la descreșterea valorii reale a pensiilor. Rata de înlocuire reală netă a scăzut de la 51% în anul 1990 la 47% în anul 2001.

Această deteriorare a ratei de dependență a sistemului a avut consecințe negative asupra stabilității financiare a sistemului de pensii. Una dintre soluțiile

implementate pentru menținerea deficitului sistemului sub control a fost creșterea ratei de taxare la contribuțiile de asigurări sociale. La ora actuală rata de taxare la contribuțiile de asigurări sociale este extrem de ridicată. Cumulat pentru angajat și angajator, rata de taxare la fondul de pensii este de 34%. Aceste rate de taxare ridicate au condus la creșterea costurilor cu forța de muncă și au avut consecințe negative asupra angajării în sectorul formal reducând baza de impozitare. Problemele au fost amplificate de incertitudinea legată de beneficiile viitoare și de gradul ridicat de discreție exercitată în managementul sistemului ceea ce a diminuat încrederea contribuabililor.

Conform noilor reglementări ale legii sistemului de pensii (Legea 19/2000), reforma parametrică constă în promovarea următoarelor măsuri:

- creșterea vârstei de pensionare (creșterea imediată a vârstei de pensionare de la 55 la 57 pentru femei și de la 60 la 62 pentru bărbați, și o creștere graduală ulterioară de la 62 la 65 de ani eșalonată până în 2014)
- o extindere a bazei de impozitare cu scopul de a cuprinde toate categoriile profesionale
- o nouă formulă de calcul a beneficiilor, bazată pe un sistem de puncte, care ia în considerare întreaga istorie a contribuțiilor
- o raționalizare a ocupațiilor speciale și hazarduoase care beneficiau de pensionare anticipată
- introducerea unor penalități pentru evitarea pensionării timpurii.

Noile reglementări trebuiau să corecteze dezechilibrele acumulate în sistem, iar pilonul public de pensii era

planificat să se echilibreze până în anul 2005 și să mențină până în anul 2015 excedente modeste, presupunând că este aplicată valoarea minimă a punctului definit de legislație (38,5 procente din salariul mediu brut) și că indexarea se va realiza la indicele inflației. După acest an, deficitele vor reapărea și vor atinge 3 la sută din produsul intern brut în 2040.

Anumite probleme din punct de vedere al implementării Legii 19/2000 au apărut în 2001 și 2002. Aceste probleme sunt următoarele:

- amendarea legislației și creșterea valorii maxime a punctului la 50 de procente din salariul mediu brut (de la 45 la sută cât era la momentul inițial planificat)
- o reducere a penalităților care sunt aplicate în cazul neplătii contribuțiilor
- adoptarea unui plan de recorelare a pensiilor, adresat persoanelor pensionate înainte de 1998 care a condus la o creștere a cheltuielilor cu pensiile estimate până la un procent din produsul intern brut în 2005, erodând astfel poziția de echilibru pe care ar fi atins-o sistemul între 2005-2015.

Drept rezultat recenta reformă a sistemului public nu a rezolvat problema fiind nevoie de implementarea unor măsuri suplimentare. În acest sens este nevoie de introducerea pilonului doi și trei cu scopul diversificării plasamentelor și minimizării riscurilor asociate, asigurării unei rate de randament adecvate și îmbunătățirii sustenabilității pe termen mediu și lung a sistemului.

Rezolvarea acestor probleme implică alocarea unor resurse bugetare suplimentare și creșterea cheltuielilor publice. De asemenea, resurse

suplimentare trebuie alocate în domeniul educației, protecției mediului înconjurător și îmbunătățirii infrastructurii.

În plus, întărirea capacității administrative și implementarea acquisului comunitar și atingerea obiectivelor majore de politică externă pe care ni le-am propus vor necesita realizarea unor cheltuieli bugetare suplimentare.

La ora actuală nivelul cheltuielilor publice realizate în România este relativ scăzut. Așa cum rezultă din tabelul de mai jos, dintr-o perspectivă comparată România a realizat în ultimii ani cheltuieli publice în medie de aproximativ 34 la sută din produsul intern brut în condițiile în care majoritatea celorlalte state candidate din Europa Centrală și de Est au realizat cheltuieli publice de peste 40 la sută din produsul intern brut. În ultimii ani tendința scăderii cheltuielilor publice ca raport în produsul intern brut s-a menținut.

România. Dintr-o perspectivă comparată așa cum rezultă din tabelul de mai jos cheltuielile pentru sănătate s-au cifrat la 4,4 la sută din produsul intern brut în Ungaria, la 6,6 la sută din produsul intern brut în Cehia și la 4,5 la sută din produsul intern brut în Polonia.

În plus reformele majore din domeniul sănătății care au fost implementate în 1998 nu au reușit să reorienteze resursele de la tratamentul secundar specializat către sectorul de tratament primar. Așa cum rezultă din tabelul de mai jos peste 70 la sută din resursele alocate în domeniul sănătății continuă să fie cheltuite de către spitale.

Se observă în mod evident că resursele alocate medicinei preventive și tratamentului primar (doctorii de familie) au cunoscut o diminuare lucrărilor, fapt care ridică semne serioase de întrebare cu privire la eficiența procesului de reformă

**Evoluția cheltuielilor publice ca raport în produsul intern brut**

	1995	1996	1997	1998	1999	2000
Ungaria	52,3	48,5	49	47,6	47,2	46,2
Polonia	45,3	45,1	45,3	43,3	43,3	42,7
Cehia	43	42,2	41,7	41	42,2	44,3
Bulgaria	44	51,3	36,3	36,1	39,1	42
România	34,7	33,8	33,6	34,8	35,1	35,5
Slovenia	43,2	42,4	43,3	43,8	44,3	44,2
Medie Europa Centrală și de Est	41,5	41,9	40	40,5	41,3	40,6
Medie UE	51,4	51,1	49,4	48,4	47,9	45,8
Medie de țările coeziune	45	43,7	42,3	41,5	41,8	40,7
Medie OECD	44,4	43,8	42,5	42,1	41,8	40,6

Sursa: Expenditure policies towards EU accession: A World Bank Regional Study by Bernard Funck

Dintr-o perspectivă comparată România a investit resurse mult mai scăzute în domenii sensibile ca educația, sănătatea sau infrastructura.

Astfel, cheltuielile medii pentru sănătate s-au cifrat între 1995 și 2000 la 3,1 la sută din produsul intern brut în

din domeniul sănătății. În consecință se impune cu prioritate o reformă a spitalelor cu scopul realocării resurselor către tratamentul primar și medicina preventivă. În plus este nevoie de o creștere a resurselor alocate în domeniul sănătății cu scopul asigurării unei calități

Pondere în totalul cheltuielilor alocate sănătății(%)

Categoriile de cheltuieli	1999	2000	2001
Medicina primara	13	12	10
Medicina ambulatorie	14	19	18
Spitale	70	68	67
Alte categorii	3	2	5
Cheltuieli totale	100	100	100

Sursa: Public expenditure review Banca Mondiala

corespunzătoare a serviciilor medicale.

În plus, cheltuielile medii pentru educație între 1995 și 2000 s-au cifrat la 3,3 la sută din Produsul Intern Brut în timp ce, în același interval de timp, aceste cheltuieli s-au cifrat la 4,8 la sută din produsul intern brut în Ungaria, 4,6 la sută din produsul intern brut în Cehia și 5,6 la sută din produsul intern brut în Polonia.

Tabel: Evoluția cheltuielilor bugetare în domeniile sănătății, educației și infrastructurii (procent din produsul intern brut)

Țară	Educație (1995-2000)	Sănătate (1995-2000)	Investiții (1999)
Bulgaria	4	3,6	4,5
Slovacia	4,2	3,9	n.a
Cehia	4,6	4,3	6,2
Ungaria	4,8	4,4	5,9
Slovenia	5,6	4,5	5,1
Polonia	5,6	5,7	3,8
Lituania	5,7	5,7	5,8
Letonia	5,7	6,6	5,1
Estonia	6,5	7,4	5
<b>România</b>	<b>3,3</b>	<b>3,1</b>	<b>2,8</b>

Sursa: Expenditure policies towards EU accession: A World Bank Regional Study by Bernard Funck

De asemenea este nevoie de o reformă calitativă a sistemului în următoarele direcții:

- nivelul de educație secundară care trebuie să asigure mai degrabă abilități generice pentru câteva familii de specializări decât cunoștințe extrem de specifice pentru domenii de activitate relativ limitate
- educația vocațională care ar trebui să pună un accent mai ridicat pe

dezvoltarea unor abilități de rezolvare a problemelor, de comunicare și de lucru în echipă și care ar trebui să dea o importanță mai scăzută abilităților specifice locului de muncă

- educația universitară ar trebui să fie dezvoltată substanțial și să devină mai flexibilă din punct de vedere al accesului. De asemenea trebuie îmbunătățite posibilitățile de transfer între

programe și facultăți diferite iar stimulentele pentru obținerea unei performanțe mai bune atât din partea studenților cât și a facultăților trebuie îmbunătățite

- cadrul fiscal și legal trebuie îmbunătățit pentru a oferi angajatorilor un mediu adecvat cu scopul dezvoltării pentru angajați a unor programe de învățare pe termen lung care să le îmbunătățească

abilitățile necesare și să le crească mobilitatea pe plan local și global.

Este evident că accelerarea procesului de convergență reală și creșterea nivelului produsului intern brut potențial nu poate fi realizată fără alocarea unor resurse bugetare adiționale în astfel de domenii.

Există doi factori majori care explică nivelul relativ scăzut dintr-o perspectivă comparată al cheltuielilor realizate în domeniile mai sus menționate. România are un nivel mai scăzut atât al veniturilor bugetare ca raport în Produsul Intern Brut cât și al deficitului bugetar efectiv în condițiile în care deficitul quasi-fiscale s-au menținut la niveluri ridicate ca rezultat al ritmului mai scăzut al reformelor structurale.

### Veniturile bugetare

La ora actuală așa cum rezultă și din tabelul de mai jos, România are un nivel scăzut al veniturilor bugetare.

