REGIONAL POLICIES AFTER 2006: COMPLEMENTARITY OR CONFLICT?

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Abstract

The future development of regional policy in an enlarged EU cannot be viewed simply from a national perspective but needs to consider the inter-relationships between national regional policies, EU regional policy and EU competition policy. Recent policy developments have been characterised by tensions between these areas of policy, associated with differing policy objectives and a contested division of responsibilities. This paper has four main objectives: to examine the evolution of national regional policies in the Member States; to consider the future challenges for the Structural Funds; to assess possible future directions for EU competition policy; and to pose questions as to whether and how these different components of regional policy might best be reconciled post 2006. The paper concludes by arguing that greater conflict is by no means inevitable and that a fundamental review of policy objectives, policy focus, policy responsibilities and the relationship between policy instruments and regulatory frameworks could, in fact, improve the complementarity of the policy areas rather than heighten tensions.

Preface

This paper is based on the Plenary Paper prepared for the Sub Rosa Strategic Discussion on 13-14 June 2003 in Brussels. The paper was commissioned by the Sub Rosa Steering Group from the European Policies Research Centre, University of Strathclyde, and funded by Highlands and Islands Enterprise, the Scottish Executive and Scottish Enterprise, in order to provide a common context for the discussions.

The paper was originally drafted as a starting point for discussion, in particular to promote frank, informal but confidential debate among participants at the meeting. Following the meeting, the paper was revised to take account of the conclusions of the meeting reported by the Rapporteurs and Chair of the meeting.

It should be noted that the paper does not represent the official position of Highlands and Islands Enterprise, the Scottish Executive and Scottish Enterprise, or of any of the participants at the Sub Rosa meeting.

The authors would like to thank participants of the Sub Rosa meeting for their helpful comments on the paper, in particular the Chair and Rapporteurs.

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September 2003

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INTRODUCTION

In recent years, regional policy in many Member States has undergone extensive reassessment. In virtually every country, there has been a debate about future policy directions, in several cases associated with major policy reviews and new legislation. The changes often represent a significant break with past practice; this has been characterised as a shift in the 'paradigm' of regional policy.

These policy developments have occurred against a background of major economic upheaval in the face of structural difficulties, rapid technological change, enhanced international competition and globalisation. At the same time, important new social and ecological dimensions have been introduced into economic development, as well as a very different institutional context for regional policy – involving, on the one hand, increased regionalisation of policy development and delivery and, on the other, more Europeanisation of policymaking. This has seen growing EU competition policy control of regional aid over the past thirty years (impacting on aid types, coverage and maxima), combined with the development of a distinct EU regional policy that has significantly influenced the implementation, focus and spatial targeting of national regional policy.

The new policy environment created by these developments provides the starting point for this paper. The future development of regional policy in an enlarged EU cannot be viewed simply from a national perspective but needs to consider the *inter-relationships* between national regional policies, EU regional policy and EU competition policy. This is an important issue, since recent policy developments have been characterised by tensions between these areas of policy, associated with differing policy objectives and a contested division of responsibilities.

In the light of these tensions, this paper looks beyond the current reform debates to consider whether friction and conflict between national regional policy, EU competition policy and EU regional policy is inevitable. The paper has four main objectives (and sections):

- to examine the evolution of national regional policies in the Member States;
- to consider the future challenges for the Structural Funds;
- to assess possible future directions for EU competition policy; and
- to pose questions as to whether and how these different components of regional policy might best be reconciled post 2006.

NATIONAL REGIONAL POLICIES

The most significant longer-term developments in Member State regional policies are: a shift in policy objectives towards the promotion of regional competitiveness; a decline of traditional demand-side policy instruments in favour of softer, supply-side measures; a contraction of regional aid areas; a growth of bottom-up, local economic development initiatives; more policy targeting; changes in policy governance (towards decentralisation, partnership and policy coordination); and a growing interest in sustainability and social inclusion. It is possible to characterise these policy trends in terms of movements towards a new regional policy paradigm. However, the usefulness of this conceptualisation depends on the extent to which such policy developments are continuing to take place. While trends are not universal, a review of recent policy change confirms many of the above generalisations.

The past two or three years has been a period of continuing high levels of policy change, stimulated on the one hand by the beginning of a new Structural Funds programming period and, on the other, by the entry into force of new Regional Aid Guidelines from the start of 2000. White papers, policy frameworks, strategy documents and policy memoranda have been published in Denmark, Finland, France, the Netherlands, Sweden and the United Kingdom, while the joint Federal-*Land* approach to regional policy delivery has been the subject of review in Germany. Added to this are important revisions of policy in those countries where the Structural Funds play a major role – Greece, Ireland, Italy, Portugal and Spain – and it is clear that the scale of recent policy review and change has been significant.

Recent policy developments have seen: more stress on the *efficiency goals* of regional policy, reflecting a growing emphasis on international competitiveness and productivity and on the role of regional competitiveness in contributing to national growth and development; a continuation of the shift in policy focus to the *regional level* in the context of broader devolutionary and regionalisation trends; increased interest in *policy coordination* – at the national level, in the regions and between the centre and the regions; more pressure on *regional policy budgets*; related, a tendency to move away from business aid and towards non-aid-based instruments involving more integrated approaches and incorporating a *wider range of policy instruments*; and *increased targeting* of regional aid. Many of these developments reflect the significant impact which the Regional Aid Guidelines and Structural Fund Regulations have had on Member State regional policies. They have also had a marked influence on developments in the new Member States in the context of the accession negotiations.

EU REGIONAL POLICY

EU regional policy is in a challenging and dynamic period of change. Not only are there significant administrative challenges to overcome in both the current and the new Member States but, of longer term significance, there is a major ongoing debate about the reform of EU regional policy after 2006.

Post 2006, the principal policy challenge concerns *economic and social cohesion* in an enlarged Union. Enlargement will lead to a severely imbalanced EU territory in terms of the widening disparities between Member States and especially between regions and in the capacity of Member States to address regional problems. The challenge of economic and social cohesion has to be set within the overarching EU policy priority of *improving competitiveness*, as agreed at the Lisbon Council. So far, progress has been slow in EU-15 and will be even more difficult to achieve in the new Member States. Moreover, there is currently no mechanism for linking the Lisbon agenda with EU regional policy.

Integral to the EU's competitiveness objective is the question of the *sustainability of development* (as agreed at the Gothenburg Council). Current programmes are subject to extensive sustainability requirements, but research suggests that progress is uneven. A 'step change' will be needed in learning, commitment and practice if the ambitious and integrated response required by the Gothenburg objectives is to be achieved.

The degree to which EU regional policy can meet these various challenges will be determined by *budgetary constraints*. The period of successive increases in EU regional policy ended at the Berlin Council in March 1999. This underlined the importance of base year figures for the subsequent flow of funds. A range of parameters seem likely to influence the financial envelope for the 2007-2013 period:

- the commitment allocation for 2006;
- the current ceiling on structural operations spending (0.45 percent of EU GDP);
- the absorption cap for structural spending in the new Member States (4 percent of GDP for the 2004-2006 period);
- levels of aid per head for different categories of area;
- the split between the Structural Funds and the Cohesion Fund.

There is an ongoing debate as to whether funding should be set below, at or above the current ceiling of 0.45 percent of EU GDP. As an indication of the range of possible expenditure, the EU regional policy budget for 2007-2013 could vary between €270 billion (if spending in 2006 is used as the reference point) and €350 billion (if related to the 0.45 percent ceiling).

A further aspect of the debate concerns possible *allocations of the budget.* The complexity of the issue can be illustrated by the different types of eligible Structural Fund area being considered post 2006: Objective 1 areas; statistical effect regions (Objective 1A); special provision regions (low population density, outermost regions); Objective 1 phase-out regions; and regions outside Objective 1. There are diverse views on a future 'Objective 2'. These concern: the proportion of funding that should be allocated to non-Objective 1 areas; the priorities for the assistance (possibly menu-based); and the process of area designation. In addition, the allocation of the Cohesion Fund must also be considered

The reform of the Funds must also be seen in the context of the current debate of the *future governance* of the EU. The EC, other European institutions and many Member States and subnational interests support the current model whereby the task of addressing economic and social cohesion is shared among European, national and subnational levels. A fundamentally different approach has been advocated by countries such as the Netherlands, Sweden and United Kingdom, which consider that the current approach is no longer sustainable. A further aspect of the implementation debate concerns the simplification of systems and procedures for administering structural actions.

Finally, the future course of EU regional policy is being influenced by perceptions of effectiveness and, in particular, '*Community added value*'. Structural Fund programmes have had tangible net economic impacts in the Cohesion countries and other large Objective 1 regions. Outside these areas, economic impacts are difficult to quantify. However, the Funds have enabled additional economic activity to take place and the quality of economic development to be improved as well as acting as a catalyst for regeneration. More broadly, important qualitative effects have been identified relating to the deployment of economic development resources; the promotion of a strategic dimension in policymaking; the introduction of new types of intervention; enhanced partnership; and the promotion of a learning and innovation dynamic. On the other hand, added value is currently undermined by administrative complexities, fragmented maps, the n+2 rule and risk-averse funding mechanisms.

EU COMPETITION POLICY

EU competition policy control of State aid is entering a new phase. Although the extent of material change to date is modest, it is clear that the Commission recognises the need to modernise its handling of State aid discipline to reflect new realities. Chief amongst these is the impact of enlargement. In addition, the liberalisation agenda has exposed new activities to international competition, highlighting the potential conflict between the universal provision of key services and the State aid rules. Further, the increasingly sophisticated range of policy instruments designed by national policymakers keen to operate 'close' to the market poses new challenges to existing approaches to State aid control.

Several important themes have emerged from recent Council conclusions and Commission reports and statements. First, recent developments in State aid control have given greater prominence to market failure arguments in the justification for State aid (though the Commission has emphasised the need to question whether State aid is always the most appropriate response to market failures). Second, there has been more emphasis on the efficiency and effectiveness of State aid and, related, a growing interest in evaluation and exchange of experience. Third, there has been a Commission commitment to consider the feasibility of developing economic criteria for assessing State aid impacts. And finally, efforts have been made to simplify, modernise and clarify the State aid rules.

With respect to the control of regional aid, the Commission has confirmed that the Regional Aid Guidelines introduced in 1998 are set to apply unchanged until 2006. It has also indicated that a review of the rules will be carried out "in due course" in order to enable the notification and approval of new assisted area maps for the period after 1 January 2007. DG Competition is conducting a 'sounding out' exercise involving externally-commissioned studies, bilateral discussions with the Member States and internal policy review; Commissioner Monti also asked Member States to provide any comments, observations or information relevant to a review of the Guidelines by 30 May 2003. In short, although the current guidelines will apply unchanged until 2006, regional aid control policy is about to enter a period of intense scrutiny.

No decision has apparently yet been taken on whether a radically new approach might be adopted post 2006 or whether small adjustments to the existing approach might suffice. What seems clear, however, is that maintaining the status quo is not a realistic long-term option. Reasons for this include: the impact of enlargement; the outcome of the German legal challenge to the Commission Decision based on the guidelines; and the attitudes of national regional policymakers. Each of these factors has important implications for the future design of regional aid controls.

COMPLEMENTARITY OR CONFLICT?

A common theme of the above trends is that of change. National regional policies in many countries have been characterized as increasingly based on new policy paradigms. EU regional policy faces not only the challenge of enlargement but also the need to address some major governance issues. EU competition policy is confronting an ambitious reform agenda. In entering a period of reappraisal, a key question is how future policy interrelationships might evolve.

The final section first reviews current policy relationships and tensions between the three areas of policy. It then considers whether future linkages are set to be more complementary or more conflictual. Four main aspects of policy are addressed: policy objectives; policy focus; policy governance; and policy instruments. Key questions are:

- Policy objectives: what does cohesion mean?
- Policy governance: who should do what and why?
- Policy focus: is spatial targeting really the way forward?
- Policy instruments: how to facilitate innovation?

The section concludes by arguing that greater conflict is by no means inevitable and that a fundamental review of policy objectives, policy focus, policy responsibilities and the relationship between policy instruments and regulatory frameworks could, in fact, improve the complementarity of the policy areas rather than heighten tensions.

It is perhaps unrealistic to imagine that such potentially radical considerations are really on the agenda. Precedent is a powerful driving force in EU policy evolution and many Member States are likely to prefer the comfort of minor and relatively predictable adjustments to an existing approach (however unsatisfactory) rather than a radical overhaul that seeks to address the underlying objectives of policy. This may indeed mean that policy change is incremental, but it is important that it also be effective and coherent.

Regional Policies After 2006: Complementarity or Conflict?

1. INTRODUCTION

1.1 The changing context for national regional policies

Over the past decade, regional policy in most EU Member States has undergone extensive reassessment. In virtually every country there has been a debate about future policy directions, in several cases associated with policy reviews and new legislation. The changes often represent a significant break with past practice; this has been characterised as a shift in the 'paradigm' of regional policy.[5]

These policy developments have occurred against a background of major upheaval in the 'global socio-economic order' over the past 25 years and lively theoretical debates about patterns and processes of regional development. For many Member States, the last few decades have been a period of difficult adjustment. With some exceptions, sustainable high rates of economic growth have proven difficult to achieve, and unemployment rates have often been high, not just in designated regional policy areas but nationwide, with youth and long-term unemployment being particular concerns. In addition, governments have had to deal with regionally-concentrated economic development problems, notably in old-industrialised areas, whilst also facing threats to competitive advantage across the economy in agriculture, traditional and modern industrial sectors and in producer services, affecting many parts of the country.

During this period, the rapidity of technological change, combined with market liberalisation and deregulation, has greatly increased the exposure of regions and countries to international competition. Enterprises have greater flexibility in the production and delivery of goods and services, and investment is more mobile. Especially within Europe, barriers to trade, investment and factor mobility have been reduced, and governments are less able and willing to provide protection to sectors or firms.

In this more globalised production environment, competition is increasingly viewed as being between regions and cities, rather than countries. Successful regions are those that can develop and maintain agglomeration economies in competitive sectors. Competitive success is based on the ability to adapt and innovate, produce new ideas, products and services. Effective systems of adaptation and innovation depend not only on factors such as the quality of infrastructure, SMEs, the skills base and sources of RTD but also the types of relations, inter-relationships and networks between institutions (public, private, quasi-private) that facilitate the flow of ideas, knowledge, finance and technology.

[5] Bachtler J and Raines P (2002) *A New Paradigm of Regional Policy? Reviewing Recent Trends in Europe*, Report to the EoRPA Regional Policy Research Consortium, European Policies Research Centre, University of Strathclyde.

