

# Cohesion Policy in an Ever Larger Union\*

*Frank Bollen*

*Lecturer, EIPA*

## **Introduction**

Cohesion policy has gradually been introduced into the set of Community activities and, since the Maastricht Treaty, strengthening economic and social cohesion, has formally been defined as one of the objectives of the European Union. However, achieving this objective has also become more difficult over time as the Union expanded. The forthcoming eastward expansion of the Union further complicates the issue since it will involve a large number of relatively poor and agricultural countries. In its 'Agenda 2000', published in July 1997, the European Commission presented, among other things, its proposals for reform of the cohesion policy in anticipation of the next enlargement.<sup>1</sup> The challenge facing the EU will be to make the cohesion policy more effective while budgetary means remain broadly unchanged and the number of beneficiary countries increases. All ingredients seem to be present for an extremely difficult political bargaining exercise starting this autumn. Interestingly, this bargaining will be conducted by current Member States only, even though it will certainly affect prospective new members.

It has to be stressed from the outset that the concept of 'economic and social cohesion' is rather vague and ill-defined in the literature. The Treaty on European Union refers in Article 130a to the aim of promoting an overall harmonious development, in particular through a reduction of 'disparities between the levels of development of the various regions and the backwardness of the least-favoured regions, including rural areas'. As argued below, economic and social cohesion is primarily a political target; the economic rationale behind the cohesion policy can be seriously questioned. Molle describes cohesion as 'the degree to which disparities in social and economic welfare between different regions or groups within the Community are politically and socially tolerable'.<sup>2</sup> Obviously, the internal market and several common policies (e.g. competition, environment, research and development, etc.) all have a direct or indirect impact on internal cohesion, and should therefore be taken into account when evaluating the overall cohesion situation. However, this is not the aim of this article, which will only assess the main cohesion instruments, the EU Structural Funds and the Cohesion Fund. Subsequently, the 'Agenda 2000' proposals on economic and social cohesion will be analysed in view

of the start of accession negotiations with Cyprus and at least some Central and Eastern European Countries (CEECs) in early 1998. It will be questioned whether the cohesion policy in an enlarged Union can remain an important facilitator of European integration.

## **Regional and social disparities in the EU: trends and causes**

In general, growth at EU level is an important facilitator for narrowing regional disparities in output and income. One could say that in times of overall economic prosperity the so-called 'catching-up process' of the relatively poorer countries seems to proceed more smoothly, while this apparently becomes more difficult during periods of economic slowdown. A second general trend is that this catching-up process is clearly a long-term development, which has particular implications for the time needed to bring the CEECs up to the level of the current poorest EU Member States. The particular situation of the CEECs will be considered below.

Looking first at the present four poorest EU countries, one notes that between 1983 and 1995 Greece, Spain, Ireland and Portugal made, on average, considerable improvements in their performance compared with that of the other Member States. The average per capita GDP of these 4 countries stood at 66% of the Community average in 1983 and rose to 74% by 1995. However, there are considerable differences in the progress made by these countries individually. Ireland recorded the highest growth and managed to reduce its gap to close to 90% of the EU average in 1995. Economic growth was also above Community average for Spain and Portugal, whereas the economic performance of Greece has been more modest, with average growth remaining clearly below the Community figure.<sup>3</sup>

The picture becomes more complicated when disparities at regional level are considered. Not surprisingly, the disparities across the Union then become much more pronounced and tend to show a centre-periphery pattern. The evolution at regional level has in fact been less promising. The gap between the richest and poorest regions in terms of GDP remained virtually stable over the period 1983-1993, while the unemployment gap has actually widened.<sup>4</sup>

One of the main challenges for the cohesion policy is not so much to identify disparities but rather to try to explain them and thereby determine their causes. A whole set of different but related factors all come into

\* Un bref résumé de cet article en français figure à la fin.

play, including physical infrastructure endowments (transport, energy, telecommunications), human resources (qualified workforce, training facilities), innovative capacities, research and development, etc. While the importance of innovation and industrial research is undoubted, Begg *et al.* noted that changes in these factors are much more difficult to achieve than in the upgrading of infrastructure.<sup>5</sup> Not surprisingly, in the past the emphasis of the EU regional policy was indeed on infrastructural developments. Only since the end of the 1980s have actions become more diversified, including more attention devoted to the development of human resources.