Venituri bugetare comparate(% din Produsul Intern Brut)

	1997	1998	1999	2000
România	30,3	331,7	33,2	31,5
Poland	42,8	41,5	41,4	41,6
Czech Republic	40,2	39,1	40	40,3
Hungary	45	44,9	44,8	45,2

Sursa: IMF Country Report

Există patru factori care explică nivelul redus al veniturilor bugetare colectate de-a lungul ultimilor ani. În primul rând slaba colectare a impozitelor și taxelor a fost determinată de ineficiența administrației fiscale, cu efect în creșterea arrieratelor. Al doilea factor a fost reprezentat de exceptările și scutițiile de impozite și taxe acordate pentru încurajarea investițiilor care au diminuat baza de impozitare și de asemenea au condus la realizarea unor presiuni suplimentare pentru menținerea și extinderea facilităților. Al treilea factor a

fost reprezentat de anularea și reeșalonarea impozitelor și taxelor care au condus la apariția și dezvoltarea unor comportamente caracterizate de hazard moral și au determinat creșterea înclinației agenților economici de a ignora plata impozitelor și taxelor curente. Al patrulea factor a fost determinat de existența unei rate de taxare ridicate la contribuțiile la asigurările sociale care s-au situat pe panta negativă a curbei Laffer încurajând evaziunea fiscală.

1) La ora actuală este în curs de implementare un proces de reformă în ansamblu a administrației fiscale. Un prim obiectiv al acestui proces a fost deja atins prin crearea unei unități pentru contribuabilii mari care este deja funcțională în București. Următorii pași ai acestui proces constau în crearea unei administrații fiscale semiautonomie care să permită o îmbunătățire a serviciilor de

asistență fiscală către contribuabili și să conducă la o creștere a gradului de conformare voluntară a contribuabililor. În plus, acest proces de reformă implică unificarea colectării, controlului și executării silite a contribuțiilor la asigurările sociale (pensii, sănătate și șomaj) și integrarea acestora în cadrul administrației fiscale.

Trebuie menționat însă că acest proces de reformă a administrației fiscale nu va conduce la o îmbunătățire a colectării și la

o întărire a constrângerilor bugetare dacă nu este însoțit de o reformă radicală a mecanismului de faliment și de o creștere a sprijinului politic necesar implementării unor măsuri care să implice ieșirea de pe piață a agenților economici ineficienți din punct de vedere structural.

2) România are o bază de impozitare mai redusă decât celelalte state candidate. Principalii factori care explică această situație sunt existența unui sector agricol supradimensionat și numeroasele facilități și exceptări de la plata impozitelor și taxelor.

Acum doi ani a fost adoptată noua legislație în domeniul taxei pe valoarea adăugată și a impozitului pe profit eliminându-se o parte semnificativă din exceptările și scutirile de la plata impozitelor și taxelor. Efectele noii legislații au fost pozitive din punct de vedere al îmbunătățirii procesului de competiție, al ameliorării mediului de afaceri și al creșterii transparenței politicii fiscale.

În plus odată cu eliminarea posibilității de angajare pe baza de convenții civile și cu creșterea plafonului de impozitare la sistemul de pensii de la trei la cinci salarii s-a reușit extinderea bazei de impozitare și la sistemul de asigurări sociale compensând parțial pierderea de venituri rezultată din scăderea ratei de taxare asupra forței de muncă.

Este necesară continuarea acestui proces de extindere a bazei de impozitare. În acest sens se impune o accelerare a procesului de reformă în agricultură cu scopul realocării forței de muncă în domenii de ocupare alternativă și creșterii bazei de impozitare.

3) Numeroasele exceptări și scutiri de la plata impozitelor și taxelor care au fost acordate după 1990 au avut un

efect negativ asupra credibilității autorităților fiscale și au încurajat neplata impozitelor și taxelor. Aceste facilități au condus la apariția și la dezvoltarea unor comportamente caracteristice hazardului moral care s-au manifestat atât în sectorul de stat cât și în sectorul privat care a acumulat arierate din ce în mai mari către bugetul consolidat al statului. Noua legislație promovată după 2001 a reprezentat un progres față de perioada precedentă în măsura în care ștergerea majorărilor și a penalităților de întârziere nu s-a mai realizat în faza inițială a procesului de reeșalonare acestea continuând să fie menținute în contabilitatea agentului economic până la finalizarea procesului de reeșalonare. În acest interval contribuabilii sunt obligați să își plătească datoriile curente și principalul asociat stocului de datorie istorică. În cazul în care contribuabilii nu își respectă planul de reeșalonare a datoriilor fiscale nu li se acceptă ștergerea penalităților și a majorărilor de întârziere asociate evitându-se astfel posibilitatea obținerii unor împrumuturi cu dobânda zero din partea administrației fiscale. De asemenea, conform noii legislații, agenții economici care nu își respectă planul de reeșalonare intră automat în procedura de executare silită indiferent de forma de proprietate sau de mărimea acestora. Cu toate acestea, din punct de vedere al implementării noii legislații este menținut în continuare un regim

financiar dual întrucât marii contribuabili care au beneficiat de asemenea planuri de reeșalonare și nu le-au respectat nu au fost introduși în executare silită iar majorările de întârziere și penalizările au fost calculate în continuare. Este evident că trebuie luate măsuri consistente de restructurare a agenților economici mari cu scopul obținerii unui surplus operațional necesar plății impozitelor și taxelor și respectării planului de reeșalonare. În plus, chiar dacă au fost mult mai reduse ca număr în raport cu perioada precedentă, au existat tranzacții de ștergere unilaterală a stocului de datorie fiscală și a majorărilor și penalităților de întârziere cum este cazul Ordonanței 152/2001 care a implicat Termoelectrica și alte companii din sectorul energetic. Este evident că luarea unor astfel de măsuri nu fac decât să reducă eforturile de restructurare la nivel microeconomic cu consecințe negative asupra ritmului de realocare

a resurselor de forță de muncă și de capital în domenii din sectorul privat care au o productivitate mai ridicată.

- 4) România are rate de taxare statutorii comparabile sau chiar mai reduse la majoritatea impozitelor și taxelor principale în raport cu media celorlalte state candidate.

Cu toate acestea, dintr-o perspectivă comparată, există o excepție majoră reprezentată de rata de taxare la contribuțiile la asigurările sociale. Chiar dacă această rată de taxare a fost redusă cu 10,5 la sută în ultimii doi ani, se menține la un nivel ridicat dintr-o perspectivă comparată. Este nevoie de o continuare a efortului de reducere a acestei rate de taxare cu scopul diminuării înclinației agenților economici de a nu-și plăti contribuțiile și reducerii dezavantajului de competitivitate fiscală pe care îl avem cu celelalte țări candidate.

Creșterea veniturilor bugetare trebuie realizată prin promovarea unor măsuri de îmbunătățire a colectării, extindere a bazei de impozitare și reducere suplimentară a ratei de taxare la contribuțiile la asigurările sociale.

Rate de taxare și colectare comparate (2001)

TARA	TVA			Securitate socială		IVG		Impozit pe PROFIT	
	Veniturile % din PIB	Rata standard	Rata redusă	Veniturile % din PIB	Rata de contribuție	Veniturile % din PIB	Rata maximă	Veniturile % din PIB	Rata standard
BULGARIA	8,3	20	-	7,8	42,7	3,6	38	3,9	28
CEHIA	7	22	5	14,7	47,5	4,9	32	4,3	31
SLOVACIA	7,6	23	10	12,2	50,8	4,6	42	2,3	29
SLOVENIA	9,6	19	8,5	13,6	38	6,3	50	1,5	20
UNGARIA	8	25	12	13	42	6,8	40	2,1	18
POLONIA	7,3	22	7/3	9,9	45	3,2	40	1,8	30
ROMÂNIA	6,4	19	-	10,9	57	3,2	40	1,9	25

Sursa: FMI, Articolul IV Consultări

## Cadrul fiscal pe termen mediu

Pe plan european există o tendință evidentă de reducere a intervenției statului în economie prin diminuarea cheltuielilor bugetare. Această diminuare este obținută de regulă prin reducerea veniturilor bugetare ca urmare a relaxării fiscalității directe asociate în special forței de muncă.

Această tendință este evidentă și pe plan regional, majoritatea țărilor în tranziție asumându-și proiecții prin Programele Economice de Preaderare pe termen mediu și lung ușor descrescătoare ale veniturilor și cheltuielilor bugetare. Ca și în cazul statelor membre ale Uniunii Europene această diminuare a veniturilor și cheltuielilor ca raport în produsul intern brut este explicată de reducerea fiscalității directe asupra salariilor.

Spre deosebire de grupul țărilor mai sus menționate, România se află într-o situație specifică. Pe de o parte veniturile bugetare de numai 30 la sută din Produsul Intern Brut sunt mult mai reduse în raport cu veniturile bugetare ale celorlalte țări candidate care se cifrează la peste 40 la sută din produsul intern brut. Pe de altă parte, nevoia de cheltuieli bugetare suplimentare este foarte pronunțată. Este evident că trebuie să facem toate eforturile pentru creșterea veniturilor bugetare pe termen mediu și lung prin îmbunătățirea colectării, lărgirea bazei de impozitare și reducerea suplimentară a contribuțiilor la asigurările sociale.

Începând cu cea de-a doua jumătate a anului 2003, veniturile bugetare au început să înregistreze o creștere ca raport în produsul intern brut. Astfel, dacă inițial prin legea bugetului se anticipau venituri de 30 la sută din produsul intern brut, nivelul

realizat la sfârșitul anului a fost de aproximativ 30,9 la sută din produsul intern brut.

Cu toate acestea trebuie menționat că există anumite constrângeri care limitează tendința de creștere a veniturilor bugetare pe termen lung. Principalele constrângeri sunt reprezentate de existența unui sector agricol extrem de supradimensionat care are o producție orientată în marea majoritate către autoconsum și care nu este impozitată. În plus există un număr de întreprinderi mari care structural nu își pot plăti impozitele și taxele, care își finanțează necesarul de capital circulant în acest mod și care trebuie restructurate cu scopul realocării forței de muncă în domenii cu productivitate ridicată. De asemenea există un număr de întreprinderi care sunt profitabile și care nu își plătesc impozitele și taxele datorită credibilității scăzute a autorităților fiscale și existenței unor comportamente caracteristice hazardului moral.

Este evident că reforma administrației fiscale și schimbarea strategiei Guvernului prin implementarea unor măsuri de îmbunătățire a colectării vor conduce la o oarecare creștere a veniturilor bugetare. Cu toate acestea trebuie menționat că această creștere a veniturilor nu va fi suficientă nici pe departe din perspectiva efortului de reformă care trebuie făcut într-un interval atât de scurt de timp și în condițiile în care există atât de multe obiective care trebuie atinse cel puțin parțial (accelerarea reformei microeconomice, realocarea forței de muncă din agricultură, reforma sistemului de pensii și protecție socială, implementarea acquis-ului comunitar-în special cofinanțarea transferurilor de la UE și mediul înconjurător, investiții în

infrastructura, alocarea de resurse suplimentare în educație și sănătate, reforma instituțională etc).

