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GABRIELE TONDL

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Experiences and Future Concerns

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Althanstraße 39 - 45, A - 1090 Wien / Vienna
Österreich / Austria
Tel.: ++43 / 1 / 31336 / 4135, 4134, 4133
Fax.: ++43 / 1 / 31336 / 758, 756
e-mail: europafragen@wu-wien.ac.at

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Für den Inhalt verantwortlich: Univ.-Prof. Dr. Stefan Griller,
Althanstraße 39—45, A—1090 Wien.

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Table of Contents

Abstract 4

I. Introduction 5

II. The arguments for EU regional policy 6

A. Regional income differences in the EU 6

B. The motivation of EU regional policy from the perspective of economic theory and political concerns 9

III. Policy priorities, financial contribution and institutional procedures of EU regional policy in the programme period 2000-2006 12

A. Policy Priorities 12

B. Financial allocation of Structural Funds to EU 15 member states 15

C. Pre-accession aid and the transfer of EU regional policy to new Eastern European members in the period 2000-2006 16

D. Institutional procedures 18

IV. Development problems and policy focus in Objective 1 regions and achievements 20

V. Objective 2 policies 29

VI. The future of EU regional policy 33

References 37

Bisher erschienene EI Working Papers 41

Bisher erschienene Bände der Schriftenreihe des Europainstituts 44

EU Regional Policy. Experiences and Future Concerns[1]

Gabriele Tondl

Europainstitut
Wirtschaftsuniversität Wien
Althanstrasse 39-45, A-1090 Wien, Austria
phone: 0043 1 31336 5566
e-mail: gabriele.tondl@wu-wien.ac.at

Abstract

The European Union´s regional policy has become one of its principal policy areas: It accounts for a major share of EU´s budget and is of essential interest for its beneficiaries, the Southern countries and the new EU members of 2004. Created with the ambition to reduce income differences between countries and regions in the EU, it did not only achieve success and thus has also repeatedly been criticised.

This paper wishes to present the most important facts of EU regional policy as it developed during the past two decades. It starts with the historical development and discusses the major theoretical arguments which motivate EU regional policy. Consequently, the policy priorities, the so-called „objectives", are presented and the financial contribution made by the Structural Funds to old and new members is shown. The experience in objective 1 areas: Ireland, Spain, Portugal, Greece, the Italian South and East Germany, are discussed in detail. A look at the variety of regional problems in objective 2 areas follows. The paper concludes with the main arguments involved in the present drafting stage of the future EU regional policy.

[1] A shorter version of this paper is published in Tondl, G., "EU Regional Policy", in: M.P. Van der Hoek (ed.), Handbook of Public Administration and Public Policy in the European Union, New York, Taylor & Francis, 2004.

I. Introduction

The European Union has set itself as one of its prior objectives to assure equal income standards and economic development between member states and regions. Under this goal the Union introduced in several steps the EU regional and cohesion policy, operated through the EU Structural Funds. In 1975, following the first enlargement, the main instrument of EU regional policy was established with the creation of the European Regional Development Fund (ERDF) which was meant to address the increased problem of regional imbalances. In 1986, a genuine common regional policy was created in the context of the Single Market project and enshrined in the Community treaties with the Single European Act. It was designed to meet the rising economic imbalances after the Southern enlargement and to assist the new members to offset the burdens of restructuring associated with the Single Market. The reform of the Structural Funds – the ERDF together with the European Social Fund (ESF) and the European Agricultural Guarantee and Guidance Fund (EAGGF) - in 1988, established the main policy guidelines of EU regional policy which are valid until today. In the 1990s, EU regional policy continued to gain in importance as it received the task to assist the less prosperous member states, the so-called cohesion countries, to meet the Maastricht convergence criteria while keeping economic development on track. The Cohesion Fund, intended to finance large-scale infrastructure was created and total financial resources of EU regional policy were raised to the double of the previous amount. After two generations of regional policy support programmes, Agenda 2000, which laid the policy foundations for EU regional policy for the period 2000-2006, established a substantial revision in order to streamline policy instruments and to improve its efficiency. Moreover, there was agreement between the member states to limit the financial scope of EU regional policy and keep its financial contribution made to the beneficiaries steady. With that, the principal financial scope of EU regional policy for the period after enlargement was laid down. The recent enlargement will bring a substantial reduction of regional policy aid for the old beneficiaries that are at the threshold of overcoming the development gap. The debate for a further policy reform necessary to accommodate the old and new members of the EU after 2006 is currently under way.

In the following sections we shall discuss the regional policy of the EU with respect to its objectives, its instruments, its impact on development and future prospects. Section II presents the arguments which are brought forward in the EU to justify regional policies. This is broadly speaking the concern for lasting regional imbalances and for the functioning of European economic integration. In section III, we shall present the policy priorities,

institutional procedures and financial contribution of EU regional policy. This will show that EU regional policies have made a significant contribution to economic development particularly in the cohesion countries but that their impact is also important in some richer member states. Section IV will focus on EU regional policy in Objective 1 areas and assess its contribution to development. Section V looks at Objective 2 policies. In section VI, we shall look at the current debate of how to reform regional policies for the next programme period after 2006.

II. The arguments for EU regional policy

A. Regional income differences in the EU

The essential argument for EU regional policy is the existence of large income disparities in the EU and the insight that a balanced economic development is a prerequisite for functioning economic integration, - both in economic as well as in political terms.

Today EU 15, i.e. the group of EU members before the 2004 enlargement, has no more than two member states, Portugal and Greece, which have a per capita income level of below the threshold of 75 per cent of EU 15 average income, which has been customarily used to indicate the less developed areas. Some ten years ago, Ireland and Spain belonged to that group of countries as well, while at present a substantial part of these two countries is already well above the threshold.

Nevertheless, there are still important income disparities in EU 15. While they have become less pronounced at the member state level, where most member states have an income position of above or below 10-20 per cent of the EU 15 average (see table 1), regional income disparities are still a reason of great concern. The most prosperous regions in EU 15, the centres of economic activity, laying on the well known "banana" that stretches from Northern Italy, Southern Germany to Brussels, Île de France and Southern England, have a per capita income of 120 to over 140 per cent of EU average.[2] Other dispersed centres, such as Vienna, Hamburg, Uusimaa and Stockholm have similarly high income levels. In contrast, there are large parts, particularly in the periphery of EU 15, that have an income level of about only 70 per cent. This group consists of the East German Länder, the North West and Centre of Spain, the Algarve in Portugal, the Athens area, as well as the Aegean Islands and Crete in Greece. A small group of regions remains with a per capita income of 61 to about 65 per cent of EU

[2] Note however that a number of old declining industrial areas are also found close to prosperous centres on the "banana", particularly in Rhein-Westphalia, Saarland, Liège, Namur, Lorraine (Rodríguez-Pose 1998).

average income. Here we find today the Southern Italian regions, the South of Spain and large parts of Portugal and Greece. In contrast, the capital areas of Madrid and Lisbon have reached average income levels. Table 1 shows that income disparities exist not only in the poorer member states but also in the richer ones.

There are some import changes over time within the group of less developed Community areas. The income gap of all cohesion countries has diminished since 1988. Among those, Ireland is an extreme example which – probably due to exceptional circumstances and a focused development strategy – saw an increase of its relative GDP per capita from 64 per cent in 1988 to 115 per cent in 2000. However, in Spain, Portugal and Greece the relative income steadily improved from 1988 to 2000: in Spain it rose from 72 per cent of EU average to 82 per cent, in Portugal from 59 to 68 per cent, and in Greece from 58 to 68 per cent. (European Commission 2002; 2003). In East Germany, due to a quick transformation process and substantial national support for development, per capita income rose from 37 per cent in 1991 to 69 per cent in 2000. Nevertheless, there are also less satisfactory developments. Particularly on the regional level, we see that catching-up is not uniform. In Southern Italy, relative income rose very modestly in the period under concern. The catching-up process of East Germany stagnates since 1997 and in Greece, the improvement in income position is only a recent development since the mid-1990s, after income had stagnated for almost one decade (see below section IV).

The European Union´s cohesion problem can be roughly summarized by the development in per capita incomes, although the problem of unequal welfare manifests in a number of other indicators as well, e.g. labour market indicators, the quality of public health and other social services and education (see European Commission 2001). It would be beyond the scope of this chapter to give a detailed description of social-economic developments in the EU regions.

Unfortunately, the issue of cohesion is about to become a continuing problem for the EU. With the accession of ten new members from Eastern Europe (Hungary, the Czech Republic, Slovakia, Slovenia, Poland, Estonia, Latvia, and Lithuania), Malta and Cyprus in 2004 income disparities became much more substantial in the EU than ever experienced before. A large part of the new members has a GDP per capita of less than 40 per cent of the EU-15 average (see table 1).

