

AGRICULTURE, THE STRUCTURAL FUNDS AND THE BUDGET AFTER ENLARGEMENT

Jim Rollo*

ABSTRACT. *The purpose of this article** is to examine how the legacy of the, often bruising, negotiations at Copenhagen and subsequently over agriculture will affect the political economy of the European Union and specifically the challenges facing the CAP, the Structural Funds in the next decade. The EU Budget for the remainder of the 2000-2006 Framework was fixed by the EU-15 at the Brussels Summit of October 2002 (European Council, 2002b) and is very unlikely to change. That is why the first real battle over resources engaging the new members will turn out to be the Financial Framework post 2006. This article will discuss the general context, before examining agriculture policy and structural funds after Copenhagen summit and finally the implications for the next Financial Framework.*

In 1993, Richard Baldwin, one of the most prolific and original economists working on European integration, declared that the Central and Eastern European countries are too poor and too agricultural ever to be members of the EU. The point of this comment is that if money is the lifeblood of the Union then eastern enlargement was unaffordable. As was seen at the Copenhagen Summit in December 2002 (European Council, 2002a), which settled the next enlargement of the EU, when finally the Council got to the money they engaged in real negotiations. How the negotiated outcomes on agriculture, the Structural Funds and the EU Budget will affect the future political economy of the Union is one of the major challenges from the 2004 enlargement.

The initial attempt to deal with the

challenges thrown out by Baldwin's statement by the EU Commission was the document Agenda 2000 (European Commission 1998). This was intended to show how policy needed to change if EU enlargement was to be 'affordable' in the context of the 2000-2006 Financial Framework, which would set out the EU budgetary strategy for that period. The report and the Commission proposals for 2000-2006 were considered at the Berlin Council in March 1999 (European Council 1999). There the Commission's proposals were substantially altered under pressure from Finance Ministers anxious to limit the growth of the Budget and the French President who single-handedly destroyed the Commission proposals on agriculture. The latter effectively vetoed or reduced the price cuts put forward in Agenda 2000. The

* Jim Rollo is Director of the „One Europe or Several?“ research programme of the British Economic & Social Research Council. He is Professor of European Economic Integration at the University of Sussex, Co-Director of Sussex European Institute and Director of the Centre on European Political Economy. He was until December 1998, Chief Economic Adviser in the British Foreign Office and before that Director of the International Economics Research Programme at the Royal Institute of International Affairs in London. His main research interests are European integration, trade policy, agricultural policy, EU enlargement and EMU.

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Commission obtained a mandate for a mid-term review of the CAP (a review resisted by France and for which it said there was no legal basis) proposed for 2003 and completed at the end of June 2003 after marathon negotiations. Following Berlin the shape of the enlargement assumed in Agenda 2000 changed. The number of countries increased from 6 to 10 and the date of accession was delayed from 2002 to mid 2004. These two factors required a further consideration of the budgetary framework by the EU-15, which took place at the Brussels European Council in October 2002 (European Council, 2002b) where heads of government agreed on the shape of the budgetary offer to be made to the candidates in Copenhagen the following December.

The purpose of this article is to examine how the legacy of the, often bruising, negotiations at Copenhagen and subsequently over agriculture will affect the political economy of the European Union and specifically the challenges facing the CAP, the Structural Funds in the next decade. The EU Budget for the remainder of the 2000-2006 Framework was fixed by the EU 15 at the Brussels Summit of October 2002 (European Council, 2002b) and is very unlikely to change. That is why the first real battle over resources engaging the new members will turn out to be the Financial Framework post 2006.

First of all, this article will discuss the general context, before examining agriculture policy and structural funds after Copenhagen summit and finally the implications for the next Financial Framework.

