

Executive summary

Introduction: the policy context and cohesion objectives

Economic growth in the EU has slowed appreciably over the three years since the publication of the last Cohesion Report. As a result, unemployment has risen again in many parts of the Union with all the social implications which this entails. The sluggish performance of the EU economy over the long-term, however, suggests that there are more fundamental problems that need to be overcome if growth is to be sustained at an acceptable rate in future years.

These problems are reflected in the low growth of productivity in the EU in recent years, especially as compared with the US. Unlike in the Union, growth in the US has accelerated as innovation has increased and the use of information and communication technologies (ICT) widened. At the same time, up until the 2001 recession, employment growth was generally higher than in the EU and a large number of people of working age were in employment. In consequence, income per head in the US has remained some 30% above the EU level.

If growth in the EU is to be sustained once recovery gets underway, investment in physical and human capital needs to be increased, innovation needs to be stepped up and ICT more widely used to boost productivity and employment. This, however, needs to happen not just in central parts where productivity and employment are highest and innovative capacity most developed but throughout the Union.

While it is instructive to consider the performance of the EU economy overall, it is important not to ignore the wide disparities in output, productivity and employment which

persist between countries and regions. These disparities stem from structural deficiencies in key factors of competitiveness — inadequate endowment of physical and human capital (of infrastructure and work force skills), a lack of innovative capacity, of effective business support and a low level of environmental capital (a blighted natural and/or urban environment).

Countries and regions need assistance in overcoming these structural deficiencies and in developing their comparative advantages in order to be able to compete both in the internal market and outside¹. Equally, people need to be able to access education and training in order to develop their capabilities wherever they live. EU cohesion policy was strengthened some 15 years ago at the time the single market project was initiated precisely to meet these parallel needs. Such assistance is even more important now in the face of the widening of disparities which enlargement entails.

The contribution of cohesion policy to EU growth

If the EU is to realise its economic potential, then all regions wherever they are located, whether in existing Member States or in the new countries about to join, need to be involved in the growth effort and all people living in the Union given the chance to contribute. The cost of not pursuing a vigorous cohesion policy to tackle disparities is, therefore, measured not only in terms of a loss of personal and social well-being but also in economic terms, in a loss of the potential real income and higher living standards. Given the interdependencies inherent in an integrated economy, these losses

¹ See, for example, T. Padoa-Schioppa, *Efficiency, stability and equity - A strategy for the evolution of the economic system of the European Community*, Oxford University Press 1987, which emphasises that "there are serious risks of aggravated regional imbalance in the course of market liberalisation ... (and) adequate accompanying measures are required to speed adjustment in structurally weak regions and countries ... reforms and development of Community structural funds are needed for this purpose" (pp. 5-6).

are not confined to the less competitive regions or to individuals who are not working or who are in unproductive jobs but affect everyone in the Union.

Strengthening regional competitiveness throughout the Union and helping people fulfil their capabilities will boost the growth potential of the EU economy as a whole to the common benefit of all. And, by securing a more balanced spread of economic activity across the Union, it will reduce the risk of bottlenecks as growth occurs and lessen the likelihood of inflationary pressure bringing growth to a premature end. It will equally make it easier to sustain the European model of society and to cope with the growing number of people above retirement age and so maintain social cohesion².

Situation and trends

A narrowing of disparities between EU Member States but major challenges remain

Disparities in income and employment across the European Union have narrowed over the past decade, especially since the mid-1990s. Between 1994 and 2001, growth of GDP per head in the cohesion countries, even excluding Ireland, was 1% a year above the EU average, and the proportion of working-age population in employment in all apart from Greece increased by much more than the average.

In Greece, on the other hand, as in Ireland, growth of labour productivity was over twice the EU average over this period and it was also well above average in Portugal. In these two countries, therefore, the productive base seems to have been strengthened, increasing the potential for continued convergence in income in future years.

Despite the narrowing of disparities, large

differences remain. In Greece and Portugal, GDP per head is still only around 70% or less of the EU average and in Greece and Spain, some 6–8% fewer people of working age are employed than the average.

Disparities in both income and employment will widen much further when the new Member States join the EU in the coming months. Average GDP per head in these 10 countries is under half the average in the present EU and only 56% of those of working age are in jobs as against 64% in the EU15.

Although growth in these countries taken together has been around 1½% a year above the EU average since the mid-1990s, it has slowed since 2001 as markets in the Union on which they are dependent have been depressed. Achieving the high rates of growth in future years which they require for development depends on growth being sustained in the present Member States. Equally, however, given the interdependencies, high growth in the new countries can be a significant boost to the rest of the enlarged EU economy. But to attain this, they will need substantial help over the coming years to tackle their wide-ranging structural problems and realise their growth potential.

Disparities at regional level

Regions suffering from structural weaknesses which limit their competitiveness and prevent them from contributing fully to sustainable economic growth in the EU tend to be those which suffer from low productivity, low employment and social exclusion.

Regions with problems of competitiveness, however, are not confined to the worst off cohesion countries in the present EU and the new Member States. A number of regions, despite adequate endowment of infrastructure and human capital, have deficient innovative capacity and difficulty in sustaining economic growth.

² On this and previous points, see Agenda for a growing Europe, report of an independent high-level study group, chaired by André Sapir, July 2003.

Increasing convergence of lagging regions in the EU

Development problems are more acute in lagging regions which lack the necessary infrastructure, labour skills and social capital to be able to compete on equitable terms with other parts of the Union. These regions, which either receive assistance under Objective 1 of the Structural Funds or will do so in the near future, are largely concentrated in the cohesion countries and the new Member States.

Since 1994 when the Structural Funds were strengthened, GDP per head in Objective 1 regions has converged towards the EU average. Between 1994 and 2001, growth of GDP per head in these regions taken together averaged almost 3% a year in real terms as against just over 2% a year in the rest of the EU

The extent of convergence, however, has varied markedly between regions, in large part reflecting their relative importance in the Member States in which they are situated. In those in the four Cohesion countries, which benefited from both substantial assistance and growth-oriented policies at national level, growth of GDP per head was much higher than in the rest of the EU.

The number of people in employment has also risen markedly in the cohesion countries since the mid-1990s. The increase was particularly large in Ireland and was even larger in Spain, although the employment rate remains well below the EU average. The increase was more modest in Portugal and in Greece.

Outside of the Cohesion countries, growth in Objective 1 regions has been less impressive, dragged down in part by slow national growth. In the German new Länder, GDP per head increased by much the same as the EU average between 1994 and 2001, but in the Italian Mezzogiorno, it was below average. In both cases, however, productivity rose by more than in the rest of the EU, implying perhaps an improvement in competitiveness, but little if any employment growth. Only 43% of working-age population in southern Italy were, therefore, in jobs in 2002, well below anywhere else in the

Union, while unemployment remains high in the new Länder.

Strengthening competitiveness and employment creation

There are a number of areas in the EU in which structural problems deter investors and inhibit the growth of new economic activities despite reasonable levels of infrastructure and work force skills. These tend to be old industrial regions or those with permanent geographical and other characteristics which constrain development.

There are, for example, 11 NUTS 2 regions in the EU15 in which growth of GDP between 1994 and 2001 was around half the average or less (at only 1% a year or so) and in which GDP per head in PPS terms was above the 75% threshold for Objective 1 support but significantly below the EU average. These regions are spread across the Union, in the north-east of England, in northern parts of Germany and in sparsely populated-areas in the north of Sweden. In each case, they had low growth of productivity as well as of GDP per head. Many contain areas in which GDP per head is below 75% of the EU average.

The challenge for cohesion policy in these cases is to provide effective support for economic restructuring and for the development of innovative capacity in order to arrest declining competitiveness, falling relative levels of income and employment and depopulation. A failure to do so now will mean the problems are even greater when action is eventually taken.

A substantial widening of regional disparities with enlargement

Some 92% of the people in the new Member States live in regions with GDP per head below 75% of the EU25 average and over two-thirds in regions where it is under half the average.

If Bulgaria and Romania, where GDP per head is under 30% of the EU25 average, were to join the Union, the population living in regions with GDP per head below 75% of the EU average

would more than double from the present number (from around 73 million to over 153 million). The gap between their average GDP per head and the EU average would also double (from around 30% below average to over 60% below).

At the same time, economic restructuring has led to a fall in the number employed in the new Member States, with the result that the proportion of working-age population in employment is well below the EU15 average.

The effect of enlargement is to add just under 5% to EU GDP (measured in Euros) but almost 20% to the Union's population. As a result, average GDP per head in the EU of 25 Member States will be around 12½% less than the average in the EU of 15. For 18 regions with GDP per head at present below 75% of the EU15 average with population totalling around 19 million, including Malta, one of the new Member States, this will mean that their income per head is no longer below the 75% threshold.

Since the regions concerned have exactly the same structural weaknesses after enlargement as before, there is a compelling case for maintaining support.

Social cohesion and the risk of poverty

A significant number of people in both the present and new Member States have income levels which put them at risk of poverty, in the sense of relative deprivation (defined as income below 60% of the median in the country where they live). In 2000, around 55 million people, some 15% of the total population, faced the risk of risk of poverty, more than half of these having income levels this low for three years in a row. The proportion was relatively high in the countries of southern Europe and Ireland and was also higher than the EU15 average in many of the accession countries. (Accession countries is used throughout this report to denote the 10 new Member States plus Bulgaria and Romania.)

Households most at risk of poverty tend to be those with people aged 65 and over, especially

if they live alone, and lone parents (predominantly women), especially in the UK.

The risk of poverty is closely linked to unemployment and inactivity. Almost 40% of the unemployed had income below the poverty level in 2000, while the integration of people with disabilities, the long-term unemployed and ethnic minorities into employment remains a key challenge if the risk of poverty and social exclusion is to be reduced.

The ageing of the population and increasing dependency rates

Population of working age will begin falling over the present decade in all four southern Member States, Germany and most of the accession countries. In the next decade, the fall will spread to all countries, apart from Ireland, Luxembourg and Cyprus. On the latest projections, the number of people aged 15 to 64 is projected to be 4% smaller in the EU15 in 2025 than in 2000 and in the accession countries, 10% smaller.

This decline will be accompanied by substantial growth in the number of people of 65 and over. By 2025, there will be 40% more people than now beyond retirement age in both the present EU15 and the accession countries, implying a ratio of under three people of working-age for every one aged 65 and over as opposed to a ratio of over four to one at present. Other things being equal, the ageing of population will lead to a gradual contraction of the EU's work force and is likely to have implications for growth potential.

The significance of this, however, will depend on real income and employment growth in future years, which will determine the ease or difficulty of supporting those in retirement. In practice, only 64% of people of working-age in the EU15 and 56% in the accession countries are in employment and generating income at present. The effective ratio, therefore, is already only around 2½ people in work to every one in retirement in the enlarged EU. In 2025, if employment rates remain the same, this ratio will have fallen to under two to one.

These prospects give added importance to the need to sustain economic growth across the EU and to increase employment rates and reduce early retirement. Immigration could in some cases be an important source of additional labour supply, giving greater prominence to the effectiveness of integration policies.