In any event, the very small budget allocated for cohesion policy severely limits the possibilities of conducting an effective policy. The entire EU budget represents currently less than 1.2% of its gross national product (GNP), with the so-called 'structural operations' taking up almost one third of that. The famous MacDougall Report published by the European Commission in 1977 anticipated that fiscal transfers from richer to poorer regions would play a central role in the EU once the integration process would approach Economic and Monetary Union (EMU). The report recommended that the Community budget should rise to 2-2.5% of Community GDP in the 'pre-federal stage' and to 5-7% of GDP when real political federation emerges.<sup>6</sup> Following the accession of Spain and Portugal in 1986 and the plans to establish the Internal Market, agreement was reached at the Brussels European Council in February 1988 on a major reform of the Structural Funds, including a doubling of the budget in real terms between 1987 and 1993.<sup>7</sup> However, despite the considerable budgetary increase that has subsequently occurred, the total size of the Structural Funds and the Cohesion Fund (created in 1993) remains very modest, representing at present less than 0.46% of the overall EU GNP.

### **Reforms of the Structural Funds in 1988 – Revision in 1993**

The Structural Fund reforms of 1988 undoubtedly constituted a major shift in the EU cohesion policy. Although the doubling of the funds may have to be nuanced (doubling from a low starting point), a number of key principles have been formalised or introduced which currently continue to govern the policy. One of the key principles was that the funding would be concentrated on a number of priority Objectives, of which Objective 1 became the most important as it addresses the problems of the less developed regions (i.e. those regions with a GDP per capita of less than 75% of the EU average). It was anticipated that around 80% of the European Regional Development Fund resources would go to the poorest regions. Objective 2 was targeted to regions suffering from industrial decline, and Objective 5b was devoted to rural areas. Secondly, instead of spending funds on small, individual and often overlapping projects, support would become more coordinated through the

introduction of multi-annual integrated programmes. Thirdly, the partnership principle called for all parties concerned (European Commission, national, regional and local authorities, etc.) to be involved in all programming stages. This resulted in some cases in direct communication channels being established between the Commission and the regional authorities, thereby bypassing the national level. Finally, a long-standing principle was retained, i.e. the additionality principle requiring that European funding should be in addition to funding from national or regional sources.

When the Structural Fund regulations were revised in 1993, some modifications were made in the definition of the Objectives, the programming procedures and the process of verifying Member States' compliance with the additionality principle. Prior to this, the Edinburgh European Council in December 1992 had agreed to a further budgetary increase for structural funding, particularly for the 4 poorest countries. Interestingly, when comparing the first programming period 1989-1993 and the current period 1994-1999, it can be seen that there has been a notable extension of area coverage of the Structural Funds, rising from 43.5% to 52.2% of total EU population (the population living in Objective 1 regions grew from 21.7% to 26.6%).<sup>8</sup> This increase has partly absorbed the additional resources made available to the Structural Funds, thereby keeping the average aid per capita in the EU roughly unchanged. This development seems to confirm that strong political bargaining took place at the time when the regulations had to be adopted and the eligibility criteria applied. It is generally recognised by the European Commission that the current distribution of funds limits the effectiveness of the cohesion policy.<sup>9</sup>

A second problem is that the procedures applied are overly complex and bureaucratic. In the current programming period, it became possible for regions to conclude a so-called 'Single Programming Document' aimed at shortening and simplifying the entire procedure. However, this change has not provided a comprehensive answer to the continuing problems encountered by operators when submitting and implementing programmes supported by the Structural Funds. Part of the problem rests at Member State level. In some cases, it apparently takes a long time before the European funds end up with the actual recipients at regional or local level.

