Searching for Consensus: The Debate on Reforming EU Cohesion Policy

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Preface

This paper on the reform of EU cohesion policy provides an assessment of the debate on the proposals put forward by the European Commission for Structural and Cohesion Funds policy after 2006. The paper was originally drafted for the EoRPA (European Regional Policy Research Consortium), which is a grouping of national government authorities from countries across Europe. The Consortium provides sponsorship for the EPRC to undertake regular monitoring and comparative analysis of the regional policies of European countries and the inter-relationships with EU regional and competition policies.

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The research for this paper was undertaken by EPRC in consultation with EoRPA partners. It involved a programme of desk research and fieldwork visits among national and regional authorities in Member States during Spring/Summer 2004.

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It should be noted that this paper was drafted in September 2004 based on the financial and budgetary information, as well as position papers, available at the time.

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Disclaimer

It should be noted that the content and conclusions of this paper do not necessarily represent the views of individual members of the EoRPA Consortium.

Abstract

In February 2004, the European Commission put forward its budgetary proposals for the 2007-13 period followed by the publication of the Third Cohesion Report outlining changes to cohesion policy. The aim of this paper is to examine the key questions associated with EU cohesion policy reform. The paper reviews the main events of the past year having a bearing on the reform debate and outlines the European Commission's proposals for future cohesion policy as a basis for discussing their implications. The first set of implications relate to eligibility issues. The paper considers how the Member States will benefit under the different priorities on the basis of current information about eligibility criteria. It also examines the potential allocation of funding to Member States under the different categories of support, applying different methodologies (both top-down and bottom-up) in order to replicate the Commission's approach. The paper goes on to discuss the debate among Member States, first with respect to the overall financial framework for 2007-13 and then regarding the proposals for cohesion policy. Finally, the paper highlights questions about the scope for making savings on the budget, the approach to the negotiations, the focus for future spending, the objectives of territorial cohesion and the new planning framework.

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INTRODUCTION

In February 2004, the European Commission put forward its budgetary proposals for the 21007-13 period followed by the publication of the Third Cohesion Report outlining changes to cohesion policy. The aim of this paper is to examine the key questions associated with EU cohesion policy reform. The paper reviews the main events of the past year having a bearing on the reform debate and outlines the Commission's proposals. It then considers how Member States will be affected by the eligibility criteria and possible mechanisms for financial allocation, and it discusses the different views of Member States in the reform debate. Lastly, the paper highlights some wider issues.

CONTEXT FOR THE REFORM DEBATE

Underlying the need for the reform of EU cohesion policy are the implications of EU enlargement for economic and social cohesion of the EU. The latest data published in the Third Cohesion Report illustrate the long-term challenge to achieve convergence between the new Member States and the EU15. A second issue is the slow progress of the EU in meeting the goals of the Lisbon Agenda and the need to improve growth and competitiveness. A third set of developments concerns the institutional changes associated with the adoption of the Constitutional Treaty. Among the revisions to EU legal and institutional frameworks, the Constitution incorporates the objective of territorial development as a goal for cohesion policy.

In its Financial Framework for 2007-13, the Commission proposes an increase in the EU budget of 31 percent by 2013 compared to 2006. Annual cohesion policy expenditure (excluding rural development) would rise from €38.8 bn in 2006 to €51bn in 2013. The financial resources for the Structural and Cohesion Funds would represent c.0.41 percent of GNI in an EU27. In addition, the Commission has proposed changes to the own resources system, including the replacement of the current system of budgetary compensation for the UK with a generalised correction mechanism applicable to all larger net contributors.

EC PROPOSALS FOR COHESION POLICY

The Commission is proposing to change EU cohesion policy in several important respects. First, the rationale for cohesion policy places more stress on the promotion of regional competitiveness as a contribution to the Lisbon Agenda. Greater emphasis is also accorded to territorial cohesion, broadening the remit of policy beyond spatial imbalances in income and employment to address issues such as polycentric development of urban areas and the specific problems of areas with geographical handicaps.

Second, future EU cohesion policy would be targeted on the themes of: innovation and the knowledge economy; accessibility and services of general economic interest; environment and risk prevention; employment, training and adaptation; and social inclusion. The current Objectives 1, 2 and 3 would be superseded by three new priorities: convergence; regional competitiveness and employment; and territorial cooperation.

Third, the Commission is proposing to make significant changes to the way that EU cohesion policy is implemented. While the key principles underlying the Structural Funds would be retained, a new planning framework would be introduced with strategic frameworks for cohesion policy at European and national levels. Measures to simplify and decentralise implementation are also proposed.

ELIGIBILITY ISSUES

On the basis of the information currently available in the Third Cohesion Report and the Commission's legislative proposals, it is possible to make some initial assessments of eligibility for future cohesion policy. All of the new Member States would qualify for the Cohesion Fund, as well as Greece and Portugal, but Spain would cease to be eligible. The Convergence priority would cover almost all (92.3 percent) of the population of the new Member States but just a small proportion (14.2 percent) of the EU15. Some 17 regions would be classified as 'phase out' regions, under the provisions for the 'statistical effect' (almost four percent of the EU25 population). The outermost regions will receive special treatment, as will 'phase in' regions whose levels of growth take them beyond the Convergence threshold. However, it is not clear what special treatment may be accorded to the sparsely populated regions.

For non-Convergence regions, a notable feature of the proposed reform is the withdrawal of the explicit designation of areas on the basis of EU-wide criteria in favour of a more thematic approach. Although mention is made of a number of types of region with particular territorial problems, at this stage it is not clear what specific criteria are envisaged.

FINANCIAL ALLOCATIONS

In broad terms, the Commission has proposed 78 percent for the Convergence priority, 18 percent for the Regional Competitiveness and Employment priority and four percent for Territorial Cooperation. Although the available information is limited, several assumptions can be made about financial allocations to Member States. First, for the new Member States, the absorption cap will play an important role, limiting allocations to €161 bn in the 2007-13 period. Second, given the influence of the absorption limit, the use of the Berlin methodology may only apply to the EU15, where annual per capita allocations under the Convergence priority could fall from €238.6 per head in the current period to €217.1 for 2007-13. Third, the share of Cohesion Fund resources as part of overall allocations will increase; estimates suggest allocations of €41 per head in the EU15 and €93 per head in the new Member States. Fourth, the relatively generous provisions for the statistical effect regions would ensure sizeable shares of Convergence priority funding going to Germany, Greece, the UK, Spain and Belgium. Lastly, the former Objective 1 'phase in' regions will face a very steep reduction in per capita allocations, from as high (in some cases) as €240 per head in 2007 to the projected per capita level for all other regions of €21 by 2012.

MEMBER STATE PERSPECTIVES

The debate on the Commission's proposals for EU cohesion policy is still in its early stages and is somewhat overshadowed by the wider question of the budget. The Commission's position on financial resources is supported by Spain, Portugal, Greece, Belgium and most of the new Member States. A very different view is taken by the richer EU countries, six of which (Austria, France, Germany, the Netherlands, Sweden and the UK) have advocated a limit on expenditure of 1 percent of EU GNI. An intermediate position is held by countries such as Finland, Ireland and Italy, some of which have suggested a budget of 1.1-1.4 percent of GNI. There is also concern about the proposed division of funding between old and new Member States, about the absorption limit (among many new Member States), and about the structure of the proposed financial framework.

With respect to cohesion policy, there has been a positive response from many Member States to the Commission's proposal to emphasise regional competitiveness, the new architecture, the approach to spatial coverage and the new delivery system. Under all these headings, however, many countries are uncertain – or have specific reservations – about particular aspects of the proposals and are seeking clarification. Under the Dutch Presidency, a Financial Perspective Ad Hoc Group is beginning a process of collating Member State reactions with a view to developing 'building blocks' of options as a basis for negotiation.

CONCLUDING QUESTIONS

The major decisions on the future of EU cohesion policy relate to the overall size of the EU budget, the share allocated to cohesion policy and the financial split between the three objectives and categories of eligible region. The broad financial issues are currently being considered within the Financial Perspective Ad Hoc Group under the Dutch Presidency, but it is widely anticipated that achieving a political basis for agreement on the budgetary issues will take considerable time. In parallel, the Structural Actions Working Party is examining the detailed proposals for the design and implementation of Structural and Cohesion Funds. As a contribution to this debate, four sets of questions are highlighted: (a) To what extent can cohesion policy support the Lisbon strategy? (b) Are the priorities for funding too broad or two narrow? (c) Is territorial cohesion an 'undefined policy objective'? (d) Will the new planning framework involve hard or soft coordination?

Searching for Consensus: The Debate on Reforming EU Cohesion Policy

1. INTRODUCTION

After a prolonged period of public debate and research, the European Commission put forward its budgetary proposals for the 2007-13 period in February 2004, closely followed by the publication of the Third Cohesion Report outlining changes to cohesion policy. In July 2004, the Commission also submitted its formal legislative proposals, starting an intensive process of negotiation within the committees of the Council.

The European Commission's proposals would involve some major changes to EU cohesion policy in the most far-reaching reforms since 1988. Apart from the increase in funding, they envisage a new 'architecture', with three priorities (convergence, competitiveness, cooperation) replacing the current structure of Objectives 1, 2 and 3. The focus is strongly on growth and competitiveness, linking cohesion policy to the goals of the Lisbon Agenda. At the same time, there is a greater concern with 'territorial cohesion' reflected in the proposal to bring all regions into the framework of cohesion and references to the specific problems of islands, mountain areas and urban centres. Responding to the criticisms of complexity and bureaucracy, the Commission proposes extensive decentralisation and simplification, with the Member States taking on more responsibility for the design and management of programmes, as well as financial control. In return, the Commission expects greater accountability – at a political level, with a new planning framework of strategies and reporting within the Council and, on the ground, through more rigorous monitoring and evaluation.

The negotiations are likely to be difficult for several reasons. First, more so than in any recent reforms, the Member States are divided on the budgetary issue. There are fundamental differences on the size of the overall EU budget, the share of funding allocated to EU cohesion policy and the 'model' for implementing policy. Second, the accession of 10 new Member States introduces a new dynamic into the negotiations and, with 25 countries 'at the table', makes the reconciliation of interests more difficult. Third, the basis for calculating financial gains and losses from the Commission's proposals is complex, with the different categories of eligible areas under the convergence and competitiveness priorities (including a new threshold in the form of the 'statistical effect'). Lastly, as in previous reform negotiations, there are other issues that play a part in the decisions on cohesion policy – the future of the own resources system, the rebate mechanism, the reforms to State aid control and tax competition.

The aim of this paper is to provide a basis for discussion on key questions associated with EU cohesion policy reform and examine the budgetary and political dimensions of the debate on reforming EU cohesion policy. Continuing a series of annual papers on this issue[1], it briefly reviews the main events of the past year that have a bearing on the reform debate (Section 2). The paper then outlines the European Commission's proposals for future cohesion policy as a basis for discussing their implications (Section 3). The first set of implications relate to eligibility issues (Section

[1] Bachtler J and Downes R (2002) *The Reform of the Structural Funds: A Review of the Recent Debate,* Paper to the EoRPA Regional Research Consortium, European Policies Research Centre, University of Strathclyde, Glasgow. Bachtler J (2001) *Regional Policy in an Enlarged EU,* Paper to the EoRPA Regional Research Consortium, European Policies Research Centre, University of Strathclyde, Glasgow

4). The paper considers how the Member States will benefit under the different priorities on the basis of current information about eligibility criteria. It also examines the potential allocation of funding to Member States (Section 5) under the different categories of support, applying different methodologies (both top-down and bottom-up) in order to replicate the Commission's approach. The paper goes on to discuss the debate among Member States, first with respect to the overall financial framework for 2007-13 and then regarding the proposals for cohesion policy (Section 6). Finally, the paper highlights some open questions about the scope for making savings on the budget, the approach to the negotiations, the focus for future spending, the objectives of territorial cohesion and the new planning framework.

2. CONTEXT FOR THE REFORM DEBATE

2.1 Political and Economic Developments

The context for the current debate on reforming EU cohesion policy comprises a mix of broad political and economic developments as well as specific budgetary proposals. Three issues are of particular importance: EU enlargement; growth and competitiveness of the EU; and the Constitutional Treaty.

First, underlying the need to reform EU cohesion policy are the *implications of EU enlargement* for economic and social cohesion of the EU. The accession of the Czech Republic, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic and Slovenia to the EU on 1 May 2004 represents a major milestone in the development of the EU. However, as noted by the European Council,[2] *"making a success of enlargement remains the key priority for the years to come".* The long-term nature of the cohesion challenge was clearly presented in the Third Cohesion Report,[3] according to EC estimates, many new Member States will have to achieve sustained economic growth of 2.5 percent above the EU15 average for 20-30 years in order to reach a GDP per capita level of 75 percent of the EU15. Major difficulties lie ahead in building up the necessary administrative capacity in the new members, as well as integrating them into the Lisbon Strategy, the Schengen *acquis*, economic policy coordination, the Stability and Growth Pact and the eurozone.

These challenges will grow as even poorer countries join the EU. The June European Council restated the EU's objective for Bulgaria and Romania to join the Union in January 2007.[4] The signing of the Accession Treaty for both countries is anticipated during 2005, subject to confirmation by the Commission that both countries are able to assume all the obligations for membership by accession. Following Croatia's application for membership, the Council has decided that Croatia is a candidate country and that the accession process should be launched; an IGC with Croatia is planned for early 2005 to begin negotiations. With respect to Turkey, the implementation of a pre-accession strategy is underway, but the EU is politically divided on Turkish membership and accession negotiations have yet to start.

The second major issue influencing the reform debate is the slow progress of the EU in meeting the goals of the *Lisbon Agenda*. The objectives of competitiveness and growth are at the heart of the EC's proposals for many of its future policies, in line with the EU's ambition of 'an integrated horizontal approach to competitiveness through coherence, synergies and complementarities between policies'. The scale of the task facing the EU was summarised by the Spring European Council as follows:[5]

> *"The Union set itself ambitious goals in March 2000. Four years later, the picture is a mixed one. Considerable progress has been made and the European Council reaffirms that the process and goals remain valid. However, the pace of reform needs to be significantly stepped up if the 2010*

[2] CEU (2003) *Multiannual Strategic Programme of the Council 2006-2006,* Council of the European Union, Brussels, 8 December 2003, POLGEN 85.
[3] CEC (2004a) *A new partnership for cohesion: convergence, competitiveness, cooperation – Third report on economic and social cohesion,* Commission of the European Communities, Brussels, February 2004.
[4] CEU (2004) *Presidency Conclusions of the Brussels European Council, 17-18 June 2004,* Council of the European Union, Brussels, 18 June 2004, CONCL 2.
[5] CEC (2004b) *2004 Report from the Commission to the Spring European Council*, Commission of the European Communities, Brussels, 16 March 2004.

> *targets are to be achieved. The European Council is committed to demonstrating the political will to make this happen."*

The latest structural indicators show the EU continuing to lag well behind the US in terms of labour productivity and productivity growth and behind both the US and Japan in R&D expenditure.[6] Further, on almost all the economic, employment and innovation indicators, there are extremely wide (and in some case widening) differences between the Member States. A key issue continues to be the implementation of commitments already made on completion of the internal market, accelerated implementation of national regulatory reform initiatives and strengthening both public and business investment in R&D.

More immediately, the EU has also agreed measures to boost growth. In December 2004, the European Council endorsed the 'European Action for Growth'. The Action covers material and immaterial investment in (a) the trans-European network infrastructure (TENS) – transport, telecoms, energy; and (b) innovation and R&D including environmental technology. Action is foreseen by the EIB to mobilise private resources through contributions from EU and national budgets.

