♦SUSSEX EUROPEAN INSTITUTE♦

Centre on European Political Economy

STRUCTURAL FUND REFORM IN THE LIGHT OF ENLARGEMENT

Iain Begg

South Bank University

SEI WORKING PAPER NO. 25

Centre on European Political Economy Working Paper No. 1

The **Sussex European Institute** publishes Working Papers (ISSN 1350-4649) to make research results, accounts of work-in-progress and background information available to those concerned with contemporary European issues. The Institute does not express opinions of its own; the views expressed in this publication are the responsibility of the author.

The **Sussex European Institute**, founded in Autumn 1992, is a research and graduate teaching centre of the University of Sussex, specialising in studies of contemporary Europe, particularly in the social sciences and contemporary history. The **SEI** has a developing research programme which defines Europe broadly and seeks to draw on the contributions of a range of disciplines to the understanding of contemporary Europe. The **SEI** draws on the expertise of many faculty members from the University, as well as on those of its own staff and visiting fellows. It is the home of the Centre for German-Jewish Studies. In addition, the **SEI** provides one year MA courses in Contemporary European Studies and in the Anthropology of Europe and opportunities for MPhil and DPhil research degrees.

Centre on European Political Economy In 1997 the University of Sussex created a new, self-contained research unit within the **SEI** to study the implications of the enlargement of the European Union to at least some of the central and east European countries and the implementation of economic and monetary union. The Centre's overarching research agenda addressses how political structures and bargaining processes in both West ad East will have to evolve in order to sustain an enlarged EU and structure the relationships between it and the central and east European countries awaiting membership. The Director of the Centre is Prof. Mick Dunford. The Administrator is Alasdair Young, Tel. 01273 877 156, Email <a.r.young@sussex.ac.uk>.

First published in August 1998
by the **Sussex European Institute**University of Sussex, Arts A Building
Falmer, Brighton BN1 9QN
Tel: 01273 678578
Fax: 01273 678571
EMail sei@sussex.ac.uk

Ordering Details

The price of this Working Paper is £5.00 plus postage and packing

Orders should be sent to the **Sussex European Institute**, University of Sussex, Falmer, Brighton BN1 9QN. Cheques should be made payable to the University of Sussex. Please add £1.00 postage per copy in Europe and £2.00 per copy elsewhere. See pages 21-22 for list of other working papers published by Sussex European Institute.

Table of Contents

Regional Inequality in an Enlarged Europe: Regional Performance and Policy Responses

On 12–13 March 1998 the Centre on European Political Economy at Sussex organised a research workshop to examine the regional dimensions of change in an enlarged Europe. The workshop brought together some 40 academics, practitioners and post-graduate students and was organised as part of the inaugural activities of Sussex European Institute's new Centre on European Political Economy. The workshop, which was supported financially by the University Association for Contemporary European Studies and the Economic Geography Research Group of the Royal Geographical Society (with the Institute of British Geographers), examined what the enlargement of the European Union to East-Central Europe will mean for the changing map of regional inequality in Europe. During the workshop three main themes were addressed:

- the level of regional inequality between the member states of the EU and the potential new members,
- the degree to which the relative performance of institutions matters in accounting for levels of inequality between regions, and
- the potential policy responses to regional inequality in a much larger Europe.

Four main papers, of which this is one, were presented and discussed during the workshop, and are published as Centre on European Political Economy/Sussex European Institute working papers. The papers were all edited by Adrian Smith, organiser of the workshop, and provide a record of some of the discussions held over the two days. For more details of the work the Centre is undertaking on European regional development please contact Adrian Smith (a.m.smith@sussex.ac.uk).

Structural Fund Reform in the Light of Enlargement

Introduction

The EU is entering a period of far-reaching change which can be expected to result in it being a very different entity a decade hence. In the next seven or eight years, the single currency will come into being, the membership of the Union could increase by up to two-thirds and a major reconfiguration of the various supranational institutions and their procedures is expected to take place. Yet faced with all these changes, the Commission in its blueprint for the coming years, published as *Agenda 2000* (European Commission, 1997), has opted for a budgetary package that more or less preserves the status quo. The ceiling for the budget will remain at 1.27% of GDP, its main heads of expenditure will continue to be agricultural support and structural policies, and the allocation to these will barely shift.

While it is easy to understand why such a cautious stance has been adopted, the approach makes few concessions to the new demands on policy that are likely to surface. Instruments to deal with asymmetric shocks have not been put in place; there is a marked reluctance even to contemplate any attempt to 'Europeanise' social protection or other forms of redistribution; and well thought out procedures for the co-ordination of macroeconomic management have not been agreed. This suggests a disjunction between the means available to the EU and the aims set out in Article 2 of the *Treaty on European Union* (TEU).

In particular, this Article makes it clear that cohesion is one of the fundamental principles the EU seeks to respect. Cohesion, however, is not an easy concept to pin down, although it is linked (in Article 130A of the TEU) to disparities between regions. In practice, what constitutes cohesion is a political rather than an economic judgement; disparities tolerable today may be unacceptable in five or ten years' time (see Begg and Mayes, 1991). The principal instruments that the EU has to advance cohesion are the Structural Funds, the Cohesion Fund and the lending effected by the European Investment Bank (EIB). Member State policies also play an important role in assuring cohesion, both by institutionalised inter-regional income transfers and by explicit programmes aimed at the economic development of less-favoured regions (see the *First Cohesion Report* - European Commission, 1996).