În consecință, România se află la ora actuală într-un cerc vicios. Pe de o parte are nevoie de resurse suplimentare pentru accelerarea procesului de reformă, iar pe de altă parte nu poate crește veniturile bugetare în mod suficient datorită amânării în mod continuu a implementării reformelor și existenței unor constrângeri majore pe termen scurt și mediu. În plus, avem un nivel scăzut al deficitului bugetar și al datoriei publice reduse dintr-o perspectivă comparată.

Reducerea inflației și îmbunătățirea dezechilibrelor macroeconomice în ultimii doi ani a fost realizată în special prin îmbunătățirea corelării politicii monetare cu politica fiscală. Astfel, reducerea deficitului bugetar de la 4 la sută din Produsul Intern Brut în 2000 la numai 2,65 la sută din PIB în 2003 a condus la diminuarea excesului de cerere agregată și la susținerea procesului de reducere a dobânzilor și de dezinflație. Aspectul secundar al acestui proces de reducere a deficitului bugetar în condițiile în care veniturile bugetare nu au putut crește din cauza constrângerilor mai sus menționate existente (sector agricol supradimensionat, întreprinderi mari cu probleme structurale care nu își pot plăti impozitele și taxele în condițiile în care au deficit operațional etc) a fost reducerea cheltuielilor publice.

România a avut stabilit pentru 2003 un obiectiv al deficitului bugetar de 2,65 la sută din produsul intern brut. Acest nivel este relativ redus atât din perspectiva criteriului privind deficitul bugetar stabilit prin Tratatul de bază al Comunității Europene cât și dintr-o perspectivă

comparată cu celelalte țări mai avansate din punct de vedere al procesului de tranziție. Astfel, conform proiecțiilor guvernamentale, Cehia a avut ca obiectiv atingerea unui deficit bugetar de 6 la sută din produsul intern brut în 2003, Ungaria 4,5 la sută din Produsul Intern Brut, iar Polonia 4 la sută din Produsul Intern Brut. Reducerea mult mai pronunțată a deficitului bugetar efectiv în România comparativ cu celelalte state candidate s-a datorat necesității diminuării ratei inflației în condițiile în care deficitul cvasi-fiscal s-a menținut la niveluri ridicate ca urmare a ritmului mai scăzut dintr-o perspectivă comparată al reformelor structurale. Astfel, conform unei analize publicate de către Fondul Monetar Internațional în cadrul Articolului 4, a rezultat faptul că deficitul cvasi-fiscal numai din sectorul energetic a fost de aproape 2,7 la sută din produsul intern brut în anul 2002. Chiar dacă s-au făcut progrese considerabile în reducerea acestuia față de anul 2000 când acest deficit s-a cifrat la aproximativ 4,9 la sută din produsul intern brut, nivelul înregistrat în anul 2002 este încă foarte mare și necesită o diminuare suplimentară. În plus există arierate și în cadrul sectorului minier, al altor sectoare cu probleme structurale și din păcate chiar și în cazul sectorului public care nu este capabil să achite la timp facturile companiilor de construcții și să ramburseze taxa pe valoarea adăugată.

De fapt aceasta este problema principală a României care ne deosebește în mod radical față de celelalte state candidate. Existența unor deficite quasi-fiscale ridicate (care implică un exces de cerere agregată-cumperi și consumuri bunuri de consum și de investiții dar nu plătești- și mențin presiune suplimentară pe inflație și

deficitul de cont curent) a condus la reducerea deficitului bugetar efectiv cu scopul susținerii procesului de macrostabilizare.

În consecință, efortul de ajustare suplimentar necesar susținerii procesului de scădere a inflației la un nivel sub 10 la sută pe termen mediu trebuie făcut într-o măsură din ce în ce mai mare de către sectorul real prin îmbunătățirea disciplinei salariale și financiare, reducerea pierderilor și îmbunătățirea performanțelor la nivel microeconomic.

În condițiile în care deficitul sectorului public în sens larg este egal cu suma dintre deficitul bugetului consolidat și deficitul companiilor publice (pierderile operaționale care sunt finanțate prin acumularea de arierate), există posibilitatea creșterii deficitului bugetului consolidat cu condiția diminuării mai mult decât proporționale a deficitului quasi-fiscal (pierderile companiilor publice). Este evident că o asemenea strategie conduce la scăderea pe ansamblu a deficitului sectorului public în sens larg, diminuarea presiunii asupra cererii agregate și menținerea economiei într-un proces de dezinflație, în condițiile obținerii unui surplus de cheltuieli publice.

O astfel de strategie va permite reducerea în continuare a ratei inflației și menținerea deficitului de cont curent în limite sustenabile din punct de vedere al finanțării în condițiile în care resursele suplimentare obținute prin creșterea deficitului bugetar efectiv și a nivelului de îndatorare sunt folosite în direcția în care trebuie (pentru accelerarea procesului de reforme structurale și creșterea cheltuielilor de investiții în infrastructura fizică, umană și instituțională a țării care să permită

îmbunătățirea capacității de a face față competiției economice internaționale). De asemenea va permite o creștere a bazei de impozitare și va conduce la o creștere suplimentară a veniturilor publice. Resursele bugetare obținute atât prin creșterea bazei de impozitare și îmbunătățirea colectării cât și prin creșterea deficitului bugetar vor putea fi folosite și la atingerea celorlalte obiective economice (cofinanțarea, reforma instituțională și implementarea acquis-ului comunitar, reforma sistemului de pensii, educație, sănătate etc). O asemenea strategie va transforma actualul cerc vicios în care se află România într-un cerc virtuos.

România a trecut printr-o terapie de șoc în anii '80 când Ceaușescu a luat decizia de a plăti stocul de datorie publică într-un interval scurt de timp. Această strategie nu a făcut decât să reducă într-un mod forțat stocul de datorie publică prin limitarea consumului și amânarea unor investiții absolut necesare în infrastructura umană, de capital și instituțională a țării cu efecte extrem de negative asupra dezvoltării economice a țării.

În consecință experiența anilor '80 este utilă pentru acest moment. Dacă România nu crește deficitul bugetar și gradul de îndatorare pe termen mediu vom avea un cost de oportunitate imens dintr-o perspectivă istorică comparabil cu cel pe care l-am avut în anii '80. În condițiile în care noi făceam în acel moment eforturi disperate și absolut inutile de plată a datoriei externe, celelalte țări, mai avansate din punct de vedere al procesului de tranziție, acumulau datorii și își sporeau gradul calitativ al infrastructurii.

Atingerea artificială și prematură a criteriilor nominale de la Maastricht cu privire la deficitul bugetar și la datoria

publică are costuri de oportunitate semnificative, conduce la o încetinire a reformelor structurale și reduce viteza procesului de convergență reală.

În acest moment este nevoie de o regândire a politicii bugetare și de îmbunătățirea corelației dintre resursele de care dispunem și obiectivele pe care le avem de atins. Se impune o continuare atât a tendinței de creștere a veniturilor bugetare prin îmbunătățirea colectării, lărgirea bazei de impozitare și reducerea fiscalității cât și creșterea deficitului

bugetar și reducerea mai mult decât proporțională a pierderilor și arieratelor companiilor publice. O astfel de strategie bine aplicată va permite creșterea cheltuielilor publice și accelerarea procesului de convergență reală a economiei românești în condițiile menținerii tendinței de convergență nominală pe care economia românească a cunoscut-o în ultimii ani. În plus, trebuie îmbunătățită prioritizarea resurselor publice cu scopul atingerii obiectivelor propuse.

## SOME VIEWS ON THE EU'S CONDITIONALITY AND PRE-ACCESSION POLICIES FOR THE CENTRAL AND EASTERN EUROPEAN COUNTRIES

Oana Mocanu\*

**ABSTRACT.** *The end of the Cold War has brought to the European public attention the issue of the 'forgotten countries' of the Eastern part of Europe. After years of totalitarian regime, these countries discovered the chance to 'return to Europe', to proclaim their freedom and their commitment to the democratic values. At the same time, they were about to face the difficulties of the transition process. Immediately after 1990, the Central and Eastern European countries (CEEC) began their quest for membership of EU. By choosing to open its doors to the Central and Eastern European countries, the European Union did not mean to make the accession process an easy one. On the contrary, EU imposed far stricter conditions for accession, bringing the 'conditionality' concept to the debates around the theories of European integration. This article will review some comments on the EU's conditionality concept and on its effectiveness in support of the CEEC efforts of political and economic transformation.*

### 1. Introduction

The end of the Cold War has brought to the European public attention the issue of the 'forgotten countries' of the Eastern part of Europe. After years of totalitarian regime, these countries discovered the chance to 'return to Europe', to proclaim their freedom and their commitment to the democratic values. In the aftermath of the Iron Curtain's dissolution, the countries in Central and Eastern Europe faced probably the biggest challenge in their history: the necessity to reform, to undertake profound economic and political transformation in order to become stable, democratic states and free market economies.

These countries were about to face the difficulties of the transition process. At the same time, immediately after 1990, the Central and Eastern European countries (CEEC) began their quest for membership of

EU. The frequently stated openness of EU to all the European democracies has only encouraged the CEEC to try to become 'full members of the Club', this way confirming their European identity, their commitment to democracy and European values.

By choosing to open its doors to the Central and Eastern European countries, the European Union did not mean to make the accession process an easy one. On the contrary, EU imposed far stricter conditions for accession, bringing the 'conditionality' concept to the debates around the theories of European integration.

The purpose of this article is to explain the EU's conditionality concept and to try to briefly comment on its effectiveness in support of the CEEC efforts of political and economic transformation.

The second part of the article will look at the reasons EU had for imposing the

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conditions, will try to answer the question: why was conditionality needed in the accession process? The third part will mainly focus on the types or stages of conditionality. It will make note of the existing conditionality ever since the beginning of EU's relations with the CEEC, starting from cooperation and trade agreements, going through the Europe Agreements, the Copenhagen criteria for accession, the pre-accession policy established in Essen, the Partnerships for Accession and, finally, the negotiation process. The fourth part will try to synthesize the impact that EU's conditionality and pre-accession policies have had over the CEEC political and economic transformation process, the existing link between preparation for accession and the transition process. Brief note will be made on the link to the 'neo-colonial' question on whether EU's conditionality was more an imposition of 'alien models and values' on the CEEC, rather than a real support for their transition changes. The final part is reserved for conclusions.

