Implications for net positions of the agricultural reform in Agenda 2000
Leon Bettendorf and Max Merbis*

Abstract
The budgetary consequences of the reform proposals in Agenda 2000 have stimulated the debate on the financial costs and benefits of EU-membership. This article analyses the implications of the proposed agricultural reform for the net contributions by simulating three scenarios. The inclusion of implicit trade subsidies is vital in the discussion on net positions. Agenda 2000 is projected to affect substantially the net positions of member states.

Introduction
In July 1997 the European Commission (CEC, 1997a) launched a set of proposals to prepare the EU for major upcoming events such as the enlargement with Central and East European countries. The package specifies the budget of the Community over the period 2000-2006, which serves as ceiling on the expenditures and determines to a large extent the costs for the member states. The proposals therefore tend to revive the debate on the distribution of financial gains and losses over the member states. Some of the net paying countries, in particular the Netherlands and Germany, question the future pattern of net contributions, as they criticized the past allocations.

This article focuses on the contributions arising from the Common Agricultural Policy (CAP). A considerable part of the EU budget is still devoted to the financing of the CAP (agricultural expenditures accounted for 46% of total EU expenditures in 1995, down from 75% in the mid-eighties). The agricultural budget will remain important due to the nature of the CAP and the direction of CAP reform in Agenda 2000. The CAP was essentially a scheme of price support, with costs for both the consumer and the taxpayer. Consumers support the agricultural sector through high internal prices (known as intervention prices, fixed above world market level). The system of administered prices implies that internal prices must be kept above world market prices by imposing tariffs on (extra-EU) imports and by giving refunds on exports (see Merbis and Stolwijk (1996) for a formal representation of the CAP). In case of excess supply, surpluses must be bought and held in storage (called intervention stocks) or sold with a subsidy. The CAP also invokes production controls to ensure market clearing. Milk and sugar production is governed by quotas, and a substantial share of agricultural land is left idle (called set-aside land). This scheme is compulsory for arable farmers to become entitled to income transfers. Other instruments, such as supply and demand subsidies and direct income payments, complete the working of the CAP.

The core of the proposals in Agenda 2000 is a further shift from price support to income support. The level of intervention prices is lowered, and to prevent a strong fall in farmers’ incomes the level of income support (called premiums in CAP jargon, since linked to specific production activities) must go up. Support to agriculture then appears in the budget (‘budgetarisation’ of support). Premiums were introduced in the agricultural budget in 1993, and its role has increased ever since. The increasing role for income transfers ensures that a substantial share of the total EU budget will need to be allocated to the financing of farm policy.

The outlays in the CAP budget determine member states’ benefits from the CAP. The expenditures on the CAP (as well as other costs the Community is incurring) must be balanced by the own revenues of the EU and the member states’ contributions. The difference of benefits and costs, allocated to member states, is an explicit transfer to (or from) the administration in Brussels. The debate on net positions is usually a debate on these explicit transfers. However, price support also generates implicit transfers. When a producer exports a CAP commodity inside the EU, the foreign consumer has to pay the internal price. Countries with large intra-EU exports thus benefit from implicit subsidies paid by the net-importing member states. Several studies have already pointed at the significance of implicit transfers in the discussions on the principle of ‘common financial responsibility’ (see Folmer et al. (1987, 1995), Kjeldahl et al. (1994), CEC (1994) and Keyzer (1995)). Yet, other studies (Ministry of Finance, 1997, Lemmink 1995) do not acknowledge the importance of implicit transfers in the debate on net contributions.

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This article focuses on the relevance of the implicit subsidies for the discussion as how to assess net positions. It analyses the effects of the further budgetarization of support on the EU-budget and the financial transfers of the member states. The Agenda 2000 proposals will affect the size of both the explicit and the implicit contributions due to its shift to direct transfers as main instruments to support farmers. The consequences are quantified by simulating three scenarios with the CAP-Modelling and Accounting Tool (CAPMAT) for the EU15 member states.

