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DIRECTORATE-GENERAL FOR EXTERNAL POLICIES OF THE UNION
DIRECTORATE B
- POLICY DEPARTMENT -

BACKGROUND NOTE

on

EEA ENLARGEMENT

Abstract:

With a view to the 27th meeting of the EEA Joint Parliamentary Committee, the present note examines the challenge posed by the last enlargement and the solutions arrived at, including for the special case of Switzerland. It then looks at first experiences in an enlarged European Economic Area and lessons for the next round of enlargement. A financial annex details the EFTA states' contributions to cohesion in the Internal Market.

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1. AN UNPRECEDENTED CHALLENGE

Ten new member States joining the EU on 1 May 2004 posed a major challenge not only for the European Union itself, but also for the European Economic Area - although few people other than those regularly dealing with EEA issues may have been aware of it at the time, and indeed to this day. Not only would the size of the EEA internal market increase dramatically, to some 460 million people, but each new entrant brought specific circumstances which called for specific solutions, mostly through a wide range of transitional arrangements towards the full implementation of the acquis. All of this would put considerable strain on the smooth functioning of the internal market. Moreover, the eight Central and Eastern European states among the accession countries were long-standing partners of the EFTA countries, along historic trade routes that had quickly revived through free trade agreements (FTAs) when the Iron Curtain fell.

Under the circumstances, it was felt that mere 'automatic' extension of the EEA Agreement to the newcomers, as had been the practice in the 1995 EU enlargement, would not suffice in the present case. For the first time ever, formal negotiations on EEA membership for the ten accession countries were therefore opened in January 2003, once all had concluded their EU accession marathon. The negotiating parties meeting in Brussels comprised the applicant countries, the EEA EFTA states and the European Commission, representing the EU Member States. Over the course of six months, these negotiations reviewed the sometimes sensitive issues of transitional solutions for established trade flows in fish and agricultural products, as well as the delicate question of increased contributions from EEA EFTA states.

The EEA Enlargement Agreement was initialled in Brussels on 3 July 2003, and its signing was completed by November of that year. However, ratification procedures among the 28 contracting parties took their time, and were only completed in December 2005. The hard-won EEA Enlargement Agreement therefore had to be applied on a provisional basis from 1 May 2004 in order to fulfil the proclaimed objective of simultaneous enlargement of EU and EEA..

2. THE EEA ENLARGEMENT AGREEMENT

Technically, the package resulting form the 2003 negotiations consists of the EEA Enlargement Agreement itself, which by its nature is an amending agreement, as well as two additional protocols on fish between the EU and Norway and Iceland, respectively, an exchange of letters between Norway and the EU on certain agricultural products, and an agreement between Norway and the EU on a Norwegian Financial Mechanism.

2.1 Trade in Fish

Given the importance of fisheries and of the export of marine products for the economies of both Iceland and Norway, it is hardly surprising that free trade in fish constituted a key element of the the FTAs which these two countries concluded with the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Slovakia and Slovenia between 1991 and 1996. These FTAs terminated on 1 May 2004 however, as the new Member States came under the more restrictive trade regime for fish products in place between the EU and the EEA EFTA states. With a view to maintaining some of that trade at least for a limited time, lengthy negotiations were conducted on this sensitive matter. A solution was finally reached through agreement on a transitional regime for a five-year period, during which annual duty-free quotas would be available for the products most typically traded in the years prior to enlargement (essentially herring in various forms).

2.2 Agricultural produce

In a similar manner, the negotiators resolved the issue of Norwegian exports of agricultural products. Established trade with the above-mentioned new member States concerned a range of products as varied as berries, apple juice, grass seed and meat-based pet food. As for fish, annual duty-free quotas for these products were agreed in an exchange of letters between Norway and the European Community.

2.1 The Financial Mechanisms

Gaining access to a much-enlarged Internal Market, the EEA EFTA states also committed themselves to contributing towards the reduction of its social and economic disparities. A Financial Mechanism was negotiated which provides for a total contribution of € 600 million, in the form of annual grants of €120 million, to be shared by the ten new Member States and Greece, Portugal and Spain, in accordance with current EU cohesion policies.

