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The Challenges of Designing Cohesion Policy Strategies

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Preface

This paper has been prepared as a background discussion document for the Second International Conference 'Benchmarking Regional Policy in Europe' being held in Riga on 24-26 April 2005. The Conference is being hosted by the Ministry of Finance, Latvia, and organised by the European Policies Research Centre, University of Strathclyde, UK.

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EPRC, April 2005.

THE CHALLENGES OF DESIGNING COHESION POLICY STRATEGIES

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THE CHALLENGES OF DESIGNING COHESION POLICY STRATEGIES

EXECUTIVE SUMMARY

The work of developing appropriate and effective Cohesion policy strategies is characterised by the classic challenge of welfare economics: how best to allocate limited financial, human and organisational resources in order to maximise economic, social and environmental benefits. This challenge is particularly acute in those Member States – notably the Cohesion countries – which are undergoing catching-up and associated structural change and thus face a number of potentially conflicting demands on public finances. Cohesion policy is characterised by multiple goals, instruments and actors, so that the process of developing a targeted and coherent strategy can be complex.

The main potential economic impact of Cohesion policy is to provide additional funding for public investment in human and physical capital (including public infrastructure), which can improve conditions for sustained productivity growth and employment creation. Cohesion policy can also ensure that the basic conditions for business competitiveness are in place, via investment in environmental clean-up, water and waste water systems, and an increased supply of skilled labour. Clearly, these interventions can also have positive effects in terms of social inclusiveness and environmental sustainability.

The process of designing appropriate Cohesion policy strategies is typically characterised by institutional complexity, both domestically and in terms of relations with EU institutions. Similarly, policy-makers may have to find ways of managing the high expectations of a range of societal groups, both of the availability of public funding and of the speed with which economic, social and environmental change can be achieved.

This paper explores the challenges facing Member States in designing Cohesion policy strategies. It outlines the complexity of strategy design, the thematic and geographical choices to be made, and the linkages and trade-offs between choices. The paper concludes with some questions for discussion at the Conference:

- How important is it to sequence Cohesion policy funding to develop an effective strategy? What challenges are faced by policy-makers in setting strategic priorities?
- From the perspective of your Member State, what should be the main thematic priorities for Cohesion policy funding after 2006?
- What kind of approach is taken in your Member State to different geographical goals, notably national catching-up and balanced regional development?
- What methods are most effective in building effective strategies? Could better use be made of monitoring systems or evaluation studies?
- What is your experience of endeavours to ensure consistency and coherence between policy fields – either within the Cohesion policy strategy or between Cohesion policy and domestic policies?

THE CHALLENGES OF DESIGNING COHESION POLICY STRATEGIES

1. INTRODUCTION

One of the fundamental principles underlying EU Cohesion policy is a strategic approach to economic development. EU-funded development programmes are required to have an explicit strategic rationale, grounded in an analysis of development needs and opportunities, with clear, measurable objectives and coherence with other policy interventions.

For the new Member these are challenging requirements. Moving from Phare to Structural Funds has meant shifting from a logic of annual budgeting and project-based interventions involving relatively small amounts of support, to large-scale, multi-annual, multi-sectoral programmes with a range of different policy priorities and measures. Notwithstanding the analysis and consultation undertaken for the 2004-2006 National Development Plans, the scope for designing Cohesion policy strategies was constrained by the institutional capacity available and competent to absorb Structural and Cohesion Funds.

The 2004-2006 programme period is commonly – although not universally - regarded as a preparatory, learning phase for the larger scale resources due to be become available for the new Member States from 2007 onwards. In this context, new Member States have begun a process of analysis, reflection and consultation about the strategic choices to be made, in part informed by the European Commission's proposals for Community-level and national strategic reference frameworks for the 2007-2013 period. Key issues are the targeting, sequencing and prioritisation of Cohesion policy expenditure, the linkages and trade-offs between different types of funding, the relationship with domestic policy priorities, and the spatial dimension of resource allocation.

The following paper explores the challenges facing Member States in designing Cohesion policy strategies. Drawing on the experience gained in the EU15, the paper considers the strategic questions being considered by the new Member States, partly in relation to the current programmes but in particular looking forward to the preparations for the next programming period. The paper begins by outlining the complexity of strategy design and then discusses the thematic and geographical choices to be made, as well as the complementarities and tensions between these choices, concluding with some questions for discussion at the Conference.

2. MAKING STRATEGIC CHOICES

2.1 The complex challenges of strategy design

In designing strategies for allocating Cohesion policy funding, policy-makers face the classic dilemma of welfare economics: how best to allocate scarce financial, human and organisational resources in order to maximise benefits. Member States that are engaged in catching-up processes may experience particular challenges in deciding on how best to allocate resources to engage with an extensive range of economic, social and environmental problems and opportunities. Policy-makers also have to operate in a context

that is typically characterised by institutional complexity, both domestically and in terms of relations with EU institutions, as well as by high expectations among a range of societal groups over funding opportunities and rapid socio-economic impacts.

2.2 Limitations on resources

Although Cohesion policy allocations to individual Member States can be significant (amounting to around three per cent of annual GDP in, for example, Greece and Portugal in 2000-06[1]), so too are the scale and range of investment projects that could potentially be funded. Member States' domestic public investment is often constrained by other fiscal pressures, such as the need to limit levels of general government deficits and public debt, as well as ongoing demands to maintain or raise current expenditure in fields such as health, public sector wages, pensions and social security. These constraints can be particularly challenging for Member States that are endeavouring to channel public spending towards investment in order to support the process of structural change and catching-up.

In the Cohesion Countries (and in the macro-regions of eastern Germany and southern Italy), receipts from Cohesion policy and related domestic public co-financing account for a significant percentage of total public investment[2]. The EU25 average for general government expenditure on gross fixed capital formation was 2.5 percent of GDP in 2003, ranging from 1.5 percent in Germany to 5.4 percent in Malta, and was above three percent in all the Cohesion countries except Latvia (1.8 percent) and Slovakia (2.5 percent) (see Table 1). The setting of an explicit ceiling on a Member State's receipts from Cohesion policy (at four percent of annual GDP) has raised questions over the appropriate scale of EU funding. There is a potential risk that a major external fiscal stimulus, especially to the non-tradable sector of the economy, can generate serious macroeconomic imbalances and inflationary pressures (the so-called 'Dutch disease')[3]. There does not, however, appear to be a clear economic rationale for setting the ceiling on Cohesion policy receipts at precisely four percent of national GDP.