The Context

Structural Budget deficits are a feature of the members of the euro zone core. This has put the Stability and Growth Pact of EMU under great pressure, and while many think this pact is theoretically unnecessary, it is crucial for EMU credibility. This pact declares that each country should aim for the budget balance in medium term and the budget deficit should not exceed the 3% of the GDP. France and Germany are both above those strict criteria of deficit levels and Italy is struggling to remain within them against a background of weak growth. Even for those euro zone members not in structural deficit the need to aim for budget balance under the Pact forces them to look for revenue (or cut expenditure) where they can. As a result EU members are effectively short of tax revenue. And when it comes to reducing deficits the EU budget is politically a free hit. Net recipients from the Budget effectively tax foreigners and foreigners cannot vote and thus have no impact on domestic politics. Equally the net payers to the Budget look to cut their net contributions. This, above all, is German strategy but interestingly now even the Netherlands, once seen as a champion of *Communitaire* policies and an opponent of *juste retour*, tries to do the same. The Dutch Prime Minister and the Dutch finance minister sound exactly like Margaret Thatcher at the beginning of the 1980s, they want their money back, as do German finance ministers. The existing net recipients obviously look to sustain their position. The Spanish, the Greeks, the Portuguese, the Irish and even the Germans, for their new *Länder* in the East, all want to still hold onto their structural

funds money. And France threatens the veto in defence of its receipts from the Common Agricultural Policy.

Agricultural Reform and the mid term review

It is perhaps best to begin with agricultural reform. After the customs union and competition policy it is the oldest common policy, and an icon of European integration to many down the years. It affects the daily lives of all EU citizens because as consumers they are concerned by the price of food. It affects taxpayers because it represents between 40 and 50% of the European budget. In total it raises costs to taxpayers and consumers by more than € 100bn a year (OECD 2002).

In 1999, as part of fixing budget for the period of the 2000-2006 budget, the Commission proposed a reform of the agriculture policy. This reform of agricultural policy was slowed and almost stopped by the intervention of President Chirac at the Berlin Summit. But the Commission claimed and have got a mid-term review, which allowed them to return to the issue in 2003. The French at first denied that the mid term review was mandated by Berlin and at the Thessalonica summit in June 2003 (European Council, 2003) threatened to veto on going negotiations despite this being a qualified majority issue. So what was so threatening about the Commission proposals?

First the Commission proposed (European Commission, 2003a) further support price cuts for all products but sugar. Second the Commission proposed that direct payments to farmers should be production neutral, 'decoupled' in the jargon, meaning that they give no incentive to producers to produce particular products although clearly the

intention is to allow farmers to remain on the land and producing more than under a pure market. Rather support would be for farming in general and linked to total past receipts from the CAP: farmers would receive a single payment each year. Third the intention would be to favour small producers over big producers. The first € 5000 of any payment would be given in total. Above € 5000 it was proposed they be subject to reductions of 1% in 2006 rising to 6% pa by year 2011. Fourth, the receipts from this so-called modulation will be used to generate funds for a policy of rural development (sometimes called pillar two and de facto a form of agricultural structural funds). Finally the Commission proposed that to qualify for decoupled payments, producers should have to pursue environmental standards, food safety standards and animal health standards above the minimum required by EU law. This 'cross-compliance' would require the setting up of an advisory service to help farmers qualify and inspection to check.

By reducing price support and decoupling income subsidies from production the Commission attempted to move agriculture policy away from a purely productionist based policy to a social income based one. In terms of the American debate on social welfare of the 1980s and 1990s they proposed moving away from 'workfare' towards the 'welfare'. Farmers dislike it intensely since it explicitly puts them on the same footing as social security recipients rather than important members of the productive economy.

What is also interesting about this package is that despite proposed cuts in domestic support prices which would bring them close to world market levels and hence reduce the need for export subsidies,

the Commission made no explicit proposals for cuts in frontier protection. Tariffs at the frontier would still exclude imports (outside the limited tariff quotas negotiated in the Uruguay Round of trade negotiations). In reality it is the exclusion of imports that pushes up agricultural prices in the EU and it is actually where the most of farmers' support comes from, rather than from the budget or market intervention.

In terms of political economy France and Ireland, with support from Spain, Italy and some others, were the most resistant to this package; Germany is mainly interested in budget cost but there is a very big electoral interest in the food safety and the environmental issues backed by an agriculture minister from the Green Party. Finally, the United Kingdom though generally supportive of the package, was against any penalization of the biggest farmers and worried about budget costs as are the Dutch and Scandinavians who are also generally supportive of the Commission.