A large part of the economic integration literature claims that European integration helped to reduce income disparities, for which also some empirical evidence was found (e.g. Badinger 2002, Crespo-Cuaresma et al. 2002). However, there are also a number of counterarguments from integration and growth theory which propose that income convergence is not at all a

clear cut outcome of European integration. We shall discuss these arguments below in some detail. Drawing on the diverse conjectures from economic theory, EU policy makers found good reason to advocate a regional development policy of the EU. The significant amounts of resources that were spent by the Structural Funds hence force under this policy were significant enough to produce some positive effects on income development in the less developed Community areas (Roeger 1996, European Commission 2000a, ESRI 1997, Beutel 2002), although recently the effects of the Structural Funds on regional development are viewed more and more critically (see section VI).

Table 1: Income disparities in EU 15 and the new members: Relative GDP per capita 2000 (EU-15=100, PPS)

	GDP per capita	Regions with highest/ lowest income in country*	GDP per capita
EU 15 member states			
Luxemburg	195.3		
Denmark	118.6		
Ireland	115.2	Southern and Eastern	126.4
		Border, Midland & Western	83.8
Austria	114.3	Wien	157.0
		Südösterreich	95.9
Netherlands	111.2	West-Nederland	123.4
		Oost Nederland	94.3
Belgium	107.4	Bruxelles	227.9
		Vlaams Gewest	110.4
		Region Wallonne	83.3
Sweden	106.6	Stockholm	147.0
		Norra Mellansverige	91.0
Germany	106.4	Hamburg	181.5
		Hessen	129.4
		Bayern	124.0
		Baden-Würtemberg	122.0
		Sachsen	70.4
		Brandenburg	69.4
		Sachsen-Anhalt	68.4
Finland	104.0	Uusimaa	143.2
		Itä-Suomi	75.2
Italy	102.0	Lombardia	134.5
		Emilia Romagna	129.1
		Nord Est	120.6
		Sud	66.2
		Sicilia	65.4
		Campania	65.3

Table 1 (continued): Income disparities in EU 15 and the new members: Relative GDP per capita 2000 (EU-15=100, PPS)

	GDP per capita	Regions with highest/ lowest income in country*	GDP per capita
France	101.1	Île de France	158.3
		Centre-Est	100.0
		Est	90.9
		Bassin Parisien	90.1
		Méditerranée	86.0
United Kingdom	100.3	London	147.0
		South-East	110.6
		Eastern	103.9
		Wales	80.6
		Northern Ireland	77.8
		North-East	77.4
Spain	82.2	Madrid	110.0
		Noreste	97.4
		Noroeste	68.1
		Centro	68.2
		Sur	62.3
Portugal	68.0	Lisboa	90.9
		Algarve	66.0
		Centro	54.2
Greece	67.7	Attiki	77.1
		Nisia Aigaiou, Kriti	69.7
		Kentriki Ellada	59.1
New member states			
Cyprus	75.7		
Slovenia	67.2		
Czech Republic	56.2	Praha	121.0
		Jihozápad	52.4
		Stredni Morava	46.6
Malta	55.1		
Hungary	49.7	Közép-Magyarország	75.6
		Nyugat-Dunántúl	56.6
		Eszak-Alföld	31.5
Slovakia	45.9	Bratislavsky	97.9
		Vychodné Slovensko	35.5
Estonia	40.1		
Poland	38.9	Mazowieckie	58.9
		Slaskie	42.8
		Podlaskie	28.9
		Podkarpackie	27.6
Lithuania	35.7		
Latvia	30.9		

Note: * This column intends to show the extent of internal income disparities in the member states. Hence the NUTS I level aggregation is used instead of NUT II if a larger part of the country has similar income levels. Data source: European Commission 2003.

B. The motivation of EU regional policy from the perspective of economic theory and political concerns

Let us now discuss the main arguments which are put forward to justify EU regional policy. First of all we have to note that the primary reason behind this policy is a political one. The European Community has set itself the objective of equal standards of living within the European Union (Article 2 EU Treaty) and the existence of income disparities clearly conflicts with this goal. Therefore, assuring equality is one of the primary arguments underlying EU´s regional policy (Article 158 EU Treaty). At the same time, the EU wishes to portray itself as an institution that is characterized by solidarity between its members. Therefore, it has established a regional development policy that follows the principle of redistribution between rich and poor member states.

There are also very important arguments coming from economic integration theory and growth theory which can be used to justify EU regional policy.

First, let us look at European integration in the sense that it established a common market with the Single Market Programme 1992. Integration theory offers two major approaches to draw conclusions about the impact on income convergence. In the sense of the classical trade theory and the customs union theory (Viner 1950), market integration would lead to better allocation of resources and specialization which would benefit all partners, although not necessarily to the same extent. Also does specialization require restructuring which can be a heavy temporal burden. New trade theory in contrast, assuming monopolistic competition and innovation based on product differentiation, suggests that rich countries are likely to draw more benefits from integration. Thus from the perspective of trade theory, poor EU members may not be able to improve their income position vis-à-vis rich members. The New Economic Geography literature (Krugman 1991) also suggests that the rich core in the EU would first gain more from integration than the periphery due to agglomeration advantages. This pattern will only be reversed with very low trade barriers and a cost advantage of the periphery that balances for the agglomeration advantage of the core. Finally, growth theory also provides no explicit argument for income convergence. From the perspective of neoclassical growth theory (Solow 1956, Barro and Sala-i-Martin 1995), income convergence is an automatic process if technology is free and capital mobile due to higher rents in poor regions. New growth theory (Romer 1990, Aghion/Howitt 1992), in contrast, argues that rich regions can enjoy a continuous growth bonus through the generation of technological advance which is based on their better human capital endowment. In summary, therefore, neither trade theory nor growth theory offer an explicit convergence argument. It is rather the case that market

integration may in the short term lead to particular adjustment difficulties in poor regions and that long term gains can only be reached from improvements in location factors (education, infrastructures). This consideration led the European Union to create and shape EU regional policy.

From a political perspective, the creation of EU regional policy was a delicate power struggle between the rich EU members and the poorer Mediterranean countries, Greece, Spain and Portugal. They requested a redistributive policy that would balance them for potential losses from the Single Market Programme. The EU should step in to assist them to alleviate adjustment problems and improve their competitiveness through public investments (Bache 1998). This need, to achieve a balance of power between rich and poor EU members, was repeatedly felt in successive stages of the development of EU regional policy.

The creation of EU regional policy and EU integration can also be viewed from another field of economic theory, namely political economy. In this set up, integration is considered to be a public good, but that the different players, rich and poor members, have different policy goals if their economic development is different. In this context, development support of EU regional policy is meant to contribute to the formation of more homogenous policy interests which are a prerequisite to develop the common good "economic integration", in other words to keep the process of economic integration on the move. For illustration, one may consider the case of common EU trade policy, where negotiation positions of member states may differ a lot under very different economic structures. Or, consider the case of macro-economic policy coordination, – an increasingly important element of economic and monetary union. This stage of economic integration is hardly feasible with highly opposed policy requirements as they would prevail with different economic development.

Furthermore, the case for EU regional policy received yet another series of economic arguments in the light of the creation of the European monetary union (EMU) where different economic developments would mean that these economies would not form an optimum currency area (Mundell 1961), which could severely endanger its functioning. Income differences between members of a monetary union are associated with different product specialization which causes asymmetric shocks. This leads to different growth and desynchronized business cycles (Bayoumi and Eichengreen 1993, Artis and Zhang 2001). Consequently, the common monetary policy becomes problematic for the members affected by an asymmetric shock. Therefore, the Delors report which designed the monetary union project also foresaw the strengthening of EU regional policy to accelerate economic development and thus to reduce the potential for asymmetric shocks. Consequently, the

Delors II package, enforcing regional policy support, was agreed together with the Maastricht Treaty of 1993 that established monetary union. In political terms, the Delors II package can also be viewed as a compensation to the poorer member states for the extraordinary efforts they had to make to meet the Maastricht fiscal deficit criteria to enter EMU.

Another argument for EU regional policy arises from the potential of migration under unequal development and the constraints of national social policies in the recipient countries. Richer member states have been fearing scenarios of massive immigration from poorer EU members possible under the right of free movement of workers between EU member states. To prevent this scenario, EU policy makers supported the idea of a common regional policy that should help to initiate the development of backward areas and thus to eliminate the pressure of emigration. This argument was first raised with the Southern enlargement and becomes once more relevant in view of potential major migration from new Eastern members.

Finally, in terms of the associated demand effects, EU policy makers like to emphasize that EU regional policy not only benefits the recipient countries of the Structural Funds, but also the net payers of this policy through imports associated with the development programmes. A considerable share of investments generated in the context of these programmes consists of capital goods produced in the rich member states. In smaller member states like Portugal and Greece, up to 40 per cent of the investment funded by the Structural Funds goes to imports from richer member states (Hall 2003).

In summary, we can state that the European Union has created its regional policy out of the concern that economic theory provides an ambiguous perspective for income convergence and that unequal development endangers the project of European integration. Regional policy set itself the goal to assist development in the poorer EU members and thus to strengthen cohesion. This goal has been reached to some extent, but there are also increasingly critical voices which claim that EU regional policy has not fulfilled its goal but would be nothing else than a central redistribution mechanism which provides income support to less wealthy regions.

III. Policy priorities, financial contribution and institutional procedures of EU regional policy in the programme period 2000-2006

A. Policy Priorities

Since the creation of EU regional policy in the Single European Act and its implementation by the reform of the Structural Funds, regional policy focuses on the least developed areas of the Union and follows a set of policy priorities.