Although the Structural Funds and the Cohesion Fund have an explicit Treaty base, namely the mandate to address regional disparities, their underlying purposes in Union politics are not always transparent. A number of overlapping functions of the Funds can be identified:

- In some respects, the Funds can be seen as 'compensation' for the least-favoured Member States for their agreeing to the single market and EMU. This is explicit in the case of the Cohesion Fund, in so far as its purpose is to allow the recipients (currently Greece, Ireland, Portugal and Spain) to maintain public investment vital to their economic development while also making progress towards the convergence criteria.

- The Funds also provide a measure of macroeconomic stabilisation for economically depressed regions, but for many this is so limited in scale that it pales into insignificance compared with Member State fiscal flows.

- A third political function is to promote solidarity by demonstrating that 'membership of the club' provides benefits all round as well as imposing costs. The drawback here is a conflict with the aim of concentration of support. All 15 Member States receive some transfers from the Structural Funds, even though for most of them the net receipts are negative.

The current mandate for the Structural Funds derives from the 1992 Edinburgh European Council and is closely linked to the agreement reached at the same Council on the EU budgetary framework: the *Financial Perspective*. Both the *Financial Perspective* and the 'programming period' for the Structural Funds come to an end in 1999, and debate is now hotting-up on how to proceed following the publication of *Agenda 2000.* In the negotiations on enlargement of the EU that will begin shortly, it is a safe bet that the Structural Funds, along with discussions on the common agricultural policy, will be central.

This paper considers what will be expected from the Structural Funds in the years to come, focusing especially on the implications of enlargement. It reviews the rationale for EU involvement in structural policies, appraises the *Agenda 2000* proposals, and offers suggestions for the way forward.

Why have inter-regional transfers in the EU?

There are three main arguments for inter-regional transfers in an economic system, whether federal or unitary in structure. The first is stabilisation of region specific (asymmetric) shocks. If a region suffers such a shock, and in the absence of factor mobility (Begg, 1995), centrally-determined policies are unlikely to be appropriate, but the intensity of the shock will be moderated by offsetting fiscal flows. This form of risk-sharing spreads the burden of adjustment, the more so as product and factor markets are integrated. A related objective of inter-regional transfers is to spread demand in a context of full employment in some regions (Kaldor, 1970). In principle, this allows higher aggregate economic activity without triggering inflation than if there are regional disparities which mean that some regions have excess demand, while others have deficient demand.

Equity arguments provide the second class of justifications for inter-regional transfers. In any economic union, the degree of inequality that is politically and socially tolerable will be an issue. The commitment of the EU to 'cohesion' in Article 2 of the *Treaty* shows that equity matters for the Union. However, by equating cohesion with regional disparities (Article 130A) and establishing the Structural Funds and the European

Investment Bank as the main instruments for achieving it (Article 130B), income redistribution does not appear to figure as a facet of cohesion. In other words, cohesion as understood in the EU only addresses one component of equity.

The reason is that the Structural Funds are designed for a purpose that constitutes a third aim of inter-regional transfers, namely to accelerate the restructuring of less-favoured regions in order to promote 'real' convergence[1]. This third aim is still consistent with cohesion, but is distinctive in that its target is the long-term well-being of the recipient region. By focusing on structural change, these transfers will add to future rather than current income and the procedures governing the Funds - notably the insistence on additionality - place a strong emphasis on this. In practice, the system of inter-regional transfers in the EU achieves redistribution and structural change simultaneously. Indeed, the more cynically-minded would argue that the Structural Funds are little more than a disguise for redistribution and are routinely abused. Nevertheless, the restriction of policy instruments largely to infrastructure, training and business promotion aims is consistent with this, and contrasts starkly with the package of measures extending current income support to the new Länder that accompanied German monetary union.

Current arrangements for the Structural Policies

After agricultural policy, the Structural Funds are the second biggest item in the EU budget. Together with the (smaller) Cohesion Fund, they will account for 0.46% of EU GDP by 1999, when the current programming period ends. Their remit is partly the result of the incremental manner in which they evolved, but also reflects an element of pork-barrel politics (or, to use a somewhat more dignified term, *juste retour*).

There are three Structural Funds: the European Regional Development Fund (ERDF), the European Social Fund (ESF) and the guidance section of the European Agricultural Guidance and Guarantee Fund (EAGGF). These are complemented by the Financial Instrument for Fisheries Guidance (FIFG) which is formally part of the Structural Funds, and the Cohesion Fund, which is not. The Structural Funds operate according to four principles:

- Concentration, that is a focus on a set of priorities;
- Programming, which means the elaboration of a strategic plans, rather than piecemeal projects;
- Partnership, both with the Member State and sub-national tiers of government and with other interests such as the 'social partners'; and

[1] Latterly, attention has focused almost exclusively on the 'nominal' convergence targets associated with determining eligibility for participation in EMU, but it can be argued that convergence in real variables (income, unemployment) ought to be at the heart of policy.

- Additionality, which is the stipulation that spending from the Funds should add to rather than substitute for Member State spending. An obligation on Member States to co-finance programmes is intended to reinforce this principle, but has led to conflicts between different tiers of government.