Narrowing disparities in regional competitive factors

As indicated above, two complimentary sets of conditions need to be satisfied for regions in the Union to sustain economic development and employment in a competitive environment. The first is that they must have suitable levels of both physical infrastructure (efficient transport, telecommunications and energy networks, good environmental facilities and so on) and human capital (a labour force with appropriate levels of skills and training). The second is that, in the new knowledge-based economy, regions must have the capacity to innovate and to use both existing know-how and new technologies effectively as well as to follow a development path which is sustainable in environmental terms. To achieve both requires an effective institutional and administrative framework to support development.

Improving infrastructure endowment

Over the past decade, transport links both within the cohesion countries and between these and the rest of the EU have improved markedly. In particular, with Structural Fund support, the density of the motorway network in these countries increased from 20% below the EU15 average in 1991 to 10% above in 2001. This increase, however, was largely concentrated in Spain and Portugal. In Objective 1 regions as a whole, though the density was higher than 10 years earlier, it was still only around 80% of the EU15 average. In the accession countries, motorway density is much lower still (under 20% of the EU15 average). Construction is occurring at a rapid rate, despite the environmental trade-offs that have to be made, but mostly around capital

cities or on transit routes to the present Member States.

Some modernisation of the rail network across the Union has occurred over the past decade, but the rate of electrification of lines and conversion to double track has occurred at much the same pace in the lagging parts of the EU as elsewhere, so the gap remains large. In the accession countries, the state of the railways reflects decades of neglect and considerable investment is needed both for modernisation and for replacement of worn-out track. The need for investment, however, is no less acute for roads. The increase in road building, however, is reinforcing the rapid shift of both passengers and freight from rail to roads.

In telecommunications, the number of fixed telephone lines in relation to population remains much lower in both the cohesion and accession countries. This is being offset by a rapid rise in mobile phone use, though in Greece and the accession countries, usage is still less than the EU15 average, in most of the latter, substantially so. At the same time, access to broadband lines, which is important for internet use and the development of various ICT applications and services, shows wide disparities across the Union, broadly in line with relative levels of prosperity. Availability is still very limited in many parts of the EU15 as well as in nearly all the accession countries.

Other infrastructure — schools, colleges, health facilities and social support services of various kinds — is equally important, since it is likely to have a growing influence on decisions of where to invest and locate new businesses. This is especially the case in respect of knowledge-based activities, which are not tied to any particular location by a need to be close to sources of raw materials or a large market.

As regards the environment, the need for investment remains substantial in the cohesion countries and, even more, in the accession countries, as reflected, for example, in much smaller proportion of the population connected to waste-water treatment plants as compared with other parts of the Union. The need is no

less important, however, in waste management and control of emissions, especially given the rapid growth in road use occurring in the accession countries.

Strengthening human capital

While the European Employment Strategy launched in 1997 has contributed to increasing the resilience of employment in a period of economic slowdown, important structural weaknesses remain, in both present and new Member States.

In order to prevent unemployment and support the integration of the unemployed into work, there is a need to offer personalised services to job seekers in the form of guidance, training and new job opportunities. Developing preventative and active labour market policies is particularly important in the new Member States to promote economic restructuring.

A high level of education and skills is of increasing importance both for individual advancement and economic competitiveness. The relative number of people with education beyond basic schooling remains much lower in Objective 1 regions than in the rest of the EU15, especially in Spain, Italy and Portugal, the one exception being the German new Länder. Here the relative number is more similar to that in the accession countries, where it is much higher than the EU15 average (around 80% or more as against an EU15 average of 64%).

The skills obtained from further education and initial vocational training in the accession countries, however, are not necessarily in line with labour market needs and curricula and teaching structures are not well adapted to the modern economy. Moreover, many fewer young people than the EU15 average go on to complete university-level education, which is a key requirement for making a significant contribution to the development of the knowledge-based economy. This is also the case in the present Objective 1 regions in the Union, where, despite the increases over the past decade or more, the gap with the rest of the EU remains large.

Equally, many fewer people in both the cohesion and accession countries seem to participate in continuing training than in the rest of the Union (under 20% of those employed in enterprises in Greece, Portugal and all the accession countries apart from the Czech Republic and Slovenia in 1999), despite the critical need to adapt to economic change.

Strengthening social cohesion

Economic, employment and social policies are mutually reinforcing. Economic development must go hand in hand with efforts to reduce poverty and to fight exclusion. Promoting social integration and combating discrimination is crucial to prevent social exclusion and to achieve higher rates of employment and economic growth, notably at regional and local level.

Equally, providing comprehensive support to those most disadvantaged, such as ethnic minorities and early school leavers, can be important in securing economic and social gains throughout the EU.

Continuing disparities in innovative capacity

In an increasingly knowledge-based economy, innovation holds the key to regional competitiveness. The capacity to innovate, access knowledge and exploit it, however, varies between regions in both the existing and the new Member States. While the aim of policy is not to ensure that all regions have the means for contributing equally to advances in new technologies, they should nevertheless be equally placed to take advantage of those advances and to put them to productive use.

Various indicators, however — the relative scale of R&D expenditure, employment in research activities and the number of patent applications, in particular — suggest that there is a wide gap in innovative capacity between the stronger regions in central parts of the Union and others. (According to the latest figures, 8 of the 213 NUTS regions in the present EU account for around a quarter of total R&D expenditure in the Union and 31 are responsible for half.) There is

a similarly wide disparity both between the accession countries and the EU15 average and, within the former, between capital city regions and others.

There is a growing consensus about the importance for regional competitiveness of good governance — in the sense of efficient institutions, productive relationships between the various actors involved in the development process, and positive attitudes towards business and enterprise. Nevertheless, regions still differ markedly in these respects and in their ability to develop their own competitive advantage given the expertise they possess.

Impact of Member State policies on cohesion

Public expenditure in Member States is a great many times larger than the amount spent by the EU on cohesion policy. Whereas the former averages around 47% of GDP, the budget allocated to cohesion policy amounts to a bit less than 0,4% of EU GDP. Nevertheless, despite its relatively small size, EU cohesion policy performs a valuable role in tackling the underlying causes of disparities across the Union in income and employment. While Member State policies involving public spending are mainly directed at providing basic services and income support, EU cohesion policy is focused on reducing the structural disparities which directly affect the economic competitiveness of regions and the employability of people.

Public expenditure mainly focused on ensuring access to basic services ...

The bulk of public expenditure in Member States, therefore, goes on providing a range of services aimed at ensuring that everyone has access to education, health care and social protection. Together these three functions account for almost two-thirds of total government spending in the EU. By contrast, public spending on investment in human and physical capital amounts to only just over 2% of

GDP on average and is under 4% of GDP in all countries apart from Ireland and Luxembourg. The amount spent by national governments on business support services, higher education, innovation and R&D is similarly low (the latter averaging only around 0,3% of GDP across the EU).

In relation to the sums allocated to structural expenditure by Member States, therefore, the scale of the budget of cohesion policy no longer seems so small. Moreover, unlike the former, EU structural spending is concentrated in the regions which are most in need of assistance (the EU structural allocations to Greece and Portugal, for example, amount to around 2½% of their GDP in each case).

And contributes significantly to narrowing regional disparities in income...

For the most part, government expenditure per head of population in relation to GNP on basic services, like education and health care, is relatively similar across regions in Member States, reflecting a concern to ensure a common level of provision to people irrespective of where they live. However, the main variation occurs in spending on social protection because of differences in unemployment and the number of people in retirement, although spending on administration also differs because of government ministries being concentrated in the national capital.

The combined effect of these tendencies is that the contribution of public expenditure to income is in general much higher in the less prosperous regions than in the more prosperous ones, but mainly because of the lower level of income rather than higher public spending.

While government revenue is proportional to income

Government revenue, on the other hand, seems to be broadly proportional to income, in the main because in all Member States most taxes are levied centrally either on income or

expenditure. It, therefore, does not tend to offset the positive contribution of public expenditure to reducing income disparities between regions. Moreover, in countries where a significant proportion of revenue is raised locally, redistribution mechanisms are in place to reduce disparities in the income available to regions to fund expenditure.

The widespread trend towards devolving responsibility for public services to regional and local level has not, therefore, been accompanied by a similar trend in respect of raising the money to fund these services. The main exception is Italy, where responsibility for raising revenue is being increasingly devolved to the regions without a counterpart strengthening of regional transfers.

Foreign direct investment: a major factor in regional development

Foreign direct investment (FDI) can potentially play a key role in reducing regional disparities in economic performance not only as a source of income and jobs but as a means of transferring technology and know-how to lagging regions. It is particularly important for the accession countries, in need of substantial restructuring of their economies and of a step increase in productivity and competitiveness. Irrespective of the financial inducements on offer, however, foreign investors are not necessarily attracted to places where the need is greatest, for much the same reasons as domestic investors (infrastructure deficiencies, the lack of a skilled work force, and so on).

FDI, therefore, tends to go disproportionately to the stronger rather than the weaker parts of the Union. Over the period 1999–2001, investment inflows represented around 21% of GDP in Ireland — the country with the second highest GDP per head in the EU — 15% in Denmark (the country with the third highest level) and 13% in the Netherlands (the fourth highest). By contrast, inflows into Portugal amounted to only just over 4% of GDP, while the countries with the smallest inflows were Spain (1½% of GDP), Italy (1%) and Greece (just under 1%).

Within countries, FDI is generally concentrated in and around large cities, especially national capitals, with very little going to lagging regions. The new German Länder, excluding the eastern part of Berlin, therefore, accounted for only just over 2% of total inflows into Germany between 1998 and 2000 and Objective 1 regions in Spain for under 10% of inflows into the country in 2000. Similarly, in Italy, under 4% of the total employed in foreign-owned companies were in the south of the country.

The same general pattern is evident in the accession countries. In 2001, over two-thirds of inward FDI into Hungary went to the Budapest region, over 60% of inflows into the Czech Republic to the Prague region and a similar proportion of inflows into Slovakia to Bratislava.

Impact of Community policies: competitiveness, employment and cohesion

Unlike structural policy, other EU policies are not aimed principally at narrowing regional disparities or reducing inequalities between people. Nevertheless, they have implications for cohesion and in many cases take specific account of disparities.

Building the knowledge-based economy

Community enterprise, industrial and innovation policy is aimed at strengthening the competitiveness of EU producers by promoting competition, ensuring access to markets and establishing an environment which is conducive to R&D across the Union.

As is recognised, a lack of innovative capacity at regional level stems not only from deficiencies in the research base and low levels of R&D expenditure but also from weaknesses in the links between research centres and businesses, and slow take-up of information and communication technologies. The Innovation Relay Centres which have been set up and the Innovating Regions in Europe

network are therefore designed to encourage regions to develop innovation policies and to provide technological support to businesses.

Disparities in access to Community funding for research programmes are still evident, particularly at regional level, though the Sixth Framework Programme is in part aimed at improving links between scientific centres in the more central parts of the EU and those in peripheral areas.

Strengthening education and training

The skills of its work force are the EU's prime comparative advantage in global competition. A high level of education and the provision of a high standard of training, which is accessible to people throughout their working lives, are key to strengthening innovative capacity throughout the EU and to the attainment of the Lisbon objective of making the Union the most dynamic knowledge-based economy in the world. The 'Education and Training 2010' programme has been implemented to help achieve this end, with the complementary aim of making education and training in Europe "a world reference for quality by 2010".

