EUROPEAN EXPENDITURE

Part I

Interdepartmental policy study
European expenditure
Part I: agricultural expenditure

Budget preparation 1996 - Report nr. 1

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INTERDEPARTMENTAL POLICY STUDY
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PART I: AGRICULTURAL EXPENDITURE

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0. Executive summary

Terms of reference

The study was carried out to determine how the net position of the Netherlands could be improved and the gross payments by the Netherlands reduced by modifying the policy and financing system of the EU. It takes explicit account of the problems connected with the accession of the countries of Central and Eastern Europe. This part - Part I - deals with the Common Agricultural Policy (CAP).

The CAP

Under the CAP some agricultural products are subject to a heavy degree of market organisation, others to a light degree. In the case of the former, the instruments are export refunds and import duties, but intervention too is possible. Where the degree of market organisation is light, the support consists mainly of import duties at the border. There is also a category of products which has been greatly expanded as a result of the reform of the CAP and now constitutes approximately 50% of the CAP expenditure; here the support consists solely of direct payments. The Netherlands is relatively strongly represented in sectors where there is little if any market organisation.

GATT/WTO

The present CAP is basically compatible with the GATT Agreement. The main problems will probably occur in relation to the limit imposed on the subsidised export of dairy produce. Dutch cheese exports could be adversely affected in due course. In the case of a number of other products, the extra imports and greater difficulty in exporting may well lead to lower prices in the internal market.

Net position under the CAP

The net payments by the Netherlands under the CAP are expected to rise from approximately 0.9 billion guilders in 1995 to some 1.9 billion guilders in 1999. This is largely attributable to the control of EU expenditure in the dairy sector, as a result of which Dutch receipts are declining. A second factor is the reform of the CAP. The Netherlands receives an extremely small share of the MacSharry support (hectorage and headage payments). This support will account for almost 50% of the CAP in 1995 and will rise to around 55%.

Future round of GATT/WTO talks

A new round of GATT/WTO talks at the end of this century is expected to produce strong pressure for further liberalisation. Income support will in the future become increasingly independent of production and be channelled directly through the budget. It is expected that instruments other than non-product-tied aid will come under increasing pressure in the future.

Enlargement of the EU

Many countries in Central and Eastern Europe have a large production potential and are already producing in volume. Accession of both the Visegrad members and the other East European countries would be extremely difficult to accomplish under the CAP as its stands, on account of both the expected implementation problems in these countries and the difficulties that this would create for the present Member States. Although all of this is naturally dependent on the number of countries joining the EU, it is apparent that the budgetary consequences may be great. In addition, expansion of the CAP to include these countries could entail problems with the restrictions imposed by GATT. In the rather longer term, it would be impossible to apply a CAP in the Central and East European countries that is fundamentally different from that which is applied in the present Member States. This means that the value of transitional arrangements is limited. Accession of the Visegrad countries without policy changes is therefore unlikely.

Further reform of the CAP towards direct support

A further switch to direct support would be in keeping with the efforts of the Netherlands to achieve a highly market-oriented system. Such a switch should in any event take place within the existing budgetary framework, which means that replacement of the present policy by 100% income compensation is not possible. It follows that the level of support as such must also be reduced. Just as there are at present major differences between policy in the various sectors, varying from no market organisation to a heavy degree of market organisation, the pace at which further reforms are introduced can be geared to take account of the extent to which the dynamic effects occur in the various sectors. The accession of the Visegrad countries to the European Union would be greatly simplified if the only support provided at the European level were unrelated to production. This would ensure that the costs of accession do not in due course increase as a result of rising production. Nonetheless, the costs of accession may still be considerable.

Financial renationalisation

In a system of direct income payments, financial responsibility for the administration of policy need no longer be maintained at European level. The financing of the compensation could very well be carried out at national level. However, a regulatory framework should be maintained at the European level in order to prevent distortion of competition. Financial renationalisation would increase the cost awareness of the Member States. It would also be possible to take a more informed decision on the relative merits of support to the agricultural sector and other economic sectors. After financial renationalisation, the Visegrad countries too would themselves be responsible for supporting their agricultural sector. Under the present system, it would be no easy matter to provide a lower level of income support in the Visegrad countries than in EU Member States owing to the lower price levels in these countries in the past. This would be much easier in the case of renationalisation.

Conclusions

The spare budgetary resources available under the agricultural guideline could rise to over 7 billion ECU in 1999 if a very strict budgetary policy is pursued. However, in view of past experience of the EU, it seems likely that there will be great pressure to make use of any such resources under the guideline by altering existing policy or introducing new policy. The level of the agricultural guideline could therefore be reappraised. As an ever larger part of the agricultural expenditure is constant in nominal terms, the amounts under the agricultural guideline too could be subject to nominal limits.

Enlargement of the European Union to include the countries of Central and Eastern Europe means that expenditure on agricultural policy will increase sharply. The costs will probably be between 6.8 and 17 billion ECU, although if accession takes place at around the turn of the century they will be closer to the lower than the higher figure. In view of the spare funds that may be generated under the agriculture guideline if a very strict budgetary policy is pursued, the accession could be initially funded within the existing budgetary framework. However, this would change if the costs of accession of the Visegrad countries rise as a result of higher production, if more countries accede or if the spare funds under the agricultural guideline are exhausted. In addition, the EU would soon run up against the constraints imposed by the GATT Agreement if the new members were to accede to an unaltered CAP. Accession is therefore bound to put pressure on the CAP.

Account must also be taken of the pressure for further liberalisation caused by a new round of GATT/WTO negotiations. In the light of the above, further policy reforms seem inevitable. Greater liberalisation and direct income payments would seem to be the most probable direction of reform. This would also be in keeping with the Dutch policy of pressing for a greater degree of market orientation.

A complete switch to direct income support would greatly improve the net position of the Netherlands under the EU budget, notwithstanding the resulting loss of the benefits of the preferential trading effect. Reform of the CAP by the introduction of direct income payments accompanied by full compensation for the initial drop in income in the agricultural sector would not be possible within the limits of the agricultural guideline. Such a policy change would entail higher budget expenditure for the Netherlands. Only if the switch to a more liberal agricultural policy were to be accompanied by a reduction of the support to the agricultural sector as such would it be possible to contain the budgetary expenditure due to the policy reforms and the accession of the Visegrad countries within limits that are acceptable in terms of the EU budget and the position of the Netherlands as a net contributor.

This study, which examines the direct financial effects of certain policy decisions, does however show that the Netherlands will remain a net contributor to the CAP in all circumstances in which policy is financed at the European level. It follows not only that a generic system of net limiters is relevant in all these scenarios but also that the shifting of all or part of the financial expenditure from the EC budget to the national budgets (i.e. financial renationalisation of the CAP) would bring about an improvement in the net position of the Netherlands under the EU budget.

1. Introduction

On 14 February 1995 the Minister of Finance sent a memorandum on the net position of the Netherlands under the EC budget to the Lower House of Parliament.[1] The memorandum showed that the Netherlands, which had traditionally been a net recipient of funds from the EU, was expected to become the largest net contributor in relative terms to the EU in 1995; it also indicated that this position was expected to deteriorate further in the next few years. The change has been brought about because the nature of the present policy expenditure of the EU means that the already small Dutch share of this expenditure will decline still further, and also because the payments of the Netherlands to the EU will continue to rise.