In any case, the fiscal and organisational constraints on domestic public investment mean that decisions on the allocation of Cohesion policy funding in the Cohesion Countries are particularly critical. This implies the need for – often politically difficult – decisions on the targeting, sequencing and prioritising of Cohesion policy expenditure in order to maximise socio-economic benefits[4].

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[1] European Commission (2004) *Third Report on Economic and Social Cohesion: A new partnership for cohesion: convergence, competitiveness, cooperation*. Luxembourg: Office for Official Publications of the EC, page 138.

[2] Some Member States may also be in receipt of grants or loans from international financing institutions, notably the European Investment Bank, but also the World Bank or the European Bank for Reconstruction and Development.

[3] Y. Hervé and R. Holzmann (1998) *Fiscal Transfers and Economic Convergence in the EU: An Analysis of Absorption Problems and an Evaluation of the Literature.* Baden-Baden: Nomos.

[4] European Commission (2004) Catching-up, growth and convergence of the new Member States, in: *European Economy* No.6. Luxembourg: Office for Official Publications of the EC.

2.3 The range of investment needs for catching up

Such decisions can be difficult due to the wide range of complex and multi-faceted economic, social and environmental challenges that face catching-up countries. These typically include: low levels of GDP per capita and associated low productivity rates; low employment rates with sectoral, skill-based and geographical mismatches between labour demand and supply; the challenges of structural adjustment associated with a sectoral shift from agriculture and industry to lighter manufacturing and services; insufficient or inappropriate physical and human capital; and socially and geographically uneven patterns of development. Environmental problems are also acute in some Member States, often linked to industrial, energy or military legacies. Clearly, there are also important differences between the catching-up Member States, for example in terms of population size and area, sectoral structure, the pattern of trade and private investment, geographical location, the extent of social and regional disparities, the intensity of environmental degradation, and domestic macroeconomic policies and institutional frameworks.

Because of the complexity of catching-up processes, Cohesion policy provides investment in a wide range of projects that are supposed to contribute to a number of different economic, social and environmental goals. There is a risk, however, that the range of goals and types of intervention associated with Cohesion policy can undermine the quality of strategy-making by leading to a fragmentation of effort, inconsistent interventions, or a lack of clear target-setting. Various methods may be used to manage these challenges, for example sequencing goals and expenditure; setting clearly defined targets for individual projects and Measures; and taking into account the synergies and trade-offs that may occur between specific interventions.

2.4 Institutional complexities and high expectations

The work of developing an appropriate Cohesion policy co-financed strategy is further complicated by a number of institutional factors, including the implications of EU policies and procedures, interactions with existing domestic policy frameworks, and the involvement of a range of different domestic actors in the policy process.

Domestic strategies have to take into account the overall goals and structures of Cohesion policy, and be consistent with other sectoral policies (e.g. relating to the environment, employment or transport) that have been agreed by the European Council and Parliament. In terms of strategy design, one important dimension is the aggregate allocation of finance between different EU Funds – the Cohesion Fund, ERDF, ESF, EAGGF and FIFG – so that, for example, a certain proportion of funds in 2000-2006 has had to be dedicated to agriculture and fishing. It is also important to consider potential interactions between Measures financed by different EU instruments – for example the ERDF and ESF, or the Cohesion Fund and ERDF.

The effectiveness of Cohesion policies strategies is also conditional on Member States' domestic policies and institutional frameworks, so that specific consideration needs to be given to different types of policy coordination. One method of clarifying the roles of Cohesion policy funding, and ensuring coherence with other sources of public investment, is

to integrate EU funds into an overall national development strategy. In any case, it is useful to assess the availability of investment from other sources, whether domestic public authorities, international financial institutions or private enterprises. It is also necessary, however, to manage the interactions between the Cohesion policy strategy on the one hand, and domestic macroeconomic policies and regulatory frameworks on the other. The anticipated impact of public investment may, for example, depend on complementary structural reforms to reduce red-tape on business activity or to improve the functioning of labour market mechanisms.

Strategic choices may also be constrained by variations in the financial and organisational absorptive capacity of different spending categories and entities. Not only is the availability of domestic co-financing likely to vary between themes and locations, but the administrative burden associated with different forms of intervention also varies, as do the human and other resources of different implementing agencies. In the field of business support, the resources needed to implement generic State aid projects are generally lower than those for 'softer' forms of support such as advisory services and technology diffusion.

The political choices needed to build a coherent and meaningful national development strategy depend on the support of different societal groups. Consensus between different levels of government, economic partners and civil society can facilitate structural change and have, for example, been key to disinflation strategies based on coordinated macroeconomic policies, including wage moderation, in a number of Member States. There is a risk, however, that a range of potentially conflicting demands from different public bodies and societal groups may arise and lead to strategic fragmentation. These challenges may be particularly strong in some of the new Member States, where the legacy of restructuring over the past 15 years has been politically and socially painful, but where there is need for still further restructuring.

Steps may, therefore, be needed to manage the expectations of different societal groups and to ensure that effective strategic decisions can be taken. For example, Managing Authorities in some old Member States try to enhance the strategic focus of programmes by drawing on information from monitoring systems and evaluation studies that illustrate differentials in the financial absorption and potential socio-economic impact of different Measures and sub-Measures[5].

3. SEQUENCING THEMATIC CHOICES

3.1 Concentrating funds

One of the four underlying principles of Cohesion policy is 'concentration' which implies primarily that EU funds should be focused on those Member States and regions with the most acute needs. It is also is seen to imply that a critical mass of funding is needed if Cohesion policy is to make a significant contribution to economic development and structural change. This need not mean that funding should be allocated only to large

[5] S. Taylor, J. Bachtler, F. Josserand and L. Polverari (2004) Achieving the aspirations of the 2000-06 programming period. *IQ-Net Thematic Paper 14(2).* Glasgow: European Policies Research Centre.

projects, but it does indicate that a strategic approach is needed for smaller projects, to ensure that they are complementary and coordinated with one another.

An important principle in the design of economic policy – and one that is not always taken into account in Cohesion policy - is that a single policy instrument (a project, a Measure…) cannot be expected to address multiple goals, so that separate instruments are needed for different goals[6]. This implies the need to define clearly the specific contribution of different projects, Measures and Priorities to particular goals, and sometimes to limit the expectations of the range of goals that individual instruments can address.

