MANAGING DIVERSITY FOR A GROWING EUROPE: A ROMANIAN VIEW ON THE EU BUDGETARY REVIEW PROCESS

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*Executive summary***

The European Union is facing major exogenous and endogenous challenges. ***Exogenous challenges*** reside in the changing global context, which impacts on the development of the Union. Globalisation affects the status of the Union in the world, due to newly emerging global powers. There is an increased risk of massive illegal immigration, with implications concerning issues such as clash of civilisations and terrorist threats. Excessive dependence on third parties leads to insecurity and losses of bargaining power. The effects of global warming are increasingly worrying.

Endogenous challenges originate in the Union's unique character as a geo-political entity. The Eastern Enlargement has increased the complexity of the Union. Ageing population and falling birth rates endanger the welfare systems. The functionality of the single market implies the existence of the four liberties and the free circulation of knowledge, conditions which still raise questions about their complete implementation. Re-location within the Union stirs dissatisfaction and rivalry among EU citizens and challenges the solidarity among the European nations.

When re-designing the budget to better tackle these challenges, there are several **principles** which need to be considered:

- The starting point should be the different realities in the Member States, and in particular, the variety of social and economic circumstances in Europe.
- Solidarity is fundamental
- The budget reform at the EU level should lead to national budget reforms in order to ensure synergy between European and national policy-making tools.
- The legal framework of the review/ reform should be the Lisbon Treaty

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** At the 2006 December Summit the European Council asked the Commission to carry out a review of the budget of the European Union by 2008/2009, paying particular attention to the Common Agricultural Policy and the own resources system In September 2007, the European Commission launched a Consultation Paper, which started the debate on the EU budget review. This paper is part of the document presenting a Romanian, non-governmental view, which aims to contribute to this debate. The whole study is available at http://ec.europa.eu/budget/reform/index_en.htm.

- The review/reform of the EU budget should consider public opinion support for EU policies.
- No budget item should be dealt with separately, as policies are interdependent;

The **expenditure side of the EU budget** is examined by looking at the added-value of the EU action and what may constitute European public goods. What constitutes European public goods is a function of priorities that exist at the EU level, which hinge on the state of economies and societies.

The Common Agricultural Policy needs to be reformed in line with global challenges and inner pressures.

- There is increasing pressure on the demand for agricultural products due to the growing Asian economies, in particular. Also, there is considerable pressure on food supply due to effects of global warming on agricultural plots and sources of water.
- The rise in the prices of food on world markets diminishes considerably the need for agricultural subsidies in the EU. From an age of food surpluses (which originated the CAP) the world seems to be moving to an age of shortages.
- The CAP is questionable because the use of resources is questionable in terms of optimality and social equity. The answer to both problems, however, is not necessarily the further decoupling, because decoupling does not seem to work very well within the current structure of distribution of the direct aids.

A reform of the CAP should consider the following issues:

- Farmers are a particular category of society, and many of them have been threatened by globalisation side-effects. The rise in the prices of food does change the picture dramatically for European agriculture, but not a few farmers would continue to be in need of support for a while at least.
- The European production capacity of food must be valued and used so that the dependence on external sources of food supply should not become excessive
- Good quality land and water are European public goods of growing importance and should be managed accordingly, via the CAP too.
- There are other sectors and policies related to the CAP, which will be affected by the reform.
- Possible options for strengthening and diversifying rural economies.

A reform of the CAP should focus on a redistribution of expenditures within the CAP, possibly co-financed with the Member States, and improve the targeting of measures:

- More money should be allocated to the second pillar of CAP, focused on rural development
- The sums allocated for the income-support objective for farms less than 5 ha should not diminish, as long as rural modernisation and economic diversification for possible displaced farmers to find other jobs; likewise the sums allocated to large farms should be phased-out in accordance with the rise in food prices on world markets
- Crisis management schemes should be devised in order to confront delicate situations
- Targeting can be improved by moving from multifunctional purposes to a clear distinction of objectives.

The Cohesion Policy is challenged by the high expectations stakeholders have from it to tackle various needs in Europe, by the threat of 're-nationalisation', and by what we think is misdirected policy analysis to claim that the policy is responsible for re-location. The budget reform should not affect the Cohesion Policy envelope. Nonetheless it should lead to the consideration of the following elements, for a better use of Structural and Cohesion Funds (SCF):

- It is our opinion that the budget allocation for Cohesion Policy should be maintained or even increased.
- The Cohesion Policy has added-value, but there is a need to focus on results more than in the past.
- Improvements in the allocation efficiency of the SCF require both a better alignment of the national development plans with the EU policy priorities, and a better integration of the EU-wide strategic policy agenda into national development programs.
- Given the past experience of Ireland and Spain, the Cohesion Policy context could serve as a framework for anchoring national policy-making, especially in the new Member States.
- The SCF represent, in our opinion, an important instrument for accelerating real convergence within Europe, but the need to improve the allocation and efficiency of public spending, in general, remains an outstanding and sizeable challenge for many Member States.
- At national level, there is a need to improve consistency and clarify the strategic direction across policy products and processes.
- Integrating policy planning and budgeting across the government is central to sustaining growth and achieving the strategic objectives of convergence.
- More emphasis should be paid to developing medium term expenditure frameworks (MTEF) and budgets on programms, to which the SCF should be an integral part and treated similarly to other financial resources.
- Improving absorption and effectiveness of SCF should also target the reform of the annual budget cycle in some members.
- There is a need to pay significantly more attention to upgrading the administrative capacity of SCF beneficiaries, especially at sub-national level, and of managing authorities.
- The economic rate of return of SCF projects should be given more prominence, which in turn requires more focus on developing project design skills.
- In order to improve the linkages between programs performance and resources allocated from the SCF, there is a need to strengthen monitoring and evaluation (M&E) systems.