The outline of the paper is as follows. The next section briefly sketches the proposed reform in Agenda 2000. After describing the model and the scenarios, we discuss simulation outcomes. The last section concludes.

The agricultural chapter in Agenda 2000

The agricultural chapter in Agenda 2000 proposes an extension of the reform of 1992, so a brief review of this reform is useful. It introduced premiums to compensate farmers for the reduction in intervention prices and the imposed set-aside scheme. These measures were only applied to cereals, oilseeds, pulses and beef. After its implementation, the 1992 reform became instrumental for the conclusion of the GATT agreement in 1994. Premiums were sufficient to prevent a fall in average farming income, but nevertheless, the agricultural budget remained safely below the spending guidelines.

Major shortcomings of the 1992 reform are the limited coverage and depth. Measures were not extended to other sectors, like sugar and dairy, nor further deepened to tackle the various market distortions. Despite the fall in intervention prices, the gap between internal and world prices remained substantial for many products. Market access was not effectively improved, in particular for developing countries.

The GATT agreement imposes restrictions on the subsidized exports of agricultural products. Therefore the EU has only limited scope to expand on world markets of cereals, milk products, and beef. Whereas most projections of world food demand are promising. While the new WTO round will start in 2000, the EU has to prepare for negotiations aimed at a further liberalization of agricultural policies. The EU also has to prepare for the enlargement with Central and East European countries, which asks for a reduction of intervention prices to facilitate the harmonization of agricultural prices between the new and old member states. Hence, pressures increase to adapt the CAP.

Agenda 2000 can be viewed as a response to these challenges. The central part of the proposals, which were finalized in March 1998, is a reduction of intervention prices for cereals, beef, and milk. The fall in income is compensated by higher premiums and lessening of production controls. The compulsory set-aside rate is set to zero, whereas milk quota are increased by 2%. To simplify the rules, premium rates for the concerned arable crops are equalized. The system of premiums for the livestock sector is expanded, and made more complex. The Commission aims at reaching an agreement on the final text at the end of 1998 and a gradual implementation starting in 2000.

The model

CAPMAT is developed to calculate the medium run effects of CAP reforms for each of the 15 member states. The underlying database integrates information from various sources, notably commodity balances from FAO, costs and revenues of agricultural activities from EUROSTAT and detailed budgets from the CEC. As a second input source, outcomes of the applied general equilibrium model ECAM are used for projecting behavioral reactions by producers and consumers (see Folmer et al., 1995). The planning horizon is 2005.

Since intervention stocks are fixed by assumption, net exports by member state follow from commodity balance. As regards pricing rules, CAP commodities follow the common EU-intervention price while prices of other goods reflect assumed world prices. Detailed computations are performed to retrieve (1) commodity balances by country, (2) costs and revenues by activity and country, (3) farming income by country and (4) the EU-budget.

The scenarios

We distinguish three scenarios, presented in more detail in Bettendorf and Merbis (1998). These share the assumptions on world market prices, yield trends and total availability of land. For reasons of transparency, changes in EU policy are thus assumed not to affect the evolution of world prices, as projected by international organizations. In accordance with their forecasts, cereal prices will decline from their record levels in 1996 back to the levels of the early nineties. In view of expanding markets, world prices for dairy products and beef are believed to increase slightly. All figures are expressed at 1995 prices by assuming an inflation rate of 1% per year. Scenario-specific assumptions are summarized in the box.

Results

Central EU-budget

The structure of the EU-budget is summarized in Table 1 (cf. European Court of Auditors, 1997). At the expenditures side, the largest share in 1995 is taken up by outlays for the CAP. The agricultural budget is regrouped into three main categories: trade refunds, premiums & subsidies and remaining expenditures. Outlays on other (structural) funds and other expenditures (e.g. development aid, administration costs) complete the EU-budget.

The national (VAT and GDP) contributions have become the major source of revenues. Receipts of an agricultural origin consist of tariffs levied on agricultural imports and of levies imposed on sugar production. The other two
The scenarios

**Basecase**
This status-quo scenario assumes a continuation of existing policies:
- intervention prices and premium rates are kept constant in nominal terms.
- outlays on premiums are limited at the 1996 level by the use of stabilizer mechanisms
- the future rate of the compulsory set-aside is fixed at 5%.