Collectively the Structural Funds are meant to focus on six priority objectives, three of which relate to different classes of regions (objectives 1, 2 and 6, aimed at economic development or regeneration in, respectively, lagging regions, industrial regions in decline, or sparsely populated regions in the two Nordic Member States), two being pervasive albeit with regional biases (objectives 3 and 4, principally targeted at unemployment), while the sixth (objective 5, focusing on reform in agriculture and fisheries) has an overall and a spatial dimension. This means that although the Structural Funds tend to be viewed primarily as a form of regional policy, they have a wider social policy remit.

In order to obtain support from the Structural Funds, Member States or regions have to elaborate a strategic plan in the form either of a Community Support Framework (CSF) or a Single Programming Document (SPD). The EU contribution to CSFs or SPDs is up to 75% for Objective 1 regions and 50% elsewhere. The Community Initiatives, which address a range of specific problems[2], are supposedly under the direct control of the Commission, with competition between regions for projects.

The Cohesion Fund is limited to those Member States with GDP per capita below a threshold of 90% of the EU average. In practice this means the four so-called cohesion countries. The Cohesion Fund differs from the Structural Funds in three key respects:

- eligibility is assessed and transfers are effected at Member State level, rather than by region;

- support is for (large) projects which have to be in the areas of transport or the environment, rather than programmes; and

- there is no insistence on additionality, because part of the justification for the Cohesion Fund is to assist recipients in meeting the fiscal convergence criteria for EMU without unduly curbing public investment needed to ensure real convergence. The EU therefore contributes up to 85% of the project costs.

Although accounting for only a modest share of Community GDP in aggregate, the Structural Funds provide substantial net transfers for some regions or Member States. For others their political significance exceeds their direct fiscal contribution. In practice,

[2] For example, *RECHAR* supports localities affected by the decline of coal mining, *INTERREG* is focused on border regions, while *PESCA* is targeted on fishery areas.

therefore, they affect recipients in two distinct ways: the four cohesion countries obtain significant *net* fiscal transfers from the Funds; but for the rest of the Member States, the *gross* receipts are a small fraction of GDP and the *net* fiscal transfer is typically negative. For the latter group, it can be argued that money flows from national exchequers to Brussels, is subject to a bureaucratic charge, then returns with conditions.

The gross receipts from the Structural Funds over the period 1994-99 will amount to nearly 4% of GDP for Portugal, 3.7% for Greece, 2.8% for Ireland and 1.7% for Spain (European Commission, 1996). For the three poorest Member States and some regions elsewhere, *net* receipts[3] from the Structural Funds provided between 2.4% and 2.8% of GDP in 1992 (Costello, 1993). However, between them, Greece, Ireland and Portugal account for just 3% of EU GDP, making it possible for a relatively small amount of spending to appear to have quite a marked impact. For Spain, the other 'cohesion' country, Costello calculates the net transfer in 1992 to have been 0.46% of GDP.

The effectiveness of the Structural Funds - the largest and most visible component of Community cohesion policy - is open to dispute and cannot easily be evaluated because it is hard to disentangle the benefits of the transfers from other influences on change. This complicates judgements of not only how much support there ought to be, but also what the Funds ought to be doing. For most recipient regions the suspicion must be that the effects of the Funds on growth are limited. Even for Ireland, arguably a model for others, the transfers from the Structural Funds added between a half and one percentage point to the growth of GDP (Fitzgerald, 1998). This is in the context of a growth rate which has been averaging around 5% since the 1988 reform of the Funds, since when Ireland has been receiving substantial transfers (around 3% of GDP)[4].

New challenges: EMU, enlargement and subsidiarity

How the Funds should evolve will be greatly influenced not only by EMU and enlargement, but also by political developments. The articulation in the TEU of the principle of subsidiarity can be interpreted as a reassertion by the Member States of their primacy in governance, while the new flexibility clauses introduced in the Amsterdam Treaty pave the way for policy initiatives covering a subset of Member States. The former may inhibit supranational policy, while the latter could encourage more.

EMU

The challenges of EMU are, in many ways, obvious: how to deal with asymmetric shocks; the need to assure real convergence in order to advance cohesion; and how to

---

[3] After allowing for the Member State's implicit share of the financing of the Structural Funds

[4] In assessing the impact of the Structural Funds, it is important to distinguish the current value of the transfer, which could be viewed as a `windfall' increase in income (proxied by the GDP *level*), from its dynamic impact in boosting investment and thus the growth *rate*.

reconcile different demands on monetary policy. The difficulty is that for such profound and disparate objectives, the Structural Funds are neither substantial enough nor sufficiently flexible to make more than a minor contribution.

A critical difference between the EU and existing economic and monetary unions is the lack of built-in stabilisers or cross-border redistributive mechanisms. In the MacDougall Report (Commission of the European Communities, 1977) and in subsequent work by Begg and Mayes (1991) and Commission of the European Communities (1993), this source of tension between the tiers of government was highlighted, and it can be argued that the absence of a framework for fiscal federalism at the European level is bound to inhibit the development of any comprehensive system of inter-regional transfers to cope with EMU. Estimates vary markedly on the importance of flows from the federal level in the US (for example, Sachs and Sala, 1992; or Bayoumi and Masson, 1994), but are agreed in showing that both the stabilising and redistributive effects of the EU level of governance are negligible by comparison even with federations where the federal level is modest in scale.