There is also the budgetary problem caused by the future accession to the EU of the associated countries in Central and Eastern Europe. If policy remains unchanged, this accession will lead to a sharp, organic growth of the EC budget, almost all of which will have to be funded by means of extra payments by the 15 current Member States. In view of the present policy of the Union, this will either lead to a further worsening of the Netherlands' net budget position or effectively preclude the future accession of these associated countries.

The Priorities Memorandum entitled "Change and Renewal" of the Minister of Agriculture, Nature Management and Fisheries states that the aim is to achieve a greater degree of market orientation in agricultural policy and that modifications to the EU's Common Agricultural Policy are necessary in view of the accession of the countries of Central and Eastern Europe, the developments in the context of the WTO and the ongoing internationalisation of the markets in agricultural produce.

The aim of the present policy study is to examine what opportunities the Netherlands has to limit the gross payments which it makes to the Union and also to improve its net position under the EC budget by means of adjustments to both the financing system and the policy of the Union. Another subject explicitly dealt with in this study is how the financial consequences of the accession of the associated countries in Central and Eastern Europe can be scaled back to acceptable proportions.

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[1] See: Parliamentary Papers II 1994/95, 24 099, no. 1.

In Part II (other EU expenditure and general aspects), the study examines the financing system of the Union and the scope for altering the structural funds and cohesion policy. This part of the study (Part I) relates to the scope for reforming EU agricultural policy, particularly in the medium term. The Own Resources Decision (which has not yet been ratified) and the Financial Perspectives have been fixed up to and including 1999. It follows that the level of expenditure under the agricultural guideline has been largely fixed until this time.[2] The accession of the countries of Central and Eastern Europe and the consequences of a new round of GATT/WTO talks also relate to the period after 1999. It follows that there is no possibility of fundamental policy changes in the period up to and including 1999. The first reference point chosen for the present study is the agricultural guideline expected in 1999. And the second reference point is the size of the expected Dutch payments to and receipts from the Common Agricultural Policy (CAP) and hence the net position of the Netherlands under the CAP in 1999.

Section 2 gives a survey of structure of the CAP up to and including 1999, the resulting net position of the Netherlands under the CAP, and the developments that will affect the structure of the CAP in the future. A number of scenarios based on these developments are then outlined in detail in section 3. The final section - section 4 - discusses the various scenarios in the light of the expected future developments described in section 2. The study ends with some conclusions.

[2] As the budget discipline order is not limited in time, the agricultural guideline applies in principle even after 1999.

2. The Common Agricultural Policy

2.1. Introduction

The circumstances of the market to which the Common Agricultural Policy (CAP) of the European Union applies are in constant flux. For example, the Community imported many products until the early 1980s, but is now a major exporter. A feature of the changes is also that there is less and less scope for the EU to pursue policies independently. This section briefly examines the present policy frameworks, the net position of the Netherlands under the CAP and the main developments which affect the CAP. First, however, there is a brief historical review.

2.2. History

The European agricultural policy dates from 1968 when a common European market and pricing policy took effect after a transitional period of some 6 years. This replaced the existing policy of the various Member States in this field. The objectives of the CAP as laid down in Article 39 of the Treaty of Rome are to:

- increase agricultural productivity;
- ensure a fair standard of living for the agricultural community;
- stabilise agricultural markets;
- safeguard the availability of supplies;
- ensure supplies to consumers at reasonable prices.

These objectives of the policy are not always easy to reconcile with one another. This problem was exacerbated initially because all these different objectives were pursued in principle by means of a single instrument (pricing policy). Stabilising the market and guaranteeing a reasonable income proved particularly hard to reconcile. The policy developed by the EC was based on three pillars:

- unity of market and price;
- Community preference;
- common financing.

When the policy took effect in 1968, the Community was a net importer of many products. By levying duties at the border, it found a simple and relatively cheap way of ensuring that the prices on the internal market remained at the desired level. This was why pricing policy was chosen as an instrument of incomes policy. Owing to the unity of the market for agricultural

produce, however, it was necessary that this policy be pursued at EC level. The choice of pricing policy as an instrument of incomes policy therefore provided a strong boost for the development of European policy on agriculture. The main instrument employed in the structural policy for agriculture was the granting of (interest) subsidies. This meant that a European approach was much less necessary here. In this area of policy, the European influence is indeed therefore much less marked.

2.3. Current policy

2.3.1. Market organisation

The CAP is not the same for all sectors. Protection and aid is the greatest for the soil-related products. Dairy produce, cereals, beef and veal, olive oil, wine and sugar are the products for which there has been a high degree of market organisation since the CAP was established. This means that besides export refunds and (variable) import levies, intervention too is possible.

Where there is light degree of market organisation, the support mainly consists of import levies at the border. Only in certain situations does intervention occur and are export refunds granted. Limited market organisation exists in the cases of vegetables and fruit, fibre crops, tobacco, pigmeat and poultry meat. Even in this group, the extent of the aid in fact differs widely from product to product. For example, a large amount of aid is provided for tobacco, but relatively little aid is given for pigmeat and poultry meat.

In addition, there is a category of products for which the support consists solely of direct payments. This is because at the time the market organisations in question were introduced it was not possible to levy duties at the border owing to GATT. Such a system exists for sheep and goats, oilseed and protein crops. In recent years, the number of products for which direct payments have existed has grown substantially. Finally, there is a category of products for which there is no market organisation whatever. Examples are flowers (ornamental plants), potatoes and certain vegetables.

Table 2.1. gives a breakdown of the production value of the sectors among the different market organisations for the Netherlands and the EU. The total production value of European agriculture was approximately 460 billion guilders in 1992. The Netherlands' share in this is approximately 8% or some 37 billion guilders. The table clearly shows that Dutch production is relatively strongly represented in sectors where there is little if any market organisation.

	EU (%)	NL (%)
High degree of market organisation	**50**	**37**
wheat	*6*	*1*
corn	*2*	*0*
sugar beets	*2*	*2*
dairy produce	*17*	*24*
beef	*12*	*11*
wine	*6*	*0*
other	*5*	*0*
Light degree of market organisation	**39**	**37**
fruit	*5*	*1*
vegetables	*10*	*12*
pigmeat	*12*	*18*
eggs	*2*	*3*
poultrymeat	*5*	*4*
other	*5*	*0*
No market organisation	**11**	**26**
potatoes	*2*	*3*
other	*9*	*23*
Total	**100**	**100**

Table 2.1. Share of the various sectors in the total production value in the EU and in the Netherlands (1992).

2.3.2. The MacSharry reforms

The present agricultural policy in the EU is largely determined by the reforms which it underwent in 1992. As a result of these reforms, which bear the name of Mr MacSharry, the then Agriculture Commissioner, a large part of the price support for the important cereals sector (and also for oilseeds and protein crops) was converted into hectarage payments. The extent of the payments is determined by the average cereal harvests determined on a regional basis. Eligibility for payment is conditional on the setting aside of a given percentage of the arable land for which the payment is granted.