There are also important new social and ecological dimensions of economic development. Public policy has increasingly recognised the social factors that underly the exclusion of certain groups from the labour market and economy, especially women, the disabled and ethnic minorities. There has also been a growth in concern about the environmental implications of economic and social activity, from global issues such as climate change and species diversity to more local matters such as waste management, water quality and ground pollution. Reflecting this, sustainable development has become a common policy theme, based on an increasing recognition of the need to take account of the inter-relationships between the economic, social and environmental aspects of development.

Finally, the institutional context for regional policy has changed. At one level, there is increased involvement in economic development on the part of regional and local institutions and groups, as a substitute for, or complement to, central government action. Issues of regional identity, local democracy and accountability also underlie a general trend for the devolution and decentralisation (to differing degrees) of central government responsibilities. At another level, there has been a clear trend towards the Europeanisation of policymaking through the influence of EU structural and cohesion funds and EU competition policy on the regional policies of Member States.

1.2 Changing EU policy frameworks

Provisions for the competition policy control of State aid within the Member States are in the original Treaty articles and, as early as the 1960s and 1970s, the Commission began to have an impact on the use of State aids as instruments of regional policy.[6] Over the years, Commission interventions became both more extensive and more systematic, increasingly constraining the types of aid on offer, the coverage of the designated aid areas and the maximum rates of award available in those areas. The growing influence of DG Competition on Member State's regional policy culminated in the publication of the Regional Aid Guidelines in March 1998;[7] these equated regional aid discipline with control of the coverage of the regional aid areas (both globally and within the individual Member States) and required the Commission to approve both the methodology adopted for area designation and the geographical units used as designation building blocks. Taken together with the need for Commission approval of award maxima and Commission determination of acceptable forms of aid, this left only regional aid expenditure outside the direct control of the competition policy authorities.

Compared to the control of State aid, economic and social cohesion has been a relatively recent Treaty preoccupation. Although the Community operated a nascent regional policy from the 1970s, this was initially an adjunct to (and subsidy for) national regional policies. The status of Community economic and social cohesion policy changed radically in the mid 1980s, its upgrading largely a

[6] For an overview of the development of regional State aid policy, see Wishlade, F G (2003) *Regional State Aid and Competition Policy in the European Union*, Kluwer European Monographs 43, Kluwer Law International, The Hague.

[7] EC (1998) Guidelines on national regional aid, *Official Journal of the European Communities* C74; 10.3.1998, pp 9-31.

consequence of negotiations over the Single European Act and the associated completion of the Single Market. Subsequently, the reform of the Structural Funds in 1988 created a distinct EU regional policy, with important implications for national approaches to regional development. In particular, EU policy principles (eg. programming, partnership, evaluation) increasingly permeated national regional policy, while the need for co-finance directly influenced national policy priorities. In addition, the creation of an EU-wide typology of regions impacted on the designation of national regional policy areas, the more so since DG Regio was keen to achieve coherence between national and EU designated areas.

1.3 Changing policy interrelationships

The new policy environment created by these developments provides the starting point for this paper. The future development of regional policy in an enlarged EU cannot be viewed simply from a national perspective but needs to consider the *inter-relationships* between national regional policies, EU regional policy and EU competition policy. This is an important issue since recent policy developments have been characterised by significant tensions between these areas of policy, associated with differing policy objectives and a contested division of responsibilities.

Each of the three policy areas – national regional policy, EU regional policy and EU competition policy – was established to meet specific policy needs. Each has evolved along trajectories over the past 30 years such that they now increasingly impinge on each other. Indeed, it can be argued that it is now almost impossible to consider one area of policy without taking account of the other two. It is evident that while each policy area has an internal logic in terms of political objectives and policy priorities, the inter-relationships between them are, in some respects, becoming a source of tension and conflict. In reviewing future policy options, it is therefore essential to take a more holistic view and consider how these three policy areas are likely to interact post 2006.

1.4 Objectives of the paper

The aim of this paper is to look beyond the detail of the current reform debate to consider broader policy influences and trends with respect to national regional policies, EU regional policy and EU competition policy. In particular, the paper discusses whether further friction between these three areas of policy is inevitable. This might be considered to be likely in a post enlargement situation which seems bound to be characterised by enhanced policy concentration and selectivity, certainly within EU-15.

This paper has four main objectives:

- ***to examine the evolution of national regional policies in the Member States***, notably the growing concern with regional growth and competitiveness, but also associated trends towards the regionalisation, coordination and consolidation of policy;

- ***to consider the future challenges for the Structural Funds***; while the main policy goal must relate to the achievement of economic and social cohesion in an enlarged Union, other concerns include the overarching EU policy priority of improving competitiveness, the question of how to achieve sustainable development over time, the difficulty of responding to growing budgetary constraints, the need to take account of changing views about the future governance of the EU and the importance of demonstrating policy effectiveness;

- ***to assess possible future directions for EU competition policy***; in particular, how it might reconcile the need to be more sensitive to the wishes of countries and regions to operate a viable regional policy with the desire to maintain competition policy ambitions of concentrating regional support and avoiding competition distortions; and

- ***to pose questions as to whether and how these different components of regional policy might best be reconciled post 2006***.

The paper is in four further sections. The first three deal in turn with key policy developments and future policy challenges for national regional policies, EU regional policy and EU competition policy respectively. The final section then reviews the main tensions that exist between and among these three areas of policy, before discussing questions about the future operation of regional policy in the EU.

2. NATIONAL REGIONAL POLICY – A NEW PARADIGM

2.1 Longer-term trends

As a starting point it is useful to consider the most significant longer-term developments in Member State regional policies. As highlighted in the first Sub Rosa paper (in 2000),[8] the key drivers of national regional policy are:

- enhanced international competitive pressures;
- a recognition of the importance of more localised policy responses to increasingly complex spatial problems;
- a growing interest in the decentralisation of government associated with changing attitudes to regional problems and disparities; and
- increasingly influential EU policy frameworks.

These developments are influencing a number of important longer-term policy trends:

- a shift in policy objectives towards the promotion of regional competitiveness;
- a decline of traditional demand-side policy instruments (particularly business aid schemes) in favour of softer, supply-side measures;
- a contraction of regional aid areas;
- a growth of bottom-up local economic development initiatives;
- more policy targeting both spatially (in particular, towards urban areas) and sectorally (clusters);
- changes in policy governance (towards decentralisation, partnership and policy co-ordination); and
- a growing interest in sustainability and social inclusion.

It is possible to characterise these various policy trends in terms of movements towards a new regional policy paradigm.[9] This identifies a new type of regional policy, termed 'modern regional policy' in Table 1. Such policy appears to want to achieve both equity *and* efficiency, in contrast to the focus on equity *or* efficiency under traditional (classical) regional policy. The sphere of policy action is broad, operating over numerous sectors, with a planned, pro-active and strategic approach, rather than the essentially reactive, project-based focus of traditional policies. Policy encompasses *all* regions rather than just the designated aid areas of classical regional policy. Further, support aims to develop the business environment, with multiple policy targets and types of instruments; this contrasts

[8] Bachtler J, Wishlade F and Yuill D (2000) *Regional Policy in Europe after Enlargement*, Paper prepared for the first Sub Rosa meeting on 29-30 September 2000, final version – 12 December 2000.
[9] Bachtler J (2000) *Where is Regional Policy Going? Changing Concepts of Regional Policy*, Report to the EoRPA Regional Policy Research Consortium, European Policies Research Centre, University of Strathclyde.

with traditional policy which tends to operate via demand-side measures, particularly business aid schemes. Another feature of modern regional policy is that it is based on region-level analysis to create regional solutions, involving negotiation if not consensus between partners – bargaining is both horizontal (within the region) and vertical (between levels of government). Classical regional policy operates instead through top-down centralised mechanisms. Lastly, modern policy implementation operates over multi-annual planning and is subject to ongoing monitoring and evaluation. In contrast, traditional regional policy is built around annual budgets and tends to be evaluated ex post.

Table 1: The Changing Paradigm of Regional Policy

Criteria	**Classical**	**Modern**
CONCEPTUAL BASIS		
	Industrial location theories Key factors are regional attributes eg. production costs, availability of workers	Learning region theories Key factors are regional capabilities eg. innovative milieux, clusters, networks
POLICY CHARACTERISTICS		
Aim(s)	Equity ***or*** efficiency	Equity ***and*** efficiency
Objectives	Employment creation Increased investment	Increased competitiveness (eg. entrepreneurship, innovation, skills)
Sphere of action	Narrow (economic/industrial)	Broad (multi-sectoral)
Mode of operation	Reactive, project based	Pro-active, planned, strategic
POLICY STRUCTURE		
Spatial focus	Problem areas	All regions
Analytical base	Designation indicators Regional exporting	Regional SWOT analysis
Key instrument	Incentive scheme	Development programme
Assistance	Business aid Hard infrastructure	Business environment Soft infrastructure
ORGANISATION		
Policy development	Top down/centralised	Collective/negotiated
Lead organisation	Central government	Regional authorities
Partners	None	Local government Voluntary sector, Social partners
Administration	Simple/rational	Complex/bureaucratic
Project selection	Internalised	Participative
Timescale	Annual budgets	Multi-annual planning periods
EVALUATION		
Stage(s)	Ex post	Ex ante, interim, ex post
Outcomes	Measurable	Difficult to measure

Source: Bachtler J (2000) *op. cit*.

The usefulness of this conceptualisation depends, of course, on the extent to which it fits with reality. While trends are not universal, a review of recent policy change confirms many of the above generalisations.[10]

2.2 Recent policy developments

The past 2-3 years has been a period of continuing high levels of policy change, stimulated on the one hand by the beginning of a new Structural Funds programming period and, on the other, by the entry into force of new Regional Aid Guidelines from the start of 2000. Among the EU-15 countries, white papers, policy frameworks, strategy documents and policy memoranda have been published in Denmark[11], Finland[12], France[13], the Netherlands[14], Sweden[15] and the United Kingdom[16], while the joint Federal-*Land* approach to regional policy delivery has been the subject of review in Germany. Add to this, important revisions of policy in those countries where the Structural Funds play a major role – Greece, Ireland, Italy, Portugal and Spain – and it is clear that the scale of recent policy review and change has been significant. In the new Member States, regional policies have also been overhauled, or, in many cases established for the first time on market economic lines, as part of the preparations for EU accession.

2.2.1 More stress on the efficiency goals of policy

Reviewing policy developments in the EU-15 in more detail, within regional policy (and economic development policy more generally), there has been a growing emphasis on international competitiveness and productivity and on the role of regional competitiveness in contributing to national growth and development. Most countries now stress the efficiency goals of regional policy rather than, or as well as, equality objectives. In many cases, productivity improvements have become a central policy goal. Related, in a number of countries there has been a move away from spatially-targeted intervention in favour of broader support for economic development in *all* regions.

In Finland, for instance, the main policy goal has become the promotion of regional competitiveness (rather than territorial balance) and the range of policy instruments has widened with a view to developing a competitive regional structure across the country as a whole. In the Netherlands, the appropriateness of the last remaining element of classical regional policy, targeted at the north of

[10] Yuill D (2002) *A Comparative Overview of Recent Regional Policy Developments in the Member States and Norway*, Report to the EoRPA Regional Policy Research Consortium, European Policies Research Centre, University of Strathclyde.
[11] Regeringen (2001) Regional erhvervspolitisk redegørelse, .reg21, København, Erhvervsministeriet.
[12] Regional Development Act 602/2002 (www.finlex.fi/pdf/saadkaan/E0020602.PDF).
[13] *Loi d'orientation pour l'aménagement et le développement durable du territoire* (LOADDT), also known as the *loi Voynet* 1999.
[14] Ministerie van Economische Zaken (2000) *Nota Ruimtelijk Economische Beleid: Dynamiek in netwerken* The Hague.
[15] Government Bill 2001/02:4, *A Policy for Growth and Viability throughout Sweden* (*En politik för tillväxt och livskraft i hela landet*).
[16] DTI/DoEE (2001) *Opportunity for All in a World of Change, A White Paper on Enterprise, Skills and Innovation*, (Cm5052) The Stationery Office, London. HM Treasury, the DTI and the ODPM (2003) *A Modern Regional Policy for the United Kingdom*, (DTI URN 03/649) available at www.dti.gov.uk/europe/consultation.pdf.

the country, has been questioned in light of the need to focus policy on areas of productivity growth. In Sweden, though traditional regional policy is largely unchanged, recent legislation has seen a shift in emphasis towards broader, programme-based measures with a view to stimulating regional competitiveness, growth and employment in all regions. In Austria, both the Regional Innovation Premium and Regional Infrastructure Support have been withdrawn as the focus has shifted towards non-spatially-targeted innovation policies. And in the United Kingdom, recent White Papers have stressed regional rather than national solutions to regional development problems: *"The new approach [to regional policy in England] will be based on putting greater emphasis on growth within all regions and strengthening the building blocks of economic success by boosting regional capacity for innovation, enterprise and skills development"*.[17]

2.2.2 Shift in policy focus to the regional level

At the same time, there has been a continuation of the shift in policy focus to the regional level in the context of broader devolutionary and regionalisation trends. Many factors have contributed to these developments, including in particular the increasing weight attached to regional competitiveness. There is now much more stress on regional actors in economic development, strengthening regional capabilities and enhancing the role of the region in the policy process; more emphasis on tailoring policy to the needs of individual regions; more weight on regional-level programming and on policy coordination at the regional level; more effort to regionalise national priorities (for instance, by feeding regional information into national expenditure decisions); and more recognition of the role of regional urban centres in economic development.

Set in the context of longer-term trends in the decentralisation of regional policy administration, such changes represent a significant shift towards the regional level across a wide range of countries. This is especially obvious in countries like Italy and the United Kingdom, where broader constitutional reforms have been undertaken, but it is also clear for instance throughout the Nordic Member States. In addition, countries like Ireland and Portugal, which previously operated highly centralised systems, have begun to introduce elements of regionalisation into the delivery of policy. At the other end of the spectrum, pressures have arisen in federal Germany (albeit for non-regional-policy reasons) to abolish the coordination and regulatory framework provided by the joint Federal-*Land* regional policy *Gemeinschaftsaufgabe* (GA) and return instead to the position of more than 30 years ago where regional policy was *Land*-determined. There are many factors which have contributed to the growing emphasis placed on the regional level. At their core, however, is the increasing stress on the importance of regional competitiveness for economic development and the belief that this is likely to be strengthened by facilitating regional solutions to regional problems.

[17] Department of Trade and Industry (DTI) and Department for Education and Employment (DfEE) (2001) *Opportunity for All in a World of Change*.

2.2.3 *Increased interest in policy coordination*

Related to these regionalisation trends, many countries have become increasingly interested in how regional-level development efforts might best be coordinated to ensure that national as well as regional goals are met. Across a range of countries, growing stress is being placed on policy coordination – at the national level, in the regions and between the centre and the regions.

