

EU enlargement and structural funds in Scotland

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Introduction

For over two decades, Scotland has been a major beneficiary of the regional policy of the European Union (EU). By 2006, it is expected that Scotland will have received around £7 billion under the Structural Funds since the inception of ERDF in 1975. During the 1990s, when Structural Fund expenditure in Scotland was at its maximum, some two thirds of the Scottish population were covered by areas eligible for EU regional policy support, averaging over £250 million per year. In the current budget planning period (2000-2006), Scotland will receive a total of £1,094 million for the various EU-funded programmes now under way.

This European funding is now under threat. As the EU prepares for enlargement to take in up to 12 new members over the next decade, plans are being made to redirect Structural Funds to the poorer countries of Central and Eastern Europe. Many of these countries have income levels well below those of the EU Member States, with extensive poverty, underdevelopment and industrial dereliction. Tackling these problems will be the priority for future EU regional policy, with any remaining available Structural Funds going largely to the present less-developed countries of the EU – Greece, Portugal and Spain. Without an increase in EU budgetary resources, it seems unlikely that the richer EU Member States, including the UK, can expect to receive much, or maybe any, funding under EU regional policy, after the end of the current budgetary period in 2006.

The following paper considers the implications of the next reform of EU regional policy for Scotland. It begins by reviewing the political context for enlargement and the economic development challenges, and then reviews the emerging debate on scenarios for reform, identifying the issues for Scotland.

Enlargement of the European union

Enlargement scenarios

In 1993, the Copenhagen European Council made the commitment that¹: “the associated countries in Central and Eastern Europe that so desire shall become members of the European Union.” Eight years on, and the European

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Union (EU) has offered the status of 'Candidate Country' (CC) to 13 applicants², but none has yet received a fixed date for accession. The EU opened formal negotiations in March 1998 with Cyprus, Hungary, Poland, Estonia, the Czech Republic and Slovenia, and in February 2000 with Malta, Romania, Slovakia, Latvia, Lithuania and Bulgaria. Each of the applicant countries has to negotiate their adoption of some 30 'chapters' of the legal and policy framework (*acquis communautaire*) of the EU. These range from the 'basic freedoms', relating to free movement of goods, persons, services and capital, to complex issues of competition policy, taxation and agricultural support.

The progress of the negotiations varies. Whereas Cyprus, Hungary and Slovenia have concluded around three-quarters of the negotiation chapters, Poland is still discussing 12 of the 30 chapters, including fundamental aspects concerning the free movement of persons and capital, while Romania and Bulgaria have not even begun negotiations in several policy areas. In its latest report on the progress of the accession negotiations, the European Commission considers that ten of the 13 CCs - Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic and Slovenia³ - will be capable of participating in the 'first wave' of enlargement. Negotiations should be concluded with the 'best prepared countries' by the end of 2002. It is an open question whether all ten, 'first wave' CCs accede together - which would imply delaying enlargement to suit the country with the longest preparation time - or whether they accede at different times over a 3-4 year period. Whatever the sequence, it is likely that by 2006 the EU will have expanded to 25 Member States.⁴

Impact of enlargement

From a macroeconomic perspective, most studies predict that the impact of enlargement will be favourable. For example, the latest report on EU enlargement⁵, considers that it will be a "positive-sum game for the parties involved", with significant benefits for the Candidate Countries and also increased growth in the EU-15. Enlargement has often been discussed in a negative language of 'threats of competition', an 'influx of migrants' and 'cost burdens', but these fears are frequently overstated.⁶ The EU-15 currently have a •25 billion trade surplus with Central and Eastern European Countries (CEECs), and there is no indication that the CEECs constitute severe trade competition for the EU countries. Similarly, the CEE economies host a stock of •27 billion of foreign direct investment from EU countries, the major part of which is motivated by market access; investment in CEE is created rather than diverted from elsewhere in the EU. Further, detailed analyses do not suggest massive out-migration from CEE countries after enlargement and foresee only minor, and by no means necessarily negative, effects on wages and employment in the EU.