Clearly, the allocation of funds across different spending categories will depend in part on domestic policy preferences in relation to the appropriate balance between, for example, economic, social and environmental goals. It will also be conditioned by the extent of acute investment needs, for example in terms of concentrations of severe environmental degradation or a lack of core international transport networks.

A further aspect is the expected ratio between costs and benefits for different types of projects. Catching-up is likely to be accelerated if funding is focused on those projects that show stronger outputs relative to cost. The main goal of Cohesion policy is to contribute to structural change that brings permanent benefits. Thus, while it may be necessary to allocate some funds to interventions that are expected to show rapid benefits in order to meet expectations and maintain momentum, funds should generally be targeted on long-run goals. For example, investment in human capital may not show results for some years, yet is critically important for long-run economic growth and employment creation. Conversely, some studies note that State aid can be associated with significant deadweight and displacement effects, and that there is a risk of business dependence on public funding[7].

Various categories of Cohesion policy expenditure are likely to contribute in different ways, and to different degrees, to a range of economic, social and environmental goals. The main potential contribution of Cohesion policy to long-run economic growth is to invest in physical, human and knowledge capital and thus to enhance conditions for overall productivity growth and sustained employment creation. Cohesion policy funding can also improve the basic conditions for business activity, by enhancing the supply and allocation of labour (e.g. via active labour market policies); upgrading public infrastructure and undertaking environmental clean-up and land reclamation; enhancing conditions for EU trade integration via investment in major transport infrastructure; and improving institutional capacity.

The economic impact of some components of Cohesion policy funding instead derives from its contribution to aggregate demand in the economy, thus providing a short-run stimulus to economic growth. Such effects are, however, reduced by leakages to other countries or

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[6] J. Tinbergen (1952*) On the Theory of Economic Policy.* Amsterdam: North Holland P.C.

[7] See e.g. P. Honohan (1998) Key issues of cost-benefit methodology for Irish industrial policy. *General Research Series* 172. Dublin: The Economic and Social Research Institute. H. Lenihan (2004) Evaluating Irish industrial policy in terms of deadweight and displacement: A quantitative methodological approach. *Applied Economics* Vol.36(3): pp.229-252.

regions via trade and investment flows. Moreover, a strong boost to demand can stimulate inflationary pressures, with negative consequences for international price competitiveness.

In terms of social goals, interventions to improve training and labour advisory services can facilitate the integration of disadvantaged groups into the formal labour market. Cohesion policy can also upgrade key public infrastructure and services, for example in transport and health, and also finances redistribution towards particular social groups, notably the agriculture and fishing sectors.

In environmental terms, Cohesion policy not only upgrades water and waste water infrastructure, but it also finances the clean-up of acutely degraded land and water, and facilitates compliance with EU environmental legislation (e.g. on waste management).

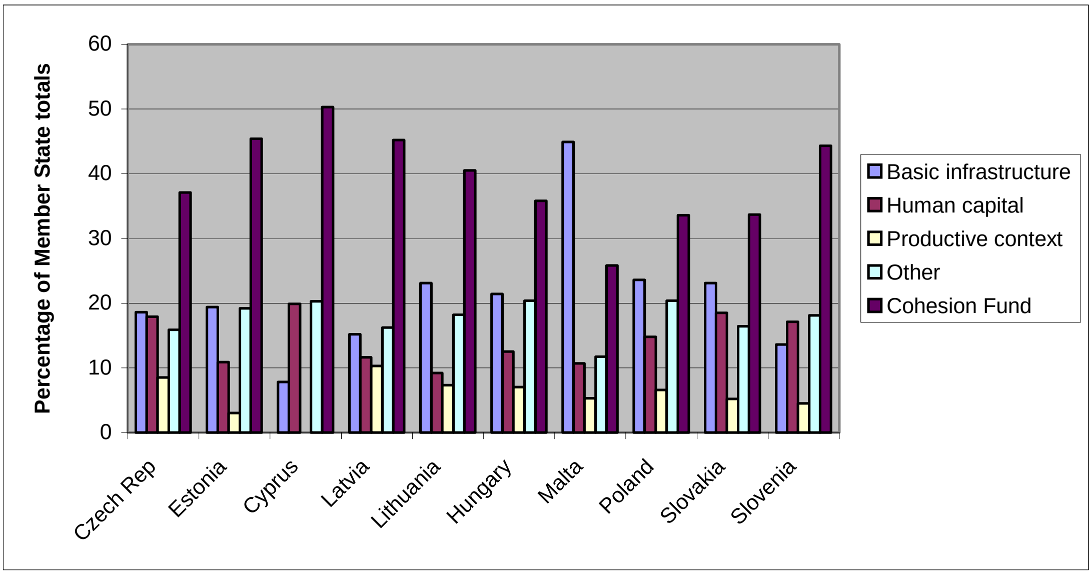
Domestic institutional frameworks are a further important conditioning factor on catching-up. Much attention has been focused on the capacity of public administrations in EU Member States to design and implement effective strategies. Broader frameworks, however, may also constrain or facilitate economic development processes. For example, Structural Funds' business support schemes may have only a limited impact if the regulatory context places heavy burdens on business activity, via a complex tax system, labour market regulations, or the administrative requirements facing start-ups.

3.2 The varying approaches of different Member States

Financial allocations across themes vary considerably, both between Member States and between programming periods. In the EU15, the share of Structural Funds' allocations (i.e. excluding the Cohesion Fund) for basic infrastructure in the Objective 1 regions ranged from zero in Finland, to 45.8 per cent in Ireland, while the allocation for the productive context varied from 22.6 per cent in Ireland to 72.4 per cent in Austria (see Table 2).

Cohesion policy in the new Member States generally show a strong focus on investment in public infrastructure for the 2004-2006 period, not least due to the decision to channel a significant share of EU funding through the Cohesion Fund and thus to Trans-European transport networks and major environmental infrastructure. There is, however, considerable diversity in the types of interventions funded, and in the financial allocations, as can be seen from Table 3, which provides an overview of the thematic distribution of financial allocations from the Structural Funds and Cohesion Fund to the ten new Member States in the 2004-06 programmes (see Figure 1).

Figure 1: Structural and Cohesion Fund Allocations, EU10, 2004-06



The need to take difficult decisions to concentrate funds on a narrow range of interventions has often been seen in the new Member States in 2004-06, due to the relatively limited amount of funds provided; the short programming period; and the challenges of engaging with Cohesion policy planning and implementation systems. These decisions could be applied at a range of levels – for example via a strong focus on transport infrastructure and relative to other types of infrastructure, or via a concentration on certain types of transport infrastructure (e.g. Class 1 roads rather than other roads), or via a focus on a limited number of projects under different categories. Trade-offs are also seen in relation to business support, where some chose to focus on providing direct aid to SMEs, rather than advisory services or business premises.