The various national-regional coordination mechanisms which have been introduced fall into three broad (and sometimes overlapping) categories.

- First, there are those, like the GA in Germany, where the aim is to ensure that, in a situation of devolved policy responsibilities, the scope for policy conflict is limited.

- Second, there are those, like the Regional Growth Programmes in Sweden, where the objective is to subject regional plans, programmes or initiatives to national review to make certain that regional-level developments are in line with national policy goals.

- Third, there are those, like the national-regional covenants in the Netherlands, where the purpose is to try to make sure that national-level policy decisions take full account of regional priorities and needs.

It remains to be seen, of course, just how effective these coordination initiatives will prove to be in practice. Policy coordination has long been a challenge for regional policymakers and is likely to continue to be elusive.

Finally, and linked to the growing emphasis on policy coordination, the appropriate role of central government in regional economic development has increasingly come under review. In line with the move away from the centralised implementation of policy, the national level is increasingly concerned with policy frameworks, coordination mechanisms, value-for-money, the identification and dissemination of best practice and ensuring that, in an increasingly devolved policy environment, national policy goals continue to be met.

2.2.4 *More pressure on regional policy budgets*

A further important feature of recent regional policy developments is that, in a range of countries, regional policy budgets have come under pressure (often related to the operation of the Maastricht criteria and, more recently, the Stability and Growth Pact) and some centrally-administered, spatially-targeted incentives have been withdrawn (for instance, in Austria). At the same time, and reflecting a more general liberalisation of economic development policy, there has been a tendency to move away from business aid schemes. In their place is a range of non-aid-based instruments, including measures to improve the business environment, local infrastructure provision and, particularly, the development of regional-level strategies. In part, such changes reflect a shift in policy focus towards endogenous development with its emphasis on supply side measures. However, they are also a response to the already-mentioned stress on identifying *regional* solutions to *regional* problems. This in turn has tended to lead to more integrated approaches, incorporating a wider range of policy instruments.

2.2.5 Growing impact of EU policy frameworks

It is clear that both the Regional Aid Guidelines and the Structural Fund Regulation have had a growing impact on Member State regional policy.

Recent policy developments have seen the increased targeting of regional aid schemes in response to changes introduced by the Regional Aid Guidelines. Most Member States experienced significant cutbacks in aid area population coverage in 2000, a continuation of a trend which had been apparent for more than two decades previously. As a consequence, many Member States found it difficult to designate appropriate aid areas under the guidelines. In addition, far more rate discrimination was introduced between designated aid areas, while overall rate maxima were also cut, particularly in Article 87(3)(a) areas. While this has not had a direct impact on award rates in most instances (since aid ceilings historically have tended to be well above average rates of award), any future reductions in award maxima may well impact on the discretion available to Member States in making regional aid awards.

These changes to regional aid regimes have been accompanied by moves in a range of countries towards non-aid-based policy instruments. Such developments have been underpinned by the Structural Fund Regulation which not only continues to emphasise support for the business environment but also, through its co-financing demands, creates a framework within which national and EU regional policy priorities tend to be aligned, certainly in those countries where Structural Fund budgets are significant (Greece, Portugal, Spain, Ireland, Italy).

2.2.6 Developments in the new Member States

One last point to make about national regional policy developments is that, within the new Member States, EU regional policy has tended to dominate regional policy debates, activities and resources. In the immediate post-1990 period, market economy based regional policies were slow to develop; instead, priority was given to political and macro-economic reforms at a time of scarce resources and national economic crisis. There was also a delay in the emergence of the spatial impact of reform, a lack of requisite institutional capacity and unresolved issues of territorial administrative reform. On the other hand, more recently, regional policy has been the focus of much greater attention. Increasing regional disparities and forthcoming EU accession have moved regional policy up the political agenda. Regional policies, in some form, are now in operation in each new Member State, relevant institutions are being created at national and regional levels and a range of policy instruments are in place.

However, a number of persistent difficulties remain. First, and most crucially, there are only limited financial resources allocated to regional policy. This is perpetuated by the EU funding where, at least in some countries, such as Poland, the dominance of sectoral policy priorities leaves little scope for addressing regional policy objectives. Second, regionalisation is slow and partial.

For instance, although regional development strategies have been drawn up in the Czech Republic, the regions do not have dedicated regional policy resources. Third, a lack of co-ordination between government ministries and with other levels of governance is a recurring problem. Finally, and as already mentioned, EU regional policy has tended to dominate the agenda, potentially leading to tensions with national policy objectives.

3. EU REGIONAL POLICY – THE REFORM DEBATE

3.1 Policy context

Compared to national regional policies, EU regional policy has enjoyed relative stability for some 15 years, but is now entering a challenging and dynamic period of profound change. Within the current programming period, Structural Funds are being implemented in the EU-15 Member States under more difficult administrative conditions than ever before. Building on the lessons of previous programming periods, some regions (especially outside the cohesion countries) have sought to increase the effectiveness and legacy of EU spending by developing more detailed strategies and more sophisticated project generation and appraisal systems.

Across the EU, decentralisation of implementation responsibilities has not been accompanied by the expected simplification. The stricter requirements for financial management, audit and monitoring have increased bureaucracy and administrative costs. In some Member States, n+2 is becoming a serious problem, with the possibility of large amounts of funding being decommitted at the end of 2003. Over the coming year, the outcome of the mid-term evaluations and reviews, the allocation of the performance reserve, and reprogramming for the remainder of the 2000-06 period will represent new challenges.

For the new Member States, the challenge is to design and implement Structural Fund programmes for the first time. Despite experience with the pre-accession funds, and considerable investment in developing institutional capacity, it is clear that programming will involve a steep learning curve in this first period. The current state of play is that the first CSFs and SPDs for the 2004-2006 are being submitted to the EC.

For those countries with Community Support Frameworks – Poland, Czech Republic, Slovakia – the CSFs and Operational Programmes have been submitted, with discussions ongoing in some cases about the admissibility of certain elements, prior to the development of negotiation mandates from June/July onwards. A similar situation applies to countries with SPDs – Cyprus, Estonia, Latvia, Lithuania, Malta, Slovenia. Among the draft programmes being submitted, there appear to be significant differences in approach, with a high proportion of regional-based interventions in countries such as Poland and the Czech Republic, as well as in terms of policy priorities (variation in the relative balance of ERDF, ESF and EAGGF).

Beyond the current implementation difficulties in both existing and new Member States, of greater longer term significance is the debate about the reform of EU regional policy after 2006. Over the past two years, a process of discussion among European institutions, Member States, regional and sectoral interest groups has been intensifying, through a mix of open debate at EU conferences and closed discussions within Council meetings. The specific positions of national governments on individual aspects of the reform debate are set out in the minutes of the Structural Affairs Working Group and the presentations to the

Informal Meeting of Regional Policy Ministers in Halkidiki[18]. The following sections provide an overview of the main issues driving the debate.

3.2 Economic and social cohesion in an enlarged EU

The principal challenge for EU regional policy concerns economic and social cohesion in an enlarged Union. Enlargement will lead to a severely imbalanced EU territory in terms of the widening disparities between Member States and especially between regions and the capacity of Member States to address regional problems.

The magnitude of the challenge facing the EU is shown in Table 2. Across the new Member States acceding in 2004, GDP per head, as a percentage of the EU-15 average, ranges from 33.2 percent in Latvia to 79.5 percent in Cyprus. The figures for Romania and Bulgaria are less than 30 percent of the EU-15 average. Moreover, it will be no easy task for these countries to achieve sufficiently high and sustained growth rates to enable convergence with the existing EU-15. The most recent economic assessment noted that, while growth appeared to be accelerating, at least in some countries[19]:

> *for many countries, the acceleration is rather minor and, given the underlying forecast error, not significant. In other words, although macroeconomic stabilisation and structural reforms are well advanced in most candidate countries, they are not expected to lead to a sizeable acceleration of average growth trends compared to those that prevailed in the past few years.*

Table 2: GDP growth and GDP per head in the accession countries

	Average annual real growth rate		GDP/head (PPS, in % of EU average)	
	1997-2001	2002-2005	2001	2005
Bulgaria	2.0	4.9	28.1	30.7
Cyprus	4.2	4.2	79.5	84.7
Czech Rep.	1.0	3.7	57.2	59.8
Estonia	5.2	5.5	42.3	47.3
Hungary	4.5	4.6	51.2	55.3
Latvia	5.7	5.3	33.2	37.2
Lithuania	3.1	5.5	37.6	41.7
Malta	3.4	3.4	n/a	n/a
Poland	4.1	3.6	39.7	41.3
Romania	-1.0	5.1	25.2	27.8
Slovak Rep.	3.3	4.2	46.4	49.8
Slovenia	4.5	4.4	68.8	73.2
Turkey	1.2	4.7	22.4	24.4
EU	2.6		100	100

Source: Directorate-General for Economic & Financial Affairs

[18] Summarised in: *Presidency Conclusions of the Informal Ministerial Meeting for Regional Policy and Cohesion,* Hellenic Presidency of the Council of the European Union, Halkidiki, 16 May 2003.
[19] EC (2002a) *Evaluation of the 2002 pre-accession economic programmes of candidate countries,* European Economy Enlargement Papers, No.14, Directorate-General for Economic and Financial Affairs, Commission of the European Communities, Brussels, November 2002.

These assessments suggest that, with the exception of the two island economies and Slovenia, it could take 15-20 years for many of the new Member States to reach even the current (EU-15) Objective 1 threshold.

According to the latest EC figures[20], in an enlarged EU, one-third of the EU's population would be in countries with a GNP/head below 90 percent of the EU average, compared to a figure of one-sixth in the current EU. The ratio of income per head in the top and bottom 10 percent of regions would increase from 1:2.6 in the EU-15 to 1:4.4 in the EU-25. The labour market situation is also less favourable in the new Member States: accession will lead to a reduction in the average employment rates and an increase in the unemployment rate. Regional disparities in both indicators would rise also.

3.3 Responding to the Lisbon Agenda

The challenge of economic and social cohesion has to be seen within the overarching EU policy priority of improving competitiveness. At the Lisbon Council in March 2000, the EU set itself the strategic goal *"to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion".* Specific targets were subsequently established, such as increasing the employment participation rate from 64 to 70 percent by 2010 (Stockholm Council) and spending three percent of GDP on R&D and innovation, two-thirds from the private sector (Barcelona Council). Although some measures have been taken to reform labour, product and capital markets, to promote a knowledge-based economy, to ensure environmental sustainability and encourage public sector efficiency, these efforts have so far been patchy. Further, in the context of slow or stagnant economic growth, the latest EC assessment on progress towards the Lisbon objectives states that[21]:

> *the pace of reform has undoubtedly slackened and is now too slow and clearly insufficient. A marked acceleration of reform is required for the strategic Lisbon goal to become within reach.*

This assessment applies to the existing 15 Member States. For the ten new Member States and three Candidate Countries, there are additional challenges. The pre-accession economic programmes have been implementing structural reforms aimed at meeting the Copenhagen accession criteria and becoming as competitive as the current EU rather than the more ambitious Lisbon process. While some of the accession countries have undertaken reforms going beyond the accession requirements (in areas such as privatisation and fiscal reforms), in many cases the structural reforms needed to prepare for accession are judged to be incomplete, for example with respect to barriers to market entry, property rights, and the institutional and regulatory environment.[22] Achieving the Lisbon goals will be much more demanding, given resource constraints and weaknesses

[20] EC (2003a) *Second Progress Report on Economic and Social Cohesion,* Communication from the Commission, COM(2003) 34 final, Brussels, 31.1.2003

[21] EC (2003b) *Annual Report on Structural Reforms 2003,* Economic Policy Committee, European Economy Occasional Papers, No.3, Directorate-General for Economic and Financial Affairs, Commission of the European Communities, Brussels, April 2003, p.4.

[22] EC (2002a) *op. cit*.

in institutions and administrative capacity, especially in the context of the current downturn in growth rates.[23]

Many of the Lisbon priorities need to be addressed through national economic and employment policies, eg. market liberalisation, competition policy, investment in R&D. However, there is currently no mechanism for linking the objectives of the Lisbon Agenda, and in particular its territorial aspects, with EU regional policy. The annual assessments undertaken by DG ECFIN for the EU-15 (and planned for EU-25 from 2003 onwards) do not systematically or explicitly identify regional disparities in the indicators of competitiveness.

An explicit link has been proposed by both the EC and many Member States as part of the reform debate, in some cases to justify a role for EU regional policy outside Objective 1 and in other cases as a means of prioritising Community intervention. Summarising the discussions during 2002 on Structural Funds reform, the Second Progress Report remarked:

> *the Commission has noted that promoting the competitiveness of the regions, as required by the policy objectives of the Union defined at the Lisbon European Council and supplemented by the sustainable development dimension at the Göteborg Council, was very often mentioned as the objective to support. That objective could be reflected through stress on the factors contributing to competitiveness such as access, the diversification oif the productive structure, the knowledge society, innovation, R&D, the environment, employment, social integration and education and lifelong training, particularly in a context of economic and social restructuring stemming from the globalisation of the economy.*

3.4 Moving towards sustainable development

Integral to the EU's objectives for growth and competitiveness is the question of the sustainability of development. While the Lisbon agenda refers to "sustainable *economic* growth" and social renewal, the Gothenburg Council added a third, environmental dimension to the growth strategy. It also established a new approach to policymaking to ensure that the economic, social and environmental effects of all policies are taken into account in decision-making. Specific commitments were (re)affirmed, many with a regional dimension, relating to renewable energy, sustainable transport and the management of natural resources.

The EU has undertaken a succession of initiatives to translate its international sustainability commitments into the European policy environment since the publication of the Brundtland Report in 1987, initially focusing on environmental actions and, from 1993, promoting the concept of sustainable development. These political priorities have been reflected in the progressively stronger

[23] EC (2003c) *Structural Reforms in Candidate Countries: Trends, Challenges and the Lisbon Strategy,* Note by the Commission Services for the Ministerial meeting between Ministers of economy and finance of Member States and Candidate Countries, Barcelona, 15 March 2002.

requirements of Structural Fund regulations over successive programming periods, fostered by critical evaluation and assessment by EC auditors.[24]

The current (2000-06) generation of programmes are subject to the most systematic and extensive requirements concerning the integration of environmental sustainability within the design and delivery of programmes. However, research suggests that progress is very uneven.[25] Opportunities for 'positive action' are frequently provided, and there is evidence of a 'mainstreaming' approach in some programmes, but the operationalisation of commitments is proving to be complex and challenging. This applies in particular to programmes that aim to go beyond environmental improvement to an integrated approach to the economic, social and environmental sustainability of interventions.