This is not to underestimate the challenge of enlargement for the economic and social cohesion of the EU. Widening

the EU to include 27 Member States would increase the territory of the Union by 34 percent and its population by 28 percent, whereas the average GDP per capita would decline by approximately 15 percent. Accession of the Central and Eastern European countries would radically alter the EU maps of regional problems and disparities. Agriculture dominates regional employment structures in the transition countries to a much greater extent than in the EU-15, much of the industrial sector is out-dated, and the service sector remains under-developed, especially outside the capital cities.

The EU-CC differences in income are wide. In 1998, the average GDP per capita (in PPS) of the 12 CCs was only 38 percent of the level in the EU-15. At regional level, the disparities are still greater. Only two CEE regions, Prague and Bratislava, have GDP per capita levels above the EU average. Three-quarters of the CCs population are in regions with a GDP per head of less than 40 percent of the EU-15 average, including all of the Baltic States, and Poland (except for the Warsaw region), Romania (except for Bucharest) and Bulgaria.

The growth rates of the Candidate Countries are currently running at high levels, but they are still only just recovering from the collapse in GDP in 1989-92. By 1998, only Poland and Slovenia (among the CEECs), had exceeded their pre-transition level. Hungary, the Czech Republic and Slovakia were poised to exceed this level in 2000-2001, but in other CEECs recovery was still some way off. It is also clear that convergence with the EU-15 is a long-term challenge. Scenarios of long-run national and regional GDP growth in the applicant countries suggest that it could take 30-40 years (under optimistic growth conditions) for the leading CEEC economies - Czech Republic, Slovak Republic and Slovenia - to reach the EU-15 average.

Implications for EU regional policy

The political debate

One of the key policy issues associated with enlargement is how the EU will respond to these new maps of economic and social disparity in an enlarged EU. As in the past, the volume of resources for EU regional policy, and its allocation among countries and regions, will depend on political bargaining among Member States. There are several, potentially conflicting sets of interests.

First, the magnitude of the development challenge in Central and Eastern Europe will require the EU to maximise and sustain the application of regional policy resources to assist the economic transition and restructuring processes underway in the CCs, in particular to enable all regions and social groups to benefit from enlargement. The CCs have already made it clear that they want to be treated fairly, receiving the same kind of entitlement to Structural and Cohesion Funds as the current poorer countries of the EU.

A second set of concerns has been expressed by the poorer EU-15 countries, whose relative statistical position will 'improve' in an enlarged EU. Several of the currently eligible regions will no longer qualify for Objective 1 support when the average EU income level is reduced by the accession of still poorer countries from Central and Eastern Europe.

Arguing that the severity of their regional problems will still need to be addressed, countries such as Spain are seeking assurances that their current receipts will be maintained by an increase in the EU structural operations budget.

A third viewpoint is that of the richer Member States who want to limit additional budgetary contributions. Some countries are determined to prevent a significant increase in the EU budget. Germany, for example, as the largest contributor, has already indicated that it does not want to see the current EU budgetary ceiling (1.27 percent of EU GNP) raised after enlargement. The richer states are concerned that few, if any, of their regions may qualify for Structural Fund support after 2006, leading to a worsening of their 'net payment' position, i.e. their contributions to the EU budget will no longer be partly returned in the form of Structural Fund receipts.

Lastly, the European Commission (EC) – which is not neutral in this matter – is trying to structure the debate to maintain or increase the EU role in regional policy. For example, the EC has rejected the option of any kind of 'renationalisation' of EU regional policy and seems to be avoiding any fundamental review of the objectives of policy. Instead, it is encouraging consideration of an EU regional policy that embraces the needs of the Candidate Countries, the current Cohesion Countries and other less-developed regions, as well as a continued EU role in addressing the problems of old-industrial regions, rural regions and sparsely populated areas in the EU-15, combined with a new focus on urban centres.