To sum up, Cohesion Policy is one of the most important EU policies at the moment because it has the capacity and the potential to contribute to a cohesive development of the Union, with tools designed to manage the EU's socio-economic complexity. There is however considerable scope for improving its implementation.

Three aspects linked to the future of **R&D and competitiveness** policy of the EU are to be singled out:

- First, the EU funding for R&D and competitiveness does provide value for money. Impact assessments in general

prove a high return of R&D investments, but there is substantial scope for greater efficiency.
- Second, there are more forms of R&D, more types of knowledge-based economies, and more types of competitiveness - depending on EU members' level of development. EU R&D expenditure EU R&D expenditure should not relate exclusively to high value added R&D and high-end product innovation.
- Third, the management and implementation of these funds is just as important as the amounts.

It is essential to invest in centers of excellence in order to combat the brain drain within and from the EU. It is also extremely important to have free circulation and access to knowledge in order to increase the propensity of fast development all over the Union.

As a global actor, the European Union should consider the following issues:

- A better coordination between the Member States and the Commission and between the world donors could lead to more significant results in tackling issues in the developing world.
- In order to be a global actor, the European Union needs to be able to act coherently and fast at the world level. This implies the necessity of a common external policy which is supported by European resources.
- Ensuring security within and for the European Union is a European public good. Member States should intensify dialogue concerning this issue and the EU budget should contribute to this end.
- The EU needs to better integrate energy policy in its external actions and to allocate more resources to ensuring energy security. The Nabucco project could be supported by the EU budget as well.

The revenue side of the EU budget

- As it stands, the own resources system is not just, particularly because correction mechanisms have been designed to respond to and adjust imbalances that belong to the past. It is fundamental to reform expenditure in order to tackle own resources issues.
- Key to a functional system is pragmatism. We need a system that works; therefore it must be sufficient, stable, simple and equitable.
- A larger budget would be needed for the EU policies to be able to sensibly contribute to tackling challenges, however serious frauds in managing EU money impede an increase of the EU funding; there should be more focus on better management.

In consequence at the moment there is no scope for introducing new taxes, and contributions to the EU budget should continue to be GNI based. Provided that the management of the European funds improves, in the long term the EU budget should be increased and new resources should be added to the existing ones.

The **implementation** of the eventual reform of the budget should be carried out gradually, preferably on the length of a Financial Perspective, in order to avoid the emergence of disequilibria. Moreover, for better management and accountability, the Financial Perspective span should be reduced to 5 years, similar to the mandate of the European Parliament and the Commission.

Increased flexibility of the Financial Perspective is an issue that needs to be considered for better answering to unforeseen situations. It should be possible to have a European reserve or to transfer a certain proportion of funds among different headings, if necessary.

1. The Common Agricultural Policy

The mission for the Common Agricultural Policy is twofold. On the one hand, its objectives, as stated by the Treaty, should continue to be met by the future reform. On the other hand, CAP, as all EU policies, must be adapted to the challenges posed by globalization and EU inner strains.

The global context is affecting agriculture dramatically. There is increasing pressure on the demand for agricultural products due to the formidable progress of Asian economies. This rise puts upward pressure on the price of basic commodities, including cereals.[1] Likewise, there is considerable pressure on food supply due to the side-effects of global warming on agricultural plots and sources of water.

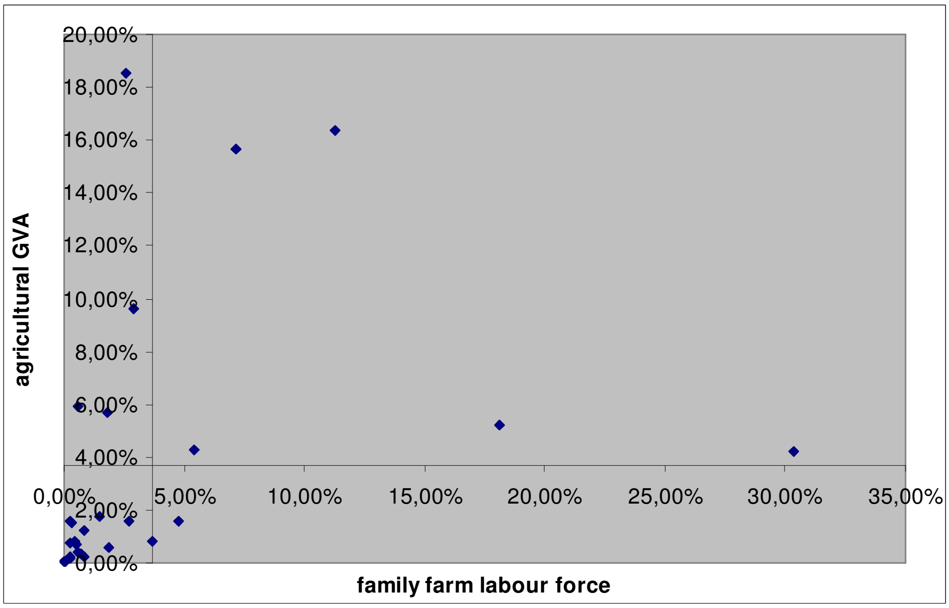
Both supply and demand side dynamics on food world markets would reduce dramatically the need for agricultural subsidies in the Union. But, the impact of global dynamics on the efficiency of farms is largely differentiated and the CAP needs to take it into account, for reasons of social cohesion as well.