The third major set of developments concerns the *institutional changes* taking place. Of most importance in the longer term is the adoption by the European Council of the final text of the Constitutional Treaty on 18 June 2004. Although the significance of the Treaty lies primarily in its revision of the legal and institutional frameworks of the EU, it also makes some policy changes, including to cohesion policy. Under the Constitution, Article III-116 modifies the goal of economic and social cohesion to include the objective of 'territorial cohesion'. Article III-116 goes on to make reference to specific territorial concerns (which are taken forward in the EC's proposals for future cohesion policy):

> *"Among the regions concerned, particular attention shall be paid to rural areas, areas affected by industrial transition and areas which suffer from severe and permanent natural or demographic handicaps such as the northernmost regions with very low population density, and island, cross-border and mountain areas".*

Following legal revision and translation, the Treaty will be signed later this year, following which Member States will have two years for ratification. Most countries are likely to ratify the Treaty through a parliamentary process, but eight countries – the Czech Republic, Denmark, France, Ireland, Poland, Portugal, Spain and the UK – have decided to hold referenda and several others are undecided.

2.2 Budgetary Developments

2.2.1 Financial framework for 2007-2013

Within the context of the above developments, the EC put forward its proposals for the EU Financial Framework for the 2007-13 period in February 2004.[7] The Commission envisages keeping the current 'own resources' ceiling of 1.24 percent of the EU's Gross National Income (GNI), with appropriations for payments averaging 1.14 percent over the period. In cash terms, the EU would commit an average of

[6] CEC (2004b) *2004 Report from the Commission to the Spring European Council*, Commission of the European Communities, Brussels, 16 March 2004.

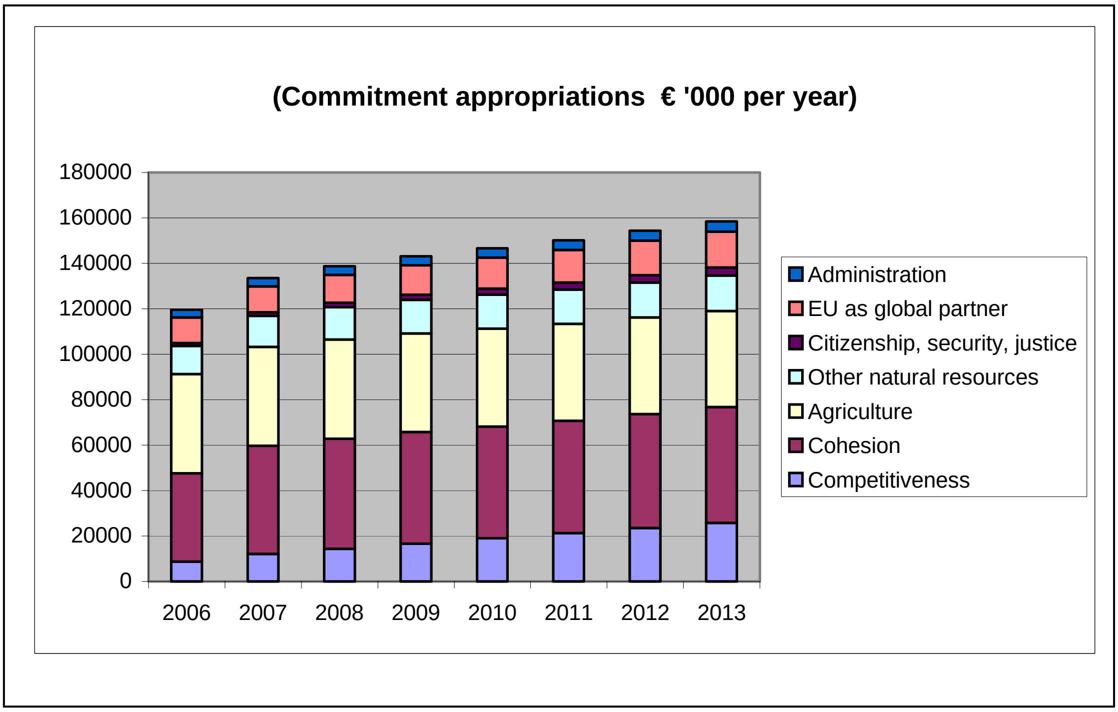
[7] CEC (2004c) Communication from the Commission to the Council and the European Parliament *Building our common future: Policy challenges and budgetary means of the enlarged Union 2007-2013,* COM(2004) 101 final, Brussels, 10.2.2004

€146 billion per year over the 2007-2013 period. This compares with a figure of €121 bn for the final year of the current period (2006), and would represent an increase of 31 percent in planned EU spending from 2006 to 2013.

With respect to the components of the EU budget, the EC has reorganised and rationalised the budget into five main headings in the interests of simplifying budgetary management. These are: sustainable growth (including competitiveness and cohesion); conservation and management of natural resources; citizenship, freedom, security and justice; the EU as a global partner; and administration. Despite some opacity in the presentation of the figures,[8] the basic trends are clear (see Figure 1). Comparing planned spending in 2007-13 with 2006:

- cohesion policy spending (excluding rural development) would increase by 31 percent, from €38.8 bn in 2006 to €51 bn in 2013;
- agricultural spending would remain virtually static over the period, averaging €43 bn per year;
- a new budget sub-heading called 'competitiveness' has been created to implement the Lisbon agenda with planned spending on areas such as R&D and trans-European networks etc rising three-fold from €8.8 bn in 2006 to €25.8 bn in 2013;
- increased resources have also been allocated to EU internal policies (citizenship, freedom, security and justice) and external relations (EU as a global partner).

Figure 1: New Financial Framework, 2007-13



The financial resources for cohesion policy (Structural and Cohesion Funds) would comprise €336.3 bn over the 2007-13 period, representing around 0.41 percent of

[8] It is not readily apparent how the current budgetary headings relate to the headings in the new financial framework. For example, Commission administrative expenditure has been integrated into the main expenditure headings.

GNI in an EU27.[9] A further 0.05 percent of GNI (€37.8 bn) would be spent on rural and fisheries measures under the CAP.

2.2.2 Review of own resources

A further dimension to the budgetary reform concerns the future own resources system. Under Article 9 of the 2000 Council decision on the system of the European Communities' own resources, the Commission is required to undertake a general review of the own resources system by 1 January 2006. Along with the draft Structural Funds regulations, in July 2004 the EC published its report on the own resources system,[10] highlighting its main drawbacks and *"proposing a generalised correction mechanism as a short term adjustment in order to address the main outstanding issue"* and outlining *"for the longer term an own resources structure that would be effective, transparent and democratic*".

At issue is the question of the system for budgetary compensation for the UK (the UK rebate). In its proposals for the future operation of the EU's own resources system, the EC argues that there has been a *"dramatic shift in the UK's position compared to the other net contributors"* since the 1984 Fontainebleau European Council when the UK correction mechanism was first introduced. According to EC figures, whereas the UK's GNI per capita was 90.6 percent of the EU15 average in 1994, it was 111.2 percent of the EU15 average in 2003.

On this basis, the EC proposes a generalisation of the correction mechanism, applicable to all larger net contributors, that meets the goals of: (a) preventing excessive negative budgetary balances combined with a reduction of differences between net contributors at comparable levels of prosperity; and (b) ensuring that the financing costs of the mechanism are kept at a reasonable level. Most of the options put forward by the EC to achieve this goal would marginally improve the net budgetary balances of the larger contributors but have a considerable adverse affect on the net contributions of the UK (which contests some of the bases for the EC's argument). The EC report also puts forward options for a different EU financing system with a increase in the share of tax-based own resources, based potentially on energy consumption, VAT resources or corporate income.

[9] This takes account not just of cohesion policy spending in the EU15 and 10 new Member States but also anticipated expenditure in Bulgaria and Romania from the date of their accession to 2013. A further €8.6bn is included under this heading for expenditure on the Solidarity Fund and Commission administrative expenditure.

[10] CEC (2004d) *Financing the European Union – Commission report on the operation of the own resources system*, Commission of the European Communities, Brussels: COM(2004) 505, 14 July 2004.

3. EC PROPOSALS FOR COHESION POLICY

In the context of the political and economic developments outlined above, the European Commission published an outline of its proposals for the future of EU cohesion policy in the Third Cohesion Report.[11] This was followed by the submission of the Commission's formal legislative proposals in July 2004 as a basis for debate and negotiation. The Commission is proposing to change EU cohesion policy in several important respects: a substantially increased budget; a broader rationale; a new architecture of Community priorities; a different implementation system; and radical changes to State aids.

3.1 Budgetary Framework

The overall budgetary framework for cohesion policy was set out in the Commission proposals on the financial perspective for the period 2007-13.[12] The Commission proposed that a sum of €344.9 billion (2004 prices) be allocated to Heading 1b, Cohesion for Growth and Employment. This figure does *not* include transfers to a proposed single rural and fisheries instrument, but *does* include allocations to a new Solidarity Fund and administrative expenses. The Structural and Cohesion Funds would be allocated €336.2 billion, of which 81 percent would be allocated to ERDF and ESF and almost 19 percent to the Cohesion Fund (Table 1).

Table 1: Structural Funds, Cohesion Fund and Transfers to Rural, 2007-13

	€ million, 2004 prices	**%**
Structural Funds and Cohesion Fund, of which:	336,194.0	100.0
• Structural Funds	273,203.6	81.3
• Cohesion Fund	62,990.4	18.7
Transfer to rural	37,706.0	
Total	**373,900.0**	

Source: COM(2004)492.

Direct comparisons with the current funding period are complicated by enlargement and by the new structure of the financial perspective. Nevertheless, it is evident that the Commission's proposals involve a substantial increase in cohesion policy funding. It is also noteworthy that, for the 2007-13 period, a greater proportion of the total would be allocated to the Cohesion Fund than at present (Table 2).

Table 2: Structural Funds and Cohesion Fund Commitment Appropriations, 2000-06

	€ million, 2004 prices	**%**
1999 Structural Funds Regulation	215,291	91.54
1999 Cohesion Fund Regulation	19,872	8.45
Total	**235,163**	**100.00**

Source: Calculated from figures in the 1999 Structural Fund and Cohesion Fund Regulations.

The Draft General Regulation presented by the Commission in July 2004 indicates a proposed budget of €336.1 billion[13] for cohesion policy financed through the European Regional Development Fund (ERDF), the European Social Fund (ESF)

[11] CEC (2004a) *op. cit.*
[12] CEC (2004c) *op. cit.*
[13] Equivalent to €373.9 billion if the transfers to rural and fisheries policy are included.

and the Cohesion Fund.[14] This would be divided among the three principal elements of the "new architecture" of cohesion policy as set out in Table 3.

Table 3: Structural and Cohesion Fund Commitment Appropriations by Priority, 2007-13 (2004 prices)

Priorities	€ billion	%	%
Convergence priority	*264.00*	*100.00*	*78.54*
• Regional convergence and employment	177.80	67.34	
• National convergence (Cohesion Fund)	63.00	23.86	
• Statistical effect	22.10	8.38	
• Outermost regions (OMRs)	1.10	0.42	
Regional competitiveness	*57.90*	*100.00*	*17.22*
• Phasing in	9.60	16.56	
• Regional competitiveness and employment	48.30	83.44	
Territorial cooperation	*13.20*	*100.00*	*3.94*
• Cross-border cooperation	35.61	4.70	
• ERDF strand of ENPI	12.12	1.60	
• Article 7(2) operations	47.73	6.30	
• Exchange of experience networks	4.54	0.60	
Technical assistance	*1.0*		*0.3*
TOTAL	**336.1**		**100.0**

Source: COM(2004)492.

3.2 A Broader Rationale

In the Third Cohesion Report, the Commission emphasises the iniquity of regional economic and social disparities as a justification for EU cohesion policy. However, it also places much more stress on the links between cohesion and the Lisbon agenda, arguing (as under many national regional policies) that promoting regional competitiveness will boost the growth potential of the EU economy as a whole. This is particularly evident in the arguments put forward for continuing with EU intervention outside the least-developed countries and regions.

A further aspect of the Third Cohesion Report is the importance accorded to territorial cohesion. Continuing the line of argument employed in the Second Cohesion Report, the Commission maintains that intervention in support of economic and social cohesion needs to be complemented by action to promote balanced development of the EU territory.[15] The EC is keen to broaden the remit of EU cohesion policy beyond spatial imbalances in income and employment to address issues such as the polycentric development of urban areas, infrastructure endowment in educational, health and social services, and the specific problems of areas with geographical handicaps (eg. islands, mountain areas).

[14] European Commission, *Proposal for a Council Regulation laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund*, COM(2004)492 final, 14 July 2004, Brussels.

[15] The draft EU Constitution proposes that the promotion of territorial cohesion should become one of the Union's objectives (Article 3) and should be addressed as an area of competence shared between the EU and Member States (Article 13).

Taken together with the proposal that *all* regions should be eligible for future EU support, the Third Cohesion Report's objectives would represent a significant change in the rationale for EU cohesion policy. Whereas in the past, EU intervention has been conceived as being time-limited and geographically focused, in order to assist with economic convergence, restructuring or diversification, the EC's proposal would lead to EU cohesion policy becoming a permanent, horizontal policy pursuing the goal of balanced territorial development.

3.3 Objectives and Priorities

3.3.1 A new architecture of Community priorities

The EC is proposing that future EU cohesion policy should focus on a limited number of Community priorities, reflecting the Lisbon and Gothenburg agendas. The future regional programmes would be targeted on a limited number of key themes:

- innovation and the knowledge economy;
- accessibility and services of general economic interest;
- environment and risk prevention.

These themes would be complemented by employment programmes focusing on the themes of employment, training and adaptation, and social inclusion under the European Employment Strategy.

The current Objectives 1,2 and 3 would be superseded by three new Community priorities:

- *Convergence*: supporting growth and job creation in the least developed Member States and regions;
- *Regional competitiveness and employment*: anticipating and promoting change;
- *European territorial cooperation*: promoting the harmonious and balanced development of the Union territory.

The use of financial instruments and the allocation of the cohesion policy budget to these priorities would be as shown in Table 4.

Table 4: Allocations to future EU cohesion policy priorities

Priority	**Financial instruments**	**Budget**	
		(%)	**(€ bnl)**
Convergence	ERDF, ESF, Cohesion Fund	78.54	264.00
Regional competitiveness & employment		17.22	57.90
• Regional competitiveness programmes	ERDF		
• National employment programmes	ESF		
European territorial cooperation	ERDF	3.94	13.20

Source: COM(2004)492

Under the EC proposals, the current instruments linked to rural development policy (EAGGF Guidance Section, FIFG) would be grouped in one single instrument under the Common Agricultural Policy. The Community Initiatives (INTERREG, URBAN, EQUAL, LEADER+) would be discontinued as separate initiatives and integrated within the mainstream programmes.

3.3.2 Priority 1: Convergence

The main focus of Community intervention after 2006 would continue to be the less-developed Member States and regions. This priority would encompass three elements.

- Least-developed regions with a GDP per head of less than 75 percent of the EU average (Objective 1 regions). As previously, these regions would be strictly defined at the NUTS II level and, on the basis of current data, would encompass about 27 percent of the EU25 population – most of the new Member States (except some capital cities) and significant parts of Greece, Portugal, Spain, Italy and eastern Germany.

- Statistical effect regions, which would qualify for Objective status in an EU15 but, because of the 'statistical effect' of enlargement, would not qualify in an EU25. Encompassing about three percent of the EU-15 population, this provision would apply mainly to regions in Germany, the UK and Spain. The support provided is regarded as transitional, to enable the regions concerned to adapt to the loss of full Objective 1 eligibility. The relatively generous transitional support proposed would be provided for the entire seven-year period on a degressive basis.

- Support under the Cohesion Fund for countries with GNP below 90 percent of the EU25 average. This would include all of the new Member States as well as Portugal and Greece. There is no recognition of a statistical effect to compensate for loss of Cohesion Fund status (Spain).

The EC is also proposing to set up a special programme for the outermost regions which are not otherwise covered by one of the above categories, ie. Canarias (Spain) and Madeira (Portugal).

3.3.3 Priority 2: Regional competitiveness and employment

The EC is proposing a twofold approach to providing support under the regional competitiveness and employment priority.

- Regional programmes funded by ERDF to help regions anticipate and promote economic change in industrial, urban and rural areas. This would cover: (a) 'phase-in regions' – current Objective 1 regions which would become ineligible for Objective 1 status even in an EU15 because of their economic growth; and (b) all other regions not otherwise designated under the convergence priority or as phase-in regions.