The arrangement in the livestock sectors is that the milk quotas will be maintained until 2000. The prices for beef and veal have been reduced by 15%, mainly because the costs of animal feed fell after the drop in the price of cereals. By way of compensation, a number of new

payments have been introduced and existing ones raised for livestock farmers who do not benefit from the reduction in animal feed prices. These headage payments are linked to a stocking rate and a maximum per farm. In this way, a link is established between the payments and the area farmed.

In summary, the policy consists at present of two important instruments:

- pricing policy, whereby the price which producers receive is boosted by various measures;
- direct payments to producers, often in the form of hectarage or headage payments.

In the former case consumers pay part of the costs of the policy in the form of higher prices. However, in the case of direct payments the support is channelled entirely through the budget.

2.4. Present policy framework

2.4.1. The agricultural guideline

The agricultural guideline was introduced in its present form in 1988 in order to tackle the problems of the growing expenditure on EC agriculture. This instrument indicates the annual maximum for agricultural expenditure (in fact, the expenditure on the Guarantee Section of the European Agricultural Guidance and Guarantee Fund). This ceiling is derived from the expenditure in 1988, plus the EU inflation and 74% of the real growth of GNP in the Union. Extra budgetary resources (the monetary reserve) can be claimed only in exceptional cases, for example if there is a major change in the exchange rate between the dollar and the ECU and in the case of realignments of the value of national currencies. It follows that the scope for extra expenditure is subject to a maximum.

Table 2.2. shows the agricultural guideline up to and including 1999.[3] The agricultural guideline is the reference point for this policy study. It should be noted here that, where the agricultural budget for 1996 has still been fixed on the level of the agricultural guideline, there is likely to be increasing underspending vis-à-vis the guideline from 1997 onwards. This is because the MacSharry premiums are not inflation-proofed and because the GATT commitments limit the scope for granting export refunds. In addition, the GATT commitments are recorded in nominal terms. The agricultural guideline, on the other hand, provides full inflation-proofing

[3] The figures in Financial Perspectives are based on an estimate of the real growth of EU GNP of 2.5% a year. Provision has also been made for inflation of 3% a year.

plus an increase equal to 74% of real GNP growth. In addition, it has been seen in recent years that wherever the budget was fixed by reference to the agricultural guideline, expenditure undershot the figure permitted under the guideline in the course of the agricultural year. On the other hand, experience of the agricultural policy shows that the majority of any funds that become available in this way are always largely used up by new policy or policy amendments. For example, the organisation of the markets in vegetables and fruit, wine and rice will in any event be altered. All in all, it is still unclear whether and if so to what extent spare budgetary resources will be available under the agricultural guideline in 1999.

	1995	1996	1997	1998	1999
agricultural guideline	37,9	40,8	42,9	44,9	47,1

Table 2.2. The agricultural guideline up to and including 1999 (in billions of ecu, in current prices).

2.4.2. GATT Agreement

The majority of policy instruments used in agricultural policy affect trade. For example, the use of price support requires protection at the border, and direct income payments mean that producers can operate more easily in the international markets. In the past, there were few binding international agreements for agricultural policy. This situation came to an end during the last round of GATT talks. The GATT Agreement ratified in 1994 provides that a number of conditions must be fulfilled by agricultural policy. These conditions can be divided into three categories:

- market access
- internal aid
- export aid.

It was specifically agreed that countries would reduce their import tariffs on agricultural produce by 36% over a period of six years and that at least 5% of the domestic consumption would be admitted at a reduced rate.[4] With the exception of the permitted forms of policy, the domestic

[4] This reduced rate is equal to 32% of the basic rate (which must itself be reduced by 36% within six years).

aid to the agricultural sector must be reduced by 20% in relation to the 1986-1988 figure.[5] Finally, the export aid must be reduced by 36% in budget terms and by 21% in volume terms (in relation to the 1986-1990 period).

According to calculations of the Agricultural Economics Research Institute (LEI), the present CAP is basically compatible with the GATT Agreement. The main problems will probably occur in relation to the limit imposed on the subsidised export of dairy products. Cheese exports, which are of importance to the Netherlands in particular, could be adversely affected at the end of the 6-year implementation period. In the case of a number of other products, the extra imports and greater difficulty in exporting may well lead to lower prices in the internal market.

2.4.3. Dutch policy principles

The policy principles adopted by the Netherlands in discussions on the Common Agricultural Policy were recently reformulated in the memorandum entitled "Change and Renewal" of the Ministry of Agriculture, Fisheries and Nature Management. The principles are as follows:

- maximum market orientation wherever possible;
- maintenance of the existing budgetary frameworks and maximum control of expenditure within these frameworks;
- arrangements to be capable of being implemented and monitored;
- income payments to be linked wherever possible to conditions governing countryside and landscape management;
- active measures to ensure close and timely coordination with other Member States.

2.5. The net position of the Netherlands under the CAP

Table 2.3 shows the expected changes in the net position of the Netherlands under the CAP (i.e. the balance of payments to and receipts from the CAP) in the next few years. It is assumed for this purpose that any spare budgetary resources under the agricultural guideline will be used up as a result of modified or new policy. The expected Dutch receipts in the event of unchanged policy have been increased on linear basis for this purpose. In other words, it is assumed that the Netherlands will manage to obtain the same share of the expenditure in the case of modified or new policy as it would by way of expected expenditure in the case of unchanged policy. The

[5] Generic, non-product-tied aid which has few if any trade effects is excluded from the reduction commitment. Examples are technical aid and research, fully unlinked direct income payments and structural adjustment programmes.

payments to finance the CAP have been calculated by applying the integral payment ratio of the Netherlands to the agricultural guideline.

(in billions of ECU)	1995	1996	1997	1998	1999
receipts	1.9	1.8	1.8	1.8	1.8
payments	2.3	2.4	2.5	2.6	2.7
net position CAP	-0.4	-0.6	-0.7	-0.8	-0.9
(in billions of guilders)					
net position	-0.9	-1.3	-1.5	-1.6	-1.9

Tabel 2.3. Expected development of the Dutch net position under the CAP in the years 1995-1999 (in current prices).

Whereas the Netherlands received over 2.5 billion guilders from the CAP as recently as 1988, these net receipts had declined to approximately 300 million guilders in 1993.[6] However, the major turnround has occurred since 1994 following the implementation of the MacSharry reforms. The consequences of these reforms will become fully apparent in 1996 once they have been fully introduced. In that year the Netherlands is expected to pay approximately 1.3 billion guilders net to the CAP. The deterioration in the net position will probably continue after 1996, mainly because fewer export refunds will be received and payments to the CAP will continue to rise.

