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Regional Policy in Europe After Enlargement

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PREFACE

This paper comprises a discussion paper on the future of regional policy in an enlarged European Union. The paper was commissioned by a consortium of government organisations – Highlands & Islands Enterprise, the Scottish Executive, and Scottish Enterprise – to provide the basis for an informal 'Sub Rosa' discussion sponsored by Scotland House on 29-30 September 2000 in Brussels. This discussion involved senior officials from a wide range of European organisations, meeting on a confidential and unattributable basis. The paper has since been revised in the light of the discussion. The authors are grateful to the sponsors, for the financial support received, and to the discussants at the meeting, but it should be emphasised that the views expressed in this paper are those of the authors alone.

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ABSTRACT

Enlargement of the EU requires new thinking about the type of regional policy appropriate for an enlarged Union. Within an increasingly complex policy environment, the future of regional policy can be considered in terms of a ‘triangle of policies’, encompassing the regional policies of individual countries, EU competition policy and EU structural and cohesion policy. The key ‘drivers’ of policy in each of these areas are not always operating in the same direction, and there is the prospect of existing tensions being exacerbated, but also the opportunity for a more coherent policy structure to be created. Future policy options might involve retention of the existing approach to EU structural and cohesion policy. Alternatively, there is the possibility of a ‘variable geometry’ approach to regional policy EU and Candidate Countries, or a ‘concentrated policy approach’ (focusing on national disparities), or even a horizontal policy approach, co-ordinating EU, national and sub-national regional development actions together within a coherent policy at Member State level. At this distance from 2006 it is difficult to come to any clear conclusion as to which of the scenarios is likely to apply. However, it is important that the EU considers some fundamental questions as to the rationale, role and scope of EU regional policy before becoming immersed in the technical issues of resource distribution and instruments.

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INTRODUCTION

- With negotiations for the enlargement of the European Union underway, there is an opportunity to think afresh about the type of regional policy that is appropriate for an enlarged EU; and, in particular, the inter-relationships between EU regional policy and other areas of EU policy-making, and between the regional development efforts of the EU and those of the Member States and regions.

- This paper explores these issues in more detail. It outlines the policy context for economic and social cohesion and reviews the key drivers and trends relating to national regional policies, and EU regional and competition policies. It then sets out the parameters for enlargement, with reference to the scale of regional differences as well as the policy constraints. Finally, a series of future policy scenarios is presented, together with key policy questions for consideration.

POLICY CONTEXT

- The environment for regional policy is becoming increasingly complex. For regional policy-makers, whether at EU, national or regional levels, the key challenge is globalisation. The challenge for regional development now encompasses a wide range of competitiveness issues, such as entrepreneurship, productivity, innovation, networking and the quality of human capital.

- The complexity of the regional development environment is difficult to measure and analyse. Policy development and policy spending are often based on inadequate data and arbitrary cut-offs. Such problems are likely to be compounded with enlargement.

- Regional policy, especially at national level, is failing to adapt sufficiently quickly to the new economic environment, for example by changing the philosophy of spending or making use of new instruments such as regulatory mechanisms.

- Regional policy has been unable to generate a broader coherence with sectoral and other government policies, partly because of its weak or diminishing political commitment and profile. Even within the regional policy field, the growing proliferation of actors has led to problems of internal coherence.

POLICY TRENDS AND RELATIONSHIPS

- The future of regional policy can be considered in terms of a ‘triangle of policies’ encompassing the regional policies of individual countries, EU competition policy, and EU structural and cohesion policy. Enlargement will bring with it challenges that affect all three parts of the triangle.

National regional policy in EU Member States

- *Key drivers.* In recent years, national regional policies have come under increased pressure on a number of fronts: international competitive challenges have grown; spatial problems have become more localised and complex; the decentralisation of government is changing attitudes to regional problems and disparities; and EU competition and structural policies have become increasingly influential.

- *Key trends.* Shifts in policy objectives are emphasising the promotion of competitiveness (new firm formation, SME development, skills, employment and innovation). The focus on large-scale, direct business aid and infrastructure is giving way to 'softer' and indirect policy measures to improve the business environment. Over the past 20 years, there has been a general and significant contraction of regional aid area coverage - in many Member States it is becoming difficult to operate a rational regional policy within the population quotas allocated under the Regional Aid Guidelines. There is a significantly enhanced role for regional and local economic development initiatives, and an increased spatial focus (urban) and sectoral targeting (clusters) within policy. Changes in modes of governance involve decentralisation, rationalisation, partnership and co-ordination in the administration of policy. Increasing policy attention is being given to sustainability and social inclusion.

National regional policy in Candidate Countries

- *Key drivers.* Regional and social disparities are growing – west/east, core/periphery, urban/rural - as the spatial effects of transition become increasingly uneven. Concern with the political and economic consequences of regional inequality is increasing, and there is pressure from the EC to develop regional policies and institutional capacity as part of the process of complying with pre-accession requirements.

- *Key trends.* Market-based regional policies were initially slow to develop, but significant recent progress has been made. Every Candidate Country has developed regional policy concepts, legislation, institutions and instruments. Regional development challenges exist in virtually every region, notably to embed a market economy and encourage structural change. Institutional capacity is being developed - most countries have a national regional development agency and a network of regional development agencies and/or councils. Policy instruments are still in their infancy, but many countries have regional development programmes and/or regional aid schemes providing direct support to enterprises.

EU competition policy

- *Key drivers*. EU competition policy has introduced a powerful, new dynamic into the relationship between national and EU regional policies. The Regional Aid Guidelines, together with the Multisectoral Framework, have significantly reduced the room for manoeuvre in the design and implementation of national regional policies. Under the Guidelines, award maxima are likely to bite for the first time, and there is greater harmonisation of Member State area designation procedures.

- *Key trends.* In recent years, there has been a growing stress placed on the population coverage of designated aid areas as a measure of aid discipline, as well as increasing involvement of the competition policy authorities in the process of area designation. The emphasis on the coherence of national and EU regional aid area maps by (some parts of) the Commission is being questioned at the Member

State level. Constraints on award ceilings and the increasing imposition of rate modulation raises doubts about the longer-term influence of regional aid on investment and location decisions. There are clear challenges for the Guidelines in an enlarged EU, with implications for the concepts and methodology used.

EU structural and cohesion policy

- *Key drivers.* Over the past 15 years, EU regional policy has been revolutionised to make a more powerful impact on economic and social cohesion. However, the Agenda 2000 negotiations clearly showed the financial constraints on the EU, as well as pressure for concentration and the desire for simplification and rationalisation of bureaucracy.

- *Key trends.* Significant changes to EU regional policy have been introduced in response to budgetary constraints. The notion of 'Cohesion countries' is in retreat, as the 1999 Structural Funds Regulation favours poorer regions at the expense of poorer countries. The difficulties in reaching agreement suggest that it is feasible to impose rigid approaches either on eligibility or on financial allocations, but not on both. The negotiations of the Regulation also make clear the power of precedent in EC regional policymaking. The outcome of the Berlin Council has significant implications for both the current membership and possible future Member States with respect to area designation and the allocation of funding. There are also issues associated with policy implementation; early indications are that the planned 'simplification' is proving to be illusory.

PARAMETERS OF ENLARGEMENT

- *Scale of regional problems/disparities***.** National differences in GDP between the EU15 and Candidate Countries are wide. Enlargement of the Union from the EU15 to an EU27 would increase Community population by 28 percent, GDP by 11 percent and area by one-third, but EU GDP per head would fall by 14 percent. There is likely to be some partial convergence in Member State GDP by the time enlargement takes place, but this cannot be guaranteed. Regional GDP per capita levels in the Candidate Countries are considerably less than the EU average – only the capital city regions of Prague and Bratislava are above this level. According to some calculations, regional disparities in an enlarged EU will increase the ratio of richest to poorest regions from 1:5 to 1:9 (in an EU25). Enlargement is expected to be associated with an expansion of trade, investment and economic activity, but with sectoral and regional variations. Migration flows are of particular concern to some EU15 countries, but the impacts may have been overstated.

- *Policy responses.* The policy response is governed first by the size of the EU budget and the share of EU regional policy. As in past negotiations on EU policy and funding, the form and allocation of EU regional policy will depend on political bargaining among Member States. The crucial questions are: (a) what the 'net payers' are willing to contribute; (b) what the current recipient countries are prepared to forego; and (c) what future recipient countries/regions are prepared to accept. In this context, the Berlin Council showed that Members States are unwilling to forego aid to their recipient regions. The degree to which Candidate Countries are able to benefit from EU regional policy is subject to several factors:

the timetable of accession; absorption limits; co-financing possibilities; and relative changes in per capita allocations. However, funding allocation is not the only issue - there is scope for new thinking about the form of policy and the nature of the instruments used as part of EU regional policy.

POLICY OPTIONS AND QUESTIONS

- There are various levels at which the future of policy needs consideration. At a pragmatic level, there is a series of possible *options* that involve adjusting current mechanisms. At a strategic level, there is a case for revisiting some of the fundamental *questions* concerning the design and conduct of policies to address regional disparities in the EU.