More and better jobs in an inclusive society

At the Lisbon European Council, the EU defined a comprehensive strategy aimed at long term economic growth, full employment, social cohesion and sustainable development in a knowledge based society. The European Employment Strategy (EES) was revised in 2003 better to underpin in an enlarged Union the objectives set at Lisbon and was directed at supporting Member State efforts to reform their labour markets, achieve full employment, increase quality and productivity at work and reduce social disparities.

Success in implementing the EES depends on a clear commitment from Member States to help workers and enterprises increase their adaptability, attract more people into employment; invest more, and more effectively,

in human capital and improve governance. Action to increase social inclusion contributes both to reducing inequalities in access to employment and to raising the growth potential of the economy. Following Lisbon, a common strategy for social inclusion was adopted by the EU in 2001. The second generation of national action plans produced by Member States in 2003 recognises the multi-dimensional nature of social exclusion and need to combat it through a wide range of measures by making economic, employment and social policies mutually supportive.

The Union's commitment to equality between men and women needs to be translated into a comprehensive mainstreaming approach, ensuring that all policies take account of their gender impact in planning and implementation. If the Lisbon employment target set for 2010 is to be achieved, the factors underlying the gender gap in employment, unemployment and pay need to be tackled vigorously. In this respect, actions which attract women into employment, encourage them to stay longer in the labour market and make it easier to reconcile a working career with family responsibilities through the provision of care facilities should be further pursued.

Environmental protection for sustainable growth and jobs

Sustaining economic development and creating long-term, stable jobs depends on protecting the environment against the potentially damaging effects of growth and on preventing excessive depletion of exhaustible resources. The Sixth Environmental Action Programme, *Our Future — Our Choice*, sets out the environmental actions necessary to sustain the pursuit of the EU's economic and social objectives. These involve limiting climate change, preserving the natural environment and biodiversity, reducing emissions damaging to health and diminishing the use of natural resources by cutting waste. They also involve taking account of environmental considerations when implementing structural policy decisions involving investment.

Although there are costs to environmental protection, not least in the lagging regions where infrastructure needs tend to be greatest, there also substantial potential gains from improvements in health and job creation in the eco-industries, as well as from more sustainable development.

The internal market and services of general economic interest

Liberalising the markets for transport, telecommunications and energy has led to increased efficiency and lower prices. It has, also, however, involved a threat to particular social groups or regions of being excluded from access to essential services. Public service obligations have, therefore, been established to ensure that everyone can obtain essential services — or ‘services of general economic interest’ — of reasonable quality and at affordable prices, as required by the EU Treaty (Article 16). Community funds have been made available to help ensure that these obligations are respected across the EU.

At the same time, the trans-European transport networks have increased the accessibility of the more remote regions and facilitated the expansion of trade, and those planned to link the new Member States with the existing ones are likely to have similar effects. The trans-European energy network guidelines, adopted in 2003, put increased emphasis on investment in gas pipelines and electricity distribution systems in land-locked, peripheral and ultra-peripheral regions in future years. And the trans-European telecommunication network programme (or eTEN) is intended not only to improve communications between more remote regions and other parts of the EU but also to tackle deficiencies in ICT applications and services.

Reforming common policies: agriculture and fisheries

Although expenditure under the Common Agricultural Policy (CAP) has declined gradually over time, it still accounts for almost 47% of the

Community Budget. Since the reform process began in 1992, direct aids to producers have risen to 70% of total spending, but they remain below the EU average in Spain, the only cohesion country where this is the case. On average payments are larger relative to income for large and medium-sized holdings than for small ones.

Support for rural development in the 2000–2006 period is larger in Objective 1 regions (56% of the total spent) than in other parts of the EU, though only around 10% of this goes on measures to strengthen the rural economy outside of agriculture. In the next programming period, 2007 to 2013, CAP expenditure will be lower in real terms, with a decoupling of direct payments from production, a reduction of payments to large holdings, lower prices and more emphasis on both rural development and the environment.

With enlargement, employment in agriculture in the EU will increase by around 60% with a substantial rise in the number of small holdings. The share of total spending under the CAP going to Objective 1 regions in the new and existing Member States is estimated to increase by around 10 percentage points to some two-thirds.

The Common Fisheries Policy (CFP) is aimed primarily at conserving fish stocks and restructuring the industry to ensure its sustainability. The recent emergency measures introduced will have significant effects on a number of regional economies, especially in Spain and Portugal. While in the longer-term, a slimmed-down industry should return to profitability once the emergency measures come to an end, in the short-term, it is largely the responsibility of Member States to alleviate the adverse social and economic consequences.

Of the accession countries, only Poland and the three Baltic States have fishing industries of any size and these are already in decline. Together their total catch amounts to under 7% of that in existing Member States.

State aid and cohesion policy

Insofar as the present regime allows for discrimination in favour of problem regions, control of state aid can both contribute to and support cohesion policy. In line with commitments made at the Stockholm Council, overall expenditure on state aid fell significantly in money terms between 1997 and 2001 and declined relative to GDP in 12 of the 15 Member States. At the same time, spending is increasingly being shifted towards horizontal objectives. Nevertheless, it remains higher in the more prosperous Member States than in the Cohesion countries.

In 2001, only around 9% of total state aid in the EU took the form of assistance to Objective 1 regions and the amount involved was under a third of that in the peak year of 1993, mainly because of large reductions of aid to the German new Länder as well as to southern Italy. Regional aid to Objective 2 areas accounts for around 6% of total state aid.

Given its effect on the regional distribution of economic activity and income, the control of state aid remains of major importance in the context of enlargement. For the period after 2006, efforts will therefore continue to be made to modernise, simplify and clarify state aid rules, taking account of changes in cohesion policy, with the aim of having less but better targeted assistance.

Justice and home affairs: improving the conditions for development

A high crime rate, the existence of organised crime and corruption tend to inhibit economic development and deter potential investors. A strengthening of the capacity to combat crime, increased cross-border cooperation, improved controls of external borders and better integration of third-country nationals into society are, therefore, all ways of supporting regional development. This is particularly the case in the accession countries.

Perceptions of Community policies in the regions

Surveys carried out among regional officials across the EU indicate that Community policies are largely identified with Community funding and that projects financed by the Structural Funds tend to be both the most visible and those regarded as having the greatest impact. This is especially the case in Objective 1 regions and most particularly in the cohesion countries. The positive impact of the Community INTERREG Initiative was also acknowledged because of its focus, visibility and stimulus to cooperation.

While the effect of the CAP on cohesion was generally regarded as being positive in regions where agriculture was most important, it was claimed to be unfair in Mediterranean regions and to favour the most profitable farms and the most developed areas in other cases. The absence of a link between the CAP and environmental policy was criticised, while the integration of environmental considerations into regional development policy was widely welcomed, as was the incorporation into the latter of investment in R&D infrastructure, considered especially important in Objective 1 regions.

At the same time, there was widespread criticism of the high cost of managing Structural Fund programmes in the present period and of the increasing complexity of procedures. By contrast, the greater involvement of businesses and the social partners was viewed as an important advance which should be carried further.

The impact and added value of structural policies

The scale and direction of intervention in Objective 1 regions

The Structural Funds and the Cohesion Fund, which amount to only around 0,4% of EU GDP, are concentrated on assisting the least prosperous parts of the Union. In the 2000–2006 period, the amount transferred to Objective 1 regions is equivalent to 0,9% of GDP in Spain and over 2½% of GDP in Greece and Portugal. More significantly, these transfers are estimated to add some 3% to investment in Spain and 8–9% in Greece and Portugal, as well as 7% in the Italian Mezzogiorno and 4% in the German new Länder.

In most cases, national public expenditure supplementing Structural Fund interventions was larger in real terms in the 1994–1999 programming period than the previous one, increasing the amount available for investment by 40–50%. This was added to further by private funding, which was especially significant in Austria, Germany, the Netherlands and Belgium, though the amounts ‘levered’ in this way were relatively small in the cohesion countries, France and the UK. The leverage effect on private investment in the present period seems to be similar, though much smaller in Germany.

Structural expenditures are also supplemented by European Investment Bank (EIB) loans. Lending to assisted areas in the EU15 totalled EUR 20 billion a year between 2000 and 2002, over half of which went to Objective 1 regions, and that to the accession countries EUR 3 billion a year. Over a third of loans went to investment in transport in the present Objective 1 regions, while in the accession countries, 90% went to transport, the environment and energy.

The Structural Funds have been deployed, in particular, to reduce disparities in infrastructure and in human capital endowment between

Objective 1 regions and other parts of the EU. Transport systems, both trans-European links and secondary networks within regions, have, therefore, been improved markedly over the past decade, while counselling and training has been given to the unemployed and those in work vulnerable to job loss in order to increase their employability and increase their skills. At the same time, support has been given to R&D and innovation, both to construct new research capacity and, equally importantly, to help formulate regional strategies for directing R&D towards meeting local opportunities for development, as well as to furthering the spread of ICT and the basic skills required to use the new technologies.

In addition, a significant proportion of the Structural Funds (14% in the 2000–2006 period) has gone to financing investment to improve the environment, to waste management and waste water treatment especially, while environmental considerations are explicitly taken into account when deciding structural interventions.

The effect of intervention on real convergence and economic integration

Empirical analysis shows not only that growth of GDP, employment and productivity in Objective 1 regions has exceeded that in the rest of the EU since the mid-1990s in particular, but that convergence has been most pronounced in the least prosperous regions among these. (It should be noted that this analysis is based on a consistent set of data specially compiled for the report.) It also indicates that structural interventions have boosted growth in the cohesion countries both by adding to demand and strengthening the supply side of the economy. In Spain, therefore, GDP in 1999 is estimated to have been some 1½% higher than it would have been without intervention, in Greece, over 2% higher, in Ireland, almost 3% higher and in Portugal, over 4½% higher. In addition, GDP in the new German Länder is estimated to have been increased by around 4% as a result of intervention.

Structural intervention has also encouraged a growth of trade between cohesion countries and

other parts of the Union — which has more than doubled over the past decade — and closer integration. The evidence suggests that, on average, around a quarter of structural expenditure returns to the rest of the Union in the form of increased imports, especially of machinery and equipment. This 'leakage' is particularly large in the case of Greece (42% of expenditure) and Portugal (35%).

Since a large proportion of any increase in spending in the new Member States goes on imports and around 60% of these come from the existing EU Member States, structural expenditure in these countries is likely to involve similarly large leakage effects to the benefit of growth in the rest of the Union. As in the cohesion countries, this spending tends to go disproportionately on imports of machinery and equipment, to the benefit of Germany, in particular, which accounts for around 45% of all such imports purchased from the EU15.

Intervention in Objective 2 regions: restructuring and job creation

Over the period 1994–1999, 82 regions in 12 Member States received Objective 2 assistance totalling around EUR 2.4 billion a year (increased to EUR 3.3 billion a year in the present period) because of the presence of areas of industrial decline. This was supplemented by similar amounts of funding from both national public and private sources, increasing overall structural expenditure in these areas to around EUR 7 billion a year. Spending was concentrated, in particular, on the reconversion of old industrial sites and business support services (together accounting for around half the total), while some 20% went on human resource development and 10% on support for R&D and ICT.