Although the decisions on the future of Structural Funds lie at least four years ahead, the debate has already begun in earnest. The EC published its Second Cohesion Report in January 2001, outlining some questions and priorities for Structural Fund reform, followed by a debate at the European Cohesion Forum in May 2001. An updated Cohesion Report is likely early in 2002, followed by a series of EC seminars on the territorial, sectoral and institutional priorities for future EU regional policy. Some of the Member States have begun to publish studies on the implications of enlargement for EU regional policy, with a range of possible scenarios and options.

One strand of thinking is to concentrate EU regional policy exclusively on the less-developed parts of the EU, eliminating aid to regions in the richer countries. For example, it has been suggested that the richer countries could 'opt out' of Structural Funds and contribute less to the EU budget. A different idea is to focus EU regional policy on national rather than regional convergence, providing support to the poorer countries (for example those with a national GDP per capita of less than 90 percent of the EU average) rather

than to poor regions. The advantage of such ideas is that they could bring more economic coherence to EU regional policy, ending the 'circular flow of money' from rich countries to the EU and back again, as well as removing the bureaucracy associated with implementing relatively small amounts of funding spread over many regions. The downside is that EU regional policy would be restricted to the CEECs, Greece, Portugal and Spain and could increasingly become to be seen as a 'welfare policy', potentially diminishing the political cohesion of the EU.

A second strand of the debate involves ideas to maintain a 'universal' regional policy that includes most if not all Member States, ensuring that both richer and poorer countries retain a vested interest in the policy area. Some have suggested an increase in the EU budgetary resources devoted to EU regional policy (by as much as 40 percent), allowing the current system to be extended eastwards while retaining support for existing recipients. Others have proposed a gradualist transition period, whereby the loss of Structural Funds to ineligible regions is phased in over a lengthy transition period of up to 15 years to allow them to adapt. A further idea is to have differential regional policy support, with one approach for the CCs and another, lower level approach for the EU-15. A more radical variant is to maintain regional policy support in the richer countries, but provided exclusively through 'Community Initiatives'.

Reallocating the Structural Funds

Central to the debate is the question of resources, notably the additional cost to the EU budget of providing EU regional policy funding to the CCs and the loss of entitlement of existing recipients in the EU-15. The starting point is to establish the budgetary parameters. At the end of the current financial planning period (2006), the EU has budgeted for possible annual spending on regional policy of some •42.3 billion, approximately 40 percent of the EU budget. At this point, the share of the current EU Member States will have fallen to •29.2 billion. This reduction will allow EU spending on structural policy in the Candidate Countries of up to •12.3 billion. In other words, the current EU budgetary framework has already begun a transfer of substantial, structural policy resources eastwards.

The population of the likely 'first wave' Candidate Countries is 75.2 million people (106 million including Romania and Bulgaria). In an enlarged EU, most of this population would be eligible for Objective 1 status, although some regions would not qualify – all of Slovenia and the cities of Prague (Czech Republic), Bratislava (Slovakia) and possibly Budapest (Hungary). If the eligible regions received the maximum levels of Structural Fund aid of •348 per head, currently received by Portugal, this would represent a cost of •24-26 billion. On the other hand, EU transfers to the CCs are subject to a so-called 'absorption limit' of four percent of national GDP, on the basis that this is the maximum amount that the CCs would be able to manage and spend effectively. Applying this limit to a projected GDP for the CCs could reduce the maximum level of their receipts to nearer •15 billion.

Several recent studies have attempted to refine these calculations, taking account of different GDP growth rates, allocation thresholds and levels of aid intensity. Their estimates of the additional, post-2006, budgetary requirements for Structural Funds range from • 12 billion to almost • 30 billion per year, with an average of circa • 21 billion per year. Taking account of the fact that the EU is already budgeting for an annual cost of post-enlargement structural operations of • 12 billion, then the 'gap' between what is required and what is available may be as high as • 18 billion but may be less than • 1 billion, with an average figure in the range • 9-10 billion.