Policy options

- *Option 1 - Current Policy Approach.* This would involve retention of the existing approach to EU structural and cohesion policy and extending it eastwards. Funding would be allocated to eligible areas for delivery through regional programmes. The Commission would retain responsibility for allocating finance, approving programmes and overseeing delivery, while Member States would have responsibility for programme implementation.

- *Option 2 - Differentiated Policy Approach.* Under a 'variable geometry' approach, the EU would take a differentiated policy approach to CEE and EU countries involving: (a) a 'cohesion policy' (or transition policy?) approach to the CEECs, providing policy support to each of the applicant countries as a whole, regardless of levels of prosperity of individual regions; and (b) maintaining 'structural policy' in the EU15 on the current or similar basis. In the CEECs, funding would be allocated to the new Member States for delivery through national development programmes, whereas in the EU15 funding would be allocated to eligible regions for delivery through regional programmes. As above, the Commission would have responsibility for allocating finance, approving programmes and overseeing delivery, while Member States would have responsibility for programme implementation.

- *Option 3 - Concentrated Policy Approach.* More radical would be a reform of structural and cohesion policy so that the Community only intervenes if cohesion "cannot be sufficiently achieved by the Member States" and can be "better achieved by the Community" (Article 5). Under this option, the EU would only intervene where Member State per capita GDP is below 90 percent of the EU average (for example), ie. providing support for the poorest Member States. In addition, the EU would intervene in fields where there is a clear Community role eg. inter-regional, cross-border and transnational co-operation as well as innovative actions etc.

- *Option 4 - Horizontal Policy Approach.* A fourth policy option would be to develop a 'horizontal' approach to regional development co-ordinating EU, national and sub-national actions within a coherent policy at Member State level. Under this approach, the EU would allocate funding to Member States according to GDP per capita and population (all Member States would receive minimum funding as with Objective 3). Each Member State would draw up a 'national regional development strategy' combining all relevant economic development actions. The EU role would be to check conformity with EU objectives, competition policy, environmental policy etc and promote good practice, pilot projects, innovative actions, inter-regional co-operation, evaluation etc. while Member States would be responsible for policy design and delivery.

Policy questions

- At this distance from 2006 it is difficult to come to any clear conclusion as to which of the scenarios is likely to apply. However, given the importance of precedent in Structural Fund negotiations, it seems likely that a continuity-based option will be chosen. While many richer Member States are actively considering more radical scenarios the pressures for the final outcome to be not too far distant from the current approach are strong. However, three key questions need to be addressed.

- The first question is whether EU policies really do aspire to address economic and social disparities. Resources are such that the Community can only expect to achieve equality of *opportunity*, not of *income*. If an appropriate EU budgetary mechanism can be developed, then the Structural Fund focus could be even more on regional economic development issues. However, there is a danger that downgrading the political importance of the Funds may result in an important link between the policies of the EU and local communities being lost.

- The second question is what the role and scope of EU regional policy should be. The primary goal must be to facilitate and promote convergence. However, it is important to note that EU regional policy has other elements: it provides a European strategic framework for regional development; it promotes integration (through, for example, cross-border co-operation); it responds to disasters; it plays a regulatory role, in particular through its State aid policy; and it can animate, evaluate and generally promote good practice. A coherent approach to European regional policy should recognise all of these objectives.

- The third question is how EU policies can best address economic and social cohesion. There is an argument that the EU should be aiming to promote a diversity of approach across regions. In this context, the relative roles of the European, national and sub-national levels in the design and implementation of policy may need to be reassessed. There is a strong argument for taking into account the relative wealth of Member States when considering the appropriate contributions of the different levels. It is also important that the temporary nature of interventions be stressed. Regional policy-makers need to find ways of breaking the subsidy 'habit' and promoting a new, more forward-looking mentality that encourages countries and regions to minimise the need for external support.

1. INTRODUCTION

With negotiations for the enlargement of the European Union underway, the Union is on course to grow to 27 Member States over the next decade or so. Whatever the timescale and sequencing of accession, enlargement will reshape the maps of economic and social disparity across the Union and necessitate a fundamental reappraisal of EU regional policy. It is also an opportunity to think afresh about the type of regional policy that is appropriate for an enlarged EU, and, in particular, the inter-relationships between EU regional policy and other areas of EU policy-making, and the inter-relationships between the regional development efforts of the EU and those of the Member States and regions.

In parallel, Economic and Monetary Union has implications for those within and outside 'Euroland'. The regional dimensions of EMU continue to be open to debate, but, on balance, academic and expert opinions incline towards negative implications for the problem regions. At the same time, while the European Union remains without the classic fiscal transfers that characterise modern welfare states, it operates a regional policy that is uncharacteristic of federal structures or free trade arrangements.

This is an appropriate moment to be discussing these questions. The 1999 Berlin European Council has settled the allocation of the EU budget for the period up to 2006, and the negotiating positions of the Member States and Commission services for the post-2006 period are still open. Many of the EU15 will need to give serious thought to the implications of losing substantial receipts from the Structural and Cohesion Funds, in particular, the legacy of the Funds. The lessons for future policy-making in the regional development field need to be considered.

At the same time, the national regional policies of the Member States are in a state of flux. Factors such as the effects of globalisation, technological change, the accelerating development of a knowledge-based economy and society, concern with sustainability and social exclusion are reshaping the agenda of regional development. Questions of governance also need to be addressed. The 'traditional' model of regional policy - run by central government through regional aid instruments - is being complemented or replaced by more decentralised and broader approaches to regional development. Especially in so-called 'unitary' states, the regions are no longer passive recipients of central aid, but active initiators of economic development with increasingly sophisticated institutional mechanisms for policy delivery. The challenge for national government authorities is how to facilitate these processes while ensuring that regional policy - nationwide - is coherent, efficient and effective.

These are also issues for the Candidate Countries, where regional policies are still in their infancy. Key decisions need to be taken about the objectives of regional policy, the structures of territorial administration, institutional capacity at different levels, the types and budgets of policy instruments and compatibility with the approach of EU regional policy which is funding much of the regional development effort in the Candidate Countries.

There are important questions for the EU as well. With over a decade of experience since the 1988 reform of the Structural Funds, much has been learned about effective policy design, strategy development, programme management, partnership, project generation, monitoring and evaluation - indeed, many of the principles are being taken over into national regional policies. The experience has also demonstrated the limitations of EU-level policy intervention in large numbers of regions. With respect to the regulatory functions of the Commission, the regional aid controls of competition policy have become increasingly effective in influencing the spatial coverage and award levels of aid, but have also raised questions about the rationale and coherence of actions in this field.

As the EU extends eastwards, the EC and the Member States have an opportunity not just to reconsider the funding allocation mechanisms under EU regional policy but to (re)articulate a 'vision' and strategy for economic and social cohesion in an enlarged EU. Part of this involves a broader assessment of how the different dimensions of EU and national policies affecting regional development can become more coherent.

This paper explores these issues in more detail. It begins by outlining some theses concerning the policy context for economic and social cohesion (Section 2) and then reviews the key drivers and trends relating to national regional policies (in both the current Member States and the Candidate Countries), EU regional policy and EU competition policy (Section 3). The paper then sets out the parameters for enlargement highlighting likely national and regional differences in an enlarged EU as well as the policy constraints associated with enlargement (Section 4). Finally, a series of future policy scenarios is presented, setting out the benefits and disadvantages of various policy options (Section 5), before raising some key strategic policy questions for the future development of regional policy in an enlarged EU (Section 6).

2. POLICY CONTEXT

The environment for regional policy is becoming increasingly complex. For regional policy-makers, whether at EU, national or regional levels, the key challenge is globalisation. The growing internationalisation of economic activity, the progressive removal of protectionist trade barriers (especially within the EU), technological change and the accelerating shift towards a knowledge-based economy and society have been reshaping the competitive advantage of countries and regions. Whereas the main objectives for regional policy in the past were limited to the promotion of increased investment, the creation of employment or the provision of adequate physical infrastructure, the challenge for regional development now encompasses a wide range of competitiveness issues, such as entrepreneurship, productivity, innovation, networking and the quality of human capital[1].

The complexity of the regional development environment is difficult to measure and analyse*.* At the EU level, certain conclusions are clear: there are major regional disparities across the Union by international standards; there are core-periphery differences in economic development; and there are major contrasts between the leading 'learning economy' regions and those suffering from underdevelopment or concentrations of persistently high structural unemployment. More detailed analysis is difficult, because of data and methodological constraints, presenting a challenge for policy design. Whereas there is great diversity in the problem region indicators used at the national level (eg. physical indicators, associated with geographical or natural conditions; economic indicators, such as differences in regional output, income or other measures of prosperity; and social indicators, notably differences in living conditions and unemployment), the EU approach to problem area analysis is forced to rely on two basic measures – GDP per head (economic cohesion) and unemployment rates (social cohesion). Policy development and policy spending are therefore often based on inadequate data and arbitrary cut-offs. Such problems are likely to be compounded with enlargement where the data base is very poor at sub-national levels, and standard EU measures are inadequate for reflecting regional problems.[2] More generally, the measurement of disparities needs to be kept in perspective[3]:

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[1] Bachtler J (2000) *Regional policy in Europe: which way forward?* in Coffey P (Ed.) Europe - Towards the Next Enlargement, Kluwer International Handbooks on Economic Integration, Boston, Dordrecht and London.