The CAP has to be re-examined against the background of the above mentioned dynamics. While the volume of subsidies should diminish decisively over a time frame the EU needs to develop intervention mechanisms to tackle risk and allow for crisis management. At the same tine, the large variety of farm efficiency in the EU should be considered, in the short term at least. Most importantly, good land, as the main agricultural asset, should be better valued (measurements via narrowly constructed cost-benefit analyses are, arguably, misleading). Good quality land and water are European public goods of growing importance and should be managed accordingly, at both national and EU levels. The CAP should be designed in such a way that it be able to answer to the new challenges and resources should be targeted to this end.

An image of the EU complexity is illustrated by the very large structural differences among the EU members in the agricultural sector. Romania and Poland account for 48.5% of the total number of agricultural holdings in the EU27, and for 53.4% of the total number of small agricultural holdings (less than 5 ha). The CAP budget for these two countries, however, represents a much lower share in the total CAP expenditures (it will grow, nevertheless, up to 2013); the indicative ratio between the share in the CAP expenditures and the share in EU number of agricultural holdings is 1:10 for these countries, while the same ratio is 6:1 for Germany and 5:1 for the Great Britain. Italy and Spain also have a large share of EU agricultural holdings and of EU family farm labour force, but they also have an even larger share in EU agricultural gross value added (GVA) – which means that, in these countries, the agricultural labour force is more efficient, and the crops are oriented towards more value-added products.

[1] The current international financial crisis, and an eventual recession in large areas of the world economy, may dampen this tendency for a while. But over the longer term the trends seems to be quite clear.

Fig. 3: Labour force and value added, total agriculture, EU27=100



Source: based on Eurostat
Note: the axes cross at non-weighted EU27 average values.

France, Spain and Italy, which are among the top beneficiaries of the CAP, have also some of the highest shares of agricultural GVA in total agricultural GVA of EU27. This might be interpreted as the result of long-time support through CAP – something that is now questioned for some of the new Member States, which would need this type of assistance. Romania and Poland are the likely candidates for more funds, but also Slovakia and Hungary have small land plots; about 90% of their agricultural holdings are less than 5 ha. Moreover, Greece, Italy and Portugal have a high share of agricultural holdings of less than 5 ha, with ceilings above 70% of total in each case. All these countries would be in fact exposed to severe losses if the decoupled direct aids system is abandoned or if agricultural financing is severely reduced.

Previous reforms attempted to reduce market distortion mechanisms which were entailed by the implementation of the CAP; however their results are questionable. Regarding the assessment of the 2003 reform, Roberts and Gunning-Trant (2007) conclude that moving toward single farm payments is likely to result in less distorted markets for agricultural products, but that there is still a large use of market distorting forms of support (tariffs, quotas, export subsidies) and that the decoupled 'payments could maintain established distortions to production patterns'. The authors identify at least two reasons for this: expectations (farmers believe they are expected to continue production, and they also expect that a review of the CAP might change the emphasis again on production), and the cost of transfer (from a subsidized product to a non-subsidized one). Hennessy and Thorne (2005), based on survey results in Ireland, hold that a considerable number of farmers would opt for using their decoupled payments in order to subsidize unprofitable production.

There are two clearly identified problems in the current framework of CAP with the distribution of direct payments:

- **The first problem is that the distribution is questionable from the point of view of social cohesion – as the Commission stressed it out on a number of occasions (European Commission, 2007).**

In EU-15, in 2005, 50% of beneficiaries received only 3% of total direct aids, while 2% of beneficiaries received 30% of total direct aids. In the ten new Member States that joined the Union in 2005 (NMS-10), 93.1% of beneficiaries received 39% of total direct aids in 2005 (less than 1250 euro per beneficiary farm), and 1.3% of beneficiaries received 45% of total direct aids. The higher share of beneficiaries receiving minimum amounts in NMS-10 reflects the predominance of small farms in the region. But the problem of highly unfair distribution is valid all around the European Union, in the new states and in the old states as well.

- **The second problem is that the distribution of direct payments is suboptimal, given their stated objectives.**
- **The answer to both problems, however, is not the further decoupling, because decoupling does not seem to work very well within the current structure of distribution of direct aids.**

Since the largest farms get most money, and since the largest farms also have the largest production potential, we could in fact expect that decoupling leads to the same result – subsidising production, mainly for the large farms. The solution is, arguably, neither reducing the support level while overall payments to big farms increase, nor increasing the amount of land per farmer to qualify for direct aid (both proposals are presented on the consultation's website[2]) – as either of these proposals would only increase the inequality of payments' distribution. On the other hand, the new situation on world markets should lead to a reassessment of direct payments mechanisms. For the reduction of the need for agricultural subsidies should be mirrored in how much direct payments presumably efficient large farms do get.

The payments for market interventions and direct aids are foreseen to decrease by 5.74% between 2007 and 2013[3]. And the new world situation on food markets would further highlight the rationale for reducing the volume of needed direct payments. However, the persistent disequilibria between the two pillars of the CAP, the beneficiary countries, and the beneficiary citizens[4], on the one hand and, on the other hand, the remaining significant market distortions induced by the CAP, require a reform of the CAP, which would lead to a reconsideration of the different realities in the Member States and of their agricultural assets, which are significant for the years to come.

