EU REGIONAL POLICY IN AN ENLARGED EU : A REVIEW OF THE DEBATE

This paper has been prepared for discussion at the twenty-second meeting of the Sponsors of the European Policies Research Centre to be held at Ross Priory, Loch Lomondside on 8 and 9 October 2001

John Bachtler

October 2001

European Policies Research Centre
University of Strathclyde
40 George Street
Glasgow G1 1QE
United Kingdom

Tel: +44-141-548-3339
Fax: +44-141-548-4898
e-mail: john.bachtler@strath.ac.uk

TABLE OF CONTENTS

1. INTRODUCTION

In March 1999, the Berlin European Council agreed the financial framework for the European Union for the period 2000-06, as part of the process for preparing the EU for enlargement. This framework provided pre-accession and enlargement-related support for the new members, but without increasing the overall EU budget. For the first time, the spatial coverage of EU regional policy contracted, the growth in Structural and Cohesion Funds was stopped, and the receipts of the existing EU 15 recipient regions (in most cases) were projected as declining over the 2000-06 period. Conducted against a backdrop of financial restraint, the agreement was the culmination of a difficult and protracted period of negotiation that left participants hoping for a period of calm before negotiations on future reforms of the EU budget resumed.

However, within two years of the Berlin Council, the debate about the size and distribution of post-2006 EU budgetary resources has started again. The first step was the publication of the Second Cohesion Report by the European Commission in January 2001, followed by the European Cohesion Forum in May 2001 and a preliminary discussion among Member State officials at the informal regional policy Council in July 2001. The EC is pushing forward the debate with a series of informal discussions and seminars on a series of policy themes over the coming 1-2 years, with a view to developing its own proposals in 2003-04 in association with the Third Cohesion Report. By setting a target date some time ahead, the EC has effectively provided a ‘window of opportunity’ for discussion before official positions need to be developed. Some Member States have been quick to respond, most notably Spain and Germany, with proposals from opposing ends of the spectrum, but other positions are emerging only slowly.

The next reform will be challenging. Although the EU-15 have budgeted for €12.1 billion in 2006 for the new Member States following enlargement, this is merely a temporary allocation of funding to cover structural operations until the end of the funding period. After 2006, the new members will expect to receive shares of Structural and Cohesion Funds that reflect the severity of their economic development problems, while the existing recipients will need either to give up on entitlements or increase the overall budget, or a combination of both. There are also more fundamental questions about the rationale and scope of EU regional policy in an enlarged EU: what should be the objectives of EU regional policy? should it address disparities between countries or regions? what type of regional problems should be addressed? what are the most important forms of aid?

One of the main difficulties is that the shape of an enlarged EU is still unclear. While the EU is committed to enlargement in principle, and has defined criteria for the accession of Candidate Countries, a timetable for membership has not been agreed. Consequently, it is impossible to determine precisely how far an eastward redistribution of Structural and Cohesion Funds will be necessary. Perhaps the most revealing aspect of the discussion so far is the way the terms of the debate have been set. There are conceivably four sets of questions for the reform debate to consider.

First, there are some difficult technical issues related to the design, management and implementation of regional policy. They include the most appropriate criteria for designating eligible areas, priorities and objectives for Structural and Cohesion Funds, the co-financing rates for EU intervention, the management arrangements for programming and the delivery systems for project selection. In the way that it organised both the Second Cohesion Report and the European Cohesion forum, the European Commission has been keen to focus discussion on these technical questions.

A second set of questions concerns financial allocation and the targeting of EU regional policy aid. The Commission's view is that it is premature to discuss financial aspects before the content of the policy is decided, and has even characterised the 'donor-recipient' debate as redundant. This ignores the fact that every Member State approaches the debate from the perspective of promoting and safeguarding its national interests which, in practice, is heavily influenced by the balance of payments and receipts (as illustrated by the recent contributions of Spain and Germany).

Third, there are some conceptual questions which have been hardly mentioned. These concern the basis for EU regional policy intervention and the interpretation of Article 158. With the EU expanding to take up to 13 new members over the next decade or so, it could be argued that the Treaty commitment to reducing regional disparities or the objectives of the EU's regional policy should be at least part of the debate. However, these are questions ignored by the Second Cohesion Report which appears to start from the premise that the fundamental principles and objectives are 'given'.

Lastly, there are wider political questions concerning the contribution of EU regional policy in addressing the 'crisis' of confidence in European policies and institutions. As the European Council, European Commission and European Parliament have recognised over the past two years, there is an urgent need to reinforce popular support for the EU and its objectives. Arguably, the debate over the future EU regional policy – one of the policy areas that has the potential to make an immediate difference to the lives of individuals and communities – should also take account of the wider EU reform agenda.

The following paper contributes to the debate by focusing on the second, third and fourth of the above agenda of questions. It begins by reviewing the political, economic and budgetary parameters of the reform debate. The paper then discusses the current state of the debate, identifying the perspectives of different contributors and the scenarios and variants on Structural Fund reform that have been put forward, as well as the results of studies quantifying the budgetary implications. Lastly, the paper considers the future direction of EU regional policy, suggesting some issues for discussion.

2. PARAMETERS OF THE DEBATE

2.1 Political framework

The most important parameter is the scope of enlargement itself: which countries accede to the EU and when. Since the Copenhagen European Council made the commitment that *"the countries in Central and Eastern Europe that so desire shall become members of the Union"*, 13 'Candidate Countries (CCs)'[1] have applied to join the EU. Although the basis of enlargement was subsequently developed at the Madrid (1995), Luxembourg (1997) and Helsinki (1999) European Councils, none of the CCs yet has a fixed date for accession. Negotiations were opened on 31 March 1998 with Cyprus, Hungary, Poland, Estonia, the Czech Republic and Slovenia, and on 15 February 2000 with Malta, Romania, Slovakia, Latvia, Lithuania and Bulgaria, and several rounds of negotiation have now been completed. Negotiations with Turkey have not yet started.

In November 2000, the European Commission drew up an indicative schedule – termed a 'road map' – in the form of a sequenced approach to the chapters in the negotiations for the period 2001-02[2]. This envisaged that it would be possible to conclude negotiations on issues such as the free movement of goods, persons, services and capital, as well as company law, social policy and employment, the environment, culture policy and external relations in the first half of 2001, with the progressively more challenging issues such as competition policy, taxation, transport, energy, fisheries, and justice and home affairs policy agreed by the end of 2001, and the difficult issues of agriculture, regional policy, financial provisions and institutions being dealt with in the first half of 2002. The European Council of Santa Maria de Feira considered that *"it should be feasible to open negotiations in all areas of the acquis with the most advanced of these countries as early as possible in June 2001"*. The Commission maintains its view that it should be possible to conclude negotiations with the most advanced CCs in 2002.

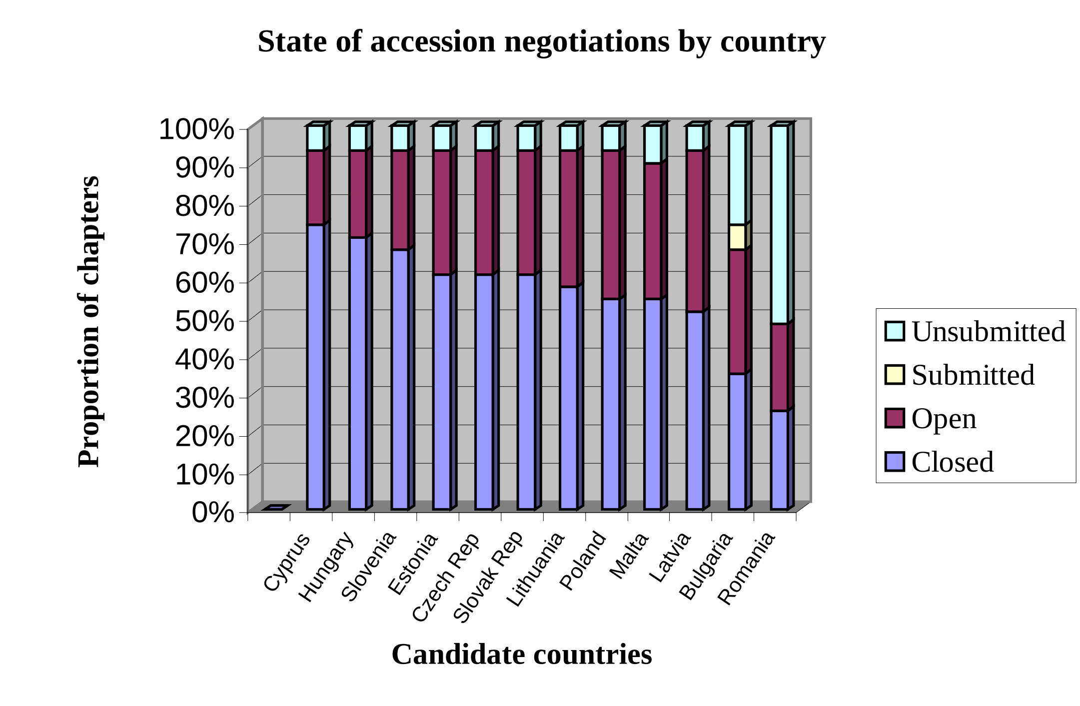
In reality, the position is more complex, with considerable variation in the progress of individual chapters between countries (see Figure 1). Whereas Cyprus, Hungary and Slovenia have concluded around three-quarters of the negotiation chapters, Poland still has negotiations underway on 12 of the 30 chapters, including the free movement of persons and capital, while Romania and Bulgaria have yet to submit their position in several areas of negotiation. In key areas of negotiation – competition policy, regional policy, justice and internal affairs and economic and financial arrangements – none of the countries has concluded any of the chapters.