The degree of tension may also vary between Funds. In Latvia, for example, the need to select between different types of interventions was recognised in relation to the ERDF, but less in relation to the ESF or EAGGF. This raises the question of whether the EU-level allocation of finance between the different Funds was appropriate for all Member States or whether, for example, a lower level of funding should have been reserved for the EAGGF and FIFG and a higher share for the ERDF.

In Slovenia, a number of specific criteria were applied in the process of deciding on the strategic allocation of funds, namely: a) the activity's potential contribution to national/regional development (hence transport and environmental infrastructure was supported only where there was direct benefit to the productive); b) complementarities between measures; c) eligibility for EU support; d) compliance with EU policies; and e) other potential sources of funding.

3.3 The sequencing of funding after 2006

A number of the new Member States anticipate that tensions between policy goals may ease after 2006, due to larger amounts of EU funding, a longer programming period, and

greater experience with implementation systems. Most intend to take a relatively similar approach to the thematic allocation of funding as in 2004-06.

The Commission's proposals for the future shape of Cohesion policy after 2006 have raised some concerns in the new Member States. One issue is the strong emphasis on RTDI and the 'knowledge economy' (often perceived to be linked to the 'Lisbon agenda'). The importance of upgrading human and knowledge capital is recognised by many of the new Member States – a number of which (eg. Slovenia) already focused funds on this dimension in 2004-06. There is some concern, however, that too narrow a focus on 'the knowledge economy' could imply insufficient funding for other fundamental interventions, notably public investment in transport and environmental infrastructure, public transport systems, education and health infrastructure. Similarly, the meaning of 'the knowledge economy' or the 'Lisbon agenda' is not always clear and in many cases might best be interpreted as funding for human capital (education, training, life long learning and other labour market interventions), as well as technology transfer and diffusion.

Another issue relates to the emergence of calls to extend the definition of eligible spending categories, compared to the list set out in the Community Strategic Guidelines. These other areas might include national and regional roads (rather than simply Trans-European Networks), upgrading local authority district heating systems, and renovating public housing (e.g. insulation and window replacements).

Issues of thematic eligibility may be particularly acute in non-Objective 1 regions. In Hungary, for example, the likelihood that the Közép Magyarország region (i.e. Budapest and the surrounding agglomeration) would be a 'phasing in' region after 2006 raises questions over the availability of funding for interventions such as health infrastructure, as well as major urban physical regeneration and land reclamation.

A further prominent feature of the Commission's proposals for thematic allocations after 2006 is the emphasis on investing in institutional capacity. This follows Structural Funds' allocations for interventions such as the reform and computerisation of the tax system in Greece, as well as the expansion of public employment services in a number of Member States. Some of the 2004-06 programmes co-finance various kinds of administrative and institutional upgrading, notably the Czech Republic, Estonia, Hungary, Poland and Slovakia for example. Although some Member States acknowledged the need to upgrade human resources in the management of EU funds, particularly at regional level, others questioned whether this should be an important focus of spending in future, outside specific areas such as e-governance. Some argued that capacity building could be better achieved through structural reforms or twinning projects, rather than additional public expenditure.

4. GEOGRAPHICAL CHOICES

4.1 The geographical dimensions of catching-up strategies

Eligibility for Objective 1 status is determined at the level of NUTS 2 regions, and for the Cohesion Fund at Member State level. In principle, however, a number of different approaches could be taken to the geographical allocation of funds within these formal

constraints. Much debate has, for example, focused in recent years on the question of whether there is a trade-off between aggregate national economic growth and interregional inequalities[8]. This proposition draws on the idea that structural economic change tends initially to be geographically imbalanced, leading temporarily to more rapid growth in the main agglomerations, driven by sectoral shifts, knowledge spillovers and economies of scale[9]. Over time, however, agglomeration diseconomies (such as congestion and high factor costs) plus a reduction in barriers to technological diffusion (facilitated by public investment in transport and communications) lead to spread effects that reduce regional inequalities.

The possibility of such a (possibly temporary) trade-off suggests that policy-makers need to consider carefully the possible implications of their choices in relation to the geographical allocation of resources, in terms of both aggregate economic growth and interregional equality. It may be appropriate to consider, not only the total allocation of funds, but also the appropriate geographical distribution of specific categories of Cohesion policy finance. It is likely, for example, that expenditure on secondary technical education will be more widely and evenly distributed in geographical terms than will expenditure on higher education and research which are characterised by spatially limited knowledge spillovers.

The idea of a trade-off between national and regional development in catching-up countries is sometimes conflated with the argument that funds should be targeted on specific 'growth poles' or 'clusters'. There is no necessary link between the two approaches, as a policy focused on national economic development could probably be better achieved by funding those projects that are most likely to contribute to aggregate economic growth, regardless of their location. If there is a trade-off between national and regional development in the Cohesion countries, however, this could imply that, if policy-makers decide to allocate a large share of their public investment to lagging regions or areas, this may constrain the availability of public investment for projects that aim to enhance conditions for aggregate economic development.

In the context of Cohesion policy strategies, difficulties are most likely to be seen in Member States whose aggregate level of GDP per capita is well below the EU average, yet where one or more of the main agglomerations does not have Objective 1 status (as in the Czech Republic, Portugal and Slovakia, and possibly other Member States after 2006). In such cases, there is a risk of strategic fragmentation and insufficient public investment to reduce major bottlenecks to national economic development, such as urban and suburban transport infrastructure, as well as linkages between the capital city and other regions.

4.2 Approaches taken by different Member States

Member States take varying approaches to the geographical dimensions of Cohesion policy strategies depending, for example, on the size of the country, the scale of the national gap

[8] European Commission (2000) *European Economy.* Luxembourg: Office for Official EC Publications.

[9] S. Kuznets (1955) Economic growth and income inequality, *The American Economic Review XLV*: pp.1-28. J.G. Williamson (1965) Regional inequality and the process of national development: a description of the patterns, *Economic and Cultural Change* 13: pp.1-84.

vis-à-vis the EU average level of GDP per capita, the extent of interregional disparities, and the scope of fiscal decentralisation. In the wealthier Member States, a regional approach is generally adopted – although a macro-regional approach is in part applied in eastern Germany and southern Italy. More centralised approaches have been adopted in the three smaller Cohesion countries – Greece, Ireland and Portugal – and it was only in 2000-2006 that there was some shift towards a more regionalised approach in Ireland and Portugal as the capital city regions were no longer eligible for Objective 1[10].