[2] Wishlade F G and Yuill D (1998) *Measuring Disparities for Area Designation Purposes*, Regional and Industrial Policy Papers No.24, European Policies Research Centre, University of Strathclyde, Glasgow.

[3] Michalski A and Saraceno E (2000) *Regions in the Enlarged EU, Report on the 18th European Carrefour on Science and Culture, Budapest, 20-25 March 2000,* Forward Studies Unit, European Commission.

> *"Regional problems defined in terms of territorial disparities in economic development…[represent]… a simplistic and no longer satisfactory criteria for identifying problem areas. There is not one but a multiplicity of problems that need to be addressed and these change over time".*

Regional policy is failing to adapt sufficiently quickly to the new economic environment. Over a 30-year period, the macro-economic environment has been one of a long-term slowdown in economic growth in Western Europe. The opportunities for 'trickle down' effects from core centres or regions have been limited by low-growth conditions in richer countries or regions and the limited effectiveness or absence of mechanisms for spreading the benefits of growth. The potential for compensating migratory flows has been curtailed, and the role of the public sector in creating jobs or the conditions for development is constrained. Regional policy, especially at the national level, has been slow to adapt to the growing complexity of regional problems, eg. by changing the philosophy of spending, or by making use of new instruments such as regulatory mechanisms. It has been argued that[4]:

- *"the* modus operandi *of today's regional policy essentially consists in reacting to or curing industrial problems instead of tackling intangible or prospective problems;*

- *regions that are less developed today do not seem* a priori *to be equipped to take a quantum leap in development and move from the status of a less-favoured region in the traditional economy to that of a strong region in the new economy;*[5]

- *regions in crisis do not have the financial assets required to make the basic investments that are vital to make a full entrance in the new economy; and*

- *current regional policy is confined within rigid administrative geographical limits that reflect village-pump mentalities rather than spatial planning considerations."*

Policy for regional development lacks coherence. In some countries, regional policy is relatively marginal, with limited or no connection between spending on regional policy and the regional allocation of spending under industrial policies (eg. RTD, environment), let alone the spending areas that have the

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[4] Saublens C (2000) *Does the New Economy Call for a New Regional Policy Concept?* EURADA, Brussels.

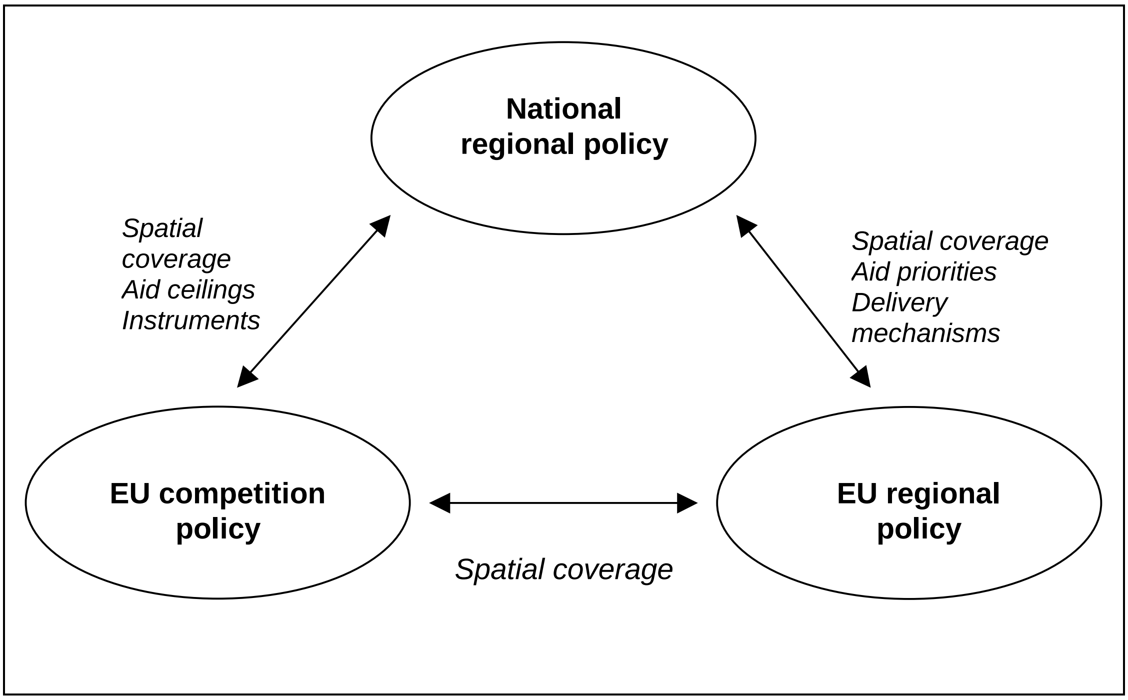
[5] This may be the case in Europe, but it can be argued that some regions in less-developed countries have been able to make this 'quantum leap'.

greatest influence on regional differences (health, education, social security).[6] Regional policy has been unable to generate a broader coherence in regional development, not least because it has itself suffered from weak or diminishing political commitment and profile over much of the past 25 years (though there are some more recent signs that it is moving up the policy agenda in some countries). Moreover, even *within* the regional policy field, the growing proliferation of actors has led to problems of internal coherence – between sub-national and national authorities; between Member States and the EU; and, within the EU, between EU structural and competition and other policies.

[6] Wishlade F G, Yuill D, Taylor S, Davezies L, Nicot B H and Prud'homme R (1998) *Economic and Social Cohesion in the European Union: the Impact of Member States' Own Policies*, Regional Development Studies No.29, European Commission, Luxembourg, 161pp.

3. POLICY TRENDS & RELATIONSHIPS

Looking towards enlargement, the future of regional policy can be considered in terms of a 'triangle of policies' (see below) encompassing (a) the regional policies of individual countries; (b) EU competition policy; and (c) EU structural and cohesion policy. In this model, each of the three policy areas (the *nodes* of the triangle) has been evolving in response to specific as well as common pressures; some of the policy trends are convergent, some are divergent.[7] However, each of the three policy areas is also inter-related (the *axes* of the triangle), particularly with respect to the spatial coverage of policy (designation of assisted areas), the priorities for regional intervention, the ceilings on regional aid and the mechanisms through which policy is implemented. Enlargement will bring with it challenges that affect both the nodes and the axes of the triangle. The following section considers each of the policy areas in turn, highlighting the 'key drivers' that are shaping policy, as well as recent trends and the tensions between the policy areas.



3.1 National regional policy in EU Member States

3.1.1 Key drivers of national regional policy (EU)

In recent years, national regional policies have come under increased pressure on a number of fronts: international competitive challenges; the localisation of

[7] Other policy areas eg. agriculture, social policy and R&D policies also have important regional dimensions.

economic development problems; decentralisation of government; and the influence of EU competition and structural policies.[8]

International competitive pressures have increased. In many EU Member States, the past decades have been characterised by public expenditure constraints, rising nationwide levels of unemployment and concern with international competitiveness, structural change and productivity. Antipathy towards government intervention has favoured a more market-led approach to economic development. The internationalisation of the economic environment has made long-term planning less sustainable and rendered many regions more vulnerable to rapid changes resulting from global market adjustments.

Spatial problems have become more localised and complex. Areas of urban decline characterised by social exclusion dominate parts of many European cities. The appropriate policy focus – interpersonal or interregional disparities in prosperity – is not always clear. At a spatial level, interpersonal disparities are not necessarily best treated through economic or regional policy instruments, but rather through welfare, educational or social measures. Nevertheless, regional disparities consist essentially of a spatial concentration of interpersonal disparities.

Growing interest in the decentralisation of government is changing attitudes to regional problems and disparities. Pressures for devolution and deconcentration exist in many countries, resulting from a mix of social, cultural, economic and political factors, and reshaping the organisation of governance. There have been significant transfers of powers to lower governmental levels (in some cases involving the creation of new administrative levels), although often without allocating additional resources or devolving revenue-raising powers. The appropriate level of intervention in economic development is central to these debates, not just in respect of instruments to address regional problems, but also wider issues related to fiscal transfer systems.

EU competition and structural policies have become increasingly influential. At the European level, competition policy pressures have increasingly shaped the nature, design, areas and rates of intervention under regional aid policy (eg. Regional Aid Guidelines). Perhaps more importantly, they have arguably contributed to, rather than controlled, competitive outbidding between Member States as regional aids have increasingly been used as instruments of FDI policy in many countries. In parallel, Structural Funds interventions have frequently modified national or regional level policy priorities as countries have been forced to adapt instruments to meet EU co-financing requirements.