Evaluation studies suggest that overall, structural intervention in these areas led to the creation of some 700 thousand jobs over the period and just under 500 thousand in net terms, while around 300 thousand SMEs received assistance to improve their production methods and to seek out new markets. At the same time, some 115 million square metres of

industrial waste land was cleaned up and reconverted, enabling new economic activities to be developed, including leisure and cultural ones. Partly as a result of these measures, unemployment declined by slightly more in these areas than in the rest of the EU, though GDP per head rose by a little less.

More detailed analysis indicates that support for R&D, innovation and technology transfer was particularly effective in creating new jobs or maintaining existing ones, though in general the innovative capacity of most Objective 2 areas remains less developed than in more successful regions. By contrast, endowment of infrastructure and human capital seems comparable to levels elsewhere.

Although the interventions have had positive effects, these might have been greater if both the areas eligible for support and the scale of operations funded had been bigger and if the time horizon for projects (three years) had been longer. These changes would enable programmes of more strategic importance for regional development to be supported.

Support for agriculture, rural development and fisheries

Interventions under Objective 5a during the 1994–1999 period were aimed at improving agricultural efficiency and helping to safeguard the countryside and seem to have been relatively effective in supporting restructuring of small farms in Objective 1 regions.

Interventions under Objective 5b amounted to around EUR 1.2 billion a year and were implemented in areas housing some 9% of the EU population. They seem to have led to some diversification of agricultural production and a growth of activities, such as agri-tourism and environmental services, while helping to renovate villages and develop public services.

In the present programming period, support for rural development has been integrated into a single overall strategy, though divided between two programmes, one subject to the Structural

Fund regulations, the other to those of the EAGGF-Guarantee. The latter are designed for agricultural market policies and not well adapted to multi-annual action programmes.

The fishing sector is concentrated in a limited number of regions in peripheral parts of the EU, which have been hit by the measures taken to preserve fish stocks and where, accordingly, interventions under the Common Fisheries Programme can contribute significantly to the development of other economic activities

Promoting employment, education and training through the ESF

During the 1994-1999 period, the European Social Fund (ESF) provided support for the development of human resources amounting to a third of overall Structural Fund interventions, around half going to Objective 1 regions.

Interventions under Objective 3 were aimed at integrating young people, the long-term unemployed, and those at risk of exclusion into employment and at promoting equal opportunities. Interventions under Objective 4 were focussed on helping workers adapt to industrial change. Evidence suggests that the most successful measures were those offering a combination of support, such as guidance, training and job search, tailored to individual needs.

In addition, the ESF provide finance for employment, education and training systems at both national and regional level. In Objective 1 regions, the ESF helped to increase levels of public investment in education and training. Although the European Employment Strategy (EES) was launched when the programming period was already underway, the ESF provided significant support, from 1997 on, for policies included in the National Action Plans for employment (NAPs), especially in the southern Member States.

In the 2000-2006 period, the link between the ESF and the EES has been strengthened considerably. With a budget of around EUR 60

billion overall, the ESF has become the main Community financial instrument underpinning the EES, and the EES, in turn, provides a stronger policy framework for ESF interventions and employment creation.

Promoting cooperation and networking

Community Initiatives are designed to promote innovation, partnership and the development of collaborative ventures between countries and regions, addressing needs often unmet by the mainstream programmes implemented under the Structural Fund Objectives.

In the 1994–1999 period, INTERREG II supported three broad types of programme, cross-border cooperation (Strand A), energy networks (Strand B) and cooperation over regional and spatial planning (Strand C). Most funding went to Strand A programmes for improving the environment, supporting cultural activities, tourism and services for SMEs and assisting the development of transport links, especially cross-border routes. Significant improvements were made, in particular, to border crossings in Objective 1 regions in Greece, Germany and Finland. The main benefits, however, have come from increased contact and better understanding between public authorities and private and semi-public organisations on either side of the border.

During the period 2000–2006, INTERREG III — endowed with around EUR 5 billion — reinforced the cross-border component (Strand A), promoted strategic cooperation at transnational level on spatial planning themes (Strand B), and favoured cooperation and exchange of experiences between regions (Strand C).

In the future, INTERREG will need to take account of the new context in which border areas represent a larger part of the EU in terms of both population and land area.

The URBAN Initiative covers the 44% of the EU population living in cities of over 50,000 people. In the 1994–1999 period, support amounted to EUR 148 million a year and was divided

between 118 cities. In the present period, this was reduced to EUR 104 million a year divided between projects in 70 cities. The main focus is on small urban neighbourhoods and on encouraging local involvement in schemes which directly affect people's lives. This has helped to raise the visibility of EU structural policy as a whole. It has also helped to attract private investment. On the other hand, the concentration of support on small areas leaves out of scope projects for tackling wider regional issues, such as the relationship between urban and neighbouring rural areas.

The EMPLOYMENT and ADAPT Initiatives supported around 9,300 projects in the 1994–1999 period, involving some 1.8 million people in programmes for labour market integration and job creation at local level. Projects funded included measures for facilitating access to work and training, support for new sources of employment, help for SMEs to anticipate change and child care support for women to make it easier for them to pursue a working career.

In the 2000–2006 period, EQUAL are been focussed on new innovative approaches to combating inequalities and discrimination on the labour market, giving strong emphasis to trans-national cooperation, partnership and the exchange of experience and good practice.

LEADER II provided support in rural areas to around 900 local action groups over the period 1994–1999 from a budget of EUR 300 million a year which was increased to EUR 700 million through co-financing. The main activity funded was tourism, though assistance was also given to SMEs and the development of local products.

With LEADER+ (2000–2006), which has the same annual budget as LEADER II, more emphasis has been put on the pilot nature of projects and cooperation has been made easier.

Pilot innovative actions

Nearly one in three regional authorities across the EU15 has formulated a Regional Innovation

Strategy (RIS) or a Regional Information Society Initiative (RISI). The most visible effects of the two Initiatives have been public-private sector partnerships and support for SMEs to access new technologies.

A new system for innovative actions, with Structural Fund support of around EUR 400 million in total, was introduced in 2001 to encourage regions to develop programmes for increasing regional competitiveness through technology and innovation (the Lisbon strategy), applying new forms of ICT (the e-Europe action plan) and promoting sustainable development (Gothenburg). So far three out of four regions in the Union have applied for funding for programmes relating to one of these three themes.

Improving the effectiveness of Structural Fund management

In the last review of the Structural Fund regulations in 1999, there was an attempt both to simplify the system and decentralise day-to-day management to Member States. Though Member States are increasingly responsible for how the Funds are spent, the Commission remains ultimately accountable to the budgetary authority for expenditure. The need before the new funding period is to review the regulations with a view to increasing the effectiveness of the system and further reducing its complexity.

The core principles

Programming, partnership, concentration and additionality have remained the central principles of the Structural Funds since the 1988 reform. Programming, in the sense of planning expenditure over a number of years to achieve strategic objectives, has resulted in greater certainty and more stability and coherence in the policy followed and the projects funded. While the programming period has lengthened as planning capabilities have increased and while objectives have become more quantified, concerns have grown over the

complexity and time involved in approving programming documents and over the need to ensure that programmes are flexible enough to adapt to change.

Partnership in the design and implementation of programmes has become stronger and more inclusive, involving a range of private sector entities, including the social partners, as well as regional and local authorities. This has led to better targeted and more innovative projects, improved monitoring and evaluation of performance and the wider dissemination of information of their results, at the price, in some cases, of additional complexity of programme management.

Concentration, in the sense of focusing funds on the areas most in need, has increased over time, though evaluations suggest that resources are still sometimes spread too widely and thinly. In the present programming period, 41% of the EU15 population live in either Objective 1 or Objective 2 regions, though the complicated process of defining the latter led to some fragmentation of regions and excessive dispersion of resources.

Additionality has been largely respected in Objective 1 regions, in the sense that the Structural Funds have supplemented rather than replaced existing public expenditure. However, verifying that this has also been the case as regards Objective 2 and 3 programmes, especially the latter, has proved more difficult.

The search for greater effectiveness

Although expertise in managing the Funds has increased over time, improving the effectiveness of programmes remains a key challenge. The control procedures required are often regarded by Member States as unwarranted given the costs involved and as duplicating national systems. A particular criticism is that present requirements were decided so late that they have led to delays in programme implementation, creating pressure for funds to be spent quickly at the expense of quality. Costs of financial management seem especially high for Objective 2 programmes.

While the management of public funds has improved, it was still the case, in the last programming period, that only a third of Objective 1 projects evaluated were completed on time, while a third were over a year late. In addition, two-thirds of projects were over budget. The discipline imposed by the N+2 rule during the current period has contributed to significantly improve the use of structural monies. In 2003, the financial execution of the Structural Funds was close to 100%.

Monitoring is an essential part of the system, but evaluations suggest that it has not been as effective as expected, partly because of the difficulty to collect meaningful information. Moreover, the focus on financial issues rather than strategic ones tends to lead to funds being spent where they are most easily absorbed instead of where they might be most effective. Although improvements have been made in the present period by identifying indicators and targets, the former are often not well defined and the latter too broad.

Evaluation has also improved over time, but still varies considerably between Member States in the way it is implemented. Evaluations are now required to be undertaken *ex ante* by Member States, at mid-term in cooperation with the Commission — in time for the results to affect decisions on the remainder of the programme — and *ex post* by the Commission, though only two years after the programme ends. More involvement of regions and Member States in the process might make it more useful and relevant.

To encourage better management, a financial incentive in the form of a performance reserve, with 4% of Structural Fund resources, has been introduced in the present period for allocation in 2004 on the basis of the achievement of programme targets specified initially.

Management systems have in many cases become more decentralised over time which, according to evaluations, has tended to increase their effectiveness by making them more responsive to regional needs.

The challenge of enlargement

The Structural Funds are of key importance to the new Member States in helping them strengthen their competitiveness. Over the period 2000–2006, the accession countries are receiving some EUR 3 billion a year from ISPA (for transport and environmental projects), SAPARD (for agriculture and rural development) and PHARE (for strengthening economic and social cohesion and administrative and institutional capacity). After the 10 new Member States enter the EU, they will continue, together with Bulgaria and Romania, to be eligible for PHARE assistance for three years (totalling EUR 1.6 billion a year).

Under ISPA, 324 projects had been approved by the end of 2003, divided fairly evenly between transport and the environment and, in the former, between road and rail. Under SAPARD, resources amounting to EUR 500 million a year go to support development plans for agriculture and rural areas formulated by the countries themselves.

The new Member States will be eligible for support from the Structural Funds over the period 2004 to 2006. Support, amounting to some EUR 21.8 billion in total over the three years, will be concentrated on a limited number of priority areas to maximise impact and minimise problems of programme implementation. The priority areas selected by the countries differ markedly in terms of the relative importance attached to spending on infrastructure, human resources and productive investment, in part reflecting differences in the prevailing state of the capital stock in these respective areas.

The need to develop a strategic approach and to focus on a limited number of priorities, highlighted during the negotiations, is to be maintained in the implementation phase. In addition, special attention will need to be given to ensuring the maximum coherence between the Structural Funds and national policies, to environmental considerations and to equal opportunities. At the same time, the issue of administrative capacity remains a concern, despite the progress made at both national

government and regional level, though experience of actually implementing programmes will help strengthen capacity.

From this and other perspectives, the 2004–2006 period can be regarded as a transitional one, allowing the new Member States concerned to prepare the ground for the next, and much longer, programming period.