The EU also differs from the highest tier of governance in most federal or unitary states in having such a small budget and very limited mechanisms for effecting inter-regional transfers. In particular, both the social protection apparatus and powers of revenue raising are competencies firmly controlled by Member States. Within countries, significant redistributive effects are achieved, first, by the inter-play between the tax and benefit systems, and second, by public spending programmes which are biased towards more needy targets. By transferring income from prosperous regions and/or social groups to the less-favoured, these mechanisms achieve substantial reductions in *ex-ante* disparities. In so doing, they also play an important role in macroeconomic stabilisation (see, for example, the various analyses in Commission of the European Communities, 1993; or the empirical estimates by Bayoumi and Masson, 1994). By contrast, there are no explicit cross-border transfers from the tax and benefit system in the EU, nor are such transfers likely to evolve under any realistic scenario for the medium-term development of the Union.

The revenue side of the EU budget is a matter that receives comparatively little attention in the debate on inter-regional transfers. Yet, as much of the research on the US and Canada shows, it is variations in tax receipts, rather than public expenditure which account for the bulk of both the stabilisation and redistribution effects. As currently levied, the EU system of own resources is far from progressive. Through the own resources system, even the four ‘cohesion’ countries are obliged to pay contributions of the order of 1% of GDP to the EU. The proceeds of the third own resource (VAT) are closely linked to aggregate expenditure, while the potentially more progressive fourth resource (GDP key) remains only a small part of the total. Limiting contributions could provide an alternative means of achieving a net transfer. Suspending or limiting such payments, possibly for an extended transitional period, would ease the fiscal burden on Member States which struggle to keep within the proposed *Stability Pact*.

Enlargement

Enlargement of the EU to include most of the countries of Central and Eastern Europe (CEE) will result not only in an unprecedentedly large expansion in the size of the Union, but also in a huge increase in its economic diversity. The accessions of Denmark, Ireland and the UK in 1973, and of Austria, Finland and Sweden in 1995 were, arguably, much easier to accommodate because they brought in countries with similar living standards and levels of economic development. The arrivals of Greece, in 1980, and the Iberian countries in 1986 obviously added substantially to the number of less-favoured regions, but the degree and scale of diversity remained manageable. If enlargement to include the ten CEE candidates[5] (the four Visegrad countries, the three Baltic states, Bulgaria, Romania and Slovenia) proceeds, there would be a quantum leap in diversity which will require far-reaching changes in the nature and implementation of key EU policies. Even the entry of the five countries given the nod in *Agenda 2000*, though excluding the very poorest candidates, would still lower per capita GDP in the EU by some 10 percentage points.

Extending the Structural Funds to CEE will be problematic on two counts. For the CEE countries, any suggestion that they should have lesser entitlement to the Structural Funds than the longer established Member States is bound to be strongly resisted. Equally, the present Member States, especially the Southern ones, are certain to oppose any attempt to water-down the support they receive from the Funds. Even with the 30% increase in budget suggested in *Agenda 2000*, some hard choices will have to be made.

Under the 75% rule for eligibility for Objective 1 status, several currently designated regions would drop out, either because of recent growth trends (Ireland being the prime example) or because the arrival of low income new members of the EU will push down average GDP. Using the figures for GDP per head presented in the fifth Periodic Report (Commission of the European Communities, 1994), accession of all ten CEE countries would lower the threshold by some 15 points and might mean an aggregate population of around 45 million in EU 15 being lifted above the threshold. The Objective 1 total would still, however, rise by 60 million from the current 92.2 million in EU 15 to over 150 million. Eligibility for the Cohesion Fund - currently set at 90% of EU GDP per head - would also be affected by the accession of the CEE countries. Assuming the same 15% drop in the average, Spain would be tipped just over the threshold, and as that country receives over half the appropriations from the Cohesion Fund, the net increase in the population eligible for the Fund would be around 65 million: approximately a doubling.

Plainly, the budgetary costs of extending the Structural Funds to CEE will be substantial if they are maintained broadly in their present form. Equally, the disparities between the regions of the existing EU 15 Member States would be unchanged: shifting the average would not alter the fact that GDP per head in Greece or Portugal is about half that of

[5] Cyprus is also a candidate, but its small population and comparative wealth will make it easier to accommodate.

France or Belgium. The coalfield regions of South Yorkshire or Wallonie would still face acute restructuring problems. Political realities suggest that pressures would be strong to retain existing allocations. The extra resources that will come from growth, together with the modest payments into the budget that will come from the CEE countries are thus the key to the viability of the *Agenda 2000* proposals.

Subsidiarity

The *Cohesion Report* (European Commission, 1996) goes to some lengths to emphasise the role of national policy in promoting cohesion. This reflects a desire in several Member States to insist on the principle of subsidiarity, but is also linked to doubts about the legitimacy of EU involvement in these policy areas. Regional authorities in many Member States have, however, invested considerable effort in developing programmes consistent with Structural Fund procedures and have become accustomed to the flows of income from 'Brussels'. Even though it is recognised that this can add to the administrative burdens, it is a welcome addition, as Councillor Sparks representing the Association of Metropolitan Authorities put it in oral evidence to the House of Lords enquiry:

> 'our money goes to Brussels and it comes back with strings attached, but that is a lot better than it going to Whitehall and not coming back at all'.

Another side of subsidiarity is the vexed question of state aids. On the one hand, they are seen by most Member States as a vital instrument of regional policy, and thus as necessary to promote cohesion. But state aids used generously in one country can complicate life for regions in other Member States which lack the fiscal capacity to compete. Greater efforts could also be made to bring in market disciplines and to chart a course by which private sector involvement is enhanced.