Thirdly, a substantial amount of the available funds has, in reality, not (yet) been used or only with substantial delays. The rates of underutilisation of Structural Funds are indeed remarkably high.<sup>10</sup> The so-called absorption capacity of the Member States seems to be limited, which is partly due to the overall restrictive budgetary policies governments have adopted in recent years as a preparation for EMU.<sup>11</sup> However, in other cases Member States have also failed to develop suitable programmes or have encountered problems in the implementation phase which delayed fund spending.

Fourthly, the additionality principle continues to pose problems regarding the verification of Member States' usage of Structural Funds. Despite the 1993 revisions of the Structural Fund regulations, the Commission encounters considerable methodological difficulties when verifying that European funds have not been used by Member States to replace national funds.

Finally, Structural Fund spending has been inadequately controlled and has been the object of several fraud cases. The European Court of Auditors has repeatedly referred to this problem in its annual reports. This particular issue, together with the high underutilisation of funds, are likely to provide some Member States with strong arguments to oppose any substantial budgetary increase for the new programming period after 1999.

In view of the abovementioned shortcomings, there are good reasons to further reform the EU cohesion policy. The fact that a large group of countries from Central and Eastern Europe is waiting to join the EU only reinforces the pressure to undertake reforms. In fact, the prospect of eastern enlargement puts the entire issue in a completely different perspective. Some Member States currently regarded as relatively poor might find themselves in the opposite category following enlargement. This immediately raises a number of politically sensitive questions, in particular regarding the position of current cohesion countries towards the eastern enlargement.

Before looking further at the enlargement issue, however, one important point must be added here. Several authors analysing the EU cohesion policy on the basis of international relations theories have argued that the policy is (partly) based on the idea of side-payments or concessions made at regular intervals to some Member States in order to further the European integration process. As such, the design and subsequent evolution of the Structural Funds can be seen as facilitators of European integration; in particular, the creation of the ERDF in 1975 following the accession of the United Kingdom, Ireland and Denmark; the 1988 reforms which were clearly linked to the southern enlargement and the Internal Market programme; and finally, the creation of the Cohesion Fund in the Maastricht Treaty as a concession to the poorer countries to help them prepare for EMU. This is an important element, since it helps to explain exactly why the overall budget for the cohesion policy remains tiny. For the poorer countries, the Structural Funds relate to a substantial part of their GDP,<sup>12</sup> but nevertheless the cohesion policy does not seem able to significantly speed up the convergence process. Therefore, Allen argues that the 'EU economy could probably survive without the redistributive effect of the Structural Funds. But it is not clear that the EU system of governance could survive'.<sup>13</sup> In view of the eastern enlargement, it then becomes rather uncertain whether the Structural Funds could continue to operate as a sort of glue for further integration. Indeed, the

challenges linked to this enlargement seem to be of a rather different magnitude, making it doubtful whether past practices can be reapplied to digest this huge operation of eastern enlargement.

### **CEECs and the EU cohesion policy**

In 1995, the 10 applicant CEECs had a GDP per capita of 32% of the EU average, ranging from 18% for Latvia to 59% for Slovenia.<sup>14</sup> Under current rules, all applicants would immediately become eligible for Objective 1 assistance upon accession.<sup>15</sup> However, their accession would also result in a modest lowering of the average EU level, thereby possibly disqualifying some of the current Objective 1 beneficiaries. In any event, considering the low development level of the CEECs, the countries appear to need large amounts of money to accelerate their growth rates and raise their standards of living to a level comparable to the EU average.