- National programmes funded by ESF to reinforce the introduction and implementation of structural reforms in the labour market and strengthen social inclusion in line with the objectives and guidelines of the European Employment Strategy.

It is estimated that the phase-in regions would be allocated about one sixth (€9.5 bn) of the competitiveness and employment allocation, with the remainder divided 50:50 between the regional competitiveness programmes and national employment programmes. In effect, it could be said that the 'new Objective 2' and 'new Objective 3' would each be allocated about €26 bn.

For the regional programmes, the eligible areas would not be determined at EU level. It is anticipated that the EC will allocate 'financial envelopes' to Member States potentially on the basis of criteria such as GDP per head, unemployment and population density. The Member States would then have the responsibility for allocating resources within countries. In the Third Cohesion Report, the EC indicates that it would be expecting the funding to be concentrated in three ways:

- thematic concentration – targeting resources on the three themes of innovation and the knowledge economy, accessibility and services of general economic interest, and environment and risk prevention;

- geographic concentration – the EC refers to programmes addressing the problems of industrial, urban and rural areas (with more cities being specifically targeted than currently under the URBAN initiative), as well using 'territorial criteria' to recognise the relative disadvantage of regions with geographical handicaps;

- resource concentration – to avoid excessive fragmentation of resources, the EC expects to introduce rules on "the minimum financial volume" of programmes and priorities.

The Third Cohesion Report recognises that current Objective 2 areas may have suffered from excessive 'micro-zoning' and suggests that future regional programmes may need to be based on larger regions to enable the development of a coherent strategy.

3.3.4 Priority 3: European territorial cooperation

The third priority, which is effectively an expanded version of the INTERREG initiative, is intended to promote the 'harmonious and balanced integration' of the EU territory by supporting cooperation at cross-border, transnational and interregional levels. The priority would be funded by ERDF with two elements:

- Cross-border cooperation along external and internal borders, including both land and sea borders, to promote joint solutions to common economic problems. A New Neighbourhood Instrument will be created to facilitate more effective actions on the external borders.

- Transnational cooperation, operating in zones to be agreed between the EC and Member States, to support strategic priorities with a transnational character such as R&D, information society and the environment.

The third element of the existing INTERREG initiative – inter-regional cooperation – would, under the Commission's proposals, be integrated within the mainstream regional programmes which would be expected to dedicate a certain amount of resources to exchanges, cooperation and networking.

3.4 A New Delivery System

The EC is proposing to make significant changes to the way that EU cohesion policy is implemented. The new system would retain the key principles underlying the Structural Funds – multi-annual planning, integrated development strategies, partnership, co-financing and concentration – but aims to simplify and decentralise the process. Several features of the proposals are worth noting.

- A new planning framework would be introduced. At EU level, the European Council would adopt an overall strategic document for cohesion policy, defining priorities for Member States and regions. This would be reviewed annually on the basis of progress reports by Member States.

- Each Member State would draw up a policy document on its development strategy as a framework for thematic and regional programmes. At the operational level, Member States would draw up programmes – defined at an “aggregate or high priority level” – for adoption by the EC.

- The current multi-Fund programme would be replaced by ERDF and ESF interventions operating on the basis of one fund per programme. The procedures for financial management, financial control and additionality would be rationalised and decentralised (within limits).

- Partnership would be enhanced by requirements to involve social partners and civil society representatives to a greater degree. Tripartite agreements between Member States, regions and local authorities are proposed.

- Performance and quality would be ensured by retaining the principle of decommitment (N+2). The EC would also be expecting a more rigorous approach to monitoring and more results-oriented evaluation.

3.5 State Aids

Finally, although the Third Cohesion Report is primarily about the future of EU cohesion policy, it contains some important proposals for the future of State aids.[16] Specifically, DG Competition would approve aid on the following basis:

- regions with GDP per capita below 75 percent of the EU average would be eligible for State aid under Article 87(3)(a);

- regions affected by the ‘statistical effect’ would be eligible under Article 87(3)(c) but with a degressive reduction of State aid limits to bring them down from Article 87(3)(a) levels at the beginning of the period to Article 87(3)(c) levels by 2013;

- other special cases (outermost regions, phase in regions and regions with sparse population) would also be earmarked for Article 87(3)(c) support; and

- other regions (ie. those regions eligible for the competitiveness and employment priority) would not have regional aid maps approved but would have to operate aid schemes in line with general State aid rules.

These proposals could radically reduce the ability of Member States to operate regional aid schemes providing investment support to large firms. In order to reduce the impact, the Commission has undertaken to provide more flexibility for Member States with respect to lower-level aid. It has produced two draft communications proposing a new framework (LASA) for the assessment of lesser amounts of State aid (30 percent of project costs up to €1 million over a three-year period) and a new framework (LET) for the assessment of State aid which has limited effects on intra-Community trade.

[16] The implications of the Commission’s proposals for the future of State aids are discussed in a parallel paper: Wishlade F (2004) *The Beginning of the End, or Just Another Chapter? Recent Developments in EU competition policy control of regional State aid*, European Policy Research Paper, No. 54, European Policies Research Centre, University of Strathclyde, Glasgow.

4. ELIGIBILITY ISSUES

Based on the information currently available, the next two sections explore the implications of the Commission's proposals, first for the process of determining eligibility for the different categories of EU support in the 2007-13 period, and second (in Section 5) for the allocation of finance.

4.1 Eligibility Criteria

As already noted, the new architecture of cohesion policy distinguishes three objectives:

- *Convergence*, which aims to accelerate the convergence of the least-developed Member States and regions (broadly equivalent to Objective 1 under the current regime). This is deemed the priority of the Funds and would, under the current proposals, be financed by the Cohesion Fund, the ERDF and the ESF.

- *Regional competitiveness and employment*, which aims to improve the competitiveness and attractiveness of the regions and promote employment by anticipating economic and social change. This would be financed by the ERDF and the ESF.

- *European territorial cooperation*, which aims to strengthen cross-border cooperation. This would be financed by the ERDF.

4.2 Convergence: The Cohesion Fund

The Cohesion Fund would contribute to the Convergence priority under the new architecture. Eligibility for the Cohesion Fund is defined in Article 5(3) of the Draft Regulation as concerning Member States whose per capita Gross National Income (GNI), measured in purchasing power parities and calculated for the last three years available, is less than 90 percent of the Community average, and which have a programme for meeting the economic convergence conditions referred to in Article 104.

The current recipients of the Cohesion Fund are Greece, Portugal and Spain, together with all of the new Member States (with effect from 2004). Ireland ceased to be eligible for the Cohesion Fund at the end of 2003 following the mid-term review.

Using GNI data for 2001-03, Table 5 lists the GNI per head figures for Member States relative to the EU25 average. The table suggests that all of new Member States, plus Greece and Portugal, would be qualify for the Cohesion Fund post-2006, but that Spain would cease to be eligible. It is also interesting to note that both Cyprus and Malta would currently qualify for the Cohesion Fund, but that, at the same level of analysis (ie. both countries are NUTS II regions), neither would qualify for the Convergence priority.

Table 5: GNI(PPS) per head 2001-03 (EU25=100)

Eligible Member States		**Ineligible Member States**	
Latvia	38.6	Spain	93.3
Estonia	41.5	Italy	107.8
Lithuania	42.9	Germany	109.2
Poland	45.7	Ireland	110.5
Slovakia	50.9	Finland	112.0
Hungary	55.6	Sweden	115.1
Czech Republic	65.1	France	115.5
Malta	71.2	Belgium	119.5
Portugal	75.2	United Kingdom	119.6
Slovenia	76.1	Netherlands	120.2
Greece	77.3	Austria	120.8
Cyprus	85.4	Denmark	122.7
		Luxembourg	190.9

Source: Own calculations from DG ECFIN AMECO database.

Table 6: Convergence region coverage post 2006?

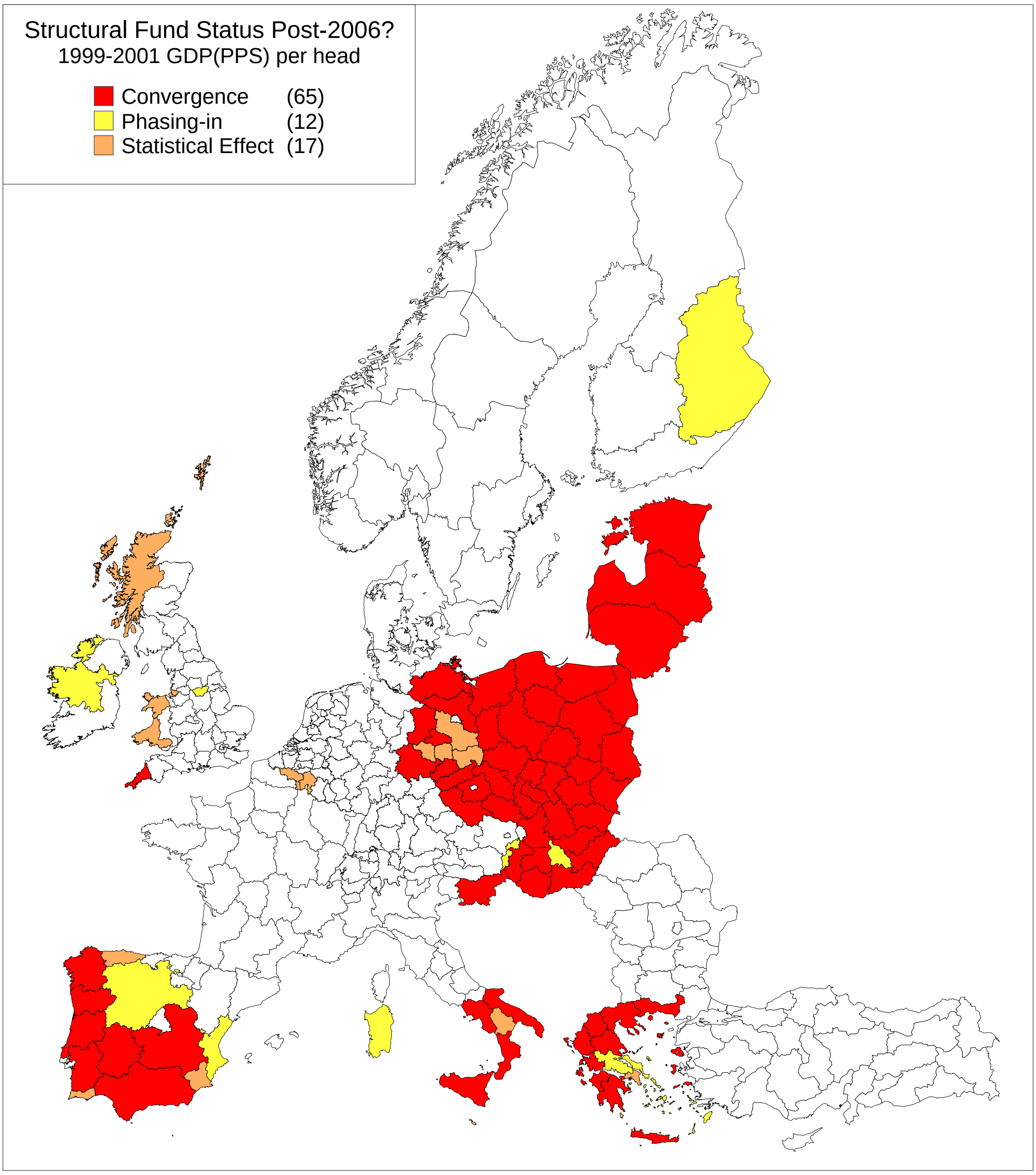
	Total Population '000s (2001)	**% in Convergence Regions**
EU25	452601.6	27.18[a]
EU15	377882.1	14.28
NMS10	74719.5	92.39
Belgium	10286.6	0.00
Czech Republic	10224.2	88.61
Denmark	5355.1	0.00
Germany	82340.3	10.59
Estonia	1364.1	100.00
Greece	10937.7	56.50
Spain	40265.5	31.83
France	59192.4	[2.91][a]
Ireland	3838.9	0.00
Italy	57926.1	29.32
Cyprus	701.5	0.00
Latvia	2355.0	100.00
Lithuania	3481.3	100.00
Luxembourg	442.0	0.00
Hungary	10187.6	72.22
Malta	393.0	0.00
Netherlands	16046.2	0.00
Austria	8031.6	0.00
Poland	38641.0	100.00
Portugal	10299.2	68.51
Slovenia	1992.0	100.00
Slovak Republic	5379.8	88.86
Finland	5188.0	0.00
Sweden	8896.0	0.00
United Kingdom	58836.7	0.85

Note: a) The French and EU25 population totals given by Eurostat do not include the population of the DOMs so that, strictly speaking, their coverage cannot be viewed as a percentage of the French population.
Source: Own calculations from Eurostat data.

4.3 Convergence Regions (formerly Objective 1)

The proposed basic eligibility criterion for the Convergence priority remains essentially unchanged from that of Objective 1, ie. NUTS II regions whose GDP per head measured in PPS and calculated on the basis of the last three years is less than 75 percent of the Community average. Table 6 lists the proportion of the Member State populations eligible for the Convergence priority on the basis of the most recent Eurostat data. As is well-known, the 'statistical effect' will bring about significant shifts in the coverage of the least-developed regions. The Convergence priority will cover almost all (92.3 percent) of the population of the 10 new Member States, but just a small proportion (14.2 percent) of the EU15 (compared with 22.3 percent for 2000-06). Figure 2 shows the map of possible Convergence priority regions, together with statistical effect and phase-in regions (discussed below).

Figure 2: Structural Fund Status Post-2006?



Source: Own calculations from EUROSTAT data.
Note: The French DOMs are omitted from the region count.

4.4 Convergence: Statistical Effect Regions

A high profile has been given to the situation of regions whose Objective 1 status is affected by the so-called statistical effect of enlargement, that is the shifting eligibility thresholds as average levels of GDP(PPS) per head fall with the accession of a number of significantly poorer Member States.

Table 7 lists those regions likely to be affected by the statistical effect and which qualify for 'phase-out' status on the basis of the most recent data. The equivalent threshold to 75 percent of the EU15 average post-enlargement is currently 82.43 percent of the EU25 average.[17] At present, 17 regions fall between these thresholds.[18] Interestingly, several regions are included – Hainaut and Namur (Belgium) and Highlands & Islands (UK) – which do not currently have Objective 1 status. The 17 regions account for around 18 million inhabitants – about four percent of the EU25 population.

Table 7: Statistical effect (phase out) regions 2007-13?

	Phase-out population ('000s)	**Phase-out pop (% of total)**
EU25	***18008.9***	***3.98***
EU15	***17615.9***	***4.66***
NMS10	***393.0***	***0.53***
Belgium	**1727.2**	**16.79**
Hainaut	1280.4	
Namur	446.8	
Germany	**5069.6**	***6.16***
Brandenburg - SW	1419.5	
Dresden	1704.1	
Leipzig	1088.2	
Halle	857.8	
Greece	**3903.5**	***35.69***
Attiki	3903.5	
Spain	**2333.4**	***5.80***
Asturias	1051.5	
Murcia	1140.2	
Ceuta	75.1	
Melilla	66.6	
Italy	**604.1**	***1.04***
Basilicata	604.1	
Malta	**393.0**	**100.00**
Portugal	**393.9**	**3.82**
Algarve	393.9	
UK	**3584.2**	**6.09**
Merseyside	1361.7	
W. Wales & Valleys	1853.1	
Highlands & Islands	369.4	

Source: Own calculations from Eurostat data.

[17] Based on EUROSTAT data for 1999-2001.

[18] Current figures being used by the Commission and Council suggest that there are 18 such regions – see Presidency Report to the European Council, *Financial Framework for 2007-2013: Analytical Report,* 10219/04 of 7 June 2004. However, these figures appear to include Tees Valley and Durham which, on the basis of later data from EUROSTAT, is above the threshold.