As priority sectors eligible for funding, the relevant protocol lists environmental protection, sustainable development, heritage conservation including urban renewal, human resources development, and health and childcare. Along the lines of EU co-financing ceilings, projects from these fields may be subsidised up to 60%, except for those that are otherwise financed by public budget allocations, where the contribution may reach 85%.

In addition, Norway pledged a further € 567 million, effectively doubling its national contribution. Grants under this separate, Norwegian Financial Mechanism are exclusively targeted at the ten new member States. While explicitly referring to the EEA Financial Mechanism's provisions, they also have a slightly different focus, emphasising the implementation of the Schengen acquis, cross-border activities and support for implementing the acquis communautaire in general.

A Financial Mechanisms Office (FMO) was created for the day-to-day management of the funding under both Financial Mechanisms. It receives and processes the applications after they have been screened by the European Commission for compatibility with Community objectives.

A more detailed breakdown of the projected total funding is provided in the ***Annex***. Table 1 lists the - considerable - sums earmarked for each country under both Financial Mechanisms, while Table 2 illustrates the different percentages resulting from their different geographical focus.

3. SWITZERLAND AND EEA ENLARGEMENT

Although equally, if not more strongly, affected by the EU enlargement, EFTA Member State Switzerland could not be party to the negotiations of Norway, Iceland and Liechtenstein with the new Member States due to its observer status with the European Economic Area. Consequently, separate negotiations had to be conducted about extending the various bilateral agreements that govern EU-Swiss relations to the ten new Member States.

3.1 Bilateral Agreements

The adaptation of existing bilateral agreements has been in principle a technical question. However, for the Agreement on Free Movement of Persons, a mixed agreement containing transitional provisions, formal negotiations with the ten new Member States had to be conducted. These negotiations were concluded in July 2004, and the resulting agreement subjected to a referendum on 25 September 2005.

In the wake of the narrow outcome of the June 2005 referendum on the Schengen/Dublin agreement, the campaign was a tense one. The right-wing Swiss People's Party (SVP) campaigned against the agreement, playing on the fear of job losses for Swiss citizens if foreign workers flood the country, despite its leader, Justice Minister Christoph Blocher, being personally in favour of extending the accords from a businessman's point of view. EU Commissioner Ferrero-Waldner warned that discrimination against certain EU Member States would not be tolerated, and reminded the public that all agreements of the 'Bilateral I' package were linked by a termination clause, and would therefore be held in abeyance in case of the new agreement's rejection. In the end, the agreement was ratified on 25 September 2005, with 56 % of votes in favour.

3.2 The Swiss Contribution

Following the example of fellow EFTA member Norway, the Swiss government has also committed to contribute CHF 1 billion in total towards lessening the economic and social gap between the old and the new Member States of the EU. First announced to run over a period of

five years (at EUR 130 million per year), this voluntary contribution, billed as an investment in emerging markets, is now more likely to be stretched over eight to ten years. Under the scheme, Switzerland would support specific projects in different areas, which it would choose and carry out autonomously. Table 3 in the ***Annex*** shows the intended breakdown by country.

A memorandum of understanding to that effect was signed in February 2006, and the corresponding bill adopted in March by large majorities in both houses of the Swiss parliament. However, the "cohesion billion" has been challenged by the SVP and several minor parties as a "tribute payment to EU", and will therefore be subjected to a referendum on 26 November 2006. EU Commission President Barroso has warned against rejecting it, calling a No vote "a very bad sign for Europe". Despite his efforts, recent polls indicate 48% of voters against it, 27% in favour and 25% as yet undecided.

4. FIRST STEPS AND PROSPECTS

Two years after EU and EEA enlargement took place, it can be said that all parties involved successfully managed a smooth transition for the Internal Market. Already noted by the various bodies meeting throughout 2005, in particular the EEA Council, this was emphasised anew by the EEA Joint Parliamentary Committee itself in its 2006 report on the functioning of the EEA Agreement adopted in Tromsø on 23 May, and explicitly echoed by the EFTA Ministerial Meeting in Höfn on 26 June 2006.