For the applicant countries, the prospect of eventually receiving support from the Structural Funds undoubtedly constitutes one of their motivations for seeking membership. In 'Agenda 2000', however, the Commission clearly expresses doubts as to the administrative capacity of the new members to manage the Structural Funds and the Cohesion Fund. In all 10 opinions on the Central and Eastern European applicants, the Commission stresses the need for creating or improving adequate administrative structures in order to be able to effectively use and financially control the Structural Funds. In fact, the applicants do not have a tradition of conducting regional policies, since for the planned economies 'regional policy was essentially the outcome of national sectoral plans which were the basis of decisions on the locations of investment, production and settlement'.<sup>16</sup> Consequently, the regional administrative level was simply nonexistent in most of the countries. Only recently have steps been taken in some of the countries aimed at reforming the territorial administrative structures.

One of the major obstacles currently hindering the development of regional policies in the CEECs is obviously the lack of finances. This relates to one key question regarding where to place priority, i.e. whether to promote primarily national or regional development. In recent years, the Commission has encouraged the involvement of regional and local authorities in the EU cohesion policy. However, it is uncertain whether this approach can be equally applied to the poorer CEECs where regional administrations are only in the process of being established. In 'Agenda 2000', the European Commission argues, in fact, that the definition of geographical priorities is not necessary in the medium term considering the overall low development level and the small size of most of the applicant CEECs. Therefore, the Commission regards combating the increase in internal disparities as part of the overall aim of reducing the development gap between the applicants and the EU average.

### **Agenda 2000 proposals on economic and social cohesion**

The Commission's 'Agenda 2000' proposals for the new financial perspective suggest that the overall ceiling of the EU finances be maintained at 1.27% of the EU GNP in 2000-2006. The largest part of the expenditures would continue to be for the common agricultural policy (around 44%). Subsequently, the Commission stresses the great political importance it attaches to economic and social cohesion, even more so for the enlarged Union. Due to budgetary constraints, however, the Commission finds it impossible for the structural operations to go beyond the upper limit of 0.46% of GNP set for 1999. As a result, for the period 2000-2006 the Commission proposes that ECU 275 billion be made available for structural operations (around 37% of total EU expenditures), i.e.:

- ECU 230 billion for the current 15 Member States: i.e. ECU 210 billion for the Structural Funds, of which about two thirds would be earmarked for Objective 1 regions, and ECU 20 billion for the Cohesion Fund;
- ECU 45 billion for the new Member States, including pre-accession aid of ECU 7 billion from 2000 onwards and their eventual participation in programmes supported by the Structural Funds and the Cohesion Fund. The proposed financial perspective assumes that the first eastward enlargement would take place in 2002.

Not surprisingly, the general approach taken is one whereby support to current beneficiaries will be more concentrated, involving phasing-out arrangements for some regions and a gradual phasing in of the new Member States. In fact, the Commission proposes that total transfers from the Structural Funds and the Cohesion Fund to both present and future Member States be limited to 4% of their GDP, effectively putting an overall limit on available support.

In order to increase the effectiveness of the policy, it would be necessary to concentrate the financial means on a reduced number of Objectives, limit the coverage of the Structural Funds to 35%-40% of the total EU population, simplify the management procedures and improve the evaluation mechanisms. Compared with the current 7 Objectives, only 3 Objectives would be retained for the new programming period.

**Objective 1** would continue to receive the highest priority as it concerns the poorest regions, with the eligibility threshold remaining at less than 75% of the Community average in terms of per capita GDP. However, the proposals for several cases include a backdoor which would require deviating from these general criteria. As such, with respect to current beneficiaries which will exceed the threshold, transitional arrangements would be required to gradually phase out Community support to these regions; the outermost regions would be treated as Objective 1 regions on an *ad hoc* basis; and special

arrangements would have to be devised for the sparsely populated Nordic regions currently eligible under Objective 6. Although at this stage the Commission proposals do not provide many details on these possible deviations, they risk infringing the concentration principle.

The new **Objective 2**, concentrating on economic and social restructuring, would resemble parts of the present Objectives 2 and 5a. It would focus on economic diversification for certain areas, with the emphasis on support for small and medium-sized enterprises, innovation, vocational training, local development potential, environmental protection and urban issues.

For those regions not covered by Objectives 1 and 2, support would be available for the development of human resources under the new **Objective 3** aimed at helping Member States to adapt and modernise their systems of education, training and employment.