4.5 Convergence: Outermost Regions

Reflecting their special status under Article 299(2) of the Treaty a separate treatment of the outermost regions (OMRs) is proposed under the draft Structural Funds Regulation. The seven regions concerned are: the four French *départements d'outre mer* (Guadeloupe, Martinique, French Guyana and Réunion); the Spanish Autonomous Community of the Canary Islands; and the Portuguese Autonomous regions of the Azores and Madeira.[19]

Of the seven regions, five currently fall within the threshold for the Convergence priority, with Madeira and the Canaries classed as phasing-in regions. However, Martinique appears close to the margins of eligibility for the Convergence priority (GDP(PPS) for the last three years is currently 74.8 percent of the EU25 average). Notwithstanding this, the draft Structural Funds Regulation makes clear that the OMRs will benefit from a specific line of funding from the ERDF.[20]

4.6 Competitiveness: Phase-In Areas

A further category of regions concerns those whose levels of growth have put GDP(PPS) per head beyond the Convergence threshold, even without the statistical effects of enlargement. These are listed in Table 8.

Table 8: Phase-in regions 2007-13?

	Phase-in population ('000s)	**% of population**
EU25	**17104.3**	**3.78**
EU15	**14274.2**	**3.78**
NMS10	**2830.1**	**3.79**
Greece	**854.4**	**7.81**
Sterea Ellada	558.1	
Notio Aigaio	296.3	
Spain	**8295.4**	**20.60**
Castilla y León	2464.9	
Comunidad Valenciana	4093.7	
Canarias	1736.8	
Ireland	**1011.9**	**26.36**
Border, Midlands and Western	1011.9	
Italy	**1646.1**	**2.84**
Sardegna	1646.1	
Hungary	**2830.1**	**27.78**
Közép-Magyarország	2830.1	
Austria	**276.8**	**3.45**
Burgenland	276.8	
Portugal	**244.4**	**2.37**
Região Autónoma da Madeira	244.4	
Finland	**678.7**	**13.08**
Itä-Suomi	678.7	
United Kingdom	**1266.5**	**2.15**
South Yorkshire	1266.5	

Source: Own calculations from Eurostat data.

[19] In addition, the Commission has set out a series of recommendations relating to future OMR support in a recent working paper: *A stronger partnership for the outermost regions*, COM(2004) 343 of 26 May 2004.
[20] Article 5(2).

Some 12 regions, (including the outermost regions of Madeira and Canarias) fall into this grouping. They have a combined population of around 17 million, equivalent to 3.76 percent of the EU25 total. For Spain, Ireland and Hungary, and to a lesser extent Finland, a significant proportion of the national population falls into this category.

What is unclear from the draft Regulation is whether any special treatment will be accorded to the sparsely-populated regions that were assimilated with Objective 1 for the 2000-06 period. The draft Regulation (Article 6(2)) states that:

> *"The NUTS level II regions totally covered by Objective 1 in 2006 under Regulation (EC) No 1260/1999 which are not referred to in Article 5(1) [ie. the Convergence regions] and 5(2) [ie. the phase-out regions] shall be eligible for a specific and transitional financing from the Structural Funds."*

In principle, this would seem to exclude the Swedish and Finnish regions eligible for Objective 1 on the basis of low population density since they were not "totally covered" by Objective 1. In Sweden *parts* of three regions were eligible for Objective 1, with the remainder of two of these regions designated as Special Programme areas in the Berlin summit conclusions. In Finland, *parts* of two NUTS II regions were eligible on the basis of population density (in addition to the NUTS II region of Itä-Suomi, parts of which are sparsely-populated, but which was eligible on the basis of the GDP per head criterion).

That these regions are excluded from phase-in status appears to be confirmed by the figures in the Presidency report to the European Council,[21] which refers to coverage of 17 million population and 12 regions; this coincides with Table 8. However, as discussed later, it makes redundant the later reference in the same document to more generous financial allocations to sparsely-populated phase-in regions. This issue is considered further in Section 5.4.1.

4.7 Competitiveness: Other Regions

As discussed elsewhere in this paper, a notable feature of the proposed reform of the Funds is the withdrawal of the explicit designation of areas on the basis of EU-wide criteria in favour of a more thematic approach. Mention is made of a number of types of region with particular territorial development problems, such as islands and mountain areas, as well as urban, rural and fisheries areas. At this stage, it is not clear, whether (and what) specific criteria are envisaged for the special treatment of these areas.

[21] See footnote 18.

5. FINANCIAL ALLOCATIONS

5.1 The Allocation of EU Funding

The allocation of Structural Funds to any given Member State is the result of the complex interaction of top-down principles on the global breakdown of funding between different priorities and country groupings and bottom-up criteria determining the share of a given budget: in short, a largely unpredictable and opaque mix of political and technical ingredients. From the information currently available, the following approach to allocation is envisaged by the Commission.

- The indicative breakdown between objectives was set out above. In broad terms, the Commission has proposed 78 percent for the Convergence priority, 18 percent for the Regional Competitiveness and Employment priority and four percent for Territorial Cooperation.

- According to the Third Cohesion Report, the Cohesion Fund would be enhanced such that it represents a third of the financial allocation for the new Member States concerned (at present, all of them).

- Overall allocations are subject to a ceiling of 4 percent of GDP for each Member State.

- Elements of the package have their own allocation criteria, implying a bottom-up approach to determining funding.

- Added to all of this is the power of precedent and Member States' own expectations about acceptable outcomes from the process.

Clearly the Commission has been active in producing funding scenarios for the new period as the basis for discussion. These are not in the public domain, and it is unclear whether they have been produced on a country-by-country basis (as opposed to a country grouping basis – ie. EU15, NMS10 and AC2). It is also not apparent to what extent these result from 'bottom up' criteria or 'top-down' principles. The internal Commission working paper, *Scenario financier 2007-2013,* provides some useful indications of the orders of magnitude around which the Commission is currently working. Even so, it is difficult, often impossible, to move from these aggregates to country-by-country allocations on the basis of the information currently available. Nevertheless, the aim in this section is to give as much insight into country-by-country allocations as possible.

5.2 Absorption Limits

An important element of the pre-accession funding in the new Member States has been the capping of EU contributions to a percentage of national income. The draft Structural Fund Regulation extends this rule to all countries (although in practice it is only likely to bite in the new Member States) and includes sums under the rural development and fisheries instruments.[22] The limit on total annual allocations from the Funds for each Member State is set at four percent of that Member State's GDP as estimated at the time of the adoption of the interinstitutional agreement.

[22] Article 22.

Table 9: Absorption limits and current financial allocations

	Absorption limit 2007-13 € bn (2004 prices)	**Annual equivalent cap 2007-13 € bn (2004 prices)**	**Annual Structural Fund allocation 2000/04-06 € m (2004 prices)**
EU25	3244.966	463566.6	42126.3
EU15	3084.008	440572.5	33411.1
NMS10	160.958	22994.0	8715.2
Czech Rep	29.119	4159.9	934.6
Estonia	2.999	428.4	248.1
Cyprus	4.286	612.3	40.5
Latvia	3.366	480.8	415.9
Lithuania	6.299	899.9	548.4
Hungary	27.951	3993.0	1142.9
Malta	1.473	210.5	31.7
Poland	65.315	9330.8	4564.1
Slovenia	8.787	1255.3	162.6
Slovakia	11.363	1623.3	626.3
Belgium	88.689	12669.9	321.4
Denmark	62.037	8862.4	129.6
Germany	687.366	98195.2	4699.4
Greece	53.765	7680.7	3923.9
Spain	258.501	36928.8	8878.8
France	510.845	72977.9	2471.2
Ireland	46.321	6617.2	599.8
Italy	429.815	61402.1	4674.0
Luxembourg	7.846	1120.8	14.5
Netherlands	144.783	20683.3	508.3
Austria	73.617	10516.7	291.5
Portugal	43.196	6170.8	3599.4
Finland	47.117	6731.0	334.4
Sweden	88.567	12652.4	350.6
UK	541.542	77363.1	2614.3

Source: Own calculations using methodology outlined in Presidency Report to the European Council, *Financial Framework for 2007-2013: Analytical Report,* 10219/04 of 7 June 2004; GDP data from DG ECFIN AMECO database; Structural Fund allocation data from Third Cohesion Report; 2 percent annual deflator applied.

An estimate of the potential impact of capping is set out in Table 9. This uses the annual growth rate assumptions provided by the Commission (4.1 percent for the new Member States and 2.2 percent for EU15) to produce a figure for the whole programming period 2007-13. For the purposes of comparison, this potential cap is also provided as an annual amount and set against annual Structural Funds allocations for 2000-06 in EU15 and 2004-06 for the new Member States.

It is interesting to note that, as far as the *current* funding period is concerned, allocations fall well short of the absorption cap. However, the relationship between the current Structural Funds allocation and the absorption cap for the future period is quite variable so that, for example, the allocation to Latvia is currently around 86 percent of what would be allowed under the future absorption cap, but the equivalent figure for Cyprus is just six percent.

In overall terms, Table 9 implies that allocations to the new Member States for the period 2007-13 could not exceed € 161 billion. However, achieving this level in total implies that the Funds would attain the four percent cap in *all* the new Member States.

5.3 Convergence Priority

The proposed overall resources for the Convergence priority amount to € 264 billion for 2007-13, broken down as set out in Table 10.

Table 10: Convergence priority resources 2007-13

	€ billion	**%**
Regional convergence and employment (ex-Objective 1)	177.80	67.34
National convergence (Cohesion Fund)	63.00	23.86
Statistical effect (phasing-out)	22.10	8.38
Outermost regions (OMRs)	1.10	0.42
Total	**264.00**	**100.00**

Source: COM(2004)492.

Beyond this, as noted earlier, the Commission has produced some calculations that outline the amounts allocated to different country groupings. For the Convergence priority, the results of these calculations are set out in Table 11.

Table 11: Financial Scenario 2007-13: Convergence priority (2004 prices)

		€ million
Regional Convergence and Employment	EU15	82,021
	EU10	83,700
	EU2	13,185
	Total	**178,906**
National Convergence (Cohesion Fund)	EU15	6,055
	EU10	48,818
	EU2	8,126
	Total	**62,999**
Statistical Effect (phasing –out)	EU15	21,688
	EU10	454
	EU2	0
	Total	**22,142**
Total	EU15	109,764
	EU10	132,972
	EU2	21,311
	Total	**264,047**

Source: *Scénario financier 2007-2013,* Unpublished document of the European Commission.

For each element of these resources a separate approach to allocation applies. In the sections which follow, attention is focused on the allocation of funds under the Regional Convergence component (formerly Objective 1), which accounts for the major part of overall resources.

5.3.1 Regional convergence allocation criteria

Initial indications are that the Commission proposes to reapply the so-called Berlin formula to the allocation of Regional Convergence (ie. ex-Objective 1) funding.[23]

The underlying philosophy in the method for calculating the financial allocations is that the level of assistance should be related to the degree of the regional development disparity in relation to the Community average, whilst taking account of national prosperity and levels of unemployment. The approach taken in the Berlin methodology[24] may be summarised as follows:

Annual aid per head in eligible regions =

Difference between regional GDP(PPS) per head and Community average	**X**	Regional prosperity coefficient (1.05%, 1% or 0.95%)	**X**	National prosperity coefficient (3, 4 or 5%)	**+**	€ 100 per person unemployed in excess of Convergence region average

The starting point for the methodology is to measure the difference in GDP per head (measured in purchasing power parities) between each of the Convergence regions of a Member State and the Community average.

For the poorest eligible regions, those with GDP(PPS) per head of less than 64 percent of the EU average, the size of the GDP per head gap is increased by a factor of 1.05 percent; conversely, for the richest eligible regions (those with GDP(PPS) per head of more than 67 percent of the EU average), the size of the GDP per head gap is reduced by a factor of 0.95 percent. The overall effect of these adjustments is to boost the allocations to the poorest regions.

The amount of aid per head per annum is calculated as a percentage of the adjusted GDP per head gap. However, the percentage applicable varies according to levels of national prosperity; this is expressed in terms of GNP per head as a proportion of the Community average.

It is not specified whether national prosperity is measured in purchasing power parities or euros; and it is also not clear whether the latest data should be used, or the same period for which regional GDP data is available.[25] For the purposes of the calculations used in this paper (see Table 12 and Table 13), GNI(PPS) figures for the last three years available have been used. Nevertheless, it is worth noting that the precise choice of indicator has a potentially significant impact on outcomes. For example, the use of GNI expressed in euros increases apparent disparities and would place five countries (Portugal, Spain, Greece, Cyprus, Slovenia) in a different national prosperity band, significantly changing their Convergence priority allocations.

It is also worth noting in passing that the use of both GNI and GDP as measures of prosperity produce some anomalies. For example, Malta would not qualify as a

[23] It is important to note that the application of the formula was partially undermined by the political deals brokered at the March 1999 Berlin Council, leading to a number of additional allocations being made on top of the formula results. For the purposes of this section, these deals have been ignored, but any future agreement would doubtless be subject to the same negotiation process in the final stages.

[24] See Wishlade, F. (1999) *Eligible Areas and Financial Allocations under the New Structural Funds: Quarts, Pint Pots and Half Measures?* Paper to the Regional Research Consortium of European Governments, Ross Priory, Loch Lomondside for a full discussion of the evolution and application of the Berlin methodology.

[25] GNI data are currently available for 2001-03 but regional GDP data only for 1999-2001.

Convergence region on the basis of 1999-2001 GDP(PPS) per head data, but falls into the least prosperous group of regions in terms of GNI.

Table 12: Measures of national prosperity (EU25=100, 2001-03 averages)

	GNI(PPS) per head	GNI (euro) per head	GDP(PPS) per head
EU25	100.0	100.0	100.0
EU15	109.5	114.1	109.4
NMS10	51.0	27.4	52.0
Latvia	38.6	18.1	38.4
Estonia	41.5	22.8	43.7
Lithuania	42.9	19.8	43.4
Poland	45.7	24.6	46.0
Slovakia	50.9	22.9	51.1
Hungary	55.6	29.6	58.3
Czech Rep	65.1	33.8	67.9
Malta	71.2	49.9	70.5
Portugal	75.2	57.6	76.7
Slovenia	76.1	55.4	75.9
Greece	77.3	61.8	77.0
Cyprus	85.4	72.8	84.7
Spain	93.3	81.4	94.0
Italy	107.8	103.1	108.1
Germany	109.2	121.9	109.0
Ireland	110.5	127.8	132.5
Finland	112.0	128.0	111.9
Sweden	115.1	136.8	115.0
France	115.5	119.3	114.3
Belgium	119.5	123.1	116.8
UK	119.6	132.8	117.2
Netherlands	120.2	128.8	121.9
Austria	120.8	128.2	121.7
Denmark	122.7	160.6	123.9
Luxembourg	190.9	220.9	208.2

Source: Own calculations from DG ECFIN AMECO database.

Table 13: National prosperity coefficients

GNI(PPS) per head (EU25=100)	Member States	Percentage rate applicable
<75	Latvia, Estonia, Lithuania, Poland, Slovakia, Hungary, Czech Republic, Malta	5 percent
>75<90	Portugal, Slovenia, Greece, Cyprus	4 percent
>90	Spain, Italy, Germany, Ireland, Finland, Sweden, France, Belgium, UK, Netherlands, Austria, Denmark, Luxembourg	3 percent

Source: Own calculations from DG ECFIN AMECO database.

In addition, an allocation is made in relation to levels of unemployment. This applies in all Convergence regions where the rate of unemployment is over the Convergence average; the allocation is set at €100 per annum for each unemployed person over and above the average unemployment rate for the Convergence regions. Owing to the absence of data, it has not been possible to calculate this allocation. However, the allocation made on the basis of unemployment rates under the Berlin formula for 2000-06 accounted for around 0.5 percent of the Objective 1 total, so this omission is unlikely to alter outcomes radically.

The result of applying the Berlin formula using the latest available data[26] is set out in Table 14. Apart from the fact that the resulting total for EU25 massively exceeds even the overall Structural Funds and Cohesion Fund budget, let alone the Convergence priority component (see Table 11), the most striking feature of this outcome is that, for all of the new Member States containing Convergence regions[27] except Slovenia, the absorption cap discussed above would bite. In other words, it is the absorption cap which determines the allocation to these countries, not the application of the bottom-up Berlin methodology.