---

[1] The current Candidate Countries are Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Romania, Slovak Republic, Slovenia and Turkey. At the Santa Maria de Feira European Council in June 2000, it was agreed that the countries of the Western Balkans (FYROM, Croatia, Albania, Bosnia Herzegovina and the Federal Republic of Yugoslavia (Serbia, Montenegro)) are 'potential candidates' of the Union.

[2] CEC (2000) *Strategy Paper- Regular Reports from the Commission on Progress towards Accession by each of the Candidate Countries*, DG Enlargement, Commission of the European Communities, Brussels, 8 November 2000.

Figure 1: Accession negotiations by country (September 2001)



Other complications may arise before the negotiations are complete, with some chapters being reopened. For example, recent reports suggest that Poland may ask the EU to reopen negotiations on the free movement of goods in order to secure longer transition periods for Polish pharmaceutical companies for drug registration procedures. In other areas, changes to the *acquis* may present new obstacles to the acquis, as in the case of the recent decision to tighten EU co-operation on security-related issues following the terrorist attack on the US.

Proposing scenarios for enlargement is a contentious exercise, but current thinking would appear to suggest the following options:

(a) *Short-term accession prospects (2003-2006):* Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic, Slovenia

(b) *Medium-term accession prospects (2007-2013):* Bulgaria, Romania

(c) *Long-term accession prospects (2013+):* Turkey, Western Balkan countries

Among the *short term prospects* are 10 CCs, all of which are making significant progress in their accession negotiations, although at differing rates. The key question is whether they all accede together – which would imply delaying enlargement to suit the country with the longest preparation time – or to allow them to accede at different times. On the basis of the present state of negotiations, some 'advanced' CCs (eg. Cyprus, Hungary) might be in a position to join the EU already in 2003. However, to give primacy to some CCs over others in the 'first wave' would potentially risk political controversy and popular alienation among those (such as Poland) whose

accession was delayed. Hence, a likely scenario may be to give all of the short-term accession prospects a fixed date for entry (something that has been lacking up until now) over the 2003-2006 period in line with the anticipated negotiation period.

With respect to the *medium-term prospects* for enlargement, it is evident from Figure 1 that there is a big difference between the readiness of Romania and Bulgaria and the other 10 CCs. While it is not impossible for either country to accelerate its preparations (as the Slovak Republic has shown in the past), the fact that both countries have yet to submit their national position in several important areas of negotiation suggests that neither Romania or Bulgaria will be among the 'first wave' of accession countries. Many of the studies cited below (See Section 3.1) assume that both countries will join the EU in the 2007-2013 period, in one case assuming their accession as early as 2005. It is, however, an open question whether, once the 'short-term prospects' have joined the EU, the enlargement date for Romania and Bulgaria will progressively recede to be incorporated into a 'south-east European' enlargement including Turkey and the Western Balkans at some point after 2013.

Within the overall timetable for enlargement and discussions about the reform of the Structural Funds, there are several political events or factors that will play a part in determining the outcome, as indicated in Table 1.

Table 1: Political Timetable, 2001-2006

Timetable	*EU Presidency*[1]	*National elections (EU)*	*National elections (CC)*
2001 (Jul-Dec)	Belgium		Estonia (President) Poland (Parliament) Bulgaria (President) Slovenia (President)
2002 (Jan-Jun)	Spain	Denmark (Parliament) France (President) Netherlands (Parliament) France (Parliament) Ireland (Parliament)	Hungary (Parliament) Czech Republic (Parliament) Latvia (President)
(Jul-Dec)	Denmark	Germany (Parliament) Sweden (Parliament)	Slovakia (Parliament) Slovenia (Parliament) Latvia (Parliament) Lithuania (President)
2003 (Jan-Jun)	Greece	Belgium (Parliament) Finland (Parliament)	Czech Republic (President) Latvia (President)
(Jul-Dec)	Italy	Austria (Parliament) Portugal (Parliament)	
2004 (Jan-Jun)	Ireland	Luxembourg (Parliament) Spain (Parliament) Greece (Parliament) European Parliament	Slovakia (President)
(Jul-Dec)	Netherlands		Romania (Parliament) Romania (President)
2005 (Jan-Jun)	Luxembourg		Hungary (President)
(Jul-Dec)	United Kingdom		Poland (President)
2006 (Jan-Jun)	Austria	Finland (President) Netherlands (Parliament) UK (Parliament)[2]	Hungary (Parliament) Czech (Parliament)
(Jul-Dec)	Germany	Germany (Parliament)	

Table is illustrative only - comprehensive information on all EU Member States and CCs not available. Parliamentary elections refer to general elections or lower house elections. (1) Presidencies from 2003 to 2006 not yet approved by Council decision. (2) May 2006 is latest possible date

First, there is the timetable of the European Commission, with various events and reviews that have a bearing on the reform discussions. This began with the publication of the Second Report on Economic and Social Cohesion in January 2001 setting out the current state of cohesion in the EU and an agenda of questions for debate. This was followed by the Cohesion Forum in Brussels in May 2001 and a preliminary discussion on the future of cohesion policy at the informal regional Council in July 2001.

Over the coming year, the EC is expected to present a report on the beneficiaries of EU regional aid and to organise a series of seminars on ten priorities. These relate to the territorial dimensions of assistance (eg. areas undergoing industrial restructuring; areas with severe geographical or natural handicaps) and priorities relating to employment and social policy which have both a general and regional dimension (eg. more and better jobs; social inclusion). In late 2002, the first results of the *ex post* evaluations of the Objective 1 and 2 programmes for the 1994-99 period are expected, as well as completion of a review of the Common Agricultural Policy (CAP), followed by the interim evaluations of the current programmes (including decisions on the allocation of the performance reserve) in 2003. In late 2003/early 2004, the Commission is expected to publish the Third Cohesion Report and its proposals for regional policy after 2006, providing the basis for formal negotiations among the Member States and budgetary decisions before the end the current budgetary period in December 2006.

A second factor is the schedule of the EU Presidency. The provisional timetable of the Presidency up to 2006 has not yet been approved by a Council decision, but the projected rota foresees Ireland, Netherlands, Luxembourg, the UK, Austria and Germany taking the EU Presidency in turn over the crucial period from the start of 2003 to the end of 2006. All of these countries are, or will be, ‘net payers’ to the EU budget, and some (at least) have a stated interest in restricting any increase in their EU budgetary contributions. On the other hand, previous experience has shown that having the Presidency at a time when budgetary decisions have to be made can be counter-productive for the host country, requiring the national interest to be subsumed in favour of getting agreement among the Member States and ensuring that the Presidency is successful.

Third, the national electoral timetable may influence the process. All EU Member States have national and, in several cases, regional parliamentary elections over the period 2002-2006. Recent elections and referenda have shown that enlargement, CAP and Structural Fund reform as well as other aspects of EU integration are politically sensitive issues. Several EU countries have anti-EU political parties, whose role in parliament or government may affect the reform and enlargement debate. Popular support for enlargement averages 44 percent across the EU, ranging from 70 percent

in Greece to 36 percent or less in Germany, France, Austria and the UK[3].The outcome of the referendum in Ireland shows that support for enlargement cannot be taken for granted.

The same issues apply to the CCs, as two recent examples illustrate. On 21 September, the Estonian electoral assembly chose a new president who, while assuring continuity in Estonia's approach to international organisations, represents a political party opposed to Estonian accession to the EU. In the September elections in Poland, two anti-EU political parties (albeit with relatively few seats) have entered parliament for the first time. In this context, the outcome of CC referenda also cannot be taken for granted. Survey evidence showed support for EU enlargement in October 2000 standing at 51 percent in the Czech Republic, 55 percent in Poland and 69 percent in Hungary[4]. The benefits of EU membership are not seen as clear cut, with vociferous opposition from groups (such as farmers) concerned about the negative impacts of accession.