The Treaty (Art. 33 TFEU) sets five objectives for the CAP: to increase agricultural productivity by developing technical progress, to ensure a good quality of life for the agricultural population, to stabilise markets, to guarantee the security of supply, and to ensure reasonable prices for food products. The CAP reform should not abdicate from these objectives; but it should better ensure that these objectives are clearly identified when resources are allocated.

[2] http://ec.europa.eu/agriculture/healthcheck/index_en.htm
[3] According to the Interinstitutional Agreement of 2006
[4] See also Boulanger (2007)

There is no one way street for reform; and we should not take for granted that a reform means necessarily a severe cut in expenditures, in a short run There is also a moral implication to it: if, let's assume, the CAP is abandoned altogether, or funds are cut across the board, or funds are redirected only based on performance, then the efficiency gaps between new Member States and other EU members (which benefited from the CAP for 40 years) will become of a chronic nature. There are several issues that need to be considered when deciding over CAP reform.

- **First, farmers are a particular category of the society; many of them have been increasingly threatened by globalisation side-effects. A new "ballgame" on world food markets does not automatically change the lot of small farms.**

In the new Member States agricultural land plots are severely fragmented. The re-conversion of agricultural labour force requires high investments and training programmes. An immediate side-effect of non-conversion will be migration to urban areas, or abroad, unless appropriate alternatives for rural development are designed. Here too, the new Member States have to face a greater challenge due to higher proportions of farmers in the total active labour force and infrastructure shortcomings.

There may be a trade-off between subsidising agriculture and accepting emigration[5] in countries where the GDP/cap is low and one could assume that maintaining CAP could diminish the propensity to migrate. Less money to agriculture may translate, in the poorer EU states, into higher incentives to leave for sources of higher income (and the propensity for migration abroad is higher than the propensity for migration within the same country). Furthermore, as national governments in the transition economies were generally unable to finance agriculture adequately, the CAP transfers may provide the incentive for some migrant workers to return at home, in the rural areas. It is fair to say, however, that the propensity to migrate is mostly due to high wage differentials between East and West and it is not up to the CAP to solve this issue.

- **Second, despite trade liberalisation, the European production capacity of food must be valued and used so that the dependence on external sources of food supply should not become excessive.**

This is necessary, particularly in the case of imports from countries where veterinary and hygiene standards are not always fulfilled, and eventual pandemics could have serious effects on food supply in Europe. The supplies on the European food market should be ensured where possible from internal sources.

- **Third, when addressing the reform of the CAP, one should keep in mind that there are other sectors and policies related to the CAP, which will be implicitly affected by the reform.**

Environment, food safety, rural economy, competitiveness and trade are usually referred to in connection with the CAP[6]. These issues are largely addressed by the CAP itself: cross-compliance requirement helps protecting the environment; rural development is implied by the 2nd pillar of the CAP, while trade distortions have been diminished (at least in principle) by downsizing the intervention

[5] For example, half of the Romanian emigration to EU between 2002-2006 (49%) comes from the rural area – see Sandu (2007).

[6] See DG Internal Policies of the Union, Policy Department on Budgetary Affairs (2007), "The EU Added Value of Agricultural Expenditure – From Market to Multifunctionality – Gathering Criticism and Success Stories of the CAP", Brussels

mechanisms in agricultural markets[7]. Therefore, the CAP reform should account for the context of other EU policies which might be affected. Direct cost-based analysis, as it is now suggested, is necessary, but it does not suffice to understand and analyze the CAP efficiency; opportunity costs should also be taken into consideration.

- **Fourth, the question is how agricultural assets are defined in the 21st century, and which of these are European public goods.**

Assets such as soil and water have increasing importance in the context of climate change. The preservation of the agricultural habitats should be a priority of CAP, so should be the good management of fertile soils. An excessive reduction of farming activities would lead to a considerable reduction in the number of animals in Europe and to a loss in soil quality. Encouraging the production and availability of organic and healthy food products is a must. The increase of public health problems due to diabetes, coronary heart diseases and obesity, particularly among children, as a result of bad alimentation is worrying. It is important for Europe to have a healthy population in the context of speeding up economic growth, ageing population, and pressures of reform on the social welfare systems. Energy security is an issue that touches upon agriculture too, given the possibility of developing biofuel crops, and wind powered stations, where landscape conditions allow.

- **In consequence, a reform of the CAP should focus on a redistribution of expenditures within the CAP, possibly co-financed with the Member States, and improve the targeting of measures.**
- **In the context of globalisation challenges and the necessity to re-orientate and develop the skills of the population occupied in agriculture, more money should be allocated to the second pillar of CAP, focused on rural development.**

The new Member States in particular need to modernize agriculture, to develop rural infrastructure and diversify rural activities. Most of the resources should be redistributed from the reduced (or totally cut) payments for large farms, which represent the bulk of the financial resources allocated from CAP.

- **The sums allocated for the income-support objective for farms less than 5 ha should continue as long as job alternatives are not available, while the sums allocated to large farms should be phased-out in accordance with the dynamics on world food markets.**

Only by doing this an effective decoupling of direct payments from production could be achieved. In this context, we agree with the idea that farms with large turnovers should be excluded from direct payments (except for emergency situations, maybe). In this regard, our proposal is bolder than the current modulation system proposed, which envisages, by 2013, marginal cuts for large farms and no increases for small farms.

