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Reform of the Structural Funds after 1999[(1)]

Iain Begg
Professor of International Economics
South Bank University, London

Introduction

Article 2 of the *Treaty on European Union* (TEU) 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 judgment; disparities tolerable today may be unacceptable in five or ten years' time.[(2)] 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 institutionalized inter-regional income transfers and by explicit programs aimed at the economic development of less-favored regions.

Although the Structural Funds and the Cohesion Fund have an explicit Treaty base, namely the mandate to address regional disparities, their underlying purposes in Community 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-favored member states for their agreeing to the single market and economic and monetary union (EMU). This is explicit in the case of the Cohesion Fund, in so far as its purpose is to allow the four recipients (Greece, Ireland, Portugal and Spain) to maintain public investment vital to their economic development while also making progress towards the convergence criteria.
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> The Funds also provide a limited measure of macroeconomic stabilization for economically depressed regions, but for many this is so limited in scale that it pales into insignificance compared with Member State fiscal flows.
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> 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.

Many supporters of economic integration believe that cohesion is best advanced by the process of integration itself. Following the textbook models, there would be improved resource allocation and regional disequilibria would rapidly be resolved by factor flows. If the openness of markets could be enhanced and obstacles to labor and capital mobility reduced, the market might well be able to achieve adjustment, and there are many who argue that this is the virtuous route to cohesion. The contrary view is that regional disparities are persistent and intractable. They result from deep-seated weaknesses in the economic structure, the institutional framework and social fabric of less-favored regions (Putnam et al, 1993). If exposed to the full blast of competition, such regions will lose relative to more competitive regions and suffer increased unemployment.

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 the first skirmishes in the battles that will put in place the rules that will apply beyond 1999 are already taking place. In parallel, negotiations on enlargement of the EU will begin shortly, and it is a safe bet that the Structural Funds, along with discussions on the common agricultural policy, will be central to these negotiations. EMU, with all its ramifications for the structure and conduct of economic policy, is also scheduled to start in 1999.

It is, therefore, timely to look at the way in which the Structural Funds operate at present and to consider how they might be reformed to meet the obligations on, and expectations of, the EU in the years to some. This paper continues with an examination of the rationale for inter-regional transfers, then goes on to discuss options for reform of the Structural Funds. Some of the evidence is drawn from a recent enquiry into the Structural Funds by the European Communities Select Committee of the House of Lords (1997).[(3)]

Why have Inter-Regional Transfers in the EU?

Work by Barro and Sala (1991) and Neven and Gouyette (1995) suggests that the long-term trend is towards convergence of real incomes in the EU, although such aggregative studies mask very disparate shifts in relative prosperity. The first Commission *Cohesion Report* also highlights the relative improvement in the circumstances of the four "cohesion" countries, notably in the last few years, but the pattern has been far from uniform. Ireland and Greece have both received substantial fiscal transfers, yet it would be hard to find two more divergent economic performances over the last decade. Although there are encouraging examples across the EU of regions which appear to have achieved real advances, many of the longstanding problem regions Calabria in Italy, Hainaut in Belgium or Merseyside in the UK continue to exhibit competitive weaknesses.

Despite the progress towards the single market in the EU, the evidence suggests[(4)] that market forces alone will not stimulate movements of labor or capital sufficient to offset regional disparities, particularly where potential host regions for surplus are anxious to restrict immigration. The dangers were articulated in the 1989 Delors Report (Commission of the European Communities, 1989), which paved the way for EMU, and have been repeated elsewhere. Yet apart from Structural Funds and the Cohesion Fund, no system of redistribution is envisaged. This prompts the question of whether extensive inter-regional transfers mediated (though not necessarily funded) by the EU might be warranted as the Union becomes more closely integrated. In the present political climate, this is wholly implausible. However, it calls into question what the Structural Funds aim to achieve.

Within member states, potential disparities between regions are mitigated by the incidence of taxation and public expenditure. Dynamic regions, typically, pay more tax while less-favored regions receive a disproportionate share of public expenditure. These net transfers occur even in the absence of an explicit system for redistribution between regions because of the structure of the tax system and entitlements of individuals to public services even if they do not contribute much. In addition, some countries implement equalization transfers based on indicators of relative prosperity, the German system of *Länderfinanzausgleich* - which transfers income directly from the better-off regions to the less favored - being a good example. Other federal states such as Canada, Australia and the US achieve this via the federal government.