**Agenda 2000**
The latest version of the proposals (March 1998) are implemented in the following way:
- intervention prices are reduced for cereals (20%), beef (30%) and milk (15%).
- all cereals and oilseeds now receive the same premium per ton. Cows and male bovines receive headage premiums, as a (partial) compensation for the price fall.
- the mandatory set-aside rate is set to zero.
- milk quotas are increased by 2%, distributed non-uniformly over the countries.
- the level of the premium rates as proposed may differ from the level actually paid to the farmer due to regulations that specify the eligibility to premiums. We express this difference as ratios, in the so-called modulation factors. As an example of modulation, beef premiums are limited to a fixed number of animals per farm, and are subject to a livestock density constraint (e.g., two cows per hectare of fodder land are eligible for premiums). Since the new proposals impose some new constraints and modify some old ones, the size of the modulation factors is still uncertain. In this scenario, the observed modulation factors of the 1992 reform are applied to the premiums for non-dairy cattle. No modulation is assumed for the new premiums of dairy cows. For crops, a reference acreage holds as constraint, limiting total expenditures.

**Partial liberalization**
From a free-trade perspective, the reduction in agricultural support can be criticized for being insufficient. A partial liberalization scenario will serve as an alternative benchmark, analyzing agriculture in a much more competitive setting:
- the fall of intervention prices is as in Agenda 2000, with additional reductions for sugar (20%) and sheep (30%).
- premiums and subsidies on CAP commodities are abolished (subsidies remain in sectors falling outside the Agenda 2000 reform).
- set-aside and milk quotas are as in Agenda 2000.

Alternatively, the Liberal scenario can be interpreted as an extension of the Agenda 2000 program, in which compensation payments are already phased out in 2005 and the coverage of commodities is expanded.
for concern about the net position. In the Liberal scenario the elimination of premiums and subsidies on CAP commodities reduces the expenditures by 82% (the southern member states still receive subsidies on olive oil).

Net contributions
The calculation of net contributions requires all items in table 1 to be allocated over the member states (remember that the non-agricultural items are fixed at the 1996 level). Some of the revenues and expenditures are not allocated to the member states, but to the Commission. These revenues (11% in 1995) mainly stem from the surplus of the previous year, exchange rate gains and cancellations of the previous year. Expenditures (24%) cover administration costs, development aid and the current surplus.

The net position of a member state is simply defined as the difference between the total revenues from the EU and total payments to the EU. From the simulated net positions in table 4 follows that EU-policy is primarily paid by Germany, with major contributions from the Netherlands and the UK (note that the inclusion of the European Commission in the list makes the average net contribution negative). Agenda 2000 causes substantial changes in the net contribution, but affects the ranking of the countries only slightly. The net position improves for countries with a relative strong specialization in cattle, like Ireland and UK. The reform turns out disadvantageous for the net payers Germany and the Netherlands.

Table 1 The simulated EU15-budget, 1995 and 2005

<table>
<thead>
<tr>
<th>1995</th>
<th>2005</th>
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</thead>
<tbody>
<tr>
<td></td>
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<tr>
<td>Total agricultural budget</td>
<td>35.2</td>
</tr>
<tr>
<td>– Trade refunds</td>
<td>7.7</td>
</tr>
<tr>
<td>– Premiums &amp; subsidies</td>
<td>24.6</td>
</tr>
<tr>
<td>– Other agr. expenditures</td>
<td>2.9</td>
</tr>
<tr>
<td>Other funds</td>
<td>15.9</td>
</tr>
<tr>
<td>Other expenditures</td>
<td>24.6</td>
</tr>
<tr>
<td>Total expenditures</td>
<td>75.7</td>
</tr>
<tr>
<td>Levies on agricultural trade</td>
<td>1.0</td>
</tr>
<tr>
<td>Levies on sugar production</td>
<td>1.4</td>
</tr>
<tr>
<td>Duties on non-agr. trade</td>
<td>13.9</td>
</tr>
<tr>
<td>National contributions</td>
<td>52.9</td>
</tr>
<tr>
<td>Other revenues</td>
<td>6.5</td>
</tr>
<tr>
<td>Total revenues</td>
<td>75.7</td>
</tr>
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</table>