The experience of the first years of the current programme period indicates that a 'step change' will be needed in learning, commitment and practice if the Structural and Cohesion Funds are to achieve the ambitious and integrated response required by the Gothenburg objectives of sustainable development.[26] This challenge is again magnified in the case of the new Member States where there is still a legacy of environmental degradation from the pre-transition era and a significant shortfall in the investment necessary to meet modern EU environmental standards. The increased allocations under the Cohesion Fund are particularly important for making progress in this area.

3.5 Establishing the budgetary parameters

The degree to which EU regional policy is able to respond to these challenges and policy priorities will be determined by budgetary constraints. The period of successive increases in EU regional policy was brought to an end by the agreement reached at the Berlin Council meeting in March 1999. In the context of enlargement, this agreement is important for two reasons: one is that it is a key Commission principle that the funding of enlargement in the period to 2006 must respect the global budgetary ceilings agreed at Berlin;[27] the other is that the Berlin financial perspective in 2006 provides the starting point for the next financial perspective covering the 2007-13 period. Past budgetary agreements have shown the importance of such base year figures for the subsequent flow of funds.

Since Berlin, a number of changes to the financial perspective have been proposed with a view to accommodating enlargement to EU-25 in 2004. Initial amendments were set out in a Communication from the Commission in January

[24] Clement K and Bachtler J (2000) 'European perspectives on the integration of environmental and protection and economic development', in A Gouldson and P Roberts (Eds.) *Integrating Environment and Economy,* Routledge, London, pp.25-38.

[25] Taylor S, Polverari L and Raines P (2001) *Mainstreaming the Horizontal Themes into Structural Fund Programming,* IQ-Net Thematic Paper 10(2), European Policies Research Centre, University of Strathclyde, Glasgow. http://www.eprc.strath.ac.uk/iqnet/iq-net/downloads/IQ-Net_Reports(Public)/10.2Horizontal%20Themes.pdf

[26] Clement K, Hansen M. and Bradley K (2003) *Assessing Environment and Sustainable Development Integration in the Nordic Structural Funds,* forthcoming report, Nordic Centre for Spatial Development, Stockholm.

[27] Speech by Günter Verheugen, Maastricht, 4 March 2002

2002.[28] Subsequently, the Brussels European Council agreed on maximum levels for agricultural direct payments and market-related expenditure each year over the 2004-2013 period and set a ceiling for Structural and Cohesion Fund payments to the new Member States over the 2004-2006 period.[29] More recently, the Copenhagen European Council concluded the accession negotiations and endorsed '*the result of the negotiations which have determined expenditure requirements resulting from the accession of new Member States respecting the ceilings for enlargement-related expenditure set out for the years 2004-2006 by the European Council in Berlin*.'[30] Following on from this agreement, a revised financial perspective was produced in February 2003.[31]

A basic point is that the commitment appropriations in 2006 set out in the financial perspective adjusted for enlargement (see Table 3) seem likely to provide a benchmark for expenditure projections over the 2007-13 period. This has already been agreed with respect to heading 1a of the financial perspective (relating to CAP expenditure but not including rural development support).

Table 3: Financial perspective EU-25 (€billion 1999 prices)

COMMITMENT APPROPRIATIONS	**2006**
1. AGRICULTURE	**45.807**
1a Common Agricultural Policy	39.612
1b Rural development	6.195
2. STRUCTURAL OPERATIONS	**37.940**
Structural funds	32.608
Cohesion funds	5.332
3. INTERNAL POLICIES	**7.972**
4. EXTERNAL POLICIES	**4.610**
5. ADMINISTRATION	**5.712**
6. RESERVES	**0.400**
7. PRE-ACCESSION AID	**3.120**
8. COMPENSATION	**0.940**
TOTAL COMMITMENT APPROPRIATIONS	**106.501**
TOTAL PAYMENT APPROPRIATIONS	**103.840**
Ceiling, appropriations for payments as a % of GNI (ESA 95)	1.06
Margin for unforeseen expenditure	0.18
Own resources ceiling (% of GNI)	1.24

Source: EC (2003c) *op. cit.* Annex Table 1a

Further, and as underlined by both the Brussels and the Copenhagen European Councils, the general stress on enhancing budgetary discipline will continue into and through the new financial perspective. This suggests that there will be resistance to expenditure streams increasing in real terms, certainly within EU-15. Clear evidence of this can be seen in the decision of the Brussels European Council to cap future, market-related expenditure and direct payments to farmers within EU-25 at a specific nominal amount each year derived from the 2006

[28] EC (2002b) *Information Note : Common Financial Framework 2004-2006 for the Accession Negotiations*, Communication from the Commission, SEC(2002) 102 final, Brussels, 30 January 2002
[29] Commission of the European Communities, *Brussels European Council, Presidency Conclusions*, 24-25 October 2002 (DOC/02/14)
[30] Commission of the European Communities, *Copenhagen European Council, Presidency Conclusions*, 12-13 December 2002 (SN 400/02), Annex I: Budgetary and Financial Issues
[31] EC (2003d) *Proposal for a decision of the European Parliament and Council on the adjustment of the financial perspective for enlargement*, Commission of the European Communities. COM(2003) 70 final, Brussels, 11 February 2003

commitment appropriation increased by just one percent per year. This compares with the two percent per year increase allowed for over the 2000-06 financial perspective. Certainly, as far as direct payments to farmers and market-related expenditure is concerned (heading 1a of the financial perspective), the framework agreed at the Brussels European Council suggests an ongoing squeeze on CAP expenditure commitments within EU-15.

With respect to structural operations, a range of parameters seems likely to influence the financial envelope for the 2007-13 period and how resources will be allocated between the Member States.

- The commitment allocation for 2006 (or a figure closely related thereto). On the basis of the agreement reached at the Copenhagen European Council, this is €29,170 million for EU-15 and €8,770 million for the new Member States, a combined total of €37,940 million in 1999 prices (see Table 3).
- The current ceiling on structural operations spending, 0.45 percent of EU GDP. The Commission regards this percentage as a "*minimum below which the credibility of future cohesion policy would be called into question*",[32] but across the EU there are widely differing views on the appropriate level of expenditure in relation to EU GDP.
- The absorption cap for structural spending in the new Member States, set at four percent of GDP for the 2004-06 period.
- The levels of aid per head for different categories of area. In this context, the January 2002 information note makes the point that the adjusted commitments for structural operations contained therein '*imply that, after applying the capping of 4% of GDP as stipulated in the Community acquis, the aid per capita for structural expenditure in favour of the new Member States would attain €137*[33] *per capita in 2006. This compares to an average of €231*[34] *for the existing four Cohesion Countries*.'[35] However, there was a subsequent (10 percent) reduction in structural operations commitments to the new Member States at the Brussels European Council and a further 5 percent cutback in Copenhagen.
- The split between the Structural Funds and the Cohesion Fund will also have an impact. The Brussels European Council agreed that one third of the overall allocation for structural operations in the new Member States would be devoted to the Cohesion Fund, well in excess of EU-15 levels.

As noted above, there are wide-ranging differences in viewpoint on the budgetary debate among Member States and European institutions. The polarisation of views is clear from the conclusions of the Halkidiki Ministers' Meeting:[36]

[32] EC (2001) *Unity, solidarity, diversity for Europe, its people and territory*, Second Report on Economic and Social Cohesion, Commission of the European Communities, Brussels, 2001.
[33] This represents nearly 2.5% of total GDP of the new Member States.
[34] This represents 1.6% of total GDP of the four Member States that currently benefit from the Cohesion Fund.
[35] EC (2002b) *op. cit.*
[36] *Presidency Conclusions of the Informal Ministerial Meeting for Regional Policy and Cohesion,* Hellenic Presidency of the Council of the European Union, Halkidiki, 16 May 2003.

> *Most of the Member States consider that the level of financing of Cohesion Policies should take into account that, in the enlarged EU, the funding needs of these policies would be greater than at present. As for the level of financing of the Cohesion Policies while some countries support an increase in resources, others consider that financing should be at the level of 0.45% of EU-GDP, and others think it should be set at a lower level. A number of Member States suggested to address the issue in terms of absolute amounts. Moreover the level of funding should be decided in the wider context of the new financial perspective including the allocation of funds. The Commission considers the level of 0.45% of EU GDP as a reference of credibility for the resources to be allocated to Cohesion Policies for the period after 2006.*

While the Cohesion Countries have advocated an increase in budgetary resources to deal with the greater scale of economic and social disparities arising from enlargement[37], some of the net contributor countries have advocated reductions in the level of EU spending on regional policy[38]; for its part, the EC is advocating that the current ceiling (0.45 percent of EU GDP) should be retained for spending on structural actions. As an indication of the range of possible expenditure, the EU regional policy budget for 2006-2013 could be some €270 billion if based on an 'absolute amount' (using spending in 2006 as a reference point), but could be some €350 billion if calculated as a proportion of EU GDP (based on the 0.45 percent ceiling).

3.6 Allocation of funding

A further aspect of the EU regional policy debate concerns the way in which the budget might be allocated among the competing interests. The complexity of the issue can be illustrated by the different types of regional eligibility being considered for Structural Funds after 2006.

The first category of regions are those regions which will qualify for Objective 1 support because of a GDP per capita below 75 percent of the EU average in an EU-25. These are projected as comprising 25.5 percent of the population of an enlarged EU (compared to 12.1 percent in the EU-15). This assumes that the eligibility criterion for designating Objective 1 remains unchanged; some countries (eg. Finland and Spain) are lobbying for other criteria such as unemployment or population density to be included.

Second, there are regions ('Objective 1A') that would qualify for Objective 1 in an EU-15 but would not be eligible in an EU-25 as a result of the 'statistical effect'.

[37] *Regional Policy and Enlargement,* Memorandum by the Spanish Government to the European Commission, 2001. Address by Elisa Ferreira, Portuguese Minister of Planning, to the Second European Cohesion Forum, Brussels, 21-22 May 2001. *Future Regional and Cohesion Policy: Meeting the Challenge of Deepening the Enlarged EU,* Memorandum of the Ministry of Economy and Finance, Hellenic Republic, February 2003.

[38] Speech by Mr Koch-Weser: *Einige grundsätzliche Überlegungen zur Ausgestaltung der EU-Strukturpolitik in einer erweiterten Europäischen Union,* Rede anlässlich der Konferenz "10 Jahre Europäische Strukturpolitik in Ostdeutschland – Bilanz und Perspektiven", 17/18 October 2001, Magdeburg. *Non-paper Dutch position on future Cohesion policy,* IBO Group, The Hague, 25 April 2002. *A modern regional policy for the United Kingdom*, HM Treasury, Department of Trade and Industry, Office of the Deputy Prime Minister, London, March 2003.

These are mostly in Germany but include significant proportions of the eligible population in Germany, Spain, the UK and Hungary.

Third, there are regions that have hitherto benefited from special provisions. These comprise areas previously eligible for Objective 6 on the basis of low population density (in Finland and Sweden), and the outermost regions (French overseas departments, the Azores, Canary Islands and Madeira), which have been covered by Objective 1. Some of the areas in these categories would be eligible for Objective 1 status in an EU-25, some would be excluded by the statistical effect, and some would require further special provisions to qualify even in an EU-15.

Fourth, there is the question of the transitional arrangements that should apply to those regions, which would lose eligibility for Objective 1 even in an EU-15 by virtue of regional growth. This situation applies primarily to areas in Greece and Ireland, and also to Spain to a significant degree. The main issue here is whether transitional arrangements should be comparable to the six-year phase-out arrangements for de-designated Objective 1 regions in the 2000-06 period.

Lastly, the EU is debating whether support should be provided for other areas outside the less-developed areas (which have currently received Objective 2 and 3 assistance) as well as support under the Community Initiatives. While the continuation of initiatives such as Interreg is generally uncontested, there are diverse views on a future ‘Objective 2’, with respect to:

- the proportion of funding that should be allocated to non-Objective 1 areas
- the regional priorities for the assistance (eg. the EC has proposed innovation and the knowledge economy, employability and social cohesion, sustainable development, accessibility, and rural development); and
- the process for designating the areas eligible for support (eg. enabling zoning to be determined at Member State or sub-national levels).

In addition to eligibility for Structural Funds, there is also the allocation of the Cohesion Fund to be considered. Assuming that the same criterion for eligibility (per capita GNP less than 90 percent of the EU average), all the new Member States except for Cyprus would qualify. Among the EU-15, Greece and Portugal would also qualify, Ireland would definitely be excluded, and Spain appears to be a borderline case, with a strong possibility that it might be excluded as a result of the ‘statistical effect’.

3.7 A new implementation model?

In addition to budgetary issues, the reform of the Funds has to be seen in the context of the current debate about the future governance of the EU, notably the powers and responsibilities allocated to EU, national and subnational levels. There are competing models of whether and how policy tasks (such as regional policy) should be allocated primarily to one level or shared.

The EC, other European institutions and many Member States and subnational interests support the current model of policymaking whereby the task of addressing economic and social cohesion is shared among European, national and subnational levels. They consider that the EU level should continue to have an active involvement in regional policy throughout the EU, on the grounds of solidarity and to ensure that EU regional policy does not become a kind of 'welfare policy' restricted to supporting the poorest countries and regions.

A fundamentally different approach to EU regional policy has been advocated by countries such as the Netherlands, Sweden and the United Kingdom, which consider that the current approach is no longer sustainable. The Dutch government has suggested an EU regional policy based on a national eligibility criterion[39]. A more fully developed proposal is contained in a UK consultation paper[40] which put forward an 'EU framework for devolved regional policy'. This foresees broad policy objectives being established at European level (based on the Lisbon agenda) but with the implementation of these objectives being undertaken by the Member States and regions without the transfer of EU resources.

A further aspect of the implementation debate concerns the simplification of systems and procedures for administering structural actions. This discussion was initiated in October 2002[41], with a ministerial meeting to consider how implementation of the Funds might be simplified in the current period as well as longer term after 2006. For the post-2006 period, possible changes have been mooted to rationalise the stages of programming, possibly through some kind of contractual arrangement between the EC, Member State and region. Greater flexibility for Member States to select priorities from a menu of EU policy priorities for interventions outside Objective 1 is also being discussed. The key question is how to ensure that the EC can discharge its responsibilities to account for the EU budget to the Council, Parliament and Court of Auditors while increasing the flexibility and simplicity of administration at Member State level. A range of systemic and procedural simplification issues is also being considered (some of which should apply to the remaining years of the current programming period) to rationalise the administrative time and cost associated with audit, reporting and financial management.

