REFORMING THE STRUCTURAL FUNDS: OPTIONS FOR CHANGE

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TABLE OF CONTENTS

1. INTRODUCTION

The reform of EU structural policies is being conducted under the most challenging conditions in the history of the European Union. Against a background of faltering EU economic growth, Member States are engaged in structural and labour market reforms, with the Union about to embark on a further deepening and widening of European integration. In several countries, political and popular confidence in the 'European project' has diminished and the commitment to solidarity in the Union is under pressure; as often occurs in times of economic constraint, the net payers are questioning the rationale and scope of transfers to net recipients.

Reform of the Structural Funds is part of a wider overhaul of EU finances to accommodate the costs of enlarging the Union. In the past, major developments in European integration - the Single European Act, accession of Spain and Portugal, the Maastricht Treaty - were accompanied by a significant rise in the resources devoted to economic and social cohesion. Successive increases in the budget for EU structural and cohesion policies raised expenditure from 3.7 billion ECU in 1985 to 33 billion ECU in 1999. The proportion of the EU budget allocated to the Funds will have risen from 18 to 37 percent over that period. On this occasion, many of the richer countries are unwilling to pay more and, indeed, are looking to reduce their net payments. At the heart of the debate is how contributions to, and receipts from, the EU budget are to be shared among EU Member States. The Union is also being forced to examine the performance and efficiency of its current spending, notably in the areas of regional and agricultural policy which collectively account for over 80 percent of the EU budget.

The reform process was initiated by the publication of *Agenda 2000*[1] by the European Commission in July 1997. As requested at the Madrid Council in 1995, the communication provided the Commission's opinion on the applications for EU membership as well as detailed analysis of the Union's financing system and proposals for the future financial framework, taking account of the implications of enlargement. Following the publication of Agenda 2000, EU and Member State authorities have been engaged in an intensive process of bilateral informal consultation, discussions within COREPER and formal negotiation in Council meetings in advance of the Luxembourg summit which will guide the Commission's subsequent formulation of detailed regulations. The preparation of official positions and compromises is influenced by the pressures on governments from the political calendar of forthcoming elections (eg. Germany, the Netherlands) and EU referendums (Ireland, Denmark). For several countries, complications also stem from the divergent priorities of foreign ministries (achieving successful EU enlargement), finance ministries (restricting public expenditure), agricultural departments (safeguarding agricultural and rural interests) and economics/industry ministries (maximising national shares of the Structural Funds).

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[1] CEC (1997) *Agenda 200 - For a Stronger and Wider Union*, COM DOC/97/6, Brussels

The politics of the reform debate are exacerbated by other issues which individual countries are keen to progress as part of the renegotiation of the financial framework. Germany, for example, is highlighting the problem of ‘tax dumping’ (*Steuerdumping)* whereby German fiscal revenues are eroded by companies exploiting the favourable tax regimes of other Member States. Denmark and Austria want action to prevent Structural Fund assisted ‘job-shopping’ as companies relocate their operations within the EU to take advantage of more generous state aid in countries such as Portugal. Belgium, France and Italy have demanded that EU institutions and decision-making be streamlined before enlargement proceeds, making up for the inability of the IGC to agree on issues such as the extension of majority voting, and the composition of the Commission.

Against this background, the following paper reviews the evolution and content of the reform proposals for economic and social cohesion in Agenda 2000 and some of the longer term challenges for regional policy arising from enlargement. The paper begins by summarising the main reform discussions in recent years. It discusses the specific proposals in Agenda 2000 and the initial reactions from Member States, highlighting some of the most contentious issues. The paper then looks beyond Agenda 2000 to the enlargement of the Union, examining the regional problems and disparities in Central and Eastern Europe and the implications for EU structural policy. The paper concludes by identifying some key points for further debate.

2. AGENDA 2000 AND ECONOMIC & SOCIAL COHESION

2.1 Performance of the Funds

The 1988 reform of the Structural Funds heralded a revolution in the approach to implementing EU regional policy. The Single European Act had recognised that economic and social cohesion within the Community formed an essential part of the completion of the Single Market and provided for a major reform of the operation of the Community’s main instruments for regional policy. It was recognised that the instruments needed to be co-ordinated more effectively and to concentrate resources on the regions in greatest need and facing the most serious structural adjustment problems, especially with the intensified regional disparities arising from the accession of Spain and Portugal. The 1988 reform aimed to transform structural policy into an instrument with real economic impact, to use a multi-annual approach for expenditure planning, and to implement a partnership between all the parties actively involved in structural policy, especially regional and local authorities. The reforms shifted spending from individual project support to programme financing, doubled the budget and introduced five specific objectives for the Funds; it also enabled a second form of financing through the Community Initiatives.

Many of the principles underlying the reform were widely greeted as positive. The emphasis on multi-annual planning and programming provided greater coherence and integration to Community support. The highly concentrated application of the Funds in Objective 1 regions provided substantial transfers to the poorer countries and regions for structural policies. However, many Member State authorities were finding it difficult to adapt to the new concepts, policy priorities and terminology associated with the reformed Funds. The universal application of the three-tier system of regional development plans, Community Support Frameworks and Operational Programmes was considered to be time-consuming and cumbersome, and the Commission was increasingly criticised for its inconsistent and opaque approach to financial allocation, programme approval and management, and its use of Community Initiatives.

In 1993 the Structural Fund regulations were revised. Responding to the new political and economic environment following the Maastricht Treaty and worsening economic conditions, resources for the Funds were increased, the Cohesion Fund and FIFG were introduced, additional regions became eligible for aid, and the remit of employment and training actions was broadened under Objective 3 and (a new) Objective 4. The revision also attempted to address the criticisms relating to implementation. Amended programming arrangements were introduced to give Member States the lead in designating Objective 2 and 5b areas. The three phases of programming were reduced to two stages with the optional use of Single Programming Documents. The proportion of expenditure allocated to Community Initiatives decreased (although real spending rose). Commitments were also made to quicker and more flexible financial implementation, more transparency in funding allocations and greater accountability through improved monitoring and evaluation.

These changes improved the operation of the Funds in several important respects. The declared objectives of greater openness, simplified procedures and stricter controls on cost-effectiveness were all welcome developments to Member States. With growing experience, programming became progressively more efficient and sophisticated in many regions. However, the broadening of the scope of the Funds increased its complexity in terms of instruments and areas; spatial coverage grew from 43 to over 51 percent of the EU's population (including some dubious Objective 1 designations) diluting the principle of concentration. Although bureaucracy may have been reduced by the introduction of the SPD option, obligations with respect to monitoring and evaluation increased, the Community Initiatives continued to proliferate and the role of the Commission was still a source of tension with Member State authorities.

Four years on from the 1993 revisions, the Union is again debating EU regional policy. After almost a decade of implementing the reformed Structural Funds, the Member States and European Commission have a new opportunity to take stock. Over that period, it is evident that the Structural Funds have achieved a great deal. 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, though to varying degrees, the Funds have generated greater interest in strategic thinking and planning of economic development and have encouraged more emphasis on institutional cooperation, involving new agencies and groups in strategy formulation and programming. They have also promoted dynamism and innovation in approaches to regional development, although this has not always been welcomed or considered appropriate by Member State authorities.

Notwithstanding such achievements, fundamental aspects of EU regional policy implementation are regarded with considerable scepticism and criticism. Cohesion may still be regarded as a worthwhile goal, but the unwillingness of some net payers to countenance increased contributions to the EU budget is at least influenced by their objections to the way in which EU regional policy is conducted. In the view of many Member States, these objections are essentially threefold[2]. First, the Structural Funds are considered inefficient. They have been characterised as a 'circular flow of money' whereby Member States make contributions to the EU budget, the money being returned 'with strings attached' in the form of a bureaucratic and administratively expensive procedure. Second, EU regional policy is seen as overly complex, with a plethora of funds and objectives with different institutional arrangements and diverse regulations and eligibility conditions. Third, many Member States are keen to reassert the principle of subsidiarity, sometimes expressed in terms of renationalising regional policy. There is widespread resentment at the influence of the European Commission on the design and implementation of programmes - sometimes at highly detailed and technical levels - as well as on the wider impact on Member States' own, national regional policies. In this context, the current debate about finance is an opportunity to protest at the role of the Commission and to press for a more decentralised and simplified EU regional policy.

2.2 Setting the Agenda

With growing pressure from Member States in recent years, the Commission has been aware of the need to reform the operation of the Structural Funds. For over two years the Commissioner for Regional Policy, Monika Wulf Mathies has been signalling the priorities for change:

> *"Although I believe that the existing principles governing the Structural Funds have proved their worth, this not to say that there is no room for improvement…. a more intensive geographical concentration of our regional policies, which now cover 50% of the population, might be considered….greater effectiveness might be achieved by establishing an overt link between the size of the budgetary resources on offer to different regions and the achievement of outcomes in regard to real convergence…we might explore further how the financial flows under the Structural Funds could be linked more directly to achievements[3]."*
>
> *Preparing for the future means at the same time preparing for the necessary change: to maximise the impact of Structural Fund interventions we will have to concentrate our efforts geographically and we have to target better the priorities: job creation, competitiveness especially of SMEs, research and development, training and qualification, sustainable development, equal*

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[2] These issues are explored further in previous Regional and Industrial Research Papers: Bachtler J and Michie R *The Preparation of EU Regional Development Programmes: Member State Perspectives*, and Bachtler J *Implementing Regional Development Programmes in the Member States*.

[3] Speech on *Economic and Monetary Union and Regional and Social Cohesion* given to the Regional Policy Committee of the European Parliament, Brussels, 29 November 1995

> *opportunities….There is further need to address technological change and deprivation and there is scope for more efficiency, better financial management and controls and constant evaluation of performance.*[4]*"*

Many of these points were developed further in the First Cohesion Report[5] produced in December 1996 in accordance with Article 130b requiring the Commission to submit a three-yearly report on the progress made towards achieving economic and social cohesion, the contribution of relevant EU measures and appropriate proposals for reform. Based on over 18 months of research, the report provided a comprehensive analysis of the impact of EU structural and cohesion policies, as well as the spatial effects of other EU policies and, importantly, the Member States' own cohesion policies.

In part, the report was presented as defence of the Commission's efforts to promote cohesion. Achievements of the Funds in the first programming period (1989-93) included overall income equalisation (in terms of GDP per head) of three percent, achieved with transfers of 0.3 percent of EU GDP. For the period 1994-99, a funding equivalent of 0.45 percent of EU GDP is estimated to be resulting in an equalisation effect of five percent. EU assistance contributed to a significant narrowing of the gaps between richer and poorer Member States: Structural Fund assistance over the period 1989-93 is estimated to have increased growth by 0.5 percent a year in the four cohesion countries, from 1.7 percent to 2.2 percent, with a projected further 0.5 percent between 1994 and 1999. Jobs created/maintained in 1989-93 are estimated at over 500,000 in Objective 1 regions, where structural policies brought about a general improvement in basic infrastructure and helped modernise the economic base; in Objective 2 regions, job creation/maintenance of 530,000 jobs in net terms has been calculated for 1989-93 and in Objective 5b regions, an estimated 500,000 jobs have been created and safeguarded for the period 1989-99. The added value of EU policies relates to their emphasis on innovation, enhanced policy changes and the development of new structures, the devolution of responsibilities, especially through the formation of partnerships, and the leverage of additional financial resources from public and private sources.

Tactically the Cohesion Report was intended to illustrate the magnitude of the cohesion challenge confronting the EU by reference to the effectiveness of the longer-standing and better resourced Member State regional and other spatial policies as well as the wider spatial effects of government spending. It noted the powerful cohesion effect of interregional resource transfers through Member States' public expenditure and taxation systems, which effectively reduce regional income disparities by an estimated 20-40 percent. It also commented that, within a difficult economic climate, national policies addressing economic and social cohesion have not been able to prevent a widening of regional and social differences internally within Member States.

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[4] Speech on *Social and Economic Cohesion in Europe: Implications for Britain* given to the Centre for European Reform, London, 27 January 1996.

[5] CEC (1996) *First Report on Economic and Social Cohesion in the European Union,* Luxembourg.

The Report also contained a frank admission of the deficiencies of EU structural policy. The main questions to be addressed to make structural policies more effective were how to:

- *target scarce resources* better on the most serious problems, through more determined application of the principle of concentration, improvement of coordination between eligibility for the Structural Funds and national regional aid, fine-tuning of the intensity of EU aid in terms of expenditure per head, better performance orientation and more flexible financial procedures;

- *optimise the use of grants and loans and public and private funding* eg. increased use of loan finance, guarantees and equity participation, increased private sector participation through public-private partnerships, and more systematic use of seed capital and development capital funds;

- *simplify procedures* with further streamlining of programming, simplified administration, enhanced coordination with other Community policies, transfer of best practice, and restricted used of Community Initiatives; and

- *strengthen subsidiarity* by clarifying the respective roles of Member States and the Union, to broaden participation at regional and local level and to involve the social partners.