The Commission recommends that the Cohesion Fund be maintained, allowing the transfer of support to those Member States having a GNP per capita of less than 90% and helping them to prepare for EMU. The Commission now proposes that participants in the third phase of EMU which have a per capita GNP below the threshold should continue to receive assistance from the Cohesion Fund for at least another 3 years, provided they comply with the requirements of the Stability and Growth Pact.

### **Evaluation**

With 'Agenda 2000', the Commission has officially launched the debate on further reform of the EU cohesion policy. The prospect of poor and agricultural CEECs entering the Union has put additional pressure on the current Member States to undertake reforms. For the new 2000-2006 financing agreement, the Commission proposes some ECU 275 billion for 'structural operations', of which around 84% would be reserved for the current Member States. This contrasts sharply with the evidently high level of support the CEECs will need to close their development gap with the current EU members. In fact, the proposals anticipate only a very gradual participation of the CEECs in the cohesion policy. In 'Agenda 2000', the Commission has stressed its concerns about the administrative capacity of the applicant countries to manage the European funds. It is therefore of the utmost importance to convince the applicants that receiving European money should not be looked at as a main objective for becoming an EU member, but rather to encourage them to identify strategies regarding the manner in which eventual European financial support could be instrumental to their overall economic development.

In the meantime, current Member States will fight a tough battle, in the coming months, over the new Structural Fund regulations. The 'Agenda 2000' proposals do not envisage any major reforms in terms of priorities for the cohesion policy. The reduction from 7 to 3 Objectives seems merely a regrouping of

current Objectives, and as such it is uncertain whether this in itself would lead to more concentration of resources. If the idea is indeed to focus, for instance, on the poorest regions, then it remains to be seen how this can be reconciled with the absorption problems that some of the current beneficiary countries have encountered in recent years. In fact, more concentration would even imply increasing the level of support to the poorest regions.

Moreover, the new budget proposals for the cohesion policy seem to indicate that, in the future, financial resources will not be distributed among the Member States purely on the basis of 'objective' criteria but rather continue to be allocated as a result of political deals. The eastern enlargement will therefore be a good test case for understanding how Member States interpret the cohesion objective of the Treaty in practice.

## RÉSUMÉ

*Par la publication "Agenda 2000" en juillet 1997, la Commission européenne a voulu ouvrir un débat sur les réformes futures de la politique européenne de cohésion. Depuis le début des années quatre-vingt, la cohésion économique et sociale a acquis une importance politique et budgétaire grandissante au niveau européen. La politique de cohésion a permis au processus d'intégration européenne de réaliser des avancées, telles que le Marché intérieur et l'Union économique et monétaire.*

*Depuis les réformes des Fonds structurels en 1988, le but poursuivi était de concentrer les ressources sur un certain nombre d'Objectifs prioritaires. Dans la pratique, il s'est cependant avéré difficile de mettre en oeuvre ce principe-clé, dès lors que les Etats membres livraient une dure bataille au Conseil pour s'assurer leur part du budget, ce qui déboucha sur un éparpillement considérable des moyens financiers sur tout le territoire de l'UE.*

*Le destin de la politique de cohésion dans la perspective des élargissements prochains vers l'Est reste incertain. L'adhésion d'un grand nombre de pays agricoles relativement pauvres d'Europe centrale et orientale pose d'immenses défis à l'Union dans son ensemble et à la politique de cohésion en particulier. Les propositions que la Commission formule à cet égard dans "Agenda 2000" n'appellent pas de leurs vœux une réforme majeure de la politique de cohésion. En fait, les 3 Objectifs des activités des Fonds structurels qui seraient retenus semblent être un simple réemballage des 7 Objectifs actuels. L'accord de financement proposé pour la période 2000-2006 envisage uniquement une incorporation progressive de certains nouveaux membres, la plus grande partie du budget de cohésion restant attribuée aux Etats membres actuels. En tant que tel, l'objectif de cohésion ancré dans le Traité sur l'Union européenne semble s'appliquer avant tout aux Etats membres d'aujourd'hui.*

