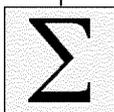


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**SIGMA - A JOINT INITIATIVE OF THE OECD AND THE EUROPEAN UNION,  
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**ENLARGEMENT OF THE EUROPEAN UNION: AN ANALYSIS OF THE NEGOTIATIONS FOR  
COUNTRIES OF THE WESTERN BALKANS**

**SIGMA PAPER NO. 37**

*This paper analyses the negotiations which will take place with the six Western Balkan countries (Albania, Bosnia & Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro and Serbia) and attempts to identify where the major problems are likely to lie.*

*The experience of the fifth enlargement of the European Union to the 12 countries of Central and Eastern Europe is used extensively in this analysis for two reasons: firstly, because the offer made to these countries is likely to be the starting point for the offer to be made to the countries of the Western Balkans; secondly, because the problems which occurred in the negotiations for the fifth enlargement are likely to be the main areas of negotiation with the six countries.*

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**SIGMA**

**Support for Improvement in Governance and Management**

A joint initiative of the OECD and the European Union, principally financed by the EU

**ENLARGEMENT OF THE EUROPEAN UNION:  
AN ANALYSIS OF THE NEGOTIATIONS FOR  
COUNTRIES OF THE WESTERN BALKANS**

**SIGMA PAPER NO. 37**

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## EXECUTIVE SUMMARY

The European Union has made it clear on numerous occasions that the future of the Western Balkan nations lies within the Union. After the Balkan wars of the 1990s, accession is seen as a guarantee of peace and stability in the region by both the 27 countries of the Union and by the six Western Balkan countries — Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro and Serbia.

This jointly-held belief is, however, an objective, which can only be reached when the six countries meet the conditions set by the Union for accession. Part of this preparation will take place through the implementation of the Stabilisation and Association Agreements (SAAs), which have been or are in the process of being negotiated with these countries. However, the conditions for accession go well beyond the programme of work implied by the SAA.

Once a country applies for membership of the Union and is adequately prepared for accession, the Union will invite it to negotiate its entry. For some of the countries in the Western Balkans, this step may seem a long way in the future. However, Croatia is already in the middle of its negotiations and others could follow over the coming years.

This paper analyses the negotiations which will take place with these countries and attempts to identify where the major problems are likely to lie. The experience of the fifth enlargement of the European Union to the 12 countries of Central and Eastern Europe is used extensively in this analysis for two reasons: firstly, because the offer made to these countries is likely to be the starting point for the offer to be made to the countries of the Western Balkans; secondly, because the problems which occurred in the negotiations for the fifth enlargement are likely to be the main areas of negotiation with the six countries.

While the same rather classic procedure and institutional set-up of the fifth enlargement is likely to characterise the negotiations with the countries of the Western Balkans, they will take place in a rather different political climate. While there is no doubt about the Union's commitment to the region, it is certainly true that the attitude to further enlargement amongst both governments and the public in the Union has become more cautious since the fifth enlargement.

**This change of attitude is likely to be felt on the ground as a much stricter monitoring of the conditionality attached to accession rather than any tightening of the conditions themselves.**

This has already been evident in the conditions attached to the accession of Bulgaria and Romania, both of which are being closely monitored after joining the Union, with the threat of a reduction in EU transfers if they do not undertake the reforms promised in the Accession Treaty. In the negotiations with Croatia, the Union has attempted to ensure that adjustment to the *acquis* takes place before the negotiations by introducing "opening benchmarks" for key chapters. Now negotiation of these chapters will not open until the acceding country has achieved these benchmarks.

It remains clear that the accession of the Western Balkan countries is in the interest of both sides in the negotiations. However, under these changed circumstances it is obvious that preparation for accession and the negotiations themselves must be approached in a well-planned way and that actions should be well-coordinated and as tightly controlled as possible. It is only through good coordination that the acceding country will be able to deliver on the promises it makes in the pre-accession period and in the negotiations.

**Strong coordination of EU policy in the government, both in the preparation for accession and in the negotiations, is essential.**

In the countries of the Western Balkans, as in all other countries, the achievement of a national objective requires strong and continuous support from the top level of the state and the government. If this support wavers, accession will drop down the table of policy priorities and preparation will falter. This may then lead to a loss of interest in that country's accession to the Union.

**Strong and continuous support for accession from the highest levels of the state is therefore vital.**

As one of the key conditions for accession is the complete adoption and implementation of the *acquis communautaire*, negotiations for accession are essentially about the timing and the conditions for the adoption of the *acquis* by the acceding country. In certain very particular circumstances it has been possible to negotiate permanent derogations from the *acquis*, but these cases over five enlargements can be counted on the fingers of one hand. However, the *acquis* will be extended in order to accommodate the specific characteristics of the acceding country; the addition of specific agricultural products to the list of protected geographical designations is one example.

The scope for negotiating even transitional periods for the adoption of the *acquis* is limited, however. The development of a negotiating strategy requires prioritisation of requests for such measures. It is essential therefore that the acceding country seriously considers the impact of the adoption of the key parts of the *acquis* on its economy and society before the negotiations open. This will involve the use of regulatory impact assessment techniques on the most important parts of the *acquis*, especially process *acquis*. The adoption of the latter, including environmental and some social policy *acquis*, can be extremely costly to both the private and public sectors.

**The impact of the Community *acquis* on the economy and society of the acceding country should therefore be established before the negotiating strategy is developed.**

These preparations for negotiations and the negotiations themselves will involve a large number of well-qualified staff in government departments (and indeed in the private sector).

**One essential part of the preparation for negotiations is therefore the training of staff to ensure that a lack of qualified human resources is not a hindrance to efficient integration.**

The most difficult areas of negotiation are likely to be those that proved difficult in the fifth enlargement. These include the chapters on: agriculture; free movement of capital and labour; justice, freedom and security; food safety; veterinary and phyto-sanitary policy; the environment and perhaps competition policy (state aids).

The negotiation of these areas will require very careful preparation by the countries of the Western Balkans. This will include close cooperation not just with interested parties at home but also with key EU Member States and Community institutions. Understanding the political economy of the negotiations will be essential to success.

**It is to be recommended therefore that the acceding countries cooperate closely with the European Commission and with as many of the Member States as possible and especially with those that either strongly support or strongly oppose their accession.**

## OBJECTIVES AND SCOPE OF THE PAPER

The enlargement of the European Union to twelve countries from Central and Eastern Europe was at the same time a sign of continuity and a new policy direction.

It was a sign of continuity as the Union has been steadily enlarging since 1973, when the first new member states joined. This was the Fifth Enlargement of the Union over a period of slightly more than thirty years. As such it was testimony to the increasing prestige of the EU and the attraction of membership to its neighbours.

It was at the same time a new policy direction in the sense that this latest enlargement opened the way for European countries in political and economic transition from the one-party state and the planned economy to join the Union. This has proved to be a difficult but mutually beneficial step in the Union's history.

The extension of the offer of accession has led to the spread of the Union's values, laws and procedures to its neighbours and therefore has favoured a stabilisation of the neighbourhood, much to the benefit of the Union itself. This has been achieved at very little cost to the Union's members and with great benefit to both old and new member states.

The extension of Union membership to the Central and Eastern European countries has however led to several important changes in the way in which accession is achieved. This is especially the case of the conditionality applied to candidate countries. At the same time the political environment in which enlargement is taking place has changed, making future enlargement somewhat more difficult than in the past.

The offer of full membership has now been made to the countries of the western Balkans and to Turkey, subject of course to these countries fulfilling the conditions set by the Union. This paper deals with the future negotiations for membership of the western Balkans, although many of the points raised will also apply to the accession of Turkey.

This paper has seven sections, which aim to:

- trace the background to the negotiations and the their political preparation and to consider the institutional and procedural structures in the negotiations
- analyse the conditionality applied to accession
- consider the scope for flexibility in the negotiations
- present a general approach to preparing the negotiations
- analyse of the core negotiating questions
- consider the preparation for negotiations in the western Balkan countries
- analyse the political economy of accession

## A. BACKGROUND TO THE NEGOTIATIONS

### 1. Enlargement After the Fall of the Berlin Wall

The enlargement of the European Union to the Western Balkans can be seen in the same context as the fifth enlargement to the countries of Central and Eastern Europe – though with the very significant additional factor of the Balkan wars of the 1990s.

None of the first four enlargements, up to and including that to the EFTA states, had been undertaken primarily for security reasons. However, security was one of the principal reasons that led the EU to decide to enlarge to countries which had formerly been behind the Iron Curtain. There were clearly other motives, including a feeling of obligation to countries, which had brought down the Communist system and which were now looking for a western anchor. However security was uppermost in the minds of the EU-15 as they agreed to sign Association Agreements in the first half of the 1990s and later to open negotiations at the Helsinki and Luxembourg summits.

Security was also uppermost in the minds of the EU Member States as they offered accession to the Union to the countries of the Western Balkans. The wars which had developed in the region in the 1990s had been atrociously brutal and they had taken place less than 300 kilometres from Vienna, in the heart of Europe.

However, security is also perhaps the main objective of EU accession for the countries of the Western Balkans. In this case it is less about external security than about regional internal security. Accession to the EU brings with it the hope of an end to conflicts in the Western Balkans for these countries; this represents a degree of stability which they could not hope to achieve outside the Union.

But the Western Balkan states also came out of a communist system relatively recently, albeit, in the case of Yugoslavia, a reformed communist system. Thus many of the problems which arose in the case of the new Member States are likely to be found in the Western Balkans. It is extremely likely, therefore, that many of the elements that characterised the accession of the Central and Eastern European countries will again shape the process in Western Balkan countries.

Since the fall of the Berlin Wall, accession to the Union has become more complex.

Two main developments had taken place by the time the Union negotiated the fifth enlargement. The first was the completion of the Community's internal market and the establishment of an economic zone without frontiers. The second was the negotiation of the Maastricht Treaty establishing the European Union, which extended the role of the Union into new areas like the Common Foreign and Security Policy and Justice and Home Affairs, and reaffirmed Economic and Monetary Union as an objective of EU policy, with the detailed design of the different stages towards its achievement.

These two developments considerably complicated the accession of the Central and Eastern European countries compared to earlier accessions. They extended the *acquis communautaire* massively, making preparation for accession far more difficult for countries, which were independently undergoing root and branch reform from a planned to a market economy.

It is important to realise that generally institutions, the law, and even the economy develop systematically and logically over the years. In countries like the United Kingdom, laws which are hundreds of years old are still applied and the institutions which have the greatest respect are also often many generations old. The same is true, though to a lesser degree, for most European countries. The organic nature of these developments has been brutally interrupted in the

countries of Central and Eastern Europe by the adoption of the Community *acquis* at a speed which exceeded anything which has happened in a democracy in history.

The completion of the internal market was a complex undertaking, even for the Member States of the European Community (testament to which are the enormous sums of money spent by governments and business organisations between 1985 and 1992 to help business understand the changes which the 1992 Programme would bring to the way business was done). For the Central and Eastern European states preparing for accession, the internal market *acquis* added another large layer of new legislation to that occasioned by the systemic reform.

The creation of an area without frontiers (including the incorporation of the Schengen *acquis* in the Treaty on European Union at Amsterdam) led to growing problems of mutual confidence between Member States in the Union. These problems would also affect the accession of the central and eastern European countries. The links between BSE and human health were being discovered, which led to the catapulting of food safety to the top of the political agenda leading to a weakening in confidence between the existing Member States (for instance, between the United Kingdom and France) and to clear breaches of Community law. Economic globalisation went together with the globalisation of crime, which accelerated with the break-up of the Soviet Union and led to international crime becoming a major subject within the EU. The increase in immigration to the EU, accompanied by the rising number of people seeking asylum from brutal regimes elsewhere in the world at a time of relatively high unemployment in the Union, also led to a tightening of regimes in these areas and a higher profile for these subjects in public debate on the EU.

The EU acknowledged that the Western Balkan countries could become EU members under certain general conditions (the Copenhagen criteria) at the meeting of the European Council in Copenhagen in June 1993 (see table 1). The Copenhagen criteria, in spite of their generality, have come to play a central role in the discussion about accession to the Union, including that of Western Balkan countries. They have formed the structure for the Commission's opinions on applications for membership and for the Commission's reports on progress towards accession.

The creation of a "pre-accession strategy" for the Central and Eastern European countries at the Essen European Council in December 1994, including the proposal to produce a White Paper on the transposition and implementation of the internal market regulation, marked the first practical policy steps of the EU to realise the perspective of accession that had been opened in Copenhagen. The associated countries generally reacted rapidly, preparing their own strategies for transposing and implementing the internal market *acquis*. One year later, in December 1995, the Madrid European Council asked the Commission to draw up its opinions on the membership applications and to review the financial aspects of enlargement and its impact on other EU policies.<sup>1</sup> The result of this work, the opinions and "Agenda 2000", were presented to the Council of Ministers in summer 1997.

The decision to begin negotiations with the Czech Republic, Estonia, Hungary, Poland, Slovenia and Cyprus was taken by the European Council in Luxembourg in December 1997. Negotiations began in earnest in the second half of 1998. The EU financial package and the reforms of the structural funds and the Common Agricultural Policy (Agenda 2000) were decided at the Berlin European Council in March 1999. Finally, the decision to open negotiations with Bulgaria, Latvia, Lithuania, Romania, Slovakia and Malta was taken at the Helsinki European Council held in December 1999. The negotiations with these countries opened in early 2000.

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<sup>1</sup> The Madrid Council conclusions also mentioned "the adjustment of their administrative structures" as being important as a preparation for accession though not as a condition.

Ten countries acceded to the Union in May 2004, the negotiations having been completed at the end of 2002. The time required to move from the start of negotiations to accession was therefore between four years for four of the Helsinki group of countries and six years for the remainder. Bulgaria and Romania joined in January 2007.

## **2. The Political Background to the Negotiations**

The countries of the Western Balkans shared many of the features of the Central and Eastern European member states until the death of Marshal Tito in 1980. This resemblance applied notably to the one-party system, although Yugoslavia had introduced many of its own variants to the planned economy. With the death of Tito, ethnic tensions grew, leading eventually to the disastrous wars of the 1990s.

The European Union was involved in the diplomatic efforts to prevent and then to end the wars and bring peace to the whole region. These efforts achieved little in the first half of the 1990s, and it was only under the active participation of the United States that the warring parties were brought together to sign the Dayton Treaty, which led to an end of the wars in Bosnia and Herzegovina. The participants in the wars had little incentive to look for peace as long as there was no feasible plan for future stability, which would outweigh the ethnic tensions in the region. In the second half of the 1990s, the international community developed the Stability Pact for South Eastern Europe and, perhaps more importantly, the European Union moved towards extending membership of the Union to the Western Balkans.

Towards the end of the decade, however, some of the newly independent states of former Yugoslavia themselves showed an interest in closer relations with the Union. Croatia began to consider integration with the European Union seriously in 1998 leading to the early establishment of an Office for European Integration. However, the essential improvement of political and economic conditions in the region only came with the introduction of the Stabilisation and Accession process (SAP), which included the prospect of full accession to the European Union.