[8] Yuill D, Bachtler J and Wishlade F G (1999) *European Regional Incentives 1999*, 18th Edition, Bowker Saur, London. Hugonnier B (1999) *Regional Development Trends in OECD Countries*, Paper to the Regional Australian Summit, Canberra, 26-29 October 1999, Territorial Development Service, OECD, Paris.

3.1.2 Key trends in national regional policy (EU)

Shifts in policy objectives towards promoting competitiveness. Regional policy objectives were generally conceived in terms of reducing spatial disparities in economic growth, infrastructure provision or employment. Over the past 15-20 years, regional policy goals have been increasingly concerned with optimising the contribution of regional resources to the creation of economic growth by promoting competitiveness and entrepreneurship. The policy focus is on wealth creation at the local level – and the agenda is increasingly one of new firm formation, SME development, skills, employment and innovation.

Decline of traditional policy instruments. The focus on large-scale business aid and infrastructure is giving way to softer policy measures (stimulated, in part, by the Structural Funds). However, financial incentives have proven to be a resilient policy instrument - easy to administer, flexible, transparent, capable of bringing policy-makers and (growing) firms together in a positive policy environment, as well as being blessed with a high policy/political profile. A key factor in their continued utilisation is their influence on FDI location decisions - rationalisation or abolition would require concerted action across the EU (which seems unlikely). Notwithstanding the downward trend, national regional incentive expenditure exceeds ERDF commitments in all Member States, except for the four 'cohesion countries' and Denmark.[9]

Contraction of regional aid areas. Over the past 20 years, there has been a general and significant contraction of regional aid area coverage. In a majority of northern and central Member States, there has been a reduction of population coverage of 50 percent or more. In contrast, Greece, Portugal, Ireland and Spain have largely retained their coverage, though both Portugal and Ireland recently experienced major Article 87(3)(a) cutbacks (one-third in Portugal, two-thirds in Ireland). In many Member States, it is becoming difficult to operate a rational regional policy within the population quotas allocated under the Regional Aid Guidelines.

Enhanced local economic development initiatives. The localisation in the scale of economic development problems has partly led to a growth in 'bottom-up' initiatives by a mix of public, private and quasi-public actors. This has been encouraged by the 'bidding culture' that selects projects, programmes or initiatives on a competitive basis. This is evident in the emergence of labour market policies that are spatially targeted as well as the explicit targeting of urban initiatives or social and educational policy instruments. The key feature of these instruments is that they focus more on social, employment and individual needs than on wider economic development issues.

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[9] Wishlade F G (1998) EC Competition Policy: The Poor Relation of EC Regional Policy?, *European Planning Studies*, 6(5), 573-597.

Increased spatial focus (urban) and sectoral targeting (clusters). There has been an increasing emphasis on the role of urban centres/agglomerations as 'motors' of development - partly related to the area designation constraints imposed by the Regional Aid Guidelines (examples include Finland, the Netherlands, Ireland, Austria, France). Increasingly, urban centres are seen as playing a key role in promoting national competitiveness and the development of surrounding rural areas. The language of growth poles, growth points, strategic centres etc. has returned. The concern with identifying 'motors' or 'drivers' of economic development is also reflected in the sectoral targeting of policy, especially in the growing interest in cluster policies.

Changes in modes of governance (decentralisation, rationalisation, partnership, policy co-ordination). In policy debates, the relative roles of the central and regional levels in economic development have been a subject of keen discussion. In France, Italy, the UK, Sweden and Denmark, recent decisions reflect a more decentralised approach to regional policymaking. At the same time, there is evidence of a more co-ordinated approach to policy, both within the regions and centrally – for example, in Italy, Ireland, UK, Finland and the Netherlands. While the growing role of the regional level is widely recognised, the centre continues to be important, not only to facilitate co-ordination but also to provide balance and ensure equity.

Growing interest in sustainability and social inclusion. These are not just Structural Fund concerns, but are also relevant within an increasing number of national regional policies (eg. the recent French Law on Sustainable Regional Development; specific regional aid for areas of social exclusion in Scotland). In addition, the stress being placed on urban problems in a range of countries reflects, amongst other things, the weight attached to countering the problem of social exclusion.

3.2 National regional policy in Candidate Countries

3.2.1 Key drivers of national regional policy (CEE)

Growing regional and social disparities – west/east, core/periphery, urban/rural. The regional economic effects of transition are increasingly uneven. Notwithstanding the severe limitations of data availability and reliability, research evidence suggests that regional disparities in income, investment and employment in Central and Eastern Europe (CEE) have grown quickly and significantly since 1989, with a prediction of widening disparities in future and a fragmentation of regional economies.[10] Leading regions include the core and capital city regions and regions close to borders with EU countries. The economic development situation has been less favourable for certain 'lagging regions' which face difficulties in adapting and demonstrating

[10] Dunford M and Smith A (2000) Catching up or falling behind? Economic performance and regional trajectories in the "new Europe", *Economic Geography*, 76, 169-75.

positive growth potential. Areas with high and unsustainable levels of agricultural employment, for example, often offer few alternative employment opportunities and attract little foreign investment, resulting in high rates of unemployment and the out-migration of the young and better qualified population. These areas are particularly evident on the eastern borders of CEE. Another group of disadvantaged regions are the old industrial areas, the former drivers of economic development under the socialist central planning regime.

Concern with political and economic consequences of regional inequality, at least where national political stability is threatened. Regional development questions were largely sidelined for much of the 1990s in most countries. Structural reforms were concentrated in the 'sectoral' policy sphere, and the interplay between 'regional' and 'sectoral' issues has not been fully developed. To some extent this is understandable. The pressure of major problems, like macro-economic stability, the dynamics of growth, external economic relations and balance of payments, industrial restructuring, and social problems like unemployment and poverty have preoccupied the political élites and governments in countries that, in general, have not enjoyed social and economic prosperity. For most countries, problems like growing regional differences or the marginalisation of certain territories have been, and in many cases still are, considered to be of secondary importance. The main exceptions are cases where economically and/or politically important regions face problems that may threaten national political stability.

Pre-accession aid of the EU and pressure from EC to develop policies and institutional capacity. The EU is providing increasing financial support for the Candidate Countries through the pre-accession structural instrument and enlargement operations, focused on institution-building and developing national regional policies that are compatible with the Structural Funds. As part of this process, each CEE country has been developing a hierarchy of concepts, strategies, plans and programmes for regional development. These have several common characteristics. At the apex tends to be a 'national concept' or 'strategy' for regional development providing a conceptual regional policy framework, including a statement of aims and objectives, an outline of the institutional structures and identification of the different policies with a regional dimension or impact. This concept or strategy is then translated into a multi-annual regional development plan, describing in detail how the EU financial aid (under ISPA, SAPARD, Phare) will be allocated between policy areas, managed and delivered. As with the Structural Funds in EU countries, the regional development plans are intended to be submitted to the European Commission for approval and implemented through a series of operational programmes.

3.2.2 Key trends in national regional policy (CEE)

Market-based regional policy was slow to develop but significant recent progress has been made.[11] Regional policy is not a new phenomenon: several CEE countries have a tradition of regional development and spatial planning experience (mainly sectoral). Market economy based regional policies were initially slow to develop, with priority being given to political and macro-economic reforms at a time of scarce resources in the face of national economic crisis. There was also a time lag in the emergence of the spatial impact of reform, a lack of requisite institutional capacity and unresolved issues of territorial administrative reform. However, there have been significant changes in the regional policy situation over the past five years, and every Candidate Country has developed regional policy concepts, legislation, institutions and instruments.

The policy challenges are major, as are the policy constraints. Regional development challenges exist in virtually every region, notably to embed a market economy and encourage structural changes of different types. The objectives of regional development policies are trying to meet disparate policy goals, with a combination of efficiency and equity objectives and a focus on both reducing disparities and spatial targeting. However, policy design and delivery is constrained by the lack of strong regional structures, institutions and budgets. Coherence with the principles of EU structural policy is problematic in some cases.

Institutional capacity is being developed rapidly. Every Candidate Country has developed regional policy-making capacity at national level, although ministries are sometimes weak and prone to being reorganised in line with political shifts. Moreso than in EU Member States, CEE countries have established inter-ministerial co-ordination mechanisms, often brought together in a national regional development board or council to co-ordinate the design of regional development strategies and funding allocations. Most countries have a national regional development agency and a network of regional development agencies and/or councils. Territorial administrative reforms have been undertaken in some countries (Poland, Czech Republic, Hungary, Romania) in recent years, with the creation of 'macro-regions' that have varying degrees of self-government.

Policy instruments are still in their infancy[12]***.*** It is often difficult to isolate regional policy instruments given the continued dominance of sectoral budgets. Regional development programmes (accounting for the majority of regional support) are generally available in most regions outside the capital cities. Assistance is disbursed through sub-national offices of the State,

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[11] Bachtler J, Downes R and Gorzelak G (Eds.) (2000) *Transition, Cohesion and Regional Policy*, Ashgate Publishers, Aldershot.