## **2. Reasons for EU's Conditionality**

Before trying to explain the reasons for EU's conditionality in the accession process of the Central and Eastern European countries, it is useful to first define the concept. What is conditionality? How can it be best defined? 'Conditionality' refers to the sum of conditions that EU has imposed on the candidate states in order for them to become full members of the Union. A wide-range of conditions has been imposed on the CEEC during the last 10-12 years, at different stages of their preparation for accession to EU. These types or stages of conditionality will be further analyzed in the next part.

One can find the EU's reasons to apply this policy of conditions, if one focuses upon the concepts of diversity and asymmetry. It is a wide-known fact that this enlargement round is, in many ways, different from the previous one. One thing that makes this particular enlargement unique is the diversity of the countries involved. First of all, it is the first time that EU expands to countries with an economic development level much lower than its present Member States. These are countries in transition from a centrally planned economy to a free market system. Secondly, it is the biggest enlargement round, as far as the number of candidates is concerned. Thirdly, most of the candidates are new, fragile democracies. Not only their economy, but also their legal and administrative structures are less developed.

Enlargement of EU to the East has raised the question of increased diversity as a threat/challenge for the European Union (Amato and Batt, 1999, p.11). Some analysts expressed their concern about this 'problematic diversity' (WRR Report, 2001, p.354). Increased diversity carries the risk of immobility in the decision-making system. At the same time, this diversity can facilitate cooperation and promote further integration, it can be a source of competition, self-improvement and innovation (Zielonka and Mair, 2002, p.6-8). On the other hand, the CEEC candidates are not a uniform bloc. The diversity among the Central and Eastern European countries seems to have increased in the last decade, rather than decreased (Thornton, 2002, p.1).

All these specific features matter in the enlargement process. Analysts often argue that it was precisely for these existing differences between EU and CEEC, that the

conditionality was so necessary in the overall process of enlargement, in order to ensure a smoother integration of the new member states.

Adding to the difficulties of the transition process, the necessity to adopt and implement the full *acquis communautaire* prior to accession makes the whole preparation for accession even more troublesome for the candidate states. One has to take into account the volume of EU legislation that the new member states have to adopt, which is more extensive than in previous enlargement rounds, now including also the enhanced Single Market regulations, the Economic and Monetary Union provisions and the Schengen *acquis* (Brenton 2002).

The question of existing asymmetries between EU and CEEC is also worth mentioning in this analysis. The existing difference between the economic and political weight gives CEEC very little bargaining power compared to EU. The two sets of countries have rather non-compatible economic infrastructure and legislation. The CEEC lack expertise and knowledge in EU law. In the field of trade relations, EU has maintained protectionism exactly in the key areas for the Central and Eastern European countries: agriculture, textiles, steel industry.

Engelbrekt (2002) argues that the most obvious EU-CEEC asymmetry is in the field of 'formal legality'. Applicants are obliged to comply with Copenhagen criteria and to adopt the whole *acquis*, instead the EU has only committed to the enlargement procedure, undertaking no legal obligation to admit one country or another. Moreover the candidate states recognize the supremacy of EC law prior to their full

membership without having the possibility to have a say in the rule-making process (Engelbrekt, 2002, p.44-45).

Two asymmetries are inevitable: first, the EU Member States hold a veto over enlargement, so they have the ultimate power to say 'no' to the accession of a particular country. Secondly, the *acquis* is a moving target, it is continuously growing and the candidates' taking up further more legislation is unavoidable (Engelbrekt, 2002, p.49).

The European Union has felt that it had to impose strict conditions on the entrance of these new Member States not only to reduce the gap between them, making easier their absorption into the Club, but also in order to preserve the gains of its existing structure.

### 3. Main Stages of EU's Conditionality

In the aftermath of the profound political changes that occurred in the Central and Eastern European countries around 1989, the European Union responded quickly to the new challenges that the East was about to encounter. The EU's first response was focused on trade and aid. The so-called 'first generation agreements', namely the trade and cooperation agreements were signed with CEEC on an individual basis and were meant to be a start for intensive trade relations, by progressively eliminating the quantitative restrictions on import of EU goods (Tsoukalis, 1997, p. 248). The European Union created then the Phare programme, initially set up for Poland and Hungary, and, then extended to all CEEC. At first, this programme was meant to give the CEEC the necessary technical assistance

in the process of economic transformation in the transition period, but later on it was extended also to the 'civil society component'.

The next stage of conditionality came along with the Europe Agreements that EU has signed with each of the Central and Eastern European countries, starting 1991. The Europe Agreements were meant to liberalize the trade with industrial goods between EU and the associated countries, with a more rapid liberalization from the EU part. These second generation agreements received two main criticisms from the Central and Eastern European countries: one regarding the association status they conferred to CEEC, not clearly linked to a future membership of EU, and the second regarding the EU's reluctance to open up its market for agricultural products, textiles, coal and steel - the most sensitive areas both for EU and for CEEC economies (Sedelmeier and Wallace 2000).

The Europe Agreements were not merely trade agreements. Important provisions were made towards a free movement of services, capital and labour and they established a general framework for political and economic cooperation.

The conditionality was reflected in the 'eligibility for a Europe Agreement, which depended upon five conditions: rule of law, human rights, a multi-party system, free and fair elections and a market economy' (Grabbe, 1999, p.11).

The next step of EU's conditionality was the set-up of the accession criteria during the Copenhagen European Council in 1993, where it was agreed that the associated countries should become members of the European Union. In order to become full members, all the candidate states have to

comply with the Copenhagen criteria, namely: to have stable institutions guaranteeing democracy, rule of law, human rights and respect for and protection of minorities; to have a functioning market economy and the capacity to cope with competitive pressures and market forces within the Union; to have the ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union. On the other hand, the European Union must have the capacity to absorb new members (European Council 1993).

Grabbe (1999, p.3) explains the dual character of the conditionality, given that conditions were set in order to 'minimize the risk of new comers becoming politically unstable and economic burdensome to the existing EU, to reassure reluctant Member States, as well as to guide CEEC applicants'.

It is the first time that EU sets political conditions for membership (first time it introduces political conditionality). Until this moment, they were considered to be implicit. This was generated by a feeling of mistrust from EU part on the real commitment of CEEC to a democratic system. 'The tougher conditionality employed in the current enlargement, compared to the previous ones suggests to candidates that they are viewed as less competent and trustworthy than the previous ones' (Fowler, 2002, p. 433).

This also created a feeling of discomfort from the CEEC part, given that the EU Member States were putting stricter conditions for the new entrants than for themselves, giving rise to the question of 'double standards' (Amato and Batt 1999).

The economic conditions imposed by the Copenhagen criteria were meant to

help the applicants prepare themselves for full membership and complying with this criterion was also meant to reduce the potential negative impact that entering the Union could have had on poorer economies, unable to face the competition within the enlarged Union.

As far as the adoption of the *acquis* is concerned, this condition is probably perceived as the most difficult one for the candidates. It was the first time in the history of enlargement that the candidates were obliged to adopt and implement the full *acquis*, prior to their accession. What made this process even more complicated was the continuously evolving character of the *acquis*: 'the *acquis communautaire* is fluid rather than fixed, and hence an unstable basis for judging the credentials of candidates, just as it is an unstable basis from which candidates are forced to judge the possible or probable implications of accession' (Wallace, 2002, p.660-661). The fact that the *acquis* is continuously growing only rendered more difficult for the candidates the compliance with 'the legislative criterion'.

On the other hand, the European Union's fears regarding the potential costs that Eastern enlargement could have on its institutions and policies is best reflected in the fourth criterion, the ability of EU to absorb new members. Grabbe (1999) explains that, in fact, 'this is a condition for enlargement, while the others are conditions for entry'. This way, enlargement depends also on whether EU considers itself capable to open up for new members.

Hillion (2002) argues that the substance of these criteria was not entirely new, but it made the accession conditions appear more institutionalized than in previous

enlargements. The application of accession conditions is stricter than before, and this is also reflected by EU's non-acceptance of opt-out clauses for the present candidates.

CEEC had to cope with evolving obligations. Madrid European Council (1995) introduced another condition for accession, namely the capacity of candidates to adjust their administrative and judicial structures.

One could ask for reasons for EU's shift from the association agreements to the offer of full membership for the candidate countries. Several analysts explain this phenomenon by the external factors, the deteriorating security environment leading to constant pressures from CEEC for a more clear commitment to their EU membership. 'Because EU could not protect itself against the spillover effects of political instability or conflict at its borders, it had to increase its engagement with the region in order to stabilize it' (Friis and Murphy, 1999, p.220).

However, the Copenhagen criteria were welcomed in the way they precised the common basic standards expected of EU Member States (Amato and Batt, 1999, p.35).

A première in the enlargement process was the EU's initiative to set up a pre-accession strategy for the candidate states. The formal launch of this strategy took place at the Essen European Council in December 1994. This strategy incorporated the Europe Agreements and Phare programme and also new elements such as: Single Market White Paper and the structured dialogue (Grabbe 1999). The Essen strategy was meant to help the applicant states better prepare for accession, aiming at free movement of industrial goods, services, capital to some extent and giving them the possibility of a

more regular schedule of dialogue with the EU's representatives through the 'structured dialogue'.

Tsoukalis (1997, p.250) defined the main elements of the 'pre-accession strategy' as: 'improved conditions of market access for the exports of the associated countries, the progressive integration of CEEC in the internal market, a reorientation of Phare programme and a reinforced and extended multilateral dialogue and a structured relationship with EU institutions'.

A very important component of the pre-accession strategy was the Single Market White Paper, approved by Cannes European Council in 1995, containing all the key legislation governing trade in goods and services in the EU's Internal Market (Grabbe 1999). Although 'not a legally binding agreement', the White Paper became an important part of EU conditionality for the candidate states, since progress in taking on the measures was judged later on by the Commission's Opinions on the applicant states (Grabbe, 1999, p.14). The White Paper set out what should be approximated as regards internal market legislation in 23 sectors (Hillion, 2002, p.415).

The White Paper and the pre-accession strategy were also seen as a 'protective strategy': the more of the *acquis* the applicants introduced before membership, the easier it would be to incorporate them as new members (Friis and Murphy, 1999, p.222).

One major step in EU's conditionality was the issue of Commission's Opinions on the progress of applicant states towards accession in 1997. The opinions were the first documents that generated the possibility of differentiation between the

applicants, according to their progress in meeting the Copenhagen Criteria. The 'enhanced pre-accession strategy' was based on the Accession Partnerships in Agenda 2000. The Accession Partnerships, elaborated by EU for each applicant country for the first time in 1998, were meant to make conditionality even stricter. These partnerships set short and medium-term priorities for policy reforms, focusing mainly on the third criterion, namely the adoption of *acquis* (Grabbe 1999).