The origins of the SAP go back to the Council conclusions of 29-30 April 1997 on the “regional approach”, at which the Union agreed on the application of conditionality to the Western Balkan region in order to develop a “coherent EU strategy for the relations with the countries in the region”. On the basis of these conclusions, the Commission developed its ideas for the SAP, which it presented in its Communication of 26 May 1999 [COM (99) 235]. With the Kosovo conflict ongoing and threatening to destabilise neighbouring countries in the region, the Commission proposed a “Stabilisation and Association process” which foresaw the negotiation of “Stabilisation and Association Agreements” (SAAs) with the countries of the region, “with a perspective of EU membership”. The European Council meeting in Cologne in June 1999 confirmed the SAP and the promise to countries of the Western Balkans of a “perspective of EU membership”.

Relations between the EU and the Western Balkans developed rapidly after the Cologne summit, although the development was uneven across the region. At the end of 2000, the Zagreb summit brought together the EU and all the countries of the region. In return for an offer of the prospect of accession, the five countries agreed on a clear set of objectives and conditions. It established that the way to accession led through the successful negotiation and implementation of Stabilisation and Association Agreements.

The Union confirmed the offer to Western Balkan countries of full EU membership at the Thessaloniki European Council in June 2003. The meeting confirmed the terms of the Thessaloniki Agenda, agreed in the Council conclusions of 16 June 2003. This document announced the introduction of several elements which had been present in the accession of the

new Member States in Central and Eastern Europe: European Partnerships, twinning and the opening of Community programmes. It also increased the level of EU financing for the region.

Soon after the Zagreb summit, both the fYR Macedonia (9 April 2001) and Croatia (29 October 2001) signed SAAs with the EU. Both countries began rapidly with the implementation of the interim agreements and the agreements themselves, although the latter only entered into force in 2004 (fYR Macedonia) and in 2005 (Croatia). By the time of their entry into force, both countries had their eyes firmly set on accession. Croatia had applied for membership in February 2003 and fYR Macedonia in March 2004.

Progress with the other countries of the region was slower. Albania finally signed an SAA in June 2006. Negotiations for an SAA are underway with Bosnia and Herzegovina, but they are suspended with Serbia. The Union hopes to start negotiations with the new Republic of Montenegro in the near future.

The European Union decided to start negotiations for membership with Croatia in October 2005. Screening of the *acquis* has been completed, and the first chapter of the negotiations has been provisionally closed. The fYR of Macedonia was granted “candidate status” at the European Council in December 2005, but a decision regarding the opening of negotiations was put off until later.

The “Salzburg Declaration”, made at the EU Foreign Ministers’ Gymnich meeting in March 2006, reconfirmed the offer of accession to the Western Balkan countries once the conditions for membership have been met. However, the declaration also makes reference to the absorption capacity of the Union. This underlines the more prudent attitude of existing EU members to enlargement.

This change in attitude is the result of several different factors:

- the difficult situation of labour markets in several core EU states, with high unemployment rates feeding into a somewhat negative public attitude towards enlargement;
- the failure of the European Constitution in referenda held in France and the Netherlands, effectively blocking institutional reform, which many consider a necessary precondition for further enlargement;
- the need, felt by many, for more time to absorb fully the 12 new Member States, which entered the EU only in 2004 (Romania and Bulgaria in 2007).

These developments do not put in doubt the future accession to the Union for the Western Balkan states. However, they do mean that preparations for accession need to be thorough.<sup>2</sup> They will also mean that the negotiations for accession will need to be particularly well prepared, both politically and technically.

At present, negotiations for accession are of immediate significance for just two Western Balkan states, Croatia and fYR Macedonia. However, as the other countries of the region begin to implement SAAs or move towards agreeing SAAs, it is important to consider the ultimate objective of these agreements, namely accession.

In many respects, the negotiations with the Western Balkan countries are likely to be similar to those with the 10 new Member States from Central and Eastern Europe which joined in 2004 and 2007. This similarity will apply to the institutional structure of the negotiations and to the position which the Union is likely to take in key areas. It is therefore important for countries in the region

<sup>2</sup> Alan Mayhew (December 2005), *The Preparation of Countries in South East Europe for Integration into the European Union*, Sigma Background Paper.

to study carefully the history of the last two enlargements. In this way some of the errors made in the earlier negotiations can be avoided and the outcome improved.

However, some elements will certainly be different:

- By the time the last country in the region joins the Union the *acquis communautaire* will have changed considerably. On the one hand, new regulations will have been adopted and on the other hand, under the simplification agenda, some regulations may have been rolled back and others may have been simplified.
- Changes to the treaties on which the Union is based may have been implemented, leading to significant institutional change
- Conditionality may have been increased even further to take account of the experience gained from the last two enlargements.
- The specific economic and social conditions in the acceding countries will be taken into account, as was the case in the fifth enlargement, where these differences do not compromise the implementation of the *acquis communautaire*.

### **3. Institutional Structures and Procedures**

#### *a. Structures and institutions*

The structures, institutions and procedures of the negotiations essentially will be the same as used in previous enlargements. This underlines the “classic” nature of the enlargement process.

An Intergovernmental Conference (IGC) on accession negotiations will be established for each candidate country. This emphasises that, in the Union, enlargement negotiations are essentially inter-governmental on the one hand and on the other that they are always bilateral between the candidate country and the EU Member States. In the current negotiations, as in previous enlargements, the only part of the process which has been multilateral is the early screening of legislation between the Commission and the negotiating countries (in this case Croatia and Turkey).

The formal negotiating sessions take place in the IGC, with ministers from the Member States and from the candidate country. The more significant negotiating sessions are those at the “deputy” level, between the Permanent Representatives of the EU Member States and the Chief Negotiators or other high officials of the candidate countries.

The real workhorses of the process are however the working groups of officials in the Council of Ministers in Brussels and the negotiating teams in the candidate countries. It is here that the work to prepare the Position Papers (negotiating positions) of the candidate countries and the Common Positions of the EU is done. In the Council of Ministers it is the Enlargement Working Group, consisting usually of officials from the Permanent Representations, which co-ordinates most of the work and which reports to the Member State Permanent Representatives in COREPER.

The European Commission prepares documents and negotiating positions for the Council. The Draft Common Positions are prepared by the Commission as responses to the Position Papers of the candidate countries. These always form the basis of the Common Positions of the Member States, although they can diverge considerably from the Commission proposals. The Commission also prepares technical papers on the implications of negotiating positions. The Commission undertakes, above all, the crucial unofficial negotiations with the candidate countries and provides advice on the implementation of the *acquis communautaire*. As such the Commission is traditionally the ally of the candidate country, negotiating with the Member States on their behalf, albeit up to clear limits imposed by Community practice and institutional loyalty.

The European Parliament, which will eventually have to give its assent by simple majority to the accession treaties, will certainly take a greater role in the negotiations than in previous enlargements. This results from its growing role in the Brussels institutional framework. While the Parliament is limited, by time constraints and its own prioritisation of the issues which come before it, it can still give opinions on specific elements of the negotiations, which will exert some pressure on the negotiating parties.

There are of course structures in all the Member States to deal with enlargement. These develop the national positions and feed into the negotiations between Member States in the Council working groups and the COREPER in Brussels. National parliaments are also deeply involved in determining Member State positions, often preparing influential reports on specific aspects of the negotiations.

In the Western Balkan countries, the institutions and structures involved in the negotiation of accession vary quite widely, depending on different traditions and in some cases on the personalities involved. All the countries will have chief negotiators, who will attend the Deputies' meetings in Brussels. Here however the similarity ends. In some countries these Negotiators will report directly to the Prime Minister, in others they may be placed within the Ministry of Foreign Affairs, reporting to the Foreign Minister.

Chief negotiators rely usually on negotiating teams from the line ministries to construct the first draft of Position Papers. Their influence on the final drafts varies considerably from country to country and depending on the character and position of the individuals concerned. The co-ordinating role of the Chief Negotiator is however essential, especially as the negotiations enter their final phase, and it is necessary to look at the horizontal balance of the Accession Treaty.

Within each line ministry, EU units work to produce the analysis necessary for constructing the Position Paper. Arbitration first at ministerial level, then in the negotiating team and finally at the level of the government (council of ministers, cabinet, etc.), leads to the final decision on the negotiating position which is despatched to the Member States through the Presidency of the Union in Brussels.

One of the key problems of the candidate countries is the shortage of human resources applied to the European integration process. This is particularly the case in relatively small candidate countries, like those in the Western Balkans. The administrations of the candidate countries are sometimes rather small and the officials working directly on European integration tend to be young and extremely talented but with limited experience. Poor remuneration is also an important reason for the frequent departure of these young and talented staff for the rapidly expanding private sector. Combined with the unfinished transformation of the administration, the lack of human resources will pose a significant constraint on all the countries.

On both sides lobbying goes on at all levels. A most important difference between the enlargement to the Western Balkans and the first four enlargements is that whereas lobby groups in the EFTA states were as well established as those in the EU, this was not the case in Central and Eastern Europe and will not be the case in the Western Balkans, where lobbying is a more recently developed activity and where there is still a resistance to corporatist structures of representation.

This difference is important for two reasons. Firstly, it makes the governments of the candidate countries less able to represent national interests (it also, to some extent, protects them from supporting "wrong" causes supported by powerful lobby groups). Secondly, it deprives the negotiators of important information coming from businesses, or trade unions, or other institutions and organisations. The negotiators on the candidate country side are therefore likely to have a lower level of information to work with and less support from such lobbying groups.

This is a description of the institutions of the classic method of enlargement. If the classic method is to be short-circuited for political or other reasons or if a major political initiative is to be started on either the EU or the candidate country side, the European Council is certain to be involved in a very significant way.

*b. Procedures*

The classic procedures of enlargement are likely to be followed with the countries of the Western Balkans. These procedures develop, however, as conditionality changes. The negotiations are divided for convenience into chapters, each representing one policy area and its *acquis*. There are 35 chapters in the current negotiations with Croatia.

After the screening of the *acquis communautaire* by the Commission with the candidate countries, the Intergovernmental Conference (IGC) is created and decides which chapters should be tackled first. For the first time in the case of Croatia, increased conditionality means that the first step for the EU side is to decide on the conditions – the “opening benchmarks” – to be met before the chapters can be opened. Once the decision has been made by the IGC to open a chapter, the position of the candidate country is then drawn up and sent as its “Position Paper” to Brussels.

The Commission studies each Position Paper and draws up a Draft Common Position of the EU as a reply to the Position Paper of the candidate. The Commission acquired a certain routine in the fifth enlargement, with 12 negotiating countries and 29 active negotiating chapters, and even the first round of the exchange of positions led to the production of over 300 papers to be sent to the Member States in Brussels for approval.

The Member States meeting in the Council and working on the basis of the Draft Common Position decide on a Common Position of the Union, which is sent to the candidate country. At this point the chapter can be “opened” and negotiations can begin.

Frequently the EU reply to the Position Paper of a candidate is a long series of further questions, to which the candidate is asked to reply. This may lead to new Position Papers and new Common Positions of the Union.

When agreement is reached on the chapter, it can be provisionally closed, although the Union always reserves the right to return to provisionally closed chapters. As chapters are closed, the core of the negotiation becomes visible in the relatively few chapters, which remain open.

As the differences are narrowed through the elimination of some requests for transition periods and the provisional granting of others, attention is drawn to the final negotiations, which will no longer respect the neat division into chapters but which will require deals to be made across chapters.

With the conclusion of the negotiations, accession treaties will be signed by the EU-Member States bilaterally with each candidate. The treaties will be put to the European Parliament for approval and to Member State parliaments and candidate country parliaments for ratification. The ratification process may take up to two years to complete after signature of the accession treaties.

## **B. CONDITIONALITY**

The development of conditionality in the enlargement process is one of its most significant features.

Of course there had always been project conditionality applied to the grant financing made available to third countries. The Phare Programme, which was agreed in 1989, just after the first

free election in Poland and the opening of the Iron Curtain in Hungary, applied conditions to the granting and use of funds. Conditions have been applied to all the other grant programmes which have followed Phare, and generally this conditionality has become stricter over time.

However, it is the conditions attached to the accession process which are more relevant here.

The main condition for accession to the European Union has always been the adoption of the *acquis communautaire*. Negotiations have been about the details of when, and sometimes how, the *acquis* was to be adopted. The Union has rarely changed policy because of the accession of a new Member State or allowed incoming countries to derogate permanently from the *acquis* (although there are one or two examples from previous enlargements).

In the case of the countries of Central and Eastern Europe, coming from a different political and economic system and being considerably poorer than the EU-15, the Union considered it appropriate to reconsider the conditions for accession. At the Copenhagen European Council in 1993, the Member States recognised the right of accession for the countries of Central and Eastern Europe, but they also spelled out the conditions which the countries would have to meet before acceding.

The Copenhagen criteria (see Table 1) are essentially political, economic and institutional.

**Table 1: Criteria for Accession to the European Union**

Copenhagen criteria:
1. existence of democracy and the observation of human rights and protection of minorities
2. existence of a market economy
3. ability to cope with competitive pressures from the EU
4. ability to take on the responsibility of membership (to implement the <i>acquis communautaire</i> )
5. the capacity of the EU to absorb new members
Madrid "criterion"
The Madrid Council conclusions also mentioned "the adjustment of their administrative structures" as an important element in the preparation for accession, although not as a condition.

The conditions are rather vague. This has the advantage for the Union that they leave a lot of scope for interpretation. This was indeed the express objective of the Member States when decisions were made at Copenhagen. More specific or indeed quantitative conditions would have led to automatic opening of accession negotiations once the conditions had been fulfilled. The advantage of the Copenhagen criteria is that they can always be considered as unfulfilled in some detail or other.

The **political criteria** concern the sharing of the basic values of the Union and the demonstration of these shared values in public life. Essentially these values are a common view on human and minority rights and freedom, democracy and the rule of law. They have since been incorporated into article 6 of the EU Treaty.

The political criteria have proved to be the most crucial part of conditionality. The only times at which the EU has really threatened to stop the integration process with a third country has been when the fundamental values of the Union were clearly not shared. This was the case, for instance, in Slovakia, when the Government of Mr. Meciar was considered to be ignoring the rule of law. The Union also made it clear to Estonia and Latvia that their accession to the Union would be affected by their treatment of minorities. Today the difficulties in the negotiations with Turkey essentially stem from the fact that the Union is not sure that Turkey shares its fundamental values in areas like religious freedom, the position of the army in the state, and the treatment of minorities.

In its relations with the Western Balkan states, it has also been the political criteria which have been uppermost in the minds of EU Member States. Co-operation with the International Criminal Tribunal for the former Yugoslavia (ICTY), the protection of minorities, the resettlement of refugees, and the capacity of countries in the region to work constructively together have all been key conditions for deeper integration.