Flexibility

Given that the Treaty of Amsterdam is not yet ratified, it is an open question whether subsets of Member States might take advantage of the flexibility provisions to devise new structural policies. Some form of stabilisation instrument might also be envisaged, possibly under the control of Euro-X.

The *Agenda 2000* proposals

Perhaps the most significant component of the plans for the Structural Funds is that they will be pegged at 0.46% of EU GDP. The Commission argues that because of GDP growth, this will allow real growth in expenditure which will rise from ECUs 200 billion (at 1997 prices) in the 1993-99 programming period to ECUs 275 billion for the period 2000-06. Within this total the Commission proposes that 210 billion be available for Structural Fund spending in EU 15, 45 billion for the CEE countries (including pre-accession aid), with the balance being spent by the Cohesion Fund. Although the aggregate for EU 15 will be higher than in the current programming period, the net effect of the proposals will be to reduce the outlays slightly from the levels that will be reached by 1999[6].

The second key proposal concerns concentration of the Funds, with a refocusing from seven to three priority objectives, and a reduction in the proportion of the EU population in eligible regions to ‘ between 35% and 40%. The three new objectives are to be

- an objective 1 which broadly emulates the current one by targeting regions lagging behind in their economic development;

- a newly configured objective 2 which brings together all other ‘problem’ regions. This would encompass the existing objectives 2, 5b and 6; and

- an objective 3 covering various facets of human resource development.

Objective 1 will continue to have an eligibility criterion of 75% of EU GDP per capita or below and, we are told, this ‘should be strictly applied’. Criteria for *Objective 2* are not spelled-out, although unemployment, the level of industrial employment, activity in primary industries and social exclusion are mentioned as possibilities. The intention is that *Objective 3* will be available in regions not covered by the first two objectives ‘to adapt and modernise their systems of education, training and employment’. For those current recipients of support from the Structural Funds expected to lose their designations, transitional arrangements will permit an orderly winding-down of transfers so as not to disrupt public investment unduly.

Despite the simplification of the objectives, the administration of the funds will still encompass the four instruments: ERDF, ESF, EAGGF and FIFG. Community initiatives are, however, to be scaled down, with most being incorporated into the mainstream funds, leaving only those with a genuine ‘Community interest’. More focus will also be introduced in innovative and pilot projects. About two-thirds of expenditure will be devoted to *Objective 1*, 5% to *Community Initiatives* and 1% to pilot projects, with the balance to be spent on objectives 2 and 3.

For the CEE countries, pre-accession aid is anticipated up to the point at which the countries join, then they will be eligible for the Structural Funds on much the same terms as the EU 15. The countries which do not join will continue to receive pre-accession aid and will find the amounts available increasing as the first candidates switch to become Member States. Figure 1 shows how the overall EU budget will evolve in the course of the 2000-06 *Financial Perspective* with a gradual increase in the level of expenditure on

[6] This is because expenditure grew year by year during the 1993-99 period: in the two most heavily supported Member States, it will reach some 400 ECUs per head next year.

structural operations. Figure 2 shows that this is accounted for principally by the assumption that a growing share of Structural Fund spending will go to the CEE countries after 2002[7]. *Agenda 2000* also makes clear the planned growth in spending on the CEE countries other than through the Structural Funds. The figures are, in fact, difficult to interpret as they are not well explained in the text - see table 1, taken directly from *Agenda 2000*.

The reform agenda

Reconciling the different demands and influences on cohesion policy will pose a difficult challenge to the EU in the future (Wulf-Mathies, 1996). Maintaining the status quo is the default solution. Politically, it is probably the easiest way forward, if only because it avoids negotiation of entirely new 'deals', but the weakness of this approach is that it would mean that crucial choices were avoided. But three other options could be envisaged:

- Abolition or large-scale 'repatriation from Brussels' of relevant policies may be worth considering for some Member States.

- Major expansion of the Funds is likely to be sought by prospective recipients and would also anticipate the accession of CEE. Its drawback is that net donors will resist strongly, so that politically this is the least probable outcome.

- The third option would be broadly to retain the scale of the gross transfers effected by the Funds, but with substantial reforms of their rules and administration.

In practice, *Agenda 2000* is the status quo with some nods towards this third choice. It is instructive to reflect on how it will pan out. Although the proposals presage a simplification of the objectives of the Funds and their administration, and although greater concentration is planned, this has yet to be approved.

Coverage and priority objectives

The plans to reduce the geographical coverage of the Funds will mean that many current recipients stand to lose valued support, but it would allow the limited budget for the Structural Funds to be better targeted. Any attempt at a reduction in the geographical coverage of the Structural Funds will encounter political as well as economic objections. Because it would necessarily create losers as well as winners it must be expected to involve hard choices, though there may be a hidden benefit in forcing the EU to reflect more carefully on why it deploys the Structural Funds. *Agenda 2000* signals that the required reduction will come from:

---

[7] This is predicated on the first new members acceding by 2002, a timetable which many consider optimistic.

- enforcing the eligibility thresholds for *Objective 1* so that markedly fewer regions qualify for support; and

- devising stricter criteria than in the past for the new *Objective 2*

Alternatives would have been to tighten the Objective 1 criteria or to do away entirely with Objective 2. More radically, ‘regional’ targeting itself can be questioned. In some countries, the principal cohesion problems arise in large cities: the decline of manufacturing centres on the Franco-Belgian border, the inner city problems in the UK or the bleak suburban developments in France, accelerating congestion and environmental degradation in Southern European cities. In others, the main problems are in rural areas. It could be argued that the targeting of support should be on deprivation wherever it manifests itself, and not on regions *per se*.