Several months after the Cohesion Report was published, the Commission organised the 'European Cohesion Forum' in Brussels in April 1997 as an opportunity for c.1800 representatives of Commission services, national government departments, regional and local authorities, regional and sectoral interest groups to discuss the future shape of EU structural policies. Conceived with the aim of examining the success of Union policies on cohesion, looking at ways of improving these policies in the future, and evaluating the impact of other Community and national policies affecting this process, the Forum provided a public platform for the intensifying process of lobbying the Commission which was underway to influence the content of Agenda 2000. The large number of participants inevitably produced a plethora of position papers ranging from radical reforms to defensive arguments for retaining aid to particular areas or interests, but a number of key issues dominated the debate.

First, there was a continued case for a Community role in strengthening economic and social cohesion but its objectives needed to be more focused, suited to the future development of the Union, and tested against the requirements of subsidiarity, effectiveness and efficiency. Most contributions agreed that the Funds play an important role in promoting social solidarity and economic cohesion, but recognised that current problems and future challenges from enlargement require reform.

Second, 'simplification' and 'concentration' were commonly advocated, but with little agreement on how they should be achieved. Several different models for the future configuration of Funds, objectives and initiatives were proposed, ranging from a single fund to three separate funds and with different combinations of objective. There were numerous contradictions between proposals for improved efficiency and parallel proposals for conditionality, greater differentiation of award rates, more sophisticated monitoring and evaluation requirements and greater flexibility in the use of instruments. Most agreed with the principle of geographic and thematic concentration but with little sign of a willingness to give up assisted areas.

Third, a reduction in the coverage of Objectives 1, 2 and 5b was envisaged, reducing spatial coverage to under 40 percent, and with a greater role for Member State authorities. Designation should use functional territorial units. Several proposals were put forward for designating relatively broad-band eligible areas within which there would be a concentrated application of funds using Member State specific criteria. Transition provisions for de-designated areas were of widespread concern; the adoption of revolving funds across all programmes prior to enlargement was suggested to maximise impact.

Fourth, a review of the approach to programming was considered essential, notably a rethink of the relationships between the Commission and Member States, and between the Commission services. The requirement for more subsidiarity was discussed extensively, requiring a clearer definition of roles and responsibilities at every stage of programming. Quicker approval procedures, less bureaucracy, greater flexibility in using assistance (especially through global grants), use of different forms of funding, and clearer common guidelines were recommended. Interventions need to be adapted more to regional conditions and requirements; some activities require a distinctive strategic approach. The learning curve of programming should be recognised and respected.

Lastly, there was a general acceptance that the next funding period would not involve an EU regional policy budget exceeding the 1999 proportion of EU GDP, which will have to accommodate any allocations to new Member States. Savings were proposed from a strict application of Objective 1 eligibility criteria and potential differentiation of award rates in Objective 1 regions, a more concentrated map of Objective 2 areas, improved efficiency in the implementation of Objectives and a shift from productive investment to softer instruments under Objectives 2 and 5b.

2.3 Agenda 2000

Agenda 2000 was published by the European Commission on 15 July 1997. Responding to requests made of the Commission at the Madrid European Council in December 1995, it outlines the broad perspectives for the development of the Union and its policies after 1999, the proposals for enlargement and the future financial framework. From the outset, the communication makes clear the dominant role of enlargement in the future financial package and that policy reforms and the absorption of new members will have to be accommodated within a tight budgetary framework.

The Commission’s assessment of the development of Union policies begins by identifying a series of overall goals: enhancing the conditions for sustainable growth and employment, particularly through market liberalisation and deregulation; investing in research, innovation, education and training; modernising labour markets and employment systems; and improving living conditions in areas such as public health and the environment. These objectives relate to EU internal policies but the focus of Agenda 2000 is on the two policy areas that account for most of the EU budget: the Structural and Cohesion Funds and the Common Agricultural Policy.

Under the heading of *economic and social cohesion*, Agenda 2000 reaffirms that economic and social cohesion must remain a political priority, especially in view of the development challenges associated with enlargement. It proposes a ceiling on structural policy spending of 0.46 percent of Union GDP for 2000-2006, projecting resources of ECU 275 billion for both Structural and Cohesion Funds of which ECU 45 billion would be allocated to the new Member States. Greater concentration is foreseen by reducing the present seven Objectives to three, cutting the population coverage of the designated areas from 51 percent to 35-40 percent, and restricting the Community Initiatives to three fields. The Cohesion Fund would be retained in its present form. Structural Fund aid to present or new Member States would be limited to four percent of national GDP. Increased cost-effectiveness is to come from the simplification of management procedures, greater flexibility and decentralised implementation. The use of other forms of assistance than grants is advocated.

For the *Common Agricultural Policy*, the Commission confirms the policy proposals outlined in its December 1995 Agricultural Strategy Paper for improving the competitiveness of the European agricultural and agri-food sectors, further evolution of the CAP and the development of a coherent and integrated rural policy to accompany the reform process. It advocates specific gradual changes to the price regimes for the cereal, beef and dairy sectors and the introduction of an individual ceiling on all direct income payments, while warning of the need for more radical reforms in the future. These developments are to be supported by a reorganisation of existing rural policy instruments in the new Objective 1 and 2 areas as well as horizontal measures in other regions. Agri-environmental measures are to be reinforced.

Apart from regional and agricultural policy, Agenda 2000 argues for external relations activities to be upgraded, notably development support for neighbouring countries to the east (CIS) and the southern Mediterranean rim, and the capability for the Union to act in foreign policy and international trade liberalisation. The communication also mentions the efforts being made to improve management and organisation functions within the Commission services through Sound and Efficient Management (SEM 2000) and Modernisation of Administration and Personnel policy (MAP 2000)

The second part of Agenda 2000 deals with the ‘challenge of enlargement’, explaining the Commission’s approach to the accession process and presenting its views on launching the accession negotiations. The applicant countries are assessed on the basis of political and economic criteria as well as their ability to take on the obligations of membership; Hungary, Poland, Estonia, the Czech Republic and Slovenia are recommended as candidates. The Commission proposes a pre-accession strategy for all Central and Eastern European applicant countries including aid for agricultural development and structural aid for infrastructure and institutional adaptation. The accession of Cyprus is also reviewed. Although no detailed timetable for accession is provided, the Commission assumes that the ‘first wave’ of accessions will take place around 2003-2004.

Finally, Agenda 2000 turns to the new financial framework for 2000-2006. The Commission aims are to produce a framework: covering a sufficiently long period of time, including changes to Community policies, and the preparation for and immediate consequences of enlargement; capable of financing essential requirements, especially the reforms to the CAP and structural policies; and ensuring the sound management of public finances. On the latter point, the Commission's projections of resource availability assume growth rates of 2.5 percent per year for the existing EU 15 and 4 percent per year for the applicant countries, but that adoption of a working budget "well beneath" the 1.27 percent ceiling should provide a margin of safety. The communication also raises the subject of the financing arrangements, notably the prospects of a new own resource to increase the percentage of tax-based own resources. However, financing of a significant part of the Community budget from autonomous fiscal resources is deemed as having "little chance of being countenanced by all Member States in the present phase of the integration process". Significant technical obstacles also inhibit rapid change of the present system.

3. MEMBER STATE PERSPECTIVES ON AGENDA 2000

Since the publication of Agenda 2000, the principles of the reform proposals are being debated by Member State authorities and European institutions with a view to achieving some preliminary agreement on the way forward at the Luxembourg summit. Thereafter, the Commission is expected to propose the detailed regulations for the reformed Structural Funds in early 1998 in anticipation of getting agreement under the British presidency. Ideally this would allow more than one year for the process of area designation and programme preparation and the timely launch of the new programmes at the start of 2000.

The following review of Member State perspectives on Agenda 2000 draws on discussions with Member State authorities over recent months, in some cases representing preliminary observations rather than the formal positions of sponsoring countries. It is, of course, an on-going discussion; many questions are still being clarified in the discussions between Member States and Commission services, and several aspects depend on the content of the new regulations.

3.1 Overall Approach

The majority of Member States have given a cautious welcome to many of the proposals for economic and social cohesion. The envisaged reduction in spending and spatial coverage, the rationalisation of objectives and reduction of Community Initiatives, and the reform of management procedures and administrative simplification respond to many of the criticisms described in the previous section. Inevitably reactions are influenced by each country's interest in maximising funding shares and/or territorial coverage. However, there are several areas of common concern with respect to the overall approach of the Agenda 2000 communication.

First there is the question of specificity. Many of the proposals are presented in very general terms, and there are question marks against the recommendations for area designation, the rationalisation of objectives and financial allocation will proceed. Member States are pressing the Commission for more detailed information on the potential regulatory position in areas such as eligibility and allocation criteria, simplification, flexibility, division of responsibilities and decentralised management.

Second, the long-term position is vague. Several countries are concerned at the lack of a longer term view with respect to the cost of enlargement. There are important reservations about the conditions under which the new Member States will enter the EU and the potential impact on structural policy expenditure. The Commission is being pressed to provide more detailed explanation of the longer-term implications, to establish a structural policy framework which will be durable beyond 2006 and to provide a commitment to further reform once the impact of enlargement become clearer.

Third, there are reservations over the policy coherence of the proposals, notably the separate treatment and approach of structural and agricultural policies. The Commission's proposals for a parallel decrease in annual Structural Fund spending (c.11 percent) and increase in agricultural policy expenditure (c.14 percent) over the 2000-2006 period in the EU15 have been criticised. At least from the perspective of economics, industry and finance ministries in most EU Member States, the agricultural reforms are considered too timid. A more integrated approach to the reforms is being advocated, particularly to avoid the overlap in rural development policy as currently proposed which could prove problematical.

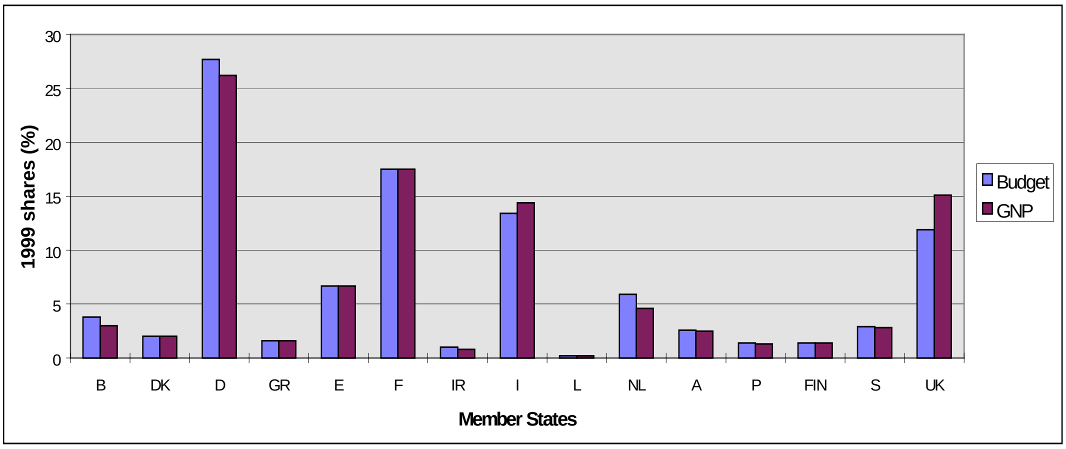
Lastly, some Member States have doubts about the potential generosity of transition periods and conditions, particularly for de-designated Objective 2 and 5b regions. A maximum transition period of two years has been advocated by several countries, with strong opposition to transition periods of 5 or 6 years which would inevitably reopen the question of further designation in the run-up to the post-2006 funding period. This would send a clear signal that EU structural policy cannot be considered a permanent source of subsidy and that the Union is serious about concentration.

3.2 Finance

The financial proposals for the future Structural Funds have to be seen in the context of the wider discussion over the reform of EU finances which range across the financing arrangements for the Union, the resources for the 2000-2006 period and the balance of payments and receipts for individual Member States. Currently, the EU budget is determined by a complex system of resources, mainly GDP and VAT contributions as well as customs duties and agricultural levies. The budgetary ceiling has risen from a ceiling of 1.20 percent of EU GNP in 1993 to 1.24 percent in 1997, projected as rising further to 1.27 percent in 1999. Total resources have been between 0.05 and 0.09 percent below this ceiling over the past five years, a margin which is expected to rise to 0.12 percent in 1999 ie. assuming a budget of 1.15 percent. Member State shares in the financing of the Union broadly correspond to shares of EU GNP (see Figure 1), although Germany, the Netherlands and Belgium pay more in relation to GNP and the UK and Italy the reverse; Commission projections for 1999 show the two indicators moving more into line, with the notable exception of the UK.