Those policy priorities are the well-known "Objectives" of EU regional policy: Objective 1, Objective 2 and Objective 3. Each of them addresses a specific policy priority.

Under *Objective 1*, EU regional policy wishes to promote the development and structural adjustment of regions whose development is "lagging behind". The beneficiaries of this policy priority are the poor, weakly developed parts of the European Union with a GDP per capita below the threshold of 75 per cent of average EU income. The Community areas classified as Objective 1 areas in the programme period 2000-2006 include Southern Italy, the Midlands and Border Region in Ireland, Portugal (except for its capital area) and the major part of Spain, as well as Greece and Eastern Germany. As a consequence of catching-up, a number of regions are being phased out in this period from Objective 1 status, e.g. the Mid-East and Mid-West region in Ireland, the Highlands in Scotland, or Corsica and Lisbon. Thus Objective 1 areas are generally large territories and traditionally have coincided with member states. (Note that for the poor member states, Portugal, Spain, Greece and Ireland, largely having consisted of Objective 1 areas, also the term cohesion countries is used since they are entitled to transfers from the Cohesion Fund; see below.) There are however, also a few, smaller regions in richer member states with Objective 1 status such as West Wales, Cornwall, Merseyside and South Yorkshire in the UK, the Burgenland in Austria, Hainaut in Belgium and Flevoland in the Netherlands. Finally, two large territories of the EU, the thinly populated areas of Sweden and Finland (less than 8 inhabitants per square meter) are assisted under Objective 1, although there is no development problem in the strict sense (given their unfavourable natural location there is no perspective of a broad economic development). Objective 1 areas are generally defined at the NUTS II level, the medium aggregation level of the EU´s regional classification.[3]

For Objective 1 areas, almost 70 per cent of the Structural Funds, i.e. 135 billion Euro, are reserved for development assistance in the period 2000-2006. 22 per cent of the EU 15´s population lives in Objective 1 areas. EU regional policy supports economic development in the Objective 1 areas by funding infrastructure investment, encourage business investment and promote training of students and workforce.

In addition to the support through Objective 1 policies, the weakest member states receive support from the so called *cohesion fund* to finance large scale infrastructures in the transport

[3] NUTS II corresponds to traditional administrative regional units, such as the Regierungsbezirke in Germany, the Régions in France, the Comunidades Autónomas in Spain and the Bundesländer in Austria, etc. The next, less aggregated regional level is NUTS III.

and environment sector. The cohesion fund was conceived in 1993 to provide additional funds for public investment in order to counterbalance the cuts in budgetary spending requested by the Maastricht convergence criteria to enter monetary union. It was meant to permit the beneficiaries, the cohesion countries, to continue important projects for economic development while consolidating their budgets. The cohesion countries were defined as countries with a GDP per capita of less than 90 per cent of EU average and originally included four countries in 1993: Spain, Portugal, Greece and Ireland (phasing out). In the programme period 2000-2006, the cohesion countries receive 18 billion Euro from the cohesion fund.

Under its policy priority *Objective 2*, EU regional policy wishes to support economic and social conversion in small industrial, rural, urban or fisheries dependent areas in the richer member states, which face structural difficulties. Although an important share of the EU 15 population, namely 18 per cent, lives in Objective 2 areas, support for Objective 2 areas is much less significant than in Objective 1 regions. Only 11.5 per cent of the Structural Funds are reserved for Objective 2 policies in the programme period 2000-2006. There are particularly many Objective 2 areas in the United Kingdom, France, Spain, Italy, Finland and Austria.

Under Objective 2 a diversity of various regional problems is addressed. First Objective 2 includes industrial conversion areas. They are defined as NUTS III level regions where the unemployment rate is above the Community average and the employment share in the industrial sector is higher than the Community average. Second, Objective 2 covers rural areas with regional problems. Those are NUTS III level regions with a low population density or a decline in population as well as high agricultural employment share and unemployment above the Community average. Third, Objective 2 covers urban areas with social problems, such as an above average long-term unemployment level, high levels of poverty or crime rates, low education levels, or environmental problems. Finally, Objective 2 covers areas that are dependent on fisheries and suffer a decline in employment in this sector.

Under the third policy priority, Objective 3, EU regional policy contributes to active labour market policies outside Objective 1 areas. It co-finances training schemes to upgrade and modernize professional skills in order to fight structural unemployment, youth and long term unemployment. Objective 3 is a thematic policy, it is not constrained to certain territories. 12.3 per cent of EU regional policy funding is conferred to Objective 3 measures in 2000-2006.

In addition to priority objectives, EU regional policy has established a number of small scale policy areas, the *Community initiatives,* the *fisheries* measures, and the *innovative actions.* The Community initiatives address regional problems that are common to the member states and that can be dealt more effectively at the Community level. In 2000-2006, Community initiatives include Interreg III, Urban II, Leader+ and Equal. *Interreg III* aims to promote cross border cooperation between internal and external EU border regions to foster a balanced territorial development at the super-regional transborder level. The common planning of transport infrastructure of border regions from two member states would be a typical activity envisaged by Interreg. Urban II aims to revitalize city areas suffering an economic downturn, e.g. North Belfast or Berlin Kreuzberg. *Leader+* addresses rural areas and aims to promote their sustainable development by supporting local activities and projects. *Equal* aims to combat discrimination of sex or race in the labour market. In the previous EU regional policy programme periods, the number of Community initiatives was much larger, most of them aiming to promote specific industries hit by crisis. In order to streamline policies and abandon minor scale measures, the number of Community initiatives was cut for 2000-2006. In the current programme period, Community initiatives receive 5.3 per cent of the Structural Funds budget. In addition to the Community initiatives, the EU targets the specific problems of regions depending on *fisheries*, particularly in the Objective 1 areas, by specific EU regional policy measures. Finally, with *Innovative actions* the EU supports the planning and design of projects of an innovative strategic character related to innovation, communication and local cultural identity.

B. Financial allocation of Structural Funds to EU 15 member states

The financial allocation of the Structural Funds and the Cohesion fund on policy priorities and the EU 15 member states, as foreseen in the Agenda 2000, is shown in table 2. We see that the largest share of EU regional support, 50 per cent, goes to the cohesion countries. Spain by far receives the highest share of EU regional policy support, 26.5 per cent. It is followed by Germany and Italy, which both have large Objective 1 areas, with 14 per cent of the allocations each. Portugal and Greece receive about 10 per cent each of the regional policy budget, Ireland now only about 2 per cent since it is partly phasing out Objective 1 support. Except for the UK and France, which have a number of Objective 1 and Objective 2 territories and thus also a higher share in EU support of about 7 per cent, all other wealthy member states receive no remarkable share of the EU regional policy budget. In terms of GDP, the contribution from the Structural Funds reaches 2.4 per cent in Greece, 2 per cent in Portugal,

1.2 per cent in Spain, but only 0.6 per cent in Ireland. The contribution has decreased to a certain extent with respect to the previous programming period, as regional policy support for old member states was curtailed with Agenda 2000 to free resources for pre-accession aid to prospective members from Eastern Europe. In the richer member states, the contribution of EU regional policy accounts for 0.23 per cent in Italy and 0.35 per cent in Germany. In practically all others, the contribution remains below 0.2 per cent of GDP.

Table 2: Regional policy transfers to EU 15 member states 2000-2006 by priority objectives

	Structural Funds & Cohesion Fund 2000-2006 total mil. Euro	average annual contribut. 2000-2006 in per cent of GDP 1999	average annual contrib. 1994-99 in per cent of GDP 1994	Objective 1*	Objective 2*	Objective 3	Fisheries Instrument	Community Initiatives	Cohesion Fund	share of member state in receipts
						mil. Euro				
rich EU members:										
Belgium	2037	0.12	0.15	625	433	737	34	209	-	0.9
Denmark	825	0.09	0.14	0	183	365	197	80	-	0.4
Germany	29764	0.23	0.24	19958	3510	4581	107	1608	-	14.0
France	15666	0.18	0.23	3805	6050	4540	225	1046	-	7.4
Italy	29656	0.35	0.36	22122	522	3744	96	1172	-	14.0
Luxemburg	91	0.07	0.15	0	40	38	0	13	-	0.1
N/lands	3286	0.12	0.15	123	795	1686	31	651	-	1.5
Austria	1831	0.14	0.15	261	680	528	4	358	-	0.9
Finland	2090	0.27	0.30	913	489	403	31	254	-	1.0
Sweden	2186	0.16	0.13	722	406	720	60	278	-	1.0
United Kingdom	16596	0.18	0.21	6251	4695	4568	121	961	-	7.8
cohesion countries:										
Ireland	3974	0.64	2.53	3088	-	-	-	166	720	1.9
Spain	56205	1.18	1.62	38046	2651	2140	200	2008	11160	26.5
Portugal	22760	2.04	3.87	19029	-	-	-	671	3060	10.7
Greece	24883	2.38	3.34	20961	-	-	-	862	3060	11.7
total	211850			54780	17803	21910	906	6630	18000	100.0

Source: Data from Eurostat, European Commission DG 16 and own calculations. * includes transitory assistance.