Lastly, looking towards the outcome of the political negotiations on the reform of EU regional policy, it is important to remember that achieving agreement will again require unanimity among Member States. The outcome of the last InterGovernmental Conference delayed until 2007 the introduction of Qualified Majority Voting on decisions relating to Structural and Cohesion Funds. This means that the structure and allocation of post-2006 EU regional policy will again require unanimous approval from the Member States. As at Berlin in March 1999 (and previous budgetary negotiations), this will doubtless require protracted negotiation, with the additional complexity of more Member State interests to be considered, possibly 25 countries in all. Even if the 'first wave' CCs are not all members when the decisions are made, their views will have to be considered to avoid a renegotiation of the package once they accede.

2.2 Economic framework

The economic framework for the reform of the Structural Funds depends on the implications of transition and post-transition trends in economic development in the CCs and the implications of enlargement for both current and future Member States. In its latest EU research on the impact of enlargement[5], the EU puts forward an optimistic view, supporting the findings of other studies:

---

[3] CEC (2001a) *Eurobarometer Survey of Public Opinion in the EU*, Survey No. 54, April 2001, DG Press and Communication, Commission of the European Communities, Brussels.

[4] CEORG (2000) *Trends in EU, Czech, Hungarian and Polish Public Opinion on Enlargement: Implications for EU Institutions and Industry*, Joint Omnibus Survey, Central European Opinion Research Group Foundation and European Parliament, 17 October 2000.

[5] CEC (2001b) *The Economic Impact of Enlargement*, Enlargement Papers No.4, Directorate General for Economic and Financial Affairs, Commission of the European Communities, Brussels, June 2001, pp9-10.

> *"enlargement is a positive-sum game for the parties involved. The candidate countries should benefit greatly from enlargement thanks to a more efficient allocation of resources, greater investment and higher productivity growth… Growth is also expected to increase in EU-15 due to enlargement…with those countries with relatively strong ties to the transition economies, such as Germany and Austria, benefiting the most".*

However, the enlargement of the EU will not be a spatially homogenous process, and will have differing impacts both on the regions of the current EU 15 and those of the Central and Eastern European Countries (CEECs).[6] Looking at recent trends, during the 1990s the CEECs managed to re-direct their exports away from the former CMEA members towards the European Union. The trade volume has increased significantly and the EU has become the most important trading partner of the CEECs. From the point of view of the EU, the CCs are much less important partners. Geographical proximity seems to play a key role in determining bilateral trade flows. The main trading partners being Germany and Austria, as well as Finland, Italy and Greece on the EU side and Poland, the Czech Republic and Hungary on the CEE side. Regional trade data available indicate that this pattern also applies at the regional level. However, eastern German, as well as western Polish regions do not account for significant shares in total trade of their respective countries.

A further trend is that CEECs have been able to change the commodity structure of their exports from inter-industry to intra-industry trade, ie. their export structure is now more similar to that of the EU as in the early 1990s. However, it is important to note that bilateral exchange is overwhelmingly trade in vertically differentiated products with the CEECs being exporters of product variations with lower unit values. Only Hungary seems to be an exception. There is no indication that the CEECs constitute a severe competition for the EU cohesion countries or other EU members.

As in the case of trade, recent years have seen a marked increase in foreign direct investment (FDI) flows from the EU to CCs, dominated by the main trading countries but also by France and the Netherlands. While FDI flows are important for the receiving countries (most notably Hungary, the Czech Republic and Poland), Austria is the only EU member where CEE plays a prominent role as a destination for FDI flows. Other than for trade, there are practically no FDI flows from the CEECs to the EU. The choice of destination seems to be influenced, in general, by proximity and political stability. The motives for investment are not entirely clear. While surveys show a slightly above average importance of wage costs advantages for FDI in CEE (compared with overall FDI outflows from the EU), there are also indications that this is not the dominating influence factor. Market access and first-mover advantages also play a decisive role.

---

[6]A comprehensive review of the impact of enlargement on cohesion, summarised here, is contained in one of the background reports to the Second Cohesion Report: Weise C, Bachtler J, Downes, R, McMaster I and Toepel K (2001) *The Impact of Enlargement on Cohesion,* Report to the European Commission (DG Regio), Berlin and Glasgow.

Migration is often cited as the most important post-enlargement effect with automatically associated negative consequences for EU members. High estimates of future migration are introduced in the debate apparently based on crude measures and without econometric and economic-modelling background. More diligent analyses do not expect a massive influx of migrants after enlargement and see only minor – and by no means necessarily negative – effects on wage and employment in the EU. Migration flows will be directed mostly into Germany and Austria as these countries are already home to the largest shares of CEEC citizens in the EU. Inside these countries, they will be directed to centres of economic activity, not necessarily to the border regions. Actual migration flows depend on the income gap, the labour market situation in the destination country and the stock of migrants. The share of citizens of the country of origin that are already living abroad determines, on the one hand, the destination choice of new migrants. More importantly, on the other hand, it dampens the potential for further emigration from a specific country because the propensity to migrate is not distributed evenly among the population. It is, therefore, to be expected that migration flows will rise after enlargement (there are only comparatively few CEECs citizens already living in the EU). However, the inflow will not be as excessively high as sometimes expected and it will slow down over time. The actual labour market effects do not just depend on the number of migrants but also on their qualification. Highly qualified migrants can have positive effects for low qualified domestic workers.

In summary, enlargement has often been discussed in a negative language of 'threats of competition', an 'influx of migrants' and 'cost burdens'. The DIW/EPRC research summarised above shows that it is important to keep these issues in perspective. The EU-15 currently have a €25 billion trade surplus with CEECs, particularly in investment goods, and there is no indication that the CEECs constitute severe trade competition for the EU cohesion countries or other EU members. Similarly, the CEE economies host a stock of €27 billion of foreign direct investment from EU countries, only a small part of which appears to be driven by low-wage costs in CEE. The major part of FDI is motivated by market access; investment in CEE is created rather than diverted from elsewhere in the EU. Lastly, high estimates of future migration appear to be based on crude calculations. More detailed analyses do not suggest massive out-migration from CEE countries after enlargement and foresee only minor, and by no means necessarily negative, effects on wages and employment in the EU.

Nevertheless, as noted above, the critical factor for a positive enlargement scenario is the *preparedness for structural change.* Along with the economic, industrial and social policies of the EU and national governments, enlargement presents formidable challenges for EU structural policies. Widening the EU to include 27 Member States would increase the territory of the Union by 34 percent and its population by 28 percent, whereas the average GDP per capita would decline by approximately 15 percent. Accession of the ten Central and Eastern European countries would radically alter the EU maps of regional problems and disparities. Agriculture dominates regional employment structures in the transition countries to a much greater extent than in the EU-15, while the service sector remains relatively under-developed, especially outside the capital cities. The agriculture bias is associated with low per capita GDP.

EU enlargement will, therefore, require a reorientation of the Structural and Cohesion Funds. Under the current budgetary parameters, for whatever objectives and criteria are used for allocating funding, there would need to be a substantial shift away from current recipients to the transition countries. With respect to the relativities in GRP between the EU-15 and CCs – fundamental to the debate about the reform of the Structural Funds – three points are worth noting.

First, the EU-CC differences in income are wide. In 1998, the average GDP per capita (in PPS) of the 12 CCs was only 38 percent of the level in the EU15; by comparison in 1980, the average GDP per capita of Greece, Portugal and Spain was 60 percent of the level in the then EC-9[7]. At regional level, the disparities are still greater. Only two regions in Prague and Bratislava have GDP per capita levels above the EU average, with Budapest, Slovenia and Cyprus approaching two-thirds of the EU level. Three-quarters of the CCs population are in regions with a GDP per head of less than 40 percent of the EU-15 average, including all of the Baltic States, Bulgaria, Romania (except for Bucharest) and Poland (except for the Mazowiecke region – containing the capital city, Warsaw). Almost one-third of the CC population have a GDP per capita level of less than 30 percent of the EU-15 level, many of these regions being situated on the eastern borders of the CEECs adjoining Russia, Belarus and the Ukraine. The very poorest regions, which are in Bulgaria, have GDP per head levels of 22-23 percent of the EU average.

Second, the growth rates of the Candidate Countries are currently running at high levels but they are still only just recovering from the collapse in GDP in 1989-92. Since the early 1990s, growth rates for the CCs as a whole have generally ranged between 2.5 and 6 percent, with the exception of 1994 and 1999. There have been large variations between countries – consistently strong growth rates in Poland, Slovenia, Cyprus and Malta, compared with large fluctuations in economic growth in Romania and Bulgaria. The latest Eurostat figures show that, for the first time since the start of transition, all CC-12 countries recorded positive economic growth in 2000. However, the magnitude of the recovery task can be seen in the fact that, in 1998, only Poland and Slovenia (among the CEECs), had exceeded their pre-transition level. Hungary, the Czech Republic and Slovakia were poised to exceed this level in 2000-2001, but in other CEECs recovery was still some way off[8].

Third, convergence with the EU-15 is a long-term challenge. Scenarios of long-run national and regional GDP growth in the applicant countries suggest that it could take 30-40 (under optimistic growth conditions) years for the leading CEEC economies – Czech Republic, Slovak Republic and Slovenia – to reach the EU-15 average. Even in 2030, only two CEEC region – Prague and Bratislava – would exceed the EU-15 average, and some regions in Bulgaria and Romania could still be below 50 percent of the EU-15 average[9].