Instruments

There are many aspects of the operation of the Structural Funds that have been criticised and which merit scrutiny in advance of the new mandate for the Funds. A first, basic issue is deciding whether the approach should be that of the Structural Funds, which stresses regions, or the Cohesion Fund which determines eligibility on a Member State basis.

A second area for discussion is whether the Structural Funds continue to be targeted at particular forms of structural policy, or indeed, whether any transfers should be hypothecated at all. One alternative model would be a form of *Finanzausgleich* which is used to boost the fiscal capacity of less-favoured regions, leaving them free to determine how they use the support. A related issue is the proliferation of instruments: rather than having multiple Funds, it can be argued that a significant simplification could be achieved by streamlining them into one contact point for each recipient region.

In the past, the Structural Funds (and, latterly, the Cohesion Fund) have supported a wide variety of projects: some huge, some tiny; some that could readily have been funded by lower tiers of government, others which simply would not have proceeded at all, let alone more quickly, without the Funds. Much of the regional development effort has been on improving infrastructure, though the current programming period has seen more weight given to business development. In the social field, projects are often locally-based initiatives. This does not detract from their value and it may indeed be the case that a spread of such projects can revitalise a locality. But the question that has to be posed is whether a training centre, a business incubator unit or support for voluntary sector activities are properly the province of the supranational tier of government. Although the programming approach has enhanced the coherence of regional development supported by the Funds, there is still evidence - certainly in the UK - of projects being selected on a piecemeal basis, and sometimes to ensure that each locality or interest receives its slice of the pie.

Administrative procedures

Various questions about the rules and procedures governing the Funds deserve attention. First, there is the capacity of the potential recipient regions to absorb transfers subject to current Structural Funds' terms. A shortage of 'fiscal capacity' for co-financing of projects is one dimension of this, but perhaps more of a constraint is the need for administrative capability to implement structural programmes. Substantial transfers can be two-edged in inhibiting indigenous efforts at structural reform, a phenomenon well-known in development economics. All these points are especially relevant for the CEE countries as prospective recipients of structural aid.

The balance between efficiency and accountability will always be a tricky one, as many of the procedures are designed to ensure that fraud is avoided and that conditions for support are adhered to, notably additionality. This prompts the question of why the principle of additionality should be retained, rather than simply leaving Member States (or regions) free to decide how best to use the resources. The argument for retaining additionality is the focus of the Funds on public investment in physical capital or in training and skills and the concern to ensure that recipients do not use the transfers to boost current incomes. But in practice, the distinction is difficult to apply: should spending on, say education, be regarded as investment or consumption?

The issue of co-funding, an obligation on Member States that bears on additionality, is another contentious area, especially when it brings EU and Member State policy priorities into direct conflict. Co-funding complicates the whole administration of the Funds by requiring two (or more, where sub-national governments are involved) sets of decision-making, and frequently involves the initiators of projects in drawing together funding coalitions and having to deal with multiple paymasters. Co-funding is, moreover, likely to be an especially tricky matter for the CEE countries which will face acute fiscal pressures in the years to come.

Enlargement

Successive enlargements have been accompanied by significant changes in the competencies and priorities of the supranational tier, with at least an element of '*juste retour*' dictating their emphasis. Thus, the ERDF was instituted following the accession of the UK and Ireland and can be seen as a concession to these countries' interests. After the Iberian countries joined, the role of the Structural Funds was enhanced and, from 1988, their value effectively doubled. Further growth was introduced for the 1994-99 programming period, and the advent of the Cohesion Fund established a new principle of transfers to eligible Member States, rather than regions. Even the accession of the two Nordic countries in 1995 was marked by a new objective 6 for the Structural Funds - promoting the economic development of sparsely populated areas.

Given this history, it is highly likely that new policy instruments will be devised to accommodate the new members. The question then is whether these will fall under the umbrella of regional policy or whether an altogether different policy tack will be taken. The magnitude of the problems faced by so many of the CEE countries might, for example, warrant EU involvement in explicit industrial policies of a sort that have hitherto not been acceptable. It is, moreover, possible to envisage policy instruments which, though not designed to effect inter-regional transfers, nevertheless have this outcome. The starting-point will be to identify how the circumstances of the prospective new entrants differ: environmental clean-up, modernisation of infrastructure and transfer of ‘know-how’ constitute some of the main structural problems, and fiscal capacity is likely to be a medium-term difficulty. An appropriate approach could focus on national rather than regional measures - and might include exemption from paying-in - rather than attempting to adapt the current Structural Funds’ policy mix. Perhaps a new *Transition Fund*, modelled on the Cohesion Fund but with different eligibility and operational conditions, could be envisaged.

The proposals set out in *Agenda 2000* have a number of implications for the CEE countries. First, they appear to sanction the notion of a cap on the share of a country’s GDP that can come from the Funds. This has two consequences: first, most CEE countries would receive a significantly lower per capita budgetary transfer than the two most heavily supported current Member States (Greece and Portugal); second, among the CEE countries, the transfers to the better-off would, perhaps perversely, be higher than for the poorer ones.