The implications of these figures are two-fold. First, if the absorption limit is applied strictly, then the transfers to the new EU members will probably be less than was projected by earlier studies. Even without a formal limit, the current level of administrative and financial management capacity in many CCs could restrict the volume of transfers. Second, the cutbacks in receipts for the EU-15 will be sizeable, but considerable funding may still be available after 2006. If the above figures are correct, then the current receipts of the EU-15 would have to be reduced by about 30 percent - equivalent to the entire Objective 2 budget and one-third of the Objective 1 budget. However, even without an increase in budgetary resources, some • 10-15 billion might still be available to the EU-15, and possibly as much as • 20 billion.

For the EU, this would mean that the current recipients could continue to benefit from the Structural Funds. Some would still qualify for Objective 1 support, even in an enlarged EU. Of the 83 million people currently covered by Objective 1, 33-38 million would retain eligibility in an EU-25 or EU-27 (albeit with lower levels of aid per head), mainly regions in Greece, Portugal and Spain, but also a few regions in Italy and Germany. Further, those Objective 1 areas that were 'de-designated' would probably be eligible for some transitional support. On the basis of precedent, the richer countries might also insist that cutbacks in Objective 2 should again be subject to some kind of 'safety net', ensuring some continued resources for industrial reconversion and rural development. There will also be pressure to retain employment and training assistance under Objective 3 and inter-regional and urban support under the Community Initiatives.

This line of argument pre-supposes that the current method of distributing Structural Funds is maintained. Certainly, there will be pressure from both national treasuries and the wide range of regional and sectoral interest groups with a stake in the Funds to retain as much of the current receipts as possible. On the other hand, there is a need - as well an opportunity - for real reform of the Structural Funds, to improve its economic development logic and effectiveness. This would involve ending EU subsidies in the richer countries and concentrating them in the poorer parts of an enlarged EU, as well as giving consideration to fundamental changes in the way the funds are designed and implemented.

Implications for Scotland

As noted at the start of this article, Scotland has done well out of the Structural Funds. Over the period 1975 to 1999, at least £5,483 million of Structural Funds were allocated to Scotland, with a further £1,094 million programmed for the period 2000-06 (see Table 1).

Table 1: Structural Fund Allocations to Scotland, 2000-06

	• millions	£ millions
Objective 1 (Highlands & Islands Special Programme)	300	194
Objective 2 (Western, East and South Scotland)	807	521
Objective 3 (all Scotland, except Highlands & Islands)	481	310
Community Initiatives	105	68
Total	1,693	1,094

Source: Scottish Executive

Looking to the future, Scotland has a choice as to how it approaches the reform debate. The first option would be to adopt a strategy of maximising Structural Fund receipts to Scotland, as in the past. On the basis of the more optimistic assumptions discussed above, significant amounts of Structural Funds might still be available making it worthwhile to influence the EU debate and the UK negotiating line in Scotland's interests. Possibilities for exploiting the criteria used for area designation and funding allocation might be as follows.

- Economic criteria. At present, economic criteria are used for designating Objective 1 areas (using GDP per capita). There would appear to be no scope for Scotland to have any areas qualifying under such economic criteria. In an EU-27, the Highlands & Islands would have an estimated GDP per capita of 87.9 percent of the EU average, well above the 75 percent threshold. Following the example of Cornwall and West Wales, a sub-division of the Highlands & Islands (eg. to exclude Inverness) may have more possibilities, but it is doubtful whether the EC would accept this. It may be possible to argue for different criteria, but, given that the EU has made such a virtue of applying the Objective 1 criterion strictly in the recent negotiations, it is unlikely that other economic criteria would be considered.
- Social criteria. In recent reforms, unemployment and employment structure have been the key indicators for