## NOTES

- <sup>1</sup> The European Commission's 'Agenda 2000' includes the Opinions on the 10 Central and East European applicants, as well as proposals on a new financing agreement (2000-2006) and further reform of the agricultural and cohesion policies. The Commission recommended opening accession negotiations initially with the Czech Republic, Estonia, Hungary, Poland and Slovenia, whereas negotiations with the other 5 applicants, Bulgaria, Latvia, Lithuania, Romania and Slovakia, should only be started once they fulfil the EU membership criteria.
- <sup>2</sup> Molle, W., 'Redistribution: Cohesion policies' in: *The economics of European integration. Theory, practice, policy*. Dartmouth, 1994, p. 421.
- <sup>3</sup> In 1995, the GDP per capita for Spain stood at 76.2% of the EU average, for Portugal at 68.4% and for Greece at 64.3% (European Commission, *First Report on Economic and Social Cohesion*, 1996, p. 133).
- <sup>4</sup> In 1993 the 10 best performing regions in the EU had a per capita GDP which was about 3.1 times higher than the 10 worst performing regions (similar to the 1983 ratio). In terms of unemployment, the rate of the 10 best performing regions was 5.1 times lower in 1983 than the 10 regions most hit by unemployment. By 1993 this ratio had grown to 6.8 (European Commission, *Ibid.*, p. 132).
- <sup>5</sup> Begg, I., Gudgin, G., Morris, D., 'The assessment: Regional policy in the European Union' in: *Regional Policy*. Oxford Review of Economic Policy, Volume 11, No. 2, 1995, p. 6.
- <sup>6</sup> MacKay, R., 'European integration and public finance. The political economy of regional support' in: Hardy, S. et al., *An enlarged Europe: Regions in competition?* London, Regional Studies Association, 1995, p. 160.
- <sup>7</sup> Prior to the 1988 reform, the main financial instrument for the cohesion policy was the European Regional Development Fund set up in 1975. The total Structural Funds (i.e. ERDF, plus the European Social Fund and the Guidance Section of the European Agricultural Guidance and Guarantee Fund) represented 4.8% of the Community budget in 1975, rising to 9.1% in 1987.
- <sup>8</sup> European Commission, *Ibid.*, p. 151.
- <sup>9</sup> European Commission, *Ibid.*, p. 117.
- <sup>10</sup> For the structural measures in 1995, 92% of the commitments of the definitive budget were implemented and 80% of the payments. Regarding the transitional measures, the rates of implementation are 41% (commitment appropriations) and 50% (payment appropriations). The rate of implementation for payments for the Community Initiatives is 58% (cf. Court of Auditors, *Annual Report on the Financial Year 1995*, OJ C 340, 12 November 1996, p. 124.)
- <sup>11</sup> According to the additionality principle, Member States have to co-finance programmes supported by the Structural Funds.
- <sup>12</sup> For the 1994-1999 period, the EU structural intervention expressed as a percentage of gross domestic product amounts to 3.98% for Portugal, 3.67% for Greece, 2.82% for Ireland, and 1.74% for Spain (European Commission, *Ibid.*, p. 144).
- <sup>13</sup> Allen, D., 'Cohesion and structural adjustment' in: Wallace, H. and Wallace, W., *Policy-making in the European Union*. Oxford University Press, 1996, p. 231;
- <sup>14</sup> European Commission, *Agenda 2000: Volume II: Reinforcing the pre-accession strategy*, p. 37.
- <sup>15</sup> The European Commission estimates that in an enlarged Union with 26 Member States, 60.9% of the total EU population would live in areas eligible for Structural Fund assistance (cf. Agenda 2000, Volume II, p. 39).
- <sup>16</sup> European Commission, *National and regional development in Central and Eastern Europe: Implications for EU structural assistance*. Economic Papers, Number 120, 1997, p. 5. □