CEPS ESSAY
Thinking ahead for Europe

Struggling with an Opportunity:
The first 10 years with the EU for Central Europe and the Baltics
A few lessons

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In 2004, ten new members joined the European Union, radically reshaping its geography and governance characteristics. Earlier expectations predicted a more gradual process of accession – like a more gradual earlier evolution had been expected for the new European currency that had been adopted in 1999 by no less than 11 members. But these were the times of euro-enthusiasm.

Euro-optimism implies that rapid convergence of the new member states would happen both in terms of economic levels of development and, closely related, governance characteristics. Of the former, many studies established a varied picture: strong growth and catching up until the crisis, and highly varied continuation during the crisis. In this short essay, we look at one important aspect of the story, based on our practical experience with EU Structural Funds, particularly the EU Social Fund – since those funds are supposed to contribute to convergence, and thus to the EU's internal cohesion. Our work at trying to link the EU funds with such a vitally important issue as the Roma exclusion in the region has revealed a complex web of obstacles to a functional use of the funds. The starting point is that EU funds are proportionately much more important for the new EU member states than for most of the old ones simply because their per capita GDP is much smaller. Thus, their share of EU funds is larger both in GDP and as a percentage of the national budget, as well as of public investment. Hence it is particularly important that the funds are used strategically.

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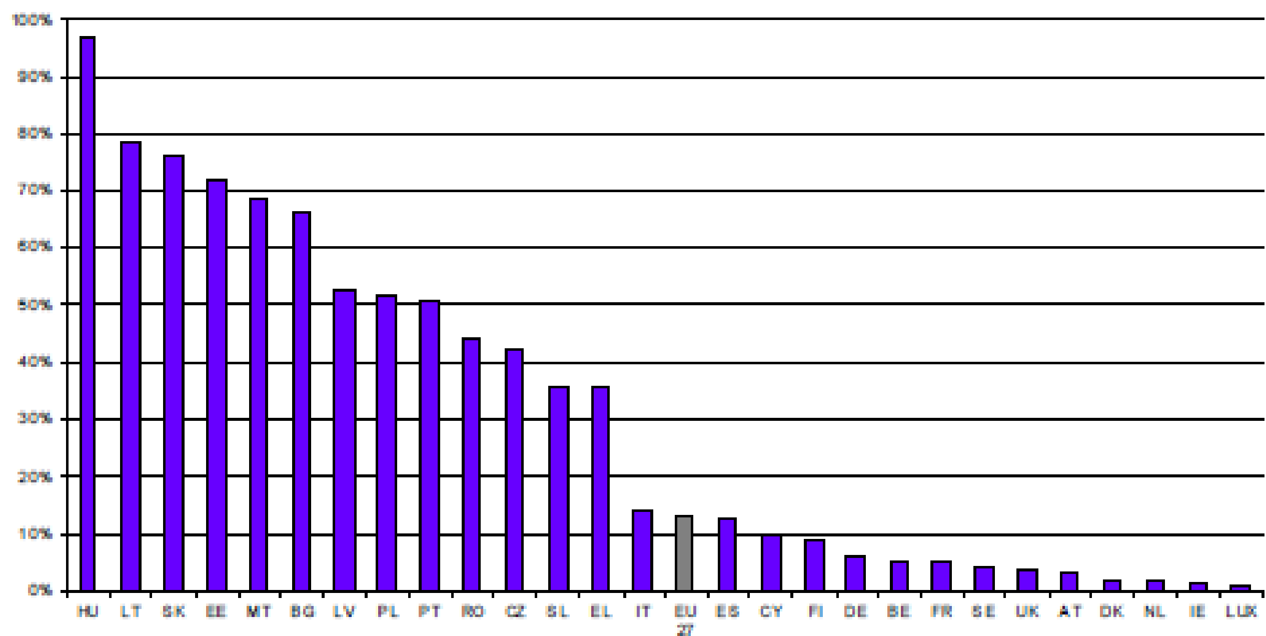
Structural Funds and national co-financing as % of total public investment (average 2009-2011)



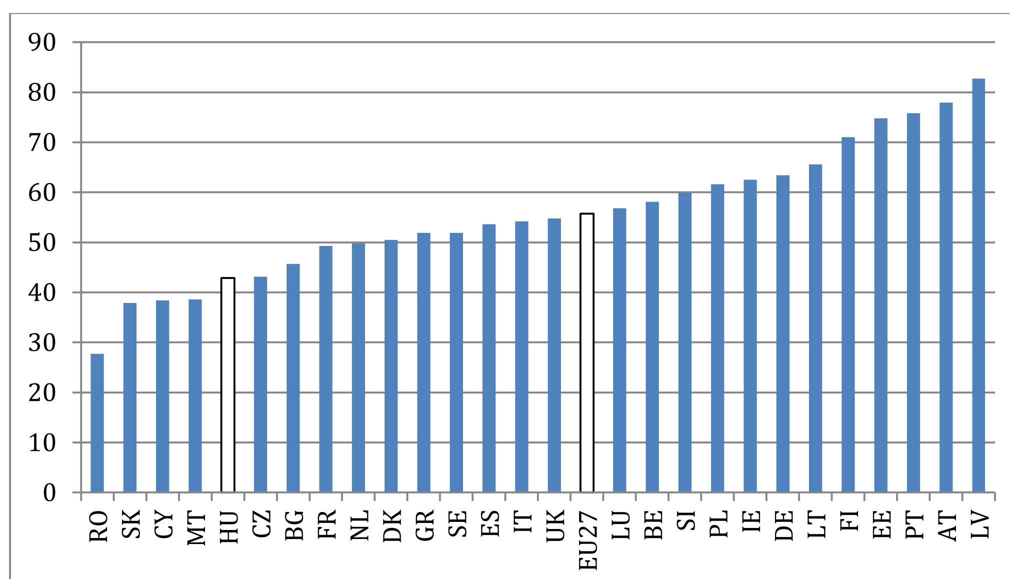
Source: European Commission (2012): EU Structural Funding for Growth and Jobs.