Until these criteria are met, there is little chance of the Union agreeing to negotiate accession or indeed to deepen integration. This has been made very clear in relations with both Croatia and Serbia. Croatia was recognised as a “candidate country” at the end of 2004, but the opening of negotiations was delayed until spring of 2005 subject to Croatia cooperating fully with ICTY. The following spring, however, the EU did not consider that this criterion had been met and did not agree to open negotiations. It was only in the autumn of 2005, when the Chief Prosecutor in The Hague declared that Croatia was fully co-operating, that negotiations were opened.

For the same reason the Union has suspended negotiations for a Stabilisation and Association Agreement with Serbia. Once however good co-operation with the ICTY is established, the EU’s negotiations with Serbia could accelerate.

The **economic criteria** concern the establishment of the market economy, the implementation of EU competition and state aid policies, and the capacity to ensure that the rules of the EU internal market are applied.

The crucial elements of the economic criteria are the overall competence of a state to run a stability-oriented macroeconomic policy and proven capacity to carry out structural reforms and to ensure that economic regulation is supporting the smooth functioning of the Union’s internal market.

The interest of EU Member States is to ensure that the acceding country will not be a cause of economic problems once it becomes a member. These problems might occur because:

- macroeconomic policy, rather than being aimed at stability, is used as a political tool;
- structural reform is not progressing perhaps because privatisation is either progressing too slowly or is being undertaken in a less than optimal manner;
- institutional reform, such as the independence of the monetary authority or the imposition of EU competition policy or state aid control, is not taking place.

Economic conditionality is important but is less sensitive than political conditionality. The “market economy” is itself a very loose term. It includes relatively “statist” Member States, which still have significant state sectors and which are attached to the concept of state provision of “public services”, as well as very liberal states, which have essentially privatised the whole economy and believe in minimal regulation of the economy. The Union can therefore judge economic reforms in acceding countries more positively or more harshly depending on whether it senses that reforms are genuine and long-lasting or rather more cosmetic.

For countries of the Western Balkans, the economic criteria may prove difficult to meet, judging from the present situation described in the Commission's most recent Progress Reports.<sup>3</sup>

The **institutional conditions** are essentially about the capacity to adopt and implement the *acquis communautaire*.

The appropriateness, efficiency and public acceptance of institutions proved to be key problems in the fifth enlargement. Accession requires the reform or abolition of certain existing institutions and in certain cases the creation of new ones. The reform of existing institutions can be a very difficult and long process. Perhaps the reform of the judiciary is a good example. For many of the countries acceding to the EU since 1989, a complete reform of the judiciary was a necessary component of the reform of the one party state to a multi-party democracy with the rule of law. Judges had to be retrained in order to be able to function in the new system. The introduction of the *acquis communautaire* led to further changes in the legal framework, requiring more retraining. Still today, of course many of the judges in Central and Eastern Europe and in the Western Balkans were trained in a totally different legal system and tradition, and while change is happening, it can be slow and complicated. The inefficiencies of the judiciary have made it hard for companies, including foreign investors, to establish the legal implication of contracts. With the establishment of new institutions, the problem of public acceptance frequently arises. It takes time for institutions to gain public recognition and to be taken seriously. This process of building public trust may take many years and can be slowed down if institutions are considered to have made serious errors in their early years. Sectoral regulators, for instance, often find that they need a very long time to establish themselves as serious operators, even when they have strong legal positions.

The institutional conditions for EU accession require several different elements:

- efficiency of the government to plan the adoption of the *acquis* in an orderly sequence;
- quality of the legal proposals which are drawn up;
- efficiency and quality of parliament in passing the necessary legislation;
- effectiveness of institutions charged with the implementation of the *acquis*;
- ability of the judiciary to deal with European law and to provide speedy, objective jurisdiction that is free of political bias.

These elements constitute the core of the hard work in preparing for accession. The capacity of a candidate country will be judged on whether it has lived up to the promises it has made on *acquis* implementation.

The fourth Copenhagen criterion, the **capacity of the Union to accept new members**, has only recently been raised seriously by certain Member States, which are concerned that the rapid enlargement of the Union is leading to a dilution of its integration.<sup>4</sup>

In the specific case of the Western Balkan countries, additional criteria, resulting from the recent history of the region, apply. These "Stabilisation and Association process" conditions include full co-operation with the ICTY, a commitment to good neighbourly relations and the development of regional co-operation, and the resolution of any outstanding border disputes.

The Copenhagen conditions still form the heart of EU conditionality. What has changed over the years is the way in which these conditions are monitored.

<sup>3</sup> European Commission (8 November 2006), *Enlargement Strategy and Main Challenges 2006-2007* (including progress reports on Western Balkan countries and Turkey), COM (2006) 649 + 1383-1390.

<sup>4</sup> Op.cit., pages 15-22.

## **Programming Conditionality and Monitoring**

A major difference to the first four enlargements was the importance given to monitoring the progress made by the Central and Eastern European countries in the Fifth Enlargement. This was an almost automatic result of increased conditionality.

In the case of the Western Balkan countries, the depth of monitoring has increased further, leading to the impression that conditions have become more rigorous. What in fact has happened is that the Commission has become more careful in the way it monitors performance on the accession criteria.

During the fifth enlargement, the Commission developed new tools to ensure that the countries of Central and Eastern Europe were adapting to meet the Copenhagen criteria.

Bilateral "Accession Partnerships" listed the objectives of the Union for each country in terms of adjustment to the *acquis* and to EU policies. They were divided into short-term and medium-term priorities. As accession drew near, the Accession Partnerships became ever more specific, listing individual parts of the *acquis*, which remained to be implemented before accession was to take place.

The Accession Partnership objectives were monitored by the Commission. The results of this monitoring process were presented annually in the "Regular Reports" on the acceding countries. These Reports went far beyond simple monitoring of the Accession Partnerships, however. They became accepted finally as one of the key international assessments on reform in the applicant countries and therefore had implications for each country, well beyond the question of EU accession. Towards the end of the accession process, the Commission also produced Comprehensive Monitoring Reports based on the Regular Reports, indicating where the country was meeting or falling down on its promises made in the Accession Treaty.

The tightening up of the monitoring of progress towards meeting the Copenhagen criteria has already been seen in the Bulgarian and Romanian cases as compared to the 2004 accessions. In the case of the eight Central and Eastern European countries which signed the Accession Treaty in 2002 and joined the Union in 2004, a Comprehensive final Monitoring Report was produced in 2003. From the signing of the Accession Treaty with Bulgaria and Romania in April 2005, the Commission prepared three Monitoring Reports (October 2005, May 2006, September 2006) on the two countries. This can be partly explained by the decision of the Council (anchored in the Accession Treaty) to allow itself a choice between 2007 and 2008 for the two countries' accession. However, this delay in itself also points to the increase in the Union's prudence as far as enlargement is concerned.

For the countries of the Western Balkans, the bar will be raised again. The same structure of Accession Partnerships (evolving from the European Partnerships which exist under the terms of the Stabilisation and Association Agreements) and "Regular" or "Progress" Reports has been established with respect to Croatia. However, the "Negotiating Framework" agreed by the Council in October 2005 and the course of the negotiations so far clearly show how the monitoring of conditionality has been ratcheted up since the fifth enlargement.

The Negotiating Framework firstly clearly states that if Croatia defaults on the political conditions for accession, the Union can suspend the negotiations. A procedure is spelled out in detail. Interestingly the decision to halt negotiations can be made by qualified majority. While this is only formalising what could have been done anyway in any of the enlargements, it does indicate how seriously the Union takes the monitoring of progress in the candidate countries.

Benchmarks are decided by the Council for the provisional closing of chapters of the negotiations and in certain cases for the opening of chapters. As the negotiations proceed these benchmarks can be revised by the Council. This goes beyond the relatively informal process of deciding on

the opening and closing of chapters in the Fifth Enlargement. The following table shows the situation with respect to the Croatian negotiations in October 2006:

**Table 2: Chapter Overview – Croatian Negotiation**

Closed	DCP in Council	DCP in preparation	Awaiting HR position – no benchmark	Benchmarks set	Screening report <i>with</i> benchmarks in Council	Screening report <i>without</i> benchmarks in Council	Screening report expected November 2006
Science and research	Education and culture	Customs	EMU	Public procurement	Goods	Fisheries	Statistics
			Services	Competition policy		Agriculture	Financial services
			Industrial policy	Social policy		Financial control	Consumer and health protection
			IPR	Justice, freedom and security			Energy
				Capital			Information society

From this table it is obvious that benchmarks are being set for the key chapters of the negotiations, while the chapters to which no benchmarks apply are those in which there is little *acquis* (e.g. education and culture) or where there is not likely to be any conflict (e.g. Economic and Monetary Union – EMU).

The benchmarks which have been set for Croatia are very detailed and one has sometimes to ask whether they do not include elements which should be dealt with in the negotiation of the chapter rather than as a condition for opening the chapter. An example is the benchmark required for the opening of the chapter on the free movement of capital:

“Chapter 4 – Free Movement of Capital

In view of the above, the EU considers that the opening of this chapter could be envisaged once it is agreed by the Member States that the following benchmarks are met:

- Croatia complies, on non-discriminatory basis, with its obligation in particular under Article 60 of the Stabilisation and Association Agreement to authorise, by making full and expedient use of its existing procedures, the acquisition of real estate by EU nationals except in the exempted areas listed in Annex VII of the Agreement. In doing so, Croatia also reduces substantially the backlog of pending requests from EU citizens, improves transparency and speeds up the procedures for all.
- Croatia submits an action plan, including milestones and deadlines, setting out specific measures aimed at harmonizing its anti-money laundering legislation with the *acquis* and at strengthening enforcement, inter alia, by strengthening the awareness of reporting entities, the supervision of reporting entities, law enforcement, prosecution, judiciary and effective cooperation between the entities of the maintenance chain.”

The monitoring of progress in the implementation of the *acquis* will be intense. This is brought out in the text of the negotiating mandate:

“Croatia will be requested to indicate its position in relation to the *acquis* and to report on its progress in meeting the benchmarks. Croatia’s correct transposition and implementation of the *acquis*, including effective and efficient application through appropriate administrative and judicial structures, will determine the pace of negotiations.”

and further on:

“To this end, the Commission will closely monitor Croatia’s progress in all areas, making use of all available instruments, including off-site expert reviews by or on behalf of the Commission.”

The essential conclusions from this discussion of conditionality and monitoring are:

- The Western Balkan countries will be subject to the same conditionality as the countries of the fifth enlargement, with the addition of the specific SAp conditions.
- However, the monitoring of the respect of these conditions will be considerably tighter than in the past.
- The countries of the region must therefore ensure that they can deliver on what they promise. The result of not doing so is likely to be a considerable delay in the negotiations or a possible interruption, with all the political damage that this can have, both externally and internally.

### **Safeguards in the Accession Treaties**

In line with the intention of the Union to more strictly enforce conditionality in the negotiations, it also retains the right to use safeguards after accession if the acceding country does not meet the terms of the Accession Treaty.

The safeguards included in the Accession Treaty with Bulgaria and Romania are identical to those which were inserted for the first time in the Accession Treaties of the fifth enlargement in 2003 (with the exception of the now redundant clauses concerning the possible delay of one year in the accession of Bulgaria and Romania).

To date, no Member State has attempted to use these possibilities introduced by the safeguard clauses with respect to the ten new Member States, but this does not imply that they will not be used before the end date agreed in the Treaties of 2003 and 2005 (three years after accession).

It is obviously very probable that safeguard clauses which are at least as strong as those for the fifth enlargement will be applied to the accession of the Western Balkan countries.

## **C. RIGIDITY AND FLEXIBILITY IN THE NEGOTIATIONS**

The scope for negotiation in an accession is limited. This is essentially for two reasons:

- The negotiation is about the conditions for joining a deeply integrated regional grouping, which operates in some ways like a club. This involves the new member taking over the rules of the club – in this case the *acquis communautaire*.
- Unlike most clubs, new members are not accepted with a majority vote of existing members but only with a unanimous vote. Thus, not only must the whole regional grouping be satisfied that the accession is in its interest, but each individual member must be satisfied. This eliminates much of the flexibility which is needed to accommodate the real needs of the candidate countries.

The rules for dealing with membership applications can be contested, but they are fact, anchored in the Treaties. The accession of the Western Balkans will not be dealt with differently than previous accessions, and there is always a risk that Member States will be tempted to put

short-term national interest before medium-term, strategic European interest. It must therefore be assumed that this will be a constraint on enlargement throughout the process.

### **The Tools of Flexibility in the Negotiations**

The whole *acquis* has eventually to be adopted by the candidate country. There are essentially three types of flexibility which can be achieved in the negotiations:

- permanent derogations from the *acquis*;
- temporary derogations and transitional arrangements;
- technical adjustments to the *acquis*.

Derogations can be requested in negotiations. In the past, permanent derogations have been agreed in rare cases. The most famous is perhaps the permanent derogation for “chewing tobacco” negotiated with Sweden, and the most contested the derogation obtained by Denmark on the purchase of certain real estate by foreigners in the context of completion of the internal market. Such permanent derogations are unlikely to be agreed in the future other than for exceptional situations that have practically no impact on the internal market (the Swedish derogation is a case in point). No permanent derogations were agreed in the fifth enlargement, but the derogation on the hunting of lynx in Estonia comes nearest, although it is to be reviewed some years after Estonia’s accession.

It should be assumed that no permanent derogations will be granted to the Western Balkan states.

The main flexibility in the negotiations is the agreement to delay the implementation of part of the *acquis* until after accession.

Transition periods (of which temporary derogations are a small part) can be requested by both parties. In the Spanish accession, the EU requested transition periods for the free movement of labour and for free access to the EU market for certain Spanish agricultural products. In the EFTA enlargement, the candidate countries obtained transition periods in agriculture and on environmental standards. In the fifth enlargement a considerable number of transition periods were granted.

The Union view of transitional periods is succinctly laid out in the Negotiating Framework with Croatia as follows:

*“The Union may agree to requests from Croatia for transitional measures provided they are limited in time and scope, and accompanied by a plan with clearly defined stages for application of the acquis. For areas linked to the extension of the internal market, regulatory measures should be implemented quickly and transition periods should be short and few; where considerable adaptations are necessary requiring substantial effort including large financial outlays, appropriate transitional arrangements can be envisaged as part of an on-going, detailed and budgeted plan for alignment. In any case, transitional arrangements must not involve amendments to the rules or policies of the Union, disrupt their proper functioning, or lead to significant distortions of competition. In this connection, account must be taken of the interests of the Union and of Croatia. Transitional measures and specific arrangements, in particular safeguard clauses, may also be agreed in the interest of the Union, in line with the second bullet point of paragraph 23 of the European Council conclusions of 16/17 December 2004.”*

Transition periods for the candidate countries, from the EU point of view, should be kept as short as possible. They should be accompanied by a timetable for the progressive achievement of full

compliance with the *acquis*, and their application should be monitored. Obviously, the candidates, on the other hand, are sometimes interested in obtaining long transitions in order to reduce the financial strain of accession. The Union is usually helpful here if the transition period does not lead to distortions of competition, as the above extract suggests.