Some – but not all - of the new Member States perceive a potential trade-off between national catching-up and balanced regional development. Some chose to focus primarily on the goal of national economic development in 2004-2006, not least due to the limited funds available. A number have – at least in principle - adopted the 'growth pole' approach of endeavouring to target funds on a limited number of agglomerations.

Geographical goals are more complex in some Member States, with the Slovak Republic, for example, emphasising the aim of developing links between Bratislava and other main agglomerations, but also of enhancing the potential of smaller regional centres, and of stabilising the population in rural areas. Similarly, the Czech Republic aims to target growth poles as well as lagging regions, and to support Prague, but also other core agglomerations, and overall balanced development.

Some CSFs or SPDs explicitly pre-allocate funds to certain regions or areas, while others do not. For some Measures, Lithuania has the aim of funding, for example, one project in each municipality. In other cases, project selection criteria may provide for the allocation of additional points to projects in certain locations. Slovenia aims to support both aggregate growth and balanced regional development, targeting 60 percent of total funds on areas designated as "lagging" under national regional policy, and *inter alia* using geographical criteria in allocating funds.

4.3 Geographical choices for future strategies

Some of the new Member States which had prioritised national development in 2004-2006 are now considering shifting their focus towards balanced regional development in the next programming period, even though their national levels of GDP per capita remain low relative to the EU average. In others, notably Poland, there may instead be a stronger emphasis on concentrating funding on the main metropolitan areas, as well as on enhancing transport linkages between regional centres. Poland is, however, likely to continue to allocate a percentage of funding to lagging regions, notably those undergoing agricultural or industrial restructuring.

There is a recognition in some of the new Member States that stimulating development in the weakest areas is far from simple. In Latvia, for example, policy-makers question whether mainstream forms of business support would be successful in structurally weak

[10] C. Garnier (2003) Conclusions. In: B. Funck and L. Pizzati (Eds.) *European Integration, Regional Policy, and Growth*. Washington D.C.: World Bank.

areas, due not least to the very small numbers of businesses in such locations. It may therefore be necessary to develop alternative approaches.

In Hungary, a key issue for the next programming period is the status of the Közép Magyarország (the region of Budapest's agglomeration), as current European Commission data suggest that it would be in 'phasing in' (the current Objective 2). This could lead to strategic fragmentation in geographical terms, and would also limit public investment in the Budapest agglomeration, in core themes such as road links, rail and metro systems, and waste water infrastructure.

5. LINKAGES AND TRADE-OFFS BETWEEN CHOICES

5.1 Different types of interaction

Cohesion policy strategies cover a wide range of different policy fields, and also interact in various ways with a number of domestic policies. A key dimension of strategy design is thus an assessment of the potential complementarities and tensions, both between different components of Cohesion policy funding, and with the broader policy environment.

It often proves difficult to exploit potential positive interactions between the different Funds (ERDF, ESF, EAGGF and FIFG) due to different sets of procedures, targets and management systems. For example, business aid for training employees is financed by the ESF and thus separate from business aid for physical capital and technological innovation – even though in practice these interventions should be closely linked. Similarly, explicit steps need to be taken to ensure that ERDF funding for educational and training infrastructure complements ESF current expenditure on human resources. It can also prove challenging to ensure that interventions funded by the EAGGF and FIFG are sufficiently integrated into the overall economic development strategy, partly for procedural reasons and partly because they do not always clearly contribute to the broader goals of economic growth and employment creation.

The appropriate division of tasks between the Sectoral Operational Programmes on the one hand, and the Regional Operational Programmes on the other is also a key challenge. In some cases, it may be possible to draw clear lines of demarcation, even within single policy areas (for example for investment in different classes of roads). At other times, it may be more difficult, notably in relation to business support, where a fragmentation of responsibilities can lead to an inefficient proliferation of overlapping schemes.

Explicit attention also needs to be paid to potential interactions with the domestic policy environment. A first issue concerns the possible implications of a large influx of external funding in terms of potential macroeconomic imbalances, particularly if it implies a strong stimulus to non-tradable sectors, such as the construction industry, as this can potentially lead to inflationary pressures and overheating in the domestic economy.

A related issue is the need to ensure coherence between the Cohesion policy strategy and domestic sources of co-financing. A third issue is the extent to which the domestic regulatory framework conditions the effectiveness of public investment. The structural context is particularly important in sectors such as railways and district heating systems,

where there may be a need for structural reforms in order to reduce indebtedness, restructure capacity and ensure long-term viability. Questions of the sequencing and targeting public investment in such cases are likely to be especially important but also politically and socially sensitive.

5.2 Managing interactions between Cohesion policy instruments

All programming documents address questions relating to interactions between Cohesion policy interventions, and note the various institutional and procedural steps which are taken to ensure effective coordination. For example, the Hungarian CSF notes a series of mechanisms that link Cohesion Fund management with CSF management, including cross-membership of Cohesion Fund and CSF and OP Monitoring Committees; a single organisation - the National Development Office - acting as Managing Authority for both the Cohesion Fund and the CSF; and a uniform Operating Manual for the Structural Funds and Cohesion Funds.

Some Member States perceive some overlaps or insufficient complementarities between Operational Programmes, generally those co-financed by different EU Funds, or between Sectoral and Regional Operational Programmes. However, a number have put in place mechanisms aimed at promoting synergies between Measures and Priorities. For example, Slovenia aims to ensure complementarity between the ERDF Measure for tourism and the EAGGF Priority for rural diversification, by ensuring that the ERDF strategy takes into account the potential for agri-tourism in its zoning criteria, and also by ensuring that farmers are represented on the ERDF joint body managing tourism marketing.

Coordination mechanisms are particularly important where different regions within a single Member State are eligible for different Objectives. In the Czech Republic and Slovakia, all NUTS 2 regions are eligible for Objective 1 except for the regions of Praha and Bratislavský kraj, which are covered partly by Objective 2 and fully by Objective 3. In both Member States, coordinating mechanisms are in place. In Slovakia, for example, the Objective 1 CSF Monitoring Committee is also a coordinating body for the Objective 2 and 3 SPDs. There are also a number of joint working groups that coordinate activities, and common guidance is issued on procedures under the different Objectives. However, both Member States have faced certain challenges in maintaining effective coordination and communication due to the multiplicity of procedures and partners involved.