The key coalition remained France and Germany. They agreed ahead of the Brussels European Council of October 2002 that the agricultural budget should be frozen until 2013 and that was duly agreed by the Union at Brussels. This meets some German objectives by at least limiting the room for increased budget burdens. Ahead of the first Agriculture Council in June 2003 they also agreed at head of government level that the degree of price cuts and the proportion of production covered by decoupling should be less than proposed by the Commission. And indeed that is what happened at the final negotiations overnight on 25/26 June 2003 (DEFRA, 2003).

First the degree of potential decoupling was reduced from 100% to 75% for arable

(60% for Durum wheat) and between 75% and 0% for beef and sheep subsidies. This all on a voluntary basis and could be introduced as soon as 2005 or delayed until 2007. So some member states could be 100% decoupled for all eligible products as soon as 2005 while others could be between 75% and 0% decoupled depending on product and would not have to introduce any decoupling before 2007.

On prices the proposed cut in cereals prices of 5% has been rescinded although some technical adjustments to seasonal prices may cut overall price support a little across the year. The cut in butter prices proposed in Agenda 2000 for the year 2000 is reduced from 35.8% to 25% and will not be introduced until 2005. The milk production quota increase also proposed in Agenda 2000 for the year 2000 has been delayed another year to 2006 and additional increases of 2% have been dropped.

Modulation is introduced but beginning at 3% in 2005 and rising to 5% by 2007. This is a year earlier than originally proposed by the Commission and at higher levels until 2011. This will generate significantly higher funds for the second pillar policies in the years before 2011 than originally proposed. This may help both new members and the amount of support that can be transferred from the 'blue box' to the 'green box' in the early years of any WTO agreement - see below.

All in all while decoupling has been introduced it is in a differential and weakened way (notably for beef and sheep) and proposed price cuts or production quota increases have been significantly reduced in arable and dairy. And sugar remains untouched.

The WTO dimension

The Doha Development Agenda has set up an agenda for agricultural negotiations which focus on three main areas reducing trade distorting subsidies and market support (broadly consistent with support price cuts and decoupling), cutting export subsidies and the increased market access for basic agricultural products, the latter mainly aimed at the developing countries.

The mid term review only deals with a part of that. The agreed outcome does offer some decoupling of production from support, which potentially reduces the trade distorting potential of the CAP. It thus seems to offer something to a WTO round.

Most notably it will allow the EU to move a large proportion of its total support from the 'blue box' (trade distorting but allowed for the moment) to the 'green box' of permitted, non-trade-distorting subsidy.

There are problems however. The impact on export subsidy of decoupling is unclear but is likely to fall short of the complete abolition demanded by the US, the Cairns Group of agricultural exporters and major developing countries like India and China. EU Tariffs remain prohibitive. The tariff level on grain into the EU is in excess of 200%. By comparison the average tariff on manufactures into the EU is currently 3%, even on textiles and apparel, which are heavily protected, the average tariff is around 25%. So starting from 200% a very large cut is necessary if any imports (outside the small quotas allowed at reduced tariffs and which are currently not even filled) are to take place. Hence there is very little in the Commission Package that yet significantly contributes to the development objectives of the Doha Round.

The Enlargement Dimension

So where does the enlargement fit to all this? The Copenhagen summit left the new member states with no more than 25% of direct payments (those payments now to be decoupled) commonly financed by the EU budget when they join in 2004. That will rise to 100% by 2013 (the end of the next budgetary period). This is yet another part of a process of fixing the 2007-2013 financial framework along an important dimension before the new members join the EU.

And the budgetary pressures of enlargement on new members are quite significant (Spokeviciute (2003), Mayhew (2003)). If, as negotiated, they top up these direct payments from their own budget, it is a serious budgetary problem. There do exist budgetary constraints in almost all new members. Add to that the fact that the costs of just adopting the *acquis communautaire* will require another 5-9% on existing expenditure. Under these pressures they will find it hard to meet the excessive deficits procedures of the EU let alone meet the Maastricht criteria for membership of EMU or the Stability and Growth pact. All of which could put their future accession to EMU in danger.

The new member states have big agricultural populations, many on small, quasi-subsistence holdings, but seem to have poor rural infrastructure. The increased spending under the new second pillar of the CAP may help them. On the other hand with so many very small holdings and weak bureaucracy they may find it hard to take advantage of the rural development funds or to meet the cross compliance standards necessary to qualify for direct payments.