Transition periods are agreed for a number of different reasons:

- Technical: it is sometimes technically impossible to apply the *acquis* as from accession. A case in point might be where adoption of the *acquis* depends on the revoking of an international treaty, which cannot be completed before accession or where equipment cannot be procured in time to meet the standards demanded by the *acquis* before accession.
- The need to mitigate the impact of systemic change: payments to EFTA farmers to ease the transition to lower CAP prices are a case in point, and access to the EU market for Spanish agricultural products or labour is another.
- The need to protect higher standards existing in the candidate countries: for instance, transition periods on higher environmental standards were provided for the EFTA countries.
- The political need to defend perceived key national interests: restrictions on land sales to foreigners in Poland or maintaining controls on the passage of heavy lorries through Austria are two examples.
- The need to help the candidate countries complete their social and economic transition can justify a transition period.
- Major financial concerns: examples include instances where the rapid implementation of the *acquis* might have destabilising effects on the enterprise sector or on the state budget or where accession might lead to strains on the Community budget — for instance, the implementation of the Urban Waste Water Directive.

Acceding countries may request transition periods in years from the date of accession, or they may be defined by end-dates. Technical problems can usually be dealt with within a certain period from the starting date and therefore set dates can be given for their resolution. In cases where the problems of adjustment are financial or more complex, a date is usually given as from the date of accession, because implementation of the measure is considered to have negative near-term impacts.

Temporary derogations may be given on a similar basis to transition periods, the only difference being that a candidate country would be allowed to set aside the implementation of Community law for a set period without having to present a plan for the transition.

Technical changes to the *acquis* following accession do not usually give rise to problems and are generally undertaken by the Commission. A typical change would be the addition of specific food and drink products with a protected name from the acceding state to the list of protected geographical designations.

In addition to transition periods and derogations, the financial and institutional settlements have to be negotiated and agreed. The financial settlement is usually complex and is likely to be especially so in the case of the Western Balkan states. The institutional settlement (number of Commissioners, votes in the Council, etc.) is usually less complex because precedents exist with current Member States. However, in the case of the Western Balkans, the Union may try to solve its own institutional problems before dealing with the institutional elements of the negotiations.

Even though the EU will not want to agree generous packages of flexibility with the candidate countries, potentially everything can be negotiated. However, each request for a concession from

the Union uses up part of the negotiating capital of the candidate country, thereby limiting its ambitions.

## D. GENERAL APPROACH TO THE NEGOTIATIONS

### 1. The Negotiating Position of the European Union

The initial position of the Member States of the European Union in any accession negotiation is “the *acquis* and nothing but the *acquis*”. This is clearly laid out in the Copenhagen criteria, in the opening position of the Union which precedes the detailed negotiation, and in each Common Position. Irrespective of discussions on “closer co-operation” or flexibility in the future, the new Member States will have to transpose and implement the whole of the *acquis* existing today, including that referring to monetary union.

As in past enlargements, however, a certain amount of flexibility will be shown within this overall constraint. Transition periods and temporary derogations have regularly been used in the past and will be used in the current negotiation as well. However, it is unlikely, as mentioned above, that any permanent derogations from application of the *acquis* will be granted.

In both the Iberian enlargement and the fifth enlargement, the EU insisted on a transition period for the liberalisation of labour markets. In the EFTA enlargement not only were many transition periods allowed, but certain changes were made to the functioning of EU policies. In the structural funds regime, for instance, a new “objective” was added to deal with the problems of the extreme northern parts of the Nordic Member States.

Comparing the future enlargement of the Western Balkan countries with that of Portugal and Spain, the major difference is the size and scope of the *acquis*. The internal market *acquis* is today a major part of the total, increasing considerably the scope of the *acquis*. Scope has been added by the development of the Common Foreign and Security Policy and of Justice and Home Affairs, the incorporation of the Schengen *acquis* in the Treaty, and monetary union. In addition, existing policies have been further developed, leading to considerably more *acquis* having to be transposed and implemented than was the case in the Iberian enlargement. Environmental policy is perhaps the most dramatic example of a major expansion of legislation since the mid-1980s.

For the Western Balkans, adjustments will also be complicated by the continuing high rate of legislative activity in the Union. As the countries adjust to one directive, a revision will appear, forcing them to readjust. Areas such as the environment, food safety or financial regulation are producing significant new legislative initiatives, which the candidates will have to adopt.

The combination of an unfinished transition process in the candidate countries and a large and rapidly expanding *acquis* is certain to lead to a greater need for flexibility in this enlargement than was the case even in the fifth enlargement. From an EU perspective, the objective nevertheless will be to keep transitional measures to a necessary minimum and to ensure that they do not affect the essential working of the Union.

For the Union, some parts of the *acquis* are more important than others. In some areas no concessions will be made to the candidate countries, while in others much more flexibility will be shown. A good understanding of the significance for the EU of different parts of the *acquis* is important for the design of any negotiating position by the candidate countries. The main categories of the *acquis* are as follows:

- *Product regulation in the internal market:*

The internal market remains the core of the European Union, and it relies for its smooth functioning on the transposition and implementation of the specific internal market legislation.

The application of this regulation as from the date of accession, with perhaps a few unavoidable but limited technical adjustment periods, will be non-negotiable for the EU. This includes traditional harmonisation legislation, new approach directives and all of the institutional adjustments needed to apply this legislation – certification, accreditation, voluntary nature of standards, and so on<sup>5</sup>.

- *Essential market economy rules:*

The Union as a whole, and the internal market in particular, relies on the implementation of a series of market economy rules, which it must be applied by the date of accession at the latest. EU competition policy, control of state aid, rules on public procurement and company law form the backbone of this regulation. The full implementation of intellectual and industrial property rights should also be considered part of this *acquis*, although there are some interesting questions to be resolved, particularly on intellectual property rights as applied to pharmaceuticals. There may be more room for manoeuvre in some parts of the market economy rules for limited transition periods. Rules which impose heavy regulation adapted to old EU members, such as the financial capacity of certain types of banking institutions, and which are not appropriate in the first years of EU membership for weaker Member States would be an example.

- *Process regulation:*

Regulation which affects processes – the way in which goods and services are produced – is less important for the operation of the internal market because it does not impinge directly on the functioning of the internal market. Typical here is much of the environmental and social regulation, where the most flexibility from the Union is to be expected. However, further EU criteria restrict this flexibility:

- *Regulation directly affecting enterprise competitiveness:*

Where regulation directly affects the costs incurred by enterprises there will be less enthusiasm on the EU side to grant transitional arrangements. Some social legislation may be of this type, for instance health and safety-at-work regulation or regulation of working hours. It is interesting to note that one of the EU's worries in the negotiations will be to protect the competitive advantage of its enterprises, yet one of the Copenhagen conditions for accession is the ability of candidate countries to withstand competitive pressure from the Union.

- *Regulation of high political concern in the EU:*

This category includes today areas such as food safety law, international organised crime, nuclear safety, and migration and asylum rules. Some areas of the *acquis* are of particular interest to lobby groups, which exert power through the political process. Agricultural and environmental policies are typically of interest to these groups. The agricultural lobby has been most effective in obtaining protection in the past. Environment policy, apart from its general importance for citizens, also has particular support from the Green Party, especially in the European Parliament.

- *Regulation affecting cross-frontier movement:*

The Member States will be particularly reticent in offering transitional arrangements for regulation, which is likely to lead to negative externalities. Transitional arrangements for regulation affecting long-range pollution or the quality of water in rivers or seas to which other Member States have access are the type of problems which occur under this heading.

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Traditional areas of harmonisation, such as regulation relating to cars or food safety, require the harmonisation of product characteristics. New approach directives rely, on the other hand, only on respect for essential requirements (necessary safety rules, for instance) laid down in directives and referral of technical standards to voluntary Community standards, as well as on the free movement of goods respecting the essential standards.

The above categories would appear to exclude most of the *acquis* from any flexibility in the negotiations. However, some parts of the *acquis* have relatively little to do with any of the above categories; the drinking water directive is a case in point. Nevertheless, the power of the Union to refuse reasonable requests for transition periods is not unlimited, and it is bound to prioritise its resistance to such requests in the face of pressure from the candidate countries and from third parties. Even within the internal market regulation there are degrees of importance, and some flexibility should be shown as long as it does not compromise the essential operation of the internal market.

There will be pressure from some Member States for the EU to be more flexible towards the demands of the Western Balkan countries. This was illustrated by a declaration made by the British Foreign Minister concerning the fifth enlargement negotiations in 2000:

“We should be fair. Existing member states benefited from transitional arrangements when they acceded. The EU should be sympathetic to requests for transitional periods from the present applicants as it has been to past applicants...The EU should not expect every expensive capital investment to be completed on the date of accession...We should be generous. Existing members of the EU have a huge economic advantage over applicant countries. The EU can afford to open its markets rapidly to the new members.”

However, the capacity of individual Member States to fight for their national interests in the negotiations should also not be underrated. Before detailed positions are agreed in key areas, there will be negotiations between Member States, which are at least as difficult and complex as those between the Union and the candidate countries.

## 2. The Negotiating Position of the Candidate Countries

The basic negotiating position of the candidate countries is of course that they will implement the whole *acquis* of the Union. However, for the candidates it is usually clear that this process cannot be completed before accession. All of the fifth enlargement countries submitted requests for transition periods or other forms of derogation.

For technical reasons, candidate countries have usually adopted dates for accession. Hungary chose 2002, while the others in the fifth enlargement decided to opt for the start of 2003. Croatia has effectively chosen end-2008 so as to be in time for the European Parliamentary elections in 2009. Although the choice of accession date is a technical assumption, on which basis impact analyses are carried out and requests for transition periods made, it goes beyond the technical aspect, representing the candidate's assessment of the earliest realistic date of accession. As the “realistic” date appears to drift further and further into the future, some negotiating positions will have to be reconsidered.

Candidate countries must take into account a series of domestic and external factors in assessing their negotiating positions. Amongst these factors are the following:

- The impact of Community regulation has to be considered in the light of the continuing requirement of economic transition in the candidate countries. Accession should not delay or prevent changes, which are essential to complete the transition. Ideally, the candidate countries will have undertaken thorough impact analysis of the key parts of the *acquis* before defining their negotiating positions.<sup>67</sup> Such analysis will enable them to

<sup>6</sup> Tokarski and A. Mayhew (December 2000), “Impact Assessment and European Integration Policy”, Working Papers in *Contemporary European Studies* (WP 38), Sussex European Institute, University of Sussex, UK.

<sup>7</sup> In practice this is only partially the case. In the fifth enlargement, the Hungarian Government established a non-government body under the chairmanship of Prof. Inotai, which evaluated major policy areas in the Union and considered their implication for the Hungarian society and its economy. In Poland the approach was less

assess the impact of accession on the key remaining challenges of transition, such as completion of privatisation, transformation of state-owned enterprises, and institutional reform.

- The impact on the financial situation of enterprises and of the state is perhaps the most important constraint on accepting the implementation of the *acquis* as from the date of accession. Implementation of the *acquis* must be planned in such a way that neither is the state budget deficit increased significantly nor is the financing of investment in the private sector made more difficult.
- The impact of accession on the candidate's relations with third countries, especially those in the same region of Europe, must also be taken into account. Accession should not worsen the bilateral relations of the candidate with third countries and should not destabilise the region. This is particularly important in a complex region like the Western Balkans.
- Essential national interests must be defended, although the term "essential national interests" is very imprecise. These interests may appear to be very significant for the other party, such as the question of land ownership in the candidate country, or of minor importance to all countries except the candidate country – e.g. the interest concerning Swedish chewing tobacco.
- Finally, the domestic political situation and the maintenance of support for accession by the majority of voters must be uppermost in the minds of the governments in candidate countries. The apparent "cession" of such recently regained sovereignty to Brussels, together with the growing dominance of western European and American economic interests and the sometimes arrogant attitudes shown by EU governments towards these countries, makes them particularly susceptible to arguments that the government is not governing in the best interests of the people. Domestically, as in the Union, democratic governments are concerned with being re-elected, and this concern will put strong pressure on the government to adopt for key areas negotiating positions that are popular with the electorate.

It is interesting to note that the new Member States from the last enlargement did not seem to follow the "precautionary principle". There was clearly an attempt by governments in these countries to reduce the number of transition period requests to a minimum in order to speed up negotiations. Early entry into the Union was considered the best way of defending national interests.

This strategy is obviously a gamble. The candidates might not achieve early accession and, by not applying the precautionary principle, they may be taking on a financial burden which will hold back economic reform and development. They may also find that if accession is delayed, popular opinion may move against accession, leading to significant political changes.

## **E. THE CORE OF THE NEGOTIATIONS<sup>8</sup>**

For the purposes of the negotiations, the *acquis* is divided into operational chapters – 30 in the case of the new Member States, and 35 for Croatia. To a certain extent this division mirrors the organisation of the European Commission and thereby eases work for the Union. The increase in

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comprehensive, although a series of interesting exercises was completed. Latvia and Lithuania were perhaps the shining examples in accession-related impact analysis.

<sup>8</sup> This section is based on the experience of negotiations between the EU and the new Member States of the fifth enlargement. It is anticipated that many of the problems discussed here will reoccur in the case of the Western Balkans.

the number of chapters from one negotiation to the next reflects the fruit of experience in the fifth enlargement, leading to the division of over-complex chapters or the development of certain policy areas since that enlargement. The traditional sectoral approach involves working through these chapters, taking the easiest first. Individual sectoral problems are resolved in turn, and chapters are provisionally closed, as described above.<sup>9</sup> Gradually the difficult areas of negotiation can be identified. Problems in these areas cannot be resolved independently of other chapters and usually are resolved together in one “end-game” final package of measures.

**It should be remembered that in negotiations with the Western Balkan states, “opening benchmarks” will apply to many chapters, even if the chapters require little negotiation. An example could be the chapter on the judiciary and fundamental rights, in which there is relatively little to negotiate, but the Union may require drastic improvements before allowing the chapter to be opened.**

## The Chapter-by-Chapter Approach

### i) *The “easy” chapters*

A series of chapters pose no problems for the negotiations, basically because they cover areas where there is hardly any Community regulation or where the *acquis* has little immediate impact on the acceding country. The first two of these are areas where a constitutionalist might question whether the Union should be active at all, dealing essentially with policy issues, which are primarily Member State responsibilities. The following group come into this category:

- Science and research
- Education and training
- Industrial policy
- Statistics
- EMU (economic and monetary policy)
- Trans-European networks

These six chapters can be closed relatively quickly, assuming that the screening reports have been agreed. The first chapter on science and research was closed with Croatia in June 2006 and education and training do not hold a greater challenge for the negotiators. Industrial policy sounds important, but in fact the Union does not have an interventionist industrial policy but rather relies on competition and state aid policy, trade policy, intellectual property law and the proper implementation of internal market regulation. Statistics is an important but technical issue, although later on the adoption of EU Statistical Office rules may have a real implication for the measure of certain criteria, e.g. the definition of the government deficit in the Maastricht criteria for EMU or the Stability and Growth Pact. The EMU chapter requires the acceding country to take over the rules of monetary union and of fiscal co-ordination and surveillance. No negotiation will really be possible or necessary here, especially as the Western Balkan states will enter EMU as members, with a derogation from the use of the euro. Finally, the area of trans-European networks contains little *acquis* and should not pose any major problems.