---

[7] CEC (2001b) *op. cit.*

[8] Weise C *et al* (2000) *op.cit.*

[9] Weise C *et al* (2000) *op. cit.*, Annexes 4 and 5.

These factors are worth bearing in mind for several reasons. The magnitude of the development challenge in the CEECs requires the EU to find ways of maximising sustained application of structural and cohesive fund resources. Relatively small transfers from an EU-15 perspective can make a significant difference to the CEEC economies: a transfer of 0.1 percent of EU-15 GDP is equivalent to 2.2 percent of the CEEC GDP. On the other hand, the large differences in GDP also underline the constraints on making large-scale transfers to relatively small CC economies with weak institutional capability.

2.3 Budgetary framework

At the heart of the debate about enlargement and EU regional policy is the issue of budgetary payments and receipts. The current financial framework was agreed at the Berlin European Council in March 1999 (See Table 2). Over the 2000-2006 period, it projected annual appropriations of €89.6 billion in 2000 rising to 94.7 billion in 2003 and then falling to €89.3 billion in 2006. At the end of the period, the financial framework anticipates appropriations amounting to 0.97 percent of EU GNP (for the EU-15), comfortably within the own resources ceiling of 1.27 percent, assuming year-on GNP growth of about 2.5 percent over the 2000-2006 period. With respect to structural operations, allocations for the EU-15 will decline progressively to allow increasing amounts of structural support for pre-accession and enlargement aid.

The Berlin conclusions present a 'hypothetical' financial framework for an EU-21, forecasting appropriations of €103.5 billion to cover additional commitments (structural operations, agricultural payment etc) of €14.2 billion associated with enlargement in 2006. With a larger GNP base, the EU-21 appropriations would be equivalent to 1.09 percent of EU-21 GNP, leaving a margin of 0.18 percent with respect to the 1.27 percent own resources ceiling.

Table 2: Financial Framework for 2000-2006 (€ mill)

Financial Framework EU-15	***2000***	***2001***	***2002***	***2003***	***2004***	***2005***	***2006***
Appropriations for payments	89590	91070	94130	94740	91720	89910	89310
Appropriations as % of GNP	1.13	1.12	1.13	1.11	1.05	1.00	0.97
Structural operations	33085	32495	31905	31325	30635	30635	30210
Financial Framework EU-21	***2000***	***2001***	***2002***	***2003***	***2004***	***2005***	***2006***
Appropriations for payments	89590	91070	98270	101450	100610	101350	103530
Appropriations as % of GNP	1.13	1.12	1.14	1.15	1.11	1.09	1.09
Structural operations	33085	32495	36245	37155	38555	40635	42290

The key point is that these budgetary allocations are ring-fenced. Therefore, if accession does not take place before the end of 2006, the ring-fenced accession funds cannot be used for any other purpose. However, at the Berlin Council, the EU was working on the basis that enlargement would take take place within three years and that only six countries (the original 'first wave' countries) would accede. Since then, as noted earlier, it has become likely that ten CCs will join the EU over the period 2003-2006. Although accession-related commitments are already included in the budget, the above projections will be affected by a delay in the requirement for accession commitments, but also a requirement for additional expenditure to fund

structural operations in an EU-25 (rather than an EU-21) in 2005 and 2006. However, given that the ‘additional’ new members are relatively small economies, the financial impact could be contained within the framework by savings from earlier years (2002-2003) and the margin of 0.18 percent (which represents some €17 billion).

Looking to the post-2006 budgetary situation, it is difficult to speculate given the many political and economic uncertainties. The Berlin Council agreed changes to the ‘own resources’ of the EU which apply from the start of 2002, increasing the importance of the GNP-based element of the resource and modifying the approach to the UK rebate. It is likely that own resources for the post-2006 period will be subject to further debate. For example, the contributions of the new Member States to the Union budget would increase the volume of own resources, but it is questionable whether the new Members should be required to make a full contribution immediately following accession: *“It would appear more reasonable for there to be a transitional period in which their contributions to the budget only gradually build up to the level of normal contributions”*.[10]This is more likely to apply in the pre-2006 period, when the CC budget receipts are still at a relatively low level, but it could potentially also affect the size of the EU budget in the early years of the 2007-13 period.

It is the policy of some ‘net payers’ that the own resources ceiling of 1.27 percent of EU GNP will continue to apply, but the need to achieve unanimity in the reforms may make it unsustainable to maintain the ceiling and, at the same time, reconcile the diverse interests in an EU-25. Within this ceiling, the allocation of resources to structural operations will depend on the share of the agricultural budget, in particular whether a continued shift away from price support towards income-based support measures (perhaps with some re-nationalisation of agricultural support) requires an increase in allocations to rural development and accompanying measures. During the Second Cohesion Report debate, several contributors advocated an increase in the allocation to structural operations within the EU budget “*to remain credible*”[11].

3. SCENARIOS FOR REFORMING EU REGIONAL POLICY

In considering the future of EU regional policy, the pressures for reform and the options for change need to be carefully considered. On the one hand, the EU Treaty commitment to economic and social cohesion is an important pillar of the European social market economy and it underpins intervention through EU structural policies. On the other hand, the economic development logic of EU action is undermined by a perception of the Structural and Cohesion Funds as a ‘side payment’ to enable agreement in other policy areas and by the political bargaining associated with the

---

[10]Mayhew A (2000) *Financial and Budgetary Implications of the Accession of Central and East European Countries to the European Union*, SEI Working Paper No.22, Sussex European Institute, Falmer.

[11]Dufeil E (2001) *Report on the 2nd Cohesion Forum, Brussels 21-22 May 2001*, DG Regio, Commission of the European Communities, Brussels (mimeo). See for example: CPMR (2001).

allocation of funding. EU enlargement presents an opportunity to improve the allocational logic of EU regional policy and maximise its impact on economic and social cohesion.

The principles of the 1988 reform of the Structural Funds – concentration, multi-annual programming, partnership and additionality – have proved to be a good basis for regional development policy. However, their impact outside the Cohesion Countries has been obscured by the dissipation of aid over small areas, the bureaucracy of programming, the wide range of interventions and the short programming periods (in Objective 2 areas). For EU structural policy in CEE, it will be important to develop medium-to-long-term priorities and consistent objectives for policy measures. In particular, there is a need to concentrate on a limited number of key priorities. Arguably, assistance should be concentrated geographically (growth poles) and be export-oriented to promote the 'motors' of development.

An important lesson of the past 15 years of Structural and Cohesion Fund implementation in the EU is the critical role of institutional capacity. There are major differences in the mode of implementation among Member States, but the common experience is that there is a long 'learning curve' relating to all aspects of programming. Given the historical institutional legacy in many CEECs, the 'vacuum' of regional self-government and the slow process of territorial administrative reform, it will be important to recognise, for the time being, the primary role of national governments in the implementation of the Funds and to respect the institutional differences between countries.

3.1 The reform debate

The starting point for the reform debate is the Second Cohesion Report[12], providing an analysis of economic and social cohesion across the EU and the operation of Structural and Cohesion Funds. The purpose of the Report was also *"to prepare the basis for a debate on the future of cohesion policies"* with a view to encouraging discussion of the priorities of future policy before addressing issues such as financial allocations. The Report begins by reiterating the need for an active, interventionist role for Community cohesion policy in supporting actions contributing to a reduction of economic, social and territorial disparities in the EU:

> *"the Union must support factors that play a decisive role in promoting competitiveness and help to reduce the profound imbalances affecting its territory. In short, supporting investment in physical and human capital must remain the key objective of Community cohesion policy before and after enlargement"*.

In addressing imbalances, productivity is considered to be the key factor for achieving growth and convergence, requiring a (sustainable) policy targeting the quality of human resources, physical infrastructure endowment and the capacity for innovation.

[12] CEC (2001c) *Unity, solidarity, diversity for Europe, its people and its territory*, Second Report on Economic and Social Cohesion, Commission of the European Communities, Brussels, 31.1.2001.

The least developed regions remain the principal priority of EU cohesion policy, but the Report also recognises territorial problems associated with urban areas, the diversification of rural areas, cross-border, transnational and inter-regional co-operation, areas undergoing industrial restructuring, and areas with severe geographical or natural handicaps. The horizontal priorities are again highlighted: more and better jobs; supporting the new economy and knowledge society; promoting social inclusion; and equality of opportunity.