- **Targeting can be improved by moving from multifunctional purposes to a clear distinction.**

A part of direct aids should be allocated to income-support for farms less than 5 ha, possibly co-financed with the Member States.

[7] Gros and Micosi (2005) say that the CAP, by pushing relative prices and incomes in favour of agriculture, discourages investment in industry and services. Moreover, they say that the new member states have a much larger potential in the latter sectors, and should therefore be less interested in supporting the CAP. Their assertion, however, is not substantiated by facts; on the contrary, the prices of production means grew faster than the prices of agricultural production, over the last 10 years.

The other part of direct aids should be allocated for improving the cross-compliance of standards, soil and water management, and preservation of agricultural habitats.

It is important, however, to agree on the direction of the reform. We believe that, as far as the CAP reform is concerned, the liberalization of agricultural markets can be achieved for those who are able to face it; that is mainly large farms. At the same time, the reform should focus on the redistribution of expenditures within the CAP, and on an improved targeting of the measures. As indicated above, there are essential European public goods, which should be managed at the European level through an equilibrated instrument mix. This analysis focused on the role of financial assistance in agriculture, but legislative measures and guidelines should also be considered.

2. The Cohesion Policy

The Cohesion Policy is challenged by the high expectations stakeholders have from it to tackle various needs in Europe, by the threat of 're-nationalisation' , and by what we think is misdirected policy analysis, by claiming that the policy is responsible for re-location. There have been claims in previous negotiation rounds that Cohesion Policy does not deliver at the European level; and that particularly in the case of wealthier Member States, national governments could tackle regional disparities on their own. There have also been claims that Cohesion Policy favours re-location by simply transferring wealth from West to East, rather than reducing the gaps of development and advance cohesion among EU regions. The recent decision by Nokia to close down a factory in Germany and to open a new one in Romania was interpreted by some EU politicians as a Cohesion Policy side-effect. The policy was accused of encouraging re-location rather than reducing the development gaps between European regions and creating new jobs[8]. In our opinion this is a misdirected policy analysis as re-location is a globalization effect, which takes place all over the world. The issue is not to avoid re-location within the EU. It is much more important to avoid re-location taking place from the EU to third countries, to the extent this possible.

This section addresses Cohesion Policy by first assessing its current situation, second, by identifying the problems it should tackle and its added-value and third, by proposing some direct measures to improve its impact.

The challenge to manage EU complexity could not be better reflected than in the case of Cohesion Policy. The shape of the policy itself is a result of conflicting paradigms materialized in negotiation rounds carried out over the years between sympathizers of neoliberal capitalism and those favouring a regulated approach (Hooghe, 1998). The debates between the Friends of Cohesion and the Cambridge Circus, the two informal groups of Member States in Cohesion Policy negotiations, always concerned the size of the policy budget, its redistribution function, and its focus on traditional objectives such as infrastructure, on the one hand, and added-value, sound financial management, competitiveness, and absorption capacity, on the other.

Cohesion Policy is often thought to be a 'pork barrel' policy (De Rynck and McAleavey, 2001). It targets numerous measures within its broadly defined objectives and additional provisions for several Member States with *special status*, in order to allow every Member State to benefit from it. Although these political implications are not contested, globalization side-effects cause problems across Europe. The Union is varied and

[8] See Schui, H. (2008)

disparities materialize in different ways across the regions and Member States, demanding different types of interventions. Consequently, issues are raised questioning the impact and added value of the European Cohesion Policy.

- **The added-value of Cohesion Policy is visible and can be improved.**

Let us approach Cohesion Policy, going back to the idea of spillovers and 'the scale and effects of the EU action' mentioned by Art. 5 in the Treaty. There have been numerous attempts to asses the impact of the Structural and Cohesion Funds (SCF)[9]. Most indicate that convergence was improved, particularly in the case of Objective 1 regions (those with a GDP/cap of less than 75% of EU average). With the exception of the regularly cohesion reports published by the European Commission, which tend to be more optimistic, convergence was hard to prove in the case of regions, other than those under Objective 1. Nonetheless, there are several limitations to this type of evaluations that should be considered.

First, providing that these studies managed to isolate the impact of SCF from other factors and their results are pertinent, is the lack of real convergence in Objective 2 regions, for example, a result of lack of added value or is it a result of few resources allocated at the EU level, which do not allow for a stronger impact? One may recall that Objective 1 regions, where some convergence was reached, have always received more than two thirds of Cohesion Policy allocations, and the EU involvement was greater, providing over 75% of the total assistance and having more clout in the management and targeting of the funds in these areas. On the contrary, the Objective 2 regions were allocated considerably less funds (currently they benefit from 16% of the total allocations), which were implemented in a less coordinated way. Thus the question of impact and added-value should not be isolated from that of resources and implementation approach. In our opinion, claims of re-nationalisation are not justified. In fact, it seems to be the case that added-value can be seen, where EU intervention was greater.