The challenge ahead for structural policy in the new Member States is:

- to identify the structural deficiencies in each region which have the most damaging effect on competitiveness and growth potential and to give priority to tackling these first;
- to formulate a long-term development strategy for each region in line with its comparative strengths and weaknesses, which recognises that all needs cannot be tackled simultaneously and which orders investment projects in the light of the interaction between them and the growth path it is intended to follow over the long-run;
- to give due weight to environmental considerations in investment decisions in order to ensure that the growth path chosen is sustainable;
- to avoid excessive concentration of investment in the present growth centres where the impact on economic activity might be greatest in the short-term but which may be at the expense of balanced development over the long-run;
- to help strengthen the administrative capacity for designing, implementing and managing development programmes at regional level.

Conclusions: a proposal for a reformed cohesion policy

The Commission adopted a proposal on 10 February 2004 for the budget of the enlarged European Union³ of 27 Member States for the period 2007-2013.

This was an important decision, the Commission taking the view that Union's intervention in a number of key policy fields required strengthening. In particular, the Commission decided that an ambitious cohesion policy should be an essential element of the total package. Importantly, in the new budgetary structure, the Commission maintains the view that cohesion policy should be allocated a single, and transparent, budgetary heading which is essential in order to provide the certainty and the stability necessary for the planning of the next generation of national and regional multi-annual programmes.

The decision reflected the work that has been undertaken since the publication of the Second cohesion report in 2001 which launched the debate on the future of cohesion policy in the enlarged Union for the period beginning in 2007. The conclusions of the Third cohesion report that follow present a detailed proposal for the priorities and delivery system for the new generation programmes under cohesion policy in conformity with the broad guidelines set out in the financial perspective. Following the introductory remarks, Part I sets out the new priorities for cohesion policy. Part II describes the main elements of a new delivery system. Part III sets out the resource implications.

It is worth recalling that cohesion policy – one of the pillars of the European construction together with the single market and the monetary union – is the only policy of the European Union that

explicitly addresses economic and social inequalities. It is thus a very specific policy involving a transfer of resources between Member States via the budget of the European Union for the purpose of supporting economic growth and sustainable development through investment in people and in physical capital.

This also means that the concept of cohesion that has applied at the European level has not been a passive one that redistributes income but a dynamic policy that seeks to create resources by targeting the factors of economic competitiveness and employment, especially where unused potential is high.

Four challenges for the future

1. More cohesion needed in an enlarged Union

The enlargement of the Union to 25 Member States, and subsequently to 27 or more, will present an unprecedented challenge for the competitiveness and internal cohesion of the Union. As illustrated in this report, enlargement will lead to the widening of the economic development gap, a geographical shift in the problem of disparities towards the east and a more difficult employment situation: socio-economic disparities will double and the average GDP of the Union will decrease by 12.5%.

At the same time, the whole of the Union faces challenges arising from a likely acceleration in economic restructuring as a result of globalisation, trade opening, the technological revolution, the development of the knowledge economy and society, an ageing population and a growth in immigration.

Demographic ageing in Europe is a particular challenge. The regional variations in this respect are considerable reflecting trends in fertility and mortality, and in migration. Addressing the problems is not simply a question of coping with a rise in the dependent population. It also requires ensuring that national and regional development strategies are adapted to demographic circumstances and

³ European Commission, *Building our common future: policy challenges and budgetary means of the enlarged Union, 2007-2013* COM(2004)101

are able, in particular, to promote active ageing policies and to exploit the often underused potential of the older population.

Finally, economic growth in the EU has slowed appreciably over the three years since the publication of the last Cohesion Report. As a result, unemployment has risen again in many parts of the Union with all the social implications which this entails. As a springboard to the future, the Union should fully exploit the opportunities provided by the current trend towards recovery.

2. Reinforcing the priorities of the Union

In an effort to improve the performance of the EU economy, the Heads of State and of Government of the Union meeting in Lisbon in March 2000 set out a strategy designed to make Europe the most successful and competitive knowledge based economy in the world by 2010. The Nice Council in December 2000 translated the Lisbon objectives on poverty reduction into a co-ordinated EU strategy for social inclusion. At the Gothenburg Council in June 2001, the Lisbon strategy was widened adding a new emphasis on protecting the environment and achieving a more sustainable pattern of development.

Cohesion policy makes an important contribution to realising these aims. In effect, growth and cohesion are mutually supportive. By reducing disparities, the Union helps to ensure that all regions and social groups can contribute to, and benefit from, the overall economic development of the Union. Articles 3 and 158 of the Treaty reflect this vision, which has been reinforced in the draft Constitution by the introduction of a clearer reference to the territorial dimension of cohesion.

Cohesion policy is also necessary in a situation where other Community policies have important benefits combined with limited but localised costs. Cohesion policy helps to spread the benefits. By anticipating change and facilitating adaptation cohesion policy can help to limit the negative impacts.

For this reason, cohesion policy in all its dimensions must be seen as an integral part of the Lisbon strategy, even if today, as the Commission pointed out in the financial perspective, the policy design underlying Lisbon needs to be completed and updated. In other words, cohesion policy needs to incorporate the Lisbon and Gothenburg objectives and to become a key vehicle for their realisation via the national and regional development programmes.

3. Increasing quality to promote more balanced and sustainable development

This report has shown that disparities in output, productivity and access to jobs which persist between countries and regions stem from structural deficiencies in key factors of competitiveness – inadequate endowment of physical and human capital, a lack of innovative capacity and regional governance, and a low level of environmental capital.

The cost of not pursuing a vigorous cohesion policy to promote growth and tackle disparities is therefore measured not only in terms of a loss of individual and collective well-being but also in economic terms, in a loss of potential real income and higher living standards. Given the interdependencies inherent in an integrated economy, these losses are not confined to the less competitive regions or to individuals who are not working or who are in unproductive jobs but affect everyone in the Union.

Strengthening regional competitiveness through well-targeted investment throughout the Union and providing economic opportunities which help people fulfil their capabilities will thus underpin the growth potential of the EU economy as a whole to the common benefit of all. By securing a more balanced spread of economic activity across the Union, regional policy helps to reduce the pressures of over-concentration, congestion and bottlenecks.

4. A new partnership for cohesion

The reform of cohesion policy also should provide an opportunity to bring greater

efficiency, transparency and political accountability. This requires, first and foremost, the definition of a strategic approach for the policy spelling out its priorities, ensuring co-ordination with the system of economic and social governance, and allowing for a regular, open review of progress made.

The corollary of the above is the need to reinforce institutional capacities at all level of government throughout the Union, building on one of the key strengths of cohesion policy.

I. A new architecture for EU cohesion policy after 2006

More targeted interventions

In the public debate on the future of cohesion policy referred to above, a general conclusion was that there are a number of matters which are important for cohesion in the Union as a whole. (...*“the issues of competitiveness, sustainable development, and economic and social restructuring are relevant in all Member States”*⁴). These elements are key to understanding the proposal below on future priorities.

In effect, the Commission proposes that actions supported by cohesion policy should focus on investment in a limited number of Community priorities, reflecting the Lisbon and Gothenburg agendas, where Community intervention can be expected to bring about a leverage effect and significant added value. Accordingly, for the regional programmes, the Commission proposes a core list consisting of a limited number of key themes as follows: **innovation and the knowledge economy, environment and risk prevention, accessibility and services of general economic interest**. For employment related programmes, the focus will be on implementing the reforms needed to progress towards full employment, improve quality and productivity at work, and promote

social inclusion and cohesion, in line with the guidelines and recommendations under the **European Employment Strategy**.

These priority themes would be valid for the Union in general, but they would need to be completed and expanded to take account of the specific needs of the less developed regions and Member States, where additional needs persist, for example, in relation to the provision of infrastructure and to institutional capacity building. These aspects are dealt with below (see also Box 1 for details).

Three Community priorities

The pursuit of the priority themes would be organised around a simplified and more transparent framework with the future generation of programmes grouped under three headings: *convergence; regional competitiveness and employment; territorial co-operation*.

Convergence: supporting growth and job creation in the least developed Member States and regions

The convergence programmes concern the less developed Member States and regions which in accordance with the Treaty are the top priority for Community cohesion policy. The Treaty calls for a reduction in disparities between *“the levels of development of the various regions and the backwardness of the least favoured regions or islands, including rural areas”* (Article 158). Enlargement will bring about an unprecedented increase in the disparities within the Union, the reduction of which will require long-term, sustained efforts.

This objective would concern, first and foremost, those regions⁵, whose per capita GDP is less than 75% of the Community average⁶.

⁵ Strictly defined at the NUT II level.

⁶ Measured in purchasing power parities and calculated on the basis of the Community figures for the last three years available at the moment the decision is taken.

⁴ COM(2003)34 final of 30.1.2003, p.4.

The key objective of cohesion policy in this context would be to promote growth-enhancing conditions and factors leading to real convergence. Strategies should plan for the development of long-term competitiveness and employment.

The Commission proposes that temporary support should apply under this heading to those regions where per capita GDP would have been below 75% of the Community average as calculated for the Union of Fifteen (the so-called statistical effect of enlargement). These are regions where objective circumstances have not changed, although their GDP per head will be relatively higher in the enlarged Union. In the interest of equity, and to allow the regions concerned to complete the process of convergence, support would be higher than decided in Berlin in 1999 for the so-called "phasing out" regions of the current generation.

It should be noted that in making this proposal, the Commission is opting for the more rigorous among the four options presented in the Second cohesion report, in the interest of concentration and a more effective cohesion policy overall. It should be understood that this support would end in 2013 and would not be followed by a further phasing out period.

Programmes would be supported by the financial resources of the European Regional Development Fund (ERDF), the European Social Fund (ESF), and the Cohesion Fund⁷, in accordance with the principles set out in the Treaty.

For illustration, the **ERDF** would provide support for:

- modernising and diversifying the economic structure of Member States and regions, with particular attention to innovation and enterprise, notably by creating closer links between research institute and industry, favouring access to and use of information and communication technologies (ICTs)

⁷ Each of these Funds would have at its disposal resources to finance technical assistance.

developing conditions favourable to R&D, improving access to finance and know-how and encouraging new business ventures;

- extending and upgrading basic infrastructures such as transport, telecommunications and energy networks, water supplies and environmental facilities;
- protecting the environment, notably by helping Member States to achieve full compliance with the body of EU law, supporting the development of eco-industries, rehabilitating derelict industrial sites, supporting measures to prevent natural and technological risks, investment in infrastructure linked to Natura 2000 contributing to sustainable economic development favouring cleaner methods of transport and the development and use of renewable energy;
- Reinforcing the institutional capacity of national and regional administration in managing the Structural Funds and the Cohesion Fund.

The **ESF** would strengthen its role as the main Community financial instrument in support of the European Employment Strategy (EES). It would provide support for:

- improving the quality and responsiveness of labour market institutions, education and training systems, and social and care services;
- increasing investment in human capital by raising educational levels, adapting the skills of citizens and ensuring access for all to the labour market; and
- promoting the adaptation of public administration to change through administrative and capacity building.

The new generation of employment-related programmes should also seek to take on board the lessons of the current EQUAL initiative across the EU (covering innovation, empowerment, partnership and trans-national co-operation in employment matters).

The **Cohesion Fund** will apply to Member States with GNP lying below 90% of the Community average⁸. As for the current period, the Commission proposes to maintain the mid-term assessment of eligibility for the Cohesion Fund.