The purpose of these partnerships is to make sure that the Phare assistance is directed specifically towards the candidates' needs in their preparation for membership (Hillion, 2002, p.416). The Accession Partnerships also establish a control procedure and system of sanction, through a reduction or suspension of pre-accession funds. An important element is the National Programme for the Adoption of *Acquis* (NPAA) which involves applicants to specify the main laws, institutions, administrative reforms they intend to undertake in the priority areas of the Accession Partnership (Nugent, 2003, p.505).

The pre-accession conditions for this enlargement round are likely to result in less favourable negotiating terms than in previous enlargements, given that the applicants must meet all the conditions prior to their accession and the transitional periods that they negotiate are few and limited in time (Grabbe, 1999, p.24). The reluctance of EU to offer more extensive transitional periods and derogations is an important factor that testifies for the EU's conditionality in the negotiation process, as well.

#### 4. The Effectiveness of EU's Conditionality in the Economic and Political Transformation of CEEC

Analysts often argue about the effectiveness of EU's conditionality in support of CEEC efforts of political and economic transformation. Some of them tend to say that EU's conditionality was beneficial for CEEC; it gave them the right direction to become stable free market economies and strong democracies.

'EU's conditionality has two goals: to support the post-communist transformation and to guide the CEEC towards taking on the obligations of membership'. In the academic literature it is often stated that accession and transition are part of the same process, they share the same goals. However, if one takes into account the fact that EU's policies, norms and regulations were designed for the Western economies, which are quite different from the CEEC' economies, one could say that these policies were not designed for and, therefore, are not fit for the countries in transition (Grabbe 1999).

Still, both EU and CEEC have tried to maintain this link between EU accession and the transition process, as a 'means for legitimizing enlargement'. The CEEC leaders have often justified the need for reform as a compulsory condition for accession. This implies that, if reforms are successful, CEEC elites may claim responsibility for themselves, if not, they can always blame the accession goal for the necessity to undertake painful reforms, which can lead to 'a risk of disillusionment with accession' (Fowler, 2002, p. 428). On the other hand, EU might be tempted to lay the blame for the

burden of its own reform on the difficulty to absorb the new Member States, this way creating a more negative public opinion vis-à-vis enlargement within the Member States (Amato and Batt, 1999, p.11).

In the academic literature, some specialists argued that the accession conditions might have been an imposition of 'alien models and values', a form of neo-colonialism. They focused their theory on the fact that EU's Member States have vast colonial practices experiences and they tend to transform EU in 'another project of manipulating boundaries' (Borocz and Kovacs, 2001, p.8). Despite that, one should bear in mind that the classical theories of colonialism refer to the purely exploitative relationship center-periphery, therefore this could not be applied to EU, since the applicants have chosen to join EU on a voluntary basis and since they will obtain real power in the overall EU's decision-making process once they become full Member States (Engelbrekt, 2002, p.42).

It is very difficult to measure the efficiency of EU's conditionality in the overall process of transition. Some people would agree that it was an imposition of too many and too strict conditions and they shifted the focus of CEEC from the real, profound structural transformations that transition implies to the obligation to rapidly assimilate the whole EU legislation into their own.

Others argue that EU's conditionality and pre-accession policies have helped the transition process, have given a more precise direction for the changes to be done and have rendered smoother the whole process of becoming a free market economy.

One can mention at least two benefits that CEEC had obtained in the pre-accession period: one is the improvement of the investment climate, given the prospect of accession, and the other is the permanent increase of exports to European Union, which proved to be a real driver for growth (Baldwin et al. 1997).

Somehow, 'conditionality challenges the notion that post-communist reforms and preparations for EU membership are synonymous, since it implies that the reforms in question might not otherwise be implemented' (Fowler, 2002, p.431).

Some of the candidate states have done quite well in their way to reform. Avery (1998) argues that the prospect of EU membership has been the best incentive to CEEC to persevere economic and political transformation, though painful, in some cases. Mayhew (1998, p.368) also considers that without conditionality, there would have been no real incentive for the associated countries to pursue reform.

The CEEC have felt not only discriminated by the EU's imposition of so many new burdensome conditions for their accession, but also discontented with EU's reluctance to liberalize trade in sensitive areas, keeping restrictions on movement of workers and, more general, failure to undertake institutional reform in order to be able to accommodate the new members and to be able to cope with the new challenges (Barysch and Grabbe, 2002, p. 24). Candidates are also interested in the successful reform of the European Union, since they will not join Economic and Monetary Union but after at least two years after accession and they will be allowed to join the Schengen area only when the other EU members are satisfied with their ability

to control their borders with third countries. Thus, conditionality will carry on, even after accession (Barysch and Grabbe, 2002).

In addition, the Commission is planning to introduce a new and tougher monitoring system for Romania and Bulgaria, the two countries that did not join the EU in 2004. This system is giving the EU the possibility to delay accession for a year "if commitments undertaken during membership negotiations are not properly implemented". Another sample of EU's conditionality, this system is meant to ensure that reforms will carry on in these two countries in the period between signing the Accession treaty and the actual accession to EU.

## 5. Conclusions

It is difficult to affirm that EU's conditionality was more of a burden for the CEEC than an incentive for reforms. If one thinks of the variety of conditions that EU imposed on the candidate countries for their accession, one might think of them as a burden. Some analysts say that it could have been better to let these countries do the reforms their own way, to focus more on developing their economies at their own pace rather than assimilating the whole *acquis communautaire* in such a short time.

On the other hand, if one takes the time to look at the statistics, it is obvious that all the CEEC have developed their economies in the last decade. The prospect of accession was, in many ways, the strongest incentive they had for undertaking severe and painful reforms. The investment climate has improved considerably in these countries, the prospect of EU accession giving only positive feedback to foreign investors. The

trade relations that CEEC developed with the EU had a major contribution to their general economic growth.

Taking all these into account, one could conclude that the European Union's conditionality proved to be more of a stimulus for reform and economic development in the candidate countries, rather than an obstacle.

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## CHIRAC'S GAULLISM - WHY FRANCE HAS BECOME THE DRIVING FORCE BEHIND THE EFFORT TO BUILD AN AUTONOMOUS EUROPEAN DEFENCE

Marcel H. Van Herpen\*

**ABSTRACT.** *The author analyses Chirac's European defence policy and how it fits into the Gaullist tradition. He starts by sketching the original Gaullism of General De Gaulle which is based on four pillars: a national industrial policy, an independent foreign policy, the possession of a French nuclear deterrent and the ambition to build an independent European defence. His efforts in the last realm, however, are blocked by the US and its European NATO allies. In the Non-Gaullist Interregnum between 1974-1995 President Giscard d'Estaing jeopardised the Gaullist legacy, but President François Mitterrand became - against all expectations - a 'Socialist Gaullist' and it was he who realised one of De Gaulle's objectives by creating the Eurocorps. His successor, Jacques Chirac has conducted a highly volatile European policy. The author distinguishes no less than six different and often contradictory phases in Chirac's European defence policy. Despite the failures, some successes, however, have been booked, especially after the Saint-Malo Summit with Tony Blair. But much will depend in the coming years on how Chirac will succeed his balancing act between the EU-25, the French-German tandem and the 'Big Three'.*

### Introduction

During the stand-off on Iraq between France and the United States many commentators have drawn a parallel between President Chirac and his predecessor General De Gaulle. As De Gaulle before him, Jacques Chirac would have been driven by hidden anti-American feelings, which would have induced him to conduct an anti-US foreign policy. But was De Gaulle anti-American? De Gaulle's son, admiral Philippe De Gaulle, wrote in a recent book on his father:

„Why have they wanted him to be anti-American? He often said: 'Does it mean not to like the Americans when one thinks that they don't have to decide for France? Does it mean to dislike them when one says that what they decide without us is not always good for France?'" (1)

In the same way, Chirac wrote, twenty-five years ago, that 'our alliance with the United States' was not only 'fundamental', but also 'beyond all criticism'. „But the alliance," he continued, „is one thing, subordination is another. The United States tends to exercise a hegemonic power (...). It is not a question of attacking them, but only of confronting them, if necessary, with a friendly and firm refusal." (2)

Jacques Chirac considers himself to be the contemporary heir of the Gaullist legacy. To understand Chirac's policies one should, therefore, go back to De Gaulle and have a closer look at the basic principles of his doctrine. What are these principles and how did they influence De Gaulle's defence and foreign policy? And how did they influence non-Gaullist presidents as Valéry Giscard d'Estaing and

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François Mitterrand? Finally, we will turn to Chirac and analyse the six different phases of his security and defence policy. Chirac is known to be a volatile, impulsive and populist politician. There are big differences of temperament and character between him and the General. In how far can he be considered a genuine Gaullist?

### I. What is Gaullism?

Let us start with the first question. What exactly is Gaullism? Gaullism has many aspects, but there is one basic aspect without which Gaullism loses its sense. This basic aspect is a *deep belief in a specific historical role of France*.

France is not just a country, but it stands out among the other sovereign nations. This specific role of France is not so much due to the fact that it is one of the oldest independent nation-states in the world, nor that it is an established democracy, or that it is one of the five or six richest industrial countries in the world - although all these factors certainly help. Its unique position is especially due to the fact that France *is a carrier of universal values*. France is a country with a mission. It has a historical role, a *destin* (destiny), which is to share its values with other peoples and nations. The slogans of the French Revolutions: *liberté, égalité, fraternité* were not only meant for French citizens, they were meant for all people, citizens of Europe and beyond. This idea of a French mission is a core belief in Gaullism. We find it also back in Chirac's writings, when he speaks of '*la mission*' and '*la grandeur*' of the French people and of France's 'eternal need of universality' (3)

In order to play this universal role France needed, according to De Gaulle, three things:

- a strong, unified executive
- to be fully sovereign
- to create new vehicles of power in the post-colonial era

The Fourth Republic with its weak, 'Italian-style' coalition governments was in De Gaulle's eyes totally inappropriate for the leading role France had to play in the world. For this reason, immediately after his comeback in 1958, he introduced a new constitution that gave supreme powers to a directly elected President. He also stressed France's sovereignty through an independent foreign policy vis-à-vis the two superpowers, and immediately started to create new vehicles of power. In a period in which France had just lost Algeria after a bloody colonial war, this was of extreme importance.