Table 14: Application of the Berlin formula

	Eligible pop (000s)	National pros-perity coefficient	GDP based allocation 2007-13 (€ m), 2004 prices	Cap exceeded?
EU25	*124373.6*		*380481.3*	
EU15	*55342.3*		*82996.4*	
NMS10	*69031.3*		*297485.0*	
Belgium	0.0	3	0.0	
Czech Rep	9059.4	5	32688.6	YES
Denmark	0.0	3	0.0	
Germany	10083.0	3	10806.4.0	
Estonia	1364.1	3	3938.6	YES
Greece	6179.6	4	12623.1	
Spain	12816.2	3	17605.8	
France	1724.2	3	2963.8	
Ireland	0.0	3	0.0	
Italy	16981.1	3	21364.1	
Cyprus	0.0	4	0.0	
Latvia	2355.0	5	12474.2	YES
Lithuania	3481.3	5	17242.9	YES
Luxembourg	0.0	3	0.0	
Hungary	7357.6	5	34250.4	YES
Malta	0.0	5	0.0	
Netherlands	0.0	3	0.0	
Austria	0.0	3	0.0	
Poland	38641.2	5	170727.5	YES
Portugal	7056.1	4	16828.2	
Slovenia	1992.0	4	3096.3	
Slovakia	4780.7	5	23066.5	YES
Finland	0.0	3	0.0	
Sweden	0.0	3	0.0	
UK	502.1	3	804.9	

Source: Own calculations from Eurostat data.

Importantly, and as already noted, the absorption limit applies not just to the Regional Convergence priority but to all monies from the Structural Funds, the Cohesion Fund

[26] GDP for 1999-2001 and GNI for 2001-2003.
[27] That is, eight countries, Cyprus and Malta being ineligible.

and from the rural development and fisheries instruments. Moreover, according to the Third Cohesion Report, the Cohesion Fund is to account to a third of the financial allocation for the new Member States, further squeezing the amount that can be allocated to these countries under the Regional Convergence priority.

The implication of this outcome is that, in practice, the Berlin formula can only apply to the EU15 Member States: equal treatment of all Member States under the formula produces results that fall foul of other considerations – the absorption cap, the overall budget limit and/or the Structural Funds/Cohesion Fund split.

Assuming that the Berlin formula is applied to the allocation of funding for EU15, it is interesting to compare outcomes between the current and future funding periods. Table 15 sets out the total and annual per capita Regional Convergence / Objective 1 funding for 2000-06 and 2007-13. As would be expected, the overall total falls significantly, from € 141 billion to € 82 billion (slightly more without the budget adjustment).[28]

Table 15: Objective 1 allocations 2000-06 and budget-adjusted estimates for 2007-13

	Total allocation 2000-06 (€m)	**Total allocation 2007-13 (€m)**	**Annual allocation per hd (€) 2000-06**	**Annual allocation per hd (€) 2007-13**
EU15	140807.5	**82021.0**	238.6	**217.1**
Belgium	0.0	**0.0**	0.0	**0.0**
Denmark	0.0	**0.0**	0.0	**0.0**
Germany	21228.8	**10679.4**	214.3	**175.0**
Greece	23140.9	**12474.8**	315.5	**288.4**
Spain	41669.4	**17398.9**	256.3	**193.9**
France	3592.4	**2928.9**	312.1	**242.7**
Ireland	1451.8	**0.0**	215.3	**0.0**
Italy	24216.2	**21113.1**	179.2	**177.6**
Lux	0.0	**0.0**	0.0	**0.0**
Neths	0.0	**0.0**	0.0	**0.0**
Austria	288.1	**0.0**	149.4	**0.0**
Portugal	17800.9	**16630.4**	384.4	**336.7**
Finland	1008.0	**0.0**	133.7	**0.0**
Sweden	797.1	**0.0**	117.0	**0.0**
UK	5613.8	**795.5**	153.5	**226.3**

Notes: All figures are in 2004 prices. The 2000-06 figures *include* additional allocations made at the March 1999 Berlin European Council on top of the Berlin formula. Per head figures refer to eligible population. The total for 2007-13 (€ 82,021 million) is taken from Table 11. Using the same method as under the Berlin formula, the outcomes in Table 14 were adjusted proportionately to arrive at the overall budget figure.
Source: Own calculations from EUROSTAT data and Third Cohesion Report.

The major reduction in the EU15 allocation reflects two main factors. First, compared to the 2000-06 period, a number of regions within EU15 are excluded from eligibility owing to the statistical effect of enlargement or real increases in GDP(PPS) per head. Second, enlargement also affects the relative criteria used in the calculations – fewer EU15 regions fall into the poorest regional grouping (for the application of the regional prosperity coefficient) and none of the EU15 Member States falls into the poorest grouping of countries (for the application of the national prosperity coefficient).

[28] The bottom-up allocation of the Berlin formula gives a total EU15 allocation of €82.996 billion (see Table 14). The lower budget-adjusted figure in Table 15 takes account of the figures in Table 11 (see also the note to Table 15).

The impact of such factors carries through into annual *per capita* allocations. Table 15 shows that these would fall from an EU15 average of € 238.6 for 2000-06 to € 217.1 for 2007-13. In all EU15 Member States except the UK, the annual *per capita* allocation would fall compared with the current period.

Table 16 adjusts the allocations to the new Member States on a *pro rata* basis in order to attain the overall figures for Convergence regions given in the *Scénario Financier* (that is €83,700 million). This involves reducing the allocation to each new Member States by a factor of around 0.28 (compared with around 0.98 for the EU15). Of course, it is not known whether the Commission has taken a similar approach in its calculations, or indeed how the allocations for Convergence regions are dovetailed with those under the Cohesion Fund while ensuring that the absorption cap is not exceeded for any given country.

Table 16: Budget-adjusted estimates for Convergence regions in the new Member States

	Total allocation 2007-13 (€ m, 2004 prices)	Annual allocation per head (€, 2004 prices)
NMS10	83700.0	173.2
Czech Republic	9197.2	145.0
Estonia	1108.2	116.1
Cyprus	0.0	0.0
Latvia	3509.7	212.9
Lithuania	4851.4	199.1
Hungary	9636.7	187.1
Malta	0.0	0.0
Poland	48035.7	177.6
Slovenia	871.2	62.5
Slovak Republic	6490.0	193.9

Notes: Per head figures refer to eligible population. The total for 2007-13 (€ 83,700 million) is taken from Table 11. Using the same method as under the Berlin formula, the outcomes in Table 14 were adjusted proportionately to arrive at the overall budget figure.
Source: Own calculations from EUROSTAT data.

The most notable feature of Table 16 is that, even at the aggregate level, the *per capita* allocations to the Convergence regions in the new Member States are significantly lower than in the EU15.

5.3.2 National convergence (Cohesion Fund) allocation criteria

The draft Structural Fund Regulation provides scant guidance on mechanisms for allocating the Cohesion Fund, stating only that it would use *"population, per capita GNI taking into account the improvement in national prosperity over the previous period, and surface area".* The Third Cohesion Report noted that the Cohesion Fund would be enhanced to represent a third of the financial allocation for the new Member States concerned (although it is unclear whether this refers to them individually or collectively).

Within EU15, the most notable change for the future funding period is the change in Cohesion Fund eligibility (see Table 17). As noted earlier, Ireland and Spain would not qualify for the Cohesion Fund in 2007-13. This is especially significant as Spain has hitherto accounted for almost two-thirds of Cohesion Fund allocations. It is difficult to envisage that no transitional arrangements will be made for Spain, especially given the treatment of Ireland in 1999, but at present there are no indications of any such treatment.

Table 17: Cohesion Fund 2000-06 allocations in EU15

	2000-06 (2004 prices, € mn)	Indicative share(%)	Share of allocation (%)
Greece	3378.2	61-63.5	17.16
Spain	12320.6	16-18	62.57
Ireland	613.8	2-6	3.12
Portugal	3378.2	16-18	17.16
	19690.9		**100.00**

Source: Own calculations; 1999 Cohesion Fund Regulation; Third Cohesion Report.

For the new Member States, some € 7591 million (1999 prices) was allocated under the Cohesion Fund for 2004-06. The breakdown between the countries concerned is set out in Table 18.

Table 18: Cohesion Fund 2004-06 allocation in the new Member States

	2004-06 (2004 prices, € mn)	Share of allocation	7-year equiv. allocation (2004 prices, € mn)
Cyprus	53.0	0.63	134.9
Czech Rep	922.9	11.01	2349.3
Estonia	304.7	3.64	775.6
Hungary	1097.4	13.09	2793.3
Lithuania	600.6	7.17	1528.7
Latvia	508.9	6.07	1295.5
Malta	22.1	0.26	56.2
Poland	4121.2	49.18	10490.4
Slovenia	186.6	2.23	474.9
Slovakia	563.0	6.72	1433.2
	8380.5	100.00	21332.1

Source: Own calculations from Third Cohesion Report.

Table 19: Estimated Cohesion Fund allocations 2007-13 (2004 prices)

	Total Allocation 2007-13 (€ m)	Allocation per head *per annum* €
Greece	3027.5	39.54
Portugal	3027.5	41.99
EU15	**6055.0**	**40.73**
Cyprus	308.7	62.86
Czech Rep	5376.3	75.12
Estonia	1775.0	185.89
Hungary	6392.5	89.64
Lithuania	3498.5	143.56
Latvia	2964.7	179.84
Malta	128.6	46.75
Poland	24007.1	88.75
Slovenia	1086.8	77.94
Slovakia	3279.8	87.09
NMS10	**48818.0**	**93.34**

Source: Own calculations from Table 17, Table 18 and *Scénario Financier.*

As noted earlier, the Commission has undertaken some calculations on allocations post 2007. Table 11 suggests a Cohesion Fund allocation of € 6.055 billion for the EU15 and € 48.818 billion for the new Member States. In the absence of any detailed information on the distribution of these sums, a broad indication of the likely allocations can be gained from carrying forward past shares of the respective budgets. This is done in Table 19.

Given the assumptions made in these calculations, and the unofficial provenance of information on the Cohesion Fund split between the old and new Member States, Table 19 should be treated with some caution. Nevertheless, the overall budgets and eligible areas implied suggest that per capita Cohesion Fund allocations in the new Member States are likely to be around double those in Greece and Portugal.

5.3.3 Statistical effect allocation criteria – phasing out

Provision for the so-called statistical effect or phasing-out regions is included within the Convergence priority. This concerns regions that lose Objective 1 eligibility owing to shifts in the EU averages of GDP per head, not because of economic growth. The Commission's *Scénario financier* referred to earlier indicates that a total of € 22,142 million (2004 prices) would be allocated to the statistical effect regions, of which almost 98 percent would go to the EU15 countries.

Some indications of the allocation criteria have been provided by the Commission to the Council.[29] In broad terms, it seems that the Berlin formula will be followed for the phase-out regions, but that their GDP(PPS) per head will be assumed to be 75 percent of the EU average for the purposes of the methodology, and, importantly, aid intensity per head will be capped at 85 percent of 2006 levels. As a result, the aid intensity will be different in each eligible region. Aid will be degressive, that is, from 2007 the annual allocation will decline by five percentage points each year.

Clearly the 85 percent "cap" cannot apply to phase-out regions not qualifying for Objective 1 in 2000-06 (Namur, Hainaut and Highlands & Islands).[30] These are deemed to constitute a special case and *"will benefit from a fair and non-discriminatory solution",* as are the new Member States (on the basis of current data, only Malta). However, no details of this are provided, although clearly Malta must be the recipient of the entire sum for phase-out regions in the new Member States – some € 454 million for 2007-13 (see Table 11).

There are several points to note before examining the outcomes of this process. First, it has been assumed that 2006 allocations should be brought on to a 2004 prices basis. Second, it has also been assumed that the Paragraph 44 additions made at the Berlin summit should be included in the per capita aid intensities for the 2000-06 period; this has been done on a *pro- rata* population basis. The amounts are significant for Portugal and Greece (€10.7 and €6.8 per head in 2006, respectively), but less so for Spain (€1.4). Third, the regional boundaries applicable to the German eligible regions for 2000-06 have changed. Last, as for the Convergence priority, the absence of labour market data precludes the calculation of the unemployment related component for the period 2007-13.

[29] See Annex V of Presidency Report to the European Council, *Financial Framework for 2007-2013: Analytical Report,* 10219/04 of 7 June 2004.

[30] These three regions fall within this category according to the calculations undertaken for this paper which are based on the latest data. The Third Cohesion Report, which was based on earlier data, suggests that Tees Valley and Durham is also in this group

Table 20: Estimated phase-out (statistical effect) financial allocations 2007-13

	Formula-derived aid per head (€), 2007	**Aid per head in 2006 (€)**	**Aid per head (€), 2007, after capping**	**GDP-based allocation 2007 (€ m)**	**GDP-based allocation 2007-13 (€ m)**
EU25				***3195.3***	***19970.4***
EU15				***3070.4***	***19189.8***
NMS10				***124.9***	***780.6***
Belgium				**329.3**	**2058.3**
Hainaut	190.7	~	190.7	244.1	
Namur	190.7	~	190.7	85.2	
Germany				**920.7**	**5754.4**
Brandenburg - SW	190.7	185.1	157.3	223.3	
Dresden	190.7	212.5	180.6	307.8	
Leipzig	190.7	212.5	180.6	196.6	
Halle	190.7	225.0	225.0	193.0	
Greece				**742.2**	**4638.9**
Attiki	254.2	223.7	190.1	742.2	
Spain				**448.3**	**2801.9**
Asturias	190.7	187.9	159.7	167.9	
Murcia	190.7	224.4	224.4	255.9	
Ceuta	190.7	203.4	172.9	13.0	
Melilla	190.7	203.4	172.9	11.5	
Italy				**85.4**	**533.7**
Basilicata	190.7	166.3	141.4	85.4	
Malta	**317.8**	**59.0**	**317.8**	**124.9**	**780.6**
Portugal				**90.1**	**562.9**
Algarve	254.2	269.0	228.7	90.1	
UK				**454.3**	**2839.7**
Merseyside	190.7	142.8	121.4	165.3	
W. Wales & Valleys	190.7	138.8	118.0	218.6	
Highlands & Islands	190.7	~	190.7	70.4	

Notes: All figures are in 2004 prices. Because there was no Objective 1 aid to Hainaut, Namur and Highlands & Islands for 2000-06, there is no basis for capping. Similarly, the special arrangements for Malta are not known.
Source: Own calculations using methodology outlined in Presidency Report to the European Council, Eurostat data and Wishlade, F. (1999) *Eligible Areas and Financial Allocations under the New Structural Funds: Quarts, Pint Pots and Half Measures?*

The EU15 total given in Table 20 (€ 19189.8 million) differs from that in the Commission's *Scénario Financier* (€21,688 million) – see Table 11. The differences can probably be accounted for by the lack of information on capping for the non-Objective 1 statistical effect regions, coupled with the exclusion of Tees Valley and Durham from the calculations. Tees Valley and Durham appeared to be eligible on the basis of provisional GDP data, but not on the basis of more recent statistics; it is thought that the Commission's calculations included Tees Valley and Durham. As for the new Member States, Malta is the only region eligible (the whole country is NUTS 2) and must clearly be the recipient of the entire sum for phase-out regions in the new Member States – some € 454 million for 2007-13 according to Table 11.

On the basis of Table 20, Germany and Greece together account for over half the allocation for statistical effect regions, but the allocations to Spain and the United Kingdom are also significant (uncertainty about the Highlands & Islands allocation notwithstanding).

5.3.4 Outermost regions

Article 5(4) of the draft Structural Funds Regulation provides for specific funding from the ERDF for the outermost regions. This amounts to some €1.1 billion for 2007-13 (see Table 10). According to Article 16(1)(d) of the Regulation, the indicative allocation by Member States is to be made on the basis of the eligible population.