With respect to the targeting of aid, the Report notes that in the next programming period, the presence of new, less-prosperous members will necessitate *"a massive refocusing of the effort in order to achieve a significant catching up within a reasonable period"* while still responding to the needs of the least developed regions of the EU15. Four options are presented for determining eligibility and temporary support after 2007:

1. application of the present GDP per head threshold of 75 percent irrespective of the number of countries joining the Union;

2. application of the present threshold of 75 percent, but where all current Objective 1 regions above this threshold should receive temporary support (phasing out), the level being higher the closer their GDP per head to the eligibility threshold. Two levels of temporary support could be envisaged, one for regions which, because of the extent of their convergence at the end of the 2000-06 period, would no longer be regarded as having lagging development in an EU15, the other set at a higher level, for those which would have been below the 75 percent threshold without enlargement;

3. the setting of a GDP per head threshold higher than 75 percent of the average, at a level which would reduce or even eliminate the automatic effect of excluding those regions in the EU-15 simply because of the reduction in the average EU GDP per head after enlargement (but at a level which excludes those regions which would no longer qualify at the end of the current programming period in an EU-15 without enlargement);

4. the fixing of two thresholds of eligibility, one for the regions in EU-15 and one for the candidate countries, and leading *de facto* to two categories of lagging region.

The initial response to the Second Cohesion Report indicates the difficulty facing the EU. It is evident, for example, that the Candidate Countries want to be treated on the same basis as the current Cohesion countries – avoiding discriminatory treatment, either positively or negatively. There are obvious concerns that a regional policy focused solely on the poorest countries would be seen as a 'welfare policy' rather than a policy of development and would, as a result, lead over time to reduced solidarity contributions from the richer Member States.

A second set of concerns has been expressed by the current Cohesion Countries, whose relative position will change in an enlarged EU. In particular, several of the current eligible regions will no longer qualify for Objective 1 support when the average EU level is reduced by the accession of poorer countries from Central and Eastern Europe. Arguing that the absolute severity of problems will not have changed,

countries such as Spain are seeking assurances that their current receipts can be maintained by an increase in the EU structural operations budget.

A further viewpoint is that of some of the so-called ‘net payers’ who want to limit additional budgetary contributions. Given that the richer Member States will cease to qualify for significant EU Structural Fund support, their net payment position will worsen following enlargement. This concern has been voiced by Germany – the largest contributor to the EU budget – which has suggested that richer countries should have reduced budgetary contributions as a price for not receiving any Structural Funds. Some form of ‘trade off’ between EU regional policy and EU competition policy has also been mooted, whereby countries receiving no Structural Funds would have greater flexibility under EU State aid rules to provide support under national regional aid policies.

Lastly, the European Commission is trying to structure the debate in accordance with its interpretation of the future of EU regional policy. It has, for example, rejected the option of any kind of ‘renationalisation’ of EU regional policy and seems to be avoiding any fundamental review of the objectives of policy. Instead it is encouraging consideration of an EU regional policy that embraces the needs of the Candidate Countries, the current Cohesion Countries and other less-developed regions, *as well as* a continued EU role in addressing the problems of old-industrial regions, rural regions and sparsely populated areas in the EU-15, combined with a new focus on urban centres.

3.2 Scenarios for reform

3.2.1 Calculating the costs of enlargement

Over the past year, there have been several attempts to formulate scenarios and estimates of the implications of enlargement for EU regional policy. Several of the key studies are shown in the following box.

STUDIES ON THE SCENARIOS AND COSTS OF ENLARGEMENT

- DIW study – comprehensive and detailed analysis by the Deutsches Institut für Wirtschaftsforschung (German Institute for Economic Research) for the German Federal Ministry of Finance (May 2001), presenting scenarios for enlargement and calculating the costs
- Dresdner Bank study – comprehensive review of the 'challenges of enlargement' (April 2001), identifying economic and budgetary consequences for applicant and EU countries
- EPRC study – for the 'Sub Rosa' Seminar 'Regional Policy in Europe After Enlargement' (September 2000), examining the enlargement implications for EU regional policy, EU competition policy and national regional policies and presenting four options for Structural Fund reform
- European Parliament study – review of EC, CC and research institute perspectives on enlargement and presentation of budgetary costs according to different parameters
- IBO study – interdepartmental study (2001) carried out for the Dutch government to review scenarios for reforming EU structural policy and the implications for the Netherlands
- RWI study – by the Rhine-Westphalia Institute for Economic Research, calculating the budgetary implications of the changes to area designation criteria in an enlarged EU, as proposed by the EC in the Second Cohesion Report

The studies each have different methodologies and assumptions, applied to different policy scenarios. For example, the IBO study[13] assumes that ten CCs will accede in 2004 and a further two after 2006, while the DIW study[1] assumes 2005 and 2007 respectively for the two groups of country and the Dresdner Bank study[14] uses 2005 and 2008 as assumed enlargement dates. The European Parliament[15] calculations have two rates of accession, each with different dates and groups of new members: under the 'rapid accession' scenario, ten CCs would accede in 2004 and a further two in 2008; under a 'slow accession' scenario, six CCs would accede in 2004, a further four in 2008 and two more in 2012. The RWI study[16] makes no assumptions about dates of accession but models results based on an EU-20 and EU-27

---

[13] IBO (2001) *The financing of the EU structural policy in the context of the enlargement of the EU.* Interdepartmental Policy Study, The Hague.

[14] Dresdner Bank (2001) *The Challenge of Enlargement*, Economic Analyses – Trends Special, July 2001, Dresdner Bank, Frankfurt/Main.

[15] European Parliament (2001) *Working document on the financial implications of EU enlargement*, Committee on Budgets, European Parliament, 11 April 2001.

[16] Schrumpf H and Budde R (2001) *Die Auswirkungen der Osterweiterung auf die Regionalpolitik der Europäischen Union,* Schriften und Materialien zur Regionalforschung, 8, Rheinisch-Westfälisches Institut für Wirtschaftsforschung, Essen.

The IBO study assumes CC growth rates of two and four percent in order to make projections for the 2007-2013 period; the European Parliament review uses the EC prediction of 4 percent annual growth for the CCs, while the Dresdner Bank study assumes an average CC growth rate of 4.6 percent. The DIW research undertakes calculations using both a standard four percent growth rate for all CCs and individual CC growth rates, generally in the range 4-5 percent. The RWI study bases it calculations on 1997 data, with scenarios for that year alone. With respect to the absorption limit, the European Parliament and Dresdner Bank studies restricts their predictions to an assumption that the four percent limit will be applied, while the IBO and DIW studies take account of the fact that the limit may not apply.

Interestingly, the IBO study also considers the effectiveness of various scenarios in terms of certain pre-conditions – financial controllability, subsidiarity, Communitarity, priority/rationality, proportionality, effectiveness and efficiency, absorption capacity, sensitivity to fraud, flexibility in spending, and integration or gearing with other policy fields.

With respect to the outcomes of these studies, the basic estimates of the cost of enlargement are presented in Table 3. It should be stressed that these estimates are not directly comparable, given the difference in methodologies and assumptions underpinning the different studies. Nevertheless, they do reveal the possible range of enlargement costs over the 2007-2013 period, ranging from €115 billion to almost almost €240 billion. Leaving aside the top figure in the range (from the Dresdner Bank study, which was predicated on an assumption that the Objective 1 threshold will be raised to retain the eligibility of the current Objective 1 regions), the average of the estimates suggests that the costs of enlargement could be around €150 billion over the 2007-2013, or an average of €21 billion per year.

Table 3: Estimates of the cost of structural operations in the Candidate Countries, 2007-2013

Study	*Cost of structural operations in the CCs, 2007-13 (bn)*	*Assumptions*
DIW (maximum)	118.2	Based on average of separate estimates for 2007 and 2013 according to different scenarios
DIW (minimum)	114.8	
Dresdner Bank	239.6	Based on assumption that the current Objective 1 threshold will be raised.
European Parliament (maximum)	160.2	Based on assumptions of different rates of accession – slow and rapid.
European Parliament (slow accession)	133.7	
IBO (maximum)	185.9	Based on assumptions that absorption limit may (not) apply.
IBO (minimum)	145.0	
RWI (lowest estimate, CC 5)	129.3	Based on assumptions using 1997 data and that current Objective 1 threshold will be raised
RWI (highest estimate, CC12)	195.1	

3.2.2 GDP assumptions

In order to illustrate the difficulties of comparing these estimates, it is worthwhile to consider some of the assumptions that need to be made. For example, over the period 2000-06, it is widely assumed that GDP growth in the applicant countries will continue to increase at rates significantly above their historical growth rates. In its most recent study[18], the EC foresees a ‘baseline scenario’ of annual GDP growth rates in the Central and Eastern European Countries (CEECs) averaging three percent per year over the 2000-09 period, even if enlargement did not occur and assuming that the reforms of the 1990s are not reversed (see Table 4). Growth would average 3.1 percent per year in the first half of the decade, falling slightly to 2.9 percent thereafter. In a second ‘central’ scenario, the EC study assumes that eight CEECs (ie. excluding Bulgaria and Romania) join the EU in 2005, the effect of which would be to boost GDP growth rates over the 2000-09 period to an average of 4 percent per year for the CEEC-10 and 4.3 percent for the CEEC-8. Lastly, in a third, ‘optimistic’ scenario, the EC study assumes that enlargement effects are fully exploited by ‘pre-growth policies’ particularly increasing average annual GDP growth rates for 2000-09 to 4.8 percent for the CEEC-10 and 5.1 percent for the CEEC-8.