Such transfers are accepted by society for a number of reasons. On the whole, they are condoned as a legitimate form of "solidarity" with fellow citizens, although recent strains in Italy point to the limits of this acquiescence. Conceptually, there are two main justifications for assigning responsibility for assistance to the poor to the highest tier of governance (see Oates, 1991 for an overview; the analysis relates to the federal level in the US so that the parallel is with the "Brussels" tier in the EU).

> First, "the well-being of the poor is of national concern". Policies adopted by lower tiers of government do not necessarily reflect this and can give rise to externalities which engender sub-optimal transfers.
>
> Second, even if there is no concern for the poor in other parts of the integrated economic space, the probability that the poor would migrate to prosperous areas is a reason for transfers to less-favored regions.

It can be argued that both conditions apply in the EU: the reference to cohesion in Article 2 of the *Treaty* is an expression of the first, and there is obvious popular antagonism to poor immigrants in the richer member states. Should the supranational tier of governance have this competency?

More generally, there are three main arguments for inter-regional transfers in an economic system, whether federal or unitary in structure. The first is stabilization of region specific (asymmetric) shocks. If a region suffers such a shock, 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, non-inflationary economic activity than if there are regional disparities, i.e. while some regions have excess demand, 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-favored regions in order to promote "real" convergence.[(5)] 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 aims 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.

The Structural Funds in Cohesion Policy

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 percent of EU GDP by 1999, when the current programming period ends. The worth of the Funds can be hard to judge, because they are called upon to fulfill disparate and potentially conflicting aims. Their current remit is partly the result of the incremental manner in which they evolved, but also reflects an element of pork-barrel politics (or, to adopt a somewhat more dignified term, *juste retour*). These various constraints will inevitably circumscribe the scope for reform of the Funds, and it is unrealistic to expect a wholesale transformation to occur after 1999. Inertia, however, is no justification for inaction, and there are many aspects of the Funds that warrant scrutiny.

Characteristics of the Structural Funds Today

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
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> *Programming*, which means the elaboration of strategic plans, rather than piecemeal projects
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> *Partnership*, both with the Member State and sub-national tiers of government and with other interests such as the "social partners"
>
> *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 programs 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 (see Appendix). Three objectives 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, and sparsely populated regions in the two Nordic member states); two are pervasive albeit with regional biases (objectives 3 and 4, principally targeted at unemployment); and one (objective 5, focusing on reform in agriculture and fisheries) has an overall and a spatial dimension. Thus, 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 subsidiary Single Programming Document (SPD). The EU contribution to CSFs or SPDs is up to 75 percent for Objective 1 regions and 50 percent elsewhere. The Community Initiatives, which address a range of specific problems[(6)], 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 percent of the EU average. In practice this means the four so-called "cohesion countries" (Greece, Ireland, Portugal, and Spain). The Cohesion Fund differs from the Structural Funds in three key respects:

> Eligibility is assessed and transfers are affected 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 programs
>
> There is no insistence on additionality, because part of the justification for the Cohesion Fund is to assist the recipients in meeting the fiscal convergence criteria

for EMU without unduly curbing public investment needed to ensure real convergence. The EU contribution can be up to 85 percent of the project cost, as opposed to 75 percent for Objective 1 regions and 50 percent elsewhere.

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, whereas for others their political significance exceeds their direct fiscal contribution. In practice, 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 State, 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, and then returns with conditions.

The gross receipts from the Structural Funds over the period 1994-99 will amount to nearly 4 percent of GDP for Portugal, 3.7 percent for Greece, 2.8 percent for Ireland and 1.7 percent for Spain (European Commission, 1996). For the three poorest member states and some regions elsewhere, *net* receipts[(7)] from the Structural Funds provided between 2.4 percent and 2.8 percent of GDP in 1992 (Costello, 1993). However, between them, Greece, Ireland and Portugal account for just 3 percent 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 percent 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 these transfers from other influences on change. This complicates judgments not only about how much support there ought to be, but also about 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 estimates quoted in evidence to the House of Lords Enquiry indicate that the transfers from the Structural Funds added between a half and one percentage point to the growth of GDP. This is in the context of a growth rate which has been averaging around 5 percent since the 1988 reform of the Funds, since when Ireland has been receiving substantial transfers (around 3 percent of GDP).[(8)]

Key Questions

As with so much in the EU, the present scale, coverage and manner of implementation of the Funds is the outcome of compromises and accommodations reached over many years. By the same token, it can be hard to ascertain the rationale for the Funds, the procedures they follow and the policy instruments they support. This raises several questions:

Why is "Brussels" involved in structural policies at all? All the member states of the EU have domestic policies, which seek to enhance the competitive position or the well being of less-favored regions. So can the supranational level bring distinctive benefits, or is it seen simply as an alternative source of funding to be invoked when national sources fail to deliver?