Table 2 Net trade refunds for CAP products, 1995 and 2005

<table>
<thead>
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</thead>
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<tr>
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<tr>
<td>Denmark</td>
<td>377</td>
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<tr>
<td>Finland</td>
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<td>1839</td>
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<td>Germany</td>
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<td>30</td>
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<td>Italy</td>
<td>271</td>
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<td>1006</td>
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<td>Portugal</td>
<td>3</td>
</tr>
<tr>
<td>Spain</td>
<td>152</td>
</tr>
<tr>
<td>Sweden</td>
<td>53</td>
</tr>
<tr>
<td>UK</td>
<td>270</td>
</tr>
<tr>
<td>EU-15</td>
<td>6706</td>
</tr>
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</table>

Implicit subsidies
The calculated explicit net contributions give an incomplete picture since the implicit benefits from the CAP price-support are not incorporated (see Folmer et al., 1995, section 6.4). Such benefits appear because exporters of CAP commodities to other member states are paid in internal and hence higher prices than world market prices. In concrete terms, Dutch exporters of cheese receive an implicit subsidy from, say, German consumers when settling their
bills at intervention prices rather than at world prices. The total (explicit plus implicit) subsidy due to trade protection is computed for each member state by multiplying its net total exports with the difference between internal and export prices. Subtracting the explicit subsidies given in table 2 yields the implicit subsidies in table 5.

In 1995 countries like the Netherlands, France and Ireland receive relatively large implicit subsidies, reflecting their strong export position of products with high internal prices (beef, dairy). For the Netherlands this subsidy equals almost 70% of the explicit net contribution. Implicit support is paid by the importing countries, such as Italy and UK. In 2005 implicit transfers are reduced in absolute value for all scenarios due to the fall of internal prices relative to external prices. In other words, Agenda 2000 will decrease the implicit gain (loss) for the net exporting (importing) countries. The only exception is Germany, where the dominating effect on net imports results in increased implicit subsidies.

**Table 3** CAP premiums and subsidies, 1995 and 2005

<table>
<thead>
<tr>
<th></th>
<th>1995</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td>Basecase</td>
</tr>
<tr>
<td>Austria</td>
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</tr>
<tr>
<td>Belgium-Luxembourg</td>
<td>179</td>
<td>175</td>
</tr>
<tr>
<td>Denmark</td>
<td>636</td>
<td>635</td>
</tr>
<tr>
<td>Finland</td>
<td>235</td>
<td>171</td>
</tr>
<tr>
<td>France</td>
<td>5695</td>
<td>5755</td>
</tr>
<tr>
<td>Germany</td>
<td>3003</td>
<td>3172</td>
</tr>
<tr>
<td>Greece</td>
<td>2091</td>
<td>2240</td>
</tr>
<tr>
<td>Ireland</td>
<td>636</td>
<td>562</td>
</tr>
<tr>
<td>Italy</td>
<td>2974</td>
<td>3261</td>
</tr>
<tr>
<td>Netherlands</td>
<td>389</td>
<td>294</td>
</tr>
<tr>
<td>Portugal</td>
<td>435</td>
<td>345</td>
</tr>
<tr>
<td>Spain</td>
<td>4057</td>
<td>2533</td>
</tr>
<tr>
<td>Sweden</td>
<td>347</td>
<td>384</td>
</tr>
<tr>
<td>UK</td>
<td>2188</td>
<td>1984</td>
</tr>
<tr>
<td>EU-15</td>
<td>23215</td>
<td>21930</td>
</tr>
</tbody>
</table>