So far, EU Finance Ministers have agreed to maintain the 1.27 percent ceiling for the next funding period, and there appears to be agreement about delaying any change to the basis on which national contributions to the EU budget are calculated until 2006. While the Commission is assuming retention of the margin in the early years of the next funding period, full utilisation of the budget ceiling would represent a significant increase in real resources. The main contentious issue, however, is the issue of *net* payments where universally accepted comparative data is not readily available and individual Member States have made their own calculations. Some of the figures presented during the budgetary discussions are disputed by other countries, and the Commission has been asked to prepare an objective study of the net contributions and receipts.

Figure 1: Percentage shares of Member States in the financing of the Union and in total GNP (1999)



Source: Eurostat.

Reviewing the recent debate, it appears that the new financial framework has been subject to a triangle of forces. The most powerful force is exerted by the *net payers*, most notably Germany. These are countries generally keen on enlargement but not at the expense of an increased Structural/Cohesion Fund budget. They want to see the overall EU budget and the proportion allocated to structural policies to be capped and preferably reduced. A further issue is the perceived 'fairness' of the system in terms of the balance between net payments per capita and net receipts. Pulling in a different direction are the *net recipients*, particularly the southern European cohesion countries. They are wary of the implications of enlargement for their Structural/Cohesion Fund receipts, and are concerned that their budget position will be seriously weakened by the terms of the current debate. A third set of forces on the budget come from the *new Member States* whose entry into the Union will make costly demands on the EU budget, especially agricultural and structural policies. Their main concern is rapid accession but under equitable conditions that address their economic and social disparities and treatment that puts them on a par with existing Member States.

Examining national positions in more detail, many of the net payers (Germany, the Netherlands, UK, Sweden, Austria, Finland) have insisted that they are unwilling to make an increased contribution to the EU budget beyond the current ceiling of 1.27

percent of EU GNP for the 2000-2006 period. Further, Germany, the Netherlands and the UK have insisted that net payment levels should take greater account of relative national GNP. The German position is that, since unification, it has slipped to fifth position in the league table of GNP per capita, behind Luxembourg, Denmark, Austria and Belgium; German calculations[6] of its net contribution in 1995 and 1996 range from 10.9 to 13.5 billion ECU, accounting for 55-60 percent of total payments (but only 25 percent of total EU GNP) and significantly ahead of other net payers. On this basis, the German government initially proposed that all net payers should get back two-thirds of contributions exceeding 0.3 percent of their GDP, and explicitly advocated a reduction in the 1.27 percent ceiling. The Dutch position is similar, arguing that the financial contribution of the Netherlands to the EU budget must be brought into line with its per capita income, and claiming that the country is eighth in the league of income per capita but with the largest (per capita) net contribution to the EU budget. Using various figures, other net payers - the United Kingdom, Sweden and Austria - have taken the same approach, seeking to ensure no increase in national contributions and preferably an improvement in their net payment position.

Of particular concern to those countries that currently benefit through structural policy transfers, there is clearly some alarm at the perceived lessening of commitment to economic and social cohesion. Portugal has stated that the discussion of future financing focuses too heavily on enlargement rather than the implications for cohesion among the poorer members of the existing EU15. Irish ministers view the net payers insistence on reducing the gap between contributions and receipts as running counter to the “fundamental principle - the spirit of solidarity” on which the EU is based. In view of projected loss of Structural Fund receipts, Ireland is also worried that the envisaged ‘soft landing’ with generous transition provisions may be jeopardised. At a time when the challenges to cohesion are increasing, southern cohesion countries perceive the cap on the EU budget as unrealistic; during the IGC, Spain and Greece argued for an *increase* in commitments to economic and social cohesion with a new ‘own resource’ for the European Union dedicated to this area. Consequently, they are resisting attempts to cut the contributions of the northern countries to the EU budget, arguing (in the case of Portugal) that “for a few years, we have been paying for enlargement to the new *Länder* which also places a heavy burden on the EU budget”. They also argue that the net payment argument is spurious given that enterprises in the richer Member States make significant gains from the internal market and from Structural Fund contracts in the cohesion countries. In the medium term, they want a commitment to increase the structural policy budget at the time of enlargement.

The Commission takes a similar view on many points, criticising some of the methods and data presented to justify net payment positions. It maintains that the Member State contributions are progressively becoming more proportional to GNP, but that EU structural policy is by its nature intended to be redistributive under a system determined by the political decisions of the Member States. The Commission also underlines the point that calculations of budget financing shares and receipts ignore the trade and investment benefits arising from European integration.

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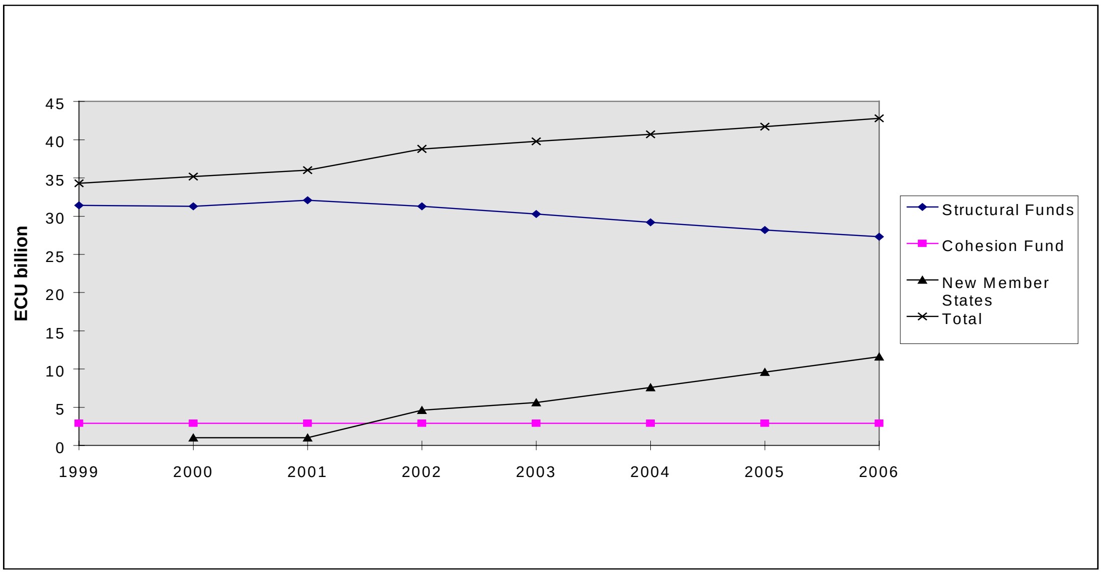
[6] Unofficial Bundesministerium der Finanzen data for 1995; Deutsches Institut für Wirtschaftsforschung data for 1996.

Figure 2: Proposed Expenditure on Structural Operations - 2000-2006 (ECU billion - 1997 prices)



Source: Eurostat.

Under Agenda 2000, budgetary constraints will limit the proportion of Union GNP spent on structural operations to the level of 0.46 percent reached in 1999. On the basis of Commission growth rate assumptions, the financial framework foresees expenditure on structural operations totalling 275 BECU over the 2000-2006 period, of which 210 BECU is allocated to the existing 15 Member States under the Structural Funds and 20 BECU under the Cohesion Fund, and 45 BECU is earmarked for the new Member States. The annual resources available will rise by almost one-quarter from 34.3 BECU in 1999 to 42.8 BECU in 2006, although the allocations to the new Member States will reduce the receipts of the EU15 countries in the latter stages of the funding period. (These figures do not take account of almost 22 BECU proposed for 'new rural development accompanying measures' under the CAP reform).

Agenda 2000 makes little detailed reference to the budgetary allocations or funding allocation formulae between Member States. However, it stipulates that total transfers from the Structural Funds and the Cohesion Fund to any Member State should not exceed four percent of its GDP. Also, two-thirds of the Structural Funds (140 BECU) should be allocated to Objective 1 regions. Indicative financial allocations should be more objective, transparent and equitable than before.

Reactions to the financial proposals have to be seen in the context of the wider debate over the financial framework outlined above. Four main issues have been raised in the discussions over the economic and social cohesion figures.

- *Budget ceiling*. While welcoming the limit on structural policy expenditure, several Member States (including Germany, the Netherlands, Sweden and UK) are concerned at the real cost increase in the budget and are pressing to lower the 0.46

percent ceiling in order to contain costs before and after enlargement. As noted above, there is a general expectation that structural support for the new Member States will be much more costly after 2006 and there is pressure for the financial perspective to be lengthened beyond 2006 - with a commitment to increasing structural policy resources in the view of the cohesion countries, but with the aim of capping expenditure in the view of some net payers. A related concern is whether the Commission's prognosis of economic growth (averaging 2.5 percent per year for the EU 15 and four percent for the new Member States) is valid, despite the existence of a possible margin of 0.5 percent. Termed a 'ticking timebomb' by one Member State, the question is how enlargement will be paid for if economic growth is less; given the difficulties of increasing the Community's own resources above 1.27 percent, financing would have to be found from within the current budget by diverting agricultural and structural policy resources.

- *Budget shares*. It has been argued, particularly by Germany, the Netherlands and the UK, that national receipts under the Funds should, in part, be inversely related to national GDP per capita. However, this is not acceptable to the Commission and to several other Member States on the grounds that EU structural policies are specifically intended to be redistributive.

- *Transfer limits*. The proposed limit on budget transfers, to be equivalent to four percent of national GDP, is generally supported, although there is some doubt at absorptive capacity in Objective 1 regions given that the same level of funding is likely to be concentrated on a smaller population, potentially reduced by about one-fifth and excluding the capital city regions of Dublin and Lisbon. There is also the question of how fair and appropriate the transfer limit is for the new Member States: on the one hand, their lower GDP levels mean that they would receive substantially less in real terms than the current cohesion countries; on the other hand, it is arguable whether they would have the absorptive capacity to receive transfer of even four percent of GDP.

- *Allocation criteria*. As in previous reforms the formula used for resource allocation will be critical, especially for the major funding allocated to Objective 1 countries and regions. Agenda 2000 refers to the need for indicative financial allocations to be more objective, transparent and equitable than before. The Commission is currently preparing indicators, with Member States taking widely divergent views on the relative importance of measures of national/regional prosperity and unemployment levels and the time periods over which they are calculated; the proposal for additional support to be granted to regions with a high level of unemployment is particularly contentious given the significant variations in unemployment rates between prospective Objective 1 regions. As in the past, it is expected that political factors will play an important role.

3.3 New Objectives

Under the Commission's proposals, rationalisation of the formerly complex list of seven Objectives would reduce them to three. *Objective 1*, for regions lagging behind in development, would continue to be the most important focus of the Structural Funds with a continued allocation of two-thirds of the EU15 budget allocation.

Programmes would place special emphasis on improving competitiveness - measures to assist infrastructure, innovation, SMEs and human resources. Although the designation criterion will be strictly applied, special arrangements will be made for the areas currently eligible under Objective 6.

The new *Objective 2* would be for regions suffering from structural problems in the form of economic and social restructuring problems, a high rate of unemployment or depopulation. These are defined as areas undergoing economic change (in industry or services), declining rural areas, crisis-hit areas dependent on the fishing industry and urban areas in difficulty. New programmes would favour diversification with increased support for SMEs, innovation, vocational training, local development potential, environmental protection and combating social exclusion. In rural areas, better urban/rural links would be promoted to facilitate diversification. Particular attention is to be given education and training and access to new technologies to ensure appropriate skill availability. A new *Objective 3* is proposed for the adaptation and modernisation of education, training and employment systems in regions not covered by Objectives 1 and 2. Funding would be concentrated and flexible, promoting activity in four areas: accompanying economic and social changes; lifelong education and training systems; active labour market policies to fight unemployment; and combating social exclusion.

The main question is whether this really represents rationalisation. As noted earlier, Objective 1 will comprise a 'core group' of strictly defined low-income regions as well as a secondary category of former Objective 6 regions enjoying 'special arrangements'. Objective 2 has 4-5 sub-elements and it is unclear how they will be judged. If the criteria are stipulated at EU level, then Objective 2 could effectively become 4-5 new objectives; on the other hand, Objective 2 allocations could be determined on the basis of GDP or unemployment and Member States would make detailed allocations within countries. Clearly the choice of indicators will be a critical issue in this objective. The old Objectives 3 and 4 also 'survive' potentially separately in the new Objective 3. Specific reactions to the proposals are as follows.

- *Objective 1.* There is universal commitment to continuing the concentration on Objective 1. The reform proposals would increase per capita spending in the new programming period; indeed some countries have argued that the concentration could go much further, perhaps to 80 percent of total resources. However, there is some ambivalence about the 'special arrangements' for ex-Objective 6 regions within the new Objective 1 category, objections ranging from those who consider that EU support for these regions should be abolished to the view that Objective 2 would be a better category for assisting these areas (although the sparsely populated regions are not 'restructuring regions').