[12] Bachtler J and Downes R (1999) Regional Policy in the Transition Countries: A Comparative Assessment, *European Planning Studies*, 7(6), 796-807.

regional development agencies or municipalities. Programmes cover a wide range of economic development activities - social as well as economic infrastructure. In addition, some countries (eg. Czech Republic, Estonia, Hungary) have regional aid schemes providing direct support to enterprises. These are generally focused on SMEs and mostly take the form of loans, interest-rate subsidies and tax incentives.

3.3 EU competition policy

3.3.1 Key drivers of EU competition policy

EU competition policy has introduced a powerful new dynamic into the relationship between national and EU regional policies. Provisions for the control of the State aid policies of the Member States under competition policy 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. Promotion of competition policy as an instrument of cohesion dates back to the Single European Act; it has been argued strongly that an effective cohesion policy requires strict control of State aid. However, while the competition rules in principle only concern measures that constitute State aid, they have indirectly played an important role in shaping the coverage of other policies, notably those co-financed through the Structural Funds.

The Regional Aid Guidelines, together with the Multisectoral Framework, have significantly reduced the room for manoeuvre in the design and implementation of national regional policies. The Regional Aid Guidelines implicitly measure regional aid discipline through control of the coverage of the assisted areas, coupled with the requirement that the Commission approves both the methodology for area designation and the geographical units used as building blocks. Given that the Commission also has the final say in maximum award values, as well as its longstanding intervention in forms of assistance, the only area left out of direct Commission control is that of regional aid spending. [13]

The Regional Aid Guidelines were designed with enlargement in mind. One of the principles underpinning the limit on problem area coverage was that national regional policy intervention should not concern more than 50 percent of an enlarged EU population. This implies a mechanistic approach to regional aid discipline and one that takes no account of the relative prosperity of regions within countries, which is unaffected by expanding membership.

The Regional Aid Guidelines have caused major difficulties for the Member States in developing appropriate national regional policies for the 2000-06 period. Under the Regional Aid Guidelines, award maxima are likely to bite

[13] Wishlade F G (1998) EC Competition Policy and Regional Aid for Large Investment Projects: the Other Half of the Pincer Movement? *Regions: the Newsletter of the Regional Studies Association*, 217, October.

for the first time. In addition, there is greater harmonisation of Member State area designation procedures; with more emphasis on coherence of national and Community regional policy assisted areas. The development of the Guidelines reflects a triangular 'tug of war' between the Member States, DG Competition and DG Regio over the assisted areas, but the balance of power has shifted over time. In 1988-93, it can be argued that DG Regio won out; more recently DG Competition appears to have regained dominance, with for instance the Structural Funds assisted areas being used as a device for reaching agreement between Member States and DG Competition on national regional aid areas. Many Member States have found the negotiations with DG Competition a difficult experience, and a reconsideration of the process adopted seems likely. The substance of the Guidelines suggests that the analytical tools for assessing the real competition impacts of State aids need to be improved.

3.3.2 Key trends in EU competition policy

There has been a growing emphasis on the use of population coverage as a measure of regional aid discipline. Under the 1998 Guidelines, this culminated in the setting of national population 'quotas' for Article 87(3)(c) areas, based on a notional total coverage figure for the EU and the coverage of Article 87(3)(a) areas. This has been coupled with tighter specifications regarding geographical units, indicators and area designation methodologies.[14]

DG Competition influence over forms of intervention is longstanding and has been maintained, even reinforced. In almost all Member States, grants are the mainstay of the regional aid package, in part at the instigation of the Commission. The new Nordic Member States were forced radically to reform policy instruments for the northern territories, which were viewed as "operating aid" by the Commission. Non-Member States have not escaped this influence: under the EEA Treaty, Norway has been forced to amend its social security concession for the north, while in Central and Eastern Europe the adoption of the *acquis* is revealing a significant number of regional development and other measures (for example, Special Economic Zones in Poland) that fall foul of Commission perceptions of acceptable measures.

The question of the coherence of national and Community regional policies has been an issue since the 1988 reform of the Funds and remains so.[15] DG Competition has generally taken a rather agnostic view on the question of map coincidence, preferring to focus on those areas in which State aids are permissible, rather than the wider question of whether the effectiveness of policies would be improved through coincident maps. Under the new

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[14] Wishlade F G (1999) 'Competition, Cohesion and Coherence? Member State Regional Policies and the New Regional Aid Guidelines' in S Bilal and P Nicolaides (Eds.) *Understanding State Aid Policy in the European Community'*, Kluwer Law International, 173-206.

[15] Wishlade F G (2000) *Concentration of the Structural Funds and the Commission Guidelines on National Regional Aid,* Paper to European Institute of Public Administration seminar 'Implementing the Agenda 2000 Reforms: the EU Structural Funds in 2000-2006' 13-14 April 2000, Maastricht.

Guidelines, superficial coherence is reinforced through: the alignment of the timetables for national map approval with the Structural Funds planning period; the same basic criteria for Article 87(3)(a) and Objective 1 eligibility; and a derogation from the general provisions on national assisted area designation to encourage map 'coherence'. If anything, the Member States have been increasingly unenthusiastic about coincident maps.[16] In a number of countries, Objective 2 eligibility was used as a device to resolve small areas of dispute between Member States and DG Competition over national map coverage. On the other hand, and more importantly, there is growing pressure from the Member States for the de-coupling of EU regional policy and EU competition policy control of national assisted areas. As Structural Fund receipts are forecast to decline further in the existing membership, Member States increasingly perceive the need, and justification, for greater freedom for national regional policy intervention.

The new Guidelines significantly reduce maximum award values under regional aid schemes to a level at which, in some areas, their impact may be questioned. Hitherto, award maxima have not really bitten, the Member States anyway preferring to offer the minimum necessary to support a given project rather than wastefully attain Commission ceilings. The new ceilings will bite, and may indirectly reduce the effectiveness of national regional policies and give rise to greater windfall gains. There are compelling arguments to support the view that, in some assisted regions, award levels that can be offered to large projects are insufficiently high for firms to consider it worthwhile factoring the aid into their investment calculations.

Enlargement represents a significant challenge for the future conduct of competition policy with respect to State aid. The conduct of the recent assisted area map reviews of the existing Member States seems set to make this a highly contested area of policy in the future. EU enlargement to the east will add significantly to the EU population, but not to its prosperity. For the existing Member States, the ratchet effect of the use of EU averages and population ceilings would exclude significant areas from eligibility under Article 87(3)(a) if EU21 or EU27 averages were used, and would impact directly on the scope for Article 87(3)(c) coverage were the current formula to be retained. These are the implications of the Commission's current mechanistic approach to approving the regional aid policies of the Member States. Any debate concerning the extension of regional aid discipline to Central and Eastern Europe will be made more complicated by the controversies which have surrounded the application of the Guidelines to the existing membership. Many Member States have been bruised by this experience and surprised by the Commission's stance on a number of questions; it will be no simple matter for the Commission simply to roll over the existing methodology for a further period. In addition, within the Candidate Countries, the differences in economic development and aid

[16] Only Italy proposed eligibility for Objective 2 as a criterion for national assisted area status (and this was rejected by DG Competition as the Objective 2 areas had not been decided).

budgets (relative to the EU15) suggest the need for reconsidering EU regional aid policy.[17]

3.4 EU structural and cohesion policy

Over the past 15 years, EU regional policy has been revolutionised to make a more powerful impact on economic and social cohesion. Successive increases in funding were combined with a multi-annual approach to expenditure planning, shifting spending from individual project support to programme financing. Implementation was increasingly undertaken in partnership between central government authorities, regional bodies, local authorities and other economic and social actors. The volume of transfers to the cohesion countries has made a major contribution to economic growth and development, most obviously in the cases of Ireland and Portugal. Across the Union, to varying degrees, the Funds have generated greater interest in strategic thinking and the planning of economic development, they have encouraged more emphasis on institutional co-operation, and they have promoted innovation in regional and local development. Notwithstanding these benefits, EU regional policy has recently been under pressure in three ways: financial constraints and the need to prepare for enlargement; the need for concentration of assistance; and a desire for a simplification of bureaucracy.[18]

3.4.1 Key drivers of EU structural and cohesion policy

The Agenda 2000 negotiations showed clearly the financial constraints on EU spending. Agenda 2000 outlined the need for an extensive overhaul of EU finances to accommodate the costs of enlarging the Union. However, whereas past development in European integration (the Single European Act, the accession of Spain and Portugal, the Maastricht Treaty) were accompanied by a significant rise in the resources devoted to economic and social cohesion, the Agenda 2000 negotiation revealed fundamental reservations among the 'net payers' with respect to countenancing an increase in contributions to the EU budget. For the first time, EU spending on regional policy in the EU15 (over the 2000-2006 period) will decrease, as larger amounts of funding are allocated to pre-accession aid for the Candidate Countries.