### Building New Vehicles of Power

What were the new vehicles of power, as conceived by De Gaulle? These were fourfold:

- an independent 'national' industrial policy
- an independent foreign policy
- an independent national nuclear deterrent: *the force de frappe*
- Europe

### A National Industrial Policy

After a more liberal beginning, a more Colbertist, protectionist national industrial policy was developed in the second half of De Gaulle's Presidency, when, after the takeover of Simca by Chrysler, it became clear that France's industry could become an easy prey for investors from the United States. In 1967 De Gaulle's government, led by Prime Minister Georges Pompidou, introduced investment controls that gave

the Ministry of Economy and Finance two months to forbid foreign investments. (4)

### ***The Philosophical Foundations of De Gaulle's Foreign Policy***

De Gaulle's second vehicle of power was an independent foreign policy. But to understand the role which De Gaulle attributed to foreign policy as an instrument of national power, we first need to look at the philosophical foundations of his worldview. These foundations were fourfold:

- the international actors are the nation-states
- the nation-states are led by self-interest and are in permanent competition for power
- a sceptical view of the role of international law and international organizations. International organizations - the UN included - are artificial 'constructs'
- nation-states act on the basis of geopolitical interests which are permanent and are not affected by changing ideologies. Ideologies are only temporary epiphenomena.

De Gaulle's worldview was deeply rooted in an almost Hobbesian, geopolitical *realism*. It is not difficult to recognise similarities with the thinking of Henry Kissinger. With him De Gaulle shared not only a distrust of idealist world visions, but also a deep *historical* understanding of the political realities of his time. The only viable actors in the international arena were for him the nation-states. The UN, therefore, was a mere 'construct', as were ideologically defined states, such as the German Democratic Republic and the Soviet Union. Behind the temporary and

ephemeral communist ideology of these states loomed the real actors: 'eternal' Russia and 'eternal' Germany. De Gaulle died in 1970. It took only twenty years until history seemed to confirm his worldview. Communism was dead, as were the GDR and the Soviet Union, but 'eternal' Germany - stronger after reunification - and 'eternal' Russia - weakened after the disintegration of the Soviet empire - were still on the world stage.

The only illogical element in his 'Kissingerian' realist world view is the special role he assigned to France, assigning it the role of an unselfish and idealist Jeanne d'Arc in a bad, Hobbesian world that was led by self-interest. This, of course, is the most important flaw of De Gaulle's Gaullism and of Gaullism in general.

### ***De Gaulle's Foreign Policy in Practice***

In conducting his foreign policy De Gaulle was led by two basic principles:

- *the complete independence* of French foreign policy vis-à-vis the two superpowers
- French foreign policy had a *global* reach

The independence of the French position was emphasised by De Gaulle in 1966 when he left the military organisation of NATO and when in September of the same year he gave his famous Phnom Penh speech, in which he spoke out in favour of an independent and neutral Vietnam, implicitly criticising the US military intervention in this country. He provoked the Anglo-Saxon world even further, and without doubt unnecessarily, by his 'Vive le Québec Libre' speech when he visited Canada in 1967.

But his critical stance was double-edged: visiting Poland in 1967 and Romania in 1968, he incited the leaders of both countries - at that time the most independent countries in the Soviet bloc - to take an even more independent position vis-à-vis *their* hegemon, the Soviet Union.

The global reach of French foreign policy was clearly expressed by De Gaulle, when he, against the will of the US, recognised Communist China in 1964, and when he visited Mexico and ten other Latin American countries in the same year, making a diplomatic *percée* in what the US considered as its exclusive backyard. The recognition of France as a global power was (not without afterthoughts) given by the Soviet Union during De Gaulle's official visit to Moscow in June 1966, as a result of which a direct *hot line* was installed between the Kremlin and the Elysée - a privilege De Gaulle shared only with the President of the United States.

### ***The Force de Frappe***

De Gaulle knew, however, that an independent French foreign policy was not enough. In a Hobbesian world this policy could easily become void and without substance if it was not based on real power. And real power meant nuclear power. The decision to build a French nuclear force was already taken by De Gaulle's predecessors of the Fourth Republic after the Suez débâcle of 1956. But it was De Gaulle who, with great energy, started the build-up of the *force de frappe*. Unlike the UK, which received direct support from the US, the US did not want to help France realise its nuclear ambitions, because of supposed and real presence of communists in the Commissariat à l'Energie Atomique

(CEA). (5) This had two results: first that the acquisition by France of nuclear weapons was much more costly than for the UK, which was able to buy its weapons *off the shelf* in the US. Second that - unlike Britain - France was totally independent as regards the use of its deterrent.

But De Gaulle had to define a philosophy *and* a strategy for this relatively small, non-allied French deterrent.

His underlying *philosophy* may be summarised in two points:

- the force de frappe is by its nature a purely *national* deterrent. It is the ultimate means for *national* survival. No country will risk its national survival for another country. This means that a broader role for French nuclear weapons is not feasible. It means also that the US nuclear guarantee for Europe is a promise which cannot be trusted.
- the force de frappe is a *medium sized* deterrent and cannot match the huge nuclear arsenals of both superpowers. This does not, however, jeopardise its function, i.e. deterrence. Even if the French nuclear force is capable of destroying only ten big cities in the Soviet Union and a quarter of its industrial capability, then this will be sufficient to deter a Soviet attack on France. These principles of *suffisance* and of the *dissuasion du faible au fort* will remain the founding principles of the French nuclear force until today.

The French nuclear *strategy*, as it was conceived by De Gaulle, can, equally, be summarised in two points:

- The French deterrent was not directed against a preconceived

enemy. It was a deterrent against *any* enemy, whoever and wherever he was. This meant that the force de frappe should be capable to strike in *all* directions, or, in French: *tous azimuts*. (6)

- The small size of the French deterrent had a direct strategic implication: it could only play its role in a *all or nothing* strategy. A strategy of flexible response with a gradual escalation was not only beyond the financial means of the French government, it tended to undermine the role of its deterrent. The French official doctrine was, therefore, *massive retaliation*. This remained so, even after the introduction of the tactical Pluton missile. (7)

### ***Europe: A Vehicle for French Power***

Europe was De Gaulle's fourth vehicle to strengthen France's power. But, although he considered Europe vital for an enhanced role of France in the world, he still had an ambivalent attitude towards Europe. De Gaulle did not like any policy that tended to build *supra*-national institutions. Not only because such a supra-national entity would be another *machin*, an artificial construct that had nothing to do with the living reality of nations, but especially because in such a supra-national Europe, France would become some kind of a province or, at best, a federal state, which would contradict France's *vocation* to be a leading nation. De Gaulle's European policy, therefore, was based on five pillars:

- Europe is a vehicle for France's *grandeur* and leading role
- To play this role France needs to

build a partnership with Germany

- The Anglo-Saxons should be kept out of the European project
- No supranational Europe
- An intergovernmental European Defence and an intergovernmental European Foreign Policy should be built under French leadership

De Gaulle conducted this European policy with an iron consequence. In 1962 he signed with chancellor Konrad Adenauer the Elysée Treaty, a friendship treaty between the old foes France and Germany. In the same period he came forward with the Fouchet Plan which intended to make an intergovernmental Europe, run by a Council of Heads of States and Government, and which encompassed far-fledged cooperation in the field of defence and foreign affairs. When these plans were blocked by Belgium and the Netherlands, De Gaulle retaliated by vetoing in 1963 British membership of the European Community. In 1966 France left the military organisation of NATO. After having lost the first battle for an intergovernmental Europe with the demise of the Fouchet Plan, De Gaulle prepared - as a good military officer - for the next battle. This battle came in 1965, when he refused to implement articles 145 and 148 of the Rome Treaty to extend qualified majority voting to new areas, something what in his eyes came close to a creeping federalisation. He instructed his ministers to boycott the Council meetings and, finally, had his way when in the 'Luxembourg Compromise' of January 1966 unanimity of decision-making, and thereby a national veto, was maintained.

The balance sheet of De Gaulle's European policy, however, was mixed. He succeeded in building a solid partnership with Germany. He succeeded also in his purpose to give France the leading *political* role in this Franco-German tandem, leaving to Germany the role of economic leader. His two other 'successes': keeping the Brits out and stopping qualified majority voting, had more the character of Pyrrhic victories. Even a second veto in 1967 could not prevent the UK from joining in 1973 - only three years after De Gaulle's death - and QMV became a normal procedure in European decision-making.

His greatest failure, however, and it is certain that he himself has also felt this to be so, was his failure to convince his European counterparts to build a common European defence.

After the demise of the Fouchet Plan and after the French retreat from the military integrated structure of NATO, European defence had become a political *no go zone*. The partners of France were unwilling to discuss defence matters in the framework of the European Community, which, for them, was predominantly an *economic* organisation. Europe's defence was, according to them, best guaranteed under the NATO umbrella. It would take more than a decade before another French president would restart De Gaulle's dream of building a European defence, and, most strange of all, it would not be a Gaullist president, but a Socialist, someone who had been De Gaulle's most ferocious critic during the 1960s: François Mitterrand.

## II. 1974 - 1995 The Non-Gaullist interregnum

### Valéry Giscard d'Estaing: The Gaullist Legacy Endangered

After Pompidou, who only reigned five years and represented a moderate form of Gaullism, presidential power in France was exercised by non-Gaullists. First by the Centrist Valéry Giscard d'Estaing (1974-1981), then by the Socialist François Mitterrand (1981 - 1995).

Although Giscard can be placed in the 'right' camp, he was the less 'Gaullist' of these two.

With Giscard, in fact, five cracks appear in the Gaullist legacy:

- the first of these cracks appeared when the Gaullist principle of a strong, unified government was jeopardised. This happened when the first *cohabitation* took place between Centrists and Gaullists from 1974 to 1976. De Gaulle would never have imagined that a Gaullist prime minister (Jacques Chirac) would serve *under* a Centrist president (Giscard d'Estaing). Not only was the place of a Gaullist at the helm of the state, but also his power had to be undivided.
- A second crack in the Gaullist legacy appeared when under Giscard's Presidency a rapprochement took place between France and the United States. President Nixon and his National Security Adviser Henry Kissinger wanted this rapprochement. The first result was that in the Ottawa Declaration of 1974, NATO, for the first time,

openly acknowledged the positive role of the independent French nuclear deterrent. Even more surprising was the hidden support given by the US during this period for the modernisation of the French nuclear 'force de dissuasion' in the form of 'negative guidance' (8).