The deterioration of the net position of the Netherlands is largely due to the control of expenditure in the dairy sector, which is causing Dutch receipts to decline. Owing to the introduction of dairy quotas, the expenditure on this product has remained fairly constant. The Netherlands receives a relatively large share of this expenditure. Since the total CAP expenditure continued to rise, the share of the dairy sector in it declined, together with the Dutch share of CAP expenditure. This is shown in table 2.4. It is evident from the table that the dairy sector accounted for 50% of Dutch receipts in 1992. This rose to as much as 60% in

[6] These figures have been corrected to allow for Dutch receipts by way of export refunds which benefit other Member States. In 1988 and 1989 in particular, foreign exporters channelled many export products through the Netherlands in order to benefit from the favourable exchange rate. The figures involved were approximately 850 million ECU in 1988, 1 billion ECU in 1989, 500 million ECU in 1990 and 200 million ECU in 1991.

	share sectors in CAP		share sectors in Dutch receipts	
	1992	1995	1992	1995
hectarage payments	-	34.6	-	7.4
headage payments	-	13.1	-	4.1
beef (other)	20.8	7.4	13.4	8.0
cereals	39.4	7.7	23.9	5.3
sugar	6.2	5.1	5.1	5.7
fruit/vegetables	4.0	4.8	0.6	2.0
wine/tobacco	7.4	7.0	0.0	0.1
dairy	12.8	10.6	48.2	59.6
other	9.3	6.1	8.9	6.9
guidance measures	-	3.7	-	0.9
total	100.0	100.0	100.0	100.0

Table 2.4. Share of the sectors in the CAP and the share of the sectors in the Dutch receipts from the CAP.
Source: European Court of Auditors, Ministry of Finance.

1995. At the same time, the share of the dairy sector in the total expenditure of the CAP declined from 12.8% to 10.6%.

As already indicated, the MacSharry reforms brought about important changes from 1993 onwards. In 1995 the so-called MacSharry aid (hectarage and headage payments) accounted for almost 50% of the CAP; this percentage will continue to rise in the next few years to around 55%. Clearly, the MacSharry aid, in relation to the share in the CAP, is contributing to the Dutch receipts from the CAP only to a very limited extent; the share of the Netherlands in the MacSharry aid is only 1.1%.

By far the most important effect of these MacSharry reforms has been that the price support in the cereals sector has been largely replaced by hectarage payments. In consequence, the expenditure on this sector in the EU rose from 5.5 billion ECU in 1992 to 10.5 billion ECU in 1995 (burden shifted from the consumer to the budget). Since the Netherlands is only a small producer of cereals it receives little of these payments, although it does have to pay a proportionate part of the increase in expenditure to the budget.

In addition, the processing aid for oilseed was converted into hectarage payments. As a major processor of oilseed, the Netherlands had always received a relatively large share of these resources. However, the producers who actually benefited from the aid were for the most based

abroad. Under the present scheme, the aid is paid directly to the growers. Since little oilseed is grown in the Netherlands, the receipts are correspondingly small. In economic terms, little has changed as a result of this conversion. But as far as the calculation of the net position is concerned, it has definitely made a difference. The changes in this sector clearly demonstrate in fact that more receipts were imputed to the Netherlands in the past than actually benefited the Dutch economy.

A last reason why the MacSharry reforms have adversely affected the net position of the Netherlands is the introduction of criteria governing the size of business and the stocking rate in the case of headage payments. Since the Netherlands has large, intensive agricultural holdings, such requirements tend to limit the aid earlier than in many other countries.

Needless to say, the gross approach too is important. From the budgetary point of view, the main factor is what gross payments have to be made by the Netherlands under the CAP. These payments compete with other domestic policy expenditure. For the agricultural sector, it is important to determine how much of the EU expenditure ends up in the Netherlands; the net position provides an indication of this. It is also necessary to remember that the net position is determined by calculating the balance of the direct financial flows to and from the EU, with an adjustment for transit effects. This makes no allowance for the fact that exports achieved with the help of refunds relieve the burden on the entire internal market and thus influence prices throughout the EU. Furthermore, payments may not only be made through the budget; they may also take place between Member States through the medium of consumers, in which case they are not visible in the budget. This effect - known as the preferential trade effect - occurs in the case of products subject to a pricing policy and works to the advantage of exporting countries. It can, for example, be argued that since the Netherlands exports many dairy products to other EU Member States, the consumers there are paying part of the income of Dutch dairy farmers. In a recent study by the British Ministry of Agriculture, the benefit to the Netherlands was estimated at around 1.2 billion guilders in 1993. It should, however, be noted that the extent to which this effect occurs declines as the MacSharry reforms are implemented. However, this will not have any major impact on the dairy sector.

2.6. Future developments

Owing to the effects of the GATT Agreement described above and to the possibility of a new round of GATT/WTO talks at the end of this century, which is expected to produce strong

pressure for further liberalisation, income support will in the future become increasingly independent of production and be channelled directly through the budget. This shift from price support to direct income payments is a trend that has existed for some time in agricultural policy. The MacSharry reforms are simply the most recent example in Europe. These reforms were in fact pushed through mainly in order to ensure the success of the GATT negotiations that were in progress at that time.

At present, it is not expected that agricultural policy will change greatly in the next few years. As prices on the world market are rising, there will be little need for reforms in the cereals sector on account of the available budget or GATT. In the dairy industry, which is another important part of the CAP, the milk quotas have been fixed until the year 2000. With the exception of a few relatively minor price reductions or quota cuts, policy in this sector too is not expected to change significantly. As the sugar arrangements have recently been extended until 2002, few major changes are expected here either. However, changes are expected in the case of a number of more minor products, for example the organisation of the markets in fruit and vegetables, wine and rice. These changes will very probably entail a reduction in the prices and/or a limitation of the scope for intervention. In consequence, the export refunds too will be limited. Direct income support will be paid as compensation in a number of cases. It is also possible that a further price reduction may be necessary in the beef and veal sector in order to meet the GATT commitments; this will probably result in an increase in the headage payments. No major changes are therefore anticipated in the case of the main products before the turn of the century. However, the policy will slowly but surely place ever greater emphasis on direct income support.

It was provided in the GATT Agreement that a new round of GATT/WTO talks would be started in 1990 in order to promote further liberalisation of the trade in agricultural products. It is expected that instruments other than non-product-tied aid will come under increasing pressure in the future. Non-product-tied aid is after all the agricultural policy instrument that causes the least disruption to trade and is therefore compatible with freer trade. In view of the ideas in other important countries such as the US, it is expected that the only instrument of agricultural policy that will remain after the next round of GATT/WTO talks will be direct income support.

Another major determinant of the future CAP is the number of countries that will join the EU. During the meeting of the European Council in Copenhagen it was agreed that the associated countries in Central and Eastern Europe which wished to join the EU could do so. However, it

was stipulated that in order to join a country must be able to meet the commitments entailed by membership. Another condition was that the Union must have put its own house in order. It follows that the question now is not whether but when these countries may join. For the time being, it seems likely that only the four Visegrad countries (Poland, Hungary, the Czech Republic and Slovakia) will be able to fulfil the conditions of EC membership in the near future. The other East European countries may possibly follow later.

Many countries in Central and Eastern Europe have a large production potential and are already producing in volume. Under the agreements with the EU, these countries at present have certain import access opportunities in the European market. Accession of both the Visegrad members and the other East European countries would be extremely difficult to accomplish under the CAP as its stands, on account of both the expected implementation problems in these countries and the difficulties that this would create for the present Member States. Although all of this is naturally connected with the number of countries joining the EU, it is apparent that the budgetary consequences may be great. In addition, expansion of the CAP to include these countries could entail problems with the restrictions imposed by GATT. In the rather longer term, it would be impossible to apply a CAP in the Central and East European countries that is fundamentally different from that is applied in the present Member States. This means that the value of transitional arrangements is limited.