In line with the priorities set by the financial perspective, the Cohesion Fund should strengthen its contribution to sustainable development. In this respect, trans-European transport networks, in particular, the projects of European interest, and environment infrastructures would remain the central priorities. In order to reach an appropriate balance to reflect the particular needs of the new Member States, it is envisaged also to support projects such as rail, maritime, inland waterways, and multimodal transport programmes outside the TEN-T, sustainable urban transport and environmentally important investments in the key fields of energy efficiency or renewable energies.

Regional competitiveness and employment: anticipating and promoting change

While interventions in the less developed Member States and regions remain the priority of cohesion policy, the analyses of the Third report confirm that there are, to different degrees, important challenges that concern all EU Member States.

In particular, Member States, regions and citizens will have to adapt to a world experiencing rapid economic and social change and restructuring, trade globalisation, a move towards a knowledge-based economy and society. They will also have to tackle the particular challenges that derive from an ageing population, growing immigration, labour shortages in key sectors and social inclusion problems.

In this context, the Union must have an important role to play. First, the implementation of the Lisbon agenda has been disappointing. In

these circumstances, Community financial support can act as a catalyst, helping to mobilise national and regional policies and resources and to target them more resolutely on the Union's objectives.

Second, the visible presence of cohesion interventions throughout the EU is an essential element for the political, economic and social integration of the Union and for promoting involvement of public and private stakeholders, and gaining their commitment to achieving the Union's objectives.

For cohesion policy outside the least developed Member States and regions, the Commission proposes a two-fold approach:

- 1) First, through *regional* programmes, cohesion policy would help regions and the regional authorities to anticipate and promote economic change in industrial, urban and rural areas by strengthening their competitiveness and attractiveness, taking into account existing economic, social and territorial disparities;
- 2) Second, through *national* programmes, cohesion policy would help people to anticipate and to adapt to economic change, in line with the policy priorities of the EES, by supporting policies aiming at full employment, quality and productivity at work, and social inclusion.

Anticipating and promoting regional change

The regional programmes will help to address the problems faced by urban and rural areas relating to economic restructuring and other handicaps. This report describes the difficulties facing many areas, for example, those dependent on traditional industries, or the urban areas in decline, or, again, the rural areas often confronted with a highly dispersed or ageing population and poor accessibility.

Under the new programmes the Commission proposes a stricter concentration of interventions on the three priority themes referred to above (see Box 1).

⁸ Measured in purchasing power parities and calculated on the basis of the Community figures for the last three years available at the moment the decision is taken.

The single funding source for the new programmes would be the ERDF. From a resource allocation point of view, two groups of regions need to be distinguished:

- The regions⁹ of the Union covered neither by the convergence programmes nor by the “phasing in” support described below.
- The regions currently eligible for Objective 1 not fulfilling the criteria for the convergence programmes even in the absence of the statistical effect of enlargement. Such regions would benefit from a higher level of support (under the heading “phasing in”) on a transitional basis (the reduction would follow a path comparable to that for regions no longer eligible for Objective 1 in the period 2000-06).

Helping people to anticipate and respond to change

Actions in this sphere would be delivered through national programmes with the aim of reinforcing the introduction and implementation of structural reforms in the labour market and strengthen social inclusion in line with the objectives and guidelines of the EES.

To this end, support should focus on three policy priorities that are crucial for the implementation of the EES and where Community funding can provide added value:

- increasing the adaptability of workers and enterprises, by investing in skills and in-company training and by supporting the development of efficient life-long learning strategies;
- attracting more people to employment and preventing early exit from the labour market, in particular through active ageing policies and measures to support the participation of women;
- increasing the employment potential of people who face greater difficulties in accessing the labour market and retaining their job, such as people with disabilities, ethnic minorities and migrants.

⁹ Defined at NUTS I or NUTS II depending on the institutional system of each Member State

The single funding source for the new programmes would be the ESF.

European territorial cooperation: promoting the harmonious and balanced development of the Union territory

In the Second progress report on economic cohesion¹⁰ the Commission pointed to “*the high level of value added by the Union to measures concerning co-operation, the exchange of experiences and good practices and the role played by the Community Initiative programmes was widely acknowledged. Strengthening the instruments for transnational, cross-border and interregional co-operation and assistance on the external frontiers of the Union were the aspects most often mentioned*”.

Building on the experience of the present INTERREG Initiative, the Commission proposes to create a new objective dedicated to further the harmonious and balanced integration of the territory of the Union by supporting co-operation between its different components on issues of Community importance at cross-border, transnational and interregional level.

Action would be financed by the ERDF and would focus on integrated programmes managed by a single authority in pursuit of key Community priorities linked to the Lisbon and Gothenburg agendas.

In principle, all regions (defined at NUTS III) along the external and internal borders, terrestrial as well as maritime¹¹ would be concerned by *cross-border co-operation*. The aim would be to promote joint solutions to common problems between neighbouring authorities, such as urban, rural and coastal development and development of economic relations and networking of SMEs.

In this context, the Commission intends to propose **a new legal instrument** in the form of a European co-operation structure (“Cross-

¹⁰ COM(2003)34 final of 30.1. 2003, p.27.

¹¹ Only maritime borders proposed by Member States would be eligible.

border regional authority”), in order to allow Member States, regions and local authorities to address – both inside and outside Community programmes – the traditional legal and administrative problems encountered in the management of cross-border programmes and projects. The aim would be to transfer to this new legal structure the capacity to carry out co-operation activities on behalf of public authorities.

In order to allow more effective actions on the external borders of the enlarged Union, the Commission will a New Neighbourhood Instrument (NNI) in the context of the European Neighbourhood Strategy. The NNI would operate on both sides of the external border, including where appropriate maritime borders. The NNI will promote, *inter alia*, sustainable economic and social development, and build on past experience of cross-border cooperation, in particular partnership, multi-annual programming and co-financing.

As far as the broader actions to promote *transnational co-operation* is concerned, the lessons should be drawn from current experience. In particular, Member States and regions would be invited to assess the usefulness and effectiveness of the existing 13 transnational cooperation zones (defined under INTERREG IIIB) in the light of enlargement. The objective would be to decide together with the Commission on a number of zones for transnational cooperation which are sufficiently coherent and where there are common interests and opportunities to be developed. It is envisaged that such cooperation would focus on strategic priorities with a transnational character such as R&D, information society, environment, risk prevention and integrated water management.

Finally, the Commission proposes that regions should in future incorporate actions in the field of *interregional cooperation* within their regional programmes. To achieve this, regional programmes would need to dedicate a certain amount of resources to exchanges, cooperation and networking with regions in other Member States. In addition, the Commission would seek to facilitate exchanges of experience and good

practices on a European scale by organising networks involving regions and cities.

An integrated response to specific territorial characteristics

One of the key characteristics of an effective cohesion policy lies in its adaptability to specific needs and characteristics of territories.

This report has shown that particular geographical or natural handicaps may intensify development problems, particularly in the outermost regions of the Union, many islands, mountain areas and in sparsely populated parts in the far north of the Union.

The report has also identified the role cities throughout the Union play as centres of economic development, although they are also faced by problems linked to environmental pressure, social exclusion and economic restructuring. It has also emerged from the analysis that rural areas continue to be faced by large-scale changes. Their revitalisation depends on the diversification of economic activity and the strengthening of their links with urban areas.

While recognising the different circumstances and challenges, the Commission considers that the next generation of programmes should be defined in such a way that the different territorial problems (and opportunities) can be addressed without multiplying the number of programmes or the number of instruments. Any given individual programme should therefore provide the framework for different situations to be dealt with and for integrated and holistic solutions to problems to be addressed.

Integrating urban deprivation and regeneration into regional programmes: URBAN+

The foregoing is relevant to urban policy. Building on the strengths of the URBAN initiative, the Commission intends to reinforce the place of urban issues by fully integrating actions in this field into the programmes.

To carry this out, at the beginning of the next programming period, each Member State would propose a list of urban areas which would benefit from a specific action within the programmes. The extent of the problems facing the cities, and their role in promoting regional development would suggest that the number of cities concerned should be greater than the 70 today covered by the URBAN initiative in the Fifteen.

Critical to the success of urban actions is the involvement of the city authorities both in the design of the programmes and in the management. It is therefore envisaged that an arrangement involving a sub-delegation of responsibilities to these authorities would be necessary within the regional programmes. The scale of interventions organised in this way would be decided when the programmes are drawn up but it is worth noting that today more than 10% of the total EU contribution to Objective 1 and 2 is devoted directly or indirectly to financing urban-related measures.

As indicated above, cooperation between cities – an important element of the added value of European action – would be included under the heading of territorial co-operation.

Outermost regions

The Commission intends, within the convergence objective, to set up a specific programme to compensate for the specific constraints of the outermost regions, as recognised by article 299.2 of the Treaty and requested by the European Council of 21-22 June 2002 in Seville. In addition, an action “Grand Voisinage” aimed at facilitating cooperation with the neighbouring countries would be included under the new “European territorial co-operation” programmes. In accordance with the request of the Council, the Commission will shortly present a report on an overall strategy for the outermost regions.

Addressing persistent problems of development in regions with geographical handicaps

Problems of accessibility and remoteness from large markets, are particularly acute in many islands, some mountain areas and in sparsely-populated regions, particularly in the far north of the Union.

The allocation of the resources for the regional competitiveness and employment priority should take account of this by using “territorial” criteria, thus reflecting the relative disadvantage of regions with geographical handicaps. Member States should ensure that the specificities of these regions are taken into account when it comes to the targeting of resources within regional programmes.

In an effort to promote more action in these sometimes neglected areas and to take account of the higher cost of public investment in per capita terms, for the next period it is proposed that territories with permanent geographical handicaps should benefit from an increase in the maximum Community contribution.

A better organisation of the instruments operating in rural areas and in favour of the restructuring of the fisheries sector

In the draft financial perspective, the Commission proposes to simplify and to clarify the role of the different instruments in support of rural development and the fisheries sector.

The current instruments linked to rural development policy would be grouped in one single instrument under the Common Agricultural Policy designed to:

- Increase the competitiveness of the agricultural sector through support for restructuring (for instance, investment aids for young farmers, information and promotion measures);
- Enhance the environment and country side through support for land management,

including co-financing of rural development actions related to Natura 2000 nature protection sites (for instance agri-environment, forestry, and Least Favoured Areas measures);

- Enhance the quality of life in rural areas and promoting diversification of economic activities through measures targeting the farm sector and other rural actors (for instance, qualitative reorientation of production, food quality, village restoration).

The present Community Initiative, LEADER+, would be integrated into the mainstream programming.

Similarly, action in favour of the restructuring of the fisheries sector would be grouped under a single instrument, which would focus on actions to accompany the restructuring needs of the fisheries sector, and to improve the working and living conditions in areas where the fisheries sector, including aquaculture, plays an important role.

An important part of these proposals is that the financial resources transferred from cohesion policy to these new instruments would continue to be deployed in such a way that the same degree of concentration is achieved as today on helping the less developed regions and countries covered by the convergence programmes.

Outside these interventions, cohesion policy would support the diversification of the rural economy and of the areas dependent on fisheries away from traditional activities, in conformity with the priority themes listed in Box 1.