Pressure for concentration. Following successive increases in the spatial coverage of EU assisted areas under Objectives 1, 2, 5b and 6 during the 1990s, the European Commission and (some) Member States advocated a concentration of Structural Fund interventions geographically, with a reduction

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[17] Minkova M (2000) *Regional Development in the CEECs: Aid Policy,* Discussion Paper No.15, Open Society Institute, Budapest.

[18] Bachtler J (1998) Reforming the Structural Funds: Challenges for EU Regional Policy, *European Planning Studies*, 6(6), 645-664.

in spatial coverage, and better targeting of priorities on the most serious problems.

Desire for simplification and rationalisation of bureaucracy. A further 'driver of change' has been the bureaucracy associated with Structural Fund implementation. At its extreme, this criticism has characterised EU regional policy as 'side payments' or as a 'circular flow of money' from Member States to the EU budget and back again in the form of a bureaucratically and administratively expensive procedure. More generally, it is acknowledged that the implementation of the Funds carries with it a heavy administrative burden and considerable investment in institutional capacities at different levels.

3.4.2 Key trends in EU structural and cohesion policy

Significant changes to EU regional policy in response to budgetary constraints. After a 15-year expansion in the budget and coverage of EU regional policy, the Berlin European Council heralded a net reduction in spatial coverage and a progressive reduction in spending in the EU15 over the 2000-2006 period. This was accompanied by a rationalisation of the Objectives and Community Initiatives. There has been a significant transfer of programme implementation responsibilities to the Member States at the expense of stricter monitoring and control conditions.

The notion of 'Cohesion countries' is in retreat[19]. Agenda 2000 signalled an important change in emphasis regarding the Cohesion Four. The Berlin Summit Conclusions referred to the current four beneficiaries of the Cohesion Fund, but did not otherwise make reference to the Cohesion Four as a group; as a result, no special provision was made for the Cohesion countries - under the basic methodology, financial allocations to all Objective 1 regions were calculated using the same indices and averages.

The new Regulation favours poorer regions at the expense of poorer countries. Taking the Cohesion countries as a group the overall share of the Cohesion Four in Structural Actions spending will decline from 53.8 percent of the total in 1994-9 to 51.7 percent in 2000-6. There is greater concentration of Structural Fund resources on Objective 1 than in the past - but the Cohesion Four do not benefit from this directly in 2000-6. This is partly because their share of the Objective 1 population is lower than in the 1994-9 period (Ireland, in particular, is more prosperous), but also because the emphasis on regional prosperity, which was reinforced during the negotiations, favours the very poorest Objective 1 regions; within the Cohesion countries these tend not to be the more populous areas.

The difficulties in reaching agreement for the 2000-06 period suggest that it is feasible to impose rigid approaches either on eligibility or on financial

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[19] Wishlade F G (1999) Who gets what? Eligible Areas and Financial Allocations Under the New Structural Funds, *Regions: The Newsletter of the Regional Studies Association*, RSA, London.

allocations, but not on both. In this context, the mechanisms used for Objective 1 and 2 are diametrically opposite. Simple eligibility criteria for Objective 1 were coupled with a complex system of distributing funding; the latter was complemented by a series of exceptional allocations essentially compensating the 'losers' in the process, but arguably undermining the allocation methodology. Conversely, for Objective 2, the allocation criterion was simple - a set amount per head of eligible population; however, eligible population was essentially determined by complex rules related to the minimum and maximum population coverage, rules which themselves largely rendered the eligibility criteria redundant.

The negotiations of the Structural Funds Regulation make clear the power of precedent in EC regional policymaking. For Objective 1, this is reflected in lengthy, often generous, transitional provisions. For Objective 2, the determining factor in future assisted area coverage for most countries was current coverage. This tendency has made the objective of concentration difficult to achieve. Objective 2 coverage broadly meets the stated 18 percent maximum specified at the outset; however, in 2006, Objective 2 coverage rises to 19.1 percent of the Community population with the addition of areas from Objective 1 phase out. This means that, taking Objective 1 and 2 together, coverage for the first six years (2000-5) amounts to 43.9 percent of Community population, falling to 41.4 percent in 2006. This clearly exceeds the proposed 35 to 40 percent suggested in Agenda 2000, but is nevertheless an achievement, being the first occasion on which assisted area coverage has actually fallen.[20]

There are significant implications for both the current membership and possible future Member States. In particular, the transitional provisions for Objective 1 and 2 apply only until the end of 2005; the Objective 1 phase-out regions only qualify for Structural Funds assistance in 2006 if they meet the criteria for Objective 2. This establishes an important point of principle for the future: in the past, the role of precedent in Structural Funds area designation has been central. Looking forward, the erection of a 'firebreak' in 2006 should reduce pressures for simply rolling over assisted area status into the next planning period. These provisions seem likely to increase concentration in assisted area designation among the existing Member States after 2006. However, the shift away from national prosperity as an eligibility and allocation criterion points towards a situation in which Community regional policy intervenes in parts of every Member State. For potential new Member States, such as the Czech Republic or Hungary, where the capital regions are significantly more prosperous than the remainder of the country, the reforms make clear that any expectation of 'Cohesion country' treatment, as under the 1988 and 1993 Regulations, may be unrealistic.

The Structural Funds continue to have important implications for national approaches to regional development. Across the EU, there is a variable

[20] Wishlade F G (2000) *op. cit.*

approach to implementing EU regional policy. While some countries (eg. Germany, Spain, Austria) have effectively ‘subsumed’ the allocation of EU funding within national policy delivery systems, others have set up separate implementation systems (eg. UK, Sweden) for administering the Funds and delivering programmes. Regardless of the mode of delivery, it is evident that there have been considerable ‘policy transfers’ from EU to national regional policies. In several countries, the principles of programming and partnership, as well as experiences with monitoring and evaluation, are being ‘transferred’ into the implementation of national regional development policies. On the other hand, it is arguable that the goal of rationalised implementation of the Funds may not be achieved: early indications are that the planned ‘simplification’ is proving to be illusory.

4. PARAMETERS OF ENLARGEMENT

The previous sections have emphasised the importance of considering the future of regional policy in Europe in a coherent manner. Nevertheless, the political realities underlying the debate mean that decisions are dependent on the scale of the regional problems and disparities in an enlarged EU and the budgetary calculations inherent in the EU policy response.

4.1 Scale of regional problems/disparities

National differences in GDP between the EU15 and the Candidate Countries are wide. According to estimates derived from Eurostat figures, enlargement of the Union from the EU15 to an EU27 would increase Community population by 28 percent, GDP by 11 percent and area by one-third, but EU GDP per head (PPS) would fall by 14 percent. Taken together, the applicant countries have a GDP per capita (PPS) of 38 percent of the EU average, and some of the countries (Bulgaria, Latvia, Romania) have GDP per capita levels of 30 percent or less. On the other hand, some of the Candidate Countries have much higher levels of economic prosperity – Slovenia (GDP per capita of 67 percent relative to the EU average) and the Czech Republic (63 percent).

There is likely to be some partial convergence in Member State GDP by the time enlargement takes place. Most scenario planning has assumed future growth rates in the Candidate Countries in excess of the EU average, thereby achieving some modest convergence between current and future Member States by 2006. However, recent Eurostat data presents a pattern of decreasing GDP growth in the Candidate Countries (CC). Since 1995, when the overall CC13 rate stood at 6.1 percent, the Candidate Countries have recorded GDP rates of +5 percent in 1996, +4.7 percent in 1997, +2.8 percent in 1998 and –0.2 percent in 1999 (the first time that the Candidate Country growth rate has fallen below the EU15 since 1994). This picture does, however, hide diverging national changes, ranging from GDP growth rates of over +4 percent for 1999 in Poland, Hungary and Slovenia to negative growth rates of less than –3 percent in Romania and Lithuania. Looking to the future, all of the projections and scenarios are hedged with great uncertainties, but even the more optimistic scenarios suggest that it could take 25-40 years for countries such as the Czech Republic, Slovakia, Slovenia, Hungary and Estonia to reach or exceed the EU15 average.

Regional differences present a more varied pattern. Within CEE countries, regional disparities in GDP and unemployment are smaller than in some EU Member States. Overall, regional GDP per capita levels in the Candidate Countries are considerably less than the EU average – only the capital city regions of Prague and Bratislava are above this level. The poorest regions are in eastern parts of Bulgaria, Poland and Romania (under 25 percent of the EU15 average). Regional unemployment rates are relatively low in CEE regions compared to the EU - rates range from 3.1 percent in Prague to 21.6 percent in eastern Slovakia. According to CRPM calculations, regional disparities in an enlarged EU will increase the ratio of richest to poorest regions in the EU from 1:5 to 1:9 (in an EU25).[21]

Enlargement is expected to be associated with an expansion of trade, investment and economic activity, but with sectoral and regional variations. Research suggests that enlargement will produce longer term gains for both the EU15 and Candidate Countries but with variations according to sectoral structure and trade relations. There are likely to be gains for EU15 countries/regions specialising in investment goods, high-productivity industries, business and financial services, and competitive pressures on EU producers of labour-intensive goods (eg. textiles, footwear), certain agricultural products (eg. grain, vegetables, fruit, cattle and pig farming) and products with a low level of technological sophistication (eg. printing, chemicals). Under such scenarios, the employment impact would be on unskilled and low-skilled employees in the EU15 as well as employment more generally in rural areas, particularly in Mediterranean regions and eastern border areas. For CEE countries and regions, some of the research predicts competitive advantages based on low labour costs (in areas such as textiles, steel and chemicals), but also disadvantages (especially for SMEs) given the combination of greater competition and the cost of compliance with EU regulations. Previous experience, however, suggests that such predictions are likely to be too simplistic, given that sectors/regions in both EU15 and CEE will diversify, specialise and otherwise adapt both before and after accession.