Are the Funds sufficiently integrated with other policy domains and with other structural measures? European Commission technology policy, the lending of the EIB and the regional and industrial policies of member states all influence the development of less-favored regions, yet for many regions they seem poorly coordinated. More generally, the aims and instruments of cohesion policy, with the Structural Funds to the fore, appear only to be loosely linked either to macroeconomic management of the EU economy or to other prominent supply-side imperatives such as competition policy.

Should the Funds continue to be so widely dispersed, or would a significant concentration enable them to be either more effective or better targeted in a way that advanced cohesion? Perhaps surprisingly, 51 percent of the EU population resides in areas eligible for support from the regionally targeted Funds. The Commissioner for Regional Policy, Monika Wulf-Mathies, has questioned this coverage and suggested that it might appropriately fall to 35 percent, although without indicating which regions or classes of regions should lose their eligibility (Wulf-Mathies, 1995).

Is the range of instruments (three separate Structural Funds, the Cohesion Fund and the fisheries instrument which provide grants for structural purposes) warranted? This proliferation of funding sources, often for relatively modest amounts of money, requires a substantial bureaucracy. The Commission also reserves a proportion of the "Structural Funds" budget (currently 9 percent) for *Community Initiatives*. What scope is there for, and what would the objections be, to a rationalization of this support?

How could the administrative procedures surrounding the Funds be improved? This issue arises in decision-making, implementation and evaluation, all of which have been criticized.

How will the various cohesion instruments have to be adapted to accommodate enlargement of the EU? Although the problems confronting the Central and Eastern Europe (hereafter, C&EE) countries in making the transition to modern market-based economies differ in character from those of the less-favored regions of the EU-15, the lesson to learn from the experience of the latter is that neither relatively modest fiscal transfers nor traditional regional policies can be expected to yield rapid results in engendering convergence.

New Challenges: EMU, Enlargement and Subsidiarity

How the Funds should evolve will be greatly influenced by the coming changes in the EU itself. EMU and enlargement will result in far-reaching changes, but important political factors also need to be taken into account. One is that 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. This will make it problematic for the EU tier to expand its role in structural policies. It must also be considered unlikely that the own resources ceiling of 1.27 percent the cap on the EU budget will be raised, so that any growth in the resources at the disposal of the Structural Funds will have to come either from GDP growth or from some reallocation within the budget. As Mrs. Wulf-Mathies stated in addressing the Bundestag (Wulf-Mathies, 1996), a reasonable hypothesis is that the next "round" of the Structural Funds will have some 30 percent more funding in real terms than during the 1994-1999 period.

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 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 stabilizers 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 of the importance of flows from the federal level in the US (for example, Sachs and Sala, 1992; or Bayoumi and Masson, 1994), vary markedly. But observers agree that both the stabilizing and the 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 programs which are biased towards more needy targets. By transferring income from prosperous regions and/or social groups to the less favored, these mechanisms achieve substantial reductions in *ex-ante* disparities. In so doing, they also play an important role in macroeconomic stabilization (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 any 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 in public expenditure, which account for the bulk of both the stabilization 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 percent 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 C&EE would result not only in an unprecedentedly large expansion 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 1981, and the Iberian countries in 1986 obviously added substantially to the number of less-favored regions, but the degree and scale of diversity remained manageable. If enlargement to include the ten C&EE candidates[(9)] (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.

Given that an extension of the Structural Funds to C&EE would require a sharp increase in the EU budget, a decision regarding expansion will inevitably be political rather than economic. For the C&EE countries, any suggestion that they should have lesser entitlement to Structural Funds than the longer established member states is bound to meet strong resistance. Equally, the southern member states are certain to oppose any attempt to water down the support they receive from the Funds. Even with the 30 percent increase in budget anticipated by Mrs. Wulf-Mathies, some hard choices will have to be made.