Second, assessing real convergence does not mean assessing overall the impact of Cohesion Policy. The latter does not concern only economic cohesion, but also social and territorial cohesion. Added-value should have a broader definition in order to try to capture these aspects too. For instance, studies[10] that considered other variables besides economic indicators found positive results. These variables included the positive effects of cross-border cooperation, the exchange of knowledge and best practices, and the effects that Cohesion Policy has on the implementation of other national policies with which it interacts. It is noteworthy that social and territorial cohesion is difficult to evaluate empirically. Like economic cohesion, social and territorial cohesion is reached in the long-term. A simple evaluation of a Financial Perspective span cannot lead to conclusive results. Furthermore, the Eastern Enlargement has just taken place. The new Member States are still in a learning process concerning the use and the development of their absorption capacity.

Third, there are differences in performance in the EU, which are embedded in the national policy-making context, rather than in the capacity of SCF to deliver results. There are countries and regions that have progressed rapidly in terms of living standards and productivity, while others continue to lag behind in spite of benefiting from substantial transfers. What has made the difference

[9] See for example Bachtler and Taylor (2003), Begg (2004), Boldrin and Canova (2001), Bradley and Morgenroth (2004)

[10] See for example: Bachtler and Taylor (2003)

between the two sets of SCF beneficiaries? Evidence indicates that there is a broad array of factors explaining the divergence in performance. These can be grouped into three major sets. The first set reflects the limited success in fully integrating national development plans, the umbrella for the SCF deployment, into the country development agenda. The second set has to do with the capacity to plan at strategic level and develop a coherent policy framework, backed by a solid budget formulation and execution process. A third set of factors reflects the poor administrative capacity in the beneficiary institutions, associated sometimes with the initial conditions.

Some would argue in this case that the best approach is a concentration of Cohesion Policy assistance towards those who did not manage to make the most of it previously due to the kind of shortcomings indicated above and to the less developed Member States who are likely to face these difficulties in the future. For the successful cases, re-nationalization would be the right option. A policy targeted only at the poorer Member States of the Union would reinforce a sense of a divide between the rich and the poor; it would stress further the case for simple financial transfers and bring more dissatisfaction for western European citizens. It would contravene to the very purpose of the policy, which is to foster cohesion in Europe and not to divide it. Furthermore, globalization brings challenges that can and should be tackled only together, such as re-location effects, increasing the flexibility of the European labour force, and tackling migration within the EU. Besides building infrastructure, Cohesion Policy facilitates changes of best practices and speeds up the circulation of knowledge, which are essential for fostering growth.

The Treaty (Art. 158, the Reform Treaty) sets a clear objective for Cohesion Policy: to reduce the gaps of development between European regions, in order to promote the Union's 'overall harmonious development'. According to the Treaty, this can be achieved through economic, social and territorial cohesion and solidarity among Member States. Cohesion Policy has proven a great capacity to adapt to new challenges over time in order to answer to its objectives. Currently, a part of its expenditure is allocated to Lisbon Strategy objectives. The second objective of the Cohesion Policy, Regional competitiveness for growth and employment, allocates three quarters of its ceiling to this purpose, and a proportion of 60% of the sums allocated to the Convergence objective in the EU 15 areas are earmarked for Lisbon Strategy priorities. Nonetheless, most of the areas eligible for the Convergence objective are in the new Member States. These areas are still in need of traditional Cohesion Policy actions, such as infrastructure networks in order to connect better with the poles of development in Europe. Actions of this kind are not old fashioned. The purpose of Cohesion Policy is therefore primarily to reduce gaps of development and if this can help implement the Lisbon Agenda so much the better. One agrees that globalization presses for a faster economic growth in Europe and increased competitiveness and Cohesion Policy should help tackling these issues too. However, investing in R&D is not the only way. Regions, which lack basic infrastructure and institutional capacities, will not be able to become competitive unless their underdevelopment related handicaps are tackled first.

- **It is our opinion that the budget allocation for Cohesion Policy should be maintained or even increased.**

Its current structure is, in our view, appropriate, although the former definition of Objective 2, targeted at industrial reconversion might have better served reaching cohesion all over the Union. However, given the current global context and the need to support the Lisbon objectives, the three policy objectives addressing convergence, regional competitiveness, and territorial cooperation are well designed and resources are proportionately allocated. The objectives capture at the same time the need for traditional structural investments, the need for fulfilling the Lisbon Agenda objectives, and the need for territorial cooperation. Nonetheless, there is much scope for improving the implementation of the policy, and in particular for developing the absorption capacity of the Member States that joined the Union after 2004 and need to speed-up their progress in order to catch up with the most developed areas in the EU.

- **Our view is that there is a need to focus on results more than in the past.**

In turn, this requires a more pro-active stance of the EU institutions, the national governments and the regions vis-à-vis the efficient use of the SCF, including the establishment of solid and performance oriented monitoring and evaluation systems at all levels. To achieve this, a review of the allocation of responsibilities between the EU, national and regional institutions in the management of the SCF might be warranted. Enhancing the institutional capacity of the SCF beneficiaries, both at local and central levels, to design and implement projects should **be** a priority.

The resources allocated to the Structural and Cohesion Funds have constantly increased from around 17.2% in 1988 to an estimated 35.7% in 2013 of the EU budget. There are countries and regions that have made progress in becoming more competitive and there are others where progress has been limited at best. Similarly, there are countries and regions that are catching up with the frontrunners in terms of incomes, while others seem to be trapped, in spite of substantial funding support from both the SCFs and national budgets. Concomitant with the increase in SCF resources, the flexibility of their use has been substantially enhanced, decision making decentralised and more of the funds go towards boosting competitiveness, growth and jobs. Evidence suggests that challenges manifest along two dimensions: a) generic problems, that have to do with meeting the development objectives against which the SCF are being deployed; and b) specific problems, that have to do more with programme implementation.