Table 21: Indicative allocation of specific ERDF funding for the outermost regions

	Pop, '000s (2001)	**Share of OMR pop (%)**	**Indicative allocation 2007-2013 (€ m)**
Canarias	1736.8		
Spain	**1736.8**	**44.05**	**488.4**
Guadeloupe	432.5		
Martinique	387.2		
Guyane	169.7		
Reunion	734.8		
France	**1724.2**	**43.73**	**484.9**
Açores	237.6		
Madeira	244.4		
Portugal	**482.0**	**12.22**	**135.5**
Total	**3943.0**	**100.00**	**1108.8**

Source: Own calculations from Eurostat data.

Overall, the levels of funding are fairly modest. However, in *per capita* terms, the amounts are not insignificant (at around €40 *per annum*). Morever, it is important to note that *all* the OMRs are, on the basis of current data, eligible for the Convergence region priority, except Canarias and Madeira which have phasing-in status (GDP(PPS) per head above even the EU15 75 percent threshold). As such, the above allocation would come *on top of* other funding.

5.4 Competitiveness and Employment

The proposed overall budget for the Competitiveness priority is some € 58 billion for 2007-13 (Table 22). This is broken down between, on the one hand, regions which have ceased to be eligible for what was formerly Objective 1 owing to economic growth beyond even the EU15 75 percent threshold (phasing-in) and, on the other, the Regional competitiveness and employment priority, which broadly replaces Objective 2.

Table 22: Regional competitiveness resources 2007-2013

	€ billion	**%**
Phasing in	9.6	16.56
Regional competitiveness and employment	48.3	83.44
Total	57.9	

Source: COM(2004)492

Beyond this, and as noted earlier, the Commission has produced some calculations that outline the amounts allocated to different country groupings. For the Competitiveness priority, these indicative allocations are set out in Table 23.

Table 23: Financial Scenario 2007-13: Competitiveness priority (2004 prices)

		€ million
Phasing-in (ex-Objective 1)	EU15	8513
	EU10	1073
	EU2	0
	Total	**9586**
Regional competitiveness and employment	EU15	48034
	EU10	279
	EU2	0
	Total	**48313**
TOTAL	EU15	56547
	EU10	1352
	EU2	0
	Total	**57899**

Source: *Scénario financier 2007-2013,* Unpublished document of the European Commission.

For each of the two elements into which the Competitiveness priority divides (ie. phasing-in and regional competitiveness) a separate approach to allocation applies. These are now discussed in turn.

5.4.1 Phasing in (former Objective 1)

Some indications of the allocation criteria for phasing-in have been provided by the Commission to the Council.[31]. The approach adopted is similar to, but not surprisingly less generous than, the provisions made for phasing out (that is, the statistical effect regions). In broad terms, the indicative allocation criteria suggest that the Berlin formula will be followed for the phase-in regions, but that their GDP(PPS) per head will be assumed to be 75 percent of the EU average for the purposes of the methodology, and, importantly, aid intensity per head will be capped at 75 percent of 2006 levels (80 percent for the sparsely populated regions). As a result, the aid intensity will be different in each eligible region. Similar to the approach adopted for phasing-out, aid will be degressive, but the decline will be much steeper. Between 2008 and 2010 the annual allocation will be reduced in a linear manner. Between 2011 and 2013 the regions concerned will receive aid per inhabitant equivalent to that in areas eligible for the new regional competitiveness priority, this being €21 per head on average (see Table 24).

Table 24 suggests a total allocation of €8974.5 million over the seven years 2007-13; of this, more than half would be allocated to Spain, with the amounts for other countries at rather modest levels. The overall figure is somewhat below the *Scénario Financier* figure of €9586 million cited earlier (see Table 23) and the discrepancy cannot readily be accounted for. However, as noted earlier, the treatment of regions eligible for Objective 1 in 2000-06 on the basis of low population density is unclear. Although there is reference to higher financial allocations for sparsely-populated phase-in regions, none of sparsely-populated regions appears to meet the criteria in Article 6(2) of the draft Regulation – specifically the reference to NUTS II regions *totally* covered by Objective 1 in 2006. At the same time, it seems untenable that these regions should lose Objective 1 status without any transitional provisions.

[31] See Annex V of Presidency Report to the European Council, *Financial Framework for 2007-2013: Analytical Report,* 10219/04 of 7 June 2004.

Table 24: Estimated phase-in allocations 2007-2013

	Aid per head									€ million
	Formula-derived 2007 aid	**Aid in 2006**	**2007 (capped)**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2007-13 GDP based alloc**
EU25										***8974.5***
EU15										***7901.5***
NMS10										***1073.0***
Greece										**712.3**
Sterea Ellada	254.2	323.0	242.3	242.3	186.9	131.6	76.3	21.0	21.0	514.2
Notio Aigaio	254.2	226.7	170.0	170.0	132.8	95.5	58.3	21.0	21.0	198.1
Spain										**4513.7**
Castilla y León	190.7	178.0	133.5	133.5	105.4	77.3	49.1	21.0	21.0	1332.9
Valencia	190.7	180.6	135.5	135.5	106.8	78.2	49.6	21.0	21.0	2241.6
Canarias	190.7	178.0	133.5	133.5	105.4	77.3	49.1	21.0	21.0	939.2
Ireland										**602.4**
BMW	190.7	198.8	149.1	149.1	117.1	85.1	53.0	21.0	21.0	602.4
Italy										**708.6**
Sardegna	190.7	136.0	102.0	102.0	81.8	61.5	41.3	21.0	21.0	708.6
Hungary										**1073.0**
Közép-Magyarország	317.8	69.6	~	~	~	~	~	~	~	1073.0
Austria										**128.9**
Burgenland	190.7	149.4	112.1	112.1	89.3	66.5	43.8	21.0	21.0	128.9
Portugal										**396.6**
Madeira (PT)	254.2	442.7	442.7	442.7	337.3	231.9	126.4	21.0	21.0	396.6
Finland										**291.3**
Itä-Suomi	190.7	135.5	101.6	101.6	81.5	61.3	41.2	21.0	21.0	291.3
United Kingdom										**547.6**
South Yorkshire	190.7	136.7	102.5	102.5	82.1	61.8	41.4	21.0	21.0	547.6

Note: No information is available on the special arrangements for the new Member States (only Hungary is concerned). Also, as elsewhere, the absence of labour market date precludes the calculation of the employment-related component. All figures in 2004 prices.
Source: Own calculations using methodology outlined in Presidency Report to the European Council, Eurostat data and Wishlade, F. (1999) *Eligible Areas and Financial Allocations under the New Structural Funds: Quarts, Pint Pots and Half Measures?* The figure for Hungary is from the *Scénario Financier.*

Notwithstanding the reference in the draft Regulation to NUTS II regions that are "totally" eligible for Objective 1 in 2006, Table 25 provides some estimates of allocations to sparsely-populated phase-in regions. In so doing, it takes account of the Special Programme areas in northern Sweden, which are not, however, formally considered part of Objective 1. This calculation suggests that provision may indeed have been made for these regions within the phase-in total. Other assumptions being correct, the allocation for these regions would bring the total to €9561.8 million, just short of the *Scénario Financier* total of €9586 million.

Table 25: Estimated allocations to sparsely-populated phase-in regions 2007-13

	Aid per head (€)							**€ m**
	2006	**80% cap**	**2007/8**	**2009**	**2010**	**2011**	**2012/3**	**2007-13**
Väli-suomi	129.9	103.9	103.9	83.2	62.5	41.7	21.0	26.5
Pohjois-suomi	130.5	104.4	104.4	83.6	62.7	41.9	21.0	137.0
Finland								**163.6**
Norra mellansverige	129.9	103.9	103.9	83.2	62.5	41.7	21.0	32.0
Mellersta norrland	129.9	103.9	103.9	83.2	62.5	41.7	21.0	79.5
Övre norrland	129.9	103.9	103.9	83.2	62.5	41.7	21.0	86.1
Special prog. areas	106	84.8	84.8	68.9	52.9	37.0	21.0	192.9
Sweden								**423.7**
TOTAL								**587.3**

Note: All figures in 2004 prices. As elsewhere, the absence of labour market date precludes the calculation of the employment-related component. Figures are based on 1996 population data (rather than 2001 as elsewhere), this being the only information available given the partial coverage of the regions concerned.
Source: Own calculations using methodology outlined in Presidency Report to the European Council, Eurostat data and Wishlade, F. (1999) *Eligible Areas and Financial Allocations under the New Structural Funds: Quarts, Pint Pots and Half Measures?*

5.4.2 Regional competitiveness and employment

The major part of the Competitiveness and employment strand concerns the former Objectives 2 and 3. As already noted, the current proposal is to abandon the system of designated areas in favour of a more thematic approach centred on horizontal and some regional priorities.

Little is known about how this might impact on the distribution of funds between Member States, but an average figure of € 21 per head per year has been mentioned.[32] In Table 26 this amount is applied to the population ineligible under all the spatial components discussed do far (convergence, phase-out, phase-in and sparsely-populated phase-in). The total arrived at (€ 43,344.1 million) falls somewhat short of the *Scénario Financier* total of € 48,313 million, although the amount for the new Member States exceeds the *Scénario Financier* amount (see Table 23). These discrepancies cannot readily be accounted for. However, it is known that the Commission proposes to compensate permanent geographical handicaps through higher allocations; in addition, it may be that amounts for the new Member States are constrained by the absorption cap.

[32] Presidency Report to the European Council, *Financial Framework for 2007-2013: Analytical Report,* 10219/04 of 7 June 2004 at Annex V.

Table 26: Estimated Competitiveness and Employment allocations 2007-13

	Competitiveness regions pop ('000s)	% of population	2007-13 allocation (€ m, 2004 prices)
EU25	294857.7	65.1	43344.1
EU15	292392.3	77.4	42981.7
NMS10	2465.4	3.3	362.4
Belgium	8559.4	83.2	1258.2
Czech Rep	1164.8	11.4	171.2
Denmark	5355.1	100.0	787.2
Germany	68551.8	83.3	10077.1
Estonia	0.0	0.0	0.0
Greece	0.0	0.0	0.0
Spain	16820.5	41.8	2472.6
France	59192.4	100.0	8701.3
Ireland	2827.0	73.6	415.6
Italy	38694.8	66.8	5688.1
Cyprus	701.5	100.0	103.1
Latvia	0.0	0.0	0.0
Lithuania	0.0	0.0	0.0
Luxembourg	442.0	100.0	65.0
Hungary	0.0	0.0	0.0
Malta	0.0	0.0	0.0
Netherlands	16046.2	100.0	2358.8
Austria	7754.8	96.6	1140.0
Poland	0.0	0.0	0.0
Portugal	2604.8	25.3	382.9
Slovenia	0.0	0.0	0.0
Slovak Rep	599.1	11.1	88.1
Finland	4136.4	79.7	608.1
Sweden	7923.2	89.1	1164.7
UK	53483.9	90.9	7862.1

Source: Own calculations from Eurostat data.

An alternative view of these figures suggests significant differences between EU15 and NMS10 in terms of *per capita* allocations under the Competitiveness objective. This is arrived at by dividing the *Scénario Financier* allocation (Table 23) by the population eligible for the competitiveness objective. The outcome is illustrated in Table 27.

Table 27: Estimated per capita Competitiveness and Employment allocations (2007-13)

	Total 2007-13 (€ m)	Population ('000s)	Annual per capita allocation (€)
EU15	48034	292392.3	23.5
EU10	279	2465.4	16.2
EU25	48313	294857.7	23.4

Source: Calculated from *Scénario Financier* (Table 23) and Table 26.

Table 27 suggests that *per capita* allocations in the new Member States will be € 16.2, compared with € 23.5 in EU15. This figure and the EU25 average per capita figure are substantially higher than the € 21 per head quoted earlier.

5.5 Concluding Points

The aim of this and the previous section has been to provide some estimates of the eligibility and financial implications of the Commission's current proposals for cohesion policy post-2006. These estimates should be treated with some caution, and this for several reasons. First, there are discrepancies between the data available at the time of the Third Cohesion Report, on which the Commission's figures appear to be based, and more recent data available from Eurostat; this has implications both for eligibility and financial allocations. Second, there are significant gaps in the information needed to replicate the Commission's approach to distributing funds. Third, in any event, decisions will not ultimately be taken on the basis of the data used in this paper (1999-2001 for GDP per head) but on the basis of later information – perhaps 2001-2003. Last, this chapter has not addressed the issue of funding for Bulgaria and Romania, which are currently due to accede during the next funding period.

Technical issues aside, some broader issues of principle complicate the process of estimating funding allocations. In particular, it is unclear which proposed allocations are the result of applying a "bottom-up" formula or a "top-down" principle. Moreover, the precise relationship between the different parameters that impact on allocations (for example, the notional splits between country groupings or funds and the impact of the absorption cap) is unknown.

At a more political level, some issues appear still to be addressed. For example, it hardly seems tenable that Spain can cease to qualify for the Cohesion Fund with no transitional arrangement, but no explicit provision is made for this. In addition, higher rates of award for certain competitiveness regions have been mentioned, but no detail is given.

6. MEMBER STATE PERSPECTIVES

6.1 Current Status of the Debate

The debate on the financial perspective is still in its early stages. Member States have been making clear their general positions for some time, and it is evident that there is considerable polarisation of views on the budgetary question. There has, though, been only limited discussion on this issue hitherto, in the interests of making progress on other matters where there is the prospect of some consensus.

The Council is currently in a phase of analysing the Commission's communication, clarifying issues and providing feedback. An Analytical Report[33] was prepared by COREPER for the European Council meeting in Brussels on 17-18 June, which recognised that further work needs to be done. An *ad hoc* group has been set up by COREPER to examine the structure and associated mechanisms of the financial perspective (spending categories, flexibility, institutional aspects), the content of the financial perspective and the content and mechanisms of the own resources system[34]. Detailed work on the Draft Regulations is currently beginning within the Structural Actions Working Party, beginning with a first reading of the General Regulation during September followed by more specific discussions during October.[35]

The timetable envisaged in the Multiannual Strategic Programme[36] aims at reaching political agreement on the financial perspective at the European Council in June 2005, with a view to final adoption of the new financial perspective and the detailed legislation under which it will be implemented by end 2005. Over the next six months, the objective of the Dutch Presidency is, in accordance with the Multiannual Strategic Programme, to make it possible for the European Council to reach decisions in December 2004 on *"principles and guidelines in respect of the 2007-2013 Financial Perspective"*.[37]

The following sections focus primarily on the views of Member State governments with respect to the overall financial framework and cohesion policy in particular. However, three points should be noted at the outset.

First, in some EU countries, the national position is determined or influenced by the views of sub-national authorities, which may have quite different perspectives from those of the national government. This applies to federal countries, especially Belgium, but also Germany and Austria. In Germany, for example, there are at least three distinct 'blocs' of *Länder* (states): the eastern states, most of which benefit heavily under Objective 1; a group of western states which benefit little from Structural Funds (eg. Bayern, Baden-Württemberg); and other western states (notably Nordrhein-Westfalen) which are major beneficiaries under Objective 2. Divisions are also evident in Austria, between the eastern *Länder* of Burgenland, Niederösterreich and Steiermark, which are recipients of significant EU funding, and other states which have less of an interest in Structural Funds. The reconciliation of such differences means that the ability of federal governments to take or change

[33] *Financial Framework for 2007-2013: Analytical Report*, Report to the European Council, CADREFIN 11, Brussels, 7 June 2004.
[34] Presidency Note CADREFIN 12 - 11441/1/04
[35] Structural Actions Working Party note CADREFIN 13 – 11563/04
[36] Council Secretariat note POLGEN 76 – 15047/03
[37] Presidency Note CADREFIN 12 - 11441/1/04

positions has to be carefully negotiated. The need to recognise regional, local and sectoral interests applies in other countries also, especially where a measure of devolution exists (eg. Spain, the UK, Italy), but to a lesser extent than in federal countries.

Second, the positions being taken on the financial perspective relate not just to payments into and receipts from the EU budget. Other European policy issues that are being discussed in parallel also govern the shaping and evolution of national views. Most of the richer Member States, for example, are very concerned about the DG Competition proposals for the reform of regional aid control, particularly the prospect of a so-called ‘double whammy’ involving both loss of Structural Fund receipts and the ability to operate high-value regional aid schemes. Several countries (notably Germany, France and Ireland) have also linked discussion of the reform of Structural Funds to the question of perceived ‘unfair tax competition’ on the part of new Member States.