C. Pre-accession aid and the transfer of EU regional policy to new Eastern European members in the period 2000-2006

In order to assist the Eastern European candidate countries in catching-up, the European Union has already begun to provide financial assistance for restructuring and development. The central instrument, the *Phare* programme, was already established in 1989. Originally intended to support new investment in business and infrastructure and social measures, it has now shifted its focus to the improvement of institutions, administrations and public bodies in order to apply Community law correctly, not least with a view to the implementation of the

future EU regional policy programmes after accession. The second programme, *SAPARD*, started in 2000 and was designed to prepare the accession countries to join the Common Agricultural Policy. It supports the modernization of agricultural structures, the introduction of EU foodstuff quality standards, the development of rural areas and protection of environment. The third programme, *ISPA*, also initiated in 2000, corresponds to the cohesion fund and aims to co-finance large scale infrastructure projects in the transport and environment sectors. In total, Agenda 2000 envisaged a pre-accession aid to the Eastern candidate countries of almost 22 billion Euro for the period 2000-2006, slightly more than the cohesion fund budget for the EU cohesion countries. In addition, some 40 billion Euro were reserved for structural expenditures for the accession countries for the post accession period 2004-2006.

The accession negotiations, completed with the ten candidate countries (Hungary, Czech Republic, Slovakia, Slovenia, Poland, Estonia, Latvia, Lithuania, Malta and Cyprus) in December 2002 at the Copenhagen European Council, fixed the framework for extending EU regional policies to the new member states from their accession in 2004 until the end of the current programme period. The new members are eligible for Objective 1 policies with the exception of a few areas, namely Prague, Bratislava and Cyprus. They will receive 24 billion Euro (at 2004 prices) for their first EU regional policy programmes from the Structural Funds and the cohesion fund starting after accession, which means a support of 117 Euro per capita. Since a part of the reserved resources in the EU budget for new member states was reallocated to CAP measures in these countries, this is less than originally foreseen by Agenda 2000. EU regional policies are gradually extended to the new members with a lower support level than that of present Objective 1 areas, accounting for 217 Euro per person. (European Commission 2003)

Table 3 shows that Poland will receive the lion´s share of EU support for this programme period. In terms of GDP, however, the contribution will be highest in the Baltic republics with 2-3 per cent of GDP. Hungary, Poland and Slovakia will receive a support of about 1.4-1.8 per cent of GDP, while that of the wealthier Czech Republic, Slovenia, Malta and Cyprus will remain below 1 per cent. After becoming fully applicable for EU regional policies after 2006, support can be expected to rise to higher levels, despite being restricted by the 4 per cent of GDP maximum support level stipulated in Agenda 2000.

Table 3: Commitments of the Structural Funds (SF) and Cohesion Fund for EU regional policies in the new members 2004-2006, in million Euro, 1999 prices

	Objective 1	Objective 2	Objective 3	Community initiatives	total Structural Funds	avg.annual contribution SF in per cent of GDP	Cohesion Fund
Hungary	1765.4			87.7	1853.1	1.40	879-1108
Czech Rep.	1286.4	63.3	52.2	89.3	1492.2	0.96	741-932
Slovakia	920.9	33.0	39.9	56.5	1050.3	1.85	433-586
Poland	7320.7			314.6	7635.3	1.74	3465-4002
Slovenia	210.1			26.7	236.8	0.41	130-207
Estonia	328.6			13.0	341.6	2.30	219-333
Latvia	554.2			20.6	574.8	3.10	384-537
Lithuania	792.1			30.4	822.5	2.74	467-620
Malta	55.9			3.2	59.1	0.57	12-27
Cyprus		24.9	19.5	5.4	49.8	0.19	32- 63
total	***13234.3***	***121.2***	***111.6***	***647.4***	***14114.5***	***1.52***	***7595.5***

Source: own calculations based on European Commission 2003, Eurostat.

D. Institutional procedures

In the following section, the most important *institutional procedures* of EU regional policy are described. The major decisions on EU regional policy preceding a new programme period are a politically highly delicate issue. On the one hand decision making has to face the Union´s cohesion problem and the request of the poorer EU members for EU development support. On the other hand, this policy is very costly and uses a major share of the EU budget. Therefore, decision making needs to be sensitive to the interest of the policy´s paymasters. Consequently, the central decisions on EU regional policy are taken at the top political level, the meetings of the European Council. For the policy period 2000-2006, the major decisions were taken at the 1999 Berlin summit in Agenda 2000. It settled the financial framework of the EU for 2000-2006 in general and laid down the major policy guidelines for EU regional policy. They include the map of Objective 1 areas, the Structural Funds shares reserved for countries with Objective 1 areas, the policy priorities (e.g. Objectives1-3 for 2000-2006) and the population ceilings relevant for subsequent decisions on assisted areas. Given the far reaching impact of these decisions and the need for consensus between the member states, elaboration of the draft regulations and negotiations would already have to start more than two years in advance of a new programme period.

At the same time, member states begin to make their lists of Objective 2 areas. Member states have to present the concerned region´s problems with the aid of socio-economic indicators

which will then be the basis for negotiations with the Commission. Finally, the Commission adopts the list of regions eligible for Objective 2 support. Since Objective 2 regions are usually small areas, often only parts of NUTS III regions, the list contains a large number of territories.

In a next stage, member states elaborate the programme documents for their Objective 1 and Objective 2 regions which are then submitted to the European Commission and adopted after discussion and possible amendments. The key documents for Objective 1 policies are the Community Support Framework Programmes (CSF) for each country with major Objective 1 areas. It consists of multiregional, thematic operational programmes (OP) and regional operational programmes. For Objective 2 policies, Single Programming Documents (SPD) on the NUTS II administrative level contain the development programmes for all Objective 2 regions in the territory.

The planning of EU regional development programmes follows the partnership principle, i.e. cooperation of the regional and national administrations and the Commission. Regional authorities are meant to play a major part in problem formulation and proposition of regional development strategies and measures. Member states perform a coordination function on the national level.

Regional development programmes are run under the central responsibility of a managing authority and a financial authority, usually at the regional level. They are responsible for the correct implementation and financial management in compliance with Community regulation. Actual programme implementation and project selection may be delegated further to special agencies and institutions, such as those responsible for special business aid schemes.

With the present programme period, specific payment criteria were introduced in order to improve project performance and prevent misuse of funds. First, member states receive only an advance payment of 7 per cent of the commitment to development programmes when the programme is adopted. Further payments are only made upon presentation of certificates of actual expenditures. If programmes fail to advance within 2 years after adoption, the advance payment needs to be refunded. Second, there is now a performance reserve amounting to 4 per cent of the commitment for a member state. In 2003, this reserve is allocated to those programmes of the member state which are most effective in implementation and use of funds.

Finally, we have to note that EU regional programmes involve a great deal of monitoring activities. Monitoring committees are composed of central government officials and

representatives of the Commission. They monitor programmes on the basis of regular implementation reports of the management and payments authorities. Programme evaluations, that need to take place *ex-ante* and at mid-term by independent institutions (consultancies, research institutes) according to EU policy guidelines, provide the framework for monitoring and corrective measures. Finally, *ex-post* evaluations, performed after the completion of the programme, inform the European public on the effect of regional policies.

IV. Development problems and policy focus in Objective 1 regions and achievements

In the following section we shall look more closely at the Objective 1 policy of EU 15. Table 4 contains the list of Objective 1 regions in EU 15 which have had that status during the 1990s and traces their income position and unemployment.

At the beginning of the 1990s, we can distinguish between different groups of Objective 1 regions:

First, there was a group of wealthier Objective 1 areas with a GDP per capita of above 70 per cent of EU average, comprising Ireland, the Italian Mezzogiorno, Spanish Objective 1 regions, those of the UK, as well as Corsica and the two small Objective 1 regions Hainaut and Flevoland. (Note that EU average refers to EU 15 including East Germany, in order to permit to trace the development of the income position over the 1990s. The inclusion of East Germany reduces the average income level so that some areas pass the 75 per cent threshold in 1991. If using the EU average without East Germany, - which underlies the classification -, they would not). Despite a relatively well developed income situation, those Objective 1 areas face serious unemployment problems in the early 1990s with unemployment rates of 12 per cent in the UK, about 15 per cent in Ireland and Italy and more than 18 per cent in Spain.

Second, there were the Objective 1 areas in the two poorer cohesion countries, Greece and Portugal, which showed a relative per capita income of 61 and 65 per cent of EU average respectively. In general, their unemployment situation was much less of a concern than with the first group. Unemployment reached 3.6 per cent in Portugal and 6.9 per cent in Greece in 1991. A few regions of these countries were already better developed, e.g. the Athens and Lisbon areas and the tourist sites of Crete, the Southern Aegean Islands, and the Algarve.

Third, the new German Länder had received Objective 1 status after German unification and constituted the least developed parts of the EU in Europe in 1991, with a GDP per capita of barely 40 per cent of EU average. Nevertheless, their unemployment levels were still not much above the EU average, amounting to 10 per cent.