<sup>9</sup> Provisionally closed chapters can be reopened, although this will not be welcomed. They may nevertheless have to be reopened when a new EU regulation is adopted between the provisional closing and the signing of the Accession Treaty.

ii) *Chapters with negotiating problems of limited significance*

A series of nine chapters contain only rather insignificant negotiating problems, which should be resolved separately from other parts of the negotiation<sup>10</sup>:

- Customs union
- Company law
- Information society and the media
- Public procurement
- Foreign, security and defence policy
- Financial control
- Regional policy and the co-ordination of structural instruments (excluding decisions on financing)
- External relations
- Judiciary and fundamental rights

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<sup>10</sup> Some of these chapters include vital problems for successful integration with the EU, but these problems are not necessarily reflected in the difficulty of the negotiations – the chapter on the judiciary and fundamental rights is a good example.

**Table 3: Summary of transitional arrangements agreed with Poland**

<b>Chapter</b>	<b>Transitional Arrangements</b>
Free movement of goods	To 31.12.2008 for introduction of Community procedures on registration of pharmaceuticals
Free movement of persons	Seven-year transition (2+3+2) for freedom of movement of workers to EU-15 (reciprocal)
Freedom to provide services	To 31.12.2007 for the rules on minimum capital requirement of certain co-operative banks
Free movement of capital	12 years for farmland and forests; excludes self-employed farmers having leased and worked land for three or seven years minimum (depending on region); five years for secondary residences
Company law	None
Competition policy	End-2011 incompatible aid for small enterprises, end-2010 for medium-sized enterprises; conversion to regional aid for large companies subject to limits; transition period for certain environmental aids; restructuring of steel industry by end 2006
Agriculture	Transition to 2013 for full payment of direct-income subsidies; top-up allowed up to agreed limit; top-up from rural development funds for 2004-2006; base levels for market organisations agreed; also for milk quota; transitional period for upgrading dairies and meat-processing plants; transition to 2010 for elimination of certain potato diseases
Fisheries	None
Transport	Three-year (max. five-year) transition period for cabotage (required by EU-15); end-2010 on access to Polish infrastructure by heavy vehicles; end-2006 for opening up Polish railways to competition
Taxation	VAT: end-2007 for 7% level on building industry; zero rating for books and periodicals; low VAT rate for restaurants; April 2008 for 3% VAT level on food products; exemption on international passenger travel; <i>Excise</i> : April 2005 reduced rate on environmental fuels; end-2008 lower rate on cigarettes; <i>SMEs</i> : exemption rate for VAT set at 10,000 EUR
EMU	None
Statistics	None
Social policy, employment	End-2005 on work equipment directive
Energy	End-2008 for reaching minimum oil-storage level
Industrial policy	None
SME	None
Education and research	None
Telecoms and IT	End-2005 on postal liberalisation
Culture, audio-visual	None
Regional policy, co-ordination of funds	None
Environment	To 2017, large combustion plants; 2015, urban waste water; 2012, landfill of waste; 2010, IPPR; 2007, packaging and shipment of waste; 2006, ionising radiation, sulphur content of fuels; 2005, volatile organic compounds in fuels
Consumer protection, health	None
Justice and home affairs	None
Customs Union	None
External relations	None
CFSP	None
Financial control	None
Finance and budget	No transition periods. Schengen Fund, structural fund allocation partly translated into budget subsidy; lump sum transfer
Other	Institutions – Nice Treaty

These chapters contain regulation, which is of great economic significance and which also provides interesting negotiating problems. The first is clearly the case for the chapters on **information society and the media, consumer protection and health, public procurement and company law**. The regulation and liberalisation of telecommunications is a policy which fits in well with the aims of economic transition in candidate countries and should therefore be welcomed as an additional spur to reform. Telecommunications liberalisation may pose certain problems on the ground, including institutional issues, although problems are unlikely to occur in the negotiations. In the fifth enlargement a minor transitional arrangement was agreed for the portability of telephone numbers in Bulgaria. A key directive in the media area is the “television without frontiers” directive (89/552), which is honoured in the breach by some Member States, but this did not cause major problems in the negotiations.

Consumer protection is another area of regulation which was largely absent under the central planning system and has to be developed in the move to a market economy. In each of these cases the negotiating problems that were raised (for instance, requests for short transition periods for full liberalisation) were easily resolved, and these chapters were quickly (provisionally) closed for all. Implementation of consumer law may be slow, as this is a new area of regulation for most candidates. This will not disturb the working of the internal market, however.

Public procurement, while being a difficult area on the ground, is unlikely to cause serious problems in negotiations. The Western Balkan countries will simply have to take over and adopt EU regulations. However, this chapter looks as though it will be more complicated than it was in the fifth enlargement, at least judging from the experience of the Croatian negotiations. Here the benchmarks for opening the chapter attempt to ensure full conformity with the *acquis* before the negotiations begin.

Company law, now that intellectual property law has been taken out of it, should not provide any great negotiating problems for the Western Balkan countries. There were no agreed transition periods in company law in the fifth enlargement, although adjustment in certain cases was delayed until the day of accession.

**The Common Foreign and Security Policy (CFSP) and the European Security and Defence Policy (ESDP)** are key areas of EU policy and today do not pose serious negotiating problems for the Western Balkan countries, although they may in a few years' time, probably after accession. These policies are essentially areas of intergovernmental co-operation. They may indeed pose as many significant problems in the preparation for accession as afterwards. The EU expects candidate countries to support CFSP by joining the numerous foreign policy declarations of the Union. This posed problems for Poland prior to accession, as its policy on Belarus was somewhat different from that of the EU-15.

**Financial control, regional policy, and customs union** are technical chapters which concern the detail of how the European Union works in these areas. There are few real policy concerns involved and little to negotiate; in financial control there is none. In structural policy (regional fund, etc.), the candidate countries would be classed as “Objective 1” countries (receiving the highest intensity of aid) under current rules. However, the Western Balkan countries must consider that it is possible that the rules governing the structural funds and indeed the level of financing may change before they join. There is little that they can do about policy changes, however, as these changes will be decided by the EU-27 and will not form part of the negotiations. In the preparations for accession, the Commission will want to ensure, as far as is possible, that the acceding states have the institutional capacity to administer the structural funds, responsibility for which has been substantially delegated to the Member States.

The customs union *acquis* was somewhat more disputed in the fifth enlargement, with Hungary asking for a transition period for tariff levels concerning trade with Russia and with Slovenia wanting to maintain trade agreements with other states of the former Yugoslavia. These problems were however policy issues and may well be considered as part of the external economic relations chapter. The *acquis* in the strictly customs areas is directly applicable in Member States and is not subject to negotiation, and while the institutional questions related to customs are vital, they will not be a significant part of the negotiations.

The chapter on **external relations** does contain real policy issues for the Western Balkan countries, which may give rise to problems but which will not persist into the “end-game” of negotiation. In external economic relations there are indeed serious questions about the extension after accession of current trade arrangements with third countries. This issue is part of the complex of foreign affairs and regional stability issues, which may persist into the final stage of the negotiations. On the specific issue of trade agreements with third countries, however, the acceding countries have no choice but to accept the *acquis*. A problem will arise if the countries of the Western Balkans join the Union at different times, as is to be expected. If we assume that Croatia joins the Union first, it will then leave the Central European Free Trade Area (CEFTA), which has created free trade amongst the countries of the Western Balkans. If no further agreements are made with the remaining countries of the region, the conditions for trade between Croatia and the other Western Balkan countries would change slightly, although there is free trade in industrial goods throughout the region and with the EU.

The chapter on the **judiciary and fundamental rights** concerns an exceptionally important area for countries of the Western Balkans, but they will probably have to show that they are meeting EU standards before negotiations begin, as this chapter touches the question of the fundamental values of the Union. In the 2006 Progress Reports on these states, the judiciary is one of the areas which comes in for strongest criticism, even for Croatia. Corruption is another problem which the Progress Reports dwell on at length. But these are not negotiating problems. The countries know that their resolution is one of the criteria for the opening of negotiations and that there is no scope for negotiation.

*iii) Chapters with serious sectoral policy concerns*

A series of chapters contain serious sectoral policy concerns, which however should be resolved within the negotiating chapter, although there is clearly a risk that these problems may flow over into the final “end-game”. These concerns are the following:

- Free movement of goods
- Intellectual property law
- Financial services
- Taxation
- Competition policy and state aids
- Social policy and employment
- Establishment and freedom to provide services
- Energy
- Transport
- Common fisheries policy

The chapter on the **free movement of goods** contains the heart of product-regulation in the internal market. The scope for derogations from this type of regulation is obviously very restricted, as mentioned above. The negotiating positions from the previous enlargement show

that the requests from candidate countries, although significant, were technical in nature and rather limited in extent.

One of the most significant areas in the negotiations was that concerning pharmaceutical products. This issue was treated both under this chapter and under the chapter on company law. Cyprus, Hungary, Lithuania, Poland and Slovenia were granted transition periods for the implementation of Directives 2001/82/EC and 2001/83/EC on the marketing of proprietary medicinal products to enable them to continue to supply domestic markets with generic drugs after accession. Without this concession the impact on state health insurance schemes could have had important budgetary consequences. The Czech Republic and Slovenia also asked for agreement to maintain stricter norms than those applied in the EU in toy safety and in the use and trade of chemicals and pesticides. Finally, Hungary asked for confirmation that its strict control of the export of cultural goods could be maintained after accession, as well as the continuation of the use of non-cocoa vegetable fats in chocolate.

These problems may perhaps be quite difficult to resolve. Pharmaceutical companies established in the EU were not happy with transition periods which kept their higher priced branded goods out of the new Member State markets. They also worried that if transition periods were agreed for the new Member States, they would normally be allowed to export their products in the internal market, thereby undercutting EU-15- based products. Nevertheless, these are not the sort of problems which are going to have to wait to be resolved in the final stage of the negotiation. They may well not be resolved in the most economic way, but technical compromises can be found.

The chapter on the free movement of services in the fifth enlargement revealed a series of problems related to the provision of financial services essentially linked to the size and structure of the new Member States' financial sectors. These problems have now been grouped in a new chapter on **financial services** (in the case of Croatia). The problems arose mainly from the existence of small-scale, often co-operative, financial institutions which could not meet the requirements for investor protection or minimum capital requirements. Hungary and Poland both obtained transition periods for their co-operative banks in the context of the directive on capital adequacy (89/646). Both countries, as well as Estonia, Latvia and Lithuania, also requested and were granted transition periods to implement the directive on the minimal level of guarantee of depositors' funds in credit institutions. In the new Member States the average level of bank balances is far smaller than in the EU-15. Hence these countries maintained that, for an interim period, lower levels of depositor guarantee were adequate and that this would reduce the strain on local banks' capital and help them to compete with western banks. Such requests are determined by the far lower level of GDP per capita in the accession countries and by their lower wealth. The young financial markets of Central and Eastern Europe might also find it difficult to raise the capital necessary to immediately underwrite an insurance scheme at the EU level. This is the type of problem linked to the transition and development processes, which met with a degree of understanding by the EU Member States. While it represents a breach in the internal market in financial services, a transition period in this area is unlikely to have any major impact on competition. Similar problems are bound to arise in the Western Balkans.

The chapter on the freedom to provide services consists mainly of rules on establishment, on the regulated professions and on the liberalisation of certain public services, such as postal services.<sup>11</sup> These areas may prove to contain difficult problems, especially in the case of the regulated professions. The adoption of EU rules may lead in some countries to certain professional qualifications not being recognised under EU law. Considerable attention needs to

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<sup>11</sup> The *acquis* in this area has been substantially widened since the fifth enlargement by the adoption of the "Services Directive".

be given to this question, although solutions will be found before the “end-game” of the negotiations.

In the area of **intellectual and industrial property rights**, the countries which registered problems in implementing the *acquis* in these areas (Estonia, Hungary and Poland) were essentially worried about the value of patents and trademarks registered by them nationally in the past and about the impact of the application of certain EU patents on their own domestic industries. It was agreed to extend the area of Community trademarks and designs to the territory of the new Member States, while protecting prior rights acquired in those states. The western European and American pharmaceutical companies, for their part, were concerned that some of their patents would not be valid in the new Member States. The European Federation of Pharmaceutical Industries and Associations (EFPIA) was extremely active in this area. In the end and after complex negotiations, an agreement was reached between the EU and the new Member States which permitted the latter to continue to market, unprotected by patents, drugs which had been marketed by EU companies prior to accession, until the patents expire. In return these drugs cannot be exported from the new Member States to the old EU-15.

In the area of **taxation**, most of the new Member States in Central and Eastern Europe obtained transition periods, both in certain aspects of the *VAT regime* and for some *excise duties*. The problems encountered here were those encountered by the old Member States, namely the application of specific rates of VAT to goods and services which were regarded as a special national priority. These priorities differ from one state to another. Frequently they reflect the national choice to support poor or large families by charging a lower indirect tax rate on “necessities” (such as energy supplies and food served in canteens in Hungary) or on “cultural items” (such as books in Poland). There is also the worry that major tax hikes will lead to a sudden jump in inflation as the whole of the tax increase might be pushed through to the price (Czech Republic). *Excise duty* on cigarettes posed yet another general problem across most of the accession countries. This is a reflection of the higher impact of expenditure on cigarettes on the general price level than in EU-15 countries and the general unpopularity of a sharp rise in smoking costs. Bulgaria and Romania were granted quite generous transition periods for the minimum level of excise duties on various fuels. A rare example of a derogation was that granted on the level of excise duties on home-brewed, fruit-based alcohols.

A further specific request concerned the level of turnover below which businesses can choose to be excluded from the VAT system (applicable to all 12 new Member States). These states argued for a higher turnover limit to the exemption of small businesses from the VAT system.

These are serious problems potentially affecting competition in the internal market, as well as price stability and the popularity of European integration in applicant countries. The position of the European Union is relatively weak in many of the indirect taxation and excise areas, given that most of the current Member States have been granted exemptions in Community directives. This applies equally to the question of the maximum turnover level for exemption from VAT.<sup>12</sup> Arguments concerning the impact of tax changes on the level of inflation in Western Balkan countries will also be strong.

