Report by the European Parliament on German reunification (May 1990)

Caption: In May 1990, the European Parliament's Directorate-General for Research draws up a working document which considers the impact of German reunification on the revenue and expenditure of the Community budget.

Source: Parlement européen-Direction générale des études (sous la dir.). L'impact de l'unification allemande sur la Communauté européenne. Luxembourg: Office des publications officielles des Communautés européennes, 1990. 179 p. ISBN 92-823-0215-6. (Dossiers d'études et de documentation-Document de travail N°1).

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The impact of German unification on revenue and expenditure under the Community budget (May 1990)

1. The procedure for establishing the budget of the European Communities normally begins with the drafting, by each individual specialist department, of a breakdown and an estimate of the resources required to finance its planned activities. Accordingly, an assessment of the impact of German unification on the Community budget should also be based on analyses and financial assessments of the measures required to incorporate the territory of the GDR into the Community. As this basic information is not yet available, this document can only offer a preliminary and necessarily approximate assessment of the budgetary impact of such measures.

2. The Commission, which is required, under the Community budget procedure, to submit proposals and, if necessary, a preliminary draft supplementary and amending budget, likewise feels unable as yet to make firm statements on the basis of reasonably reliable figures. The Commissioner responsible for the budget explained this in detail most recently on 24 April 1990, at a meeting of Parliament's Committee on Budgets. The same view emerges from the Commission communication to the Dublin European Summit, which describes every estimate of the budgetary impact of the incorporation of the GDR as approximate at this stage.

3. German unification will have a general impact on the Community budget for the following reasons:

- The incorporation of the GDR into the Community will raise the EC's overall GNP. Following the financial reform and the new own resources regulation of 1988, up to 1.2% of overall Community GNP is available to fund the Community budget and the actual sum involved will increase after the incorporation of the GDR.

- With regard to expenditure, the full application of the existing Community legal order to the GDR will give rise to justified claims on the Community budget, particularly in connection with structural policies, the common agricultural policy and industrial development. This will necessarily increase total expenditure under the Community budget unless the current system is changed with a view to redistributing expenditure to the detriment of its present recipients.

The question as to whether these developments will bring about a fundamental change in the financial structure of the Community will depend on the balance between increased revenue and higher expenditure: should the Federal Republic of Germany's current net payments be reduced following unification, this would increase the burden on the other Member States.

4. Any assessment of the budget implications must therefore take account not only of expected increases in revenue but also fresh claims for payment under existing legal bases. Given the current complete lack of reliable data, calculations or estimates of this kind are marked by ignorance or, at best, sketchy knowledge of the key factors, so that there is scant basis for putting reliable figures to the sums involved. Particular problems include:

- <u>The lack of statistical data</u>: the GNP of the GDR for 1989 has yet to be calculated with sufficient accuracy and its GNP for 1990 cannot yet be estimated. As a state-trading country with a centrally planned economy, the GDR has no national accounting system like that employed by the OECD countries. It is particularly difficult to convert the available figures for the GDR with a view to applying this technique. The GDR Statistics Office (previously Central State Administration for Statistics) has only very recently published initial calculations of the GNP of the GDR which as yet give only preliminary results for the country's GDP. The figures for agricultural production and foreign trade are also approximate.

- <u>The time factor</u>: the point at which unification will be implemented under international law is not yet known. Unless specific transitional rules valid for a certain period after unification are agreed, the Community finance system can only be fully applied in what is now the GDR once that process has been completed. The current economic situation in the GDR and, therefore, the basis for calculating the impact on the Community budget can be expected to change very considerably during the period leading up to the incorporation of the GDR in the Community finance system. The economic and monetary union between the Federal Republic and the GDR scheduled for early July 1990 should immediately stimulate an economic recovery on the territory of the GDR whose speed cannot as yet be estimated but whose results may affect the impact on revenue and expenditure under the Community budget.