Table 4: Development of relative income, growth and unemployment in Objective 1 regions in the 1990s

	GDP per capita (in PPS, EU-15=100)			real growth of GDP 1991-2000	unemployment rate	
	1991	**1993**	**2000**		**1991**	**2000**
East Germany (excl. Berlin)	***38***	***55***	***69***	***5.6***	***9.9***	***15.3***
Berlin		73	96	4.2	9.7	13.0
Brandenburg	41	59	69	5.8	9.1	14.7
Mecklenburg-Vorpomm.	39	53	69	5.5	12.0	15.3
Sachsen	38	54	70	5.6	8.6	15.0
Sachsen-Anhalt	38	55	68	4.9	9.9	18.0
Thüringen	34	53	70	6.5	9.9	13.4
Greece	***61***	***64***	***68***	***1.7***	***6.9***	***11.1***
Anatoliki Makedonia, Thraki	56	57	55	1.4	4.8	8.6
Kentriki Makedonia	60	64	68	2.1	5.5	10.7
Dytiki Makedonia	63	60	67	0.2	7.2	14.7
Thessalia	59	58	61	1.2	6.2	12.4
Ipeiros	42	43	47	1.7	8.8	10.6
Ionia Nisia	56	59	59	2.3	3.5	5.1
Dytiki Ellada	52	55	51	1.7	7.8	10.2
Sterea Ellada	71	66	76	0.9	6.3	13.6
Peloponnisos	58	57	58	1.1	5.0	9.3
Attiki	65	72	77	2.3	8.9	12.2
Voreio Aigaio	45	48	66	1.9	7.9	7.4
Notio Aigaio	69	73	80	2.6	3.2	10.5
Kriti	65	68	66	2.1	3.6	6.7
Spain Objective 1	***71***	***69***	***70***	***2.1***	***18.8***	***17.1***
Galicia	62	62	65	2.0	12.3	15.0
Asturias	75	74	71	1.2	16.1	17.9
Cantabria	79	76	80	1.7	15.4	14.2
Castilla y León	71	74	76	1.9	14.5	14.1
Castilla-la Mancha	68	67	67	2.1	13.6	12.7
Extremadura	54	56	53	2.5	24.2	24.8
Comunidad Valenciana	82	76	79	2.2	15.2	11.9
Andalucia	62	58	61	2.0	24.7	25.3
Murcia	76	70	69	1.5	16.5	12.0
Ceuta y Melilla	70	69	68	3.3	29.7	25.5
Canarias	77	76	78	3.1	24.4	14.5
France DOM	***-***	***48***	***57***	***-***	***31.0***	***27.2***
Guadeloupe	-	41	58	-	31.1	26.1
Martinique	-	54	67	-	32.1	27.7
French Guyana	-	51	54	-	24.0	22.0
Réunion	-	47	50	-	36.9	33.1
Ireland	***78***	***83***	***115***	***6.7***	***14.6***	***4.4***
Border, Midland & Western	-	-	84	6.0	-	5.8
Southern & Eastern	-	-	126	7.4	-	3.9

Table 4 cont.

	GDP per capita (in PPS, EU-15=100)			real growth of GDP 1991-2000	unemployment rate	
	1991	1993	2000		1991	2000
Italy Objective 1	***75***	***72***	***71***	***1.3***	***15.2***	***19.0***
Abruzzo	93	87	84	1.1	8.0	7.6
Molise	79	75	79	1.3	12.8	13.6
Campania	71	68	65	0.6	17.8	23.6
Puglia	75	70	67	1.1	13.2	17.6
Basilicata	65	66	73	1.9	17.0	17.4
Calabria	62	60	62	1.5	18.6	27.7
Sicilia	72	69	65	1.1	18.7	24.2
Sardegna	79	78	76	1.4	15.7	20.5
Portugal	***65***	***68***	***68***	***2.2***	***3.6***	***4.1***
Norte	56	60	56	3.0	2.7	4.1
Centro	51	55	54	3.1	2.3	1.8
Lisboa and Vale do Tejo	85	87	91	2.1	4.4	5.4
Alentejo	53	54	54	1.2	9.1	5.7
Algarve	68	71	66	2.4	3.9	3.3
Açores	46	49	52	0.9	3.7	3.4
Madeira	47	51	74	2.6	3.0	2.3
UK Objective 1	***73***	***76***	***72***	***1.7***	***12.1***	***7.7***
Merseyside	73	75	70	1.1	14.9	11.2
South Yorkshire	76	-	75	1.4	11.6	8.1
West Wales and The Valleys	-	70	71	0.9	-	7.4
Cornwall & Isles of Scilly	67	-	65	3.0	9.8	7.1
Highlands and Islands	-	81	75	1.3	8.3	4.1
Northern Ireland	78	80	78	2.8	16.0	8.2
others						
Corsica	88	84	76	2.3	11.3	12.5
Flevoland	77	75	80	5.1	5.7	4.0
Burgenland	66	72	73	2.7	3.1	3.6
Hainaut	79	84	71	1.4	10.7	13.1
EU-15	**100**	**100**	**100**	**2.2**	**8.2**	**8.4**

Source: own calculations based on Eurostat Regio database; Cambridge Econometrics, regional database; European Commission (2000b, 2001, 2002, 2003).

Fourth, the French overseas departments (DOM) and the Portuguese islands Madeira and Azores were the least developed Community areas before German unification, with a relative GDP per capita of 45 per cent of EU average. These French departments faced a serious unemployment situation with unemployment rates of about 30 per cent.

The structural economic weaknesses of the Objective 1 areas were well known when the European Union started to launch the major development initiative for these regions after the reform of the Structural Funds in 1988 (EC Commission 1991, Tondl 1998, Tondl 2001):

- Most regions, - except for the new German Länder, UK, Belgian and Dutch Objective 1 regions -, had a high agricultural employment share of above 10 per cent, with many Greek regions even 20 per cent. An important concern of EU regional policy programmes was to improve the efficiency of agricultural production and of product marketing. At the same time it was clear that the gradual decline of the agricultural sector, which these regions had already witnessed since the 1980s, was a major reason for mounting unemployment.
- Consequently, EU regional policy wished to support the modernization of industry and services in order to create alternative income sources to agriculture. A large share of the Structural Funds was therefore used to finance business aid schemes. The creation of new firms and modernization of enterprises was therefore promoted by investment aids of more than 50 per cent of the investment project.
- Objective 1 areas suffered from weak infrastructure in the areas of transport, energy and other public services. In view of the peripheral location of the Objective 1 areas, this was considered highly problematic for economic development. Therefore the financing of infrastructure was also one major policy focus in Objective 1 areas. The Structural Funds and the Cohesion Fund could co-finance 75-90 per cent of public investment projects in infrastructure. EU regional policy acknowledged that infrastructure would improve the long-term attractiveness of Objective 1 regions as business locations and thus would lead to better economic prospects.
- Finally, the population in Objective 1 regions had much lower education levels than in richer EU regions. In 1992, according to Eurostat data, the average secondary educational attainment rate in the population was 14 per cent in the Southern cohesion countries, Spain, Portugal and Greece, and 22 per cent in Ireland and the Italian Mezzogiorno. In contrast, secondary education attainment rates of the population had reached about 50 per cent in German and Belgian regions. This was considered as a major handicap for the creation of modern economic production with specialized skill requirements and as a main reason for high unemployment levels. Thus EU regional policy financed education and training measures in the Objective 1 regions with the aim of raising the skill level of the working population and to secure long term economic development by a better human resource base.

The Community Support Framework programmes of the member states with Objective 1 regions addressed these development problems to a different extent. Table 5 shows the allocation of the Structural Funds to different policy measures in the programme period 1994-

1999 and 2000-2006. We see that particularly the Greek, Spanish and Italian Objective 1 programmes put a strong emphasize on infrastructure development in the first and the second programme period. Greece aimed to develop the main motorway axes Pathe and Egnatia and the Athens underground system with the help of the Structural Funds. Spain also emphasized large scale transport projects like the high speed train link between Madrid and Barcelona. In a detailed investigation of yearly Structural Funds commitments by policy priority, accounting also for annual changes of commitments, which reflect reallocation of resources between sub programmes, Rodríguez-Pose and Fratesi (2003) found an even stronger emphasis of EU regional policy on infrastructure in the indicated countries. From Table 5 we see that, in contrast, the programmes of Ireland, the UK, East Germany and Portugal placed a much stronger emphasis on the development of the business sector. Major inward investment was promoted with investment aid schemes co-financed from the Structural Funds. The Italian Objective 1 programme equally stressed business investment along with infrastructures. This pattern roughly holds for both programme periods although business support is generally reduced in the second period. Ireland, which partly is phasing out its Objective 1 status was forced to accept a major cut of Structural Funds allocation and in particular for business support in 2000-2006, which explains the shift. The third policy measure, development of human resources, also received different emphasis between member states´ programmes. The Irish programmes stress human capital development, while the Italian programme put very little weight on training measures in the first programme period, which was problematic in view of the unemployment situation, despite higher Italian educational levels. Although there are still differences between member states, it becomes clear that the new support programmes put a stronger emphasis on human resources, an obvious response to mounting unemployment rates in Objective 1 areas (see table 4) and in line with the European employment strategy.