3.8 The effectiveness and 'added value' of policy

Finally, the future course of EU regional policy is being influenced by perceptions of the effectiveness of the Structural and Cohesion Funds. The issue of 'Community added value' has been particularly prominent in the debate, both in judging the effects of current and past programmes as well as assessing priorities for the future. As the EC noted in the Second Cohesion Report [42]: *"a future reform of cohesion policies should ideally take the opportunity to increase the added value and the visibility of Community policy".*

Clearly, Structural Fund programmes have had tangible net economic impacts in the cohesion countries and other large Objective regions. Outside these areas,

[39] *Cabinet Standpoint concerning the Interdepartmental Policy Study on "EU Structural Policy in the Context of the Enlargement of the EU",* Dutch Ministry of Foreign Affairs, Ministry of Finance and Ministry for Foreign Trade, The Netherlands, 2001.
[40] *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.
[41] *Note on the simplification, clarification, coordination and flexibility of Structural Fund management in the period 2000-06*, Commission of the European Communities, Brussels, October 2002.
[42] EC (2001) *op. cit.*

the economic impacts are difficult to quantify. However, the Funds have clearly enabled additional economic activity to take place, and there is evidence of programmes improving the quality of economic development and acting as a catalyst for regeneration.

More broadly, recent research on Community added value suggests that EU regional policy has several important qualitative effects.[43] First, programmes have influenced the deployment of resources for economic development, in particular at local level. They have enabled a wider range of organisations to engage in economic development and focused intervention on the needier areas. The Funds have safeguarded or increased the level of domestic regional development spending, and encouraged forward-looking regional development strategies. An important intangible effect of the Structural Funds is to make the EU more visible to citizens, communities, businesses and public authorities.

Second, the EU programming approach has promoted a strategic dimension in regional development policymaking. Regional development has become more integrated and coherent, through the multi-sectoral and geographically focused approach of programmes. Multi-annual programming periods have also provided a more stable policy environment, allowing longer term planning. In several Member States, there is evidence that the lessons of EU programming are being transferred into domestic policies.

There is mixed evidence of the influence of Structural Funds on domestic policy priorities. For the most part, the EU programmes do not appear to have 'bent' expenditure against the direction of national policy trends. However, they have played an important part in pioneering new types of intervention (in areas such as community economic development and the horizontal themes) and have been associated with institutional innovations in the management of regional development.

Third, the most frequently cited area of added value associated with the Structural Funds is partnership. This fundamental principle of Structural Fund programming is considered to have brought enhanced transparency, co-operation and co-ordination to the design and delivery of regional development policy, and better quality regional development interventions as a result. The partnership principle is implemented in different ways across the EU, but the commonly perceived benefits of partnership are improved vertical coherence, stronger involvement of local actors, a greater awareness of the 'bigger picture', collaborative working and co-operation on economic development initiatives, and improved decision-making in the management of economic development interventions.

Lastly, learning is an integral ingredient of Structural Fund programming. The Structural Funds have provided an exceptionally stable yet adaptable policy framework, which has promoted a dynamic of learning and innovation. In some regions, they have helped to institutionalise a 'learning reflex' as part of the routine delivery of regional economic development policy.

[43] Bachtler J and Taylor S (2003) *The Added Value of Structural Funds*, IQ-Net Special Paper, European Policies Research Centre, University of Strathclyde, Glasgow. www.eprc.strath.ac.uk/iqnet/iq-net/downloads/IQ-NET_Reports(Public)/IQ_NET_Added_Value.pdf

Counteracting at least some of these trends, the added value contributed by the Structural Funds is undermined by some negative aspects of the programming environment. Prominent among these is the burden of administration associated with operating the Funds, which affects not just administrators but also project implementers and final beneficiaries. Other aspects of the detailed configuration of the Funds (including fragmented eligible area maps, the n+2 rule, and risk-averse funding mechanisms) are believed to detract from their potential to encourage innovative and high quality interventions.

4. EU COMPETITION POLICY – A NEW PHASE

4.1 Evolution of EU competition policy control of State aid

As with EU regional policy, EU competition policy control of State aid is entering a new phase. Although the extent of material change to date is modest, it is clear that the Commission recognises the need to modernise its handling of State aid discipline to reflect new realities. Chief amongst these is the impact of enlargement. In purely practical terms, expansion to 25 Member States creates major resource and linguistic difficulties and has thrown into sharp relief the need to focus on those measures that pose the greatest threat to competition. In addition, the liberalisation agenda has exposed new activities to international competition, highlighting the potential conflict between the universal provision of key services and the State aid rules. Further, the increasingly sophisticated range of policy instruments designed by national policymakers keen to operate ‘close’ to the market poses new challenges to existing approaches to defining State aids and determining their compatibility with the Treaty on the basis of current frameworks.

At macroeconomic and political levels, attitudes towards State aids have continued to shift. The Council of Ministers has taken a growing interest in curbing the scale and improving the efficiency of government intervention, reflected in the Stockholm Council commitment to less State aid spending overall and a reorientation of that expenditure towards *“horizontal objectives of common interest, including cohesion objectives”*[44] and in the wider substance of the Lisbon agenda for economic reform, innovation and social cohesion.

Successive European Councils have added little in the way of substance to the means of achieving the ‘less, but better’ objective, at least in terms of *concrete* commitments to reduce spending by the Member States. Nevertheless, the political climate has given an impetus to Commission action in the form of a series of ‘scoreboards’[45] on State aid expenditure, a progress report on the reduction and reorientation of State aid[46] and an emerging policy reform agenda.[47]

Several important themes have emerged from recent Council conclusions and Commission reports and statements:

- a consideration of the role of market failure in the justification for State aid;

[44] Presidency Conclusions, *Stockholm European Council*, 23 and 24 March 2001.
[45] The most recent being European Commission, *State Aid Scoreboard – Spring 2003 update,* COM(2003) 225 final of 30 April 2003, Brussels.
[46] EC (2002c) *Progress report concerning the reduction and reorientation of State aid*, European Commission COM(2002) 555 final of 16 October 2002.
[47] RAPID Press Release, Mario Monti, *Contribution of competition policy to competitiveness of European economy,* Institute of European Affairs, Dublin, SPEECH/03/264 of 26 May 2003; Philip Lowe, *Objectives of State aid policy in the European Union and in the international context*, Information seminar for MPs of the Candidate Countries on EC State aid policy, European Parliament, 26 May 2003.

- an emphasis on the efficiency and effectiveness of State aid and, related, a growing interest in evaluation and exchange of experience;
- a Commission commitment to consider the feasibility of developing economic criteria for assessing State aid impacts;
- efforts to simplify, modernise and clarify the State aid rules.

These themes seem likely to impact on the future relationship between regional State aid and competition policy, although how precisely they might interact is likely to be the subject of considerable debate.

4.1.1 More stress on the role of market failure in the justification of State aid

Recent developments in State aid control have given greater prominence to market failure arguments in the justification for State aid. On the one hand, it has been stressed that State aids should be targeted at clearly identified market failures.[48] On the other hand, the Commission has emphasised the need to question whether State aid is always the most appropriate response to market failures. For example, it has been argued that Member States *"should assess, on a case-by-case basis, whether existing market imperfections affecting SMEs would be better addressed through the provision of state aid, advisory and information services, the intensification of structural reforms, or a combination of these measures."*[49]

4.1.2 Greater emphasis on the efficiency and effectiveness of State aid and on the role of economic analysis in State aid control

A related question is that of the efficiency and effectiveness of State aid. The Commission has procured external research that aims, *inter alia*, to draw up a list of criteria that make it possible to assess the circumstances in which aid is likely to be more or less effective.[50] For their part, at the November 2002 Competitiveness Council, the Member States undertook to improve the exchange of experience on a range of issues, including *ex ante* and *ex post* evaluations of State aid.

The role of economic analysis in State aid control is also rising up the Commission's agenda. Two main factors appear to underpin this. First, the Commission has been sensitive to criticism of its hitherto rather formalistic approach. Philip Lowe, the new Director General of DG Competition, has observed that *"there is the impression that we are simply applying rules which aim to curtail state aid as such rather than concentrating on controlling aid which really distorts the European single market"*.[51] Second, the impact of enlargement

[48] 2467th Council meeting – Competitiveness (Internal Market, Industry, Research) – Brussels, 26 November 2002, 14365/02 (Presse 360).
[49] European Commission, *State Aid Scoreboard – Spring 2002 update*, COM(2002) 242 final of 22 May 2002, Brussels.
[50] EC (2002c) *op. cit.*
[51] Philip Lowe, 'Introduction', *EC Competition Policy Newsletter,* 2003(1) Spring.

on resources means that greater priority needs to be given to those measures that have the greatest impact on EU competition and trade.

There are two levels of analysis at which the role of economic criteria are relevant. First, the decision about whether a measure is caught by Article 87(1) at all – ie. does it constitute State aid? The key question in this context is whether a measure, *inter alia*, distorts or threatens to distort competition or affect trade between Member States. It has been observed that the Commission interpretation of Article 87(1) almost amounts to a *per se* rule*: "if aid is granted, the conclusion that the aid distorts competition is almost automatic"*.[52] Some recent cases have suggested a rather more reasoned approach to finding impacts on intra-Community trade.[53] Nevertheless, these few cases do not amount to a relaxation of the definition of what constitutes a State aid and policy is inevitably constrained by existing jurisprudence and precedent.

The second level of analysis concerns the severity of the distortion involved. Philip Lowe has suggested that work could be undertaken on the economic basis for a distinction between aid that is particularly harmful and aid that, although it falls within the scope of Article 87(1), does not *significantly* distort competition and trade.[54] This in turn could be reflected in procedural reforms that might ease the burden of examining less significant cases but identify those where closer scrutiny were merited.[55]

There are two main precedents for adjusting levels of scrutiny or control to the perceived risk to competition. At the 'bottom' end of the spectrum, the introduction of the *de minimis* facility in the early 1990s effectively limited the scope of Article 87(1), enabling aid subject to certain ceilings and conditions to escape the notification requirement.[56] Although it has been suggested that it might be possible to extend the *de minimis* Regulation (presumably by raising the threshold), a *sui generis* block exemption Regulation is thought to be a more likely route.[57]

At the 'top' end of the spectrum, the Commission has sought to constrain the scale of regional investment aid to large projects under the Multisectoral Frameworks. For most activities, the 1998 Multisectoral Framework[58] applies until end 2003 when the 2002 Multisectoral Framework[59] enters into force for all

[52] Evans A and Martin S (1991) 'Socially acceptable distortions of competition: Community policy on State Aid', *European Law Review,* 79-111.
[53] For example, the Dorsten Swimming Pool case, which has been highlighted by the Commissioner as an instance in which the definition of aid has been more tightly circumscribed – see Mario Monti, 'Services of General Interest in Europe', *Europäische Zeitschrift für Wirtschaftsrecht* (EuZW), Vol 6/2001, p161; 24 March 2001; a similar conclusion was reached in the Brighton Pier case – see Aids N 560/01 and NN 17/02 – United Kingdom - Brighton West Pier, C(2002) 942 fin of 9 April 2002.
[54] Philip Lowe*, op. cit.*
[55] COM (2002) 555 at point 15.
[56] The *de minimis* facility is now enshrined in Council Regulation (EC) No 69/2001 of 12 January 2001 on the application of Article 87 and 88 of the EC Treaty to *de minimis* aid, OJEC No L 10 of 13 January 2001.
[57] Philip Lowe, *Handlungsspielräume der Wirtschaftsförderung der Länder nach der Erweiterung*, Speech to the Ausschuss des Bundesrates für Fragen der Europäischen Union*,* Berlin, 6 December 2002.
[58] Multisectoral framework on regional aid for large investment projects, OJEC No C 107 of 7 April 1998.
[59] Multisectoral framework on regional aid for large investment projects – Rescue and restructuring aid and closure aid for the steel sector, OJEC No C 70 of 19 March 2002.

sectors.[60] This will mean that, for projects involving eligible expenditure in excess of €50 million, a reduction matrix will be applied to the standard maximum award rates. In addition, very large awards will be subject to individual notification. Last, and perhaps most importantly, the 2002 Multisectoral Framework provides for the Commission to draw up a list of sectors where serious structural problems prevail; aid to firms in these sectors will be strictly limited. The Commission takes the view that the risk of distortion of competition is higher where a single company has a high market share and where production capacity is expanded without a corresponding increase in demand. A "systematic analysis" of the sectoral situation in the Community is underway with a view to drawing up a list of activities where such conditions prevail.[61]

4.1.3 Steps to improve simplification, modernisation and clarification of the State aid rules

A number of steps have been taken, or are envisaged, with respect to the simplification, modernisation and clarification of the State aid rules. In 2002 the Commission adopted a block exemption Regulation for employment aid,[62] adding to the list of policy areas where reporting rather than prior notification are required. The Commission has also sought to clarify the relationship between the financing of services of general economic interest and the State aid rules,[63] although the outcome of this must await the European Court of Justice judgements in the Altmark and GEMO cases. Regarding enforcement and sanctions, the Commission has formalised its approach to complaints[64] and indicated its intention that, in the future, reimbursement of unlawful state aid will be subject to interest at compound rates.[65] More generally, the Commissioner has announced that the Commission is reviewing existing State aid control instruments with a view to simplification and elimination of potential conflicts between the texts.[66] Together with the procedural Regulations adopted over the period 1999-2001, these changes amount to a substantial reform package.

4.2 Developments in regional aid control

Against this background, the control of regional aid appears to be in a quiescent period. The Commission has confirmed that the Regional Aid Guidelines introduced in 1998 are set to apply unchanged until 2006; however, it has also indicated that a review of the rules will be carried out "in due course" in order to enable the notification and approval of new assisted area maps for the period

[60] See 'Regional aid and large investment projects' in Wishlade F G (2003) *Regional State Aid and Competition Policy in the EU* (Kluwer Law International, The Hague), for an overview of the two Multisectoral Frameworks.
[61] COM (2002) 555 at point 12.
[62] Commission Regulation (EC) No 2204/2002 of 12 December 2002 on the application of Articles 87 and 88 of the EC Treaty to State aid for employment, OJEC No L 337 of 13 December 2002.
[63] DG Competition, *Services of general economic interest and state aid,* non-paper of 12 November 2002 available from the DG Competition WebSite at: <http://europa.eu.int/comm/competition/state_aid/others/>
[64] *Form for the submission of complaints concerning alleged unlawful State aid*, OJEC No C 116 of 16 May 2003.
[65] *Commission communication on the interest rates to be applied when aid granted unlawfully is being recovered,* OJEC No C 110 of 8 May 2003.
[66] Mario Monti, *Contribution of competition policy to competitiveness of European economy, op.cit.*

after 1 January 2007.[67] DG Competition is conducting a 'sounding out' exercise involving externally-commissioned studies, bilateral discussions with the Member States and internal policy review. Commissioner Monti also wrote to all the Member States in April 2003 requesting any comments, observations or information relevant to a review of the Guidelines by 30 May 2003. In short, although the current guidelines will apply unchanged until 2006, regional aid control policy is due to undergo a period of intense scrutiny.