designating Objective 2 areas. If Objective 2 is retained, it is probable that some Member States will argue for a 'safety net' to be applied, limiting cutbacks to one-third of current coverage. Given that any future Objective 2 support would be highly focused on 'areas of need', there would be scope for the urban areas of Scotland to benefit. However, Scotland's unemployment indicators (unemployment rate, youth employment, long-term unemployment) are relatively good compared to most other EU Member States and regions, exacerbated by the high proportion of the workforce in urban areas (such as Glasgow) not included in the employment statistics. Therefore, Scotland may need to argue for a different statistical approach, potentially focusing on social inclusion, although it is difficult to find indicators capable of comparing social inclusion across regions within countries (let alone across the EU). Even if Objective 2 is discontinued, the EC is proposing continued intervention in several fields (areas of industrial restructuring, diversification of rural areas, deprived urban areas and social inclusion) that may benefit the current recipients.

- Geographical criteria. As in 1998-99, Scotland could attempt to make 'common cause' with Sweden and Finland to publicise the special problems of peripherality and the 'Northern Dimension' with a view to retaining special provision for areas of low population density. It is perhaps questionable whether, at the political level, Finland or Sweden would be prepared to back a relaxation of the population density criteria to benefit Scotland. Historically, there has been little understanding or sympathy for the problems of remote Nordic areas in either the Commission or other Member States (although the Treaty does make a commitment to remote areas and islands). Nevertheless, in its list of future priorities, the EC has identified "areas suffering from geographical or natural handicaps" as a possible target for support. Given that the populations in such areas are small, and the financial cost to the EU budget is relatively low, political pressure could potentially secure special provision for remote areas in the Nordic countries and Scotland.

There might, therefore, be possible financial benefits for Scotland in arguing for retention of the status quo and seeking to influence the social and geographical criteria used for determining eligible areas and financial allocations for the 2007-2013 period.

An alternative option would be for Scotland to make a more radical contribution to the debate. This would mean making a case for reforms to EU regional policy to improve its impact in the less-developed countries of the current EU and future Member States, but potentially at a financial cost of losing future Structural Fund receipts in Scotland. This would be a very communautaire approach, similar to that taken by the Irish Government i.e. recognising that the country has done well out of Structural Funds over many

years and now it is the turn of others to benefit as much as possible.

The advantage of this approach is that arguments for changes to EU regional policy would be much stronger without the suspicion of 'special pleading' that characterises many of the contributions to the debate. It would build on the profile that Scotland has already established in the reform debate and would attract international attention. Scotland's approach to many aspects of Structural Funds is well respected abroad, and advocacy of CC interests would benefit the increasingly important role that Scottish organisations are playing in the regional development field in Central and Eastern Europe.

The disadvantages of this approach are four-fold. First, if the above budget figures are credible, then it is likely that other Member States and regions will seek to ensure continued receipt of Structural Funds, and it may be difficult to explain why Scotland is not energetically pursuing the same approach. The Structural Funds have an extremely high profile in Scotland in relation to their value, and the numerous organisations that have benefited from the Funds would be vocal in seeking retention of these benefits. Second, if the EU continues to pursue 'coherence' between Community and national regional policy maps, loss of Structural Funds could potentially damage the coverage of national regional aid areas in Scotland. Third, the Structural Funds have been used to pioneer innovative ways of delivering economic development in Scotland – for example, with respect to integrated regional strategies, programme management, partnership working, sustainability, equal opportunities, evaluation – which are recognised across the EU. Withdrawal of the Funds risks this expertise being lost.

Conclusions

EU enlargement is the most ambitious project ever undertaken by the Union, with far-reaching consequences for many aspects of European integration. The major economic and social differences between the current Member states and Candidate Countries mean that the EU will have to focus much of its resources on assisting the new members to cope with structural change, under-development and poverty. EU regional policy will need to be redirected and adapted to meet the needs of the CCs, with potentially significant implications for current recipients in the EU-15.