If the 75 percent rule for eligibility for Objective 1 status (economic development in lagging regions) continued to be applied, several currently designated regions would drop out, although in a number of cases, the relevant borders would have to be reexamined. Thus, Ireland, currently designated in its entirety because of the data used in 1993[(10)], would move above the threshold, but the less-favored regions in the west of Ireland would still be below. Using the figures for GDP per head presented in the fifth Periodic Report (Commission of the European Communities, 1994), accession of the C&EE countries might mean an aggregate population of around 45 million being lifted above the threshold.[(11)] 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 percent of EU GDP per head - would also be affected by the accession of the C&EE countries. Assuming the same 15 percent drop in the average, Spain would be tipped just over the threshold: 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 C&EE will be substantial if they are maintained broadly in their present form, so that some cuts are likely to be demanded. 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 in France or Belgium. Political realities suggest that pressures would be strong to retain existing allocations. The implied increase in the EU budget, though hefty, would not be prohibitive: even a trebling of the costs of Objective 1 as planned for 1999 would only add about 0.5 percent of GDP to total EU spending. Moreover, by the time any C&EE countries accede fully (assuming some transition period), the EU's GDP should have risen further, adding to the EU budget. Also, some revenue will be received from the new members, so that budgetary constraints, of themselves, should not be a binding constraint on extending cohesion policies to C&EE.

Subsidiarity

The Cohesion report (European Commission, 1996) goes to some lengths to emphasize 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 programs consistent with Structural Fund procedures and have become accustomed to the flows of income from "Brussels". Even though it is recognized that this can add to the administrative burdens, it is a welcome addition, as Councilor 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. On the other hand, 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.

Options for Reform of the Structural Funds

Reconciling the different demands and influences on cohesion policy will pose a difficult challenge to the EU. The Funds after 1999 could take one of four main directions:

> *Maintaining the status quo* 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 are avoided.
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> *Abolition or large-scale "repatriation from Brussels" of relevant policies.* This may be worth considering for some member states.
>
> *Major expansion of the Funds.* This is likely to be sought by prospective recipients and would also anticipate the accession of CEEC. Its drawback is that net donors will resist strongly, so that politically this is the least probable outcome.
>
> *Keeping the overall scale of transfers affected by the Funds,* but with substantial reforms of their rules and administration.

Politically, the last option is the most likely and is, therefore, explored in the remainder of this section.

Coverage and Priority Objectives

There is an emerging consensus in Brussels, prompted in part by "kite-flying" on the part of Commissioner Wulf-Mathies, that the geographical coverage of the Structural Funds should be reduced from the current 51 percent of the EU population to around a third. With such a reduction, many current recipients would lose valued support. But the reduction 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. Any change would, because of the way public investment in assisted regions has become entwined with the Structural Funds, require carefully thought-out transitional arrangements. There are, essentially, three ways to reduce the coverage of regions:

> *By raising eligibility thresholds* so that markedly fewer regions qualify for support. For Objective 1 regions, currently supposed to be eligible only if their per capita GDP does not exceed 75 percent of the EU average, a cut to, say, 70 percent might be envisaged. Based on the 1991 figures presented in the Fifth Periodic Report, this would exclude regions with an aggregate population of some 25 percent of the current total Objective 1 total, freeing substantial resources for either more targeted or for alternative spending. Objective 2 and 5b regions absorb much lower proportions of the budget, and the eligibility criteria are in any

case less precise, so that any change in the spread of these objectives would be political rather than rule-based.

By restricting support to member states below a certain threshold, as happens with the Cohesion Fund (the limit is 90 percent). Here the result would be to exclude the majority of member states - in fact, as a result of its recent growth, Ireland would be amongst the excluded.[(12)] This would make sense from the point of view of ending the circular flow from member states to Brussels and back again, and ensure that the Structural Funds were genuinely an instrument providing net transfers to poorer countries. This could have political consequences that should not be overlooked, namely, that many member states would no longer perceive any *retour* whether *juste* or not: and that might undermine their willingness to pay.

By reducing the number of priority objectives, possibly by cutting out Objectives 2, 5b and 6, and merging the two social objectives, 3 and 4. Under this option, the net transfer would be concentrated in the least prosperous member states, but a trickle of support would still flow to nearly all the other member states. However, it would pose severe problems for those regions, particularly in Europe's "rustbelt", which have become accustomed to receiving support from the Structural Funds.

More radically, "regional" targeting itself can be questioned. In some countries, the principal cohesion problems arise in large cities: the decline of manufacturing centers 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. It could be argued that the targeting of support should be on deprivation where it manifests itself, and not on regions *per se*.

Instruments

Many aspects of the operation of the Structural Funds have been criticized and 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 that of the Cohesion Fund which determines eligibility on a Member State basis.

A second area for discussion is whether the Structural Funds should 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-favored 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. What should become of the Community Initiatives is another tricky question. The main criticism of them is that they are small, thinly spread pockets of money, which, though no doubt very helpful in some circumstances, could for the most part be incorporated in the mainstream Structural Funds.