- *Objective 2.* Again there is general support for a geographical objective addressing restructuring problems in areas of high unemployment. The different elements within the proposed new objective provide the potential for greater flexibility and adaptation to the specific restructuring problems of individual Member States, but there are widespread concerns about 'policy overload' within this category and its fragmentation into wide and disparate sub-objectives. Not all Member States agree with the proposed focus on urban problems and social exclusion, arguing that the

Union should not be adding new categories of problems to the tasks of the Funds and that social exclusion is a highly local issue best suited to Member State action. Among other issues discussed by Member States is the need for a ‘fair balance’ between the deprived urban, rural and industrial areas in this category. Considerable importance is placed on Member State authorities having a major role in determining the areas eligible under this Objective, especially in view of its diversity.

- *Objective 3.* The relevance and role of the proposed new Objective 3 is the most disputed aspect of the new objectives. Prior to Agenda 2000 being published, the position papers of most Member States advocated retention of a horizontal objective promoting employment and training, although at least one country saw scope for abolishing Objectives 3 and 4 (on the grounds that employment and training activities could be adequately addressed by Member State policies), and having a third geographical objective concentrating on inter-regional cooperation and border regions. It has also been argued that ESF is the least cost-effective area of Structural Fund expenditure, that it is difficult to justify and encourages an “industry of training”; a more fundamental point is that the ‘isolation’ of employment and training within a separate objective is inefficient and that it needs to be integrated with other aspects of economic development policy. Within the terms of the current proposal, an important concern is the potentially wide-ranging support possibilities and the need for the Objective to focus much more on specific activities, particularly those addressing long-term, structural labour market changes as opposed to short-term unemployment. The articulation of boundaries between Objective 2 and 3 also needs to be clarified, particularly with respect to social exclusion. The proposed focus of Objective 3 on areas ineligible for Objectives 1 and 2 addresses the criticisms of overlapping objectives under the current system. However, the new approach effectively represents a third geographical objective, potentially delivered through regional programmes in non-designated areas, which could counteract support given to the problem regions.

- *Co-ordination.* There are information gaps in Agenda 2000 regarding what the objectives will fund - the types of activity or project and the award rates as well as other aspects of the eligibility rules. A further key issue concerns the mix of funds. One of the most important problems under current and previous programming periods has been the policy and institutional conflicts between Commission services, reflected in the contrasting - in some cases contradictory - approaches of the different Funds, especially ERDF and ESF. This led some Member States initially to propose a single Structural Fund regulation and a single fund, although this now appears a remote possibility. For those involved in programming, it is important for eligibility rules and programming approaches to be dovetailed, not just between ERDF and ESF but also with the CAP rural development policy

3.4 Area Designation and Allocations

The approach to area designation is central to the net payment issue. Agenda 2000 proposes that the percentage of the EU 15 population covered by Objectives 1 and 2 should be reduced from the current 50.6 percent to between 35 and 40 percent, although it is tacitly accepted that spatial coverage is more likely to be at the upper end of the range.

For *Objective 1* regions, the threshold of a per capita GDP of 75 percent of the EU average would be applied strictly with complete congruence with the regions designated by Member States under Article 92(3)(a). De-designated areas would qualify for an unspecified transitional period to phase out transfers. The outermost regions will be treated as Objective 1 regions on an ad hoc basis, and most northern regions with an extremely low population density, not qualifying for Objective 1 but eligible under Objective 6, should enjoy special arrangements.

Under *Objective 2* the Commission proposes geographical concentration on "the areas most affected at EU level", aiming to identify a limited number of significant areas in order to facilitate an integrated strategy for economic diversification and for zoning to be less scattered. It foresees simpler, transparent and specific eligibility criteria with account taken of relevant socio-economic criteria such as unemployment rates, levels of industrial employment, agricultural/fishing activity, and degree of social exclusion. EU criteria are to be used in conjunction with the Member States, and areas are to be as consistent as possible with areas designated by Member States under Article 92(3)(c). De-designated areas under the current Objectives 2 and 5b would enjoy limited financial support for a transitional period

- *Objective 1*. Member State reactions to the proposals reveal widespread support for a strict application of the designation criteria, and an acceptance that the Objective 1 areas of richer EU countries will disappear (although the UK expects some areas to fall below the threshold) along with designated status for Cantabria and Valencia in Spain. However, there is significant concern in both Ireland (concerning the impact of the whole country losing Objective 1 status) and Portugal (with respect to the potential de-designation of Lisbon), both arguing that the recent positive trends of economic convergence could be jeopardised without appropriate provision.

- *Objective 2*. There is general agreement with the Commission proposal to give the Member States more responsibility for designation but it is not clear how it would work in practice. There appears to be a contradiction between the proposals for simple and transparent eligibility criteria and the range of indicators proposed for use, especially complex criteria such as "degree of social exclusion". Informal contact with the Commission suggests that half of the Objective 2 regions would be designated by the Commission on the basis of the old criteria (a), (b) and (c)[7], and the other half would be designated by the Member States on the basis of their own criteria. Under this system, the Commission would allocate a population quota figure for the Member States to designate their own areas, but the practical operation of this system is unclear. In principle, this approach would be acceptable to several of the countries currently with Objective 2 and 5b areas, some of which

[7] Under Article 9 of the amended Council Regulation No 2091/93, Objective 2 areas were designated on the basis of three main criteria (a) the average rate of unemployment recorded over the last three years; (b) the percentage share of industrial employment in total employment; and (c) trends in industrial employment.

have argued the case for a higher weighting to be attached to national criteria. However, there appears to be a contradiction between the Commission saying that designation would be left to the Member States and the fact that the Commission appears to be preparing a major input to the exercise. Nevertheless, the dual approach could ensure the Commission's objective of each country getting designated areas, even those with (currently) low unemployment levels such as the Netherlands.

- *Coincidence of national and EU designated areas*. The coherence of EU and national assisted areas has been debated for many years with contrasting positions taken by different Commission services and Member States[8]. Agenda 2000 does not indicate how coherence would be achieved and which criteria would be used. Many countries accept the logic of having a close relationship between the two maps, but several countries would have practical difficulties with map coherence, arguing that the objectives of EU regional and EU competition policy are different, as are the objectives and priorities of EU regional policy and some national regional policies. Whereas some countries (eg. Germany, Austria) use the Structural Funds extensively for co-financing national regional aid, others (eg. the UK, Sweden) use EU regional support to a limited extent or not at all to co-fund their regional policy schemes. Agreement on this issue is complicated by DGIV's proposals for new limits on the spatial coverage of national aid areas and its current negotiations with several Member States over their regional aid policies.[9]

- *Transition periods*. The issue of transition periods has already been mentioned; there is strong support among Member States for limited periods of transition, perhaps a maximum of two years with a clear end point for assistance. The same transition period for all objectives has been proposed, although this would be resisted by Ireland in particular.

3.5 Community Initiatives

Agenda 2000 proposes extensive rationalisation of the Community Initiatives (CIs), reducing the number from the present 13 to three 'fields' where added value by the Community is considered to most obvious: (i) cross-border, transnational and inter-regional cooperation to promote harmonious and balanced spatial planning; (ii) rural development; and (iii) human resources, especially equal opportunities. The targets of other CIs are to be incorporated in the Objective 1, 2 and 3 programmes, and the share of resources allocated to the CIs is to be reduced to five percent. Currently spending on the CIs is 18.4 BECU (at 1997 prices) over the 1994-99 period, averaging 3 BECU per year. New spending would be five percent of the total ie. 10.6 BECU over the 2000-2006 periods, averaging 1.5 BECU per year. This implies fewer but much larger CIs in the next programming period.

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[8] The arguments are discussed in detail in the Regional and Industrial Research Paper, Wishlade F and Yuill D (1996) *Measuring Regional Disparities for Area Designation Purposes: Issues for the European Union*.

[9] These issues are discussed in the Regional and Industrial Research Paper, Wishlade F (1997) *EC Competition Policy and Regional Aid: An Agenda for the Year 2000?*

Member States are divided over the future of the Community Initiatives. INTERREG is highly valued, especially by countries with external borders, and LEADER is also well regarded in some States. However, there is some strong feeling that the CIs ought be abolished entirely on the grounds of lack of cost-effectiveness. The bureaucracy involved in the administration of CIs has long been severely criticised. It is noted that both rural development and human resource actions could be readily incorporated within Objectives 2 and 3 respectively, and inter-regional co-operation could also be addressed within mainline programmes. The need for an additional rural measure has been particularly questioned, given the policy support already being provided through the proposed Objective 2 and reformed CAP. If the CIs are retained, their design and use should be determined by a Community perspective, delivering added value and innovation beyond what can be achieved through the regional programmes.

3.6 Cohesion Fund

The Commission proposes that the Cohesion Fund should be retained in its present form for Member States with per capita GNP of less than 90 percent of the EU average and taking part in the third phase of economic and monetary union. The Fund should have a total of 3 BECU per year, with 2.9 BECU per year allocated to EU15 Member States, thereby retaining the level of funding reached in 1999 under the current financial framework. Macro-economic conditionality should continue to apply as well as compliance with the Stability and Growth Pact.

There is considerable ambivalence among Member States about the future of the Cohesion Fund. On the hand it is important for the current recipients, and many net payers accept its existence as a significant commitment in principle to the cohesion countries, whose sensitivities are important in achieving agreement on enlargement. On the other hand, Germany, in particular, has argued that Member States meeting the convergence criteria for the euro should no longer qualify for Cohesion Fund support. This would allow additional savings, increased resources for the Structural Funds or more substantial Cohesion Fund support to be progressively channelled to the new Member States to help them prepare for EMU. A secondary criticism of the Cohesion Fund is that the co-financing rates are too generous, with insufficient incentive for the recipients to take an appropriate level of responsibility and 'own risk' for resource allocation.

3.7 Management of Programmes

The final aspect of Agenda 2000 addressed here concerns the Commission's proposals for improving programme management. Single, multi-annual programmes would be prepared for each Objective 1 and Objective 2 region and a national programme or set of regional programmes for Objective 3. Under a clearer division of responsibilities, Commission and national/regional/local authorities would identify priorities and targets, and programmes would be implemented with decentralised management and simpler financial administration. Member States and regions would need to account directly for Structural Fund usage, and the Commission would ensure that adequate systems for management, evaluation and auditing exist. A performance reserve scheme would be introduced. Greater use of other forms of assistance would be encouraged.

There is universal agreement among Member State authorities at all levels that the management of programmes needs to be overhauled with significant rationalisation of administrative procedures. As noted above, there is scope for simplification at every stage of programming. The Commission's proposals have elicited several reactions.

- *Lack of clarity*. The proposals for simplification are framed in very general terms, raising doubts about whether they would have real impact in practice. Several Member States are unconvinced about the Commission's approach to simplifying management in the light of proposals for better evaluation, performance assessment etc which would entail additional bureaucracy. They are looking for an extensive reduction in the number of programmes and committees, with simple, clear and consistent management guidelines, and administrative costs to be related to the scale of funding. The greater use of established institutional structures and delivery systems has been advocated.

- *Role of the Commission.* From a Member State perspective, a priority is for co-operation within the Commission to be improved, harmonising or co-ordinating the different regulatory approaches and procedures used by various Directorates-General and improving the efficiency of working relationships between them. For example, proposals to use alternative forms of assistance will have to avoid the problems that have bedevilled their usage in the past, notably resistance from DGIV over the transparency of non-grant instruments for state aid control purposes and DGXX concerns about the use of capital from a budget control perspective. A further issue is the role of the Commission within programmes, which requires a clear division of responsibilities, adapting the involvement of Commission services to the scale of EU funding, and perhaps concentrating Commission activity on the small number of major Objective 1 programmes. Also required are improvements in the training of Commission personnel and the quality and consistency of advice given to Member States.

- *Performance reserve scheme.* Under the scheme, the Commission proposes to retain ten percent of programme budgets as a reserve to be allocated at the mid-point of programmes to the better-managed programmes. Although conceived as a way of improving efficiency, it is also seen politically as a way of maintaining significant Commission influence on programmes. It does, however, suffer from a range of potential technical problems associated with comparability of programmes between regions and countries, the availability of data and the differential implementation of programmes and projects, as well as the political drawbacks of making judgements on 'best performing' programmes and reallocating programme resources. While there is a general commitment to improving efficiency among national government authorities, the potential bureaucracy, subjectivity and Commission role associated with the proposal has led most Member States to question or oppose the reserve scheme.