Migration flows are of particular concern to some EU15 countries, but the impacts may have been overstated. Some research has argued that migration flows from CEE to the EU15 would exceed 20 million, particularly to Germany and Austria. However, recent studies suggest that these predictions are exaggerated. While migration will certainly increase after enlargement, and most likely involve significant flows to Germany and Austria, these are likely to be reduced by restrictions on the free movement of labour and bilateral agreements between EU15 and CEE countries[22].

4.2 Policy responses

The policy response is governed first and foremost by the size of the EU budget and the share of EU regional policy. These are primarily political questions; the current expectation is for the budget limit (1.27 percent of EU GNP) to be maintained, although in real terms the budget will increase with enlargement. The future of the own resources system is a key issue: it is possible that Treaty changes could alter the process of generating the EU

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[21] CRPM (2000) *Towards a new regional policy in 2007*, Report from the Conference of Peripheral Maritime Regions of Europe.

[22] Boeri T and Brücker H *et al* (2000) *The Impact of Eastern Enlargement on Employment and Labour Markets in the EU Member States,* Report for DG Employment, European Integration Consortium (DIW, CEPR, FIEF, IAS, IGIER), Berlin / Milan.

budget, but the Commission's negative assessment in 1997 of the prospects of Member States countenancing independent fiscal resources for the EU still appears to be valid. The future of the Common Agricultural Policy is another critical factor, in particular whether and how further reforms are introduced and the way in which adaptation of the Candidate Countries to the CAP is managed. Institutional or Treaty changes could also alter the process of allocating the budget, giving more flexibility to the Commission in determining the objectives and spatial coverage of funding allocations (and indeed a more radical reshaping of EU regional policy), but this is again speculative.[23]

As in past negotiations on EU policy and funding, the form and allocation of EU regional policy will depend on political bargaining among Member States. The crucial questions are: (a) what the 'net payers' are willing to contribute; (b) what the current recipient countries are prepared to forego; and (c) what future recipient countries/regions are prepared to accept. In this context, there are several lessons from the Agenda 2000 negotiations.

- The Berlin Council showed that Members States are unwilling to forego aid to their recipient regions. Radical reform was not possible, though greater concentration was achieved.

- The Berlin agreement meant that focus was more on poor regions at the expense of poor countries. If this is taken as a precedent, it is unlikely that the Candidate Countries will get the special treatment previously given to the 'Cohesion Four'. The ending of transition periods for de-designated Objective 1 and Objective 2 regions in 2005 means that there is a 'firebreak' in area eligibility. However, new precedents have been introduced – six-year transition periods and a floor on cutbacks (safety net for Objective 2 regions) which will be used to argue for generous transition provisions post 2006.

- There has been extensive discussion of 2000-2006 being the 'last opportunity' for more developed EU countries to receive substantial funding and the need for 'exit strategies', *but* EU countries/regions are already thinking of arguments to influence the post-2006 debate to ensure continued receipt of Structural Funds. Hence, there is a likelihood that 'net payer' countries will continue to demand a share of the Funds.

- While indices of regional prosperity in the EU15 (relative to EU averages) will change, neither the relativities of regions within the EU15 nor the severity of their regional problems will diminish. If EU funding is withdrawn, there is the question of how the funding shortfall (as well as continuation of institutional structures, partnerships etc) would be

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[23] Ferrer J N and Emerson M (2000) *Goodbye, Agenda 2000 - Hello Agenda 2003: Effects of the Berlin Summit on Own Resources, Expenditures and EU Net Balances*, Working Document No.140, Centre for European Policy Studies, Brussels. Martin R (1998) Financing EU Cohesion Policy in Central and Eastern Europe: A Budgetary Timebomb? *Intereconomics*, May/June, 103-111.

addressed. This will be used as a strong argument for continued policy support, whether from EU or national sources.

- Estimates of the additional costs of enlargement to the Structural Fund budget range from 7 to 16 billion per year (over the 2006 projected levels), depending on the method of calculation and assumptions about future growth. This does not necessarily represent a major shortfall for the EU budget overall, but it would potentially worsen the budgetary position of the net contributors very significantly.

The degree to which Candidate Countries are able to benefit from EU regional policy is subject to several factors. While there have been calculations of the implications of enlargement for the Structural Fund budget, the potential allocation to CEEC will depend on:

- the timetable of accession - all ten Candidate Countries will not become members of the EU at the same time;

- absorption – allocations would need to be kept within the so-called ‘absorption limit’ (four percent of national GDP);

- co-financing – depending on the rate of national funding required, there may be co-financing problem from national budgets in some countries; and

- relative changes in per capita allocations – it is unlikely that average annual per capita allocations to the Candidate Countries could be significantly greater than current Objective 1 maxima.

There is scope for new thinking about the form of policy and the nature of the instruments used as part of EU regional policy. There have been significant changes in the objectives, form and structure of EU regional policy over the past 20 years over successive programming periods. This is likely to continue as thinking about regional development evolves. For example, a new Treaty may lead to new emphasis on urban issues, rural development or the European spatial development perspective. Other policy influences also need to be considered, such as European employment policy/strategies and the role of environment policy. Similarly, different types of funding instrument could be applied on a more widespread scale, such as the use of lending for major infrastructure projects, or revolving funds for certain priorities.

5. POLICY OPTIONS

Against the background of the shifting context for regional policy in Europe after enlargement, there are various levels at which the future of policy needs consideration. Somewhat prosaically, at a pragmatic level, there are a series of possible *options* that essentially entail adjusting current mechanisms to a greater or lesser extent to take account of changing circumstances; in essence, these involve more continuity than radical reappraisal. At a strategic level, however, there is a case for revisiting some of the fundamental *questions* concerning the design and conduct of policies to address regional disparities in any jurisdiction, whilst recognising that the European Union is quite unlike any other jurisdiction.

With respect to the possible options, these theoretically range from an EU-wide inter-regional fiscal transfer system, at one extreme, to a complete 're-nationalisation' of regional policy, without a role for the EU, at the other end of the spectrum. Between these extremes are several plausible options for future funding allocations.

5.1 Options 1 - Current Policy Approach

Principles. The first option is that the existing approach to EU structural and cohesion policy is retained and extended eastwards. Funding would be allocated to eligible areas according to EU criteria for delivery through regional programmes. As now, the Commission would retain responsibility for allocating finance, approving programmes and overseeing delivery while the Member States would have responsibility for programme implementation.

Implications for funding allocation and area designation. According to Eurostat data for 1997, all of the CEECs would be classified as Objective 1, except for Slovenia and Prague, Bratislava and Budapest. Many current Objective 1 regions would lose eligibility except for Sachsen-Anhalt and some other districts of eastern Germany, significant parts of Greece and Portugal and some areas in Spain. However, the CEECs are unlikely to be able to utilise all the 'potential' Objective 1 funding for a number of reasons: (a) it is unlikely that all 10 CEECs will be members by 2007; (b) potential allocations could exceed the 'absorption limit' of four percent of national GDP in CEECs; and (c) there are likely to be problems co-financing programmes from national budgets in some countries. Current Member States would continue to receive a share of the Funds, at least through Objective 1 transition provisions lasting for part of the next funding period, but possibly also for high unemployment and social exclusion among current Objective 2 areas.

Advantages. This option preserves the scope for achieving *political* cohesion since most (all?) Member States would receive some Structural Funding, and net payers are kept on board. The use of established methodologies and indicators (however imperfect) limits controversy. The established implementation systems, on which capacity-building in CEECs has hitherto been based, facilitates policy continuity.

Disadvantages. This would be more of a political than an economic solution. There remains the difficulty of obtaining usable indicators and data to support the approach to area designation and allocating funding, exacerbated by the fact that existing measures of disparity are unsuited to CEEC conditions. It would maintain and potentially enhance the bureaucracy of Structural Fund implementation with additional regional programmes needing to be negotiated, managed, delivered, monitored, evaluated and controlled. A major injection of funding into the CEECs entails problems of monitoring and control, especially at regional levels. The CEECs are unlikely to have adequate institutional capacity at sub-national levels.