For the business community, EEA enlargement did not happen on 1 May 2004, but started with the opening of EU accession negotiations, which sent a strong signal about the likely evolution of the regulatory and business environment in the future Member States. beyond the growing trade flow, companies from very diverse sectors and from every EEA EFTA state began to invest in the region, e.g. Iceland's *Byko-Lat* lumber or garment producer *66° North*, Norway's *Statoil*, *Orkla Foods* or *Dressman* fashion, or *Hilti AG* and *Kaiser Fahrzeugwerk* from Liechtenstein. While benefiting from low wage cost for production or distribution centres today, most of these investors expect these advantages to shrink as living standards start to rise, to be compensated by increased demand in the same markets. Combined with favourable tax regimes in many new Member States, the enlargement of EEA translates into an enlargement of business opportunities.

The Financial Mechanisms, established at least partly in recognition of these enhanced business opportunities in an enlarged market, have proceeded apace. Individual memoranda of understanding were signed with the respective beneficiary countries, and open calls for project proposals subsequently launched in Poland, the Czech Republic, Hungary, Portugal, Slovakia, Slovenia and Malta. Faced with an unexpectedly high number of applications, the FMO has inaugurated its co-operation with the European Commission while perfecting internal procedures and technical tools. It also organised a range of information seminars, as well as workshops about sustainable development and good project governance. The Financial Mechanisms have thus reached their implementation phase, with some 300 million Euro made available to applicants by June 2006.

Meanwhile, the shift in the EEA's overall membership numbers undeniably affects the potential impact of the EFTA states' stance on any given issue. Besides increased efforts at making their voice(s) heard and their position(s) understood, new avenues for early decision-shaping in the established Committees and Working Groups may have to be explored, possibly including increased interaction with the competent committees of the European Parliament.

The experience of 2004 has proved that a smooth transition into an enlarge EEA Internal Market is possible, but that success depends heavily on good will from all sides, hard work at negotiating and implementing, and a timely start of the whole process. From 2004 successive EEA Councils have regularly welcomed the progress of Bulgaria and Romania towards accession, for the same reasons, both economical and political, as it encouraged the last round of enlargement. The fact that its equally regular call for the parties concerned to open negotiations had to be renewed again in June of this year, barely six months from potential enlargement, raises some concern about the prospects of repeating the 2004 performance and ensure the continued good functioning of the EEA.

ANNEX

Table 1: Financial Mechanism shares by beneficiary, in Euro

Beneficiary state	**EEA Financial Mechanism**	**Norwegian Financial Mechanism**	**Total**
Cyprus	1,260,000	3,402,000	4,662,000
Czech Republic	48,540,000	62,370,000	110,910,000
Estonia	10,080,000	22,680,000	32,760,000
Greece	34,260,000	0	34,260,000
Hungary	60,780,000	74,277,000	135,057,000
Latvia	19,740,000	34,020,000	53,760,000
Lithuania	27,000,000	40,257,000	67,257,000
Malta	1,920,000	1,701,000	3,621,000
Poland	280,800,000	277,830,000	558,630,000
Portugal	31,320,000	0	31,320,000
Slovakia	32,340,000	37,989,000	70,329,000
Slovenia	6,120,000	12,474,000	18,594,000
Spain	45,840,000	0	45,840,000
Total	***600,000,000***	***567,000,000***	***1,167,000,000***

Table 2: Financial Mechanism shares by beneficiary, in percentages

Beneficiary state	**EEA Financial Mechanism**	**Norwegian Financial Mechanism**
Cyprus	0.21 %	0.60 %
Czech Republic	8.09 %	11.00 %
Estonia	1.68 %	4.00 %
Greece	5.71 %	---
Hungary	10.13 %	13.10 %
Latvia	3.29 %	6.00 %
Lithuania	4.50 %	7.10 %
Malta	0.32 %	0.30 %
Poland	46.80 %	49.00 %
Portugal	5.22 %	---
Slovakia	5.39 %	6.70 %
Slovenia	1.02 %	2.20 %
Spain	7.64 %	---

Table 3: Shares in Swiss voluntary contribution, in Swiss Francs

Czech Republic	109,780,000
Estonia	39,920,000
Cyprus	5,988,000
Latvia	59,880,000
Lithuania	70,858,000
Hungary	130,738,000
Malta	2,994,000
Poland	489,020,000
Slovenia	21,956,000
Slovakia	66,866,000