Explicit account will have to be taken of the budgetary consequences in quantitative terms in the various scenarios. The relationship between accession and GATT will be considered in qualitative terms.

3. Scenarios for the reform of the CAP

3.1. Introduction

This section provides a quantitative assessment of a number of basic scenarios. In principle, five important sets of figures are involved:

- the total costs of the CAP;
- the payments by the Netherlands to the CAP;
- the receipts by the Netherlands from the CAP;
- the net position, i.e. the balance of payments and receipts;
- the cost to the central government budget.

It should be emphasised that to some extent the scenarios in question describe extreme situations. They are therefore intended mainly as an aid to the formulation of ideas and should not be regarded as a reliable prediction of the developments expected in EU policy. On the basis of, among other things, the scenarios presented in the present section, section 4 below will examine how the reforms could be achieved in practice.

It should also be remembered that this is to some extent a partial approach. The study sets out to determine the direct financial consequences of certain policy decisions.

3.2. The scenarios

3.2.1. Scenario 1: unchanged policy

Two variants are given in the case of unchanged policy because of the uncertainty about the introduction of new policy and the resulting uncertainty about the level of expenditure in 1999.

Scenario 1(a) involves the extrapolation of expenditure in 1999 from current expenditure and on the basis of current policy. Estimates have been made for each product group up to and including 1999. Together with the amount estimated by the Commission for the related measures, they constitute the total amount for 1999 if the current policy is continued unchanged.[7] It has therefore been assumed that there will be no important changes to policy.

[7] The Dutch payments to the CAP are based on the estimates in the 1966 Budget Memorandum. The receipts have been calculated by adding up the estimates for the different products. The estimates are based on the current world market prices and European prices.

However, allowance has been made for the limitations imposed on policy by the GATT/WTO. In particular, the possibility of granting export refunds has been limited as a result. This partly explains why the expenditure in 1999 will, on the basis of this assumption, be below the level provided for in the agricultural guideline.

Scenario 1(b) is a variant of scenario 1(a) and allows for the possibility that new policy will be introduced or existing policy altered. It has been assumed that any spare budgetary resources under the agricultural guideline will therefore be fully utilised in 1999. It has already been indicated in the previous section that as far as the net position is concerned the assumption is that the Netherlands will manage in the future to retain its share of current policy expenditure owing to the additional EU expenditure on changed or new policy.

3.2.2. Scenario 2: direct income payments

The assumption in scenarios 2(a) and 2(b) is that the policy has been completely reformed and that support will henceforth be provided only in the form of direct income payments or allowances.[8] It follows that border protection, intervention, quota schemes, sales support and export refunds have been abolished. For the purposes of this scenario, the protection provided for certain products in the form of price policy and/or border protection has been converted into compensation in the form of direct payments.[9] The expenses currently borne by the consumer are then in fact converted into budgetary expenditure.

In scenario 2(a) the resulting decline in the income of farmers is fully offset by direct income payments. This calculation has been based on the static approach, which has hitherto prevailed in the policy pursued by the EU in practice. In other words, compensation is provided not only for the loss of income as a result of the policy changes but also for the loss of capital.

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[8] For the purposes of the calculations, scenarios 2 and 3 are based on the same level of expenditure as scenario 1(a). Any additional costs owing to new or changed policy in the period up to and including 1999 may therefore result in additional costs in the case of scenarios 2 and 3.

[9] The difference between the world market price and the intervention price has been determined in these calculations. This difference is regarded as the income transfer (producers' surplus) from consumer to producers. Where no reliable world market prices are available, for example because the world market is very small compared with the EU market, use has been made of the PSEs calculated by the OECD. These indicate the extent of the price support. The transfers have been calculated for the existing production (1994 or, if these figures are not available, 1992) in the EU. The share of the Netherlands in the total EU production then indicates what proportion of the compensation will be received in the Netherlands.

Scenario 2(b) provides for compensation amounting to 50% of the static loss of income, as determined in the manner described above. Although this results in a loss of income, particularly in the short term, it should be noted in this connection that dynamic model studies have shown that in such scenarios the farmers' income is boosted by other mechanisms too. These dynamic studies, which are based on the assumption that the allowances are exclusively related to the individual, indicate changes which can offset part of the loss of income. In addition, liberalisation can be expected to have a positive effect on world market prices. If other major agricultural producers too were to reform their policy, the impact on world market prices would be even more marked. These dynamic effects would therefore help to make a scenario based on unlinked income payments a more attractive proposition.[10]

3.2.3. Scenario 3: financial renationalisation

In this scenario, agricultural policy once against consists solely of direct income payments. It differs, however, from the previous scenario in that the cost of the policy is divided differently among the Member States. In scenario 2 each Member State pays for the agricultural policy in proportion to its contribution to the EU budget. In scenario 3, the payment of the income allowances has been renationalised. The crucial assumption is that each country should compensate its own farmers by means of direct income payments and that there is no longer any European expenditure on agricultural policy. An important assumption is that the Netherlands grants the same degree of support to the agricultural sector in the form of direct income payments as the EU formerly provided in scenario 2. No allowance is made in this connection for the consequences of the resulting policy discretion of the national authorities. Scenario 3(b) is based on the level of EU expenditure in scenario 2(a) (full income compensation), whereas scenario 3(b) is based on 50% compensation of income. Needless to say, a regulatory framework would have to be maintained at EU level in the case of financial renationalisation in order to prevent disruptions of the market.

3.3. Results of the scenario calculations

The results of the scenario calculations described above are presented in table 3.1. The first part shows the size of the EC budget for agricultural policy in the various scenarios. Afterwards, the table shows the impact on the Netherlands of the various scenarios, in particular the Dutch payments to the CAP, the Dutch receipts from the CAP and the net position of the Netherlands

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[10] See for example: C. Folmer, M.A. Keyzer et al., The Common Agricultural Policy beyond the MacSharry reform, 1995.

under the CAP in 1999. The effect of financial renationalisation on the net position of the Netherlands in relation to the EU can be calculated by determining the balance of scenarios 2 and 3. Finally, the table shows the direct costs to the central government budget of the different scenarios.

(in 1999)

CAP expenditure (in billions of ECU, in current prices):

1a. unchanged policy	40.0
1b. unchanged policy (based on agricultural guideline)	47.1
2a. direct income payments (100% compensation)	57.0
2b. direct income payments (50% compensation)	28.5
3a. renationalisation (100% compensation)	0.0
3b. renationalisation (50% compensation)	0.0

Dutch net position under the CAP (in billions of guilders, in current prices):

	payments	receipts	net position
1a. unchanged policy	4.7	3.1	-1.6
1b. unchanged policy (based on guideline)	5.6	3.7	-1.9
2a. direct income payments (100% compensation)	6.8	5.8	-1.0
2b. direct income payments (50% compensation)	3.4	2.9	-0.5
3a. renationalisation (100% compensation)	0.0	0.0	0.0
3b. renationalisation (50% compensation)	0.0	0.0	0.0

Costs for the central government budget (in billions of guilders, in current prices):

1a. unchanged policy	4.7 (= EU contributions)
1b. unchanged policy (based on guideline)	5.6 (= EU contributions)
2a. direct income payments (100% compensation)	6.8 (= EU contributions)
2b. direct income payments (50% compensation)	3.4 (= EU contributions)
3a. renationalisation (100% compensation)	5.8 (= national subsidies)
3b. renationalisation (50% compensation)	2.9 (= national subsidies)

Table 3.1. The impact of the various scenarios on CAP expenditure, the Dutch net position and the costs for the central government budget in 1999.