5.2 Option 2 - Differentiated Policy Approach (Variable Geometry)

Principles. Under a second option, the EU would take a differentiated policy approach to CEECs and EU15. For the CEECs, it could take a 'cohesion policy' (or transition policy?) approach, providing policy support to each of the applicant countries as a whole, regardless of levels of prosperity of individual regions. For the EU15, the current approach to 'structural policy' could be maintained. In the CEECs, funding would be allocated to new Member States for delivery through national development programmes; in the EU15, funding would be allocated to eligible regions for delivery through regional programmes. As above, the Commission has responsibility for allocating finance, approving programmes and overseeing delivery, while the Member States have responsibility for programme implementation.

Implications for funding allocation and area designation. The CEECs would be designated in their entirety. EU15 eligible regions would be designated according to Objective 1 and 2 criteria. The implications of this are the same as for Scenario 1.

Advantages. The approach has a measure of economic development logic - countries such as Slovakia, Czech Republic and Hungary need to have their capitals as part of the eligible area as 'drivers' of economic development (cf. experience of Portugal and Ireland). This option would allow funding allocations to the CEECs to be determined according to different criteria from those used hitherto, and problems of inadequate designation indicators and data in making international comparisons between CEE and EU regions are avoided. In addition, CEECs can take a national approach to the design and delivery of policy to suit national conditions. Again, most EU15 Member States would get some Structural Funding, and the net payers are kept on board.

Disadvantages. This option remains largely a political, rather than an economic solution. It entails a reversal of the recent trend away from supporting poor countries in favour of poor regions (although this may be justified) and involves differential treatment of Member States (why not treat Portugal and Greece in the same way?) which may be politically unpalatable. The approach does not guarantee that CEECs use resources for less-favoured regions (but does this matter in the short term?) and could increase internal regional disparities

5.3 Option 3 - Concentrated Policy Approach

Principles. A more radical option would be a reform of structural and cohesion policy so that the Community only intervenes if cohesion "cannot be sufficiently achieved by the Member States" and can be "better achieved by the Community" (Article 5). Under such a policy option, the EU would only intervene where Member State per capita GDP is below 90 percent of the EU average (for example). In other words, the EU would provide support for the poorest Member States and other fields where there is a clear Community role eg. inter-regional, cross-border and transnational co-operation as well as innovative actions etc.

Implications for funding allocation and area designation. According to current Eurostat figures, under this option the EU would only intervene in the CEECs, Greece and Portugal.

Advantages. This approach would clearly respect the principle of subsidiarity. Structural policy becomes a Community policy with an economic rationale for intervention, focusing on convergence among Member States. It avoids the so-called circular flow of income from net payers to the Commission and back again. It also avoids problems of inadequate designation indicators and data in making international comparisons between CEE and EU regions. The approach allows recipient countries to take a national approach to the design and delivery of policy to suit national conditions, and the implementation of policy becomes more manageable for the Commission.

Disadvantages. The net payers are not recipients of EU funding, potentially lessening their financial commitment to the EU and to structural policy in particular. The Commission does not have a 'place at the table' in all countries, and the profile of the EU is potentially diminished. Pressure for spending in areas where the current membership could benefit more may be increased (aspects of agricultural policy, R&D policy) as may pressure for relaxation of the regulatory environment, especially in the area of national regional aid.

5.4 Option 4 - 'Horizontal' Policy Approach

Principles. More radical still might be a 'horizontal' approach, whereby greater coherence to regional development might be achieved. This would involve promoting the co-ordination of EU, national and sub-national actions within a single regional development policy framework at Member State level. Under this option, the EU would allocate funding to Member States according to GDP per capita and population (all Member States would receive minimum funding as with Objective 3). Each Member State would have a 'national regional development strategy' combining all relevant regional development actions. The EU role would be to check conformity with EU objectives, competition policy, environmental policy etc and promote good practice, pilot projects, innovative actions, inter-regional co-operation, evaluation etc. The Member States would be responsible for policy design and delivery.

Implications for funding allocation and area designation. There would be no area designation at EU level. Member States would designate one set of areas only. Funding would be allocated to all Member States on the basis of GDP per capita and population, ie. the poorest countries with lowest GDP per head would receive the maximum per capita allocation.

Advantages. This option respects the principle of subsidiarity and promotes coherence – a single map of eligible areas, and coherence between all economic development actions within Member States. It would retain a universal system of regional development, and the net payers would retain a vested interest (albeit small in some cases).

Disadvantages. There would be the danger of inadequate consideration of EU regional development objectives and potentially a partial return to the pre-1988 situation. Again, there would probably be pressure to relax the constraints of State aid controls.

6. POLICY QUESTIONS

At this distance from 2006 it is difficult to come to any clear conclusion as to which of the scenarios is likely to apply but the likelihood is that a continuity-based option will be chosen. On the one hand, there are powerful forces that promote continuity and point to a variant of the first two options being chosen:

- the importance of precedent in Structural Fund negotiations;
- the fact that the accession negotiations with the Candidate Countries are based on the *acquis communitaire* which incorporates the current approach;
- the concerns of many that a regional policy focused solely on the poorest countries will be seen as a welfare policy rather than a policy of development and will, as a result, lead over time to reduced solidarity contributions from the richer Member States; and
- the reluctance of new Member States to be treated separately from the members of the 'club' they are joining.

On the other hand, the change in the balance, in an enlarged Community, between Structural Fund proceeds and the bureaucracy which accompanies the distribution of the Funds is encouraging many, richer Member States to actively consider options 3 and/or 4. Against this, all of these countries have a large domestic constituency which benefits directly from Structural Fund support. Allied to the fact that the Commission itself seems likely to favour an approach which will continue its involvement in *all* Member States - and bearing in mind too that the absorption limit is likely to leave a considerable pot to be played for by the current Member States - the likely outcome may well be not too far from the current approach.

Past trends in negotiating structural policies suggest that the most realistic outcome is likely to be a variant on one of the above options, with many elements of current policy retained and any reform characterised by the impact of precedent and phase-out provisions. A major drawback of adopting a continuity-based option at a significant turning point in the development of the European Union is that it shelves any fundamental reappraisal of the role and purpose of European cohesion policies until at least the second decade of the new century. It is far from clear that the Union has the appetite to engage in the depth of debate that is required to provide a vision for regional policy in Europe, but three key questions remain to be addressed.

The first question is whether EU policies really do aspire to address economic and social disparities. The main point of note is that, at present, there are not sufficient resources nor the political will to justify transfers at the required level to bring about equality of *income*. Arguably, all the Community can aspire to is equality of *opportunity*; the provision of relatively limited funds to help regions help themselves, thus becoming more competitive over time. Regional competitiveness is of obvious and growing importance in the context of increasing globalisation etc. EU regional policies have been criticised for being little more than a 'side payment' and redistributive mechanism for budgetary allocations. This raises the important issue of the need to develop a fair and appropriate budgetary mechanism for the EU. If this issue were to be adequately addressed, then the *juste retour* element of regional policy could be downgraded, allowing the key policy focus to be on regional economic development issues. On the other hand, it could be argued that the current role of the Structural Funds in the overall budgetary mix gives EU regional policy a political prominence beyond what it actually achieves in practice; concentration of the funds could mean that an important link between the policies of the EU and local communities would be lost.

The second question is what should be the role and scope of regional policy in a Union that is more than a free trade area but less than a federation? The primary goal of any EU regional policy must be to facilitate and promote convergence across the Community. Following enlargement, diversity within the EU will increase markedly. This suggests that a more differentiated policy approach will have to be introduced in the context of developing an appropriate strategic framework for EU regional policy. Certainly, there needs to be a move away from an 'all-or-nothing' approach to policymaking; at the same time, the expectation will grow that richer Member States should contribute relatively more to the development of their own problem regions. However, it is important to note that regional policy has other elements, apart from promoting convergence: it provides a European strategic framework for regional development; it promotes integration (through, for example, cross-border co-operation); it responds to disasters; it plays a regulatory role, in particular through its State aid policy; and it can animate, evaluate and generally promote good practice. A coherent approach to European regional policy must recognise all of these objectives.

The third question is how EU policies can best address economic and social cohesion and, in particular, strike the appropriate balance between wealth creation and distribution, between solidarity and competition? There is, of course, a case for rejecting the dichotomies posed and attempting to do both. More generally, there is an argument that the EU should anyway be aiming to promote a diversity of approach across regions; one of the positive features of the current Structural Funds is that they do incorporate considerable diversity within a common framework, though not all Member States would agree. The EU will also need to reassess the relative roles of the European, national and subnational levels in the design and implementation of policies for economic and social cohesion. From the perspective of EU regional policy, it is important to be clear whether the basic point of reference is the region in an EU context, or the region in the context of its Member State. There is a strong argument for taking into consideration the relative wealth of Member States when considering the appropriate contributions of the regional, national and EU levels. Finally, an important feature of policy is that it should be viewed as temporary in nature. Once the relative position of the area in question has improved then policy should no longer apply. In this context, the use of lengthy transitional arrangements has been a disappointing feature of recent policy developments. More generally, regional policy-makers need to find ways of breaking the subsidy ‘habit’ and promoting a new, more forward looking mentality that encourages countries and regions to minimise the need for external support.