4. THE CHALLENGE OF ENLARGEMENT: REGIONAL DEVELOPMENT IN CENTRAL AND EASTERN EUROPE

The previous sections in this paper have examined many of the political and technical aspects of the Agenda 2000 proposals for economic and social cohesion and the current discussions among Member States. Although much of the debate is concerned with the immediate questions of eligibility and allocation criteria in the next funding period, it is evident that many Member States are concerned about the development of the Structural Funds following enlargement through and beyond 2006.

The discussion over enlargement has concerned the number of accession countries, the timing of accession and the cost of enlargement. Initial proposals for accession negotiations to begin with all 11 candidates were rejected in favour of the five countries proposed in Agenda 2000, although the inclusion of other countries is advocated by Greece (Bulgaria), France (Romania) and the Nordic countries (Latvia, Lithuania). Several Member States have drawn attention to the limited financial projections in Agenda 2000 concerning the cost of enlargement. France, the Netherlands and the UK, among others, have requested a longer-term financial perspective, to establish the budgetary implications beyond 2000.

Countering the desire of the candidate countries for quick accession to the full benefits of Union membership, are the concerns about the impact of enlargement among current cohesion countries, some suggesting that new Member States should be allowed in gradually to permit existing Member States to adapt. The poorer EU States and the countries closest to Central and Eastern Europe - Germany, Austria and Finland - have particular reservations about the potential effects on agriculture in the EU15 and the implications of uncontrolled migration following enlargement. The German Labour Ministry has estimated annual flows of 340,000-680,000 economic migrants seeking to enter the German labour market from the five accession countries, figures which are used to justify lengthy transition periods following accession.

Agenda 2000 does not contain a detailed analysis of regional problems or disparities in the new Member States nor the effects of enlargement. The following two sections explore this issue in more detail. This section addresses the regional dimensions of transition and the state of regional development in the candidate countries; the subsequent section discusses the implications of enlargement for cohesion in the Union[10].

4.1 Transformation Processes

The transition towards a market economy and democratic government in Central and Eastern Europe has been in progress for some seven years, undertaken via various forms of transformation ranging from ‘shock’ programmes to gradualist change. The

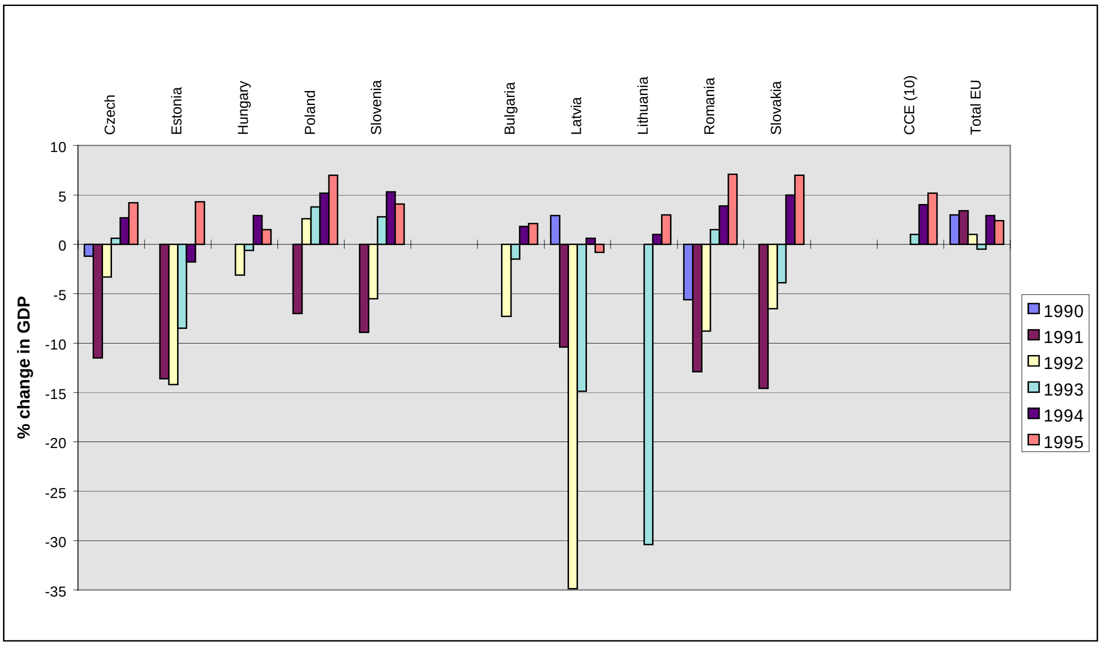
[10]The two sections draw on material from an on-going research EPRC programme *Regional Restructuring in Central and Eastern Europe and the NIS*, in particular two research studies conducted for the European Commission: Bachtler J and Downes R (1995) *Regional Disparities in the Visegrad States*, published in the Fifth Periodic Report; and a study conducted jointly with the Rhine-Westphalia Institute for Economic Research- Bachtler J, Downes R and Raines P (eds.) (forthcoming, 1998) *The Impact of EU Enlargement on Cohesion in the European Union*, RWI- Veröfferntlichungen, Essen.

initial consequences were immediately apparent in a sudden fall in output, rising inflation and hyper inflation, and (partly) a fall in living standards. In the first years of transformation, the collapse of output was such that countries are still struggling to regain their 1989 position. Since 1992, stabilisation began to be evident in Poland, Hungary and the Czech Republic, and more recently for Bulgaria, Romania and the Baltic states where negative economic indicators are now beginning to be reversed. The immediate economic crisis associated with transformation appears to be largely overcome. Comparative data indicates that the economy of much of the CEE region is growing at 4-6 percent per year (see Figure 3 and Figure 4). Inflation is still high by Western European standards but has fallen significantly almost everywhere from the hundreds/thousands of percent annual increases in the early 1990s. Budget deficits have been brought largely under control. Apart from the Baltic states, industrial production has begun to recover, accounting for much of the positive growth trend.

Market economic systems appear to be firmly embedded. Across much of the CEE region, especially in the early reform states, there has been comprehensive liberalisation of prices and reduction in budget subsidies, rising share of the private sector, reduction in customs tariffs and extensive market economic institution building and reform. All CEE countries have undertaken privatisation programmes, though at differing rates. The private sector share of GDP and employment now exceeds 50 percent almost everywhere - Bulgaria and Romania are lagging in this regard - driven by significant growth in the private sector, especially distribution, retail and producer services.

Labour markets are being radically reshaped. At the outset of transition, the share of manufacturing employment was twice as high as in Western European economies; agricultural employment was also very high; and the tertiary sector was artificially small, especially in the private services sector. Over the past seven years, manufacturing employment has contracted by 10-25 percent; agricultural employment has fallen by up to 40 percent in Hungary and the Czech Republic (although less so elsewhere); and the service sector has grown by between one-quarter and one-third.

Figure 3: GDP growth rates in Central and Eastern Europe (1990-1996)

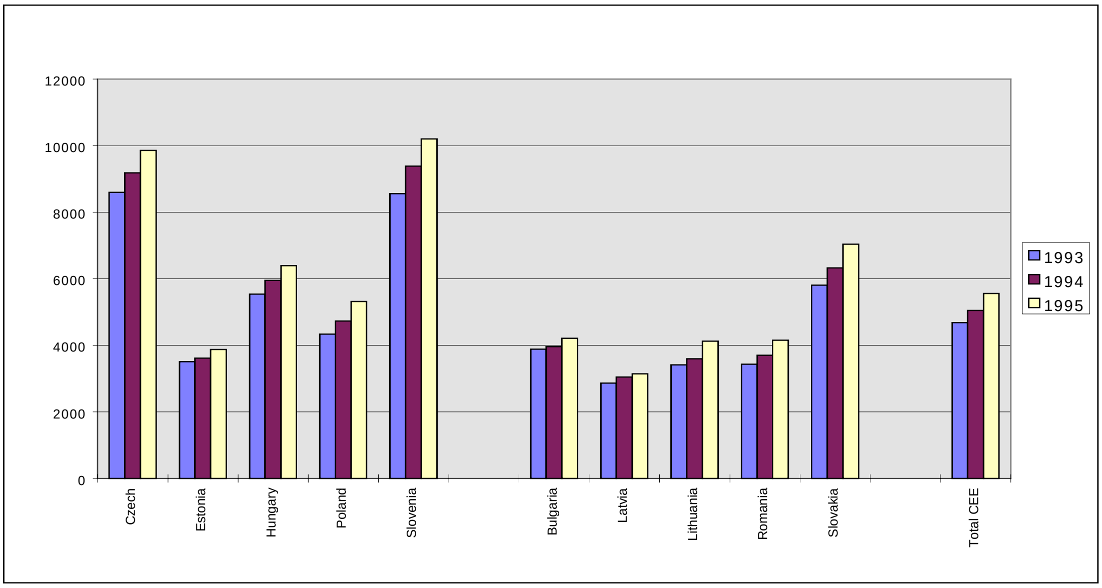


Source: Eurostat.

The revitalisation of foreign trade and investment, and its reorientation from COMECON to Western markets, has been a central feature of reform programmes. Measures have been taken progressively to remove many national trade restrictions by CEE countries, to introduce currency convertibility at international rates, to reduce foreign exchange controls, and to negotiate trade agreements with major partners. Foreign trade is dominated by the Visegrad states: Poland, Hungary, the Czech Republic and Slovakia account for almost three-quarters of all OECD trade with CEE countries. Since liberalisation, there has been a surge of foreign direct investment into CEE. Cumulative FDI is estimated to have risen from US$ 2.5 billion in 1989 to US$ 21.9 billion by the end of 1995[11], mostly directed to Hungary, Poland and the Czech Republic, particularly from the US and Germany.

Figure 4: GDP per capita of Central and Eastern European countries - 1993-95

[11] UN ECE (1995) *Economic Survey of Europe in 1994-1995*, New York: United Nations Economic Commission for Europe.



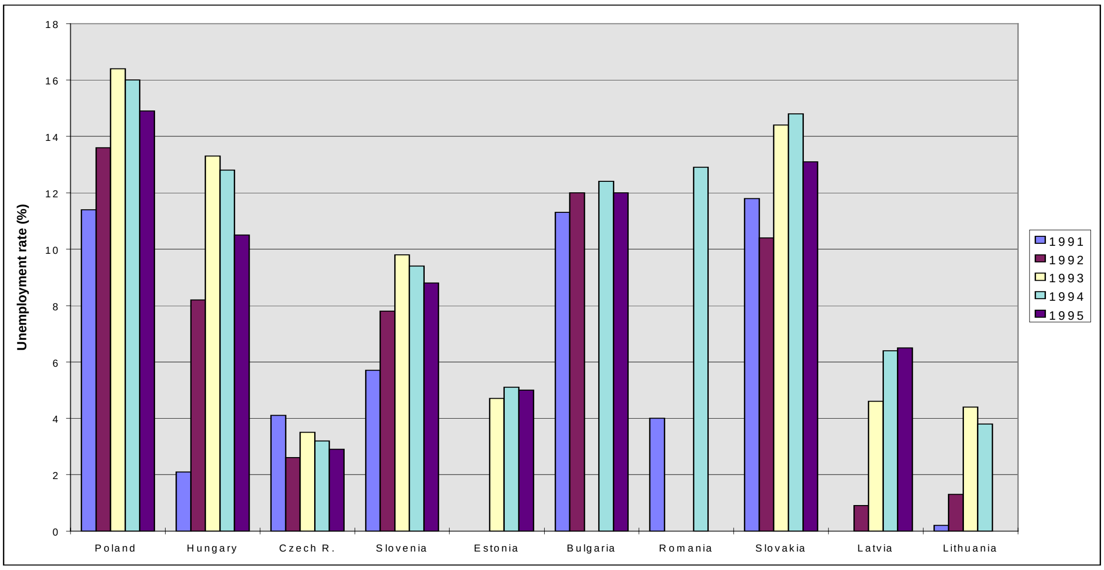
Source: Eurostat.

For the most part, democratic political institutions and systems have been established. Parliamentary and legal systems have been introduced with a separation of powers between the executive, legislature and judiciary. New constitutions are gradually being developed, although basic elements are still partially rooted in the old socialist system. In more advanced countries, like Poland and Hungary, the primary task is to consolidate institutions to ensure their effective operation and maintain the separation of powers. New private sector institutions and institutional structures have been created, in some cases accelerated through Western support, but many are still operating imperfectly, lacking expertise or resources. New electoral systems have been adopted, generally operating proportional representation and/or party list systems. The political landscape is characterised by numerous political parties covering the entire political spectrum and fluctuating in form and composition.

The enduring negative effects of transition have given rise to a certain ‘reform fatigue’ in terms of the popular commitment to reform, manifest in a political backlash against liberal, reform-oriented parties and the rise of anti-reform parties (eg. ‘reconstructed’ communists) and extremist groups. For the majority of people, the social situation has deteriorated. Most CEE countries have seen a decline in average incomes and purchasing power, while the gains from transition (eg. opportunities for new firm formation) have been limited in extent. Differences in income between social groups have increased and the incidence of poverty has intensified.