No decision has apparently yet been taken on whether a radically new approach might be adopted post 2006 or whether small adjustments to the existing approach might suffice. What seems clear, however, is that maintaining the *status quo* is not a realistic long-term option[68] and this for at least three reasons: first, the impact of enlargement; second, the outcome of the German legal challenge to the Commission Decision based on the guidelines; and third, the attitudes of national regional policymakers. Each of these factors has important implications for the future design of regional aid controls.

4.2.1 The impact of enlargement

The reality of eastern enlargement from 2004 radically alters the context for the logic which underpins the 1998 Regional Aid Guidelines. This takes as its starting point the notion that coverage of the national assisted areas should total less than half the Community population. Coverage for 2000-06 (set at 42.7 percent of the EU-15 population) was determined on the basis of predictions about enlargement during the period, coupled with an assessment of the minimum population coverage needed to enable 'coherence' between the national aid area and Structural Fund maps. A similar approach (but setting aside the issue of coherence) would imply coverage of up to 50 percent of the enlarged population. Moreover, equal treatment of the Member States would suggest the use of data covering an enlarged Europe in assessing regional disparities.

A range of scenarios can be envisaged for incorporating the new Member States into the existing methodology.[69] Whatever the scenario, the almost inescapable conclusion is that the impact on many current Member States would be significant and this on a number of levels.

- Most obviously, the relative poverty of the new Member States would result in most of those countries being covered by Article 87(3)(a) in their entirety; this

[67] *Commission Communication: Review of the guidelines on national regional aid for the period after 1 January 2007,* OJEC No C 110 of 8 May 2003.

[68] The Commission could, presumably, decide to extend the authorisation of the existing maps for a limited period pending the finalisation of new regional aid guidelines.

[69] For example, EU-25 data could be used throughout with further enlargement dealt with when it arose; alternatively EU-27 could be used as the basis for designation. Perhaps more persuasive and in line with the past, the population ceiling could be set on the basis of EU-27 population but GDP and unemployment could be assessed on the basis of EU-25 indices, pending further enlargement. There is, of course, the question of the overall population ceiling and whether 50 percent should be the absolute upper limit; on the other hand, the Commission might seek to exert further downward pressure on coverage.

uses a large proportion of the overall population ceiling, leaving considerably less for the current Member States.[70]

- Many existing Article 87(3)(a) regions would be squeezed out of eligibility, not because their absolute position has changed but rather because of the statistical effect of enlargement on EU averages. This raises conceptual issues that are separate from those pertaining to eligibility for the Structural Funds.

- Related, although overall Article 87(3)(c) coverage might rise within EU-15, this would not be enough to accommodate regions losing Article 87(3)(a) status unless the overall ceiling were increased.

- The effects of enlargement would not be limited to spatial coverage but would also impact on rates of award, especially the scope of the 10 percent rate and, related, aid differentials in countries currently containing Article 87(3)(a) and (c) regions.

- The impact of enlargement on the outcomes of the methodology vary widely between existing Member States, partly reflecting levels of unemployment (an indicator of questionable comparability), but also due to the impact of existing safety nets and the presence of absolute designation criteria which, unlike GDP per head, are potentially unaffected by enlargement (notably population density and the treatment of Northern Ireland).

4.2.2 The German legal challenge to the Article 87(3)(c) adjustments

A further impediment to simply rolling forward the guidelines post 2006 relates to the German legal challenge[71] against the Commission Decision approving its assisted areas and the consequences of the case for the Guidelines.[72] The essence of the German case concerned the 'corrections' made to the initial Article 87(3)(c) population quotas allocated under the Guidelines. These corrections involved ensuring that all countries:

- had a minimum Article 87(3)(c) coverage of 15 percent outside the Article 87(3)(a) areas;

- had enough quota to cover all areas losing Article 87(3)(a) status and low population density areas; and

- had coverage at least equal to 75 percent of their previous coverage.

In order to remain within the overall population ceiling of 42.7 percent of the EU-15 total, the coverage of Article 87(3)(c) areas was proportionately reduced in

[70] On the basis of EU-27 population and data and a 50 percent overall ceiling, EU-15 coverage could fall to 36 percent of the population, compared with 43 percent at present – see 'Enlargement and the Future of the Regional Aid Guidelines' in Wishlade, F G (2003) *op. cit.*
[71] C-242/00 *Federal Republic of Germany v Commission* [2002] ECR I-05603.
[72] For a fuller discussion of the issues arising see 'The Impact of Competition Policy on Regional Aid Policies' in Wishlade F G (2003) *op.cit.*

any country not affected by these corrections. For Germany, this process involved the loss of some 5.8 percent of the national population from the Article 87(3)(c) quota in order to 'compensate' other countries.[73]

The German challenge was unsuccessful on essentially formal grounds. However, on substance, the Advocate General was critical of the political motivation for the corrections which partially overrode the analysis of regional disparities in a European and national context, and consequently breached the fundamental principle of equal treatment. The Court itself agreed that the case was inadmissible and did not consider the issues of substance, save to observe that it was still open for the German authorities to notify an additional list of regions covering the population lost through the correction process and for the Commission to assess whether the designation of these areas was compatible with the Treaty.

Although the outcome of the case might be considered to be unsatisfactory from a German point of view, from the Commission perspective it is arguably even more so. At best, the Advocate-General's views on the 1998 Guidelines create considerable uncertainty as to the legitimacy of the current method. It seems unlikely, as Philip Lowe has himself indicated,[74] that such observations could be ignored in any review of the rules.

4.2.3 Member State attitudes

The third obstacle to continuing the *status quo* concerns the attitudes of the Member States. Although the Commissioner for Competition Policy pronounced himself content with the process of approving the assisted area maps,[75] this sentiment was not widely shared among national policymakers, many of whom found the process very frustrating. The capacity of the Commission to exploit the lack of clarity in the Guidelines to its benefit was a particular irritation.[76] Also important for future regional aid relations with DG Competition, many national policymakers were dismayed at the number and extent of the inconsistencies of interpretation of the Guidelines by the Commission, with considerable implications for transparency and the principles of equal treatment and the rule of law. How far the 1998-2000 experience impacts on Guidelines for the post-2006 period will partly depend on the quality of national institutional memories; early indications are of much more intense preparations on the part of a number of Member States than took place last time, as well as of more contact between Member States on this issue. It seems likely that Member States will be much less willing to accept any future Guidelines unless they know precisely how they are to be interpreted in practice.

[73] Germany was not alone in this but was the only country to challenge the process.
[74] Philip Lowe, *Handlungsspielräume der Wirtschaftsförderung der Länder nach der Erweiterung*, Speech to the Ausschuss des Bundesrates für Fragen der Europäischen Union, Berlin, 6 December 2002.
[75] Rapid Press Release, *Commission brings its review of regional policy to a successful conclusion with the approval of the maps for Belgium and Italy,* IP/00/1024 of 20 September 2000, Brussels.
[76] See 'Issues and Challenges: the Future of Regional Aid Control' in Wishlade F G (2003) *op.cit.*

4.3 Future challenges

Against this background, it is clear that the reform of regional State aid control faces a number of practical, conceptual and technical, not to mention political challenges.

4.3.1 Practical problems

At a purely practical level, time is short for a radically new approach. The present system was piloted over several years from the early 1990s; various versions were negotiated with Member States prior to adopting the Guidelines in February 1998 for application from 2000. This practice had typified earlier developments in regional aid control, but is rendered more difficult by the formalisation of the rules under the Guidelines and the use of appropriate measures to impose them. Even a minimalist approach to change presents practical challenges. Member States are divided on the degree of change required and on their approaches to initiating change. The impact of the present Guidelines rolled forward varies widely between countries and may be significantly affected by relatively small statistical changes, such that precise outcomes cannot be known until the latest data become available. This was a significant practical issue under the 1998 Guidelines; it may represent even more of a problem in the post-2006 period.

4.3.2 Conceptual concerns

At a conceptual level, the notion of ‘cohesion’ – and how competition policy control of State aids can best contribute to it – remains unclear. Since the early 1990s, the emphasis has been on competition policy enabling, or at least not frustrating, the adoption of coincident maps for national and EU regional policies. However, this is arguably a rather superficial preoccupation that conceals the need for a more fundamental debate about the appropriate articulation of spatial policy objectives at different tiers of government. It can be argued that there is a need in principle to review the implications of the different Treaty provisions on competition and cohesion. The danger is that future discussions will instead become mired in practical questions about the treatment of transitional regions (those losing Article 87(3)(a) and/or Objective 1 status).

Further conceptual challenges arise from incorporating aspects of the wider State aid reform agenda into regional aid control. The earlier discussion noted the growing interest in taking account of market failure in assessing State aids. Acceptance of the market failure justification for aid is implicit in the Treaty provisions; these ban State aid in principle, but derogate from this prohibition in a series of exceptions. However, the derogations do not explicitly require the identification of market failure in order for State aid to be justified. Further, the identification of a market failure does not, of itself, justify an exception to the general ban on State aid: Article 87(3)(c), which has formed the basis for most policy allowing the use of aid in derogation from the ban, merely refers to “*aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest.*” The identification of criteria to establish what is in the common interest remains elusive. Would evidence of market failure become a requirement for State aid authorisation? Would it be a necessary, but insufficient condition for granting a derogation? Where would the burden of proof lie in market failure arguments for State aid? Would measures that in the Commission's view were ineffective be outlawed even in the absence of significant competition concerns?

4.3.3 Technical issues

These conceptual concerns spill over into, and are difficult to disentangle from, a range of technical issues. At the heart of these are tensions between what is theoretically relevant and what is administratively feasible; between arbitrariness and relevance; and between transparency and politicisation. The regional aid control regime is easy to critique. Amongst other things, it can be argued that:

- there is excessive emphasis on regulating the scope and extent of the assisted areas and insufficient analysis of the real effects of aid on competition and trade;
- the spatial focus of regional aid control impacts on policy areas such as SME support or regeneration policies where the assisted areas approved may only be of partial relevance but where risks to trade and competition are minimal;
- policy is ill-suited to assess the increasingly sophisticated range of policy instruments being operated, or to considering those which it has not previously sought to address.

However, critics should be under no illusions about the technical difficulties involved in addressing these issues. There are important gaps in the understanding of just how State aids affect competition and trade that are not answered by the academic literature in ways that are of practical relevance. Even where policy has sought to address competition issues more directly (for example, under the motor vehicle aid rules or the 1998 Multisectoral Framework), the absence of relevant, comparative and up-to-date statistical data at an appropriate level of analysis has tended damage the credibility of policy.

4.3.4 Political challenges

Regional aid control also faces political challenges. From the outset, the role of the Council in State aid control has varied, with the Commission sometimes resisting Member State involvement and sometimes building on their apparent commitment to restraint. Recent developments suggest that State aid control is being considered more within the context of broader macroeconomic policy, reflected in the growing interest in overall levels of spend and the notion of introducing targets to limit spending. Whilst the Commission may welcome the support of the Member States as regularly expressed in Council conclusions, this support is less evident in individual cases where national interests are at stake. Moreover, the Commission may find increased Member State involvement in State aid policy formulation to be double-edged as countries float proposals that the Council, not the Commission, should decide on overall assisted area coverage or even that State aid control should be subject to Treaty change.

5. COMPLEMENTARITY OR CONFLICT?

The previous three sections have considered the broad trends and issues relating to three areas of policy - national regional policies, EU regional policy, EU competition policy. A common theme is that of change.

- National regional policies in many countries have been characterised as increasingly based on a new policy paradigm.
- EU regional policy faces not only the challenge of enlargement but also the need to address some major governance issues within a changed policy context.
- EU competition policy is confronting an ambitious reform agenda comprising not only substantive policy questions but also the practical realities of regulation within an expanded EU.

In short, all three policy areas are undergoing, or about to enter, a period of significant reappraisal. The key question is how future policy interrelationships might evolve. This final section summarises these current policy relationships before considering whether future linkages are set to be more complementary or more conflictual in terms of four key aspects of policy: policy objectives; policy focus; policy governance and implementation; and policy instruments.

5.1 Policy relationships

The future of regional policy is influenced by a triangle of interrelationships between the three areas of policymaking. In part, these relationships are mutually reinforcing, but they are also subject to tensions and areas of conflict. Each of these interrelationships is worth considering in turn.

5.1.1 EU competition policy and national regional policy

The presence of a degree of tension in the relationship between EU competition policy and national regional policy is perhaps inevitable. It is, after all, a basic task of the EU competition policy authorities to control competitive distortions arising from the award of State aid, including national regional aid. That said, all Member States strongly support the Commission in this objective and, indeed, the Council has, in recent years, increasingly stressed the need for ongoing reductions in State aid spending across the EU.

With respect to the control of regional aid, the main focus of the Commission was initially on the types of regional aid on offer, the aim being to eliminate support in the form of operating aid. However, over time, the extent and coverage of the designated aid areas took centre stage. As already mentioned, over the years, the interventions of DG Competition became more systematic, culminating in the development and subsequent implementation of the March 1998 Regional Aid

Guidelines.[77] These focused particularly on the use of aid area population ceilings to enforce State aid discipline while, at the same time, offering Member States more latitude (in principle) in the actual selection of assisted areas within the population ceilings laid down.

Despite the stated intention to give the Member States more flexibility in the designation of aid areas within the parameters laid down, Member States expressed varying levels of dissatisfaction with both the method for determining population ceilings and, particularly, with the subsequent map negotiations with DG Competition. Notwithstanding the pressure to agree new maps caused by the withdrawal of the previous maps at the end of 1999, agreement had been reached with only four countries by the start of 2000 (Ireland, Finland, Denmark, Greece). Half of the remaining Member States did not have their maps approved until June-September 2000. Moreover, a significant number remained unhappy with both the process and its outcome.[78]

5.1.2 EU regional policy and national regional policy

In the early years of EU regional policy, it was closely aligned with national regional policy and, indeed, took the form of supplementing national regional policy efforts through additional EU funding. Over time, EU regional policy gradually moved to make its contribution more distinctive, culminating in the reform of the Structural Funds in 1988 based on EU policy principles and EU-determined support areas. Even so, in many Member States, and particularly those where Objective 1 regions tend to dominate, EU regional policy and national regional policy remained closely in tune; indeed, in many Member States they were (and remain) synonymous.