There are a number of evaluation studies carried out for the CSF 1994-99 that scrutinized the effectiveness of single policy measures. The evaluation study on transport infrastructure in objective 1 areas (European Commission 2000) showed that the intended investment was on average realized between 53 and 80 per cent, depending on transport mode. The created infrastructure improved the link of regions with other national centres and thus reduced journey times on average by 20 to 50 per cent. There was a significant employment impact of 2.3 million jobs associated with these public works. However, the report also urged for a stronger commitment to complete initiated projects, particularly in Italy and Greece. It

Table 5: Structure of policy measures in EU regional policy programmes 1994-1999 and 2000-2006: Share of policy measures in per cent of total Structural Funds commitments

	Greece	Spain	Portugal	France	Italy	Ireland	UK	Germany	Belgium
1994-1999									
Infrastructure	45.8	37.1	29.5	29.2	34.7	17.2	20.6	8.0	14.2
Human resources	23.5	24.4	26.6	27.8	14.2	35.7	30.7	26.7	13.3
Production	30.1	30.0	39.3	35.7	50.3	40.0	41.7	62.9	61.2
2000-2006									
Infrastructure	43.2	42.4	22.5	29.5	37.2	45.8	22.9	22.7	14.1
Human resources	19.0	25.4	24.3	31.8	20.1	28.1	31.0	28.3	26.5
Production	25.5	28.1	38.1	33.8	39.6	22.6	44.2	44.9	52.4

Source: own calculations based on data European Commission (2001).
Note: remaining share of programmes goes to “other measures”, e.g. technical assistance.

pointed out that a large portion of carried out large scale networks can not yield full benefits since second order transport links in the regions were missing. A better management of transport flows would already improve transport in Objective 1 areas significantly. With respect to education measures, evaluation studies report on the number of persons that received training measures financed by the structural funds. 7 million persons in Spanish Objective 1 areas (CEET 2003) received training financed by the Structural Funds, however there is no evidence to which extent training measures improved the fit of qualification profiles with labour market requirements and facilitated the integration of unemployed into the labour market. The Spanish evaluation report also pointed out that a better monitoring of training programmes would be required to improve their effectiveness. In contrast, the evaluation report of the East German Objective 1 programme reports that 950.000 persons benefited from training measures financed by the Structural Funds, mainly young people and older disadvantaged persons. It further found out that training improved the employability of the trainees (Stumm and Robert 2003). In Ireland, 150.000 persons participated in training measures but their labour market effects are not reported (Fitzpatrick 2003). The evaluation study for the Italian Objective 1 area points out that although some 380.000 persons enrolled in professional education and universities as well as unemployed benefited from support by the Structural Funds support, the measures missed a clear employment strategy and cooperation with the enterprise sector did not exist (Ismeri Europa 2002). This evidence suggests that SF support made a significant contribution to the improvement of education and enrolment in training schemes. However, the employment effect of these measures may be

lean if training measures are not designed according to labour market requirements. It also proved hard to raise the innovation activity in the Objective 1 regions. In the South of Italy, R&D support benefited universities but could not change innovation activity in the enterprise sector (Ismeri Europa 2002). The same was true with the Spanish Objective 1 programme which pursued an ambitious R&D programme targeted at SME that had to be downsized (CEET 2003). In East Germany, where public and private research facilities had largely broken down after German unification, the CSF contributed to rebuild the R&D system and notably helped to give SME access to innovation activities through technology transfer centres (Stummer and Robert 2003). With respect to the programme priority investment support, one has to note that it is important for the effect on regional development to which extent these aids improve economic structures. Industrial diversification, the creation of advanced manufacturing and a broad basis of SME is needed for regional development. The Objective 1 programmes reached this goal to a varying extent. The Spanish programme made a significant contribution to the set up of SME due to the creation of new credit instruments (CEET 2003). In East Germany, investment support benefited a large number of large scale projects with important job effects and also helped to extend the SME sector. The structural effects of these investments are less clear (Stummer and Robert 2003). In Italy, a large number of much industrial investments was subsidised with the CSF, without a selective strategy (Ismeri Europa 2002). In summary, the evaluation documents provide little evidence on the structural effects linked to investment support.

In macroeconomic terms, economic theory suggests that policy measures carried out within the EU regional policy programmes should result into immediate demand effects, associated with private and public investment, and supply side effects related to the long-term structural improvement due to educational measures and improved infrastructures. The resulting growth effects associated with the EU programmes were calculated in the course of ex-ante evaluations. Two simulations were carried out with macroeconomic models, the HERMIN model of the Irish ESRI institute and the Commission´s QUEST model. In addition, the studies of Beutel (1995) provide results of an input-output analysis. (See table 6). Although coming to a quite different assessment, the HERMIN model proposed as much as 9 per cent of additional GDP in Ireland in the period 1994-99 in contrast to the more modest projections of the QUEST model of 3 per cent, those studies made a valuable contribution in discussing the likely effects of Structural Funds spending and pointing out the potential growth bonus. The different size of growth effects in these projections largely results from a stronger emphasis of supply side effects in the HERMIN model and the assumption of crowding out

effects in the QUEST model. According to the QUEST model simulations, the heavy receivers of Structural Funds in the period 1994-99, Ireland, Portugal and Greece, could have realized an additional GDP growth of 2.2-3 per cent over the whole programme period. Beneficiaries with a smaller contribution from the Structural Funds, Spain and Italy, would have realized a somewhat smaller additional GDP growth according to the three studies.

Table 6: Projected additional GDP growth associated with EU regional development programmes in ex ante evaluations. Results of simulations in macroeconomic models (HERMIN, QUEST) and input output analysis (Beutel)

	additional GDP at the end of the period, in per cent relative to baseline scenario without regional programme				
	CSF 1994-99			CSF 2000-06	
	HERMIN	QUEST	Beutel	HERMIN	QUEST
Ireland	9.3	3.0	4.2	1.8	0.5
Portugal	9.2	2.3	4.2	6.0	2.0
Spain	4.3	1.2	4.2	2.2	0.9
Greece		2.2	5.4	6.1	2.4
Mezzogiorno			2.4		
East Germany				4.0	

Source: Barry et al. 1996, Europ. Commission 1996, 2000, Beutel 1995.

In reality, the development of GDP growth and relative per capita incomes in the 1990s lags behind the potential gains suggested by the evaluation studies. Looking at table 4, we see that from the 61 regions having Objective 1 status in 1994, only 35 have improved their relative income position over the decade. In contrast, 21 regions have lost in relative income and 5 kept the initial position. A noticeable improvement of the income level has only been achieved in Ireland and East Germany, with average GDP growth rates of 6.7 and 5.6 per cent per annum. In Ireland, relative income rose from 78 per cent in 1991 to 115 in 2000, in East Germany from 40 to 70 per cent. Also Portugal and Greece improved their income levels to some extent reaching 68 per cent in 2000, as did the French overseas departments. In contrast, the income levels in Spanish, Italian and UK Objective 1 areas slightly decreased with GDP growth rates lying below the EU average. In addition to this not very satisfactory development of income levels in Objective 1 regions under the regional policy programmes, the unemployment situation only improved to a noteworthy extent in Ireland and to some degree in the UK Objective 1 regions. Spanish Objective 1 regions hardly improved their high unemployment as the rate decreased from 18.8 to 17.1 per cent only. In Southern Italy and East Germany we observe a serious increase of unemployment from 10 to 15 per cent and 15 to 19 per cent respectively. In most other regions unemployment worsened as well. Only

Portuguese regions continue to keep an unemployment level of below EU average. Finally, it should be noted that the unequal performance of objective 1 regions resulted in an increase of regional income disparities within the respective member states while at the same time a general catching up at the country level took place (European Commission 2003).

Econometric analysis looking at the growth performance of EU regions and Structural Funds support confirms the unclear contribution of EU regional policies to regional growth. Boldrin and Canova (2001) look at a panel of regions for the period 1980-1996 and test whether the fact that a region is receiving Structural Funds has an effect on its growth. They find no support for this hypothesis. An opposite result is suggested by Cappelen et al. (2001) and Beugesdijk and Eijffinger (2003). Cappelen et al. (2001) look at regional growth of 105 EU regions in the period 1980-97 and tested the impact of Structural Funds on these regions. They conclude that EU regional policy spending had a positive growth impact. Similarly, Beugesdijk and Eijffinger (2003), who test the growth effects of Structural Funds spending at the country level in the period 1984-2002, conclude that it contributed to convergence between countries. A much weaker evidence for a positive growth effect is found by Ederveen and Gorter (2002) and Rodriguez-Pose and Fratesi (2003). Ederveen and Gorter (2002) tested for the impact of SF spending in a panel of 183 NUTS II regions and concluded that regional policies had a positive growth effect but could not create absolute income convergence. Despite fostering economic growth, income disparities would remain. Rodriguez-Pose and Fratesi (2003) find a very weak positive impact of structural fund spending for the total set of EU regions in the period 1989-99, but no significant impact for Objective 1 regions.