5.3 Managing interactions between Cohesion policy and domestic policies

Programming documents also consider the degree of consistency between the Cohesion policy strategies on the one hand, and the domestic policy context and EU policies on the other. However, policy-makers' perceptions of the extent of linkages with domestic policies differ. In the case of some of the new Member States, the limited time available for planning the 2004-2006 strategies meant that there was not always effective coordination with domestic policies.

Various approaches are adopted by Member States in endeavouring to ensure effective linkages between Cohesion policy and domestic strategies. One example is the National Development Plan produced by the Irish authorities in 2000-2006, which covers domestic public investment as well as EU funds, and which also covers a wider range of thematic interventions (including housing) than those eligible for EU funding. Similarly, in Slovenia, the 2004-06 SPD is perceived to be fully consistent with the broader national Strategic Framework for Economic Development but to focus on a narrower range of interventions, not least due to limits on time, funding and implementation challenges.

A second example from the 2000-2006 programming period is provided by Italy's Objective 1 CSF, which recognises that the effectiveness of the strategy is conditional on a series of national policies, aimed at reinforcing competition on markets for goods and services; at enhancing the flexibility and efficiency of the labour market; at improving the efficiency of the public administration; and at supporting internationalisation[11].

5.4 Enhancing interactions in the future

Some of the Commission's proposals for the future aim to facilitate positive linkages, either between Cohesion policy instruments and spending categories, or between the Cohesion policy strategy and domestic policies. The proposal for mono-fund programmes, for example, is designed to improve complementarity between capital and current expenditure in categories such as human resources, which are currently financed separately by the ERDF and ESF respectively. Similarly, one rationale for the proposal that each Member State should draw up a national strategic reference framework is to enhance consistency between Cohesion policy and Member States' policies.

It would, however, be possible to devise other linkage-building methods that would be more closely adapted to the specific situations of individual Member States. A number of Member States, for example, have expressed the intention of adopting Ireland's approach of an overall National Development Plan, which would cover domestic public investment as well as EU co-financed expenditure. Indeed, Poland has already drafted such a Plan for the period 2007-2013.

A key issue for future Cohesion policy strategies in at least some of the new Member States will relate to the possible influence of Cohesion policy priorities on domestic public investment priorities. The combined effect of the scale of future EU funding, constraints on domestic public expenditure and the need to co-finance EU programmes is likely to limit room for manoeuvre in relation to autonomous public investment priorities.

6. QUESTIONS FOR DISCUSSION

As noted at the outset of this paper, the strategic thinking about future programmes under way at Member State level, and the EU discussions about the Community Strategic Guidelines make this an opportune time to be considering the challenges of designing

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[11] Ministero del Tesoro, del Bilancio e della Programmazione Economica (2000) *Quadro Comunitario di Sostegno per le Regioni italiane dell'Obiettivo 1, 2000-2006,* Decisione C (2000) 2050 del 01.08.2000. Roma.

Cohesion policy strategies. The following questions provide a starting point for discussion at the Conference:

- In your experience, how important do you think it is that efforts are made to sequence Cohesion policy funding in order to develop an effective strategy? What kinds of challenges are faced by policy-makers in setting strategic priorities?
- From the perspective of your Member State, what should be the main thematic priorities for Cohesion policy funding after 2006?
- What kind of approach – or approaches – are taken in your Member State to different geographical goals, notably national catching-up and balanced regional development?
- What methods do you think are most effective in building effective strategies? Could better use be made of systems for monitoring financial absorption and physical outputs, or evaluation studies?
- What is your experience of endeavours to ensure consistency and coherence between policy fields – either within the Cohesion policy strategy or between Cohesion policy and domestic policies?

ANNEXES

Table 1: Macroeconomic indicators in the EU25

	GDP per head (PPS, EU25=100) 2003	Unemployment Rate 2003	Employment Rate 2003	Inflation Rate 2004	General Govt Surplus/Deficit 2004	Gross Public Debt 2004	General Govt. GFCF 2003
EU25 average	100.0	9.0	62.9	2.1	-2.6	63.8	2.5
Belgium	117.8	8.1	59.6	1.9	0.1	95.6	1.6
Czech Republic	68.8	7.8	64.7	2.6	-3.0	37.4	4.0
Denmark	122.6*	5.6	75.1	0.9	2.8	42.7	1.7
Germany	108.1	9.3	65.0	1.8	-3.7	66.0	1.5
Estonia	48.5	10.1	62.9	3.0	1.8	4.9	3.4
Greece	81.2	9.3	57.8	3.0	-6.1	110.5	3.9
Spain	97.8*	11.3	59.7	3.1	-0.3	48.9	3.5
France	111.0	9.4	63.2	2.3	-3.7	65.6	3.3
Ireland	132.5	4.6	65.4	2.3	1.3	29.9	3.9
Italy	106.9*	8.6	56.1	2.3	-3.0	105.8	2.6
Cyprus	82.2	4.4	69.2	1.9	-4.2	71.9	3.4
Latvia	41.0	10.5	61.8	6.2	-0.8	14.4	1.8
Lithuania	45.8	12.7	61.1	1.1	-2.5	19.7	3.0
Luxembourg	214.7	3.7	62.7	3.2	-1.1	7.5	4.8
Hungary	60.5	5.8	57.0	6.8	-4.5	57.6	3.4
Malta	73.1	8.2	54.2	2.7	-5.2	75.0	5.4
Netherlands	121.0	3.8	73.5	1.4	-2.5	55.7	3.6
Austria	121.9	4.4	69.2	2.0	-1.3	65.2	1.2
Poland	46.0	19.2	51.2	3.6	-4.8	43.6	3.4
Portugal	74.7	6.4	67.2	2.5	-2.9	61.9	3.4
Slovenia	76.8	6.5	62.6	3.6	-1.9	29.4	3.0
Slovakia	52.3	17.1	57.7	7.4	-3.3	43.6	2.5
Finland	113.7	9.0	67.7	0.1	2.1	45.1	2.9
Sweden	115.2*	5.6	72.9	1.0	1.4	51.2	3.1
United Kingdom	119.2*	5.0	71.8	1.3	-3.2	41.6	1.7
Bulgaria	29.7*	13.6	52.5	6.1	:	:	:
Romania	29.6	6.6	57.6	11.9	:	:	:

* Forecast. **Source:** Eurostat. Employment and Unemployment Rates from Labour Market - Employment Indicators; Inflation Rate, General Government Surplus/Debt, Gross Public Debt from Structural Indicators - General Economic Background; General Government GFCF from National Accounts.