A third point is that all Member States are acutely aware of the fact that unanimity will be needed to achieve agreement on the future financial perspective. Some Member States have clearly taken a ‘hard-line’ official position on issues such as the size of the overall budget, while at the same time being aware that this position may need to be modified during the negotiations. While the Dutch Presidency aims to make progress on agreeing ‘principles’ by December 2004, if the Agenda 2000 experience is replicated it may not be until 2005 or even 2006 that political agreement is reached. At this stage, therefore, it is impossible to predict how far the positions outlined in the following sections will change over the coming months or year(s).

6.2 Overall Financial Perspective

As noted earlier, the EC proposals foresee an average of €146 bn per year being committed over the 2007-2013 period. Compared with a figure of €121 bn for the final year of the current period (2006), planned EU spending would rise by 31 percent to a commitment level of € 158 bn in 2013. To justify this increase, the Commission has three arguments:[38]

- the EU budget is limited in size, comprising little more than 1 percent of EU income compared to national budgets which are around 45 percent of national income;
- the increase in resources sought is “modest” compared to the rate of increase in national budgets in recent years; and
- the EU needs to match its political goals and priorities with additional resources: “to expect more Europe for less money is simply unrealistic”.

The EC budgetary proposals have had a mixed response. The range of reactions among Member States is summarised in the COREPER Analytical Report[39] as follows:

> *“the debate on the future financial perspectives has been characterised from the outset by differences among Member States as to the appropriate level of EU expenditure and the methodology to be followed. The Commission, with support from some Member States, starts from an assessment of what it judges to be the needs of the enlarged Union over the coming period, together with political and policy commitments already assumed by the*

[38] COM (2004) 487 – Communication on financial perspectives
[39] COREPER Analytical Report on the financial framework CADREFIN 11 – 10219/04, p.3

> *Council. On this basis, the Commission estimates that required expenditure over the period will average 1.14% of EU GNI per annum for payments and 1.26% for commitments. At the other end of the spectrum, Member States advocating a 1% expenditure ceiling propose a top-down approach according to which an overall budgetary ceiling is agreed first and policy objectives are then prioritised within that ceiling; in their view requirements of budgetary discipline and domestic fiscal situations necessitate such an approach. Other Member States take intermediate positions between these two approaches."*

Supporting the Commission position on the question of financial resources are Spain, Portugal and Greece (and also Belgium), as well as many new Member States, which have explicitly called for an increase in EU cohesion policy spending at or beyond the current 0.45 percent of EU GDP, although without specifying what level of increased expenditure would be required. The argument is that EU enlargement – but also other challenges to cohesion such as European competitiveness and the effects of economic and monetary union – require a strengthening of EU cohesion policy. For example, the Portuguese government considers that *"the current threshold of 0.45% of the Union's GDP allocated to cohesion policy is the minimum necessary to pursue its objectives".*[40] Spain takes the same view: *"agreement below this level would be very difficult".*[41] Among the new Member States, the position papers of several countries argue for at least maintaining (Slovak Republic, Malta) or increasing (Hungary, Lithuania) the proportion of EU GDP spent on cohesion policy. The Czech Republic is also keen on maintaining a strong EU cohesion policy, although it has also indicated that, with respect to the overall EU budget, 1.14 percent may be a useful starting point for budgetary discussions and an even lower figure may be feasible if savings on administration or agriculture can be identified.[42]

A very different view on the financial perspective is taken by the richer EU countries. Prior to the publication of the EC proposals, several Member States had sought to re-emphasise the perceived need for budgetary restraint. Six countries – Austria, France, Germany, the Netherlands, Sweden and the UK – wrote to the EC President stating categorically that:[43]: *"We see…no room for an EU budget near the current ceiling for own resources. Average expenditure during the next financial perspective should in our view be stabilised around current expenditure levels and should not exceed 1.0% of GNI, including agriculture spending within the ceiling set by the European Council in October 2002."* The German, Austrian and UK finance ministers reiterated this point in February and again at the Third Cohesion Forum in May. There are several arguments put forward by this group of countries.

- The German case against higher spending is based partly on the budgetary constraints being experienced at national level in Germany as well as in some other Member States. It is argued that, since national budgets are under severe pressure, with problems in operating within the three percent deficit limits of the Stability and Growth Pact, it is unrealistic to expect Member States to make higher financial contributions to the EU budget.[44]

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[40] Portuguese Position on Economic and Social Cohesion Policy Reform,

[41] Speech by Minister Miguel Angel Fernández Ordoñez, Secretary of State for Finance and Budget, Spain to the Third Cohesion Forum, Brussels, 10-11 May 2004.

[42] Draft Speech by Czech Prime Minister Vladimír Špidla to the Third Cohesion Forum, Brussels, 10-11 May 2004.

[43] Letter from the Governments of Austria, France, Germany, the Netherlands, Sweden and the United Kingdom to the President of the European Commission, 15 December 2003.

[44] Speech by Mr Karl Diller, State Secretary in the Federal Ministry of Finance, Germany, to the Third Cohesion Forum, Brussels, 10-11 May 2004.

- The UK shares the view that EU resources should be concentrated but bases its case on the added value of EU spending on cohesion policy. As originally stated in its White Paper,[45] the UK Government is not convinced that Structural Funds add significant value in comparison to domestic initiatives (because of factors such as the inflexibility of spending), and may even have negative effects by inhibiting structural reform and labour mobility. In this context, the EC budgetary proposals are regarded as not "justifiable, affordable or realistic", principally because they are insufficiently focused on areas where added value can be demonstrated.

- A related view is put forward by the Dutch Government, which frames its arguments in terms of the efficiency and effectiveness of EU cohesion policy. It considers that a more effective and efficient policy could be funded at a lower level of spending by focusing on national rather than regional prosperity, concentrating spending on the poorer Member States (instead of regions) and withdrawing support from richer countries apart from inter-regional and cross-border co-operation. "*In practice, this would mean that the rich member states no longer claim EU resources for structural policy*".[46] This chimes with the Swedish position, which maintains that the *"focus must change from reducing disparities between regions to reducing disparities between countries".[47]* Efficiency issues are also cited by the German government[48] which, while "fully supporting the principle of economic and social cohesion", consider that this objective could met more efficiently with a stronger concentration of funds on the most needy regions.[49]

- Lastly, it has been noted by several of the richer Member States that a high level of EU spending is detrimental to the new Member States. As a result of the 4 percent absorption cap on Member States' Structural and Cohesion fund receipts, a budget beyond 1 percent of EU GNI would penalise many of the poorer Member States, as their contributions will rise to fund programmes in wealthier Member States but their receipts will remain the same.

Somewhere between the views of the EC, Greece and Portugal, on the one hand, and the larger net contributors, on the other hand, is a set of 'intermediate positions' held by countries such as Finland, Ireland and Italy, which are in favour of a more 'open approach'. For example, the fact that Italy is becoming one the larger contributors to the EU's budget makes it extremely cautious on financial questions, but it believes that EU cohesion policy is required in non-lagging as well as lagging regions.[50] Despite being a signatory to the December 2003 letter, the French Government also sees itself as having an 'intermediate position'; while concerned at the prospect of a steep increase in its net budget contribution, EU cohesion policy is

[45] *A Modern Regional Policy for the United Kingdom,* HM Treasury, Department of Trade & Industry, and Office of the Deputy Prime Minister, United Kingdom, March 2003.
[46] Cabinet Standpoint concerning the Interdepartmental Policy Study (IBO) on "European Union Structural Policy in the Context of the Enlargement of the EU", The Hague, 2002
[47] *New Challenges, New Priorities: Swedish Reflections on the Next Financial Perspective,* October 2003.
[48] *Stellungnahme der Bundesregierung zum 3. bericht der Europäischen Kommission über den wirtshcaftlichen und sozialen Zusammenhalt,* Berlin, 19 May 2004.
[49] A specific issue raised in the German Federal Government's position paper is the relationship between structural policy and tax competition in the EU; it is considered unacceptable for the net contributor Member States to be financing unfair tax competition in the new Member States.
[50] Second Italian Memorandum. The Reform of the EU Cohesion Policy: Notes about the Italian position and the orientations in the forthcoming period.

regarded as important.[51] Ireland similarly finds itself on a 'cusp' between the 'one percent group' and the poorer countries. Arguably, the Czech Republic might be included in this group, given its view on the feasibility of having a 1.14 percent EU budget. The views taken by this intermediate group of countries are generally as follows.

- While a degree of budgetary discipline is necessary, it should ensure that key policies are not jeopardised, a position typified by the Finnish reaction to the new financial perspective which emphasises *"the importance of adherence to stringent budgetary policy…[but which]…must not, however, serve as a hindrance to solidarity among the Member States".*[52]

- Any 'savings' to be made should be spread across all policies, not just affecting cohesion policy, for which some 0.40 percent of GNI is considered necessary to finance an adequate Structural and Cohesion Fund budget. Italy, for instance has indicated that lower financial allocations could be discussed but only on condition that "all policies are included in the budget cuts" so that the weight and composition of EU cohesion policy remains the same as proposed by the EC.[53]

- Spending levels should be determined by policy requirements rather by setting arbitrary limits. As noted by the Czech government:[54] "*it is impossible to "yoke a horse behind a cart"…the future budget must reflect our priorities in the individual EU policies.*"

- It is not feasible to reduce spending to 1 percent of GNI. Seeking a compromise between the EC proposals and the views of the major contributors, countries in this intermediate group have advocated a level of future expenditure between 1 percent and 1.14 percent of EU GNI. At the Third Cohesion Forum, Finland suggested that concentration could be achieved with a budget of 1.1 percent of GNI.

6.3 Impact on Net Budgetary Positions

Underlying all of the views among EU15 Member States is a concern with the impact of the Commission's proposals on net contributions/receipts. All of the EU15 countries are facing a change in their net budgetary balances to differing degrees, as indicated in Table 28, where one possible scenario for future budget balances is presented. As discussed earlier, some of the larger net beneficiaries at present (Spain, Ireland) are likely to be facing substantial falls in their net receipts, but the situation is more politically sensitive in several of the major net contributor countries, whose net budgetary balances are projected as 'deteriorating' significantly. This applies to the six signatories of the December 2003 letter to Romano Prodi, as well as to Denmark, Finland and Italy, which are becoming major net contributors to the budget for the first time. The implications are particularly important for the UK, which would have been the major net contributor to the EU budget for the past seven years

[51] *Audition par la délégation pour l'Union européenne de M. Pierre Sellal, Ambassadeur, Représetantive permanent de la France auprès de l'Union européenne*, in Yann Gaillard and Simon Sutour, *Op. cit.*, Sénat: 2004, pp.60-72.
[52] *The Position of the Finnish Government Regarding the European Commission's Communication on the New Financial Framework Issued on 10 February, 2004,* Helsinki, 11 February 2004.
[53] Speech by Undersecretary Gianfranco Micciche to the Third Cohesion Forum, Brussels, 10-11 May 2004.
[54] Draft Speech by Czech Prime Minister Vladimír Špidla to the Third Cohesion Forum, Brussels, 10-11 May 2004.

without the correction of its rebate, and which is facing pressure for a 'correction mechanism' to its rebate arrangements to be introduced.

Table 28: Net budgetary balances for EU15 Member States (after UK correction)

	Net budgetary balances, 1996-2002 average (as % of GNI)	Estimated budgetary balances, 2007-2013 average (as % of GNI)	Change in budgetary balance (percentage points)
Netherlands	-0.48	-0.56	-0.08
Germany	-0.47	-0.54	-0.07
Sweden	-0.43	-0.50	-0.07
Austria	-0.30	-0.38	-0.08
Utd Kingdom	-0.18	-0.25	-0.07
Italy	-0.13	-0.41	-0.28
France	-0.11	-0.37	-0.26
Finland	-0.04	-0.25	-0.21
Denmark	0.02	-0.31	-0.33
Belgium	0.78	1.21	+0.43
Spain	1.19	0.23	-0.96
Portugal	2.49	1.50	-0.99
Ireland	2.72	0.47	-2.25
Greece	3.60	2.16	-1.44
Luxembourg	3.93	5.80	+1.87

Source: *Financing the EU*, COM(2004) 505, Brussels, 14.7.2004, plus supplementary data from DG Budget.
Note: The figures for the estimated budgetary balances, 2007-2013, assume that the current system, including the application of the UK correction, remains unchanged.

6.4 Other Financial Issues

In addition to the size of the overall budget and the budgetary balances, there are several other important financial issues that have been raised as part of the debate on the financial framework.

- There is major concern among new Member States that the proposed division in funding, allocating broadly equal shares of the cohesion budget between old and new Member States, is unfair. Some richer Member States, such as Germany, have also argued that this runs counter to the principles of solidarity and concentration. The new Member States are also arguing in favour of 'fairer treatment, for example by reducing funding flows to certain old Member States from 3 percent to 2.5 percent of GDP. In the words of the Polish Government: "*the transfers per capita in the regions still facing structural problems should not surpass those in regions of the least wealthy Member States eligible for Objective support*".[55] The Czech Republic, Hungary and Slovak Republic have made similar statements about the need for fairness in making allocations.

- While most old Member States insist that the four percent absorption limit should be applied, several new Member States have called for a more flexible approach. Some argue that the level of financial support should be proportional to the level of development of the Member States. It has also been suggested that the limit should not cover expenditure under rural

[55] Speech by Minister Krystyna Gurbiel, Undersecretary of State in the Ministry of Economy and Labour, Poland to the Third Cohesion Forum, Brussels, 10-11 May 2004.

development or the New Neighbourhood Instrument, as currently foreseen under the EC proposals.

- Some questions have been raised about the structure of the proposed financial framework. The steep increase in proposed spending under ‘competitiveness’ (Heading 1a) has been questioned, on the grounds of the added value of higher EU-level expenditure on R&D and TENS being unclear. Various Member States have expressed doubts about the proposed modification of the structure of political priorities within the financial perspective, arguing that broader categories do not necessarily improve the efficiency of implementation; there has also been criticism of the EC’s proposals for altering flexibility arrangements for utilising unspent resources.

6.5 The Debate about EC Proposals for Cohesion Policy

In the Third Cohesion Report and draft Structural Funds Regulations, the EC has put forward far-reaching proposals for changes to EC cohesion policy. These encompass the rationale for cohesion policy, a new architecture for Structural and Cohesion Funds, new foci for expenditure, a new planning framework and more decentralised implementation arrangements. Given the complexity and detail of these changes, this section provides only a summary of the main issues being discussed.

6.5.1 Rationale for cohesion policy

In general, there has been a positive response to the EC’s proposals for a broader rationale for EU cohesion policy, which places more stress on the links between cohesion and the Lisbon agenda, and the concept of balanced development which encompasses all regions. Italy is a particular supporter of a cohesion policy focus on the themes of sustainable development, growth and competitiveness, evident in the papers prepared for the Informal Meeting organised under the Italian Presidency. In other countries also (eg. Netherlands, Sweden, UK), the thrust of the EC proposals is regarded as representing a good ‘policy fit’ with the trend in their national regional policies, which increasingly are concentrating on growth and competitiveness objectives.

However, other countries have drawn attention to the dangers of focusing excessively on the Lisbon agenda, noting that EU cohesion policy exists to meet specific Treaty objectives related to economic, social and territorial disparities and problems. Ireland, among others, would be concerned at a too restrictive interpretation of competitiveness, on the basis that some less-developed regions simply do not have the capacity to absorb the more sophisticated types of competitiveness support, and that there continues to be a need to promote convergence through investment in basic infrastructure, the productive sector and human resources. Germany has pointed out that the Lisbon goals will be achieved primarily through structural reforms such as market liberalisation and not via instruments such as cohesion policy.