A second implication of the proposals is that the five countries identified as front-runners would receive a proportionally larger share of the EU budget than the back-markers relative to their populations. This could have political - and, indeed, security - ramifications if the back-markers felt that they were being unfairly treated. It also gives candidates a strong incentive to be in the front-runners group.

The proposals also suggest that the operating principles governing the Structural Funds will continue broadly as before. It is, however, open to question whether this will make sense. There are administrative and practical obstacles to such a transplant and it also has to be asked whether the structural needs are the same. Additionality and co-financing are cornerstones of the Structural Funds, yet the fact that they are not applied to the Cohesion Fund shows that structural policies need not have this approach.

An obvious administrative problem in the CEE countries is the limited decentralisation in policy-making structures. In the larger countries (Poland and Romania), the establishment of regional administrations is under review. Two medium-sized countries (Czech Republic and Hungary) have made more progress towards creating regional structures, in the former case reflecting long-standing boundaries, but Bulgaria has not. The other CEE countries are small and could reasonably anticipate being treated in their entirety, as happens at present with Ireland. For these reasons, it could be argued that there is a case for adopting different administrative procedures for the CEE countries, perhaps more along Cohesion Fund lines.

By its nature, central planning militated against local economic development initiatives, and it is apparent that the institutional capacity to deliver regional development is also limited in the CEE countries (EPRC/RWI, 1998). Hallet (1997) argues that the lack of regional administration in much of CEE means that it would be inappropriate for the Structural Funds to operate at regional level. On the other hand, an important benefit of the Structural Funds has been their role in galvanising local and regional partnerships to identify the needs of economies and to develop strategic approaches to solving economic development problems (House of Lords, 1997). This creates a dilemma: on the one hand it is apparent that this has been a tangible benefit of the Funds; but it is much less obvious that this could not have been achieved by other means without having the (expensive) addition of involvement by the European tier of government.

Conclusions

The Structural Funds are widely considered to be a useful policy instrument, particularly by those close to the ground - although part of their attraction is that they are simply an alternative to national resource transfers - and they plainly have a continuing role in advancing cohesion in the EU. It can be argued, however, that there is a qualitative difference between those Member States which receive substantial net transfers from the Funds and the other Member States where the receipts are fairly modest and where the country tends to be a net contributor to the EU budget. The CEE countries are bound to be in the former category, but may, in turn, need to be regarded as qualitatively different from even the four Cohesion countries of the 1990s.

The balance between EU programmes administered by national authorities and Community Initiatives (or, indeed, other possible means of using the resources) in a future configuration of the Funds is an important choice. Improving the coherence between national policies and the Structural Funds is a subject that deserves to be reviewed. On the one hand, Commission interventions and indigenous policies can be in conflict, especially when fiscally well-endowed authorities resort to state aids. On the other hand, Member States' actions are acknowledged to have a central role in assuring cohesion. A careful examination of the borderlines between the actions of different authorities and of the expectations on them is required. This should encompass the procedures for administration of the Funds, their dovetailing with Member State policies and the many questions surrounding co-funding, additionality, monitoring and evaluation discussed above.

A last comment is that the philosophy of inter-regional transfers in the EU warrants further thought. Thus, a more fundamental difficulty in deciding how the Structural Funds should evolve is that it remains unclear what form of supranational entity the EU aims to be. The sheer size of the potential new demands for cohesion-related policies can be expected to moderate ambitions to extend the role of the EU into areas other than public investment. But if the EU aims, genuinely, to be an economic as well as a monetary union, these are forms of inter-regional transfers that cannot be ignored indefinitely.

Table 1

Figures

References

Bayoumi T.A. and Masson P.R. (1994) ‘Fiscal flows in the United States and Canada: lessons for monetary union in Europe’ CEPR Discussion Paper No. 1057.

Begg, Iain (1995) ‘Factor mobility and regional disparities in the European Union’ *Oxford Review of Economic Policy* 11, 96-112.

Begg I.G., Mayes D.G. with Shipman A. and Levitt M. (1991) *A New Strategy for Social and Economic Cohesion after 1992* Luxembourg: Office for Official Publications of the European Community.

Commission of the European Communities (1977) ‘Report of the study group on the role of public finance in European integration’, "The MacDougall Report", Brussels: Commission of the European Communities.

Commission of the European Communities (1993) *The Economics of Community Public Finance*, Reports and Studies No 5, *European Economy.*

Commission of the European Communities (1994) *Competitiveness and Cohesion: Trends in the Regions, Fifth Periodic Report on the Social and Economic Situation and Development of the Regions in the Community* Luxembourg: Office for Official Publications of the European Communities.

Costello D. (1993) ‘The redistributive effects of interregional transfers: A comparison of the European Community and Germany’ in Reports and Studies No 5, *European Economy* 269-78.

EPRC/RWI (1998, forthcoming) *The Impact on Cohesion of Enlargement* Report to EC, DG XVI.

European Commission (1996) *First Report on Economic and Social Cohesion, 1996* Luxembourg: Office for Official Publications of the European Communities.

European Commission (1997) *Agenda 2000* Brussels COM(97) 2000 final.

Fitzgerald J. (1998, forthcoming) ‘An Irish perspective on the Structural Funds’ *European Planning Studies.*

Hallet M. (1997) 'National and regional development in central and eastern Europe: implications for EU structural assistance' European Commission DGII Economic Papers No. 120.