A complete switch from the present policy to direct income payments would, if the loss of income were to be compensated in full, result in a substantial increase in EU agricultural expenditure if the static approach hitherto adopted in practice in the EU were to be continued (scenario 2(a)). This expenditure would also easily exceed the level provided for in the 1999

agricultural guideline. If only 50% of the loss of income were to be compensated, the EU expenditure would naturally be much lower (scenario 2(b)). If there were to be complete financial renationalisation (scenarios 3(a) and 3 (b)), there would no longer be any agricultural expenditure at European level.

In scenario 1 the net payment by the Netherlands to the CAP in 1999 would be between 1.6 and 1.9 billion guilders, depending on the extent to which the budgetary resources under the agricultural guideline are actually utilised. According to the level of EU expenditure, the costs to the central government budget (transfers) would be between 4.7 and 5.6 billion guilders.

Scenario 2(a) (full income compensation) would entail a substantial increase in the payments by the Netherlands to the EU owing to the sharp rise in the EU budget required; at the same time, however, there would be a large increase in the receipts of the Netherlands from the EU. On balance, however, the net position would be clearly better than if EU agricultural policy were to remain unchanged (net payment of 1.0 billion guilders instead of 1.6-1.9 billion guilders). The parts of the agricultural community in the Netherlands that would receive large amounts in direct income compensation would be the dairy, beef/veal and sugar sectors. The cost to the central government budget under this scenario would rise sharply to 6.8 billion guilders. In the case of scenario 2(b) - 50% income compensation - the net position would naturally improve to a greater extent and the costs to the central government budget would be halved in relation to scenario 2(a). It should be noted here that in practice it would be virtually impossible to avoid a situation in which the "cohesion countries" receive more support than the richer Member States.

Full financial renationalisation of agricultural policy would mean that Dutch payments to finance European agricultural policy would cease entirely. The calculations for this scenario are based on the assumption that the Dutch authorities would compensate Dutch agriculture to the same extent through income payments as the EU does in scenarios 2(a) and 2(b). The Dutch net position in relation to the CAP would naturally be reduced to nil since the income and expenditure would no longer be channelled through Brussels. This would in itself represent a major improvement of the Dutch net position under the EU budget as a whole in all circumstances. As the Netherlands would then need to finance only the support to its own farmers and would no longer contribute to the financing of direct income payments in other Member States, the cost to the central government budget would be less than in scenarios 2(a) and 2(b). Only scenario 3(b) produces costs lower than those of unchanged policy.

3.4. Effects of accession of the CEEC

It was pointed out in section 2 above that the costs of the accession of the countries of Central and Eastern Europe cannot be estimated with any accuracy. This is why a range of possibilities has been given for the cost to the CAP of the accession of these countries in the event of unchanged policy in 1999; the lower limit is based on a study of the Agricultural Economics Research Institute (LEI)[11] and the upper limit on a study by Brenton and Gros.[12] These costs are therefore assumed to be between 6.8 billion ECU and 17.0 billion ECU (1999 prices). The estimate by Tangermann and Josling[13] of the cost to the CAP, namely 13.3 billion ECU, therefore falls roughly in the middle of this range.

On the basis of this range, the costs to the CAP of accession and the effect of accession on the net position of the Netherlands can be calculated in accordance with the three scenarios described above. It has been assumed for technical reasons that the agricultural guideline does not constitute a problem: the expenditure under the guideline is simply increased by the costs of accession. In calculating the effect on the net position of the Netherlands, we have taken the Dutch share in the GNP of the 15 EU Member States plus the Visegrad countries in 1993. The results of the calculations are summarised in the following table.

The difference in the results of the various studies is attributable to the different underlying assumptions. The main difference in these assumptions concerns the growth of production prior to accession and the response of the producers to an increase in the prices to the EU level. The LEI bases its calculations on a significantly lower level of production at the moment of accession than the other studies. To reach this level of production (in the LEI's EU scenario), these countries would have to achieve a rate of production growth equal to the long-term growth percentages of the EU, which would require a major effort on their part. It is therefore quite

[11] The Agricultural Economics Research Institute (Accession of the four Visegrad countries to the EU: cost to the agricultural budget, 1995), estimates the cost of accession in 1999 at 5.9 to 7.6 billion ECU in 1994 prices on the basis of three scenarios. The study's point of reference is the EU scenario in which productivity growth in the Visegrad countries equals the long-term growth percentages of the EU. The LEI's estimate is 6.4 billion ECU in this scenario; adjusted for inflation (3% a year), this gives a figure of 6.8 billion ECU.

[12] Brenton and Gros (The budgetary implications of EU enlargement, CEPS Working Document no. 78, 1993) estimate the additional costs of accession of the Visegrad countries around the year 2000 at a minimum of 17 billion ECU. This is based on the assumption that the countries of Central and Eastern Europe manage to cut by half the existing difference in productivity between them and the EU Member States, given comparable climatological conditions.

[13] Tangermann and Josling (Pre-accession agricultural policies for Central Europe and the European Union, on behalf of DG-1 of the European Commission, 1994) assume that prices in the Visegrad countries will be brought into line with EU prices on a step-by-step basis.

Change in CAP expenditure resulting from enlargement (in billions of ECU, in prices 1999):

	undermargin	uppermargin
1. unchanged CAP	6.8	17.0
2a. direct income payments (100% compensation)	10.3	25.5
2b. direct income payments (50% compensation)	5.2	12.8
3a. renationalisation (100% compensation)	0.0	0.0
3a. renationalisation (50% compensation)	0.0	0.0

Change Dutch net position resulting from enlargement (in billions of guilders, in prices 1999):

	undermargin	uppermargin
1. unchanged CAP	- 0.6	- 1.6
2a. direct income payments (100% compensation)	- 1.0	- 2.4
2b. direct income payments (50% compensation)	- 0.5	- 1.2
3a. renationalisation (100% compensation)	0.0	0.0
3b. renationalisation (50% compensation)	0.0	0.0

change costs central government budget resulting from enlargement (in billions of ecu, in prices 1999):

	undermargin	uppermargin
1. unchanged CAP	0.6	1.6
2a. direct income payments (100% compensation)	1.0	2.4
2b. direct income payments (50% compensation)	0.5	1.2
3a. renationalisation (100% compensation)	0.0	0.0
3b. renationalisation (50% compensation)	0.0	0.0

Table 3.2. Estimates of the impact of accession of the Visegrad-countries on CAP expenditure, the Dutch net position and the costs for the central government budget (in prices 1999).

likely that if accession were to take place in the relatively near future (i.e. in 1999) the costs would be closer to the lower limit (LEI study) than to the upper limit (Brenton and Gross study). However, it is possible that these costs would increase slightly after accession (depending on the terms of accession). If accession were to take place at a later date, production could continue to grow and the costs of introducing the CAP in the Visegrad countries would also be higher. It has been assumed in all cases that no special support arrangements are created for specific products from these countries.