Table 2: Structural Funds' allocations to EU15 Objective 1 regions in 1994-99 and 2000-06 (% of Member State totals)

	B	D	EL	E	F	IRL	I	NL	P	UK	A	FIN	S	EU13
Infrastructure	**14.2**	**8.1**	**45.8**	**37.2**	**29.2**	**17.3**	**34.8**	**23.8**	**29.5**	**20.6**	**19.8**	**0.0**	**10.6**	**29.8**
Transport	4.8	0.0	28.6	21.3	14.2	14.0	12.1	20.7	17.4	9.8	0.0	0.0	5.4	15.7
ICT	1.5	0.0	1.8	1.5	0.0	0.4	3.3	0.0	2.2	0.8	2.2	0.0	5.2	1.6
Energy	0.0	0.0	6.2	2.2	0.5	0.7	4.3	0.0	0.0	4.3	2.6	0.0	0.0	2.3
Environment & water	7.4	0.0	4.4	10.6	13.7	1.6	14.5	3.0	7.0	5.6	15.1	0.0	0.0	7.5
Health & social	0.5	0.0	4.8	1.6	0.8	0.7	0.6	0.0	3.0	0.0	0.0	0.0	0.0	1.7
Human resource	**13.4**	**26.7**	**23.5**	**24.4**	**27.8**	**35.7**	**14.2**	**18.9**	**26.6**	**30.7**	**21.6**	**32.5**	**26.4**	**24.5**
Education	1.3	0.0	13.5	7.0	3.9	16.9	2.1	0.0	10.6	0.8	2.6	12.5	15.8	6.9
Training	12.1	26.7	8.9	17.5	23.9	18.8	12.1	18.9	16.0	30.0	19.0	20.0	10.9	17.4
Other	0.0	0.0	1.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Productive environment	**61.2**	**62.9**	**30.2**	**30.0**	**35.7**	**39.9**	**50.3**	**45.1**	**39.4**	**41.1**	**56.0**	**67.5**	**57.5**	**41.0**
Industry and services	36.6	34.8	7.2	14.4	8.4	16.8	24.8	14.6	22.7	21.6	20.7	45.0	26.4	19.9
RDTI	12.0	4.5	2.4	2.4	2.9	0.8	6.8	7.3	2.8	4.2	4.3	0.0	3.8	3.5
Agriculture rural dev, fisheries	7.2	23.6	15.6	11.3	20.9	17.7	15.5	20.1	13.8	8.8	14.7	18.8	19.9	15.2
Tourism	5.4	0.0	5.0	1.9	3.5	4.5	3.2	3.0	0.0	6.6	16.4	3.8	7.6	2.4
Other	**11.2**	**2.2**	**0.5**	**8.4**	**7.2**	**7.1**	**0.7**	**12.2**	**4.5**	**7.5**	**2.6**	**0.0**	**5.4**	**4.6**
TOTAL	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

	B	D	EL	E	F	IRL	I	NL	P	UK	A	FIN	S	EU13
Infrastructure	**14.1**	**22.7**	**43.2**	**42.5**	**29.5**	**45.8**	**37.2**	**25.0**	**22.5**	**23.0**	**4.4**	**0.0**	**10.5**	**34.3**
Transport	0.6	15.8	31.0	22.3	13.5	23.7	13.4	6.1	13.2	14.6	0.0	0.0	4.6	18.9
ICT	5.7	0.0	1.6	0.7	0.3	1.5	3.0	12.1	2.9	0.1	2.4	0.0	6.0	1.6
Energy	0.8	0.1	3.4	0.7	2.5	1.3	2.5	0.0	0.0	0.5	0.0	0.0	0.0	1.3
Environment & water	7.0	6.8	4.2	17.0	11.9	11.6	17.7	2.3	2.6	7.7	2.0	0.0	0.0	10.6
Health & social	0.0	0.0	3.0	1.7	1.4	7.7	0.5	0.0	3.8	0.0	0.0	0.0	0.0	1.9
Human resource	**26.5**	**28.3**	**19.0**	**25.4**	**31.8**	**28.1**	**20.1**	**15.2**	**24.4**	**31.1**	**21.2**	**29.0**	**20.8**	**23.9**
Education*	0.0	0.0	13.2	6.4	4.8	12.5	11.0	2.3	11.3	0.0	5.2	10.7	6.7	8.3
Training	26.5	28.3	5.8	19.0	27.0	15.6	9.1	13.6	13.1	29.7	21.2	18.3	14.1	15.7
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Productive environment	**52.4**	**45.0**	**25.6**	**28.1**	**33.8**	**22.6**	**39.7**	**52.3**	**38.1**	**44.2**	**72.4**	**71.0**	**61.4**	**34.8**
Industry and services	21.1	27.0	3.8	12.7	9.4	2.0	13.9	28.8	23.6	34.3	29.2	45.0	23.6	15.5
RDTI	18.3	0.9	1.6	3.0	1.9	9.9	7.6	3.8	2.5	1.3	10.0	0.0	11.4	3.5
Agriculture, rural dev, fisheries	6.8	17.1	14.5	10.5	18.7	8.8	15.3	15.9	12.0	6.9	15.2	22.1	18.4	13.6
Tourism	6.4	0.0	5.6	2.0	3.8	2.0	2.9	4.5	0.0	1.7	18.0	3.8	8.0	2.3
Other	**7.0**	**4.0**	**12.2**	**4.0**	**4.9**	**3.4**	**3.0**	**7.6**	**15.0**	**1.8**	**2.0**	**0.0**	**7.2**	**6.9**
TOTAL	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

* Including infrastructure for education co-financed by ERDF. **Source:** Second Cohesion Report (2001), Table A.36.