**Table 4** Net (explicit) contribution (mln ecu), 1995 and 2005

<table>
<thead>
<tr>
<th></th>
<th>1995</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td>Basecase</td>
</tr>
<tr>
<td>Austria</td>
<td>– 848</td>
<td>– 170</td>
</tr>
<tr>
<td>Belgium-Luxembourg</td>
<td>– 905</td>
<td>– 929</td>
</tr>
<tr>
<td>Denmark</td>
<td>119</td>
<td>15</td>
</tr>
<tr>
<td>Finland</td>
<td>– 149</td>
<td>– 10</td>
</tr>
<tr>
<td>France</td>
<td>– 1158</td>
<td>– 373</td>
</tr>
<tr>
<td>Germany</td>
<td>– 13079</td>
<td>– 9577</td>
</tr>
<tr>
<td>Greece</td>
<td>3429</td>
<td>3723</td>
</tr>
<tr>
<td>Ireland</td>
<td>1736</td>
<td>1595</td>
</tr>
<tr>
<td>Italy</td>
<td>– 632</td>
<td>– 1237</td>
</tr>
<tr>
<td>Netherlands</td>
<td>– 2220</td>
<td>– 2355</td>
</tr>
<tr>
<td>Portugal</td>
<td>2458</td>
<td>2805</td>
</tr>
<tr>
<td>Spain</td>
<td>7206</td>
<td>5218</td>
</tr>
<tr>
<td>Sweden</td>
<td>– 915</td>
<td>– 650</td>
</tr>
<tr>
<td>UK</td>
<td>– 4741</td>
<td>– 2365</td>
</tr>
<tr>
<td>EU-Commission</td>
<td>9698</td>
<td>– 4309</td>
</tr>
</tbody>
</table>

**Total net contribution**

In view of the size of the implicit transfers, one should also look at the total net contribution, computed as the sum of the previous two tables. Rankings of total contribution per capita are given between brackets in table 6.

The explicit and the total contributions are first compared for 1995. The incorporation of implicit subsidies does not much affect the ranking for most of the countries: Germany remains the largest payer and Ireland and Greece the largest receivers (per capita). However, there are exceptions. The ranking of the Netherlands considerably improves when the broader definition is applied. Whereas the explicit contribution seems not to conform with its relative prosperity, the total contribution looks more reasonable. In terms of this broader concept, the Netherlands occupies the pursued middle position in the EU. In contrast, Belgium, Italy and the UK face opposite changes. Whereas their explicit losses seem limited, their total positions show that they effectively co-finance the current CAP.

Next, total contributions are discussed for 2005. Implicit transfers become less important and the rankings are quite stable over the scenarios. The net position of the Netherlands will deteriorate under Agenda 2000 due to a substantial reduction in implicit subsidies. When the Netherlands pursues a reduction of its net contribution, it should object price reductions compensated by premiums. Along the same line of reasoning, it should be in favor of partial liberalization, which is more in line with its credentials as free trading nation. Notice that its ranking in 2005 becomes worse than in 1995 for each scenario.
**Table 5 Implicit subsidies due to EU trade protection, 1995 and 2005**

<table>
<thead>
<tr>
<th></th>
<th>1995</th>
<th>2005</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>mln</td>
<td></td>
</tr>
<tr>
<td></td>
<td>ecu</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Basecase</td>
<td>A2000</td>
</tr>
<tr>
<td>Austria</td>
<td>146</td>
<td>90</td>
</tr>
<tr>
<td>Belgium-Luxembourg</td>
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<td>16</td>
</tr>
<tr>
<td>Denmark</td>
<td>825</td>
<td>471</td>
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<tr>
<td>Finland</td>
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</tr>
<tr>
<td>France</td>
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<td>645</td>
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<tr>
<td>Germany</td>
<td>-422</td>
<td>-117</td>
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<td>Spain</td>
<td>-448</td>
<td>-316</td>
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<td>Sweden</td>
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<td>29</td>
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<tr>
<td>UK</td>
<td>-754</td>
<td>-681</td>
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</table>

Note: column elements add up to zero.