The requests where it will be more difficult to obtain agreement from the EU are those affecting competition across the Union and those where very strong commercial interests in the EU-27 are affected. This is certainly true for the taxation of cigarettes. In the fifth enlargement, there was enormous pressure on the European Commission and on Member State governments from American and European cigarette manufacturers to eliminate distortions to competition arising from differences in excise rates in some of the applicant countries. The concern of important commercial interests is clear (and justified in the case of distorting excise rates). However, the

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In its common position, the EU indicated that it would accept a higher VAT registration and exemption threshold.

impact on national budgets is perhaps the dominant motive for both EU Member States and candidate countries in the discussions about transition periods. The candidate countries in the Western Balkans will worry that a tax-induced price rise of cigarettes may lead to a fall in tax income deriving from lower consumption and higher smuggling. The Member States will no doubt worry about the impact on revenues of the legal and illegal import of cigarettes bearing lower tax rates.

While most of these taxation problems are likely to be resolved in within-chapter negotiations, the sensitivity of these issues may mean that some of them remain unresolved until the final negotiating round.

**Competition policy and state aid** may turn out to be one of the most difficult chapters. There are no negotiating problems in the area of strict competition law; it is in the state aid areas where serious problems will probably arise.

The main problems arise in the favourable treatment given to investors in specific zones or industries and in the level of subsidies made available to certain “key” sectors. Where these different systems do not meet EU requirements, they will have to be changed. However, this poses a serious problem when the non-EU-conform systems are anchored in contracts between the acceding state and private investors. Such agreements have legal validity but may have to be broken, leading potentially to serious financial claims against the state.

The economic arguments for or against such state aid (and favourable tax regimes are often state aid in the EU sense of the term) are inconclusive. As a general rule, state aid rarely produces favourable overall economic development, though it may be extremely beneficial to the enterprise receiving the aid. On the other hand, there are examples where such aid has either attracted investors, leading to faster development in countries in transition, or where state aid has allowed a sector to be restructured, while minimising social costs. Such state aid can be particularly significant in transition economies.

In the fifth enlargement, the Czech Republic and Poland requested a general “flexibility” clause in order to take into account their needs as transition or “post-transition” countries. This request was influenced by the history of the former DDR’s integration into Germany and the Union. Massive quantities of aid were pumped into the former DDR after German reunification. The EU agreed to this aid outside all Union rules because of the political priority of reunification but also because of the objective challenges presented by the rapid transformation of a centrally planned economy to a market economy.

More specifically Poland requested that it should be granted “transitory admissibility” for a series of state aid which it was already granting as assistance to transition in the environmental, regional and industrial sectors. Finally, and perhaps most difficult, Poland requested a transition period until 2017 for certain state aids granted to businesses in the Polish ‘Special Economic Zones’. Poland was then faced either with requesting a transition period until the end of the contract or compensating the companies for breaking their contracts.

However, from the point of view of the EU’s internal market, state aid can lead to major distortions of competition.

Compromises on transitional arrangements in the above cases were generally found. It was always unlikely that the EU would agree to a “flexibility” clause for state aid, as requested by the Czechs and the Poles, even though this would have seemed to be justified both through the experience of the integration of the new *Bundesländer* in Germany and through the objective needs of a transition country. Indeed, there was a Commission draft of a special regime for countries in transition, which however was subsequently withdrawn.

As a result of the negotiations in this chapter, Cyprus, Hungary, Malta, Poland, Romania and Slovakia were all granted transition periods to wind down their illegal regimes, though the time allowed was less than requested. In addition, the Czech Republic and Poland were given additional time to restructure their steel industries using state aid, and Poland was granted a transition for some environmental aid. Certain very closely defined “existing aid” was also allowed to continue.

The real problem in this chapter, as in several others, was the degree of mutual confidence in the application of the rules. The history of state aid control in the Union clearly shows that many decisions are strongly influenced by political pressure from Member States, which have a long tradition of supporting their domestic champions. The Commission sometimes bows to national pressure in order to avoid open clashes with Member States. In the case of applicant countries, which have undergone a transition from a centrally planned system where state aid was all pervasive, the Member States assume that something from the previous system lives on and wish to see stronger rules imposed than exist in the EU. Given that there is a lack of mutual confidence within the EU, it is not surprising that this distrust is even greater in respect of applicant countries.

It is already clear that some of these problems will reoccur in the Western Balkans. Already Croatia is having to face problems with its Special Economic Zones, steel and shipbuilding aid. The latter two areas were raised in the Commission’s 2006 Progress Report on Croatia. Throughout the rest of the region, even the concept of what is a state aid is fuzzy and controls rather ineffective.

The **social policy and employment** chapter, specifically the health and safety at work section, was generally expected to create more negotiating problems in the last enlargement than it did. Health and safety-at-work legislation could potentially raise costs to producers significantly. In the end, very short transitional arrangements were agreed with Latvia, Malta, Poland and Slovenia. These arrangements applied generally to equipment or processes already installed or in use prior to accession.

The reason that applicant countries made so few requests in relation to this chapter is perhaps that they realised that non-application of health and safety directives would be politically very sensitive to the Member States. But another reason was perhaps that it is mainly the private sector, which is affected by this legislation.

The danger is that, especially where serious impact assessment has not been carried out, government negotiators perhaps do not realise the extent to which business will be affected. Governments in the Western Balkans should work closely with the enterprise sector to assess the impact of this legislation on business.

Realistically, as the length of the accession process steadily grows, the adjustment problems will become less serious, as machinery is depreciated and new investment respecting EU standards takes place.

The linked area of the **establishment and freedom to provide services** contains the potentially difficult area of harmonisation of rules for the mutual recognition of qualifications and diplomas in the regulated professions. There was a long argument in the negotiations with Poland, for instance, on the qualification of Polish nurses under the “automatic recognition” directives. On the other hand, assuring the right of establishment, while causing considerable problems in adjustment, should cause no problems in the negotiations, as it is one of the essential rights within the Union.

In **energy**, all of the new Member States, except Hungary, asked for a transition period for the implementation of the directive requiring the maintenance of oil stocks at the 90-day consumption

level. The justification was the investment cost that the extension of storage capacity would entail. The transition periods granted ranged up to a maximum of 5 years from the date of accession.

The requests for slower energy market liberalisation were either rejected or accepted with such short transition periods as to be insignificant.

In **transport policy** a wide range of rather technical problems will be resolved in the course of the negotiations and will not enter the “end-game”. These technical problems are however liable to be important for the Western Balkan countries.

In previous enlargements, four areas of transport regulation posed problems: cabotage, technical control measures, admission to the occupation, and weights and dimensions.

It is the old EU-15 Member States which pushed for restrictions on access to national transport markets of the new Member States. Hauliers in the EU-15 were afraid that they would be undercut on their home markets by those from the new Member States. Hence a transition period of three years for the opening of cabotage, with a possible extension for a further five years, was agreed. While the competitive threat from the Western Balkan states is less than it was from the 12 new Member States, it is likely that the same transition periods will be applied.

Three of the new Member States were given short transition periods for the installation of tachographs in lorries exclusively used in internal transport. Rules on admission to the occupation caused problems for several countries, basically because of the financial standing criteria laid down in Directive 96/26. Bulgaria was given a transition period running to the end of 2010, a reflection of the limited capital and reserves of domestic hauliers in a relatively poor Member State.

Finally weights and dimension rules were a problem because of the poor state of infrastructure in some of the new Member States. Bulgaria, Hungary, Poland and Romania were given permission to maintain their current limits for a transition period of six years from the date of accession and on the condition that they adhered to their programmes for the upgrading of the road network.

Other problems linked to the restructuring and privatisation of enterprises in the transport sector may arise, but these issues are most unlikely to remain unresolved into the final negotiating round. They arose in the fifth enlargement but were resolved in the negotiations, with short transition periods agreed for the opening of the rail network to competition.

The **Common Fisheries Policy** posed a problem for Poland in the fifth enlargement because Poland had liberalised its fishing industry and had to return to a more planned economy solution in accordance with EU policy. This policy is complex and requires careful negotiation. It will of course be important for those Western Balkan states with a significant fishing industry, notably Croatia.

The Common Fisheries Policy is essentially a collection of regulations, which do not need transposition into domestic law. However, the essential principles of the policy will require significant changes in the Western Balkans. The negotiations in the fifth enlargement show, however, a degree of flexibility on the part of the Union in dealing with specific regional problems. The agreements with Malta but also with the Baltic States and Poland showed a considerable amount of flexibility.

*iv) The major negotiating problems*

The remaining chapters are those where the most difficult problems lie:

- Agriculture and rural development

- Food safety, veterinary and phytosanitary policy
- Environment
- Justice, freedom and security
- Free movement of workers
- Free movement of capital
- Finance and budget, and possibly
- Institutional questions

These issues will probably not be resolved until the final round of negotiation, and they may be resolved as a package deal rather than within “chapter-by-chapter” negotiations.

The problems with the above chapters are quite diverse. Certain of these questions contain real **policy issues**. Agricultural policy and rural development are of vital importance for the countries of the Western Balkans, where the result of the negotiations will to some extent condition the structural reform of the farm sector. Food safety and veterinary and phyto-sanitary issues are very high profile matters in the Union and may put some businesses in the acceding countries at risk. Justice and home affairs is also an important policy issue because it will define and probably change both domestic and foreign policy of the applicant states. Other questions are largely **financing issues**. The environment chapter should contain real policy issues but in the end is likely to be a financial discussion about how quickly applicants can be expected to implement the environmental *acquis*. The finance and budget negotiations, including the financing of the CAP and structural funds, will lead to an agreed financing package for the whole enlargement. There are also **political issues**. The problems in the free movement of persons and the free movement of capital include the politically high profile issues of the free movement of workers and the purchase of land by EU foreigners. Both of these questions are issues because they have been made so by politicians and the media. **Institutional issues** in the Union will be very important, because no further accession is possible without modifying the Nice Treaty, a change which requires ratification.

**Agriculture** is an important issue because:

- agriculture is far more significant, as both an employer of labour and as a share of national GDP, in the Western Balkans than in the EU Member States; a satisfactory solution to the agriculture negotiations is therefore essential for these countries;
- agriculture receives high levels of subsidy through the EU budget and takes around one-half of all EU budgetary resources and, although the Western Balkan states are small, enlargement has budgetary significance;
- the World Trade Organisation’s negotiations on the liberalisation of trade in agricultural products and domestic pressures in the Union are forcing the EU to accelerate the reform of the Common Agricultural Policy (CAP).

Whereas for most of the negotiating chapters the EU’s negotiating position is straightforwardly “the *acquis*”, in agriculture it outlined its position in the Berlin European Council decisions based on Agenda 2000. Agenda 2000 dealt with the fundamental issues of CAP reform in the light of enlargement. The Berlin summit decisions on CAP reform reduced the scale and scope of the reforms proposed by the Commission in Agenda 2000. The question was therefore immediately raised as to whether the degree of reform was adequate to avoid the accumulation of large food surpluses in the future, especially considering the impact of higher prices on production in the new Member States.

The decisions made in Berlin will almost certainly be one of the starting points for negotiations in the Western Balkans. However, it is almost certain that the Common Agricultural Policy will be

significantly reformed again over the next decade. In fact, reform is going on all the time, independently of the “grand reforms” undertaken every few years. Changes in market regimes for individual crops are being proposed or acted on in the light of the direction of CAP reform agreed in 2003. Clearly this complicates any preparation which the countries of the region can undertake.

In the narrow field of negotiation, three major issues can be distinguished:

- *Levels of subsidy*: The Berlin summit “resolved” the budgetary issues concerning agriculture simply by deciding that farmers in the applicant countries would not receive the direct income subsidies, which are the major subsidy component in the new CAP and which are paid to EU-15 farmers. This forms the basis of the budgetary offer in agriculture. The Berlin decision was amended during negotiations for the fifth enlargement. In the first year of membership, farmers in the new Member States receive 25% of the level of direct income subsidies of those in the EU-15. This percentage rises annually, to reach 100% after ten years. The acceding countries were given the right to top up these direct payments by a certain amount for the period up to 2013, and they were also given the right to use some rural development funds to further top up payments during the first three years of membership, though top ups could not raise the overall level of payments above 100% of the EU-15 level. There were also a few exceptions to the general rule agreed, such as the top up to 100% of EU-15 levels for potatoes in the Czech Republic.

This offer is most likely to form the basis of the negotiations with the Western Balkan states. There may however be room for negotiation, as the farming sector in these countries is rather small in European terms and therefore the cost of any agreement to the Union budget will be rather limited.

- *Base reference dates for quotas and other base-linked allowances*: The base for quotas (sugar and milk, for instance) or for various payments (such as suckler-cow premium, area payment scheme for arable crops, or special beef premium) defines the scale of production and/or the level of subsidy for all products for which there is a Common Market Organisation. The fixing of these reference bases was made more difficult by the nature of the economic transition in the countries of the last enlargement. Re-privatisation of the land and the break-up of state farms caused major declines in agricultural production in many of these countries in the first half of the 1990s. For this reason, applicant countries preferred to take, as reference points, periods in the 1980s, the last time that agriculture was producing under relatively “normal” conditions. The EU-15, on the other hand, insisted on base reference years where output was far lower (1995-99), and it was the EU position which in general prevailed. With the changes taking place in the CAP, these payments are likely to be lower in the future, and indeed some may be phased out as the policy moves away from product subsidy.
- *Proper implementation of veterinary controls and food hygiene standards on farms and in food processing units*: This very important and difficult area, which was part of the agriculture negotiations in the fifth enlargement, has been made a separate chapter in the negotiations with Croatia (see below).

Many other detailed problems in the agricultural chapter reflect in some cases the particularities of agricultural policy in the various countries. The following list, although not exhaustive, gives a flavour of the complexities of this chapter:

- Slovenia did not wish to be forced to distribute milk and other quotas to individual producers, because this would interfere with the process of restructuring agriculture.

- The Czech Republic, Estonia and Hungary requested transition periods for bringing the standard of battery cages for chickens up to the level required by the EU for reasons of animal welfare.
- Wine producers in the Czech Republic, Hungary and Slovenia requested various transitional periods or permanent derogations to facilitate the continued production of traditional national wines.
- Poland asked for the creation of a new Common Market Organisation for potatoes and the introduction of support mechanisms for herb growers.
- Most countries requested permission to keep higher standards in certain areas or to prevent the import of substances considered dangerous (such as certain seed varieties or some bovine semen).
- Czech Republic, Hungary and Poland each requested a safeguard clause to protect their markets in the case of severe disturbance after accession.

Negotiations on agriculture are always tough, and few of the above requests were in the end granted. The main transition periods which were agreed came in the following general areas:

- Specific requests to continue some state aid for particular crops, e.g. oil pumpkins in Slovenia, or for “deprived areas” in Cyprus;
- Slight deviations from certain CAP regimes to take account of national differences, e.g. milk quota in Poland;
- Permission to continue producing and selling milk which does not meet EU quality standards on home markets (this will move to a separate chapter for the Western Balkan countries);
- Criteria for the setting up of producer organisations (Poland);
- Reduction of stocking densities under the beef premium rules (Cyprus and Malta).