Against this background of mixed outcomes, two questions appear to demand priority answers: a) are there tensions between boosting competitiveness and the redistribution of resources that affect the performance of the SCF? and b) is enhanced flexibility in allocation, which not only puts the national governments in the driving seat in terms of deciding where resources go, but also gives practically unlimited choices to them to direct the funds, a problem rather than a solution? Are implementation capacity constraints undermining the very purpose of enhanced flexibility and decentralization of decision-making? Some lessons, which illustrate these tensions, are drawn below on the basis of implementation experiences, including some from the new Central and Eastern European members.

- **Improvements in the allocation efficiency and effectiveness of the SCF require both a better alignment of the national development plans with the EU policy priorities, and a better integration of the EU-wide strategic policy agenda into national development programs.**

Experience suggests that countries where the national policy framework has placed global competitiveness at forefront, within an EU context, such as Ireland and Spain, have been most successful in mobilising SCF for development. A stable macroeconomic environment, an outward-oriented productivity and competitiveness driven industrial strategy, within the framework of the *acquis*, important improvements in human capital and physical infrastructure, competition, market liberalization and regulatory reform and, critically, improvements in governance appear to have been prerequisites for a successful deployment of SCF. In those countries the SCF not only have become instruments for attaining national development objectives, but have also shaped the whole resource allocation framework, including the prioritisation and expenditure management framework. Noticeably, this happened against a background of not-so-clearly-defined EU-wide policy agenda at the time, prior to Lisbon Agenda's beginning to take shape.

- **The Cohesion Policy context could therefore serve as a framework for anchoring national policy-making, especially in the new Member States.**

It is generally accepted that most of the priority reforms needed, many regarding the functioning of the public sector, have to occur within the member states themselves, rather than at the EU level. The experience of Ireland and Spain, for example, suggests that the EU SCFs processes have 'exported' and enhanced oversight, benchmarking and knowledge sharing, which have shaped, to different degrees, public sector processes in the beneficiary countries. The introduction of ex-ante program analyses, multi-annual planning and budgeting for SCFs, and the system of ex-post evaluation were subsequently extended in Ireland to the whole public sector, with remarkable results in terms of increasing the efficiency of public spending. We argue therefore that, at least in the context of the new members, the SCFs should have a strong national development dimension, in a comprehensive sense, given the large income and productivity gap relative to the old members. In other words, the SCFs should help the new members exploit the opportunities offered by the EU common market by playing the role of an all-inclusive, integrative framework for national development.

- **The SCF represent, in our opinion, an important instrument for accelerating real convergence within Europe, but the need to improve the allocation and efficiency of public spending, in general, remains an outstanding and sizeable challenge for many members.**

The degree of success in achieving convergence varies considerably across countries and regions in spite of substantial SCF funding support, of which some benefited for long periods. Important public resources, including SCF, still go to unproductive policy actions, or what is even worse, are misused in a fraudulent way. There is significant scope for enhancing the quality of public investment in infrastructure and human capital. Evidence points to the fact that the countries with better state of governance seem to spend more efficiently and effectively.

- **At national level, there is a need to improve consistency and clarify the strategic direction across policy products and processes.**

Policy products include government programs, plans for the implementation of the *acquis*, convergence plans, reform plans, or national development plans (NDP). These various strategic documents often derive from distinct processes involving different role players and with dissimilar purposes, some political, some focused on deepening EU integration and some focused on SCF access. In reality, not all are true strategic government-wide frameworks that give unequivocal direction to people and the public sector about what the government intends to achieve. While the enhanced flexibility in the allocation of the SCF across sectors to better respond to priorities is welcome, parallelisms in planning prevent reaping the full benefits pursued.

- **Vulnerabilities at the strategic planning stage, which generally takes place at the centre of the government, bringing decision-making into the nexus of politics and administration, manifest primarily in two areas.**

The first of these is the absence or the insufficient development of a broad government-wide policy framework that should define government goals clearly and allow the articulation of more detailed central and local government programs, roles and responsibilities. The second area relates to basic policy-making capacity constraints in sectors and line ministries, and the specification of medium-term expenditure preparation ceilings for government budget entities. This should take place for line ministries and other centres of government agencies and for local government entities. It entails revenue forecasting capacity matched with realistic and prioritised sectoral policy planning, and the decision to use such information to discipline budget preparation. Having such pieces in place would ensure a linkage between policy thinking and government fiscal realities. Without this tie, policy products and budget proposals often become undisciplined 'wish lists' that are difficult to connect to the resources framework.

- **Integrating policy, planning and budgeting across the government is therefore central to sustaining growth and achieving the strategic objectives of convergence.**

Institutional, policy and process weaknesses of the public financial management systems are central obstacles to strengthening aggregate fiscal discipline, improving the effectiveness of public resources allocation and aligning the resources with the strategic priorities of the countries. This affects also the absorption of the SCF. Evidence shows that the relationship between policy, planning and budgeting is one of the most important factors contributing to poor budgeting outcomes at macro, strategic and operational levels in the Member States. Key limitations come from the fragmentation of the public finance management system and vulnerabilities visible at all stages of the public expenditure management cycle.