**Conclusions**

A simulation model is used to study the consequences of the agricultural reform as proposed in Agenda 2000 for the financial transfers within the EU. Agenda 2000 proposes a further shift from price support to income support. The increased income payments to farmers are the dominating expenditures item of the growing agricultural budget. The allocation of these premiums becomes increasingly determined by production patterns, and hence independent from the national GDP and VAT transfers that balance the budget. Member states are thus likely to face significant changes in the resulting explicit net contributions.

Apart from the explicit transfers, the system of price support in the CAP implies that member states receive or pay implicit transfers. A country exporting agricultural products to another member state implicitly benefits from the gap between the internal and the world market price. This often neglected item is relevant for a more accurate assessment of the costs and gains of the CAP. The net position of the Netherlands in 1995 looks much more favorable when these implicit subsidies are taken into account. However, lower internal prices under Agenda 2000 reduce the implicit gain for the Netherlands, turning it into one of the largest net payers in the future.

These results should be interpreted with due caution. First, calculations of explicit refunds and implicit subsidies are sensitive to the assumed levels of world market prices. Assessing the impact of an EU reform on world markets even enhances the uncertainty of price projec-

**Table 6 Explicit and total net contribution, 1995 and 2005**

<table>
<thead>
<tr>
<th></th>
<th>1995</th>
<th></th>
<th>2005</th>
<th></th>
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<tr>
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</tr>
<tr>
<td></td>
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<td>Liberal</td>
<td></td>
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<td>-80 (7)</td>
<td>-230 (6)</td>
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<tr>
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<td>-1056 (2)</td>
<td>-912 (3)</td>
<td>-1114 (3)</td>
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<tr>
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<td>944 (11)</td>
<td>486 (10)</td>
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</tr>
<tr>
<td>Finland</td>
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<td>10 (8)</td>
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<td>52 (9)</td>
</tr>
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<td>2167 (12)</td>
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<td>-2176 (5)</td>
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</table>

Note: Ranking of total contribution per capita between brackets.
Column elements do not add up to zero due to net expenditures that are not allocated to any member state.
tions. Second, compensation payments will be affected by modulation factors, the range of which still is uncertain. Third, this study does not consider the complete Agenda 2000. The reorientation of the structural funds opts for a reduction of transfers to the relatively rich members. The costs of EU enlargement before 2005 have also been neglected in the analysis (see CEC, 1997a). Finally, Agenda 2000 is still a proposal and amendments by member states are to be expected. Analyzing the budgetary implications clearly provides only one angle to evaluate policy reforms. A full appraisal preferably considers the welfare effects on European consumers. The reform was motivated by other objectives as well, that have not been considered here, in particular whether the EU prepares itself adequately for the upcoming WTO round and accession negotiations.

References
CEC, 1994, EC Agricultural policy for the 21st century, European Economy, Reports and studies, no 4.
CEC, 1997b, Note on Agenda 2000, DG19, Internet version.

Notes
1 This model is developed as part of the FEA (Future of European Agriculture) project, a joint venture of three institutes: the Agricultural Economic Research Institute (LEI-DLO, The Hague), the Centre for World Food Studies (SDW-VU) and CPB. The project is led by Prof. M.A. Keyzer (SDW-VU). J. Muskens (LEI-DLO) also contributed to the development of the tool. The institutes present a more comprehensive analysis of Agenda 2000 in SDW-VU, CPB, LEI-DLO (1998), commissioned by the Ministry of Agriculture, Nature Management and Fisheries (Min-LNV).
2 The CEC has also announced adjustments for the olive oil, tobacco, fruit, vegetables and wine sector in the course of this year. Notice that the sugar sector is not subject to any reform.
3 The CEC (1997a) foresees an increase of total expenditures from 82 billion ecu in 1997 to 109 billion ecu in 2005 (in 1997 prices).
4 Remember that the effect of changes in EU net exports on world market prices is neglected in this analysis. An increase of the refund per unit follows when an increase of EU exports depresses the world market price.
5 The Dutch Ministry of Finance (1997) has calculated a net position of 2.0 bln ecu for 1995 (-0.68% of GNP).