Clearly, the additional cost to the CAP would be considerable. As in the case of a switch to direct income support for farmers in the 15 present countries of the EU, the introduction of

direct support in the Visegrad countries could increase the costs of administering the CAP by some 50%, if a static approach is adopted (scenario 2(a)). In scenario 2(b) the CAP expenditure declines owing to the lower level of income compensation. It should be noted here that a growth of production after accession would scarcely affect the costs of the CAP in scenario 2, whereas this would be so if policy were to remain unchanged. The costs in the case of unchanged policy could continue to increase because production growth in the unreformed part of the CAP would be accompanied by cost increases; this would no longer be the case after a switch to direct income support. It should also be noted that the calculation of the costs of switching to direct income payments is based on the difference between the present EU price and the world market price. It is therefore compensation for price reductions. Since the agricultural prices in many Central and Eastern European countries are already at the world market level, it is highly debatable whether income compensation comparable to that in the present EU countries would really be necessary. If the CAP were to have been renationalised, accession would naturally not result in any CAP-linked costs.

If the present CAP is continued or there is a switch to direct income support, the accession of the countries of Central and Eastern Europe would adversely affect the net position of the Netherlands and cause a corresponding rise in the cost to the central government budget. As already indicated above, the Netherlands will contribute between 1.6 and 1.9 billion guilders net to the financing of the CAP in 1999 in the event of unchanged policy. This net payment would increase sharply (by 0.6 billion guilders to 2.4 billion guilders a year) as a result of the accession of the Visegrad countries if present policy is continued or there is a switch to direct income support. If the CAP were to have been renationalised, accession would naturally not have any direct effect on the net position of the Netherlands in relation to the CAP.

4. Discussion and conclusion

4.1. Estimate of future developments

The first occasion on which fundamental reform of agricultural policy is likely to be discussed will probably be in the years prior to the accession of several Central and Eastern European countries; the accession of the Visegrad countries is not expected until the turn of the century at the earliest. Discussion of such reform with a view to the enlargement of the Union will therefore coincide with new trade talks in the WTO. Accession of the Visegrad countries without policy changes is unlikely. Quite apart from the extra budgetary burden which accession would entail, the GATT/WTO commitments too would probably make it impossible to continue the CAP in its present form in an enlarged Union.

The countries of Central and Eastern Europe have entered into their GATT commitments on the basis of their low level of support in the past. If production in Eastern Europe were to increase sharply and prices to rise to EU levels, the limits imposed by GATT on internal support and export support would soon be reached. In fact there would then be two options: either production would have to be limited by quotas or prices could be brought into line with world market prices. The former option would probably not be attractive to the new members because of their vast production potential. If the second option were to be adopted and the price cuts were to be accompanied by income support, budgetary expenditure would once again increase sharply. This hardly seems feasible at EU level. The inescapable conclusion is that enlargement of the EU to include the Eastern European countries would put further pressure on the CAP.

Mention should also be made of the mounting pressure for real liberalisation of agricultural policy. This is naturally connected with the successive rounds of the GATT/WTO talks with a view to the further liberalisation of world trade. During the recent evaluation of the EU's trade policy by the WTO (in Geneva on 24/25 July 1995), the importance of greater market orientation and less product-related support within the CAP was emphasised by the other parties in the WTO. The importance of a freer market was also emphasised in the Priorities Memorandum of the Minister of Agriculture, Nature Management and Fisheries.

4.2. Discussion of the policy options

4.2.1. Unchanged policy

As a large part of the present expenditure has been fixed in nominal terms and many subsidies are dependent on quotas and as the agricultural guideline can be adjusted to allow for both inflation and economic growth, some budgetary resources may become available under the agricultural guideline after 1996 if policy remains unchanged. In view of past experience of the EU, it seems likely that there will be great pressure to make use of any such resources under the guideline by altering existing policy or introducing new policy. In any event, changes to the organisation of the markets in a number of Mediterranean products are anticipated. Owing among other things to its net position under the CAP, the Netherlands is pressing for maximum control of expenditure within the existing budgetary framework and is exercising restraint regarding the utilisation of any spare resources under the guideline.

4.2.2. Direct income payments

If the CAP were to switch completely to direct income payments and if the static approach hitherto adopted in practice in EU policy were to be continued, the budgetary expenditure would rise by some 45%. This is based on the assumption that the income of farmers would remain unchanged. Although the budgetary costs would be higher, the costs to the consumer would be lower because the price of milk, beef /veal, sugar and other products would fall. The expenditure on income compensation calculated in this way would be substantially higher than the figures produced by a number of economic studies as no account is taken of the dynamic effects or of the positive impact on world market prices of a reform of the policy. If allowance is made for these effects, the level of support needed to sustain incomes can be gradually reduced. A switch to direct income payments should in any event be confined to the existing budgetary framework, which means that replacement of the present policy by 100% income compensation is not possible.

It follows that the present price support policy and the present agricultural income policy can be replaced only by partial, direct income compensation. This is in keeping with the efforts of the Netherlands to achieve a highly market-oriented system. Reference should be made here once again to the dynamic effects described above. Just as there are at present major differences between policy in the various sectors, varying from no market regulation to heavy market regulation, the pace at which further reforms are introduced can be geared to take account of the extent to which the dynamic effects occur in the various sectors.

4.2.3. Financial renationalisation

In a system of direct income payments, financial responsibility for the administration of policy need no longer be maintained at European level. The financing of the compensation could very well be carried out at national level. However, a regulatory framework should be maintained at the European level in order to prevent distortion of competition.

The main advantage of financial renationalisation would be greater cost awareness on the part of the Member States. This is because each country would bear the costs of the policy in so far as it benefits its own producers. It would also be possible to take a more informed decision on the relative merits of support to the agricultural sector and other economic sectors.

A common objection to the choice of such a policy is that it might jeopardise the functioning of the internal market. This would naturally be an uninviting prospect for the highly export-oriented Dutch agricultural and horticultural industries. This is why a regulatory framework should be maintained at the European level, just as in the case of other economic sectors. In addition, limits would have to be imposed at European level on the compensation that can be provided, in order to avoid policy competition. In specific cases such as the agromonetary scheme, there are already signs of a trend towards the provision by the Commission of limited, temporary and gradually declining income support, with optional supplementary financing by national governments.

Financial renationalisation would be to the financial benefit of the Netherlands provided that the existing budgetary frameworks at EU level are strictly maintained in the period prior to renationalisation. If there were to be a shift to 100% direct income support in the period prior to renationalisation, as indicated above, the costs of the CAP would rise sharply and the expenditure allowed for under the agricultural guideline would be exceeded. Consequently, the cost to the central government budget after financial renationalisation would be higher than the expenditure incurred by it in the basic situation (complete switch to income support). If the agriculture guideline were to be maintained in the period prior to renationalisation, this would benefit not only the net position of the Netherlands under the EU budget but also the central government budget.