Evidence reveals, however, that such an approach is sorely lacking. Truly national debates about the structure, proportions and mechanics of the use of EU funds are not taking place, thanks to the overall deficiencies of the democratic process. If there is no strong national leadership about the best way to use the funds, inevitably the stronger lobby interests will prevail at the expense of the weak. Thus the principle of cohesion and solidarity are upset in the national context. This problem goes hand-in-hand with strong corruption of the use of funds. The European Commission comforts itself in having very strong 'control' mechanisms in place. Well, these control mechanisms are limited to a narrow administrative-accounting oversight. Businesses and officials in most of the former socialist countries are far too innovative to be constrained by even enforced accounting rules. The EU oversight processes implant very little real strategic thinking in the allocation of funds and distribution mechanisms.

One could imagine two broad approaches and their combinations: one that looks at the bottlenecks to economic growth and tries to eliminate them; the other that tries to increase social cohesion through improving the life chances of people and communities with little access to pubic goods. Neither of these approaches is seriously discussed nor their combinations. Allocation mechanisms are prisoners of private interests – since much is at stake. So far thus the big promise of structural funds has not materialised as they are not spent strategically.

Improperly designed EU funds have a particular crowding out effect as well. Not only do easy public funds crowd out private funds, but they also perpetuate a behaviour that those of us old enough to have had experience under socialism know: dependence on, and waiting for, the state to provide resources. The market reform is unfinished. We need to be mindful that public funds are yes, badly needed, but they do crowd out entrepreneurship and if improperly used, their net effect may easily turn out to be negative.

ESF 2007-13 interim payments, as % of the envelope in the country, by 30/11/2013



Data source: European Commission (http://ec.europa.eu/esf/BlobServlet?docId=249&langId=en).

Added to the above problems is the fact that many of the NMSs (new member states) lack administrative capacities to use the much-needed – and wasted – funds fully. If one looks at the table above, it reveals the paradox that the countries that need it most for their development are using it the least. And among the NMSs, the poorer and worse a country is governed the less it uses the funds proportionately – Romania being at the low end of the table. The less well-governed countries are also the ones that are the poorest, so the share of EU funds in their national budgets is relatively the largest.

From this the following conclusion needs to be drawn: the structural and cohesion funds were designed for situations of (relatively) good governance. With the accession of poorer and worse-governed Central and East European countries, the challenge has emerged to get the EU more involved in the way the funds are used. But not only is more involvement needed but also a better understanding of international development at the level of the European Union. These shortcomings surface in another way as well: while being by far the largest development donor, the EU is famously passive about the way it spends this money (often taking the position of an 'administrative redistributor' rather than a donor). The reason is similar: lack of proper understanding of what kind of aid investment is generating more economic growth *and* more social inclusion, less inequality. The current EU fund mechanisms thus are very suboptimal. In some cases, probably Poland being among the better ones, EU funds seem to be used at least to some extent to help to bridge the developmental gap. The EU sees itself as a redistributor of funds and in no way as 'donor' But the developmental challenge in most of the new member states is, unfortunately, too formidable to permit such a luxury.

Thus ideas for radical reform of EU funding are needed. One option is to move forward towards linking funding with policies (see 'ex-ante conditionalities' in the new legislation) and results ('performance framework'). EU funding could perhaps be best utilised if one part is used for decreasing government debt, and another part for introducing a limited number of significant policy reforms, e.g. linked to EU2020 targets. Partnership contracts between the EU and the member states could describe these policy reforms, and the mix of tools including legislation, institution-building, national and EU funding. First steps

towards such a reform could be taken already with unspent funds ('de-commitment') in the 2014-20 budget period.

The overall balance of the first 10 years then is positive but not as overwhelming as it should be. If countries have difficulty with democracy, surely they would have more if the EU's peer and institutional pressures were not in place. But even more normative pressure is needed. Likewise, the NMSs need more vigorous economic systems to close the developmental gap – and more clever use of public funds. In the meantime, the EU is also caught up in an existential crisis. Luckily, some of the reforms that the EU as a whole needs are also ones that the individual new members need: sharper market incentives on the one hand and more institutionalised solidarity on the other. Only if the EU – and its member states – are unburdened from some of the inertial spending and overregulation can they, on one hand, show more vigorous economic growth but also reallocate funds that increases cohesion such as more complete energy networks and that also increase social cohesion by targeting the needy better. Thus, the fate of the EU at large and its new members' successes are intimately linked. This is going to be the story of the second decade.