If that turns out to be true, the combination of, at best, less than 100% receipt of direct payments until 2013 and the possibility that many of their producers might in any case fail the cross compliance test and receive nothing may make them resistant to any reduction in border protection as main source of support to their farmers. They may increase the protectionist voice in the Agriculture Council after May 2004 when they formally join and make a successful completion of the Doha Round by the end of 2004 more difficult.

More generally they are likely as a group to look to re-open the Copenhagen deal on direct payments (they have, just, a blocking majority on the Treaty of Nice voting allocations in the Council). They may also look for more direct budget support for rural infrastructure after 2006 particularly if they make no progress on direct payments. That will throw them into direct conflict with the agreed limits on the agricultural budget and the EU-15 who will lose receipts from the direct payments if the budget ceiling is breached under the financial discipline mechanism agreed in Luxembourg.

Structural Funds

The term Structural Funds is normally taken to mean the Regional and Social Funds but here will include the Cohesion Funds. This section will discuss them as a whole even though there are important differences in their operation. There are two problems facing the Funds.

First, the net contributors to the structural funds may start to lose interest and the willingness to pay. There is a discussion going on about whether net

contributors should only put in their net contributions and receive no receipts from the Regional Funds. The British finance minister for example has proposed repatriating regional policy spending in Britain and only paying the net contribution to Brussels (Guardian, 7 March 2003). That is, Regional Fund payments to British regions would come from London not Brussels. Such an approach would undercut any political support for the regional policy in Great Britain among regional or local politicians.

Second, the current recipients want to maintain their position (eastern Länder, Spain, Greece, Portugal, Mezzogiorno). Even rich Ireland, whose GDP per head is now around 120% of the EU-15 average (EU Commission 2003b, table 1) compared with the Regional Fund cut-off of 75% and who might be thought of as a large relative net contributor wants to keep the money. Ireland was a single region for the purposes of the regional policy until the last revision of regional boundaries. Then magically it became two regions. One, including Dublin and with a GDP per head over 100% of EU-25 GDP per head and the other close to the limit of 75% of EU GDP (EU Commission 2003b, map 1). This is one illustration of the political economy of the structural funds at work.

The new members were offered full access to the structural funds at Copenhagen but with a cap on their receipts of 4% of GDP as proposed in Agenda 2000. They may have difficulty reaching this cap soon (or at all) because of complex rules for planning and implementing projects, lack of administrative capacity to absorb and fully exploit these funds or lack of matching

funds which amount to one third to 45% of the total cost.

So once members they may look for simpler disbursement rules and lower rate for co-financing. If they don't make the 4% cap, financing the structural funds budget might be relatively straight forward. But if they reach it early and consistently then the impact on structural funds spending could be over € 25Bn by 2013.

On questions of political economy, first there is an upper limit on spending of 0.46% GDP (European Commission 1998b, section B and Inter-institutional agreement between the Council the Commission and European Parliament, 1999). Second unanimity is required for approval of structural funds budgets and is likely to remain so at least until after 2013 even if the proposed EU constitution is adopted as drafted by the Convention on the Future of Europe. Thus everyone has a veto. The net contributors, the current recipients and the new members will have to find a consensus, which creates a very difficult political economy.

The Budget

The enlargement package agreed at Copenhagen is mean and that may poison the new members' attitude in future negotiations. It is not just less than in Agenda 2000 (agreed by the Commission in 1998) it is even less than was agreed in March 1999 at the Berlin Council, where they cut back the Agenda 2000 proposals. The Berlin 2000-2006 budget was designed for six new members joining the EU in 2002 not ten joining in mid 2004. This saved considerable funds since the 4 extra countries were small while the time period of membership was reduced by more than

half from 4 years to 18 months.

Thus the net contributors sewed up the Budget until 2006 first at Berlin in 1999 and again in Brussels in 2003. The total budget is barely more than 1% of GDP. In real terms it has fallen back from the levels proposed in Agenda 2000 and at Berlin. Against that background the financial framework post 2006 is the real battlefield post enlargement. This is also a battleground where unanimity is required so everyone is condemned to reach a consensus.