Negotiations will also have to be held to deal with the question of geographical or traditional “designations” for agricultural products, which protect them from competition from other Member State producers. Most of these designations refer to wine or other alcoholic drinks.

All of this underlines the fact that each market organisation has its own definitions, which are applied to acceding countries unless specific arrangements are agreed in the negotiations. Very careful and early preparation on the side of the acceding country is therefore required.

Finally, there is the whole question of agreement on rural development policy. The ten states which joined the Union in 2004 were given a special temporary rural development instrument for the period 2004-2006, which included financial measures for semi-subsistence farms and financial assistance to meet EU environmental, hygiene, animal welfare, food safety and occupational safety standards. This temporary instrument was designed to cope with the situation up to the new financial framework period starting in 2007, at which time these Member States would be treated the same as the EU-15 countries. Bulgaria and Romania, however, were granted certain measures to deal with their specific situations (e.g. support for semi-subsistence farms undergoing restructuring or the payment of financial support to encourage older farmers in the dairy sector to retire in order to ease restructuring).

More important of course than these negotiating points is the nature of the future policy which the Union and the Western Balkan states wish to develop. The fifth enlargement negotiations changed agricultural policy in both the acceding countries and the Union. There is a growing consensus on the direction which the CAP should take following the 2003 reforms and it is likely that the negotiations with the Western Balkan countries will change this direction. However, the agreements themselves are constrained by the negotiations which both sides will undertake at

international level in the WTO. They are, above all, both constrained by decisions on the nature of the agricultural policy which both parties wish to see implemented.

These questions will be linked to other chapters in the negotiations and therefore cannot be resolved independently. The linkages to the budget are perhaps the easiest to understand, but there are also interrelationships with consumer protection, the internal market and the free movement of goods, land ownership issues, establishment and free movement of services, and the environment. In addition, negotiating linkages will be made with other chapters, independently of any real policy linkage. Concessions in agriculture may simply be traded against concessions in other unrelated chapters.

### **Food Safety, Veterinary and Phytosanitary Policy**

The political importance of food hygiene and food quality in the Union is so great that there is no room for manoeuvre in these areas. The problems will be on the one hand practical can the Western Balkan countries physically implement the necessary controls in meat factories, dairies and other installations before accession? And if they cannot, how will they dispose of products that do not meet EU standards? On the other hand, there is again the problem of confidence: how can the applicants persuade consumers in the EU-27 that their food exports meet the high EU standards, even when they do?

In the public health area, as in the environment chapter to some extent, the accession documents will include reference to individual enterprises and specific plants (dairies, meat and fish factories). There is little to negotiate. The question is: does each plant meet EU standards? If not, what transition period should be agreed for them to meet these standards and what should be done with their produce during the transition periods, as it obviously cannot be exported, either within the EU or to third countries.

Short transition periods were also agreed in the fifth enlargement in the phytosanitary area.

**Environmental policy** problems appear to be very complex, although they should be easier to resolve than those concerning agriculture.

The environment chapter is the one, which attracted the largest number of requests for transition periods and derogations in the fifth enlargement and where the largest number was granted. The sole reason was the ability to finance the implementation of Community environment policy in the new Member States.<sup>13</sup> There is no question that the countries did not want to achieve the same environmental quality as the existing Member States, as the communist period had left major problems of environmental degradation to be tackled. It is true that environmental policy was often not given the highest priority in the early years of the transition in Central and Eastern Europe mainly because of more urgent demands on administrations everywhere. But with growing public awareness and the development of a sizeable middle class, the demand for higher environmental standards has become more pronounced. The problem is always how to finance the implementation of the Community *acquis* in the context of other pressing demands on public finance.<sup>14</sup> The situation in the Western Balkans will not be very different, although to some extent the environmental problems may be less severe.

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<sup>13</sup> The problems of implementing the *acquis* in the area of environmental policy should not be underestimated. This is indeed the area where the existing Member States' performance is relatively poor. The large number of proceedings against Member States for non-application or incorrect application of Community environmental law is described in detail in the European Commission's annual report on "Monitoring of the Application of Community Law".

<sup>14</sup> The costs associated with the adoption of the Community *acquis* will be shared between the private sector, the public sector and consumers. Whether the public and private sectors can push through costs onto the final consumer will depend partly on the level of competition in the market. The private sector will incur costs due to new health and safety standards, the environmental *acquis* and various other parts of EU regulation. The public sector, however, will have to

The financial cost of implementing Community environmental policy, consisting of both investment costs and operating and maintenance costs, has been estimated by the World Bank and various other reliable sources.<sup>15</sup> Although some of the more macro-estimates may be corrected by detailed impact assessment, the fact remains that none of the countries concerned can afford to finance all environmental measures, in both the private and public sectors, before accession. Even if funding was to be made available, for instance from foreign loans or grants, it would still not be in the best interests of the applicant states or of the EU to proceed to undertake massive environmental investment in a short period, which would have considerable inflationary impacts and in some circumstances could raise interest rates in other sectors of economic activity.

The World Bank has made a general estimate of the costs of meeting the EU *acquis* in the environment area as follows:

8.14 The point of departure for the estimates is the European Commission study (EDC, 1997) of 1997, as well as later studies in which these figures have been revised for specific countries.<sup>173</sup> Based on estimates of investment expenditures for Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovak Republic, Slovenia, and the Baltic States, 'best guess' mean values, covering a period of 20 years, the total investment in these countries amounts to between €860 and €1,720 per capita.<sup>174</sup> The actual costs could be up to one-third lower or 50 percent higher, depending on how the investments are realized and what supporting policies are followed. The smaller countries appear to have slightly higher *per capita* investments, which is not unreasonable, as the EU environmental directives have a substantial 'fixed cost' element. Total investment for the water directives is close to that of the air directives and about 50 percent higher than solid waste directives. Estimates of the extra annual operating (as opposed to capital) expenditures that will be incurred are about €80-120 *per capita* for the group as a whole. Assuming that capital expenditures were to be spread equally over 20 years, annual outlays will be between 4 and 5 percent of present GDP – far more what CEECs currently spend

*Source:* World Bank; Country Economic Memorandum, Croatia 2003.

The requests for transition periods are likely to concern principally three policy areas: urban waste water, drinking water and discharges into water, and waste. These three areas make up a large proportion of the estimated total cost of implementation. In terms of the priorities of EU policy towards the negotiations (see above), the requests for transition periods in these areas should be considered relatively sympathetically by the Union. The direct effects of the non-implementation of directives in the first two areas in terms of the distortion of competition or trans-boundary externalities are likely to be of minor importance. It is true that water discharges flow into the Mediterranean, but progressive improvement over a decade after accession is better than no improvement or rapid improvement, which cannot be sustained (for instance, through an inability to meet annual operating and maintenance costs). Waste is a more complex issue, but here too some of the requests for transition periods will touch purely domestic waste issues.

The most sensible strategy for both the EU and the Western Balkan countries would therefore be for the two sides to consider together the most appropriate way to implement Community policy in the context of available financing sources and in the light of the need to maintain

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bear the costs of much of the new environmental legislation, which cannot be passed through to the consumer, as well as in other infrastructure areas and through changes to regulations affecting state-owned enterprises.

<sup>15</sup> World Bank (1999), *The Czech Republic: Complying with the European Union Environmental Directives*, Washington DC and EDC Ltd. (1997), *Compliance Costing for Approximation of the EU Environmental Legislation in the CEEC*, Brussels (study commissioned by the European Commission).

macroeconomic stability and economic development, while establishing effective intermediate verification of progress. The need to consider the available financing obviously requires this chapter to be considered together with the financial and budgetary issues and the agriculture chapter.

For the chapter on environmental policy, the agreed transition periods in the fifth enlargement, listed below, were sometimes very long compared to those agreed in other chapters of the negotiation (the longest transition period agreed was in this area):

- waste: transition periods of up to five years were agreed for the directive on packaging waste, and until 2012 for the landfill directive;
- water: up to 2015 for the waste water directive and for drinking water quality and up to 2007 for the discharge of dangerous substances in the aquatic environment;
- air: up to 2016 for large combustion plant directive, 2010 for IPPC, 2006 for waste incinerators;
- nature protection: up to 2008 for the birds' directive of 1979 (Malta only) and 2009 (or perhaps longer) for the hunting of lynx in Estonia.

The chapter on **justice, freedom and security** is one of the fastest expanding areas of work in the Union. New Member States must sign up to the Schengen *acquis* and to its implementing rules and must police the external borders of the Union. They must implement regulations on visa policy, promote co-operation in criminal matters (notably on trafficking in drugs and human beings) and police co-operation. All applicants must agree to do this in spite of the fact that it is a complex and expensive task to bring border controls up to the level required by the EU for its external borders.

The Schengen *acquis* must be implemented on accession, with the exception of that part of the *acquis* related to the lifting of internal border controls. Before that stage is reached, the Council must decide unanimously that the new Member State fulfils all the criteria necessary to allow internal border controls to be lifted. At the end of 2006, this decision has still not been taken for the countries which joined the Union in 2004.

The problem is one of credibility. There are major doubts in several "old" EU Member States as to whether the controls exercised by the new Member States will be sufficient to protect the Union from international crime as well as increased illegal migration. These doubts extend beyond this chapter to, for instance, doubts about the ability of the applicants to adequately control the movement of live animals across the external frontier.

This chapter may not prove to be a difficult chapter in the negotiations for the Western Balkan countries, but it is one of the greatest challenges in the accession process to prove to EU Member States that the *acquis* in this area has been effectively implemented.

The other aspect of this chapter, which is important, is the relationship between internal justice and home affairs (JHA) policy and foreign policy. The creation of impenetrable external frontiers of the Union is justified by the removal of internal frontiers, which means that individual Member States can no longer control the flow of persons from other Member States. However, this affects relations between neighbours or between closely related states. The relationship between Poland and Ukraine was affected by the measures taken on the frontier by Poland to meet the JHA *acquis*.

As the countries of the Western Balkans are likely to join the Union at different points in time, this could become a major problem. It is to be hoped that special arrangements can be made to tackle this problem before accession rather than after accession, as was the case of Poland and Ukraine. But whatever measures are taken, such as the current efforts on visa facilitation, there

will be severe impacts on policy resulting from the implementation on the ground of the *acquis* in this area.

The economic importance of the external frontier should also be noted. Where there are close economic relations across international frontiers, as in the Western Balkan states, the imposition of external border controls can have a devastating impact on local economic activity.

The essential problem in the chapter on the free movement of persons is the **free movement of labour**. There will be problems related to the mutual recognition of qualifications, and there may be problems concerning the co-ordination of social security systems, but these will hopefully be settled at the technical level.

The outcome of the negotiations in this area is probably pre-determined by the experience of the fifth enlargement. The “old” EU Member States, afraid of a flood of job-seekers from the new Member States, negotiated long transition periods for the free movement of workers. The transition regime foresees an initial period of two years, followed by a further period of three years to be decided by each individual Member State, and a final two-year period where the circumstances, in the view of the Member State, require it – in total a seven-year transition period if the Member State uses all three stages of the transition.

The regime is chosen by each individual Member State for itself. Hence there is already experience of how this system works in practice. Ireland, Sweden and the UK decided to implement the *acquis* and allow free movement, with only insignificant reservations. In the first two years since the fifth enlargement, both Ireland and the United Kingdom have received workers from the new Member States, and in numbers many times greater than expected. This experience, which has benefited these economies considerably, has led to changes in perception by the Member States. Several have decided to adopt the *acquis* after the first two-year transition period (Finland, Greece, Italy, Portugal and Spain). Only Austria and Germany appear determined to use the whole seven-year transition period.

At the same time as the “old” Member States appear to be becoming more liberal in their treatment of the first eight new Member States from Central and Eastern Europe, the more liberal Member States, Ireland and the UK, have decided to impose restrictions on workers from Bulgaria and Romania after they join the Union in January 2007.

It is true that the countries of the Western Balkans are far smaller than either Bulgaria or Romania. Nevertheless, it is extremely likely that the Union will impose the same regime as for the fifth enlargement.

There is also a labour market question for the applicant countries, namely whether there will be an outflow of highly skilled staff in the public sector (doctors, dentists, nurses) once their qualifications are recognised. This is already a problem in Poland and in the Baltic countries. In these countries there are also shortages of skilled workers in the building sector. However, this “brain-drain” argument does not play any part in the negotiations. Generally, the free movement of labour is regarded in the applicant countries as a symbolically important component of membership in the Union. It is also an important economic issue. The movement of workers from the less developed Member States to the more developed has always been an important part of the improvement of the quality of the workforce of the former. Ireland is a case in point, where large numbers of Irish citizens, who had moved to other Member States, have now returned to Ireland with improved skills and have contributed greatly to the “Irish economic miracle”.

This question is a political question rather than an economic or social question. There is considerable anxiety in regions of high unemployment in the Union (for instance in the new *Bundesländer*) that a flow of workers from the new Member States, happy to work for lower wages, will “steal” jobs. Politicians will have to pay attention to these fears in the enlargement

process. An arrangement must however be found in the case of the Western Balkans which will allow regular reviews of the labour market situation so that any agreed transition period can be ended as soon as political resistance to free movement has ebbed.

The chapter on the **free movement of capital** has two potentially difficult areas of negotiation: the liberalisation of short-term capital movements and the purchase of agricultural land and forest by EU-foreigners.

The liberalisation of short-term capital movements is considered by some to be extremely dangerous in a situation where short-term capital could leave the financial system very quickly, leading to a fall in the exchange rate and considerable difficulties for enterprises which have borrowed in foreign currencies.

In the end and in spite of considerable debate, all of the new Member States accepted the *acquis* in this area. So far the economic climate has been such that any weaknesses have not yet been tested

The sale of land to EU-foreigners however is a question, which will almost certainly be part of the final settlement. All of the new Member States obtained transitional arrangements. Just as with the question of the free movement of labour, this problem appears to be more political than real. Nevertheless this is a problem, like the free movement of workers, because it is considered a problem by politicians and the electorates.

There are three serious issues:

- the danger that large enough areas of land will be bought up by foreigners that social tension will result;
- the danger that foreigners are buying land simply for the capital gains that they expect to achieve;
- the danger that rising prices, due to the entry of foreigners into the market, will make the restructuring of farming more complicated.

There have been numerous cases of EU-foreigners circumventing national restrictions in the new Member states to buy up land, which is often only one-tenth of the price of similar quality agricultural land elsewhere in the Union. Although these illegal or quasi-legal purchases remain at a low level, they obviously lead to major worries on the part of nationals and become an important point in political discussions. This is especially so in these countries, which have often had to contend with foreign occupation of the land in the relatively recent past. There would clearly be social tension and a backlash against accession if large areas of land were to be bought up by foreigners.

Already in Croatia, this issue has become a major political question, with considerable pressure being exerted on the government to act to limit foreign purchases of real estate. At the same time, the number of EU-foreigners who have bought real estate in Croatia has reached such levels that EU Member States have come under pressure to ensure that the Croatian Government retains a liberal attitude to foreign land ownership.