5. The budgetary impact, insofar as it can yet be assessed, differs for the various stages of unification. The key difference concerns the period leading up to unification under international law and the period thereafter:

- Period leading up to unification: during this period, the GDR is a third country and measures with budget implications must comply with existing Community provisions on relations with third countries and must be agreed on by the Community bodies responsible in accordance with prescribed procedures.

- Period after unification: this phase begins with formal unification, after which the GDR is no longer an entity under international law. From this point on, the population and territory of what is now the GDR will in principle be subject to the full provisions of the Community legal system. It is highly likely, however, that a wide range of derogations from current EC law and transitional rules will be required for a certain period on the former territory of the GDR. From this point on also, the Community finance system would come into force in full, in respect of both revenue and expenditure under the Community budget.

6. Financial impact in the period leading up to unification

During this period, for the Community the GDR is a third country, and relations may be established with it, as with other third countries, in accordance with existing legal bases. A trade and cooperation agreement has already been negotiated with the GDR, although it has yet to be signed and ratified. However, given the speed of the unification process, it is doubtful whether this agreement can be put into effect and, hence, have an impact on the budget.

It should be pointed out here that appropriations to cover aid for the countries of Central and Eastern Europe have been entered in the 1990 Community budget via a supplementary budget. In principle, the GDR also has a claim to resources under this programme. The Community bodies responsible must make the political decision as to whether, and to what extent, applications by the GDR for aid from these appropriations can be considered. The GDR has as yet received no financial aid from the Community. According to the statements made hitherto by the Federal German Government, all costs in the period leading up to German unification are to be met by the Federal Republic alone so that no additional burden will be placed on the Community budget during this period.

When German economic and monetary union comes into effect, although the GDR will remain an international legal entity and, therefore, a third country for the Community, the institutionalized economic and currency links with the Federal Republic will affect the GDR's degree of integration with the other Community Member States. In this connection, accompanying measures to prepare for full unification are already required with a view to incorporating this territory into the Community. Although, at this point, no direct impact on the Community budget is yet foreseeable, indirect implications are conceivable. Thus, the question of the fixing of an artificial exchange rate for the conversion of GDR-Marks into Deutschmarks could have a considerable impact on exchange rate parities and the capital market in the Community. Any such measure will have to be financed by the Federal Republic. The Bundesbank can be expected to pursue a restrictive monetary policy which might lead to higher interest rates on the European capital market and, in turn, financial difficulties for individual Member States and the Community insofar as certain measures depend on financing via that market.

7. Impact after unification

From this point on, the territory of what is now the GDR will in principle be subject to the full provisions of the European finance system. As it cannot yet be stated what form the likely transitional and adjustment rules will take, the following is based on the assumption of the direct application of that system.

- Budget revenue

As regards the traditional Community own resources (customs duties, agricultural levies and the sugar levy), certain sums can be expected to flow into the Community's coffers from the territory of the GDR. For example, the GDR is already a sugar exporter, so that revenue from this category should be generated for the Community. However, the volume of revenue from these sources cannot be estimated in advance and they are, in any case, of minor importance in the overall revenue context.

In the case of the so-called third own resource, the 1.4% share of harmonized VAT receipts, there is as yet no basis for calculating the sums to be expected from the GDR as that country has no VAT system. It would have to be introduced by the time of unification at the latest. The Federal German Finance Minister has already announced a date between the establishment of German economic and monetary union and the completion of the unification process. However, this has still to be agreed with the GDR Government.

The fourth resource created in 1988, which involves residual financing from a share of total Community GNP rising to 1.20% in 1992 (in the case of payment appropriations), will be particularly important. The Member States contribute according to their percentage share of total Community GNP. (The special compensation measures for economically weak Member States a high proportion of whose GNP is accounted for by VAT revenue can be ignored here.) The additional GNP brought into the Community by what is now the GDR will thus increase proportionally the resources effectively available to the Community.

- According to the calculations by the GDR Statistics Office referred to under point 4 above, the GDR's gross domestic product in 1989 was 353 000 m DDR-Marks. If one applies to this figure the exchange rate of DM 1:M 2 for the conversion of non-privileged money and then converts into ECU, this produces a figure for the GDR's gross national product of around 90 000 m ECU.