First some context, the upper limit on the budget is set by the so-called 'Own Resources' (or budget income) ceiling, which is set at 1.24% of EU GDP. The Own Resources ceiling is not on the table since current expenditure is nowhere near the limit and the net payers have a veto. The EU budget is not allowed to borrow, so if its income is limited so is expenditure.

And the EU-15 has already limited the room for manoeuvre of the Commission and the net recipients. As noted above the agriculture budget is frozen by the financial discipline mechanism agreed at Luxembourg in June 2003. Second as noted above the structural funds are limited at 0.46% of EU GDP and have been since the 1993-1999 Financial Framework and this could only be changed by agreement among the Commission, the Council and the European Parliament. And the actual level and distribution of the structural funds budget is also a matter of unanimity. So change there is going to be hard to make.

Other constraints will also affect the negotiation. Romania and Bulgaria have been given very strong commitments on EU membership by 2007 in the Thessalonica European Council Conclusions of 20 June 2003 (European Council 2003). Turkey was

given the target of opening negotiations at the end of 2004 in the Copenhagen Council conclusions. Croatia has just applied for the candidature and Macedonia is on the verge of applying. So we have another five countries and Turkey above all, which want to join the European Union and which could do so during the period of 2007-2013. Money for them will need to be part of the budgetary planning procedure. Turkey in particular is likely to weigh heavily on the minds of Finance ministers because of its size (total population at 70 million only 10 million less than the 10 new members and much poorer and much more agricultural than the new members).

And other policies are on the increase and budgets are under pressure. Most notably security both internal and external. The Justice and Home Affairs agenda is likely to be at least partially Communitised after the next Intergovernmental conference in 2004 which could lead to some common financing particularly of guarding external borders. The costs of stabilising and preparing the Western Balkans for possible and eventual EU membership will along with programmes for the 'near abroad of Ukraine, Belarus and Russia as well as North Africa and the Middle East all speak to a hugely expanding foreign policy budget. Even if not part of the EU budget increased defence cooperation could lead to downward pressure on the EU budget envelope. And the Lisbon agenda, which has the aim of making the EU the most technologically advanced, high productivity economy in the world by 2010 also demands increased expenditure on Union R&D budgets. So the budget is under the wider pressures than just agriculture and the structural funds.

Political Economy of the Budget after the Enlargement of 2004

How is the political economy of this going to work out? It might be possible to carry out some complex game theoretic modelling but that is not the intention here. Instead three somewhat stereotyped scenarios will be set out to give a sense of the possible range of outcomes.

A new 'Club Med'?

All the net recipients gang up together to expand the budget, in particular the so-called „Club Med“, which includes Italy, Spain, Greece and Portugal and Ireland (although Ireland starts phasing out of the Cohesion Fund from 2004 onwards), expands to include the new members. The aim would be to unfreeze the Agricultural budget and perhaps to raise the share of the structural funds and in consequence raise the budget closer to the own resources ceiling.

This might be done with the support of the Commission who write the initial Framework and perhaps their members of the European Parliament, which could threaten not to sign the Inter-institutional Agreement on the Framework.

Each country has a veto, but more importantly as a group they do have a substantial blocking minority (186 votes see Annex). This might allow them to threaten the net payers on issues which are important to the net payers as a group or individually and which are subject to Qualified Majority Voting (QMV). Equally however the net payers also constitute a fairly, if less, robust blocking minority of 99. The outcome will therefore depend on which group is most prone to defections as a result of side payments or threats.

'Club Med' vs. 'new kids on the block'?

This becomes a spoils fight between the new members and the existing cohesion states (plus Italy or perhaps France defending its take from the CAP budget) both of which groups have blocking minority in the Council. This is driven by an essentially frozen budget on agriculture and the upper limit on the structural funds plus the Germans and other net payers trying to drive in wedges to split the net recipients. The key targets of the new members are likely to be more money for direct payments and pillar two from the agricultural budget and easier disbursement rules for the structural funds. As we have seen in the past the Spanish, in particular, are extremely adept at political infighting in the Council and have been very successful. They have also kept very close to Germany when they can and that long-term relationship could still serve them well in any budget wars.