Table 4: GDP growth rates in the CEECs 2000-09: annual averages (%)

Scenarios	***2000-09***		***2000-04***		***2005-09***	
	CEEC-8	***CEEC-10***	***CEEC-8***	***CEEC-10***	***CEEC-8***	***CEEC-10***
Baseline	3.0	3.0	3.1	3.1	2.9	2.9
Central	4.3	4.0	4.0	3.8	4.6	4.3
Optimistic	5.1	4.8	4.0	3.8	6.1	5.6

These projections clearly involve significant variation among the CEECs. Forecasts for GDP growth in 2001-02 range from 5-6 percent in Estonia, Latvia and Bulgaria to under three percent in Romania. The performance of Poland is crucial in this respect, given that the Polish economy accounts for c. 40 percent of the ten CEECs and 25 percent of all CCs. The influence of Polish economic performance is illustrated by the EC’s projections for CC GDP in early 2001 which revised estimated Polish GDP growth downwards by almost a full percentage point (to 4.2 percent) reducing aggregate CC growth rate by almost a quarter of a percentage point.[19]

---

[18] CEC (2000) *op. cit.*, pp. 27-34

[19] CEC (2001d) *EC Economic Reform Monitor*, Spring 2001, Commission of the European Communities, Brussels.

Although many other studies agree with the broad projections of growth rates in the CCs, and also with the effects of enlargement on growth rates, some forecasts are less optimistic. The latest WIIW predictions, for example, forecast GDP growth rates of 3.3 percent in 2002 and 3.7 percent in 2002 for the CEEC-7 (ie. excluding the Baltic States. Further:[20]

> *"the favourable external climate has started to deteriorate rapidly and mainly the current pronounced weakening of the EU economy is worrying. The transition economies, especially those which aspire for EU membership, may be seriously affected"*

The implications of GDP growth rates in the CCs for the allocation of Structural Funds are twofold. First, a CEEC growth rate significantly higher than the EU average could make a difference to the potential eligibility of CEEC regions for Objective 1 support. At present, as noted earlier, Prague and Bratislava exceed not only the Objective 1 threshold in an EU15 but also the EU15 average for GDP per capita. In an enlarged EU (eg. EU27), the Budapest region (Közép-Magyarország) and Slovenia would also exceed the Objective 1 threshold, even on 1998 GDP. According to the regional rankings based on 1998 GDP per capita data, other CEEC regions are below the Objective 1 threshold in an EU27 eg. several of the Czech regions (lying between 62 and 70 of the EU average (EU27 c. 100) and the Warsaw region (Mazowieckie) at 59.6 of the EU27 average. However, some of these regions are fast growing, with annual rates of GDP growth in the mid/late 1990s well in excess of national rates. If national growth rates remain significantly above the EU average, then these fast-growing regions (some of which account for a disproportionately large share of national GDP growth) could exceed the Objective 1 threshold in an EU27 by 2004. For example, by maintaining its mid/late 1990s growth rate, the region of Jihozapad (Czech Republic) could reach 77 percent of the EU average, while Mazowieckie (Poland) could theoretically even exceed this level.

The second implication of growth rates concerns the amount of Structural Funds received by the CCs. If the value of receipts is related to GDP, as implied by the absorption limit, then higher levels of GDP would give CCs a higher ceiling on Structural Fund allocations. In absolute terms, the difference in potential receipts between a 3 percent and 5 percent per annum GDP growth rate is small (perhaps of the order of €1.6 billion at exchange rates, €4 billion in PPS), but in relative terms represents a ten percent difference in the value of transfers to the CCs.

3.2.3 Absorption limit

Other important assumptions concern the absorption limit and aid intensity. Enshrined in the Structural Fund regulations, the absorption limit restricts receipts under Structural Funds by specifying that no Member State should receive funds exceeding four percent of GDP. Although the limit was introduced with the aim of capping the volume of transfers to the accession countries, it does exceed the amounts received by

[20] WIIW (2001) *Solid Outlook for the Transition Countries in 2001-2002,* July 2001 Review of the CEE Region, Vienna Institute for International Economics, WIIW.

even the Cohesion Countries during the 1990s and it recognises the potential budgetary and institutional capacity difficulties of co-financing and managing large inflows of aid. Experience from oil-exporting countries (eg. Nigeria, Venezuela) illustrates the potentially damaging effects of sudden, large-scale financial inflows and emphasises the critical importance of absorption capacity through adequate and competent institutional management.

It is possible to consider absorption capacity has having three aspects[21]:

(a) Macroeconomic absorption capacity defined in terms of GDP.

(b) Managerial-administrative absorption capacity, meaning the ability and skill of central and local authorities to prepare acceptable plans, programmes and projects in due time, to decide on programmes and projects, to arrange coordination among the principal partners, to cope with the reporting paperwork by the Commission, and to finance and supervise implementation properly, avoiding fraud, as far as possible.

(c) Financial absorption capacity which means the ability to co-finance the EU supported programmes and its projects and to collect national budgetary contributions from several partners interested in the programme or the project.

Clearly, the EC limit deals solely with the first aspect. Application of the limit, expressed in terms of GDP, would significantly affect the receipts of the CCs. For example, with a population of 104.97 million, the ten Central and Eastern European countries could conceivably receive €36.53 billion in Structural and Cohesion Funds, assuming that they receive the current maximum allocation rate of €348 per head. However, applying the absorption limit to a projected GDP for the CEEC-10 of €402 billion in 2004 would reduce the potential Structural and Cohesion Fund receipts to less than half of this figure - €16.08 billion.

There are, however, several uncertainties inherent in these calculations. First, the Council regulation does not specify how GDP is to be measured for the purpose of calculating the absorption limit, ie. whether GDP should be measured in exchange rates or PPS. The above figure of €16.08 billion is based on a projected GDP figure in exchange rates, on the basis that the absorption limit is a measure of *national* absorption capacity, which is arguably preferable to the 'over-valuation' of GDP inherent in a comparative measurement using PPS. Others disagree, and the Dresdner Bank study (among others) uses GDP in PPS for the purpose of calculating the absorption limit. This would potentially increase the Structural and Cohesion Fund receipts of the CCs dramatically. A projection of GDP (PPS) for the CEEC-10 in 2004 could be €984.2 billion, yielding potential EU regional policy transfers of up to €39.3 billion.

---

[21] Illes I (2000) *Structural Policies, EU Transfers and Regionalisation in Eastern Europe,* Paper to IIASA Workshop, EU Structural Support: Its Macroeconomic and Distributional Effects and Social Environment, International Institute for Applied systems Analysis, 9-11 November, Prague.

Second, the absorption limit is meant to be a ceiling on transfers to the CCs, but is often regarded as a target figure, implicitly assuming that the CCs should be allocated the maximum possible amount of EU funding. Leaving aside potential political objections, there are important economic objections to this approach. In effect, it could lead to the richer CCs receiving higher per capita allocations of Structural Funds than poorer CCs. For example, while low-GDP countries such Romania and Bulgaria might be limited to maximum receipts of €200-250 per head, because of the absorption limit, higher GDP countries such as Poland could receive €300-350 per head[22] (see for example the Dresdner Bank study). This would reverse the principle currently used for allocating Structural Funds in Objective 1 regions where per capita allocations are inversely related to national prosperity.

Lastly, the absorption limit may not be applied strictly. It has been rightly pointed out that, if the absorption indicators are applied to single regions, low GDP per capita could seriously constrain the structural support received by countries[23]. At the Second Cohesion Forum, several CC representatives advocated that the limit should not be applied, and several EC informal discussion papers have mooted the possibility of raising the limit or applying it flexibly.

Turning now to the policy options, these theoretically range from an EU-wide inter-regional fiscal transfer system, at one extreme, to a complete 're-nationalisation' of regional policy, without a role for the EU, at the other end of the spectrum. Between these extremes are several plausible scenarios for future funding allocations. The following sections outline the current terms of the debate and then considers the scenarios for the future of EU regional policy based around four policy options initially put forward by EPRC[24], each of which has some variants in other studies

3.3 Scenario 1 - Current Policy Approach

3.3.1 Characteristics

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

According to Eurostat data, all of the CEECs would be classified as Objective 1, except for Slovenia and Prague, Bratislava and Budapest. Many current Objective 1

[22] A further uncertain issue is how aid intensity will be determined for the CCs . Most studies assume that the current maximum of €348 per head will be carried over to the CCs.

[23] Illes I (2000) *op.cit.*

[24] Bachtler J, Wishlade F and Yuill D (2001) *Regional Policy in Europe After Enlargement,* Regional and Industrial Policy Research Papers, No. 46, European Policies Research Centre, University of Strathclyde, Glasgow..