- A third crack appeared when under the influence of this rapprochement with the US the supreme commander of the French Army, General Méry, wrote an article in the *Revue de la Défense Nationale* of June 1976 in which he proposed to reintegrate French troops into NATO in case of conflict.
- A fourth crack appeared when the Gaullist nuclear doctrine came under fire. On 20 May 1975 President Giscard d'Estaing openly expressed his doubts concerning the first use of nuclear weapons. He proposed a doctrine of No First Use, a proposal that was heavily criticised by the 'father' of the French nuclear strategy, General Pierre Gallois, in his book *Le Renoncement* of 1977, on the grounds that it would jeopardise France's strategy *du faible au fort*.
- And, last but not least, there was the French-German nuclear flirtation of 1979 when General Buis and Alexandre Sanguinetti, who was a former president of the defence committee of the French parliament, both men close to President Giscard, wrote an article in *Le Nouvel Observateur* (9) concerning the possibility that Germany would co-finance the modernisation of the

force de frappe in exchange for a French nuclear guarantee - an idea in flagrant contradiction with the Gaullist dogma that a nuclear force could only have a *national* function.

### François Mitterrand: A Socialist Gaullist?

Mitterrand's Presidency meant a return to some of the basic principles of Gaullism. This to the great surprise of many political analysts, who had predicted that his Presidency would herald the end of the Fifth Republic. As De Gaulle had done, Mitterrand acknowledged the vital role of Europe as a vehicle of France's interests. And - as De Gaulle - he saw the importance of a strengthened European defence cooperation.

In fact one can discern three phases in Mitterrand's policy to establish a European defence cooperation:

- first, a *multilateral* phase
- followed by a *bilateral* phase
- ending in a *bilateral 'plus'* phase

The multilateral phase began in 1984, when Mitterrand proposed a 'revitalisation' of the Western European Union, at that moment a 'sleeping' organisation with a secretariat in London and a Parliamentary Assembly in Paris. The British government, however, was not very enthusiastic about an upgrading of the WEU, because it feared that it could become a rival to NATO.

Thereupon followed a bilateral phase, when on 12-13 November 1987 France and Germany took the decision to set up the French-German Brigade, a unit that was operational on 12 January 1989 and consisted of 5000 troops: with mixed, as well as with national unities.

The French-German brigade had

primarily a symbolic character. But this changed when President Mitterrand and Chancellor Helmut Kohl on 22 May 1992 in Rochelle decided to build the Eurocorps, a real army with 50 000 troops and with its headquarters in Strasbourg. The Eurocorps would be operational in 1995 and would be open for other member states.

Belgium, Luxembourg, and Spain joined this initiative. When these countries joined the bilateral phase changed its character and became a bilateral 'plus' phase.

NATO, and especially the United States, was not pleased with this initiative. The US feared that German troops could be pulled out of NATO's integrated command. Germany tried to reassure the US: the Eurocorps would not push Germany out of NATO, but would, instead, pull France closer to NATO.

On 21 January 1993 SACEUR Shalikashvili met with Lanxade and Naumann, the French and German supreme commanders. It was agreed that in case of crisis French unities could be placed under operational *command* of NATO. This was a real breakthrough: since 1966 French troops could only be placed under operational *control* (10). Operational control was only for specific missions, limited in space and time. Operational command gave more power to SACEUR and the time and space limits were less precise.

Mitterrand's Presidency had, therefore, remarkable results in the field of defence: he made a genuine start with De Gaulle's project of building a European defence - but, at the same time, he avoided alienating the United States.

One would have expected that Jacques Chirac, the next French President, who claimed - after two decades of non-Gaullist

rule - to be the only real heir of the Gaullist legacy, would build upon the foundations laid by his predecessor, but, strange enough, this was not the case.

### III. Jacques Chirac: A Volatile Gaullist

When Jacques Chirac was elected President in 1995, he was the first Gaullist President in more than twenty years. Jacques Chirac considered himself to be the legitimate heir of Charles De Gaulle. But did he have also De Gaulle's broad historical vision, his consistence and his perseverance? Before he became a President, Jacques Chirac had shown on several occasions that he was a highly volatile politician, who could suddenly change his course if confronted with an adverse public mood. He seemed less to be the man with a vision who wants to educate the public and try to explain his ideas, like De Gaulle before him, but more a follower of public opinion. An example of this populism was, when during the presidential campaign of 1995 he suddenly came up with the idea of organising a referendum on the introduction of the euro - a standpoint totally opposed to international law, because France had already committed itself to introduce the euro when it signed and ratified the Maastricht Treaty.

It is, therefore, not surprising that we find this volatility back in his policies as a President.

In the nine years Chirac has been in power we can discern at least six different phases to further his ambition to establish a European defence cooperation, and, what is more, these phases are often in open contradiction with each other.

## Chirac's Six Phases

What are these six phases?

- Phase I: Nuclear Unilateralism
- Phase II: Atlantic Multilateralism
- Phase III: Anglo-French Bilateralism
- Phase IV: EU Wide Multilateralism
- Phase V: French-German Bilateral 'Plus'
- Phase VI: The Formation of a French-German-British *Directoire*

### ***Phase I: Chirac's Nuclear Unilateralism***

When Chirac became President of France he neglected the Eurocorps. The Eurocorps was, in his eyes, the creation of his Socialist predecessor and that was a reason not to like it. Chirac did not want to continue the policies of President Mitterrand. He wanted to immediately put his stamp on the world. He did so by starting a series of nuclear tests in the open atmosphere, thereby exasperating public opinion worldwide. This *unilateral* start of a President who later claimed to be a champion of international law and of multilateralism, was, at least, a bit strange.

Confronted with a wave of international criticism, he tried to woo his European critics by coming up with a new concept: *la dissuasion concertée*, which was, in fact, a remake of the 1979 proposal of General Buis and Alexandre Sanguinetti to extend the French nuclear umbrella above France's European partners. As it was already mentioned above, this concept was in total contradiction with De Gaulle's theory that the force de frappe was a purely national deterrent.(11) This shift was all the more surprising, because President Chirac himself had fully adhered to Gallois' theory

at an earlier date, when he wrote: „...the use of thermonuclear weapons causes such tremendous destruction (...), that no country in the world seems psychologically capable to use them, except for its own survival.“ (12)

The discussion on this subject, however, was quickly dropped when Germany did not show any interest in the idea.

### ***Phase II: Atlantic Multilateralism***

An even more surprising *tournure* came immediately after Phase I, when Chirac suggested that France was prepared to reintegrate itself into military NATO structures if NATO was prepared to reorganise its command structure. France was especially interested to head the South Command which had traditionally an American commander. This *tour de force* had a certain resemblance to De Gaulle's initiative of 1958, when he proposed that the US, Britain and France would form a *directoire* in NATO - a proposal that was immediately rejected by the US and Britain. The fact is that De Gaulle's proposal came in a time when France was still an important NATO member and when the NATO headquarters were still in Fontainebleau. Chirac's proposal came after a French absence of almost thirty years and he had even less trump cards to put on the table than De Gaulle before him. We all know what happened: after a period of haggling the US was not prepared to give up the South Command in the Mediterranean, a vulnerable and strategically important region, where also the US Sixth Fleet is stationed. Jacques Chirac not only made a highly surprising *tournure*, he also played his - weak - cards badly.

### ***Phase III: Anglo-French Bilateralism with Blair in Saint-Malo***

Chirac's Atlantic adventure ended in a *déconfiture*. The way back into an influential position in NATO was blocked. His personal relationship with Chancellor Helmut Kohl was rather cool and the French-German axis seemed to be in shambles. Then he made a new - totally unexpected - move: he turned to Britain, traditionally considered by the Gaullists as the Trojan horse of the US in Europe. In a summit meeting with Tony Blair on 3-4 December 1998 in the French port of Saint-Malo both men discussed the possibility of strengthening European defence cooperation. In their five-point *Declaration on European Defence* they agreed that „the Union must have the capacity for autonomous action, backed up by credible military forces, the means to decide to use them, and the readiness to do so, in order to respond to international crises.“(13) They added that „the Union must be given appropriate structures and a capacity for analysis of situations, sources of intelligence, and a capability for relevant strategic planning, without unnecessary duplication (...).“ Immediately afterwards a debate started on the interpretation of the words *autonomous* (How autonomous? Could the EU only act after NATO refused to do so?) and *duplication* (What is unnecessary duplication? No duplication at all? Or could a certain duplication sometimes be necessary?). But this did not take away the enormous importance of this growing convergence of the visions of Britain and France in the field of defence. Saint-Malo meant a real breakthrough and was a triumph for both men, Blair and Chirac.

### ***Phase IV: EU-Wide Multilateralism***

The bilateral tête-à-tête of Saint-Malo had a multilateral follow-up. First of all the German government needed to be reassured, because the Germans, having not participated in the summit, could feel excluded. The German Chancellor was informed in the spring of 1999 by the French at the Franco-German summit in Toulouse. Shortly afterwards, in June 1999, was the EU Cologne Summit, just after the Kosovo War which had showed as never before Europe's military impotence: sixty percent of the sorties were made by the US, even eighty percent of the strike sorties. The Europeans had been almost totally dependent on US intelligence, US transport, and US communications and logistics. Not only Germany, but also the other EU partners, including the neutrals, were now a willing audience for the French-British proposals and the decision was made to incorporate the WEU (except its article V) into the EU at the end of the year 2000.

The Helsinki Summit of December 1999 took the build-up of an EU defence identity even further. A Headline Goal was formulated to build a Rapid Reaction Force of 60.000 troops, deployable within 60 days and sustainable for one year. A Capability Goal was added to improve the organisational defence infrastructure by setting up a Political and Security Committee, a EU Military Committee, and an EU Military Staff.

### ***Phase V: The End of Multilateralism: Back to French- German 'Bilateralism Plus'***

But this multilateral phase - which had, without any doubt, many positive results - ended suddenly in the summer of 2002,

when the preparations for the War in Iraq already cast their shadows. The US government became more and more suspicious of the French-inspired European defence plans. How 'autonomous' should EU's defence be? Could the EU act on its own without asking NATO first?

The Iraq War seemed for a moment to restore the old 'Gaullist' world: the UK chose the side of the US, France opposed the US-British intervention. The reemergence of the Franco-British rift meant also the end of multilateralism. The EU was divided along the lines of the French-British conflict when Germany, Belgium, and Luxembourg took the side of France, and most other EU member states, including the candidate members, took the side of the UK and the US.