The key factor is of course the price differential between land in EU Member States and in applicant countries. If a totally liberalised land market develops, it is to be expected that, in the next decade, land prices will rise considerably, closing some of the gap that now exists with those in the old EU. This will lead to significant capital gains for both local and foreign landowners. Clearly, while the applicants have an interest in welcoming foreign direct investment in agriculture in order to develop the sector, they have no interest in speculative land purchase.

In Croatia this is a particularly worrying development, as the beauty of the Adriatic coastline and the relatively well-developed infrastructure attract investors from the Member States and elsewhere.

There is also a worry that rising land prices will make the restructuring of agriculture more difficult. The Hungarian Position Paper stated the argument briefly: *“It (the price increase in land) would prevent Hungarian farmers from having access to land at affordable prices and interfere with the policy of the Hungarian Government aiming at the creation of a more viable ownership structure.”* The restructuring process relies on dynamic farmers buying or leasing the land from farmers who are giving up the profession. If prices rise considerably as a result of foreign buying, this process of restructuring will be made that much more difficult.

The real unknown here is how real the pressure for land purchase by non-EU citizens will be in Western Balkan countries after accession. Some think that it will not be stronger than today because land ownership in foreign countries is usually complex and because reform of the Common Agricultural Policy will put downward pressure on agricultural land values in the EU-15. However, the attraction of the Adriatic coastline adds a dimension which was not present in the fifth enlargement. However there is no doubting that this issue is of great importance to the voters in these countries.

Finally, there is the chapter on **finance and budget**, which is clearly related to all of the other difficult negotiating chapters and will be a major battleground, although perhaps more so between the existing Member States than with the new Member States. Enlargement will not fail over the budget. After all, the European Union budget is only about 1.0% of the EU GDP or about 2% of EU public spending, and it is likely to stay at this level for the medium-term future. However, measured on the amount of discussion it leads to, one would imagine that it is the most important problem. There will have to be a financial settlement in the accession treaties which is acceptable to all parties, even if it satisfies nobody.

While finance and budget should not be as difficult as agriculture to resolve because there are fewer policy issues involved, it will be immensely complicated. In recent years the net contributors to the Union budget have become much more strident in their demands for reductions in their contributions, while the net beneficiaries apparently see financial transfers from Brussels as a right, even when they grow out of the criteria used to establish rights to structural and cohesion funds.

The financial negotiations for the accession of the Western Balkan states should not be as fraught with conflict as those in the fifth enlargement for several reasons:

- the countries concerned are small, with together only slightly over 20 million people;
- the experience with the 12 new Member States has shown that enlargement can be undertaken without major destabilising budgetary effects;
- the EU was able to develop its systems for financing the accession of poor and agricultural states acceding to the Union during the last enlargement, and it therefore does not have to go back to the drawing board in this regard;
- the Financial Framework for the period 2007-13 has now been agreed, with certain reforms which will lessen tensions over the accession of the Western Balkan states (e.g. the British budget rebate does not apply to enlargement expenditures).

Nevertheless in general the Western Balkan countries are both poor and agricultural, which means that they will have some impact on the expenditure side of the budget. However, it must not be assumed that EU policies will be the same as they are now when the last state from the Western Balkans joins the EU. The CAP will undoubtedly have undergone further reform, perhaps reducing the cost of the policy overall. Further reform of the structural funds may also

have taken place. But other policies, like the CFSP, may have started costing far more in the past. It is important for the Western Balkan countries to maintain a close watch on EU policies as they integrate into the Union.

On the receipts side of the budget, the Member States in the fifth enlargement all asked for a transition mechanism for their budgetary contributions, which would protect them from being net contributors to the Union budget in the first years of membership. Some were more formal and proposed specific mechanisms based on previous accessions, which would have effectively guaranteed net financial benefits from accession over the first five years of membership, through intervention either on the own resources side or on the expenditure side of the budget. Given the transition period on direct income subsidies in the CAP and the expected slow uptake in structural funds, this seemed a reasonable position to take. It was however rejected by the EU-15, which preferred ad hoc methods of ensuring that the new Member States did not become net contributors to the Union budget.

These ad hoc measures were all on the expenditure side of the budget. The Schengen Facility provided financial support for the installation of necessary systems and equipment to operate an external border of the Union. All of the new Member States, with the exception of the Czech Republic, benefited from this facility. Lump sum payments ("cash flow facility") were also made, to "theoretically" ensure that no new Member State was a net contributor to the budget in the first years of membership. The Czech Republic and Poland were allowed to change some of their structural fund allocations for 2004-2006 into budget subsidies in order to tackle a potentially tight budget situation in the first years of membership. Finally, certain ad hoc mechanisms were agreed, for instance to compensate countries for safety measures in nuclear installations (Bulgaria and Lithuania).

The final area for negotiation will be that of **institutional questions**. It is too early to say anything very definite on these issues because a change in the Treaties will be necessary. It appears almost certain that the Western Balkan states will be caught up in the debate on the future institutional changes in the Union, which is in full swing at the end of 2006 but is likely to last for several years yet. Some voices are suggesting that a small change in the Treaties could be made to allow Croatia early accession to the Union. At the time of writing, even this is uncertain. All that can be said about the fifth enlargement is that most of the institutional questions were resolved in the Nice Treaty in a way which was generally fair and in certain cases generous to the acceding states. Whether this will be the case for the Western Balkans is difficult to predict.

## **F. PREPARATION FOR THE NEGOTIATION OF THE KEY NEGOTIATING CHAPTERS**

Although it is difficult for states to plan for negotiations long in advance, and obviously so when one does not know when the negotiations will start, the Western Balkan countries will need to take measures early on. This is obvious for Croatia and FYR Macedonia but applies to the other countries as well.

Following on from the experience of the fifth enlargement, it is possible to develop strategies for the resolution of the more difficult chapters.<sup>16</sup>

One of the key preliminary steps is to consult as widely as possible nationally in order to ensure that the government and above all the negotiators know what the real problems posed by

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<sup>16</sup> Piotr Serafin and Alan Mayhew, *A Negotiating Manual for Croatia 2006*, prepared for the Croatian Government and sponsored by the UK FCO Global Opportunities Fund.

accession are likely to be. Consultation can of course only follow the diffusion of information on the changes which accession is likely to bring.

It is obviously important to consult business interests and the representation of labour. However, consultation should go far wider than this, so as to reach non-governmental organisations, religious groups and other parts of civil society. Consultation helps citizens to prepare for the impact of accession but also provides vital information to government for the preparation of negotiating positions.

The countries of the Western Balkans are fortunate in having the experience of the 12 new Member States to draw on for the preparation of the negotiations. This experience also allows Government to make its pre-negotiation information to its citizens far more concrete than was the case in the countries of the last enlargement.

Once the key areas for negotiation have been determined, there are several strategies which can be used to facilitate the actual negotiations.

In some areas it is possible to adopt non-discriminatory national legislation to achieve certain objectives. This has certainly been the tactic adopted by many Member States to protect national land-use objectives or real estate policies. A national law which ensures that persons who own farmland live and work on it is likely to be considered appropriate if it does not discriminate between various groups of EU citizens. One could imagine that if it was considered undesirable for social reasons to have too many properties used as second homes, laws could be made which restrict the purchase of second homes or make it financially uninteresting to own one. Again, such laws would have to be non-discriminatory. National laws aimed at the protection of important landscapes (for instance, the Adriatic coast) or national architectural treasures are also obviously compatible with EU law if they are non-discriminatory.

From an economic point of view, it rarely makes sense to protect land from foreign investors, especially in poorer regions. This is however generally a political issue of some importance. The political argument may naturally outweigh the economic argument if this is vital to maintain public support for the accession process. This was the sense of the debate in Poland, where for historical reasons the idea of foreigners buying land after accession was particularly explosive. Many foreign investors had also made the subject controversial by their use of dubious legal tactics to obtain land. The Polish law which was adopted considerably restricts the possibility of both Polish citizens and foreigners to buy agricultural land.

National laws can also be used to defend certain moral positions or traditions which might conceivably be affected by accession to the Union. The legal situation on abortion and the advertisement of abortion services varies from one Member State to another. Malta had a protocol attached to the Treaty stating that in this area national laws take precedence over Community laws. Ireland, however, has a national law which forbids the advertisement of abortion services in Ireland.

Where vital national interests are concerned, it may well be possible to convince the Member States of the Union to accept certain "peculiarities" in the Accession Treaty in order to retain support for the integration process. Here close working relations with the Commission will be essential. Traditionally, the Commission plays a role which is to some extent that of an intermediary between the negotiating parties. Although it is the executive of the Union, it has always been regarded as a "friend" to countries negotiating accession. This is quite natural. The Commission is regarded as the neutral arbiter between the Member States. It knows what the positions of the Member States are as well as the position of the acceding country. One of its roles is to work out potential compromise solutions to controversial issues, which it can then put to Member States in Council.

It is also obvious that key Member States will have to be lobbied if the acceding country is to find solutions which satisfy it. As accession is a matter decided by unanimity, none of the 27 Member States can be neglected. However, it is clear that certain Member States will have more influence on decisions than others. There will also be Member States which are particularly closely associated with the acceding countries. Croatia, for instance, has always been supported by its neighbours, especially Austria and Germany. Other Western Balkan countries will find similar support within the Union. All of these contacts will need to be made early to gain support for the decisions to be made, to ask for the Commission's opinion, and then to open negotiations.

In most cases special pleading on nationally important issues will at best open the way to the negotiation of transition periods. However, more is possible when issues are so serious that they threaten the national consensus on integration with the Union. In the fifth enlargement Malta is a good example, although being a small over-populated island made it easy for Malta to make a special case of itself. In the negotiations Malta managed to achieve the right to maintain its national legislation on secondary residences and on abortion (see above) and also to ensure that its neutrality was not compromised by the Union's Common Foreign and Security Policy.

## **G. THE POLITICAL ECONOMY OF ENLARGEMENT AND ACCESSION**

Part of the negotiation process is a negotiation amongst EU Member States. Amongst other things this negotiation arranges 'side payments' to existing Member States.<sup>17</sup> With some countries gaining from enlargement and others losing, there is likely to be a negotiation before enlargement which redistributes some of these gains from enlargement. During the fifth enlargement, Nicolaides in his paper (see footnote 13) put it succinctly: *"Member States have not yet agreed on a date for enlargement because they still have to negotiate among themselves the size of the compensatory 'side payments'."*

As most of the Union budget still concerns redistribution through the agricultural policy and the structural funds (approximately 80% of the EU budget), reform in these two areas as well as on the own resources side will effectively decide the medium-term outlook for the financial framework and the annual budgets.

Policy reform will be the subject of review of the Union budget, which was agreed for 2008/9 in the financial framework for 2007-13. Further reform of the CAP will almost certainly be an important part of that review, under pressure from budgetary considerations, the enlargement process, as well as the negotiations in the WTO. Reform will normally lead eventually to a reduction of expenditure on agriculture. If this is achieved through a price reduction and a partial "re-nationalisation" of the CAP, it will lead to an increase in the net contributor position of France and a reduction in the German contribution to the EU. If it happens through further price reductions combined with degressive direct income subsidies for farmers, it will lead overall to a sharp reduction in Community agricultural spending, a reduction in net contributions from Germany but a much more profound restructuring of German agriculture.

It is difficult to say what chance radical reform has in the medium term. What is quite clear is that the Union has been able to make quite radical reforms over the last decade and a half, thanks largely to outside WTO pressure. There are strong supporters of CAP subsidy and protection inside the Union, notably the Member States with large agricultural sectors, which now includes some of the new Member States, such as Hungary, Lithuania, Poland and Romania, as well as countries like France and Ireland from the EU-15. It is however certain that support for the subsidy element of the CAP has declined, with both the reduction in the labour force employed in

<sup>17</sup>

P. Nicolaides, "The 'End Game' of the Enlargement of the European Union: the Significance of the Feira European Council", unpublished paper submitted to Natolin Workshop on Enlargement, September 2000.

agriculture and the contribution of agriculture to GDP in the Union. If the recent strengthening in prices of agricultural products continues, the pressure for reform of the policy may well increase.

These changes, if agreed, will normally only affect the CAP in the next financial framework period, 2014-2020. Certain changes may be necessary in the meantime if the Doha Development Round in the WTO is restarted and leads to a successful conclusion. Otherwise, the immediate outlook for CAP expenditure is for a gradual increase as the payments to farmers in the new Member States increase gradually towards parity to those paid to farmers in the EU-15. It is possible however that the amounts for agriculture agreed in the financial framework will be insufficient to cover CAP expenditure until 2013. In this case, changes in policy will be necessary.

Today it is unclear to what extent the other main expenditure programme of the Union, the Structural Funds, might be reformed by the time the Western Balkan countries join. If a similar set of regulations is maintained, compared to those we have today, all five countries will be included in the scope of the programmes assisting the poorest areas in the Union. In the fifth enlargement, the new Member States were treated rather well as far as the Structural Funds were concerned, but there were vicious rows between the “old” Member States, notably between the net contributor states and Spain.

These budgetary issues are likely to be far less significant in the Western Balkan enlargement than they were in the fifth enlargement. Indeed, overall there is no strong likelihood of fundamental resistance to Western Balkan accession in the 27 Member States. All EU-27 realise the importance of delivering on the promise made to the region and the relationship between accession and stability in the region.

The danger is however that the Union itself does not find the collective strength to make the changes which are necessary for the future governance of the Union.

In its report on the “EU’s integration capacity today”, the Commission underlines three vital areas where action is needed to ensure that the enlargement of the Union proceeds smoothly:<sup>18</sup>

- ensuring that the candidates really fulfil the conditions laid down by the Union;
- ensuring support from EU citizens for enlargement;
- ensuring that the Union’s institutions, policies and budget are capable of resisting any strains put on them by enlargement.

The last area is the one which could potentially hold up the accession of the Western Balkan countries. Following the failure of the constitutional referenda in France and the Netherlands, there is no clear plan as to how institutional change should be put back on the agenda of the Union. Some Member States are in favour of making small changes to the Treaties so as to allow Croatia to join. This would be a sign to the other Western Balkan states that the Union is serious about its promise of accession. Others prefer to look for fundamental solutions to the constitutional issues rather than making small ad hoc changes, because they fear that the ad hoc solution will put off the necessary fundamental reform for several years.

The most hopeful scenario is that the current economic recovery in the Union continues to create jobs and to reduce unemployment, while the review of the Union’s budget in 2008/2009 leads not only to changes in policies but also to the necessary institutional reforms. This would open the way to the accession of the Western Balkan countries in the last three years of the current financial framework, 2007-2013.

<sup>18</sup>

European Commission (8 November 2006), *Enlargement Strategy and Main Challenges 2006-2007*, COM(2006)649.

But this outlook will depend on the states in the region ensuring that they are ready for accession. While influencing the course of events in the Union will be difficult for countries of the Western Balkans, preparing for accession is in the hands of the countries themselves.