Co-ordination and complementarity with other Community policies

Cohesion policy provides an essential complement to other Community-wide expenditures in the field of innovation (R&D, enterprise, information society and environmentally clean technologies), networks

(transport, energy, communication) and education and culture. In effect, cohesion policy helps to ensure that the necessary physical and institutional capacities are created in the Member States and regions across the whole of the Community enabling them to benefit from these other policies. The management of the latter policies, on the one hand, and cohesion policy, on the other, could be improved in future through more ongoing dialogue and exchange of information, and better co-ordination of activities.

The question of complementarity concerns a number of policy fields. Particular attention would be given to ensuring the integration of actions in favour of equal opportunities between men and women into national and regional programmes.

Likewise, the implementation of cohesion policy should help to promote compliance with internal market rules, especially as regards public procurement legislation. A rapid and effective implementation of the new legislative package for public procurement in the Member States would contribute to the simplification of procedures and therefore to the efficiency of cohesion policy.

At another level, consistency with the Broad Economic Policy Guidelines and the European Employment Strategy would help to increase the effectiveness of cohesion policy.

A key question is that of the consistency between cohesion and competition policies. The regions with GDP per capita below 75% of the average should remain eligible for the state aid regime as defined in accordance with Article 87.3(a) of the Treaty. For the regions affected by the “statistical effect”, these would be subject to a limit on state aid similar to that foreseen under Article 87.3(a) at the beginning of the period. These regions would be assimilated to the state aid regime as defined in Article 87.3(c) but subject to the relevant limits on aid intensity granted under Article 87.3(c) at the end of 2013 at the latest.

The outermost regions as defined under Article 299 of the Treaty that would not be covered by

the new convergence objective would also benefit from a specific transitional state aid regime setting limits on aid that would be comparable, initially, to those defined under Article 87.3(a), followed by a gradual reduction.

For other regional programmes, the Commission is proposing to abandon the current system whereby it draws up detailed lists of eligible areas at sub-regional level (see paragraph 103 below). Consistency would be ensured at the level of the priorities to be financed rather than at the level of the geographical areas where the actions supported take place. This means that outside the convergence objective, the different fields of intervention will have to be pursued in a manner consistent with the applicable state aid rules. At the same time, the Commission intends to keep the relevant state aid rules under review taking into account these priorities.

The Commission intends to simplify the rules as regards other state aid matters not explicitly covered by existing frameworks, guidelines or regulations. This concerns cases involving the granting of limited amounts of state aid. The principle would be one of applying a so-called "significant impact test". The result would be to provide greater legal security and more flexibility, well above what is currently possible under the *de minimis* rule, for both Member States and regions in addressing local development and employment issues.

II. A reformed delivery system

The way that policies are implemented has a decisive effect on their effectiveness. The delivery mechanism for cohesion policy has demonstrated its capacity to deliver quality projects of European interest on the ground while maintaining high standards in the management and control of public expenditure because:

- it allows interventions to be planned within a stable, medium-term (multi-annual) framework necessary for the realisation of major investments;
- through its integrated strategies for development, it combines within a single coherent framework, targeted investment in equipment, infrastructure, innovation and human resources taking into account the specific circumstances of the regions;
- it promotes good governance through closer public-private partnership;
- as a result of co-financing arrangements, it levers in additional expenditure from national public and private sources;
- it encourages more precision in public expenditure so that it is more cost-efficient while at the same time being compatible with the single market.

However, this report underlines the need to tackle certain difficulties encountered in the implementation of current programmes. Though the key principles of cohesion policy – programming, partnership, co-financing and evaluation – should be maintained, the efficiency of the policy in an enlarged Union could be enhanced by introducing a number of reforms designed, *firstly*, to encourage a more strategic approach to programming, *secondly*, to introduce further decentralisation of responsibilities to partnerships on the ground in the Member States, regions and local authorities, *thirdly*, to reinforce the performance and quality of programmes co-financed through a reinforced, more transparent partnership and clear and more rigorous monitoring mechanisms, and *fourthly*, to simplify the management system by introducing more transparency, differentiation and proportionality while ensuring sound financial management.

It should be noted that the limits of decentralisation resulting from simplification are set by the fact that the Commission is accountable to the budgetary authority and to public opinion on the sound financial management and on the results of the activities

co-financed. The reform of the delivery system in all its aspects, as presented below, would be undertaken in full respect of the Treaty and of the basic principles of the new financial regulation (article 155)¹².

The body of law for the new cohesion policy would be presented and adopted at the same time to ensure greater coherence and efficiency from the beginning of the programming period.

More strategic orientation on the priorities of the Union

The Commission proposes that an overall strategic document for cohesion policy should be adopted by the Council, with an opinion of the Parliament, in advance of the new programming period and on the basis of a Commission proposal, defining clear priorities for Member States and regions.

This strategic approach would guide the policy in its implementation and make it more politically accountable. It would help to more tightly specify the desired level of synergy to be achieved between cohesion policy and the Lisbon and Gothenburg agendas and would increase the consistency with the Broad Economic Policy Guidelines and the European Employment Strategy.

Each year, the European Institutions would examine progress on the strategic priorities and results achieved on the basis of a report by the Commission summarising Member States' progress reports.

To support this work, evaluation tasks need to be redefined with a view to become more strategic and result-oriented.

Simplification based on more subsidiarity

Already during the current period, the

¹² Council Regulation (EC, Euratom), 1605/2002 of 25 June 2002.

Commission has embarked on an exhaustive examination of ways to streamline the management of cohesion policy. For the next period, the Commission proposes to simplify further the system in a number of key aspects.

Programming

The programming system would be simplified as follows:

- At the *political level*: on the basis of the strategic document adopted by the Council, each Member State would prepare a policy document on its development strategy, which would be negotiated with the Commission and constitute the framework for preparing the thematic and regional programmes, but not having the role – as the existing Community Support Framework – of a management instrument;
- At the *operational level*: on the basis of the policy document, the Commission would adopt national and regional programmes for each Member State. The programmes would be defined at an aggregate or high priority level only, highlighting the most important measures. Additional detail, reflected today in the so-called “programme complement” would be abandoned as well as the management by measure.

Co-ordination and coherence between the Funds would be guaranteed at both political and operational level.

The number of funds would be limited to three (ERDF, ESF and Cohesion Fund) compared to the current six (see Figure 1).

As opposed to current multi-Fund programmes, future ERDF and ESF interventions would aim at operating with only one fund per programme. In this respect, the action of each fund would be made more coherent by allowing the ERDF and the ESF to finance, respectively, residual activities related to human and physical capital. Funding of these activities would be limited and directly linked to the main domains of interventions of each Fund. This would allow

both for a simplification and increased effectiveness of programming.

The Cohesion Fund and the ERDF would follow a single programming system, where transport and environment infrastructures are concerned. Large projects would be adopted by the Commission separately, but managed within the related programmes.

Financial management, co-financing

Payments would be made at the level of each high-level priority and no longer, as today, at the lower level of the “measure”. The system of payments (advances and reimbursement) as well as the essential principle of automatic de-commitment (the “N+2” rule) would be maintained.

National rules would largely determine eligibility of expenditure, with the exception of a limited number of fields such as VAT, technical assistance and passive interests¹³, where Community rules would continue to apply.

Financial control

The principle of proportionality would apply to the operation of control systems, the level of intervention by the Commission depending on the level of Community co-financing and the adequacy of the national or regional control systems. Below certain thresholds, the Member State would have the option of using its national control systems for the programmes concerned, and the Commission would rely principally on a declaration of assurance by an independent national control body. The Commission would continue to apply closure of account procedures and financial correction mechanisms, which enable it to assume its responsibility for the implementation of the budget.

Proportionality and further simplification of financial management and control should go hand-in-hand with stricter sanctions and prompt recovery in case of irregularities or fraud.

¹³ Interests to be paid by the management authority or the final beneficiary.

Additionality

Additionality - that EU resources should add to rather than replace national resources - would remain a key principle of cohesion policy. However, in line with the principle of proportionality, the Commission would verify its application only within the “convergence” objective. Member States would be responsible for ensuring that the principle of additionality applies within the “Regional competitiveness and employment” and “European territorial co-operation” programmes.

Partnership and co-ordination

Partnership would be enhanced by reinforcing the complementarity and co-operation between Member States, regions and local authorities both at the programming and implementation levels. In this respect, according to its institutional arrangements, each Member State should seek to organise the coordination between the different levels of government through tripartite agreements.

To promote better governance, the social partners and representatives from the civil society should become increasingly involved through appropriate mechanisms in the design, implementation and follow-up of the interventions.

In order to increase the leverage effect more emphasis is needed on modern forms of financing. One direction of reform would be to reinforce the partnership with the European Investment Bank and the European Investment Fund, for example, by establishing a stronger link between co-financing rates and the economic viability of programmes and projects.

* * * *

These proposed changes should bring greater transparency to the operation of the policy, facilitating the access of citizens and companies thus increasing the number of projects coming forward and helping to make a contribution to greater value-for-money through increased competition for support.

More concentration

The major concentration of resources should remain on the poorest Member States and regions with an emphasis on the new Member States. At the level of the individual development programmes, concentration would be achieved by focusing on the Lisbon and Gothenburg priorities as well as, in the “convergence” regions, on institutional capacity building.

With regard to the regional competitiveness programmes, the current emphasis (under Objective 2) on the zoning of eligible areas at the level of communes, municipalities and wards has meant that concentration has been understood almost exclusively in micro-geographical terms. While the geographical concentration of resources in the worst affected pockets or areas must remain an essential part of the effort in the future, it must also be recognised that the prospects of such areas are intimately linked to the success of the region as whole.

As many regions have recognised, this requires the development of a coherent strategy for the whole region as a way of addressing the needs of its weakest parts. For the future, it is therefore proposed to abandon the current system of micro-zoning, allowing the appropriate balance between the geographical and other forms of concentration to be determined in the drawing up of the regional competitiveness programmes in partnership with the Commission.

This should not imply any dilution of the level of effort in deploying EU financial resources. Under the “regional competitiveness” strand, concentration would take place at a two levels:

- Thematic concentration would be stronger outside the “convergence” regions, in the sense that programmes would address a maximum of three themes (see box 1).
- A second level of concentration will be assured via rules on the minimum financial volume of programmes and priorities.

In the context of the partnership, regions would have the responsibility in the first instance for concentrating financial resources on the themes necessary to address the economic, social and territorial disparities at regional level. The Commission would verify and confirm consistency at the moment of deciding the programmes.

Finally, through the principle of de-commitment of unused funds (the “N+2 rule”), a discipline unique to regional and cohesion policy, there would remain a strong incentive in favour of the efficient and rapid realisation of the programmes.

A stronger accent on performance and quality

Effectiveness calls for a greater focus on impact and performance, and for a better definition of the results to be achieved. Overall, the efficiency of cohesion policy would be improved by the establishment of an annual dialogue (see §84 above) with the European Institutions to discuss – on the basis of the Commission’s yearly report accompanied by Commission recommendations – the progress and results of national and regional programmes, so to enhance transparency and accountability towards the institutions and the citizens.

Evaluation before, during (on-going) and after the end of the programmes would remain essential to the overall effort to maintain quality. In the assessment of regional strengths and weaknesses at the beginning of each programmes, there is a need *inter alia* for an additional effort to anticipate within each Member State and region the adjustments likely to occur from trade opening and globalisation. In addition, it is recommended that trade impact assessments should in future include systematically a territorial dimension for the EU.