How should we judge this mixed evidence of the contribution of EU regional policies to regional growth and income convergence? First, as evident from the above discussion of the policy mix in regional development programmes, policy strategies may not always have been adequately focused on the specific regional problems. Most probably, the neglect of human resources in Southern Italian regional programmes contributed to stagnating development. The infrastructure focus of Greek programmes may have neglected the development of other factors important for economic development. A similar view, of making unbalanced regional development strategies responsible for the weak growth effect of EU regional policies is proposed by Rodriguez-Pose and Fratesi (2003), who argue that in many cases regional programmes failed to improve long-term growth prospects and rather led to short term demand effects, e.g. in the case of large scale transport infrastructure investment, which would often rather benefit the core regions than the poor region.

Another reason for the mismatch between projected growth impact and actual growth may be the persistent weaknesses in the financial implementation of EU regional policy programmes. In all programme periods, many regions failed to make full use of the resources committed for regional programmes. In the programme period 1994-99, Objective 1 programmes showed much difference in financial execution. While Spain, Portugal, Ireland and East Germany had used almost 90 per cent of Structural Fund commitments at the end of the programme, Italian, French and UK Objective 1 regions had only used about 67 per cent of the available funds. (European Commission 2001, Tondl 2001). Infrastructure projects were implemented at 90 per cent in Portugal and Ireland, but only at 66 per cent in Southern Italy and 33 per cent in Greece. It should be mentioned that Objective 2 regions faced even more difficulties of implementing EU programmes. Weaknesses in implementation are not only linked to institutional deficits and mismanagement but also to difficulties of creating appropriate investment projects eligible for EU support.

These insights suggest that EU regional policies may not be able to fulfil the expectations to reduce regional income disparities as stipulated in the EU treaties. We can conclude that EU regional policy may have some impact on regional economic development but it cannot claim to have reduced the cohesion problem in the European Union. Therefore it should be clear that EU regional policy largely constitutes a redistribution instrument which serves to maintain a socio-political balance between the member states.

V. Objective 2 policies

Objective 2 policies, - which cover regions with industrial conversion problems, regional problems in rural areas, areas dependent on fisheries and urban problem areas -, primarily address regional problems found in the wealthier EU member states. Those structural regional problems often have persisted for a considerable time and have been subject of intensive national regional policy schemes dating back to the 1960s. Support by the EU Structural Funds has become a benefit from which the concerned countries do not wish to refrain, although the rate of assistance from the Structural Funds is much lower than in Objective 1 areas.

Before 2000, regional policies for industrial areas and rural areas were separated under former Objectives 2 and 5b. Since industrial conversion and rural areas tend to be small regions and are close to each other or even found within one NUTS III region, when designing the programme period 2000-2006 in the Agenda 2000, EU policy makers clustered these regions under more comprehensive regional development programmes designed for larger territories

and including several assisted regions. In addition to the concern for more coherent and comprehensive regional policies, the combination under one objective served to streamline EU regional policy and to make programme management more efficient at the member state and Community level.

Objective 2 problems exist among the rich member states to a different extent. In *France*, the area covered by Objective 2 regions is most extensive accounting for 31 per cent of the population. Many of them are primarily rural areas with a decreasing and ageing population, such as Champagne-Ardennes, Limousin, Auvergne and Midi-Pyrénées. The two latter regions are not only predominately agricultural areas but also suffer from natural disadvantages given by their mountainous topography. There is no, or as in the case of Auvergne and Midi-Pyrénées, only a local or single type of industry. Thus we find Toulouse in Midi-Pyrénées which is a site of aviation and space industry, while Clermont-Ferrand in Auvergne hosts predominately chemical industries. Other traditional Objective 2 problem areas such as the Bretagne, the Normandie and Provence have both industrial and rural problems. They are usually remote, agriculturally dominated areas in the interior that may in addition be mountainous as in the case of the Provence. In Bretagne, there are still industrial conversion problems in Brest in the food processing and defense industries. In Normandie, problems with industrial change have unfolded in food processing, motor industry and port facilities, where skill levels are fairly low and unemployment reached 13 per cent in 1999. In Provence, in the industrially dominated coastal range, the highest unemployment level in France is registered in Marseille with 22 per cent. Furthermore, there are still long-term conversion problems related to the ongoing decline of coal and steel industries in Lorraine, a problem which has been more successfully addressed in the neighbouring Saarland in Germany.

Among the wealthier EU members, the *United Kingdom* also has a high share of Objective 2 regions. 24 per cent of its population live in Objective 2 areas. Typically, industrial medium size centres with structural problems are located close to agriculturally dominated areas and subsumed under one Objective 2 programme. Many industrial sites have had conversion problems for a long time. In the Midlands Objective 2 area there are problems with traditional industrial centres, such as in Birmingham, that need to modernize, as well as problems in former coal field areas and problems in rural parts. In East Wales, regional problems inherited from mining and other traditional industries persist. The North West faces problems with declining industries in Manchester as well as low populated rural areas. The North East suffers from declining industries such as shipbuilding, engineering and steel in Durham.

Further, East and West Scotland, with their centres Grampian and Glasgow, are Objective 2 regions with partly rural, partly industrial regional problems (engineering, petrochemical, coal mining).

In *Finland*, where a high proportion of the population, 31 per cent, live in Objective 2 areas (the rest of the country is eligible for Objective 1 policies, see above), regional problems are of a more recent nature. Objective 2 regions include the Southern and South Western region where manufacturing was in a substantial crisis in the 1990s, with the result of a high unemployment rate of around 13 per cent in 2000. In *Spain,* Objective 2 status was given to all areas not covered by Objective 1, in order to assist further necessary modernization (e.g. Navarra, Aragon) despite the relatively high income and low unemployment levels compared to the national average. In *Italy*, practically the whole central, mountainous Apennine part is Objective 2 territory. Both in agriculture and in industrial production, the economy is based almost entirely on small production units. In *Austria*, there are also fairly extensive Objective 2 areas, with a coverage of 25 per cent of the population. This is partly due to the coverage of extensive rural and Alpine areas under Objective 2.

Given the different regional problems roofed under Objective 2, policy measures have also varied. In industrial conversion areas, the set up of new businesses in alternative branches, the support of SMEs, the creation of technology transfer and business service centres, alongside training measures are major issues in regional policy. In rural areas, support for the creation of activities linked to the agricultural sector (processing and marketing of own products, agritourism) or of alternative activities outside the agricultural sector with a link to the regional natural heritage (spa and hiking/biking tourism, handicraft) are important pillars of regional development strategies. In urban problem areas, local social initiatives and support for business start up may be important in regional programmes.

With respect to EU regional policy programmes in *industrial conversion areas*, the evaluation study of Bachtler and Taylor (1999) provides some interesting findings concerning policy strategies and effects. In general, in the first programme period 1989-93 most operational programmes for industrial conversion areas proposed a very similar overall policy strategy which emphasized investment support to the business sector (40 per cent of expenditures) including SME, technology support and business services, public expenditure for business related infrastructure (36 per cent of expenditures), and training measures (21 per cent of expenditures). There were however some notable dissimilarities. The Belgian, Dutch, Danish, German and Italian programmes highly focused on the support of business investment where support to SME played a major role. In contrast, the programmes of France, the UK and Spain

prioritised infrastructure investment (physical regeneration of business sites and environment) and training measures. In the programme period 1994-99 the focus shifted significantly away from previous priorities to the support for business investment (45 per cent of expenditures) and human capital (36 per cent of expenditures). The creation of training and retraining facilities to qualify people for jobs in new businesses, such as tourism, innovation, and environment, received a much higher attention then before. Support for business investment became based on the approach of indigenous development which favoured for example investment in the tourism and environment sector. Promotion of R&D, support for innovation networks and technology transfer received high importance. Strategies became highly complex and sophisticated. Since the regions concerned played a major role in policy formulation, their comprehension of structural problems developed significantly in the course of the first two programme periods and they advanced a lot in formulating region-specific development strategies.

Over continuous stages of programme development, the strategies of industrial conversion areas were supplemented by data giving a regional profile of weaknesses and development targets. This permitted to measure policy effects. For example, an important goal of programmes in industrial conversion areas was the creation of jobs. It turns out that the type of job creation, immediate relief to labour market problems versus jobs with medium, long term development aspect for the region can differ significantly. Unfortunately, there is no research which documents the economic development of industrial conversion areas in the period of Structural Funds support.

In contrast to the former Objective 2 policy, there is no major work assessing and comparing the performance of *Objective 5b* programmes. These programmes are either discussed in a descriptive way, as e.g. in Ward and McNicholas (1998) who describe the UK programmes, or analysed by case studies. The existing evaluation studies indicate figures on programme achievements but further efforts would be required to construct comparable indicators which can measure the delivery of programmes and permit interregional comparison. As with former Objective 2 programmes, there is no study which systematically traces the economic development of Objective 5b areas across EU regions over time. Therefore it is hard to judge the extent of structural change that is achieved with the support of the Structural Funds.

A much greater deal of research has been devoted to the management practices of former Objective 2 and Objective 5b programmes, discussing the effects on regional administrative structures and competences. It is generally recognized that the institutional requirements set by the European Commission lead to an important learning effect with respect to regional

strategy setting, policy implementation, monitoring and evaluation at all institutional levels involved in objective 2 and 5b programmes. The requested decentralization of policy management introduced a devolution of regional policy competences to regional governments (Bachtler and Taylor 1999, Hooghe 1998).