New Members vs Candidates

The new members, despite warm words now, may find it difficult to welcome the budgetary consequences of Bulgarian and Romanian accession in 2007 right at the beginning of the Framework period, let alone the possibility of Turkish accession during it. There are 8 million Bulgarians and 23 million Romanians, which is roughly equivalent to another Poland or half the size of the current enlargement (and 70 million Turks would double that again). The impact on the distribution of receipts on agriculture and structural funds could be substantial particularly if key elements of the Budget are frozen. This

might encourage the new members to a strategy of delay on the next enlargement not least because pre-accession aid is outside agriculture and the Structural Funds budgets and thus outside any ceilings. This might lead to a policy of delay.

Conclusions

The political economy of the EU budget is going to be very messy after enlargement. It is too early to tell how it will work out but not too early to start thinking about the issue. In terms of the big choices confronting the EU:

- The Doha Round may suffer as new members look to domestic market support and market access barriers to sustain farm incomes in the absence of any new money for them before the end of 2004
- Future agricultural reform is likely to be slowed by enlargement unless new members are given more cash after 2006.
- The structural funds seem unlikely to expand and if net payers lose interest and distance themselves from them politically then deals may be hard to strike in the next Financial Framework.
- The Financial Framework is an uncertain battleground, but the need for unanimity suggests stasis unless there are some levers external to the budgetary negotiation available to the demanders/net recipients. One of the most important issues to focus on may be whether there is any sign of blocking minority coalitions emerging among the new member states or among the net recipients as a group.
- The next enlargement may also suffer. Bulgaria and Romania may

join the European Union later than the promised 2007. And Turkey may be in the waiting room until the Greek calends.

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Annex

Blocking Minorities in the enlarged EU

Votes in the Council	
<i>THE WEIGHTING OF VOTES IN THE COUNCIL</i>	
<i>Members of the Council Weighted votes</i>	
<i>Germany</i>	29
<i>United Kingdom</i>	29
<i>France</i>	29
<i>Italy</i>	29
<i>Spain</i>	27
<i>Poland</i>	27
<i>Romania</i>	14
<i>Netherlands</i>	13
<i>Greece</i>	12

<i>Czech Republic</i>	12	<i>condition is shown not to have been met,</i>
<i>Belgium</i>	12	<i>the decision in question shall not be</i>
<i>Hungary</i>	12	<i>adopted.</i>
<i>Portugal</i>	12	Extract from Nice Treaty Declaration on
<i>Sweden</i>	10	Enlargement, Official Journal, En 10.03.2001.
<i>Bulgaria</i>	10	page C81/82
<i>Austria</i>	10	http://europa.eu.int/eur-
<i>Slovakia</i>	7	lex/en/treaties/dat/nice_treaty_en.pdf
<i>Denmark</i>	7	
<i>Finland</i>	7	
<i>Ireland</i>	7	
<i>Lithuania</i>	7	
<i>Latvia</i>	4	
<i>Slovenia</i>	4	
<i>Estonia</i>	4	
<i>Cyprus</i>	4	
<i>Luxembourg</i>	4	
<i>Malta</i>	3	
<i>Total</i>	345	

Acts of the Council shall require for their adoption at least 258 votes in favour, cast by a majority of members, where this Treaty requires them to be adopted on a proposal from the Commission. In other cases, for their adoption acts of the Council shall require at least 258 votes in favour cast by at least two-thirds of the members. When a decision is to be adopted by the Council by a qualified majority, a member of the Council may request verification that the Member States constituting the qualified majority represent at least 62 % of the total population of the Union. If that

Calculating a blocking Minority

A maximum size of a blocking majority in a Union of 27 is thus 88 votes ((345-258)+1). This is 25.50725% of the total votes in the Council. Total votes in a Union of 25 is 322 (345 minus Bulgaria (10) and Romania (13)). So a blocking minority in a Union of 25 is 82 votes (322 *0 .2550725). The ten new members have 99 votes which is comfortably a blocking minority and can lose up to 17 votes in defections but Poland must remain in any coalition.

The Cohesion states Spain, Ireland, Greece, and Portugal (58 votes in total) can only muster a blocking minority if they can include Italy (defending the mezzogiorno) or France (defending the CAP) in any coalition.

Net payers, taken to be Germany, UK, Netherlands, Sweden, Austria, Finland, have 98 votes and hence a blocking majority that can be sustained against the defection of the Netherlands, or Finland, plus one of Sweden or Austria.