Table 3: Cohesion Fund and Structural Funds' allocations to the EU10 in 2004-06 (percentage of Member State totals)

	Czech Rep.	Estonia	Cyprus	Latvia	Lithuania	Hungary	Malta	Poland	Slovakia	Slovenia
Basic infrastructure	**18.6**	**19.4**	**7.8**	**15.2**	**23.1**	**21.4**	**44.9**	**23.6**	**23.1**	**13.6**
Transport infrastructure	10.7	3.9		8.2	9.5	9.1	11.0	16.8	12.2	
Environment	5.8	1.4		2.6	1.6	4.0	24.5	2.4	5.7	
Energy				1.7	4.0					
Education infrastructure		4.1		1.3	5.7	2.9	1.1		1.2	
Health infrastructure		3.7		1.3	2.3	1.6			1.2	
Social infrastructure						1.6	1.1	2.7		
Local infrastructure/Physical regeneration	2.2	6.3	7.8			2.2	7.2	1.7	2.8	
Human capital	**17.9**	**10.9**	**19.9**	**11.6**	**9.2**	**12.5**	**10.7**	**14.8**	**18.5**	**17.1**
Education inc. LLL	7.0	5.9	9.3	4.4	3.1	6.1		6.2	3.9	5.1
Active LM policies	8.0	3.9	10.6	5.6	4.1	6.5	10.7	6.7	13.7	6.8
Business training	2.9	1.1		1.6	2.0			1.9	1.0	5.1
Productive context	**8.5**	**3.0**	**0.0**	**10.3**	**7.3**	**7.0**	**5.3**	**6.6**	**5.2**	**4.5**
State aid	5.6	1.5		4.6	5.1	6.5		5.1	2.7	4.5
Other business support	2.9	1.4		5.7	2.2	0.5	5.3	1.5	2.5	
Other	**15.9**	**19.2**	**20.3**	**16.2**	**18.2**	**20.4**	**11.7**	**20.4**	**16.4**	**18.1**
R&D and innovation	3.2	5.7		3.4	1.7	3.2		3.2	0.8	6.1
Information Society	1.0	0.9		1.8	3.1	3.9		1.7	0.6	
Tourism	4.4	2.1		0.9	4.4	2.6	3.5	1.6	4.4	6.1
Agriculture/rural devt	6.5	8.3	17.2	8.0	8.2	9.8	4.9	12.3	10.3	5.5
Fishing	0.3	1.8	3.1	2.1	0.8	0.1	3.3	1.6	0.1	0.4
Administrative capacity	0.5	0.3				0.7		0.0	0.2	
Technical assistance	**2.0**	**2.2**	**1.6**	**1.5**	**1.8**	**2.8**	**1.6**	**1.1**	**3.1**	**2.4**
Cohesion Fund	**37.1**	**45.4**	**50.3**	**45.2**	**40.5**	**35.8**	**25.8**	**33.6**	**33.7**	**44.3**
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Programming Documents and EPRC own calculations.

Figure 2: The dispersion of GDP per capita across NUTS II regions in the EU25 in 2002

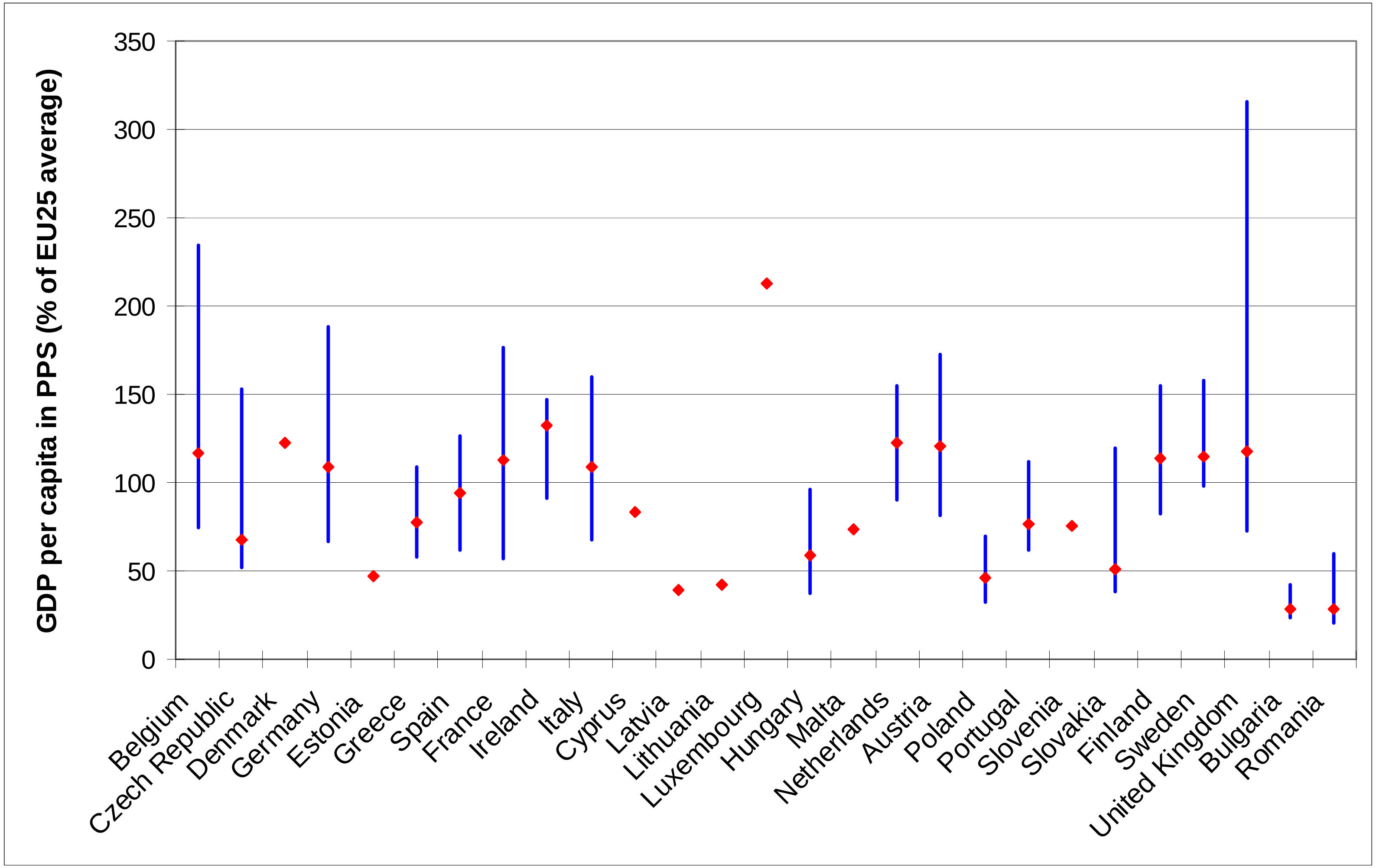

Figure3: The dispersion of unemployment rates across NUTS II regions in the EU25 in 2003