In addition, the Commission proposes to set up a Community performance reserve whose main objective would be to reward the Member States and regions which show the most significant progress towards the agreed objectives. The rules for the allocation of the

reserve would be improved and simplified taking into account the experience with the performance reserve for the current programming period.

In this context, a stronger complementarity and partnership between the Structural Funds, the EIB and EIF could be established.

Finally, the Commission proposes that Member State create within their national allocation a small reserve enabling them to respond swiftly to unexpected sectoral or local shocks resulting from industrial restructuring or the effects of trade agreements. This reserve would be used for providing ancillary support to the re-training of the most affected workers and to the diversification of the economy in the areas concerned, acting as a complement to the national and regional programmes which should constitute the principal instrument for restructuring in anticipation of economic change. The mobilisation of the reserve would be discussed and agreed with the Commission.

It is important to recall here that the new financial perspectives propose the creation of a specific instrument (Growth Adjustment Fund) to complement growth and cohesion objectives in the light of the objectives of the Union and to react to crises stemming from international economic and trade developments. The Commission proposes to add to this instrument by using the committed, but unused funds from the ERDF and ESF up to a maximum of EUR 1 billion per year,

III. Financial resources

The financial resources dedicated to cohesion policy should reflect the ambition of an enlarged Union to promote growth and job creation in its less favoured areas. For the period 2007-2013, the Commission has proposed in the financial perspectives to allocate a sum equivalent to 0.41% of the GNI of the EU-27 (which equates to 0.46% before the transfers to the proposed single rural and fisheries instruments) in support of the three priorities of the reformed cohesion policy. This percentage corresponds to EUR

336.3 billion over the period (or EUR 344.9 billion taking into account the administrative expenditures and the Solidarity Fund). With the exception of the Solidarity Fund, these resources would remain, as today, an expenditure target, while remaining subject to the rules related to de-commitment (N+2).

The indicative repartition of this amount among the three priorities of the reformed policy would be as follows:

- 1) Around 78% for the “convergence” priority (less developed regions, cohesion fund, and “statistical effect” regions), with the emphasis on help to the twelve new Member States. The absorption limit (“capping”) for financial transfers to any given Member State under cohesion policy would be maintained at its current 4% of national GDP, taking into account amounts included under the rural development and fishery instruments.

The relative importance of the Cohesion Fund would be enhanced to represent a third of the financial allocation for the new Member States concerned. This is in order to consolidate the effort begun in 2004-2006 in the light of significant needs of these countries in terms of transport and environment infrastructure. The allocation between countries would take account of the needs of each Member State and upper and lower limits would be established, as today (financial “fourchettes”).

The regions concerned by the so-called statistical effect would benefit from a specific, decreasing allocation under the Convergence objective to facilitate their “phasing out”.

- 2) Around 18% for the “regional competitiveness and employment” priority. Outside the phasing-in regions the distribution between the regional programmes financed by the ERDF and the national programmes financed by the ESF would be 50-50.

Regional programmes inside the “phasing in” regions will follow the same principle of

funding from a single source (the ERDF). Interventions inside these regions in pursuit of the EES will take place in the context of the national programmes financed by the ESF, with an appropriate earmarking of ESF resources to ensure that the profile for phasing in is fully respected, ERDF and ESF combined. The contribution of each Fund in the regions concerned would follow, on average, the same proportions as in the current multi-fund programmes.

- 3) Around 4% for the “territorial co-operation” priority.

For the distribution of the financial resources among Member States, the Commission proposes to apply the method based on objective criteria used at the time of the Berlin Council (1999) for the “convergence” priority, taking into account the need for fairness regarding the regions affected by the statistical effect of enlargement.

Resources for the objective “regional competitiveness and employment” would be allocated by the Commission between Member States on the basis of Community economic, social and territorial criteria.

Finally, the size of the population living in the relevant regions and relative socio-economic conditions would guide the distribution of resources under the “European territorial co-operation” objective.

* * * * *

The Commission will organise a Forum on 10-11 May 2004, in advance of the presentation by the Commission of the new legislative proposals. This Forum will bring together all those concerned by cohesion policy to discuss the proposals contained in this report.

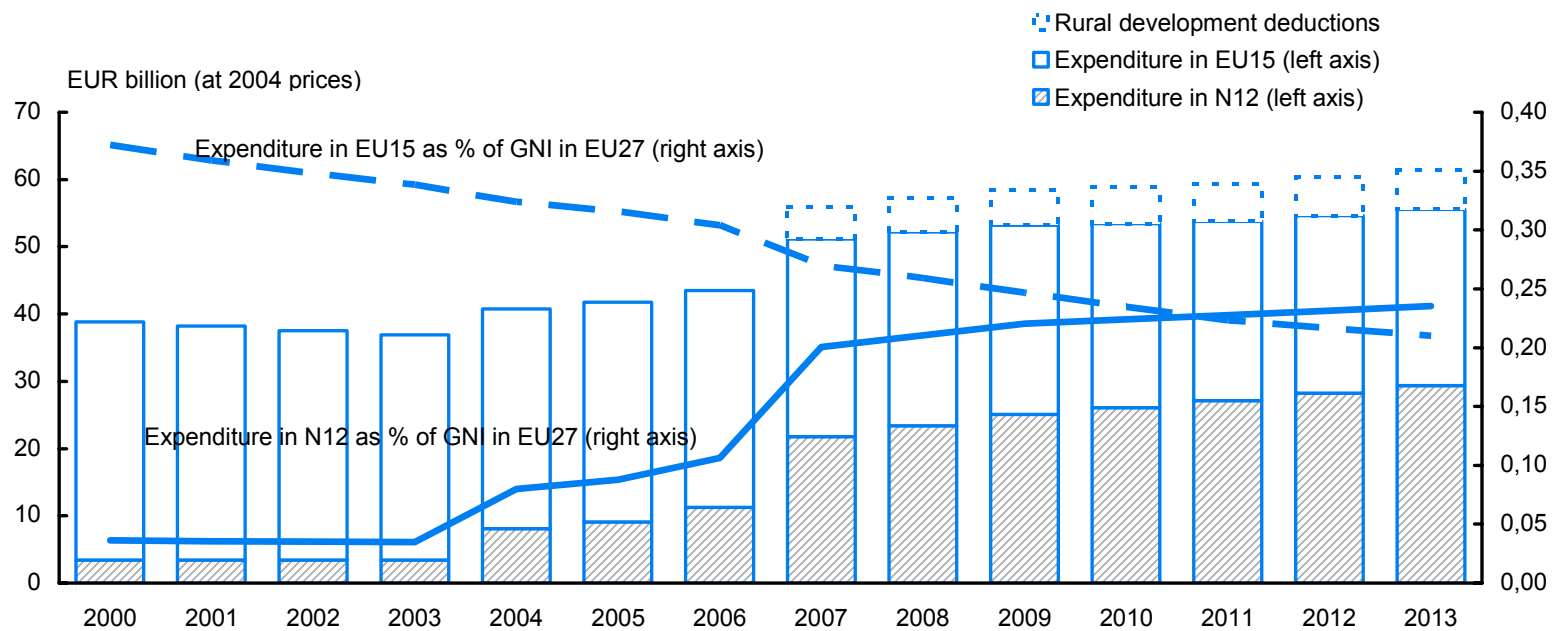
Box 1		
	“Convergence” priority	“Regional competitiveness and employment” priority Regional competitiveness strand
ERDF	1. Innovation and the knowledge economy	
	<ul style="list-style-type: none"> • Productive investment; • Development of endogenous potential. <i>Inter alia</i>: <ul style="list-style-type: none"> ○ Services to enterprises ○ Promoting innovation and R&D ○ Promoting entrepreneurship ○ Direct aid to investment ○ Local infrastructures ○ Information society ○ Tourism and cultural investment 	<ul style="list-style-type: none"> • Promoting innovation and R&D, <i>inter alia</i>, by reinforcing the links of SMEs with the knowledge base, supporting networks and clusters, or enhancing SMEs access to advanced technologies and innovation business services. • Promoting entrepreneurship, by, <i>inter alia</i>, supporting the creation of new firms from universities and existing firms, or setting up new financial instruments and incubating facilities.
	2. Accessibility and services of general economic interest	
	<ul style="list-style-type: none"> • Transport, telecommunications and energy networks, including trans-European networks; • Secondary networks; • Social infrastructures 	<ul style="list-style-type: none"> • Secondary networks, <i>inter alia</i>, road connections to TEN-transport, but also regional train junctions, airports and harbours or multimodal platforms, regional and local inland waterways, rail sections ensuring radial connections to main rail lines. • Information society, <i>inter alia</i> equitable access and use of broadband ICT networks and services; the promotion of SME access to ICTs.
3. Environment and risk prevention		
<ul style="list-style-type: none"> • Helping Member States to achieve full compliance with the body of EU law • Supporting the development of eco-industries • Rehabilitating derelict industrial sites • Supporting measures to prevent natural and technological risks • Favouring cleaner methods of transport • Energy efficiency • Development and use of renewable energy 	<ul style="list-style-type: none"> • Investment in infrastructures linked to Natura 2000 contributing to sustainable economic development • Promoting the integration of cleaner technologies and pollution prevention measures in SMEs • Rehabilitation of derelict industrial sites • Supporting measures to prevent natural and technological risks • Promotion of urban sustainable public transport • Development and use of renewable energy 	
4. Reinforcing the institutional capacity of national and regional		

	administration in managing the Structural Funds and the Cohesion Fund	
		“Regional competitiveness and employment” priority Employment strand
ESF	1. Education, employment and social support systems	1. Adaptability of workers
	<ul style="list-style-type: none"> • Strengthening labour market institutions • Development of education and training systems • Development of social and care services 	<ul style="list-style-type: none"> • Enhancement of life-long learning strategies, notably by public authorities and social partners • In-company training for the adaptability of workers
	2. Human capital and labour supply	2a. Labour supply and 2b. people at disadvantage
	<ul style="list-style-type: none"> • Initial and continuing training measures • Active labour market to ensure access to the labour market for all • Social inclusion support measures 	<ul style="list-style-type: none"> • Enhancement of active ageing strategies and prevention of early exit from the labour market • Measures to increase labour force participation of women • Measures to increase the employment potential, equal access and inclusion of people with disabilities, migrants, ethnic minorities
	3. Adaptation of public administration to change through administrative and capacity building	

Figure 1 – Instruments and objectives

2000-2006		2007-2013	
Objectives	Financial instruments	Objectives	Financial Instruments
Cohesion Fund	Cohesion Fund	Convergence and competitiveness	Cohesion Fund
Objective 1	ERDF ESF EAGGF-Guidance FIFG		ERDF ESF
Objective 2	ERDF ESF	Regional competitiveness and employment - regional level - national level: European Employment Strategy	ERDF ESF
Objective 3	ESF		
INTERREG	ERDF	European territorial cooperation	ERDF
URBAN	ERDF		
EQUAL	ESF		
LEADER +	EAGGF-Guidance		
Rural development and restructuring of the fishery sector outside Objective 1	EAGGF-Guarantee FIFG		
9 objectives	6 instruments	3 objectives	3 instruments

Expenditure on cohesion policy, 2000-2013



Source: DG REGIO