Unemployment rates do not reflect the scale of economic change (see Figure 5). Across the region, national unemployment rates are in the range 10-16 percent, except in the Czech Republic and the Baltic states. Rates have been held down by excess employment or labour hoarding and considerable numbers of unregistered unemployed people as well as strict welfare and employment policies. Youth and long-term unemployment rates are rising. Major shadow economies also exist, estimated at 20-25 percent of GDP and employment in some cases.

Figure 5: Unemployment rates in Central and Eastern Europe (1991-1995)



Source: EPRC.

Lastly, the reform of the territorial administration is still to be undertaken across much of the CEE region. In most countries there are few intermediate state institutions - and in some cases there is a political vacuum - between the central state and local government. Central governments have a high concentration of political power, while regional or provincial levels tend to be weak, having lost powers either to central government or to communes and municipalities since transition began. A process of vertical and horizontal fragmentation has taken place in the relationships between different levels of government and among actors at local/regional levels. As elsewhere, local authorities suffer from inappropriate size and expensive and unprofessional administration. Especially in the larger CEE countries, there is a general recognition of the need for territorial reform, but consensus has proved difficult to establish.

4.2 The Regional Dimensions of Transition

The ten acceding countries in CEE have a total population of 105 million. Almost 40 percent of the population is accounted for by Poland alone; over three-quarters are in four of the candidate states - Poland, Romania, the Czech Republic and Hungary. The population of the region is generally growing slowly or declining (with the important exceptions of Poland and Slovakia), mainly attributable to declining fertility rates and out-migration. The region is experiencing a net loss of people, especially from Romania and the Baltic states. Internally, there are distinctive patterns of population distribution among the CEE countries: on the one hand, a relatively, balanced, multi-polar urban structure in Poland, and mono-centric countries dominated by populations concentrated in the capital cities, such as Hungary, the Czech Republic, Latvia and

Estonia, on the other. Inter-regional migration movements appear to be slowing down, although there are still marked rural-capital movements and migration to western regions offering greater employment opportunities; intra-regional movement is also strong, especially a trend towards suburbanisation around some capitals and major urban centres. Regions losing the greatest numbers of people tend to be the less developed rural areas and eastern border regions, the out-migration of younger people exacerbating already imbalanced age-sex structures.

The regional economic effects of transition are increasingly uneven. In considering the regional dimension of the transformation, a useful starting point is the conceptual framework[12] below whereby regions in CEE are classified in terms of their position at the starting point of transition and the degree to which they have been affected positively or negatively by transformation processes (see Figure 6).

Figure 6: Typology of regions under transformation

		Post socialist transformation	
		Positive	**Negative**
Position in the socialist economy	**Good**	Positive continuity *(eg. major urban agglomerations)*	Negative discontinuity *(eg. old industrial regions)*
	Bad	Positive discontinuity *(eg. western regions)*	Negative continuity *(eg. eastern border areas)*

The *leading regions* are those that have started out from favourable positions and have demonstrated the greatest potential for rapid restructuring and adaptability to market economic conditions, ie. positive continuity. These 'leaders of transformation' comprise most of the capital cities and other major centres throughout CEE. They tend to have relatively low unemployment and high rates of new firm formation, privatisation and foreign investment. This is particularly important in the case of countries with a monocentric urban structure (Hungary, Czech Republic, Estonia, Latvia) where the capital cities dominate in terms of population, employment, economic activity, intellectual and cultural life. Elsewhere, the best-placed regions are the major agglomerations (eg. Warsaw, Poznan, Wroclaw, Gdansk in Poland) which have led the transformation, characterised by diversified economic structures, a high level of investment, a favourable geographic location and transport infrastructure as

[12]Gorzelak G (1996) *The Regional Dimensian of Transformation in Central and Eastern Europe,* Jessica Kingsley, London

well as a strong business infrastructure such as sources of capital and available research potential.

Other regions in a favourable position are the '*newcomers'* to advantageous economic development conditions - especially the western regions of the CEE countries. In the pre-transformation period, these areas were relatively disadvantaged but have been able to benefit from their proximity to neighbouring Western European regions and countries to take advantage of inflows of productive investment, tourism, cross-border shopping and cross-border economic development initiatives. In Hungary, for instance, the developing market economy has revived the traditional division between the western and eastern parts of Hungary. In the western regions, development has been assisted by proximity to Austria, relatively rapid transformation of western towns, the tourist attractions of Lake Balaton and the spread of development from Budapest. This category also includes the western areas of the Czech Republic (parts of North, South and West Bohemia).

The *disadvantaged regions* in Figure 6 are the old industrial regions. In the socialist period, heavy industrial regions were the 'drivers' of economic development, but the have been severely affected by processes of privatisation, rationalisation, loss of markets and subsidies (although restructuring has not, as yet, affected all such regions). These regions present some of the most serious economic, social and political challenges to transformation - and ultimately to integration and enlargement of the EU.

In Poland, for example, the major regional threat to transformation is posed by Upper Silesia which is on the verge of massive restructuring and a dramatic increase in unemployment. Coal-mining, heavy and chemical industries, the most important sectors of the economy, will have to undergo deep structural changes. The process will affect an agglomeration of four million people, the overall employment in endangered sectors numbering approximately 800,000. Some of the most negative aspects of transformation have also been particularly evident in North Moravia (Czech Republic), an area of coal-mining and heavy industry severely affected by structural change.

Although these regions may have experienced 'negative discontinuity' during the transformation process, they cannot be regarded universally as permanent losers. In several cases, they have a favourable geographic location, a relatively well-developed economic infrastructure, and considerable scientific and research potential. While not underestimating the scale of restructuring required, they have the foundations for adaptive capacity that can be exploited.

Lastly, among the different categories of regions in CEE are *backward peripheral areas*. These have traditionally been the least developed and sparsely populated areas with poor infrastructure, low levels of education and little investment. Under transformation, the non-western border and peripheral regions have seen little improvement in their socio-economic position and frequently a worsening of economic conditions. In Poland, the eastern part of the country (the 'Eastern Wall') has a weak economy, dominated by the primary sector and with little inducement for transformation and recovery from the other side of the border (Lithuania, Byelarus, Ukraine). The same applies to the crisis regions of north-eastern Hungary and the eastern border regions of the Czech Republic, Slovakia, Bulgaria and the Baltic States many of which suffer from a backward infrastructure and society, predominance of agrarian activity, high unemployment, low qualifications among the labour force and unfavourable age structure. Apart from border regions, several parts of CEE countries can be regarded as 'internal peripheries' - rural areas suffering from similar difficulties to the border areas eg. low levels of agricultural productivity, out-migration, poor infrastructure and environmental problems. Notable examples are the Great Plain in Hungary and several regions in Romania (Sub-Carpathians and Apuseni mountains).

4.3 Regional Policy in Central and Eastern Europe

Regional development is a relatively untried area of policy in much of CEE. Prior to the transformation period, regional policy could be equated with centrally-determined regional planning and the regional dimensions of national, sectoral plans. Since 1990, regional policies have been slow to emerge, mainly because of the priority being given to macroeconomic policies. Regional development initiatives have also been hampered by disputes over ministerial responsibility, the need to reform territorial administrative structures and the lack of financial resources. Comparative assessment of the regional development situation in the various CEE countries indicates three main patterns: limited emergence of substantive regional policies; weak regional development institutions; and unresolved issues of territorial administration.

Most CEE countries are aware of the importance of regional policy and have begun to develop appropriate concepts and plans. However, governmental administrations are still undergoing a learning process with respect to regional development, and financial resources are limited (apart from funding provided under PHARE and bilateral aid). Consequently, regional policies are not yet being implemented on a systematic basis - with clear objectives, implementation mechanisms and instruments - by central government. The main exception is Hungary where a settlement-based area designation system has been used to define assisted areas eligible for support from a Regional Development Fund mainly providing infrastructure assistance. Some regional incentive aid is available in Slovenia and the Czech Republic, in the latter case under the so-called REGION programme providing a regionally-restricted interest subsidy supplement on top of standard SME programmes.

Elsewhere, there are many examples of *ad hoc* initiatives as well as numerous measures undertaken on an area-specific basis by deconcentrated state offices or local governments. There are also instances of regional development initiatives being undertaken through sectoral policies such as employment or environmental policy. In most cases, these are reactive policies intended to ameliorate symptoms of regional decline such as unemployment; they are not 'structural policies' oriented towards reconversion and development.

In developing regional policies, politicians and officials are having to confront several challenges and dilemmas. First, they face the question as to whether regional policy is appropriate at the current stage of transition. Although regional disparities are widening and many traditional industrial and less-developed regions are experiencing severe problems, some policymakers argue that countries such as Poland or Hungary should be using scarce resources for a strong national industrial policy rather than a redistributive regional policy.

Second, most countries lack the legislative and institutional basis for regional policy. Regional development laws have been passed in some countries (eg. Hungary) but, in the majority, there is no constitutional or legal basis for regional policy. There are also deficiencies in the institutional infrastructure for designing and implementing regional policy at both central and regional levels, in both the public and private sectors. At central level, governmental administrations lack clear political and administrative leadership with respect to regional policy, and there is a lack of co-ordination between relevant government departments. In Poland, as elsewhere, there is a degree of competition between politicians for primacy in developing policy concepts and initiatives.

A similar situation exists at regional and local levels. Regional development is currently being conducted by the deconcentrated or regional representatives of central government ministries as well as networks of regional and local development agencies (again largely responsible to central government). As noted earlier, there is a missing intermediate ‘regional’ level in most countries and little agreement about the optimal solution.

Third, the development of regional policy is being strongly affected by external influences. The acceding countries by definition are preparing for potential accession to the European Union. In this regard, most are comparing the compatibility of their own policy-making and institutional structures with those of the EU, especially in the light of possible eligibility for EU structural and cohesion policies. Encouraged by programmes such as PHARE, they are having to address issues such as programming and partnership in the design of regional policy concepts and institutions. Complicating the situation still further is the role of Western bilateral aid at regional and local levels, funding the creation of structures and development strategies that are not necessarily compatible with those of central governments.

5. EU ENLARGEMENT AND COHESION

5.1 Regional Disparities in CEE and EU

Discussion of enlargement and cohesion can usefully begin by considering the relationships in income and unemployment between the countries and regions of the European Union and those in Central and Eastern Europe. The most recent Eurostat statistics (see Figure 7) emphasise the stark disparities between the candidate countries and illustrates their potential qualification for the maximum levels and intensities of aid provided by the EU.

Figure 7: GDP of candidate countries in Central and Eastern Europe

	GDP per capita (PPS) (1995)					
Country	**PPS**	**EUR15=100**		**Country**	**PPS**	**EUR15=100**
Slovenia	10,199	59		Slovakia	7,036	41
Czech Republic	9,857	57		Bulgaria	4,210	24
Hungary	6,390	37		Romania	4,159	24
Poland	5,318	31		Lithuania	4,129	24
Estonia	3,876	22		Latvia	3,144	18
Central and Eastern Europe (CEE 10)					**5,561**	**32**

Source: Eurostat.

The measurement of disparities across Central and Eastern Europe (CEE) and the European Union at the national level is fraught with well-known methodological problems. The comparison of disparities between the EU and the acceding countries is further complicated when the analysis descends to the regional level. The nature of economic transition has led to widening variations in the development patterns of different regions in CEE, often relating more to the timing and extent of reform programmes (and other political factors) than to an underlying pattern of economic forces. This makes predictions of future disparities a difficult exercise, particularly relating to the impact of EU enlargement. The following section uses a mix of quantitative and qualitative approaches to provide some comparison of sub-national disparities between the EU and CEE and consideration of regional economic consequences. It begins with a comparative assessment of data for GDP per capita and unemployment rates in the two parts of Europe, followed by a discussion of the regional implications of enlargement.

GDP has only recently begun to be calculated on a comparable basis in CEE countries, and measurements/estimates are still subject to major variation depending on the definitions and assumptions used. More than at the national level, regional income data is rarely available in an appropriate form for comparative purposes and require several stages of analysis. The starting points are the national GDP per capita figures produced by Eurostat which provide a direct means of comparison of EU and CEE countries. The best available and most recent sub-national income data were obtained from national sources and used to construct indices of regional income per capita disparity for each CEE country based on national averages. These indices were then used to allocate the Eurostat national GDP (PPS) per capita figures among the regions to produce regional GDP (PPS) per capita estimates for each CEE region in the three largest 'first wave' accession countries - Poland, Hungary and the Czech Republic. This is a relatively simplistic and crude procedure with considerable methodological and statistical drawbacks but it provides some initial yardsticks for regional comparison and enables some discussion of comparative EU/CEE regional disparities to take place (see Figure 8).