However, in some Member States there were always certain tensions between EU and national regional policy, often stemming from the perception that the EU policy tail was driving, and even distorting national policy priorities. These tensions have increased over the years as EU regional policy has taken on board a wider range of (horizontal) policy objectives, which do not always find a resonance within national regional policy. Difficulties have also arisen as EU regional policy has become more spatially concentrated, often focusing on areas (urban, rural, fisheries) that may not be designated for national regional policy purposes. Moreover, in some countries, co-financing demands are considered to have distorted national policy goals. There is also a perception that the additional administrative burdens associated with the Structural Funds have detracted from national policy priorities and practices.

5.1.3 EU competition policy and EU regional policy

Up until the reform of the Structural Funds in 1988, there were no real tensions between EU competition policy and EU regional policy. Policy strains began to emerge when areas designated under the Structural Funds were not always approved by DG Competition for national regional policy purposes. For instance,

[77] EC (1998) Guidelines on national regional aid, *Official Journal of the European Communities* C74; 10.3.1998, pp 9-31.
[78] For more details see Wishlade F, Yuill D and Méndez C (2003) *Regional Policy in the EU: A Passing Phase of Europeanisation or a Complex Case of Policy Transfer?* European Policy Research Paper No 50, European Policies Research Centre, University of Strathclyde.

DG Competition cast doubt on the designation of Abruzzi in Italy as part of the national aid area map shortly after it had been accepted as an Objective 1 region by DG Regio.

The issue of coincident maps produced sharp internal divisions within the Commission in the early 1990s. While DG Regio argued that designation for the Structural Funds should be adequate justification for the Article 87(3)(a) or (c) derogation, DG Competition was concerned to limit the use of State aid, especially in the more prosperous Member States, in order to maintain an appropriate differential in relation to the poorer regions.

Although the question of map coherence was downgraded for the 2000-06 period, it remains a sensitive topic. The extensive recourse to the Structural Fund derogation in the 2000 aid area negotiations meant that a significant number of areas were designated for Structural Fund purposes simply so that they could be incorporated within national regional aid maps.

5.2 Policy objectives: what does cohesion mean?

At the heart of current and, perhaps future, policy tensions is uncertainty about what is meant by the cohesion objective and who defines it. In the absence of a concrete definition, the Treaty requirement that national and Community policies should contribute to the achievement of cohesion has been interpreted in a manner that emphasises the geographical coincidence of policy targeting. This is at the expense of considerations about appropriate policy coordination and the articulation of different levels of policy responsibility. At the same time, successive reports on the economic and social situation in the Community have noted convergence in GDP(PPS) per head between countries, but widening disparities within them. In parallel, an important shift in the targeting of Objective 1 funding took place for the 2000-6 period with the notion of “cohesion countries” losing prominence in favour of a greater focus on poor *regions,* irrespective of the prosperity of the Member State in which those regions were located.

In practical terms, the level of tension between regional policy at the national and EU levels varies considerably between Member States. Where Structural Fund eligibility is extensive, and focused mainly on Objective 1 (as in Greece, Ireland, Portugal and Spain) there is considerable synergy between national regional policy and EU structural policy; indeed, there is often no separately identifiable national regional policy in such countries. On the other hand, where the Structural Funds are less important – and, in particular, outside of Objective 1 – there tends to be far less synergy in respect of policy objectives. On the contrary, there is often considerable tension between the objectives of the Structural Funds and those of national regional policy, not least with respect to the Structural Fund’s horizontal priorities. In addition, the different elements of Objective 2 – industrial, rural, urban, fisheries – often have only limited overlap with the main focus of national regional policy.

Looking to the future, there must be some concern that the list of objectives attached to EU regional policy will continue to grow (in part reflecting the Lisbon and Gothenburg agendas, but perhaps also in response to a menu-based approach to development priorities outside of Objective 1). Under such circumstances, it is difficult to imagine current policy frictions being significantly eased. On the contrary, enlargement and the consequent increase in disparities between countries and regions can only heighten existing conflicts if current policy trajectories are pursued. Yet there would seem to be scope for greater *complementarity* of policy if the objectives of the respective policy areas were to be clarified, policy responsibilities refocused and the emphasis on detailed aspects of policy implementation reduced.

An important issue is a tendency to perceive the pursuit of the cohesion objective in spatial terms with an emphasis on coincident maps at the EU and national levels. Enlargement and the focus on the *relative* positions of the regions of the EU for the purposes of both national and EU regional policies increases the likelihood of conflict. The focus on poor regions – namely Objective 1 - coupled with the political pressures both for special treatment of the 'statistical effect' regions *and* budgetary restraint, threatens to dilute the capacity of EU structural policy to target the worst-off parts of the EU. In parallel, the mechanistic effect of the existing population ceiling-based method of regional aid control would curtail the scope for *national* regional policies to intervene, not because the absolute position of the problem regions had necessarily improved, but rather because enlargement had altered their relative or apparent prosperity.

On the other hand, there is a compelling case for EU structural policies to focus on disparities between *countries,* complemented by leaving primary responsibility for disparities *within* countries to the Member States and/or to subnational levels. For its part, EU competition policy could facilitate the ability of the Member States to address internal regional disparities by focusing attention on aid that distorts competition to an appreciable extent, and much less on precisely *where* it is offered in geographical terms. This would allow greater flexibility to Member States to assist firms in problem regions – whether 'classic' regional development areas, urban areas, rural areas, site reclamation etc.

5.3 Policy governance: who should do what?

A major theme of the current debate on governance in the EU has been that of subsidiarity and the appropriate level of policy formulation and implementation. At the same time, a review of recent developments in national regional policies makes clear that the respective roles and relationships of different tiers of government in economic development, is undergoing fundamental change.

The key question is how the organisation of regional policy tasks should be determined at the European level. On the one hand, there are arguments in favour of a clear delineation of policy responsibilities, based on the principle of subsidiarity. The organisation of regional policy in Germany is one model of this approach, whereby the responsibility for regional development is vested in the *Länder,* and the involvement of the federal government is only justified in areas which individual states cannot address themselves (eg. funding, co-ordination). The UK consultation paper on Structural Funds reform also advocates a clearer separation of responsibilities – between the determination of policy objectives (EU level) and the implementation of those objectives (national, subnational levels) – to respect the new, regional-based approaches to national regional policy.

On the other hand, critics of this approach argue that, in the context of multi-level governance, it is not possible (or even desirable) to separate and allocate policy tasks between levels of government. Politically, there is concern that EU regional policy would be weakened, in terms of resourcing and leverage, and that it would be difficult to ensure that EU policy objectives were in fact being fulfilled.

A critical factor in this debate is what added value the European level can bring to regional policy. In countries or regions with significant development gaps relative to the rest of the EU, the value of financial transfers from the EU under Structural and Cohesion Funds to promote investment and employment is clear. There is also an undisputed policy regulation and control function in the field of State aid control.

Beyond these areas of European involvement in regional policy, there is less consensus. Many would argue that EU funding provides important added value outside Objective 1 regions, as a concrete expression of solidarity, in making the EU visible to the citizen, in improving the process of economic development through the 'Community method', and in facilitating co-operation and the exchange of good practice. However, these arguments are not universally accepted, and the challenge for the Union is to identify ways in which the EU can demonstrate its added value in the new regional policy environment.

5.4 Policy focus: is spatial targeting really the way forward?

The evolution of EU competition policy control of regional aid has been dominated by different approaches to approving the assisted area maps of the Member States. European Commission intervention has tended to focus on seeking a justification from the Member States for targeting policy at particular geographical areas and viewing constraints on overall coverage as a measure of its success in achieving discipline. As discussed earlier, recent policy statements on State aid control suggest a growing role for economic analysis in the assessment of whether measures are compatible with the Treaty. In principle, this has the capacity to reduce conflict with the Member States over regional aid control while making the operation of competition policy more relevant to genuine trade and competition concerns. A further potential benefit would be the scope to disentangle State aid for other policy areas – such as regeneration aid – from considerations of whether the targeting of the measure coincided with the national regional aid map.

Arguably, the corollary of this is that, if current approaches to regional aid control are simply extrapolated into the future, heightened tension seems inevitable. Most obviously, as discussed earlier, this will be the case with respect to designated aid area coverage, especially if a global ceiling in the region of 50 percent or less of the enlarged population is chosen. Of course, it may be that a less ambitious global ceiling is set or that different allocation rules and mechanisms are developed, but it seems certain that the scope to aid Article 87(3)(c) areas will be much reduced. This would be in line with the view within

DG Competition that regional aid is appropriate only when it contributes to *EU* cohesion; that is, only within Article 87(3)(a) areas. Indeed, the suggestion has been floated that, post 2006, investment aid for large firms should no longer be available in Article 87(3)(c) areas. This has obvious implications for the operation of national regional policy in many EU15 countries, most notably those where the tissue of SMEs alone is considered insufficient to sustain regional economic development.

A further issue is that the spatial focus of the Structural Funds does not necessarily reflect the spatial priorities of national regional policy – in part due to the different objectives of policy, but also because of the growing tendency in some countries for national regional policy to take on a whole-country focus. The lack of coherence between EU competition policy and EU regional policy has been a significant area of policy tension over the past fifteen years. Coherence has been seen mainly in terms of map coincidence, with concern in DG Regio in particular that development efforts in Structural Fund areas would be undermined if regional investment support could not be offered. Prior to the 1988 reform of the Structural Funds, this was not an issue since EU regional support was built around the national regional policies (and aid areas) of the Member States. However, it became an important theme with the designation of EU-specific maps post 1988.

There are a number of reasons for the lack of spatial coherence. One was that the typology of regions used under the Structural Funds was very different from the approaches adopted for national regional policy purposes (subject to EU competition policy approval). In particular, in many countries, regional aid areas have come to be associated with the attraction of inward investment, a very different target group from, for instance, the rural, fisheries and inner urban areas targeted under the Structural Funds. Moreover, as the coverage of both the Structural Fund and aid area maps has been reduced over time, not only has map coincidence become increasingly challenging but the pressures to compensate the loss of eligibility under one map with inclusion in the other have grown. It is noteworthy that, as Member States have gained more influence over the designation of Structural Fund areas outside of Objective 1, thus creating more scope for coherence, support for coincident maps has declined.

Looking to the future, the indications are that the Commission will again stress the importance of spatial coherence post 2006, certainly with respect to Objective 1 and Article 87(3)(a) areas. More generally, the scope for conflict arising from spatial targeting is likely to increase if the goals of coherence (map coincidence) and concentration (reduction of assisted areas coverage) are pursued. However, as noted earlier, increased conflict is not inevitable. Greater emphasis on the *economic* effects of State aid could reduce the spatial focus of competition policy approval of regional aid. This would diffuse some of the frustrations of national policymakers (lack of capacity to anticipate change; linkages across otherwise largely unrelated policy areas; interference in schemes posing minimal risks to competition and trade). At the same time, an EU structural policy that focused on disparities between Member States would largely eliminate the preoccupation with coincidence that permeates the current relationship between the national and the Structural Funds assisted areas.

5.5 Policy instruments: how to facilitate policy innovation?

A significant area of tension is the capacity of existing policy frameworks to deal with innovative policy instruments.

EU structural policies encourage innovative projects or those involving partners not habitually associated with economic development, but the rules indirectly inhibit the capacity of policymakers to take on such projects. Innovation, by its nature, inherently involves risk, but audit and other regulatory requirements push policymakers back towards projects and programmes which are more certain of absorbing expenditures and less likely to incur decommitment. The experience placed on financial engineering instruments in the current programming period indicates what might be feasible in future, but it also highlights some of the practical implementation and regulatory difficulties.

In the context of policy instruments, an important strand of competition policy control of regional aids has been concerned with 'incentive type'. Accession to the EU has typically been accompanied by a review and enforced revision of the forms of regional aid on offer, ostensibly to meet the needs of transparency and comparability and to outlaw and/or constrain what are perceived to be the most damaging forms of aid, notably intra-EU export aid and operating aid. This has often been a significant area of tension – the most recent example being the use of transport aid and social security concessions in the Nordic Member States. (State aids have also been one of the most intractable issues in the negotiations with the new Member States.) The existing approach that essentially prohibited the use of operating aid on an ongoing basis failed to take account of the permanent nature of the handicaps facing the target regions. Moreover, new rules introduced in response forced national policymakers to reverse-engineer existing measures, including transparent and automatic labour-market instruments, into a form of transport aid.

More generally, competition policy has tended to reinforce the use of grant-based aid where many countries (and indeed Structural Funds co-financed measures) have tried to move to solutions that are closer to the market and, in principle, involve forms of support that operate where the market does not. In some cases, the effects of Commission intervention have been perverse, with forms of government intervention involving higher sums escaping scrutiny while some instances of so-called 'gap funding' (where public authorities have intervened in the absence of a functioning market) has been outlawed.

As already mentioned, a potential source of conflict lies in the relationship between the State aid rules and services of general economic interest; the delicate balance between the free-market orientation of the Treaty provisions and public service considerations is of crucial importance for regional development policies. The French and German national consultative bodies on regional development recently underlined the need for competition policy to be sufficiently flexible to enable Member States to address regional inequalities or specific problems resulting from trade liberalisation and that it should not threaten the provision of services of general economic interest on which regional economic competitiveness depends. It remains to be seen what the consequences of pressures to take forward Article 16 of the Treaty and the pending Court cases will be for State aid and regional policy relations.

As noted earlier, recent policy statements on State aid control suggest a growing role for economic analysis in assessing whether measures are compatible with the Treaty. In principle, this approach has the capacity to reduce conflict with the Member States over regional aid control while making the operation of competition policy more relevant to genuine trade and competition concerns.

In reality, Commission attempts more directly to address regional aid measures that have potentially significant impacts on competition have often been opposed by Member States; in particular, proposals to target regional aid for capital intensive projects were resisted and diluted by the Member States in the 1990s before being partially subsumed into the 1998 Multisectoral Framework. The increased restraint implied by the 2002 Multisectoral Framework continues to be opposed by some countries. Thus, technical challenges are not the only obstacle to improving the relevance of frameworks to the regulation of policy instruments.

5.6 Concluding points

This final section has outlined a number of sources of tension in the relationship between national and EU regional policy and EU competition policy, highlighting the scope for future policy change and the impact of enlargement to render those relationships more conflictual. Importantly, however, it has been argued that greater conflict is by no means inevitable and that a fundamental review of policy objectives, policy focus, policy responsibilities and the relationship between policy instruments and regulatory frameworks could, in fact, improve the complementarity of the policy areas rather heighten tensions.