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 concentrated 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 revitalize a locality. But the question that has to be posed is whether training center, 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. A first 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 programs. Substantial transfers can be two-edged in inhibiting indigenous efforts at structural reform, a phenomenon well known in development economics. For these reasons, as well as to limit the cost to the EU budget, some form of cap on the scale of transfer may be desirable. All these points are especially relevant for the C&EE countries as prospective recipients of structural aid.

Much of the evidence collected by the House of Lords enquiry pointed to the heavy bureaucracy associated with the Funds, especially the Community Initiatives. 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.

Undoubtedly, the administration of the Funds could be more decentralized and does not need the degree of involvement from the Commission that it currently has. However, administrative capacity varies substantially across member states. Regarding Ireland, the House of Lords enquiry was persuaded that the machinery for delivery of structural policies was both effective and efficient. Experience in Greece, the south of Italy and some other regions has been less encouraging, with the implication that provision of technical assistance ought to figure prominently. It is far from obvious that the current administrative arrangements strike the right balance, and it is also apparent (for example in the evolution of the administration of the Funds in Greece) that an extended learning curve has to be followed by administrators. This has self-evident ramifications for extension of structural policies to C&EE.

Meaningful economic evaluation of the results of structural policies, as opposed to simple monitoring of how resources are used, is generally lacking. Indeed, some of the elaboration of plans is more on the basis of what can be pulled together, rather than on a fully thought-out strategy for the region in question. In any reform, this ought to figure prominently.

Implications for Reform and Concluding Remarks

There is a qualitative difference between those member states which receive substantial net transfers from the Funds and those whose receipts are fairly modest. This needs to be taken into account in formulating plans to reform the Funds and to concentrate their activity. It also touches on how the Funds relate to general economic policy: in Ireland, for example, the impression is that public investment strategy has been framed around the Funds.

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. Evidence collected by the House of Lords enquiry suggested that an important benefit of the Structural Funds had been their role in galvanizing local and regional partnerships to identify the needs of economies and to develop strategic approaches to solving economic development problems. While such a galvanizing effect is desirable, it might have been achieved by other means without the (expensive) addition of involvement by the European tier of government.

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 - perhaps an Objective 7 for the Structural Funds targeted at, say, economic development for transition regions - or whether an altogether different policy tack will be taken. The magnitude of the problems faced by so many of the C&EE 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 earliest likely accession of any of the C&EE countries is by 2002/3, which would be halfway through the next *Financial Perspective* and, presumably, any new mandate for the Structural Funds. Although not an immediate concern, therefore, assimilation of the needs of these countries into the approach of the Funds will have to be undertaken fairly soon. The starting-point will be to identify how the circumstances of the prospective new entrants differ: environmental clean-up, modernization 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.

The EU has already accepted a commitment to assist the C&EE countries through the PHARE program, establishing the principle of transfers to these countries. Much of this program focuses on provision of technical assistance: it could be argued, on a "horses for courses" basis, that such assistance ought to remain a substantial component of any new arrangements, rather than confining structural assistance to major investment programs.

Targeting

Better targeting of the Structural Funds is likely to be on the agenda for 1999. The radical solution to the lack of concentration of the Funds would be to end EU support other than to Objective 1 regions, thereby largely eliminating transfers to the richer member states. Even here, however, the fact that Germany has a large swathe of Objective 1 in the former GDR would be politically difficult. Such a change would inevitably place the onus on national governments to assume responsibility for structural change in disadvantaged industrial regions such as *Nord Pas-de-Calais* or South Yorkshire, or for rural areas such as the *Sud-Ouest* of France or Eastern Bavaria.

The alternative would be to target support to regions that had demonstrably been adversely affected by European integration, or were in member states that fell below a GDP per head threshold. This would, on the whole, exclude Eastern Germany, but might favor regions that had been damaged by EU steel and coal policies or by restructuring resulting from the single market. Pockets of high unemployment will, typically, be the symptom of such damage. If this philosophy were adopted, a two-pronged mandate for the Structural Funds could be envisaged:

> *Support for under-developed (lagging) regions in less-favored member states*. That is a single, *spatial cohesion* objective. This would be in-between the current philosophies of the Structural Funds and the Cohesion Fund.
>
> *Transfers aimed at reducing high unemployment* a *social cohesion* aim. Here the rationale would be to promote solidarity at the European level in recognition of the uneven incidence of integration.