- **More emphasis should be paid to developing medium term expenditure frameworks (MTEF) and budgets on programs, to which the SCF should be an integral part and treated similarly to other financial resources.**

Faced with conflicting objectives and constrained resources, Member States attempted to establish MTEF as a means of balancing the aggregate affordable resources with the policy priorities of the countries. However, rarely have the MTEF achieved their intended objectives of enhancing the clarity of policy objectives, improving the predictability in budget allocations, the comprehensiveness of coverage and transparency in use of resources. Instead, the MTEF are more of an annual exercise, projecting revenues and expenditures several years ahead, rather than a multi-year budgeting initiative to guide annual budgets, with limited substantive multi-year programming content. The MTEF are often substantially altered from year to year and lack a thorough connection with other processes, such as the NDP. In some countries, budgets are organised by programme after the line-item allocations are decided upon, indicating the use of programmatic concepts as an ex-post rather than an ex-ante tool to ensure policy orientation in allocations.

- **Improving absorption and effectiveness of SCF should also target the reform of the annual budget cycle in some members.**

Frequent shortcomings include insufficient strategic and policy guidance for the allocation of funds, weak linkages between funding and performance, frequent budget rectifications reallocating important resources within the year, delays in the effective start of the budget cycle, limited cooperation between finance departments and credit holders both in the formulation and execution of the budget. Deficiencies are sometimes augmented by an inadequate macroeconomic and revenue analysis and forecasting framework.

- **There is a need to pay significantly more attention to upgrading the administrative capacity of SCF beneficiaries, especially at sub-national level, and of managing authorities.**

The capacity to design and implement complex projects in order to access SCF is often limited. As a consequence, SCF absorption is low and resources sometimes do not commensurate with outcomes. This is particularly evident in the first years after being granted access to the SCF and in the case of the poorest local governments, which need these resources the most. This situation is occurring in spite of the fact that the new EU members, for example, have received for long periods of time substantial pre-accession funding and expertise support for capacity building. This support has been internalised by the public institutions only to a limited extent, as it was the case with the pre-accession funds (PHARE, ISPA, SAPARD) and occurred mostly outside the national budget process. As a result, the interaction between those involved in the management of the pre-accession funds and the budget planning and policy departments is traditionally limited. Consequently, the net inflows of funds to the Member States, excluding CAP direct payments, (SCF gross inflows minus Member State contributions to the EU budget) are small and often times negative in the early years of membership.

- **The economic rate of return of SCF projects should be given more prominence, which in turn requires more focus on developing project design skills.**

While there have been improvements in clarifying and simplifying the SCF framework, including in what concerns the guidelines for project preparation, the standards remain high and the beneficiaries often do not have the skills to meet them fully in the project design stage. As a result, often beneficiaries cut corners and run into problems. A frequent problem is that absorption and impact are often decoupled, and the internal rate of return of the projects does not ensure their long term sustainability ('building cathedrals in the desert'). There are numerous examples where current spending resulting from project completion was not taken into account. This introduced substantial rigidity in national and local budgets, squeezing capital spending. Identifying ways to better leverage private sector skills should improve the quality of the projects both in terms of SCF absorption and developmental impact.

- **In order to improve the linkages between programs performance and resources allocated from the SCF, there is a need to strengthen monitoring and evaluation (M&E) systems.**

These systems should assess in a comprehensive and timely manner the extent to which resources help in achieving the intended outcomes and feed-back into the policy framework for eventual corrections and reallocations. Experiences of some old members, such as Ireland, suggest that the effective use of M&E systems not only improves the overall absorption of the SCF, but it also allows for rapid redeployment of resources towards better uses. Appropriate incentives schemes, backed by performance indicators, to reward the better performers and sanction the laggards should be part of the M&E system, taking into account at the same time the institutional capacity of the beneficiaries. While the level of SCF absorption matters, it is even more important to make sure that resources go where the needs are and where their impact is maximised.

Unequivocal positions vis-a-vis these issues are probably not possible, given primarily the large disparities between Member States and regions in term of development and policy and institutional maturity, translating into a broad array of priorities at national and sub-national level. The stated objectives of the SCFs are broad, and the instruments increasingly flexible, allowing member countries to employ resources for a broad array of sectors and activities. This has clear and proven advantages. The downside is whether the funds are not rather too thinly spread in order to make a difference in terms of overarching outcomes.

In this context, a follow up strategic question vis-à-vis the SCF use is whether there is a need to better focus them, making a more clear distinction between competitiveness and redistribution. For example, the funds focusing on competitiveness could target a cross-cutting EU-wide set of policy priorities, in which case presumably the role of the EU institutions in allocating these resources should be enhanced, and the role of the member state appropriately diminished. Equally, the funds targeting redistribution should focus on narrower, country specific set of issues, in which case more delegation should be given to the Member State and eventually to the beneficiary regions themselves. The EU action, in this situation, could focus on fostering exchange of views and best practices.

- **To sum up, Cohesion Policy is one of the most important EU policies at the moment because it has the capacity and the potential to contribute to a cohesive development of the Union, with tools designed to manage the EU's socio-economic complexity.**

The policy is designed in such a way that serves to every Member State, however this reducing the impact of cohesion actions. There are also issues posed by the small absorption capacity, particularly in the new members. A balance must be found between concentrating the funds and ensuring that the problems posed by regions lagging behind all across the Union are tackled. In our view, a clearer distinction between competitiveness and redistribution could be a solution to this dilemma. Improving programming and policy planning, as suggested above are too among the ways to improve absorption and maximize the SCF's impact.

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