It is perhaps unrealistic to imagine that such potentially radical considerations are really on the agenda. In the words of one observer:

> *"policy is made in turf battles between … bureaucracies, such that policymakers are often far more concerned with enhancing their power than with solving a problem. So policies tend to be ineffective, incremental, and incoherent"*[79]

Of course, the tenor of the relationship between national regional policy, EU cohesion policy and EU competition policy does not lie in the hands of the Commission alone. Moreover, each of the three policy areas is not only multi-faceted in the objectives it seeks to address but also in the political pressures to which it is subjected. Precedent is a powerful driving force in EU policy evolution and many Member States are likely to prefer the comfort of minor and relatively predictable adjustments to an existing approach (however unsatisfactory) to a radical overhaul that seeks to address the underlying objectives of policy. However, while policy change may be incremental, it should not lose sight of the potential offered by greater effectiveness and coherence.

[79] Hooghe L (1996) *Cohesion Policy and European Integration,* OUP, Oxford. p93.

SUB ROSA STRATEGIC DISCUSSION

SCOTLAND HOUSE, BRUSSELS

13-14 JUNE 2003

6. REGIONAL POLICIES AFTER 2006: SEMINAR DISCUSSION

6.1 Introduction

The preceding paper provided the basis for a Sub Rosa 'Strategic Discussion' held at Scotland House on 13-14 June 2003. This seminar was attended by c.60 representatives of European institutions, Member States, Accession Countries, regional institutions and academic bodies. Participants attended in a personal capacity and it was agreed that individual contributions to the discussion would not be attributed. On this basis, the following section should be regarded as a review of the discussion and does not represent a common or agreed set of conclusions.

The distinctive feature of this seminar on the future of EU regional policy was that it looked at broader policy influences and relationships between national regional policy, EU regional policy and EU competition policy.

The starting point was a general consensus that EU regional policy will continue in an enlarged EU, if only because assuring cohesion is a Treaty obligation and the Structural and Cohesion Funds are the designated instruments in the Treaty. However, the philosophy, scale, spread, the instrument and the interrelationship with other policies are open to debate. On the one hand, there are critics of regional policy who believe that the solution to regional problems is largely to rely on market mechanisms (especially private capital flows), and that regional policy is ineffective and wasteful. On the other hand, there are equally strong arguments in favour of retaining EU cohesion policy on the basis of evidence that the policy works and continues to be needed in the interests of European integration and solidarity.

Discussion at the seminar was organised around four sets of questions, each of which is summarised below in turn:

- Policy objectives: what does cohesion mean?
- Policy governance: who should do what?
- Policy focus: is spatial targeting really the way forward?
- Policy instruments: how to facilitate policy innovation?

6.2 Policy objectives: what does cohesion mean?

- What is cohesion?
    - economic and social cohesion?
    - reducing disparities between countries?
    - reducing disparities between regions in the EU?
    - reducing disparities between regions within countries?
    - territorial cohesion (balanced development)?
    - political cohesion?

- How do we reconcile the different dimensions of cohesion with:
    - the Lisbon Agenda (competitiveness)?
    - the Gothenburg Agenda (sustainable development)?

Much of the discussion focused on the objectives of regional policy and the question of geographical scale. The traditional dichotomy for regional policy – efficiency versus equity objectives – has been reconfigured in the debate of competitiveness versus cohesion. Some argue that, if the priority for the European Union is to be the most competitive and dynamic economy in the world, then all other policies need to be subordinated to this objective. This is sometimes interpreted as prioritising growth over the reduction of inequality. Indeed, in an enlarging EU does it make sense to have an EU-wide objective for reducing disparities? Is this not a chimera, neither feasible nor desirable? Others maintain that policies for competitiveness and cohesion can be reinforcing. Ameliorating underdevelopment and addressing problems of structural change contribute both to the goals of improving growth and reducing disparities.

It is important to be clear about geographical scale in this discussion of policy objectives. At an EU level, there is general agreement that the EU has an important role in reducing disparities between the poorer countries and the rest of the Union. In this respect, the EU can point to some successes. As the Second Cohesion Report pointed out, EU Structural and Cohesion Funds have contributed to a reduction in disparities between the poorest and richer Member States and between the poorest regions and the EU average.

However, disparities between regions *within* the Member States have widened, a trend possibly exacerbated by EU policies. Recent development trends have been unequal at national and regional scales. As is well known, there are pockets of poverty within rich areas, and poor and rich areas are often located within the same labour markets. This is primarily a challenge for Member States - for national governments, regional and local authorities.

One cautionary point concerns the need to relate regional disparities to the scale of the problem. Disparities will always exist; the key question is whether the economic or social conditions that they represent are of a scale or severity that justifies intervention.

At national level, there are contradictory interpretations of the scale and scope of the regional policy response on the part of national governments, especially outside the Cohesion Countries. In some respects, it is possible to identify a renaissance of regional policy, with new emphasis on regionalising economic development responsibilities and promoting integrated and strategic approaches to economic development at regional level. However, many of these new regional policies provide support for all regions within a country, at the expense of traditional forms of regional policy support that favoured the ‘problem areas’. It could be argued that these newer regional policies may well increase national and (in part) regional growth and competitiveness but at the expense of regional inequality within countries.

The direction in which EU regional policy and EU competition policy are going is likely to face Member States with ‘hard choices’. Further decentralisation of responsibility for regional policy decisions, under both Structural Funds and State aid control, would mean national and, in some cases, regional governments having to make (perhaps unwelcome) choices about policy objectives, spatial coverage and modes of implementation.

A further point is that cohesion policy has not succeeded so far in eliminating unequal territorial development. The Treaty of European Union only refers to two aspects of cohesion:

- economic cohesion, as the reduction of disparities measured by GDP at the regional level; and
- social cohesion as reducing inequalities between individuals within regions with as most important targets employment and education.

Why is there an omission of the concept of territorial cohesion (with the exception of Article16 which refers to access to public services)? The answer is that spatial planning belongs strictly to the competence of the Member States. However territorial cohesion is not to be confused with spatial planning. Economic and social cohesion do not necessarily evolve in a parallel manner over *all* territories for *all* individuals. There is a spatial concentration of economic development processes: the most prosperous regions in the EU are virtually all urban (with unemployment rates slightly above the EU average). There is a clear polarisation of population and economic activities around central areas. Cohesion policies and Structural Funds have not succeeded fully in eliminating unequal territorial development. Consequently, activities have to be spread more evenly over the EU-25 territory.

Last but not least, there is a need for political cohesion. All Member States have to get involved in EU regional policy. There can be no question of re-nationalising Structural Funds policy. Finally, there was a feeling that cohesion policy is about regions lagging behind and consequently priority should remain on Objective 1 regions.

6.3 Policy governance: who should do what?

- How should future regional policies be organised?
  - delineation of responsibilities: separation of objectives from means of implementation?
  - shared responsibilities: multi-level governance approach?
- What do subsidiarity and proportionality mean in practice?
- What is the added value of EU regional policy?
  - from an EU perspective?
  - from a national perspective?
  - from a regional perspective?

There are clear differences among Member States in the organisation of future regional policy at European level. A strong case has been made by those advocating a delineation and separation of responsibilities; many others advocate a sharing of responsibilities between levels. If there is to be a multi-level governance approach, there was a general request for reducing the 'conceptual complexity' and increasing the transparency of EU regional policy. The European Commission should define stable rules, give guidance and act more as a coach than as a financial controller. Subsidiarity is based on trust and a certain degree of transparency and equity. The Commission should present a framework and leave the hard choices to the Member States. However, this does not imply re-nationalisation.

One may question the current capacity of the European Commission – and especially its officials – to assume this new role, which requires specialised skills rather different from those related to financial or legal control. Either retraining of the staff or outsourcing should be considered.

The governance of future EU regional policy should avoid the tendency towards a micro-management approach; the system needs to have the scope for policies to be tailored to local/regional situations. There should be a shift from a sectoral approach to territorial policy approach, which means that various sectoral policies (i.e. CAP, Environment, Transport etc) should be better integrated at the regional level. Sectoral policies have to be adapted to the regions and no longer the regions to the sectoral policies.

Respecting the constitutional situation in each Member State, where possible the role of the regions, should be reinforced in regional programming but not only downstream (in implementation) but also upstream in contributing to the setting of the rules. Inside the EU institutional framework and besides the European Parliament, two committees could play a more important role: the Economic & Social Committee and the Committee of the Regions. The problem with the CoR is, however, its heterogeneous composition. Thought should be given to increasing the use of partnership between public, private and voluntary sectors.

Future added value can be maximised if the EU role concentrates on providing the overall vision and strategy, non-negotiable rules, the geographical concentration of support, thematic priorities and measures to ensure the effectiveness of intervention. A minimum level of resourcing to make a difference was also stressed; if resources are limited, concentration on a few, large projects might be necessary, although there are other ways of achieving added value from small amounts of funding.

The question of resources is not the only issue. EU regional policy needs to operate in an environment that supports regional development, which encompasses other EC policies, national policies for economic and social cohesion and regional characteristics such as governance, political ability etc.

It is important to note that not all aspects of the added value of EU support are measurable. Some parts of cohesion policy (eg. provision of funding to weaker countries and/or regions) are measurable. Other effects, such as multi-annual programming, are not measurable.

Key elements of added value associated with the 'methodology' of EU intervention are perceived to be:

- partnership – forcing people/institutions/interests to talk and work together in real co-operation;
- strategic thinking – providing the impetus for strategic planning and management of support;

- multi-annual programming – a stable, predictable policy environment for local and regional organisations;
- exchange of experience and the dissemination of good practice;
- awareness of the European context – information and understanding of European institutions, policies and processes.

In considering the added value of EU regional policy, it is important to be aware of the different stages of development and experience of countries/regions. There is an evolution in the ability of regions to generate added value over successive programming periods. Added value applies in principle to all regions (old and new Member States), but their ability to exploit it depends on factors like administrative capacity, choice of resource allocation system, programming experience and scope for flexibility. For example, new Member States were not allowed to decentralise the preparation and implementation of Structural Fund programmes to the regions despite the existence of relevant national legislation; others were forced to create artificial units (NUTS II) only for the purpose of managing the Funds.

On the issues of accountability and efficiency, it was stressed that these were essential elements of the funding system. However, people on the ground are overwhelmed by cumbersome procedures and structures. The future system should be 'worth the effort' and 'user-friendly'. As a general rule, existing national mechanisms should be used for ensuring accountability instead of introducing additional systems ie. no 'double checks'.

6.4 Policy focus: is spatial targeting really the way forward?

- How do we reconcile the spatial priorities of:
  - national regional policies,
  - EU regional policy, and
  - EU competition policies?
- What are the alternatives to map-based approaches to the design and control of regional policy?

There is general appreciation that strict State aid control is a major contributor to cohesion. Aid permitted in rich regions needs to be 'compensated' by even more resources for intervention in the poorer countries/regions – resources which they do not have. Therefore, the main value of State aids control is its help in 'levelling the playing field'.

However, the relevance of controls of State aid for some segments of the economy, like tourism, can be questioned. Some take the view that the control of regional aid is overdone, on the grounds that most aid is sectoral aid, and that there is 'questionable' trade/competition distortion of much regional aid spending.

There is a major challenge to develop a 'test of significant competition distortion' which could estimate/measure impacts of State aid in the case of particular projects at regional, national and international levels. The test should be also able to differentiate between the impact of State aid on cohesion within the country versus its impact within other parts of Europe. This test would help to moderate the negative impacts of the 'maps approach' in State aid (especially the problem of location on 'the wrong side of the road').

Looking to the future, there are real concerns about a 'double negative effect' ie. the withdrawal of State aid (through more restrictive award conditions) at the same time as losing eligibility for Structural Funds, especially in Objective 1 regions. It was stressed that the main reason for losing eligibility are the EU budgetary constraints, but there is less logic to limiting State aid in 'phasing out' regions. This was considered as particularly dangerous/unfair in the case of regions losing eligibility due to the 'statistical effect'. Mapping, which implies concentration, should not necessarily lead to an ex-ante fixed ceiling of the EU population. Subsidiarity and flexibility should be allowed.

Equally, fears were also expressed about the incremental nature of impacts on competition induced by gradually supported growth of some attractive locations, for example within the 'de minimis' rule. In future, strict criteria on State aids are needed as otherwise the governments of richer Member States would be tempted to support projects even in wealthy cities.

On the key question of spatial coverage, it is difficult to move away from the fact that 'regional policy is about maps'. Maps tend to be politically favoured, they provide focus and they represent a clear, easily understood framework. If maps are not used, it becomes very difficult to maintain coherence but there are some solutions. One of them may be to disconnect the eligibility phase (e.g. the calculation by the European Commission in accordance with the Member States of the amount allocated to each region or country on the basis of the population living in areas facing social, spatial or economic problems) from the programming phase (e.g. the choice by the region in accordance with the national authorities of the thematic priorities and the areas mostly in need). Thus, as the final map will not change the financial allocation, some flexibility may be accepted, for example +/- 10 percent of the agreed population coverage. This way of proceeding would permit a combination of efficiency, concentration, and policy requirements – the relevant maps for environment, social inclusion, economic regeneration measures may not be exactly the same. It would also solve most of the marginal tensions raised when areas are designated.

The problem, in an enlarged EU, is the arbitrariness of a 50 percent limit on spatial coverage and the danger of numerous, small, designated areas that lack the subtlety required for effective regional development. A 'horizontal approach' might be an alternative, reflecting the fact that the regional policies of Member States are increasingly being applied to all regions and, in part at least, involve the co-ordination or management of resources under sectoral policies. However, there is a lack of clarity about how this could work in practice; it was argued that a horizontal approach to economic development is no longer a regional policy.

In order to reinforce its legitimacy, it is important to preserve a territorial / regional dimension to cohesion policy and avoid it fading into other sectoral policies or priorities such as the Lisbon process. It was stated that cohesion policy is as much about helping the regions to fill the gap as about giving them opportunities.

However, the support for economic development must not be confused with the support for ‘excellence poles’.

6.5 Policy instruments: how to facilitate policy innovation?

- How do we promote innovation in regional policy:
  - encouraging risk-taking and experimentation?
  - ensuring accountability and efficiency of spending?
  - controlling aid?
- What kinds of support are most appropriate? (subsidies, investment, services etc)?
- Should we be considering new methods of delivery?

Several different aspects of innovation in regional policy were distinguished:

- innovation in policy objectives
- innovation in instruments,
- innovation in procedures,
- innovation in relation to other policies (like CAP, State aids etc).

Innovation in the past was mainly territorial innovation, which means accessibility to areas. In the future, enterprises and universities should become the main drivers of local innovation. At this stage, flexibility and adaptation to specific circumstances is necessary. The definition of innovation has to be left to the regional level and not imposed by national or European authorities. Innovation should also come from local partnerships by giving more responsibility to local actors. The bottom-up approach of the Leader Community Initiative should be mainstreamed in the regional programmes.

Lastly, it was acknowledged that, at local and regional levels, competition policy is seen much more as a constraint than an incentive to innovation. The ‘block d’exemption’ system for SMEs is not an innovation-promoting instrument.