- Disregarding any likely economic upturn on the territory of the GDR, applying the 1.20% rate produces additional Community resources totalling 1 000 m ECU.

The additional financial burden for the Community then emerges as the balance between the expenditure required on the territory of the GDR and the additional revenue generated by the incorporation of that territory into the Community.

- Expenditure

Under the Community finance system, and in view of the situation in the GDR, the main areas of expenditure are likely to be structural policy and the common agricultural policy.

- Structural policy: Since 1988, Community structural policy measures have been graded by objectives, with regions covered by Objective 1 being the most needy. The measures planned for these regions are allocated the highest volume of resources. Regions are classified according to per capita GDP. Objective 1 covers regions in which per capita GDP is less than 75% of the Community average. This average will of course be changed by the accession of the GDR. As the relevant figures cannot yet be calculated with sufficient accuracy (see above under 4) and the economic development of the GDR following German economic and monetary union cannot be predicted with any precision, it is not yet clear whether the entire territory of the GDR or only parts of it will be classified under Objective 1.

The degree of impact on the Community budget will depend on this classification. As things stand, any attempt to gain an idea of the figures involved must work on the basis of a classification under Objective 1. According to provisional calculations, the GDR's per capita GDP is already considerably higher than that of Greece, Portugal and Ireland and roughly the same as that of Spain, which can therefore serve as a comparison. The structural funds have earmarked for the regions of Spain covered by Objective 1, which encompass around 20 m inhabitants, allocations totalling around 10 billion ECU over the five-year period 1989-1993, i.e. roughly 100 ECU per head of population per year.

Applying this model to the GDR, and on the assumption that the greater part of its territory will be classified under Objective 1, the additional annual burden on the Community budget through structural fund payments following German unification will be in the order of 1.5 bn ECU.

Under existing Community agreements pursuant to the five-year (1989-1993) financial perspective, appropriations totalling 60 315 bn ECU have been earmarked for the structural funds. They can be broken down by objective as follows:

	m ECU
Objective 1	38 300
Objective 2	7 205
Objectives 3 and 4	7 450
Objective 5a	3 415
Objective 5b	2 795
Transitional measures	1 150

The appropriations earmarked for Objective 1 have already been fully distributed among the seven Member States entitled to them. The appropriations for the other objectives have also already been committed since, in the regions concerned, and on the basis that these appropriations will be allocated, a start has already been made with long-term development projects to be financed from the Community budget. The budget will therefore have to be increased in order to provide the structural fund resources to which regions in the GDR are entitled. This will entail a comprehensive revision of the 1988 financial perspective which Parliament, the Council and the Commission have taken, in the 1988 Interinstitutional Agreement, as the binding framework for the Community budget to 1993. The objective of doubling structural fund resources between 1988 and 1993 will also have to be adjusted.

- Common agricultural policy: Here, it can as yet only be forecast that funding will initially be required predominantly for structural measures. The level of guarantee payments will essentially depend on how far the existing, large-scale production units (agricultural cooperatives, etc.) retain their current form and improve their productivity. The appropriations required for the GDR are currently put at around 0.5 bn ECU per year.

- The revenue/expenditure balance: On the basis of the calculations and estimates made here, for the reasons set out above no reasonably reliable prediction can as yet be made regarding the actual impact in concrete financial terms of German unification on the Community budget. Taking these calculations as a basis, however, as things stand the incorporation of the GDR would generate for the Community additional resources of around 1 bn ECU to be set against additional expenditure requirements of around 2 bn ECU. The net burden on the Community budget would therefore be of the order of 1 bn ECU, i.e. 2.1% of the total 1990 Community budget. In the light of the expected economic upturn in the former GDR, it can be forecast that the budgetary implications of the incorporation of the GDR into the Community will have cancelled themselves out after a few transitional years and the same budgetary structure will be restored in roughly its current form. In general, it can therefore be said that German unification will not have a particularly significant overall impact on the budget of the European Communities.