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

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

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

3.3.2 Variants

The IBO study proposes a variant on this approach involving continuation of the current policy but discontinuing Objectives 2 and 3 and re-allocating resources to concentrate on Objective 1. However, as noted, this offers some budgetary relief but does not address the most important drawback of the present system - subsidising poor regions in rich countries.

The DIW and RWI studies model the effects of maintaining the current system, but adopting the EC proposal of a GDP per capita threshold higher than 75 percent of the average. They calculate that the level which would eliminate the automatic effect of excluding those regions in the EU-15 simply because of the reduction in the average EU GDP per head after enlargement would be around 86-87 percent of the EU average. In other words, the Objective 1 eligibility threshold would need to be revised by more than ten percentage points. This approach would address the argument that enlargement unfairly leads to poor regions losing an entitlement to aid, not because their economic development situation has improved but because of a change in their relative position compared to even poorer regions. It would be of significant benefit to Spain, Greece and Portugal, as well as to other major Objective 1 recipients such as Germany and Italy. However, the basis of EU regional policy is a concentration of resources allocated in line with relative disadvantage. An increase in the Objective 1 threshold (which was applied strictly with some success in the Berlin negotiations)

would undermine one of the key technical principles of the Structural Funds and lead to a significant rise in the costs of EU regional policy after 2006.

A compromise solution, also considered by the DIW and RWI studies, would be to have a transitional approach. For example, the RWI suggest that the eligibility threshold for Objective 1 regions could be initially set at a sufficiently high level to enable the current Objective 1 regions to retain their eligibility in enlarged EU for a variable transition period. The threshold would then be reduced by two percentage points every three years until it had been brought down again to 75 percent of GDP per capita in an enlarged EU. This option has some attractions in that it provides for some 'phasing in' of the loss of eligibility, but a reduction by two percentage points every three years would involve a transition period of some 15 years, still involving a significant additional cost. Moreover, the power of precedent in EU negotiations would potentially see this option being used repeatedly in future enlargements with costly consequences.

3.4 Policy Options: Scenario 2 - Differentiated Policy Approach (Variable Geometry)

3.4.1 Characteristics

Under a second EPRC scenario, the EU could take a differentiated policy approach to CEECs and EU 15. For the CEECs, it could take a 'cohesion policy' (or transition policy?) approach, providing policy support to each of the applicant countries as a whole, regardless of the levels of prosperity of individual regions. For the EU 15, the current approach to 'structural policy' could be maintained. In the CEECs, funding would be allocated to new Member States for delivery through national development programmes; in the EU 15, funding would be allocated to eligible regions for delivery through regional programmes. As above, the Commission would have responsibility for allocating finance, approving programmes and overseeing delivery, while the Member States have responsibility for programme implementation.

In this scenario, the CEECs would be designated in their entirety. EU 15 eligible regions would be designated according to Objective 1 and 2 criteria. The implications of this are the same as for Scenario 1.

On the positive side, this approach has a measure of economic development logic - countries such as Slovakia, Czech Republic and Hungary need to have their capitals as part of the eligible area as 'drivers' of economic development (cf. experience of Portugal and Ireland). This scenario would allow funding allocations to the CEECs to be determined according to different criteria from those used hitherto, and problems of inadequate designation indicators and data in making international comparisons between CEE and EU regions are avoided. In addition, CEECs can take a national approach to the design and delivery of policy to suit national conditions. Again, most EU 15 Member States would get some Structural Funding, and the net payers are kept on board.

However, this scenario remains largely a political, rather than an economic solution. It entails a reversal of the recent trend away from supporting poor countries in favour of poor regions (although this may be justified). Crucially, it would involve differential

treatment of Member States (why not treat Portugal and Greece in the same way?) which would be politically unpalatable to CEECs. The approach does not guarantee that CEECs use resources for less-favoured regions (but does this matter in the short term?) and could increase internal regional disparities

3.4.2 Variant

A less radical differentiated approach would be the EC suggestion of having a two-level GDP per capita threshold for Objective 1 eligibility. With one threshold for regions in the EU15 and another for the CCs, there would be two categories of lagging region. The cost implications of this approach has been modelled by the DIW study, assuming different per capita financial allocation levels for the two types of region. The approach represents an intermediate solution, more costly than applying the 75 percent threshold in an enlarged EU, but less expensive than increasing the level of the threshold. The balance of advantages and disadvantages are the same as described above.

3.5 Policy Options: Scenario 3 - Concentrated Policy Approach

3.5.1 Characteristics

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

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

The potential 'downside' is that net payers would not be recipients of EU funding, potentially lessening their financial commitment to the EU and to structural policy in particular. The Commission would not have a 'place at the table' in all countries, and the profile of the EU could thereby be potentially diminished. Pressure for spending in areas where the current membership could benefit more may be increased (aspects of

agricultural policy, R&D policy) as may pressure for relaxation of the regulatory environment, especially in the area of national regional aid.

3.5.2 Variants

The IBO and DIW studies suggest three variants on this approach. The first set of variants use different thresholds of national GDP per capita. The IBO study uses a cut-off point of 100 percent of the EU average and the DIW study considers the impact of various thresholds from 75 to 100 percent. Under these different thresholds, eligibility for Structural Funds would be as follows:

- 75 percent - Greece and all CCs except for Slovenia and Cyprus
- 80 percent - Greece and all CCs except for Slovenia and Cyprus
- 85 percent - Greece and all CCs except for Cyprus (ie. Slovenia qualifies)
- 90 percent - Greece, Portugal and all CCs except for Cyprus (ie. Portugal qualifies)
- 95 percent - Greece, Portugal, Spain and all CCs (ie. Spain and Cyprus qualify)
- 100 percent - Greece, Portugal, Spain and all CCs

The second variant, put forward in the IBO study is a 'mixed approach' whereby Member States would be divided into three categories. Those countries in the least prosperous category (Greece, Portugal and all CCs) would be nationally eligible for structural support. Countries in a second group (Spain, France, Italy) would only receive structural support for regions that are underdeveloped. The third group of remaining 'wealthy' countries would be entirely excluded from structural support. This approach represents a combination of Scenarios 1 and 3 above. On the one hand, it would 'compensate' countries like Spain for the loss of Objective 1 eligibility. On the other hand, it would provide no 'savings' for the net payers and arguably takes insufficient account of national prosperity – for example, France and Italy would receive support while the UK would not.

A third variant, again put forward by the IBO study would be to focus EU regional policy support based on net payments (as a surrogate for national prosperity). In a policy option described as 'shortening the balance sheet', the study suggests a discontinuation of EU regional policy in the richer countries; Member States with a negative net position *"would choose to no longer be a beneficiary"* of the Structural Funds. Under this approach, receipts would be cancelled out against contributions so that the net payers would contribute less to the EU budget but receive nothing in return. The recipients would be restricted to to Spain, Greece, Portugal (major receipts in an EU-15) and Ireland and Italy (minor receipts). The benefit of this approach is elimination of the 'circular flow of money' among richer Member States. The net payers would not be worse off, and they would save on the administrative and co-financing costs of implementing Structural Funds. The disadvantage is that the net payers would not participate in EU regional policy (as discussed above).

3.6 Policy Options: Scenario 4 - 'Horizontal' Policy Approach

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

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

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

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

4. ISSUES FOR DISCUSSION

This paper has outlined the parameters of the regional policy debate at EU level and the proposals for reform. It has highlighted the fact that the 'first wave' enlargement is likely to encompass a larger number of Candidate Countries than originally expected but at a lower rate of accession than was foreseen at the Berlin Council. This will require a rebalancing of the EU budget for 2000-06 and different assumptions for the post-2006 period. Several options have been put forward for reforming the Structural Funds, with a number of interesting variants.

Looking beyond these issues, this final section returns to some of the broader questions concerning the effectiveness and credibility of EU regional policy raised in the introduction and suggests some possible future directions for EU regional policy after 2006.

(i) The budgetary implications of enlargement for Structural Funds may be less than anticipated, but should not inhibit consideration of some of the more radical scenarios for changing EU regional policy.

According to the research reviewed in this paper, the implications of enlargement for EU structural and cohesion policies may be an additional cost of approximately €21

billion per year. At the lower end of the spectrum of estimates, the cost projections amount to c.€12 billion per year, rising to almost €30 billion per year in the case of the higher estimates. Taking account of the fact that the EU is already budgeting for an annual cost of post-enlargement structural operations of €12 billion, then the 'gap' between what is required and what is available may be as high as €18 billion but, more likely, will be in the range €9-10 billion.

These are significant amounts. The budgetary implications would require either an increase in the share of the EU budget allocated to structural operations from 0.45 to 0.54 percent, or a reduction in the share of the EU-15 receipts (based on the projected figures for 2006) of about 30 percent. Such a reduction would be equivalent to the entire Objective 2 budget plus one-third of the Objective 1 budget.