On 30 April 2003, the worst possible moment, because just after the end of the War with Iraq, when US-French relations were at their deepest, France, Germany, Belgium and Luxembourg, came up with plans for a *European Security and Defence Union* with its own headquarters in Tervuren near Brussels. It meant a return of Chirac to the old French-German bilateralism, with an extension to Belgium and Luxembourg. This 'Bilateralism Plus' meant in fact that Chirac, after eight years, returned to the position of his predecessor, François Mitterrand, the creator of the 'Eurocorps'.

The three countries with which France decided to build a 'European Security and Defence Union' were not only the same countries that formed with France the so-called *camp de paix* during the Iraq crisis, they were also members of the Eurocorps. Only one Eurocorps member: Spain, was lacking, because of the pro-US stance of the Spanish Prime Minister José Maria Aznar.

### ***Phase VI: Building a European Directoire***

In the autumn of 2003 Chirac's European Policy took suddenly a new direction, when British Prime Minister Tony Blair was invited for an exclusive summit with Chirac and Schröder in Berlin on 20 September. Healing the wounds was certainly necessary after the Iraq crisis. But the meeting was not alone about mending fences: it was the beginning of a closer institutionalised cooperation between the European 'Big Three' and the other EU members reacted immediately with overt suspicion. This suspicion grew when one month later the foreign ministers of the 'Big Three' visited Tehran in an attempt to persuade the Iranian government to allow the International Atomic Energy Agency to carry out unannounced inspections of nuclear sites. This visit, proclaimed a 'success' by its initiators, was not only criticised, with reason, on *material* grounds as a new 'Munich' of three would-be Chamberlains, it was also criticised on *formal* grounds, because this initiative was in flagrant contradiction with the rules of the Common Foreign and Security Policy. Irritation of the other EU member states grew further when a new summit of the 'Big Three' was planned on 18 February 2004 to prepare for the 'economic' European Council meeting of 25-26 March. Especially the governments of Italy and Spain, two close allies of Blair, were furious to be excluded. José Maria Aznar took the initiative of the 'Letter of Six' which was sent on 17 February, one day before the summit, to the Irish President of the European Council and to Commission President Romano Prodi. In this letter the

prime ministers of Italy, Spain, Poland, the Netherlands, Portugal and Estonia expressed their concern as regards the economic performance of the EU and implicitly attacked France and Germany, that had both escaped sanctions for a repeated breach of the deficit regulations of the Stability and Growth Pact, by stressing that „sanctions must be applied in a consistent manner and on a non-discriminatory basis.“ Although the word 'directoire' was not used in this letter, it was a clear warning shot.(14)

It is, however, still an open question how this new cooperation of the 'Big Three' will develop. Will they be able to overcome their differences of interests and diverging views on the future of Europe or will their alliance only be temporary and occasional in order to defend their - common - big power interests in the debate on the European Constitution? And what exactly is France's position in this threesome? It is quite clear that a European *directoire* that includes Britain is a far cry from De Gaulle's vision of an exclusive French leadership role in Europe. As part of the French-German tandem France has always succeeded to push through its views and interests. In a trilateral group with a pro-Atlantic and free market oriented Britain this will be less evident. Maybe that is the reason why Germany seems to be more positive about the new tripartite cooperation, because it enables it to escape a bit from the tight French embrace. France, on the other hand, seems to be more cautious and might show a tendency to only reserve a role for the 'Big Three' when the Franco-German axis is in need of support.(15)

#### IV. Conclusion

In how far can one distinguish a clear red line in Chirac's European defence and security policy? We have seen that his odyssey brought him first to the atolls of Polynesia, from which he returned with the idea of the *dissuasion élargie*. An idea, however, that he dropped quickly in order to start a rapprochement to NATO, an organisation dominated by the American *hyperpuissance* and as such suspect to each self-respecting Gaullist. Being rebuked by the US, he made a next, rather surprising, overture when he started bilateral talks on European defence with Tony Blair in Saint-Malo. Strange enough this worked, not only because France and Britain had cooperated closely in the Balkan Wars, but also because Blair was the most pro-European British Prime Minister in years. The Saint-Malo summit resulted in a EU-wide multilateralism at the summits of Cologne and Helsinki. But this multilateral phase ended suddenly in the autumn of 2002 with the preparation of the war in Iraq. This war caused a deep crisis in US-French relations when the French Foreign Minister Dominique De Villepin threatened to veto a Security Council resolution and personally visited some of the African Security Council members in an attempt to actively organise an anti-American coalition in the Security Council. Even De Gaulle, in his time considered an *enfant terrible* by the Americans, would never have gone so far. On the contrary, in the international crises which took place during his Presidency (Cuba, Prague) he was one of the most steadfast allies of the US.

Locked up in 'Old Europe'during the Iraq crisis, Chirac's multilateral approach

was replaced by a new emphasis on the bilateral Franco-German axis, extended with the two other countries of the *camp de paix*: Belgium and Luxembourg. With these countries Chirac launched his project for a European Security and Defence Union.

*So at the end of the Iraq crisis, the circle was closed: Chirac arrived in 2003 where Mitterrand had ended in 1994. He concluded that his natural allies were the countries of the Eurocorps.*

But not all the countries of the Eurocorps participated in this initiative. Spain did not participate, because of the pro-US stance of Prime Minister José Maria Aznar. (Spain would, however, close ranks with France and Germany in March 2004, after the victory of the Spanish socialists under Zapatero).

The European Security and Defence Union of France with two small countries and defence free rider Germany was not credible as long as Britain was not involved. Not in the least place to save his European defence initiative from ridicule, Chirac, in the autumn of 2003, turned back to his former Saint-Malo ally in a tripartite summit in which also German chancellor Schröder participated. This was the start of a potential *Directoire*.

What steps will follow? Most probably Chirac will continue to develop a three-way approach:

- His first priority is to further strengthen the Franco-German axis.
- His second priority is to enlarge the French-German tandem with Britain into some kind of a *directoire*. The role of this Directory should, however, in French eyes, remain restricted to initiatives in the field of defence and foreign policy and to the defence of

common big power interests in the EU. When German and British positions do not coincide with French positions the Directory has no role to play. Additionally, Britain, for being granted the right to enter (from time to time) the *salon exclusif* of the French-German tandem, has to pay a price and that is to accept some kind of French leadership.

- In case Britain would take a course that is considered by France as too pro-Atlantic, there is still the third option of building a 'core' Europe with Germany, Belgium, Luxembourg, Spain and - eventually - other countries.

Like the French nuclear doctrine Chirac's European strategy can be defined as *tous azimuts*. This impulsive and volatile politician seems to move in all directions: he opens doors and closes them, and can suddenly change his tactics, his allies, and even his ideas.

But, nevertheless, his basic driving force and his central aim remain always the same and that is to develop an independent position for Europe in a multipolar world (16), based on military might, with France - and its President - in a leading position. Chirac, therefore, can certainly be called a Gaullist, be it a rather volatile and unpredictable one.

#### NOTES:

- (1) Philippe De Gaulle, „*De Gaulle mon père - Entretien avec Michel Tauriac*“, Paris 2003, p. 257 (my translation, MHvH).
- (2) Jacques Chirac, „*La lueur de l'espérance - réflexion du soir pour le matin*“, Paris, 1978, p. 224.

- (3) *ibid.*, p. 223
- (4) Serge Berstein, „*Histoire du gaullisme*“, Paris, 2002, p. 301.
- (5) The CEA was led by „Mister Curie“, Mr. Joliot-Curie, who will later be fired because of his public engagement in favour of the French Communist Party. (Cf. François Valentin, „*Regards sur la politique de défense de la France de 1958 à nos jours*“, Paris, 1995, p. 47).
- (6) The term 'tous azimuts' was coined by General Ailleret.
- (7) When the French government introduced tactical nuclear weapons in the 1970s, these were, therefore, not conceived as a weapons system of its own, between conventional and strategic weapons, but as 'pre-strategic' weapons, that were meant to give a 'warning shot' before a massive nuclear attack would be launched.
- (8) Because positive support was officially forbidden, this US support, was given in the form of 'negative guidance'. The French government, confronted with many problems in hardening missile heads, sent a list with questions to the US government. The US government thereupon answered which solutions were not adequate. Cf. Richard Ullman, „The Covert French Connection“, in: *Foreign Policy*, No. 75, Summer 1989, pp. 3-33. In the second volume of his memoirs President Giscard d'Estaing affirmed Ullman's findings (Valéry Giscard d'Estaing, *Le pouvoir et la vie*, Vol. 2, *L'Affrontement*, Paris 1991, p.179.).
- (9) „Partager l'arme nucléaire avec les Allemands,“, in: *Le Nouvel Observateur*, 20 August 1979, pp.26-28.
- (10) The NATO-France relationship was since 1966 regulated by two arrangements : Ailleret-Lemnitzer and Valentin-Ferber. In these agreements was only 'operational control' possible.
- (11) In the words of Pierre Gallois, the main theorist behind this thesis: „No government could take the risks involved in the use of arms of mass destruction if it was not for his own country.“ Pierre Gallois, *L'Europe change de maître*, Paris 1972, pp. 120-121 (My translation, MHvH).
- (12) Jacques Chirac, *La lueur de l'espérance - réflexion du soir pour le matin*, o.c., p. 214 (my translation, MHvH).
- (13) *Declaration on European Defence*, British-French Summit, St. Malo, 3-4 December, 1998, Press office of the British Embassy in Paris.
- (14) In an editorial comment the *Financial Times* of 17 February 2004 urged the 'Big Three' „to tread carefully“. „The big three would (...) be well advised to keep their energies focused on policy areas that are either half-out of the EU's remit, such as labour markets or pension and health systems, or half-formed, such as EU foreign, defence and immigration policies.“ See also André Fontaine, „Le style directoire“, *Le Monde*, 2 February 2004.
- (15) *Le Monde* of 18 February 2004 quotes 'someone close to Chirac' as

saying: „A renewed European dynamism can emerge from this trio, but the 'Franco-German' (relationship) remains for us the basis, the fundamental relationship.“

- (16) For a critique on Chirac's concept of a multipolar world, see my „France: Champion of a Multipolar World“, *In the National Interest*, Volume 2, Issue 19, 14 May, 2003, <http://www.inthe->

[nationalinterest.com/Articles/Vol2Issue19/vol2issue19vanherpenpfv.html](http://nationalinterest.com/Articles/Vol2Issue19/vol2issue19vanherpenpfv.html)

Forthcoming publication (June, 2004): „European Union Perspectives on the War on Terrorism“, in: Hall Gardner (Ed.), *NATO and the European Union - New World, New Europe, New Threats*, (Ashgate)

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sans les institutions.**

**Jean Monnet**



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