A debate about the reform of the Structural Funds has already begun. While some see enlargement as an opportunity for much-needed reform of EU regional policy, focusing its efforts on the poorest countries, others would prefer to find a way of manipulating the budgetary allocation criteria to retain a role for the Structural Funds in rich as well as poor countries.

For Scotland, these are important issues, and, as the debate gathers pace over the coming years, the Scottish

Executive will need to determine a policy position for Scotland. As in previous years, it could adopt a strategy of trying to maximise receipts, but the Executive could also play a role in pressing for reforms of EU regional policy to improve the longer-term efficiency and effectiveness of the Structural Funds. When the formal negotiations start, Scotland's interests will need to be integrated with the 'UK line' as part of the debate between Member States. However, these negotiations are probably at least 2-3 years away, and, in the meantime, there is scope for Scotland to be articulating some imaginative and innovative ideas.

In this context, the fundamental questions are whether and how the 'pork barrel politics' of EU negotiations can be changed. Previous reforms of the Structural Funds have been characterised by each Member State trying to maximise its share of the Funds. The message that the EU is making a significant and important commitment to cohesion is often lost amidst the debate of whether supposed national interests have been advanced or not. In the context of EU enlargement, a protracted argument over the share-out of Structural Funds risks promoting division and political conflict where a show of unity and solidarity is most needed.

Endnotes

- 1 Copenhagen European Council, 21-23 June 1993, Presidency Conclusions.
- 2 The current Candidate Countries are Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovak Republic, Slovenia and Turkey.
- 3 *EC Strategy Paper on Enlargement, 2001*, European Commission, Brussels, <http://europe.eu.int/comm/enlargement/report2001/index.htm>
- 4 Bulgaria and Romania are likely to accede at some point between 2007 and 2013. Turkey is not expected to accede before 2013.
- 5 *The Economic Impact of Enlargement*, Enlargement Papers No.4, Directorate General for Economic and Financial Affairs, Commission of the European Communities, Brussels, June 2001, pp.9-10.
- 6 These issues are discussed in detail in: Weise C, Bachtler J, Downes, R, McMaster I and Toepel K (2001) *The Impact of Enlargement on Cohesion*, Report to the European Commission (DG Regio), Berlin and Glasgow.
- 7 IBO (2001) *The financing of the EU structural policy in the context of the enlargement of the EU*, Interdepartmental Policy Study, The Hague. Dresdner Bank (2001) *The Challenge of Enlargement*, Economic Analyses - Trends Special, July 2001, Dresdner Bank, Frankfurt/Main. European Parliament (2001) *Working document on the financial implications of EU enlargement*, Committee on Budgets, European Parliament, 11 April 2001. Schrupf H and Budde R (2001) *Die Auswirkungen der Osterweiterung auf die Regionalpolitik der Europäischen Union*, Schriften und Materialien zur Regionalforschung, 8, Rheinisch-Westfälisches Institut für Wirtschaftsforschung, Essen. Weise C, Banse M, Bode W, Lippert B, Nölle F and Tangermann S (2001) *Reform bedarf bei den EU-Politiken im Zuge der Osterweiterung der EU*, Study for the Federal Ministry of Finance, Deutsches Institut für Wirtschaftsforschung, Berlin and Göttingen.
- 8 A detailed discussion of the various options is contained in Bachtler J (2001) *EU Regional Policy in an Enlarged Union: A Review of the Debate*, Regional and Industrial Policy Research Papers, European Policies Research Centre, University of Strathclyde.
- 9 *Report of the Inquiry into European Structural Funds and their Implementation in Scotland*, European Committee 6th Report (2000), Scottish Parliament.
- 10 See, for example, the debate referred to in Bachtler J, Wislade F and Yuill D (2001) *Regional Policy in Europe After Enlargement*, Regional and Industrial Policy Research Papers, European Policies Research Centre, University of Strathclyde.