House of Lords, Select Committee on the European Communities (1997) *Reducing Disparities within the European Union: the Effectiveness of the Structural and Cohesion Funds* Session 1996-97 11th Report, London: HMSO.

Kaldor N. (1970) ‘The case for regional policies’ *Scottish Journal of Political Economy* 17, 337-48.

Sachs J. and Sala-i-Martin X. (1992) ‘Fiscal federalism and optimum currency areas: evidence for Europe from the United States’ CEPR Discussion Paper No. 632.

Wulf Mathies M. (1996) ‘The reform of structural policy with special reference to enlargement’, speech to the 35th session of the EU-Committee of the German Bundestag, 19th June 1996.

SUSSEX EUROPEAN INSTITUTE

Working Papers in Contemporary European Studies

1. Vesna Bojicic and David Dyker — June 1993
   Sanctions on Serbia: Sledgehammer or Scalpel

2. Gunther Burghardt — August 1993
   The Future for a European Foreign and Security Policy

3. Xiudian Dai, Alan Cawson, Peter Holmes — February 1994
   Competition, Collaboration and Public Policy: A Case Study of the European HDTV Strategy

4. Colin Crouch — February 1994
   The Future of Unemployment in Western Europe? Reconciling Demands for Flexibility, Quality and Security

5. John Edmonds — February 1994
   Industrial Relations - Will the European Community Change Everything?

6. Olli Rehn — July 1994
   The European Community and the Challenge of a Wider Europe

7. Ulrich Sedelmeier — October 1994
   The EU's Association Policy towards Central Eastern Europe: Political and Economic Rationales in Conflict

8. Mary Kaldor — February 1995
   Rethinking British Defence Policy and Its Economic Implications

9. Alasdair Young — December 1994
   Ideas, Interests and Institutions: The Politics of Liberalisation in the EC's Road Haulage Industry

10. Keith Richardson — December 1994
    Competitiveness in Europe: Cooperation or Conflict?

11. Mike Hobday — June 1995
    The Technological Competence of European Semiconductor Producers

12. Graham Avery — July 1995
    The Commission's Perspective on the Enlargement Negotiations

13. Gerda Falkner — September 1995
    The Maastricht Protocol on Social Policy: Theory and Practice

14. Vesna Bojicic, Mary Kaldor, Ivan Vejvoda — November 1995
    Post-War Reconstruction in the Balkans

15. Alasdair Smith, Peter Holmes, Ulrich Sedelmeier, Edward Smith, Helen Wallace, Alasdair Young — March 1996
The European Union and Central and Eastern Europe: Pre-Accession Strategies

16. Helen Wallace — March 1996
From an Island off the North-West Coast of Europe

17. Indira Konjhodzic — June 1996
Democratic Consolidation of the Political System in Finland, 1945-1970: A Potential Model for the New States of Central and Eastern Europe?

18. Antje Wiener and Vince Della Sala — December 1996
Constitution Making and Citizenship Practice - Bridging the Democracy Gap in the EU?

19. Helen Wallace and Alasdair Young — December 1996
Balancing Public and Private Interests Under Duress

20. S.Ran Kim — April 1997
The Evolution of Governance and the Growth Dynamics of the Korean Semiconductor Industry

21. Tibor Navracsics — June 1997
A Missing Debate?: Hungary and the European Union

22. Peter Holmes with Jeremy Kempton
Study on the Economic and Industrial Aspects of Anti-Dumping Policy — September 1997

23. Helen Wallace — January 1998
Coming to Terms with a Larger Europe: Options for Economic Integration

24. Mike Hobday, Alan Cawson and S Ran Kim — January 1998
The Pacific Asian Electronics Industries: Technology Governance and Implications for Europe

25. Iain Begg — August 1998
Structural Fund Reform in the Light of Enlargement
Centre on European Political Economy Working Paper No. 1

26. Mick Dunford and Adrian Smith — August 1998
Trajectories of Change in Europe's Regions: Cohesion Divergence and Regional Performance
Centre on European Political Economy Working Paper No. 2

27. Ray Hudson — August 1998
What Makes Economically Successful Regions in Europe Successful? Implications for Transferring Success from West to East
Centre on European Political Economy Working Paper No. 3

28. Adam Swain — August 1998
Institutions and Regional Development: Evidence from Hungary and Ukraine
Centre on European Political Economy Working Paper No. 4

Sussex European InstituteWorking Paper Series in Contemporary European Studies The Sussex European Institute publishes Working Papers (ISSN 1350-4649) to make research results, accounts of work-in-progress and background information available to those concerned with contemporary European issues. The Institute does not express opinions of its own; the views expressed in these publications are the responsibility of the authors.

Ordering Details

The price of each Working Paper is £5.00 plus £1.00 postage and packing per copy in Europe and £2.00 per copy elsewhere. Cheques should be made payable to the University of Sussex.
Payment can also be made by credit card. Please give the following information when ordering:

1. type of card
2. full card number
3. expiry date
4. full name of card holder
5. the name of a person to contact

Orders should be sent to the address below

"..

Date............................... Please send .... copy/ies of Paper No. .... to:

Name:...

Address...

....

....

I enclose a cheque for £ .... (including postage)

SUSSEX EUROPEAN INSTITUTE, UNIVERSITY OF SUSSEX, FALMER, BRIGHTON BN1 9SH
TEL: 01273 678578 FAX: 01273 678571 E.MAIL: sei@sussex.ac.uk