4.2.4. Accession of the Visegrad countries

The accession of the Visegrad countries to the European Union would be greatly simplified if the only support provided at the European level were unrelated to production. This would ensure

that the costs of accession in due course do not increase as a result of rising production. Nonetheless, the costs of accession may still be considerable. After financial renationalisation, the Visegrad countries too would themselves be responsible for supporting their agricultural sector. Under the present system, it would be no easy matter to provide a lower level of income support in the Visegrad countries than in EU Member States owing to the lower price levels in these countries in the past. This would be much easier in the case of the renationalisation scenario.

4.3. Conclusions

The aim of this part (Part I) of the policy study of European expenditure has been to ascertain the scope for limiting the gross payments to the Union and improving the net position of the Netherlands under the EU budget by means of an adjustment to the agricultural policy. This has been gauged by reference to the agricultural guideline in 1999 and the net position of the Netherlands under the CAP in 1999.

As the expenditure under the agricultural guideline is growing in real terms and as much of the agricultural expenditure has been fixed in nominal terms and many subsidies are dependent on quotas, some of the funds under the agricultural guideline may not be used. These spare resources could rise to over 7 billion ECU in 1999 if a very strict budgetary policy were to be pursued. However, in view of past experience of the EU, it seems likely that there will be great pressure to make use of any such resources under the guideline by altering existing policy or introducing new policy. The level of the agricultural guideline could therefore be reappraised at this point. As an ever larger part of the agricultural expenditure is constant in nominal terms, the agricultural guideline too could be subject to limits of a nominal nature.

As far as future policy is concerned, no major changes are expected in the short term. However, the situation is different in the rather longer term. Enlargement of the European Union to include the Visegrad countries means that expenditure on agricultural policy will increase sharply. The costs will probably be between 6.8 and 17 billion ECU, although if accession takes place at around the turn of the century they will be closer to the lower than the higher figure. In view of the free funds that may be generated under the agriculture guideline if a very strict budgetary policy were to be pursued, the accession could be initially funded within the existing budgetary framework. However, this would change if the costs of accession of the Visegrad countries are increased as a result of higher production, if more countries accede or if the spare funds under the agricultural guideline are exhausted. In addition, the EU would soon

run up against the constraints imposed by the GATT Agreement if the new members were to accede to an unaltered CAP. Accession is therefore bound to put pressure on the CAP.

Account must also be taken of the pressure for further liberalisation caused by a new round of GATT/WTO negotiations. In the light of the above, further policy reforms seem inevitable. Greater liberalisation and direct income payments would seem to be the most probable direction of reform. This would also be in keeping with the Dutch policy of pressing for a greater degree of market orientation.

A complete switch to direct income support would greatly improve the net position of the Netherlands under the EU budget, notwithstanding the resulting loss of the benefits of the preferential trading effect. Reform of the CAP by the introduction of direct income payments accompanied by full compensation for the initial drop in income in the agricultural sector would not be possible within the limits of the agricultural guideline. Such a policy change would entail higher budget expenditure for the Netherlands. Only if the switch to a more liberal agricultural policy were to be accompanied by a reduction of the support to the agricultural sector as such would it be possible to contain the budgetary expenditure due to the policy reforms and the accession of the Visegrad countries within limits that are acceptable in terms of the EU budget and the position of the Netherlands as a net contributor.

This study, which examines the direct financial effects of certain policy decisions, does however show that the Netherlands will remain a net contributor to the CAP in all circumstances in which policy is financed at the European level. It follows not only that a generic system of net limiters is relevant in all these scenarios but also that the shifting of all or part of the financial expenditure from the EC budget to the national budgets (i.e. financial renationalisation of the CAP) would bring about an improvement in the net position of the Netherlands under the EU budget.

Annex I

Terms of reference
Interdepartmental policy study European expenditure

The Netherlands, traditionally a net recepient of funds from the EU, has become a large net contributor to the European Community. It is even expected that from 1995 on the Netherlands will be the single largest net contributor to the EU in relative terms. This net position is expected to deteriorate further from a net contribution of about 4.2 billion guilders in 1995 to about 6 billion guilders in 1999. The change is brought about because the nature of the present policy expenditure of the EU means that the already small Dutch share of this expenditure will decline still further, and also because the payments of the Netherlands to the EU will continue to rise.
A principal feature of the system of contributions to the EU is the own resources ceiling, which increases from 1.20% of GNP in 1990 to 1.27% of GNP in 1999. The principal expenditure categories of the EU are agricultural expenditure (about 50% of total EU expenditure) and structural funds expenditure (about 30% of total EU expenditure). The financing system lacks mechanisms and incentives to influence the outcome of the financial process.
The aim of the policy study is to examine what opportunities the Netherlands has to attain a more balanced outcome of the financial process of the EU by means of adjustments to both the financing system and the policy of the Union. Attention should be focussed on an examination of the financial consequences of changes to the agricultural and structural funds policies, as well as an examination of the possibilities to integrate in the own resources system of the EU a mechanism which limits the net contributions of member states. Bringing back the financial responsibility for agricultural policy to the national level should be one of the scenarios under examination. A similar scenario could be examined for reform of the stuctural funds policy.

Another subject explicitly dealt with in the study should be that accession of the associated countries in Central and Eastern Europe to the EU in combination with an unchanged system of own resources and policy expenditure would result in an sharp organic growth of Dutch contributions to the EU.
Because of the specific knowledge demanded for particularly the agricultural part, the study will be divided in two parts:

Part I : Agricultural expenditure

Chairman: Ministry of Agriculture, Nature Management and Fisheries

Participating departments: Agriculture, Nature Management and Fisheries; Finance; General Affairs; Foreign Affairs; Economic Affairs; Social Affairs and Employment.

Part II : Other expenditure and general aspects

Chairman: Ministry of Foreign Affairs

Participating departments: Agriculture, Nature Management and Fisheries; Finance; General Affairs; Foreign Affairs; Economic Affairs; Social Affairs and Employment.

Annex II

Members of the interdepartmental working group European expenditure, part I (agricultural expenditure)

Chairman:
mr. T.H.J. Joustra
Ministry of Agriculture, Nature Management and Fisheries

Secretary:
drs. F.H. Lemmink
Ministry of Finance

Undersecretary:
ir. A.J. Vermue
Ministry of Agriculture, Nature Management and Fisheries

Members:
ir. E. Pierhagen
Ministry of Agriculture, Nature Management and Fisheries

ir. G.A. Koopstra
Ministry of Agriculture, Nature Management and Fisheries

drs. L. Groenendal
Ministry of Finance

drs. H. Monnickendam
Ministry of Finance

mr. H.J.W. Soeters
Ministry of Foreign Affairs

mr. R.J.P.M. van Dartel
Ministry of Economic Affairs

drs. W.J.A.M. Geurds
Ministry of Economic Affairs

dhr. H.P. Zwijnenburg
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