Figure 8 indicates that regional GDP per capita disparities in CEE are much lower than in the EU15 countries[13], and much of the disparity in Poland, Hungary and the Czech Republic is attributable to the overwhelming dominance of the capital city regions, Warsaw, Budapest and Prague. Without the capital cities, regional disparities would be minor by EU standards, although clearly significant within individual national contexts and widening rapidly. On the basis of the data presented in Figure 8, the CEE regions are generally well below the Objective 1 threshold of 75 percent of the EU15 average. Only Prague exceeds the threshold, although Budapest and Warsaw are within 10 percentage points of the threshold. However, there is apparently some overlap between the GDP per capita levels of leading CEE regions and the weakest EU regions. The Czech regions and Slovenia are higher placed than the some of weaker EU regions (mainly in Portugal), and the capital city regions of Prague, Warsaw and Budapest have income per head levels in excess of the weaker regions of Portugal, Greece, Spain and Germany. Nevertheless, the figure is equally revealing about the magnitude of the development challenge facing the CEE regions in the context of EU enlargement. Outside the capitals, virtually all of Poland and Hungary (and Estonia) are below 40 percent of the EU average, and numerous regions are below 30 percent.

In a second exercise, scenarios were calculated for the CEE regions on the basis of the Agenda 2000 growth rates (see Figure 9). While the exercise incorporates simplistic assumptions - that national growth rates apply universally across the regions (which runs counter to the research evidence) it does at least indicate the range of disparities that may result. For this exercise, the 'Objective 1 threshold' was set at 75 percent of the enlarged EU average (ie. the EU20). Attribution of specific figures to particular regions is less important than the general trends involving all CEE regions.

According to the projection, several of the poorer EU15 regions would still be below the EU20 Objective 1 threshold although there has clearly been a relative shift which brings the southern European cohesion regions closer to, or above the threshold. Among the CEE regions, Slovenia would be just below the threshold, the capital city regions of Budapest and Warsaw would be above the Objective 1 cut-off point and Prague would (theoretically) be around the EU average. Most of the Czech Republic would also be better-placed than several weaker EU regions. Given that regional disparities in CEE currently appear to be growing, it could be anticipated that the leading regions (as well as major agglomerations in Poland) would be performing still better at the end of the period. However, the projections also underline the fact that much of CEE would still be facing a considerable development gap relative to the EU; even with a sustained high rate of national growth, it is unlikely that the more underdeveloped parts of CEE would share in the growth rates.

[13] EU data is at NUTS 1 level except for Sweden.

A similar comparison of regional unemployment rates in EU and CEE reveals, not surprisingly, a more mixed picture (see Figure 10). There is no clear difference in either the level or the regional disparity of regional unemployment between EU countries and the new Member States. Poland and Hungary have a very wide range of regional unemployment rates, comparable in extent to those in Spain, Finland, Italy or Germany. The Czech Republic (like other CEE countries not shown) have lower ranges of regional unemployment although, as in EU Member States, sub-regional disparities can be extremely wide.

In consequence, whereas an analysis of regional GDP per capita figures points to a significant increase in low-income areas following accession of the transition countries, the picture is less certain with regard to unemployment. Although unemployment may well rise in the acceding countries as industrial restructuring progresses and with the constant threat of a sharp relative decline in their international competitiveness (particularly their wage cost advantages), there is no indication that the problem differs in scale from that in the existing EU.

5.2 Enlargement and Regional Disparities

The previous section has demonstrated in statistical terms that significant differentials appear to exist between EU and CEE regions, at least in income levels. The evolution of future disparities will, as in Western Europe, primarily be influenced by national factors. The former economic and political system in CEE is not only responsible for sectoral but also for serious regional distortions. The location of industrial activity was largely determined by political factors - the removal of these factors with the collapse of the command economy has an impact at both national and regional levels. Hence, whether a region is to 'gain' or 'lose' during the period of transformation (at least in the short term) depends on the region's capacity to integrate into the wider European division of labour, its relative competitive advantages and its geographical location advantages, both in terms of national economic activity as well as in the attraction of international foreign investment.

Western European experience indicates that policies to address regional disparities in the CEE countries will depend on stable growth in national economies. Most CEE states have been exhibiting real growth rate increases since 1995, but, apart from Poland, none of the accession countries has reached the initial level of GDP existing before transition. Until now, the CEE states have been most successful in areas where their cost advantages (based on low wages, exaggerated by undervalued currencies in purchasing power parity terms) have encouraged a partial relocation of trade and production for wage cost-sensitive semi-finished products and finished products intended for price-sensitive market segments. However, CEE countries face strong competition in all the potential markets in which they may develop. In technologically-sophisticated product markets, the acceding countries are not competitive with most EU Member States, Japan and the USA; with labour-intensive, relatively simple products, they are in competition with the developing countries, which frequently enjoy significant advantages in terms of productivity at comparable wage levels. In markets where the CEE states are most competitive, such as agricultural and textiles products, they presently face significant trade barriers, especially in the EU.

The review of regional development in the previous section indicated that the transformation process has led to geographical concentration in the CEE states: the relative winners are the capital cities (and in the larger countries individual secondary centres and regions close to the borders of the EU). The losers are the rural regions, monostructural industrial areas and regions which border the CIS states. Research suggests that this trend is likely to continue in the near-future, as the adversely affected regions tend to have serious deficits in: (i) infrastructure, especially transport infrastructure, since the current stock is becoming overloaded and resources may have to be targeted in some areas at the expense of other regions; (ii) human resources as the demand for specific technological and management skills increases; (iii) environmental conditions: as there is a mismatch between regions experiencing severe environmental problems and the resources available to cope with the problems; and (iv) the capacity of businesses to maintain competitiveness through continuous innovation. At the same time, the previous section noted that CEE governments lack the instruments for redressing these economic imbalances, especially in shortages of regional policy strategies, resources for the expansion of the infrastructure and an experienced local administration.

Future regional disparities will be depend on the nature of integration between CEE and the EU through a combination of informal trade and investment ties as well as formal measures such as the enlargement of the EU. Establishing causality between wider regional integration and specific regional disparities is notoriously difficult and is made more complex in the CEE/EU case by various factors: the sequence of EU membership (which countries join first and the knock-on effects on the remaining non-EU states); progress with EMU and the requirements made of CEE governments; and the availability of aid and EU agricultural and regional policy funds to the acceding countries.

Several research studies have been conducted on the trade and investment impacts of CEE/EU integration, shedding some light on the possible implications for regional disparities in both CEE and the European Union[14]. Overall, these studies suggest that integration of the CEE countries into the EU would, in the *medium term*, increase competition for regions specialising in agricultural products, basic mechanical engineering, chemicals and plastics industry products, and in the price-sensitive lower market segments of the automobile industry, consumer electronics and shipbuilding. Although the impact of enlargement is unlikely of itself to cause dramatic changes in CEE or the EU, for many regions it could reinforce an existing cycle of declining competitiveness. However, in the *longer term*, there will be compensating effects for

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[14] The following points are based on a summary of several studies: CEC (1993) 'Trade and foreign investment in the Community's regions: the impact of reform in Central and Eastern Europe', *Regional Development Studies*, no. 7, DG XVI, Commission of the European Communities, Brussels. Landesmann M (1995) 'Projecting East-West trade integration' in Landesmann, M. and Székely, I. (ed.) *Industrial Restructuring and Trade Reorientation in Eastern Europe*, Cambridge University Press, Cambridge. Neven, D. (1995) 'Trade liberalisation with Eastern nations: how sensitive' in Faini, R. and Portes, R. (ed.) *European Union Trade with Eastern Europe: Adjustment and Opportunities*, Centre for Economic Policy Research, London. Gual, J. and Martín, C. (1995) 'Trade and foreign direct investment with Central and Eastern Europe: its impact on Spain' in Faini, R. and Portes, R. (ed.) *European Union Trade with Eastern Europe: Adjustment and Opportunities*, Centre for Economic Policy Research, London.

several reasons. First, the product structure of agriculture in southern Europe is complementary to that of the CEE states. Second, price advantages and competitive advantages on non-EU markets can be achieved by combining the human resource, research and development and capital-intensive input products manufactured in western Europe with the labour-intensive input products from the CEE states. Third, the undervaluation of the CEE currencies to date will not be permanent and this will compensate for the present extreme wage cost advantages. Lastly, the development of incomes in the CEE will lead to an increase in the demand for capital goods and higher quality consumer goods which better reflect the export structure of the Member States of the EU.

For the current EU 15, there are several categories of EU regions which are ‘at risk’. These include regions which are less-developed and dependent on agriculture, with a similar production range to CEE regions (grain, vegetables, fruit, cattle and pig farming) - such as the Spanish regions of Asturias and Extremadura, the Italian regions of Calabria and Basilicata and almost all of Portugal. Other areas would be those dependent on: industrial operations with labour-intensive, not particularly human resource intensive production and with low labour productivity, particularly regions specialising in textile production (eg. Merseyside in the UK); primary chemicals plants or shipyards with a relatively low level production range and low labour productivity, such as the north-eastern coastal areas of Germany; and manufacturing assembly activity and low labour productivity, such as the declining industrial areas of the Ruhr in Germany and north-western France.

The integration of the CEE states in the EU would also confront the rural regions of CEE with considerable problems of adaptation - in the agricultural sector, these regions would have to make enormous cuts in employment to become competitive in the Single Market, with the consequence that the existing job market problems would worsen. It would also put increased adaptive pressure on the regions characterised by heavy industry, a large proportion of which are monostructural, and force many large government-owned businesses to adapt their corporate structures and thus cause a significant reduction in jobs.

Finally, the current border regions between the EU and CEE can be considered a special case. On the EU side, the border regions are in most cases the weakest regions of the Community, whereas the CEE border regions are often the fastest-developing regions of the transition countries. Accession of CEE countries to the EU would have similar effects as the EU's Single Market by creating closer economic ties between the border regions on both sides through removing current barriers to the free movement of goods, services, capital and people.

6. DISCUSSION

This paper has discussed the short-term and long-term challenges confronting regional policymakers concerned with EU structural policy. It has reviewed the efficiency of the Structural Funds, identifying the key issues underlying the current debate. In the context of the Agenda 2000, the paper has examined the different perspectives of the Member States concerning the proposals for reforming EU regional policy. Looking to the medium-term, the paper has explored the state of regional development in Central and Eastern Europe with respect to the regional dimensions of transformation and regional policy. It has also considered the implications of enlargement for cohesion and the potential effects for CEE and EU regions. This final section highlights some key questions for further discussion.

Agenda 2000 is attempting to initiate the process of adapting EU regional policy to cope with enlargement. It represents a relatively small step in the direction of reform: is it the most that can be achieved at the present time?

Agenda 2000 represents a new type of reform in the recent history of EU structural policy, one being conducted within a climate of financial austerity. Agreement of a new financial framework for the Union depends, as in previous rounds, on the Council reconciling conflicting political and economic priorities among the 15 Member State governments, the European Commission, and variously influential regional and sectoral interest groups. The Commission has produced a balanced set of proposals which attempts to take account of these different interests. With little financial flexibility, it asks only for incremental change involving relatively limited sacrifice from most Member States in either territorial coverage or financial allocation. The proposals retain considerable flexibility to compensate Member States for negative aspects of the reforms.

The broadly positive reactions of Member States to the Commission's proposals reflect the fact that Agenda 2000 is essentially a 'holding document', eschewing fundamental reform to EU structural policies. It reveals that, while there is general consensus for changes to the Structural and Cohesion Funds, there is little immediate pressure for *radical* reform. With accession unlikely to take place until 2003, and possibly not until 2006, there is no imminent budgetary crisis. The hard decisions concerning the impact of enlargement have been shelved. Instead the Commission has opted to reorganise the current system to meet financial constraints and efficiency problems by reorganising the current system and with the aim of providing 'something for all'. The concerns of the net payers are addressed with the financial ceiling, concentration and ideas for improved efficiency; the poorer countries get a reaffirmation of Objective 1 and retain the Cohesion Fund (together allocated c.70 percent of resources); the Nordic countries retain support for sparsely-populated areas; both urban and rural areas are included in the new 'portmanteau' Objective 2; and employment creation is given a high profile.

What is remarkable is how little may in fact change. Although there will be a balance of gains and losses for individual countries and regions, the Commission wants to ensure that all the Member States remain part of EU structural policy with at least some designated areas. Commission services have repeatedly emphasised that most - if not all - the currently designated regions would retain their current status, even if only for a transition period. Also, the rationalisation of Objectives may turn out to be less than expected given that the new Objective 1 has two sub-categories (the strictly defined core areas and the lower aid intensity ex-Objective 6 areas), while the new Objective 2 has scope for sub-division into 4-5 sub-objectives. The Cohesion Fund and Community Initiatives remain. The proposals for simplified management, flexibility and decentralisation are (as yet) vague, and there is no mention of the range of instruments, eligible activities or aid intensities.