Although several countries support the idea of all regions being eligible for cohesion policy – which again fits in with the ‘whole-country’ approach of some national regional policies (eg. Denmark, Finland, Netherlands, UK) – some Member States are opposed to this idea. The German federal government, in particular, is sceptical about a universal cohesion policy, arguing instead that the EU should focus on those regions with specific structural economic problems. Italy is also concerned about the potential for a fragmentation of resources and the risk of reducing the effectiveness of EU support. Unsurprisingly, the more prosperous regions have supported this aspect of the EC proposals, while the traditional recipient regions of Structural Funds would like to maintain some EU influence on the spatial focus of assistance.

6.5.2 Architecture of cohesion policy

Overall, there appears to be a broad level of support for the new architecture proposed by the EC: the three objectives of convergence, competitiveness and cooperation; the concentration on thematic priorities of innovation, accessibility and the environment; and the spatial focus (especially the abandonment of micro-zoning at EU level under the competitiveness strand). Although many issues are still under discussion, some general observations can be made.

- ***Objectives***. The main issue is the division of funding between convergence, competitiveness and cooperation, with some richer countries seeking to minimise any funding outside of the convergence objective. For example, the German federal government argues that a maximum of 5-10 percent of total Structural Fund resources should be allocated to non-convergence objectives. Others take a different view: Belgium, France and Italy are concerned to ensure that the competitiveness budget is large enough to be meaningful. While there is widespread support for the territorial cooperation objective, which is generally seen as having added value, there are differences about the balance of emphasis on external versus internal borders. Some Member States have questioned the tangible benefits arising from transnational cooperation programmes (by comparison with cross-border or inter-regional programmes). The integration of inter-regional cooperation within mainstream programmes has apparently found little support.

- ***Thematic concentration***. The proposed thematic priorities are generally regarded as fitting well with the Lisbon and Gothenburg agendas, although there have been some questions about the relevance of ‘accessibility and services of general economic interest’. Several Member States consider that the EC’s proposals do not imply sufficient concentration: the view of Germany, Italy and the Netherlands, for example, is that virtually everything would be eligible under the competitiveness objective. Some countries consider that they might have institutional difficulties if Structural Funds were to cover areas that have not traditionally been covered under the heading of regional policy. By contrast, the Finnish and Danish perspectives are that cohesion policy needs to be broad enough to complement other (national and regional) programmes which aim to boost growth and competitiveness. A specific French concern is that more emphasis should be placed on entrepreneurship, reflecting the stress being placed in France on local platforms for innovative start-up companies. Italy would like to see a more positive approach to the role of cities; rather than focusing on the urban problems, they should be seen more as motors of economic development.

- ***Spatial focus***

    - *Statistical effect regions and phasing-in regions.* Member States clearly differ in whether they regard the proposed treatment of statistical effect (phasing-out) and phasing-in regions as being favourable. For the most part, Member States are still considering the implications of the EC’s proposals for their own eligibility for Structural and Cohesion Fund resources and have requested more information from the EC on the way that the methodologies would be operationalised. Spain is looking for statistical effect treatment to apply in the case of the Cohesion Fund, given its loss of eligibility.

- *Sparsely populated areas.* Germany, among others, has welcomed the EC's proposal to end special treatment for sparsely populated areas, but Finland has made it clear that a "sustainable financial solution" which guarantees permanent special treatment of the sparsely populated regions is a "threshold question" for the negotiations.

- *Regional competitiveness areas.* As noted above, there is some support for the proposal that all regions should be eligible in principle for cohesion policy under the competitiveness objective, but uncertainty as to how this will operate in practice. The EC proposals to make Member States responsible for geographical concentration has been received positively, but it is unclear what level of EU influence there would be (in terms of guidance on criteria, weightings etc) in any partnership between the EC, Member States and regions to establish the zoning of support.

- ***Rural development.*** Most Member States appear to be in favour of the transfer of rural support to the CAP. The general reaction is that the real impact of the change will depend on: (a) the interpretation made of the new regulation at national level; and (b) the translation of the regulation in the rural development programmes. Those countries which rely heavily on EU rural support (eg. Finland, France, Ireland) are concerned to ensure that rural development is adequately financed, and that an 'holistic approach' to the development of rural areas (eg. though multi-activity entrepreneurship and diversification of employment) is not undermined in favour of aid to farmers. Several Member States have pointed out the importance of sufficient differentiation between the interventions financed respectively under Structural Funds and the CAP second pillar.

6.5.3 New delivery system

There has been a universal welcome for the Commission's proposals for simplifying the management and implementation of the Structural Funds and the clarification of the division of responsibilities between the EC, Member States and sub-national authorities. Again, Member States are still at an early stage in considering the proposals and getting more feedback from the EC, but several themes emerge from the reactions to date.

- ***New planning framework.*** The EC's proposal for a new planning framework, with a Council-level strategy and national regional development strategies, has received a mixed response. The Dutch government regards the idea very favourably, on the basis that this approach will help establish a necessary 'vertical hierarchy' to policy and policymaking, allowing objectives to be set and performance subsequently to be reviewed. Italy also considers the framework to be an important opportunity for coordination, aligning cohesion policy at national and European levels in meeting the objectives of Lisbon and Gothenburg. However, Austria and Germany are more sceptical; as federal states, they are concerned that the EC proposals do not undermine the principle of subsidiarity by strengthening the national government role in economic development at the expense of the *Länder*. Other countries, such as France, are also wary of the impact that the framework might have on national-regional planning processes. Like many Member States, Ireland is concerned at the practicalities of the proposal, in particular the role of the Member States in the formulation of the Council-level strategy, the degree of detail to be contained in the national strategy documents, the sequencing of the drafting process (especially in relation to the operational programmes), the flexibility of the system and the potentially disproportionate administrative cost.

- ***Implementation arrangements.*** All Member States have reacted positively to the simplification proposals, albeit with some reservations. The main area of doubt is whether simplification will actually be delivered, partly because any new system can only be judged once it is in place, and partly because of the experience of the changes introduced in 1999, which promised a simplification that did not subsequently occur. National policymakers and programme managers repeatedly draw attention to the fact that it is the interpretation of regulatory frameworks by the EC that causes problems. Two specific points have been noted.

    - Withdrawing the requirement to produce a programme complement may not be a panacea. Managing Authorities often find that they need a detailed planning and management document, accepted in common by all regional bodies, for effective management of programmes. This applies in Austria, Germany and Spain, in particular, where the institutional arrangement for programme delivery can be complex.

    - There are big differences among Member States in their view of N+2. Most regard it as valuable for budgetary discipline and some would like to see it retained unchanged. Other countries (eg. the UK, Ireland, France) would like to see more flexibility applied, potentially in the form of an N+3, at least for the first year(s) or programme implementation. Ireland considers that N+2 should only be applied at the programme level rather than priority level.

7. CONCLUDING QUESTIONS

The major decisions on the future of EU cohesion policy relate to the overall size of the EU budget, the share allocated to cohesion policy and the financial split between the three objectives and categories of eligible region. The broad financial issues are currently being considered within the Financial Perspective Ad Hoc Group under the Dutch Presidency, but it is widely anticipated that achieving a political basis for agreement on the budgetary issues will take considerable time. In parallel, the Structural Actions Working Party is examining the detailed proposals for the design and implementation of Structural and Cohesion Funds. As a contribution to this debate, the following section highlights four sets of issues for consideration, relating to the future focus of cohesion policy, the priorities for intervention, the concept of territorial cohesion and the new implementation framework.

7.1 To What Extent Can Cohesion Policy Support the Lisbon Strategy?

The European Commission proposes to link the objectives of future EU cohesion policy to the objectives of the Lisbon strategy and the Gothenburg agenda. This focus on growth and competitiveness, along with the policies and targets under Heading 1a, is intended to mobilise EU budgetary resources to help achieve the transformation of the EU into a growth-oriented and dynamic knowledge economy. It also fits with the 'growth and competitiveness' objectives of national regional policies in the more developed parts of the EU.

However, there are limitations on what cohesion policy can do to facilitate the Lisbon strategy. While the Structural Funds (and other EU actions) can clearly play a supporting role in achieving the Lisbon goals, they depend crucially on national public investment strategies and regulatory frameworks (eg. structural reforms on product, capital and labour markets). As the regular Commission reports indicate, the response of Member States in many of these areas has been slow and uneven.

Further, there is a potential conflict between the objectives of competitiveness and cohesion. The proposed Commission response, as under many national regional policies, is to broaden the spatial coverage of policy beyond the focus on 'problem regions' to measures that encompass all regions, and to shift the thematic focus away from investment and employment to issues such as innovative capacity and skills. These policy shifts are effectively downgrading the traditional emphasis given to the equity objectives of regional policy and, at least in the short to medium term, may lead to widening inter-regional and intra-regional disparities.

Lastly, the competitiveness orientation of cohesion policy is not necessarily appropriate for less-developed regions that still have deficiencies in basic infrastructure and lack the pre-conditions for regional competitiveness strategies. In some Cohesion countries there is a justification for continued investment in areas such as core transport infrastructure or the development of human resources, as well as a need to develop the 'institutional infrastructure'.

7.2 The Priorities for Funding: Too Broad or Two Narrow?

The proposed Competitiveness objective of EU cohesion policy is reinforced by the proposed prioritisation of expenditure on the themes of innovation and the knowledge economy, accessibility and services of general economic interest, and environment and risk prevention (as well as employment, training and adaptation and social inclusion in line with the European employment strategy). For some Member States, notably the Cohesion countries, these priorities are too narrow (for the reasons outlined above), while for others they are too broadly defined.

In practice, it is clear the Commission's list of eligible expenditure for the Convergence regions is very wide. The proposed new ERDF regulation acknowledges the need to "maintain a broad range of interventions" under the Convergence objective. It places a new emphasis on research, innovation and risk prevention, while retaining an important role for infrastructures. As such, it is likely that the Commission proposals would not greatly constrain the Convergence regions from much of what has been supported in the current period.

To a certain extent, the same would be true of the Regional Competitiveness programmes. Although their eligible expenditure list is more restricted (for example, permitting only secondary infrastructure), it is not dissimilar from the measures employed in the current Objective 2 programmes, many of which are already focusing on competitiveness issues (and with basic infrastructure spending strictly limited). The main difference is that generic forms of intervention, such as business investment aid schemes, may be difficult to support. Tourism, cultural investment and community development services are the main areas of current expenditure that appear to be excluded in the new period.

There is a strong case for a tighter definition of future cohesion policy spending under the Regional Competitiveness programmes. Arguably, if EU support is to provide genuine added value in the next period, the limited amount of funding for Regional Competitiveness should be used to support innovation and experimentation at the 'leading edge' of regional development, for example to operationalise new models of regional development such as regional innovation systems and sustainable development strategies.

However, such an approach would potentially require a more radical simplification of Structural Fund implementation than is currently proposed. In the current period, there is evidence from some countries that the complexity of Structural Fund administration has inhibited the use of EU funding for promoting 'competitiveness'. In Austria and Germany, for example, Structural Funds are used to support the more basic regional development measures (eg. business aid, site development etc), while the more innovative projects are funded under (more flexible) domestic policy programmes. More generally, the results of the recent mid-term evaluations show that many programmes have suffered from low demand for some measures, at least partly because of the bureaucratic administrative requirements of EU funding, especially those related to monitoring.

Another factor inhibiting EU funding for 'innovative' measures is n+2. While the decommitment rule has been a powerful influence on financial absorption, in some countries (eg. France, the UK) it is felt to have compromised the quality of spending. This applies in particular to newer measures to stimulate innovation and entrepreneurship which require considerable investment in project generation and development and have less predictable absorption rates.

In its proposals for the new period, the Commission plans to retain n+2 and apply more rigorous monitoring requirements, more results-oriented evaluation and potentially new reporting requirements to enable assessment of progress under the new national and EU strategies. These obligations are not necessarily compatible with a more sophisticated approach to regional competitiveness under Structural Fund programmes.

7.3 Territorial Cohesion: an Undefined Policy Objective?

In the context of the Constitutional Treaty's inclusion of 'territorial cohesion' as an objective of EU cohesion policy, the Commission is proposing to give more prominence to territorial development issues in the new period. However, the term territorial cohesion has yet to be defined formally and is subject to different interpretations by policymakers and academics. Using terminology applied within the ESPON project, the Commission refers to territorial cohesion as meaning 'balanced development' of the territory of the Union. This implies a spatial policy approach which: (a) goes beyond economic and social measures to encompass any factor that has a bearing on the development of the EU; (b) has a flexible approach to spatial coverage and is not limited to the boundaries of administrative or statistical areas; and (c) is concerned with the functional inter-relationships between areas.

In its proposals, the Commission uses the concept of territorial cohesion to justify the inclusion of all parts of the EU within EU cohesion policy, recognition of the specific needs of areas with 'specific territorial characteristics' (eg. islands, mountain areas, sparsely populated areas, urban regeneration areas, rural areas etc) and a significant increase in the resources for cross-border, transnational and inter-regional cooperation. Under the ESPON project, the Commission is also seeking practical ways in which territorial cohesion goals could be pursued within future Convergence and Regional Competitiveness and Employment programmes.

In some respects, this approach 'goes with the grain' of trends in national regional policies (at least in some countries) which are increasingly going beyond economic and social development, operating across the whole national territory and are concerned with functional inter-relationships such as the networking of urban areas or urban-rural relationships. The direction of regional policy in the Netherlands is perhaps the clearest example of this. The Commission's approach also builds on similar trends within some Objective 1 and 2 programmes in the current programming period which give some implicit recognition to territorial cohesion goals.

However, there are also problems. It appears that the Commission services, Member States and sub-national authorities interpret the meaning of territorial development in very different ways. Without clarity on the meaning of this 'undefined policy objective' there is scope for misunderstanding and conflict between the Commission and Member States in the design and implementation of future EU cohesion policy. This is also important for the efficiency of future policy: only if the concept of territorial cohesion is made transparent in policy documents, and if it is clear how this objective could be operationalised, will there be an efficient response from programmes.

7.4 The New Planning Framework: Hard or Soft Coordination?

Under the EC proposals, a new planning framework would be introduced with three main elements: at EU level, the European Council would adopt an overall strategic document for cohesion policy, defining priorities for Member States and regions; each Member State would draw up a policy document on its development strategy as a framework for thematic and regional programmes; and the national and EU strategies would be reviewed annually on the basis of progress reports by Member States.

The key question is what leverage the EU would have over Member State strategies. One option would be for so-called *'hard coordination'* whereby the EU and national strategies include specific and quantified indicators and targets (associated with the Lisbon Agenda) and monitoring mechanisms to establish financial and physical progress towards meeting these targets. An analogy might be the Public Service Agreement system used in the UK. The progress reports would then require the Member States to justify their choice of strategy and progress in achieving the targets.

A second option might be so-called *'soft coordination*'. This would be more of a political exercise, whereby the Council and Member States make political and policy commitments to pursue certain regional development objectives, but having only general targets that 'guide' national policies and strategies. This could be analogous to EU employment policy or the Lisbon Agenda. The progress reports would then be more general reviews of the direction of policy and the strategies/measures employed, comparable to the type of reports published by OECD.

Initial reports suggested that the Commission envisaged the strategic frameworks as more of a 'political exercise' intended to ensure that the Council and Member States paid more regular attention to cohesion policy spending and took more responsibility for the implementation of the Funds. The draft Regulations, however, suggest a more far-reaching approach. The Commission proposes that the main priorities of each national strategic reference framework should be quantified and a limited number of performance and impact indicators identified to allow annual reporting of the Member State contribution towards implementing the Community strategic guidelines. In turn, the annual report by the Commission (from 2009 onwards) would *"state the follow-up measures to be taken by the Member States and the Commission in the light of its conclusions"*.

There are potentially important implications associated with this approach at all levels. It would require Member States to put in place a strategic framework where the regional operational programmes are consistent with EU and national reference documents and where there is demonstrable coherence between EU cohesion policy and other national policies. For Member States receiving only small amounts of EU funding, these are demanding requirements in policy and administrative terms. For federal countries, there are important constitutional implications for the relationship between federal and state levels of government. For Managing Authorities, there would be a need to harmonise monitoring systems on a national basis to operationalise comparable indicators. Lastly, for programme managers, it would require more investment in project development to tailor support more closely to policy targets and investment in programme monitoring systems to ensure the generation and collation of reliable data.