Despite these achievements, regional policy programmes under the former Objectives 2 and 5b became highly complex and ambitious so that they encountered similar problems in programme implementation as Objective 1 programmes. In 1999, only 60 per cent of Structural Funds commitments were used with former Objective 2 programmes and only 68 per cent with Objective 5b programmes, which was less then with many Objective 1 programmes (European Commission 2000d).

VI. The future of EU regional policy

After the completion of the programme period 2000-2006, the European Union will have to fully extend its cohesion policy to the accession countries, Hungary, the Czech Republic, Slovakia, Poland, Slovenia and the Baltic states Estonia, Latvia and Lithuania as well as Malta and Cyprus. Given the income gap of the accession countries, only 42 per cent of EU-25 GDP per capita in 2001, it becomes clear that enlargement constitutes a major challenge for EU regional policy. The share of "cohesion countries" which presently account for one sixth of the EU population will then constitute one third of population. Under this perspective, a central dilemma arises between the drastic increase of regional development problems and limited financial resources due to the restriction of the EU budget to 1.27 per cent of EU GDP. Consequently, an intensive debate has started on the future of these policies.

The cohesion countries will no longer be the poorest EU members. In an enlarged Union of 25 members, using 2000 figures, Greece, Portugal and Slovenia show a relative income position of about 75 per cent, Cyprus 83 per cent and Spain 90 per cent. Most accession countries will show a much lower relative income position, the Czech Republic and Malta of about 60 per cent, Hungary 54 per cent, Poland and Estonia 42-44 per cent, Lithuania 39 and Latvia 34 per cent (European Commission 2003).

Since the cohesion problem of the European Union is defined in relative terms, - the European Union is bound to focus on its least prosperous parts by the policy objective of EU regional policy -, the cohesion problem will considerably shift to the East. This means that a large number of current Objective 1 areas will lose that status. From the current 48 Objective 1 regions only 30 would pertain this status. An additional 36 Objective 1 regions will be located in the new member states (European Commission 2003). From the present member states with

Objective 1 regions, on the basis of 2000 GDP per capita levels, Southern and Northern member states would have to withdraw important parts from Objective 1 support. In the South, in Spain, Asturias, Castilla Leon, Valencia and Murcia would lose Objective 1 status, further Basilicata and Sardinia in Southern Italy, Corsica, as well as Sterea Ellada and Attiki in Greece. Practically the whole territory of East Germany would lose Objective 1 status, with the exception of Chemnitz and Dessau. Ireland would completely lose its Objective 1 status having also to withdraw the Border, Midland and Western region. In the UK, Northern Ireland, the Highlands and Islands region and Wales would lose then Objective 1 status.

The shift of EU regional policy onto the East is not only a consequence of the definition of the cohesion problem in relative terms and the threshold level of 75 per cent for the definition of Objective 1 areas, but also necessitated by the budgetary restriction in the EU. Retaining the present support for Objective 1 areas in EU 15 and providing additional assistance to the new member states in relation to their development gap would dramatically go beyond the limits of the EU budget, as pointed out among others by Baldwin and Portes (1997) as well as Breuss and Schebeck (1999). There is, however, firm consensus between the richer EU member states that budgetary resources allocated to regional policies should not exceed the present level of 0.45 per cent of EU GDP.

Nevertheless present Objective 1 areas which are prone to losing that status, argue that their development problem will still be the same even when the reference EU average income value for defining the group of below 75 per cent areas will have changed after enlargement. Among those Objective 1 areas which will be phased out some regions will be more capable to sustain their development process than others. Some can already refrain from support, as probably the Border, Midlands and Western region in Ireland or Corsica and Sardinia, while in others the development process risks to come to a stand still if EU support seizes. Thus the problem of phasing out areas calls for a careful and fair solution (Hall 2003).

The reluctance of the net budget contributors to provide additional resources has also led to fixing a 4 per cent of GDP ceiling for EU regional transfers with the Agenda 2000. Fearing that a proportionate transfer of present regional policy support to significantly poorer Eastern European regions would demand additional financial resources, the argument of limited absorption capacity for development support was put forward, followed by the demand to limit support. It was argued that Eastern European countries would have serious institutional gaps and thus would face problems to implement regional policies involving large amounts of transfers. However, there are also those that question these arguments and consider the 4 per cent ceiling as an arbitrary limit. They make the point that also the rich member states in the

EU have shown to have severe absorption problems due to institutional problems and limited ability to design appropriate projects for funding. In addition, they argue that institutional limits in Eastern countries are likely to be overcome within a short period. Even the worst performers among the Objective 1 regions, such as Southern Italy and Greece, managed to create capable regional administrations due to Community pressures and requirements. Furthermore, Eastern countries would have already learned a lot through management of pre-accession aid and partnerships with institutions in EU member states.

Given the high costs of EU regional policy and the demand from present and future beneficiary countries to maintain and increase that support, increasing scepticism with respect to the effectiveness of EU regional policy rised. Opponents of regional policy claim that it has largely failed to promote economic development and convergence (see above), some even propose that it would counteract market forces, such as agglomeration forces in the sense of New Economic Geography and therefore would either harm natural economic forces or be ineffective (Midelfart-Knarvik and Overman 2002). In view of the mixed evidence on the economic effects of EU regional policies, there are also those that demand to reformulate the goals of EU regional policy. Instead of economic development, they claim to call interregional income redistribution as the key objective of EU regional policy.

Another point of debate is the question of how to proceed with Objective 2 policies. One view is that the European Union should completely withdraw from that policy field. In view of the small resources of Objective 2, transfers would be too thinly spread on problem areas to become effective. Furthermore, as we have seen above, Objective 2 policies often show a poor status of implementation (Begg 2003). Evidently, Objective 2 areas have more problems to define projects for regional development than cohesion countries. For example, in a small coal mine area policy makers may be less inventive to define a project that really contributes to conversion. In contrast, policy makers in cohesion countries usually have a whole array of potential projects that would contribute to development, e.g. infrastructures, improvements of teaching facilities, etc. Therefore, many Objective 2 areas have hardly shown any progress over the past decade to overcome their regional problems. The growth effects lag behind those in Objective 1 areas. Consequently, EU members like the UK and the Netherlands have proposed that Objective 2 policies should be renationalized and that EU budgets for this policy should be cancelled, leaving funding as well as execution to the member state.

The proposal to renationalize Objective 2 policies with respect to policy fine tuning but keeping EU financing meets considerable opposition. The idea of providing financial means to the rich member states but allowing them to define and implement regional policies

themselves is not always welcome. Although rich member states have created well developed procedures for regional policy design and management, not least because of Community regulations, there is no convincing evidence that rich members are more efficient in regional policy implementation so that less control of the EU would be required than poor member states.

Another point of debate with Objective 2 policies is the designation of specific areas to this policy. Under the current Objective 2, very different regional problems are addressed, such as rural areas, industrial restructuring and urban problems. Even between rural areas, say in the Southwest of France or in the Alpine areas of Austria, there are big differences in the types of problem and regional policy strategies. Thus the question arises whether EU regional policy should at all keep to the tradition of drawing a map of Objective 2 areas and to pursue common policy guidelines. As an alternative it has been suggested to replace the territorial Objective 2 by a thematic objective as in the case of Objective 3 (Hall 2003). This means that the EU would identify policy areas of interest, such as innovation, and direct budgetary means towards it. For actual policy measures, member states would be responsible. Policy coordination would be carried by exchange of views and review of best practices, similar to what is currently done with the EU´s employment strategy. Such practices would leave more freedom to the rich member states for individual policies and would simplify EU procedures.

Finally, an important issue is the consistency of other EU policies with the goal pursued by cohesion policy. Several policies counteract the efforts of EU regional policy. A prominent example is the area of state aids. Despite the common framework for state aids, rich EU members have larger budgetary resources to finance state aids. Thus the total volume exceeds that in the Southern member states. This counteracts the efforts of EU regional policy (Tondl 2002). Corporate tax policies are another area of inconsistent policies. Since tax policies are not Community competence, member states could design policies that conflict cohesion policies, for example, a favourable corporate tax rate in a rich member state could counteract EU funded investment support in poorer member states. A set of other policies, like transport policies, R&D policies, labour market policies, etc. may potentially come into conflict with cohesion policies (Molle 2003).

There is no doubt that EU regional policy will continue to play a prominent role in EU policies in the future. The dramatic cohesion problem in an enlarged Union will clearly maintain the demand for this policy. However, any conversion of regional policy into a sizeable redistributive policy within a fiscal federalism system at union level, as demanded in the context of monetary union, is out of sight. Moreover, it should become clear that EU

regional policy is no guarantee for development. In the past, it did not really meet its goal to reduce income disparities. There is also no doubt that the practice of EU regional policy will have to change further in simplifying and improving policy management, both new member states, improvements at the institutional level and correct and efficient management of EU regional policies will be vital for securing the support of rich EU members for a strong future cohesion policy.

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