Nevertheless, the proposals would involve changes in the coverage of designated areas and in the allocation of resources. Among the cohesion countries, the whole of Greece should continue to qualify for Objective 1 - most Greek regions changed little in terms of relative GDP per capita over the 1988-94 period. Most of Portugal should also qualify, although the status of Lisbon (a critical issue) is in doubt with a 1994 GDP per capita level of 87 percent of the EU average, and the relatively low levels of unemployment may reduce its financial allocation significantly. Much of provincial Spain, apart from Cantabria and possibly Valencia, should also continue as Objective 1, and, given the currently high levels of unemployment in Spain, there is an expectation of receiving a similar flow of Community aid as in 1994-99. Ireland faces the progressive withdrawal of major EU support; strong economic convergence in recent years has moved the country well above the 75 percent threshold, although the Irish government is arguing for generous transition provisions over the next programming period. Outside the cohesion countries, Objective 1 should apply to the eastern German *Länder*, eastern Finland and southern Italy (giving all three countries a significant stake in the reformed Funds); the northern parts of Sweden and Finland should also benefit from the ‘special arrangements’ of lower aid intensity support under Objective 1 proposed in Agenda 2000. Elsewhere, the outcome is difficult to predict. The UK, Benelux countries, Denmark and France are likely to lose their current Objective 1 regions, and will rely largely on Objective 2 for any region-specific Structural Fund support. Although the detail of Objective 2 designation procedures and criteria are still being debated, the Commission has unofficially reassured even the best-placed countries that they are likely to have at least some, potentially self-designated, EU assisted areas.

Member States have reacted positively to the overall approach of Agenda 2000 and it is likely that the Luxembourg summit will be able to agree broad guidance to the Commission on general principles such as the rationalisation of objectives, concentration on Objective 1, budgetary ceilings etc. More specific agreement depends on the regulatory detail being developed by the Commission and clarification of the many detailed questions currently being sought by Member State authorities, such as the eligibility criteria for the new Objective 2. However, if the proposals were agreed they would achieve a limited degree of spatial concentration and improvements in efficiency within a broadly similar budget ceiling. Importantly they would represent the first step towards adapting EU structural (and agricultural) policies for enlargement. It may be inevitable that the Agenda proposals do not attempt wide-ranging reform but seek to achieve a compromise which will not jeopardise agreement on the more important political goal of enlargement.

The starting point for Agenda 2000 is the need to accommodate enlargement within a tight financial framework. Among the various technical proposals for reform, the objectives of EU regional policy are hardly addressed. What is the future rationale for the Structural Funds?

In the early discussions about the post-1999 Structural Fund reform, the Netherlands and Denmark argued the merits of an EU structural policy focusing exclusively on underdeveloped countries and regions. Such an approach would have the virtue of economic, financial and administrative logic. Arguably the most important spatial disparities in the Union - which justify active EU intervention - are the income differences between the developed and less-developed Member States, and the major challenge is cohesion in terms of income convergence. Limiting policy to underdeveloped countries and regions would simplify and focus the policy, avoiding the circular flow of money between richer Member States to the Union and back again; and it would improve efficiency by eliminating the inordinate administrative resources which need to be allocated to the implementation of (sometimes) relatively small amounts of money in many Objective 2 and 5b programmes and Community Initiatives in the more developed countries. Although the proposal attracted initial interest and backing from some other Member States, domestic political imperatives such as the net payment issue and the value of Structural Funds to key regional constituencies, as well as Commission opposition, meant that it was not followed through.

One of the notable aspects of Agenda 2000 is the fact that it devotes so little attention to the principles or objectives on which EU structural policies are to be based in the next decade. Agenda 2000 reaffirms the political priority of economic and social cohesion as set out in Article 130a of the EU Treaty, with the goal of reducing disparities in levels of regional development and the backwardness of the least favoured regions. Specifically, the Structural Funds should foster "competitive development and sustainable and job-creating growth throughout the Union and the promotion of a skilled, trained and adaptable workforce".

In part the language of Agenda 2000 echoes the First Cohesion Report; this defined cohesion to mean (a) economic convergence of basic incomes, competitiveness and employment, and (b) social solidarity through reducing unequal access to employment opportunities, social marginalisation and the incidence of poverty. Clearly there are many practical objections to these aims. Though laudable, it is unrealistic for the Union to achieve either economic convergence or social solidarity with current resources. The equity objective of reducing disparities is contradicted by the emphasis given to the efficiency goal of other EU policies and, even within EU regional policy, there are unacknowledged contradictions between the goals of economic competitiveness, sustainability and employment creation. More importantly, Member States acknowledge that the structure, coverage and resources of EU structural policy are determined primarily by political factors rather than by economic development principle. The approach to funding and resource allocation is driven by the desire of Member States to maximise their share of the available budget.

Notwithstanding these points, it is arguable that cohesion remains an important aim for EU structural policy. It signifies the Union's commitment to alleviating negative side-effects of European integration and the promotion of economic convergence and social solidarity. In reality, as the cohesion countries have pointed out, it is striking that Agenda 2000 gives little attention to cohesion by comparison with previous reforms. The focus is heavily on accommodating the costs of enlargement; Agenda 2000 also appears to embody a shift away from a commitment to long-term development towards shorter term concerns about unemployment - reflected in the proposed eligibility criteria for area designation and in the funding allocation criteria. This is perhaps understandable given the environment for reform: in the face of rising unemployment in most Member States, the Union has accorded a high priority to job creation reflected in the new employment chapter in the Amsterdam Treaty as well as territorial employment pacts and other employment initiatives. However, it leaves open the question of the future rationale for EU structural policy and the importance placed on cohesion.

One of the key objectives of reform must be to resolve the tensions between Member States and Commission services in the implementation of the Funds. How can the commitments to decentralisation, flexibility and simplification be achieved in practice?

At strategic and operational levels, the implementation of the Structural Funds has been the principal cause of tension between the Commission and Member State authorities. This tension has many facets, several of which have been referred to in this paper. They include the Commission's interpretation of the principles and regulations governing the Funds in implementing the Funds through multinannual programmes, the conflict between EC and Member State policy priorities and delivery systems and the bureaucratic and inefficient procedures associated with many aspects of programming. In part, these difficulties can be attributed to the long and steep learning curve required by all parties at European, national and local levels in delivering the Structural Funds. However, the fundamental problem is the Commission's attempt to exercise its regulatory responsibilities (to ensure the legitimate and cost-effective disbursement of funds) in a more-or-less standard manner across the Union regardless of the enormous differences in policy approach, institutional structures and systems among Member States. This explains some of the pressure from several Member States for a more decentralised mode of implementation.

In resolving these problems, the Union needs to find a way of adapting the implementation of Funds to suit different national conditions, potentially with different degrees of decentralisation. Among the options being considered, one possibility might be to develop a system of 'implementation agreements' determined bilaterally between the Commission and each individual Member State. The nature of the agreement could be determined in the light of several key factors.

i. *Type of regional problems*. It is arguable that the most important challenge for the European Union are the disparities in economic development between the cohesion countries and the remaining Member States. These reflect fundamental differences in infrastructure endowment, business activity, employment structure and income and are recognised in the overwhelming concentration of EU structural policy on Objective 1 regions. Such problems justify closer Commission involvement in supporting Member State decisions concerning the balance, direction and priorities of economic development policies and measures.

ii. *Scale of EU funding*. The Commission has overall responsibility for accounting for EU spending to the Court of Auditors, but it is justifiable to expect that the Commission's role in programme management should be adapted to the scale of funding, allocating administrative resources to the monitoring, evaluation and control programmes in line with programme size. Larger EU funding justifies more Commission intervention.

iii. *Institutional capabilities*. Member States vary in the capability and competence of their government institutions and agencies for implementing EU regional development programmes. Some countries readily admit the Commission's supportive role in promoting good government and innovation in economic development programmes; others have long-established institutional systems in place where the Commission's involvement has proved to be disruptive and inefficient. Implementation of the Funds should take account of the capabilities and capacities of existing institutions and be adapted accordingly.

iv. *Performance in programme management*. As the Commission has acknowledged in advocating its Performance Reserve Scheme (PRS), there is wide variation in the quality and competence of programme management, reflected for example in the sophistication of strategies, management arrangements, project delivery systems, absorption rates and the efficiency and impact of programmes. The Commission has a differential role to play in improving programme performance by promoting, as required, advice on best practice, exchange of experience and sanctions for poor management. In this context, it is notable that initiatives like the PRS are more likely to be politically and technically feasible if operated within a Member State rather than across borders.

Factors such as these could be used to determine the most appropriate institutional arrangement between the Commission and each Member State, with a variable role for the Commission services in each case and not necessarily on a standard basis across all regions within a country. Negotiated at the start of a programming period, covering all types of programme, and reviewed at the mid-point, such 'implementation agreements' would establish the 'ground rules' for a division of responsibilities between the Commission, Member State government and sub-national authorities. The advantages of such a system are fourfold. First, it is flexible, allowing EU structural policy to adapt to different systems of governance and institutional systems and in relation to the nature of the problems and scale of EU funding. Second, it could be dynamic, modified in line with changing conditions. Third, it would potentially be durable, applicable not only to the current EU15 but to an enlarged Union.

Lastly, it respects the principle of subsidiarity and the current pressure for more decentralised management while avoiding a return to the pre-1988 situation where the Commission was effectively impotent in influencing the allocation of EU expenditure by Member States. Indeed, it could facilitate the Commission's withdrawal from much of the time-consuming and contentious involvement in programme administration to focus on areas where it has a potentially more valuable role (such as promoting exchange of experience, transfer of best practice and innovation) and a greater justification for intervention, such as improving the quality of evaluation and auditing.

The Commission's proposals for enlargement assume a relatively small allocation for the new Member States during the next funding period, and its projections end in 2006. Will this be adequate or acceptable?

The implications of enlargement for the EU have been subject to various sets of projections over recent years. In 1990, Commission calculations suggested that, applying the Structural Fund criteria to the underdeveloped parts of the EU and Central European economies would require an increase of 22 billion ECU in the EU budget, increasing the proportion of own resources from 1.2 percent of Community GDP (1992 position) to 1.6 percent. Other research has cited estimates ranging from 12 billion ECU to 26 billion ECU as the additional annual cost to the Structural Funds of admitting the four Visegrad countries - Poland, Hungary, Czech Republic and Slovakia. Similar estimates for the accession of the Bulgaria, Romania and the three Baltic states suggested an additional annual increase in the Structural Funds of between 8 billion ECU and 16 billion ECU. EPRC/RWI research in 1996 estimated the Structural Fund cost to be 20-30 billion ECU depending on the number of accession countries with a further Cohesion Fund cost of 4-6 billion ECU. Agenda 2000 proposes a Structural/Cohesion Fund allocation to the accession countries of 45 billion ECU for the 2000-2006 period on the basis of five new Member States.

Applying the Structural Funds in Central and Eastern Europe needs to take account of several factors. First, there is the issue of the impact of transfers. Given the relativities between the average income of the EU and that of the new Member States, even small amounts of support by EU standards could have a major impact on investment and in Central and Eastern European countries. Second, the potential for regional targeting of EU aid is likely to be limited, at least in the short term. Evolution of national and regional trends among the new Member States indicates that some CEE regions will be above the Objective 1 threshold of 75 percent of EU GDP per capita by the time of enlargement. However, any cohesion-based strategy to reduce the development gap will, in the first instance, need to concentrate resources on the growth poles and regions with best development potential. Third, a crucial factor is the limit of the economic, financial or institutional capacities of CEE countries to absorb transfers. Agenda 2000 assumes a maximum of four percent of the recipient country's GDP; experience from eastern Germany suggests that the upper limit of a sustainable transfers may lie between six and eight percent, depending on wider economic conditions; but other researchers argue that absorption in excess of ten percent is feasible if concentrated in fields such as infrastructure development. Lastly, the potential for co-financing of Structural Fund expenditure by CEE governments will be limited; the financial resources available to most CEE economies for economic development are small by EU standards.

The preceding discussion about enlargement and cohesion illustrates that the new Member States have a huge development gap relative to the current EU average and (for the most part) relative to the poorest of the present Member States even if some of the income deficit is narrowed before accession takes place. Adaptation to the Single Market will exacerbate problems for several categories of CEE region, and enlargement (though positive for the Union as a whole) will have negative implications for some EU15 regions also. This will present a considerable financial challenge for the Union, yet some Member States are assuming that the EU budget can continue to absorb these costs within current limits. Under these circumstances, some debate of the longer term evolution of economic and social cohesion, and even financial planning beyond 2006, is necessary. At the very least, a commitment to fundamental reform of EU regional policy at the time of enlargement would seem to be essential.