One of the main objections to a withdrawal of support from the Structural Funds is that this would disrupt existing programs and processes. This argument has force and it is plain from direct observation of the Funds in action that a precipitate withdrawal would have serious consequences. However, the Funds would not be serving their purpose if they become too institutionalized for recipient regions: in principle, if the Funds succeed in their aims, they make themselves unnecessary. A possible resolution of this would be for the period between the start of a new mandate (1999) and the accession of the first C&EE countries to be used to wind down the Funds in a substantial number of current recipients (for example, Ireland - a long-term beneficiary which has grown sufficiently to be able to forgo the Funds, even though it still has development needs - or in many of the Objective 2 and 5b regions). In parallel, greater recourse could be had to loan funding via the EIB to substitute for grants from the Structural Funds, possibly with priority given to regions being weaned off support from the Structural Funds. The attraction of such an approach is that it would increase discipline on the viability of projects.

The Cohesion Package: Policy Assignment Between Tiers of Government

The balance between EU programs 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. The evidence suggests that much of what is done by the Community Initiatives could, without much difficulty, be incorporated in the main activities of the Structural Funds, although this would deprive the Commission of its ability to engage in experimental policies or to react to new problems.

Improving the coherence between national policies and the Structural Funds is a subject that deserves review. On the one hand, Commission interventions and indigenous policies can 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 "power to transfer", to adapt the title of a well-known book (Brennan and Buchanan, 1980), relies on agreement on political aims, on the terms on which solidarity between regions or social groups operates, and on willingness to assign policy competencies to the EU level. The *acquis communautaire* the core competencies of the Union is a hodgepodge of compromises born of political expediency, and the outlook for deepening of the Union is opaque, especially with respect to redistribution (Bureau and Champsaur, 1992). 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.

APPENDIX

Structural Funds

?? **The European Social Fund (ESF)**, established in 1957, supports vocational training, guidance and wage subsidy projects;

?? **The European Regional Development Fund (ERDF)**, established in 1975, generally supports the development of projects aimed at regional economic development such as the construction of industrial sites and premises, training facilities and industry-linked Research and Development Facilities;

?? **The European Agricultural Guidance and Guarantee Fund Guidance Section (EAGGF)**, established in 1957;

?? **The Financial Instrument for Fisheries Guidance (FIFG)**, established in 1993.

Objectives

There are six basic objectives under which the EU dispenses funds. The first five were established in Regulation No.2052/88, Official Journal L 185, July 1988, and were redefined in Regulation No.2081/93. The sixth was added after the accession of Finland and Sweden, January 1995. The "objectives" account for 92% of the overall budget and are:

Objective 1: Assisting underdeveloped regions. (ERDF, ESF, EAGGF and FIFG).

Objective 2: Assisting regions affected by the decline of traditional industries (ERDF and ESF).

Objective 3: Combating long-term unemployment and the integration of young people into the labor market. (ESF).

Objective 4: Helping workers adapt to technological change. (ESF).

Objective 5:

(a) Structural reform of agriculture, including fisheries. (EAGGF);

(b) Helping the development of rural areas (ERDF, ESF, EAGGF and FIFG).

Objective 6: Assisting rural Arctic regions and areas of very low population density. (ERDF, ESF, EAGGF and FIFG).

Source: CWES - CERN Virtual Library West European Research Resources: http://www.pitt.edu/~wwwes,Regional & Structural Policy.

NOTES

1. This paper is due to be published in *European Planning Studies.*

2. For a more extended discussion, see Begg and Mayes (1993).

3. The author served as the Specialist Adviser for this enquiry. This paper is, however, written in a personal capacity. The conclusions reached here do not necessarily reflect those of the Select Committee, and the usual suspect is responsible for any errors.

4. I have argued elsewhere (Begg, 1995) that in today fifteen member EU, there is no realistic prospect that factor mobility - especially labor mobility - will do much to reduce regional disparities.

5. 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.

6. 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.

7. After allowing for the member states' implicit share of the financing of the Structural Funds

8. 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*.

9. Cyprus and Malta are also candidates, but their small populations would make them much easier to accommodate.

10. The phenomenal recent growth of the Irish economy has, in any case lifted the country well above the threshold, but because of the way the Structural Funds regulations are framed, it will retain its eligibility until 1999.

11. The figure assumes that if a currently designated region moves above the threshold, none of its population would remain eligible and is, consequently, an upper bound. This is least plausible for Ireland.

12. Ireland's GNP, a better measure of well-being than GDP, is however, some 7-10 percentage points below its GDP, principally because of outward profit flows.

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