On the other hand, the amount of funding available to the EU-15 would still be considerable – much more so than was projected by earlier studies undertaken during the 1990s. Also, the higher figures in the studies assume that all 12 Candidate Countries will become members during the 2007-13 period, which is by no means certain. They also assume that the current high rates of growth in the CCs will continue at a constant rate of about 4-5 percent over the next five years, projections which may need to be downgraded if there is a global recession.

More importantly, there may be absorption difficulties in the CCs. Most of the research has tended to define absorption capacity in macro-economic terms, related to the GDP limit of four percent. Much of the EC and academic research on the other aspects of absorption capacity – managerial-administrative and financial – show that the CCs are, as yet, poorly prepared to receive major financial transfers from the EU. There are currently significant problems in dealing with ISPA, SAPARD and Phare projects (currently worth about €3.2 billion per year), let alone transfers ten times as great. For these reasons, the CCs may not be able to absorb as much as predicted – the four percent limit should be seen as a possible ceiling not a target figure.

If this proves to be the case, then there will be much more funding potentially available for the EU-15. This would probably reinforce the attractions of a variant on the 'status quo' policy option (Scenario 1 above) or the variable geometry option (Scenario 2 above), whereby the EU-15 and new Member States would be able to adjust the eligibility and allocation criteria to ensure that as many Member States as possible are able to receive Structural and Cohesion Funds. However, the EU has a relatively rare chance to consider the future of EU regional policy in more fundamental terms. As noted at the outset of this paper, there is currently a 'window of opportunity' to consider different policy options. Regardless of the political virtues of a further round of 'salami slicing' the Structural Funds, as at the Berlin Council, serious consideration should be given to radical changes such as outlined in Scenarios 3 and 4.

(ii) EU regional policy should concentrate on national convergence, not the reduction of regional disparities.

With enlargement requiring the most radical reconsideration of EU regional policy for almost 20 years, the EU should go back to first principles in its approach to regional development. In doing so, it should recognise the limitations of its resources, respect

the principle of subsidiarity and focus its ambitions on what is achievable. The primary task of the EU should be to promote convergence between Member States, while the responsibility for reducing regional disparities should be left to national governments.

With limited resources, the EU needs to focus its efforts on objectives where EU action is most relevant and can make most difference. In this context, the primary economic challenge for the EU is to promote the international competitiveness of the Union as a whole and convergence between Member States. In an enlarged EU, with Member States lagging seriously behind and major obstacles to competitiveness, the EU will need to concentrate on ensuring that the poorer countries can catch up. Previous experience with the Cohesion Countries, and projections for the Candidate Countries, suggest that reducing Member States disparities of 20 percent (relative to the EU average) can take 25 years or more. In many cases, achieving national convergence will mean focusing efforts on the capital cities and other urban centres, which are the 'motors' of economic development, as part of national development strategies. In poorer countries, it makes little sense to take a regional approach to defining eligible areas for Objective 1-type assistance; excluding Budapest, Prague or Warsaw from EU support could retard the effectiveness of economic development efforts. Furthermore, learning from the (mixed) experience of the Cohesion Countries, much more attention needs to be paid to ensuring that the effectiveness of EU intervention is maximised by accompanying national macro-economic and industrial policies and effective institutional capacity.

Outside of the poorer Member States, EU intervention in the richer countries should largely stop. For 15 years, implementation of the Structural Funds in the developed EU countries has constituted a 'circular flow of money'. Instituted as a means of returning some of the budgetary payments of the net contributors, Structural Funds have become an exceedingly complex policy instrument, often spread thinly over too many small areas to make a difference, with multiple policy objectives, priorities and instruments. Obtaining eligibility for Structural Funds has frequently become a totem for regional and sectoral interests, achieving a political and public profile out of all proportion to the impact of the Funds. Regional development priorities have sometimes been distorted to suit EU policy requirements, and the administrative cost of implementation has been high.

Insofar as EU regional policy intervention is justified outside of the Cohesion and Candidate Countries, it should focus on ways of supporting national government regional development priorities in ways which provide clear added value. One example would be in the sphere of *process management.* Among Objective 2 regions, the most important effects of Structural Fund intervention has been on the processes of regional development, pioneering new forms of regional strategic analysis and thinking, programme management, project delivery, partnership and evaluation, as well as encouraging the mainstreaming of gender issues and sustainable development. The EC could have a continued valuable role to play in supporting experimentation and innovation in such processes, through pilot projects, and in promoting the exchange of experience and dissemination of results.

A second example would be *inter-regional co-operation*. The existing Community Initiative has already shown the value of inter-regional, cross-border and transnational co-operation. This could be strengthened, particularly with respect to the economic component of possible actions. The new paradigm of regional policy places great emphasis on the importance of networking and co-operation, yet for enterprises in many problem regions it is difficult to 'break' into inter-regional and international networks of information, technology and contracting. Here again, the EU has a potential role in providing support, not just through financial assistance but also through institutional and regulatory mechanisms.

(iii) If the allocation of Structural Funds between Member States is to move beyond a primary concern with net payments and receipts, the terms of the debate need to change.

Since the inception of Structural Funds, the periodic reforms of EU regional policy have been marked by protracted negotiations and a desire for each country to maximise its share of the Funds. Political leaders feel a need to emerge from European Council meetings demonstrating that their national interest has been protected or enhanced in terms of the amount of Structural Funds secured or the special provisions negotiated. This is a debate largely driven by the views of prime ministers and treasury ministers, regardless of whether the receipt of Structural Funds enhances or distorts national regional development objectives and ignoring the administrative frustration and cost felt by those tasked with implementing the Funds.

This approach is clearly counter-productive on several counts. First, the value of EU regional policy is diminished. Although some two-thirds of resources may be concentrated on the poorest countries and regions, the potential effectiveness of the Funds is reduced by dispersing one third of the assistance over numerous small areas and instruments. Second, it encourages Structural Fund eligibility and receipts to be seen as a sign of 'success' and promotes a subsidy mentality among regions. Third, and more importantly in the long term, the approach undermines public perceptions of the principle of solidarity in the European Union. The message that the EU is making a significant and important commitment to cohesion is often lost amidst the debate of whether supposed national interests have been advanced or not. In the context of EU enlargement, a protracted argument over the share-out of Structural Funds risks promoting division and political conflict where a show of unity and solidarity is most needed.

If this approach is to change, then the terms of the debate about the reform of the Structural Funds needs to evolve. In particular, the discussion needs to move beyond the net payments and receipts to or from the EU budget to take account of the relative *gains* that countries and regions achieve from European integration. It would need to recognise, for example, that transfers under Structural and Cohesion Funds to the poorer regions are of benefit to the donor countries. EC figures show that significant amounts of EU regional policy aid return to the richer countries in the form of construction, telecommunications and consultancy contracts. The debate would also need to take account of the wider benefits in trade and investment from integration, linking the debate on the cost of enlargement to the annual surplus of EU-15 trade

with the CCs (€25 billion) and the stock of EU-15 foreign direct investment in the CCs (€27 billion).

(iv) The reform of EU regional policy should take account of the need to increase awareness and understanding of EU policies and institutions.

Looking beyond the problems of how to allocate EU regional policy most effectively, there are other issues that should be considered in the context of the next reforms, notably the contribution that Structural and Cohesion Funds could make to building confidence in, and support for, EU policies and institutions.

In many respects, EU regional policy is already one of the most visible and tangible aspects of the Union, in that the Funds can have a direct effect on individuals and communities, for example through improvements to local infrastructure or retraining schemes. However, the visibility of the Funds is often obscured by arcane jargon and the use of abbreviations and acronyms which are only meaningful to the professional élites. In some countries, the implementation of the Funds is 'subsumed' within national administrative systems, whereby decisions on the allocation of EU support is made in tandem with national co-financing; as a result, recipients may have only limited awareness of the role of the EU. Lastly, the visibility of the Funds is diminishing as a result of the progressive shift of Structural Funds (outside the Cohesion Countries) away from physical infrastructure to softer and less evident forms of support.

Increasing the visibility and recognition of the Funds is already being addressed by the EU, for example by the enhanced requirements to promote publicity about EU-funded regional development programmes. The increased attention being given to monitoring and evaluation could also provide opportunities for demonstrating the impact or influence of the Funds.

A more radical step would be make the Funds more flexible, enabling them to be more responsive to changing economic circumstances. For example, a proportion of the Structural Funds budget (10 percent?) could be reserved for dealing with the regional economic consequences of major crises or disasters such as the impact of foot-and-mouth disease, the impact of major plant closures or the mercury-related poisoning of the Danube. In such circumstances, governments are often expected to make an instant response through the creation of regional task forces and special regional assistance. The EU could increase the profile and perceived relevance of its regional development support by being able to react to such events with rapid economic assistance, in the form of financial aid.

Finally, in the context of enlargement, the EU could build on its country-to-country twinning programme by encouraging more formal regional economic co-operation projects between regions in developed and less-developed parts of the EU. In part, these could serve as a channel for regional support, establishing a visible link between donors and recipients but, equally important, they could provide a mechanism for developing trade and investment relationships.