Adapting to a New Funding Relationship with Europe: Spain and Cohesion Policy

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Summary: Spain has enjoyed substantial net inflows of money from the EU since accession in 1986, contributing to a strong growth performance relative to other EU member states. Specifically, as one of the poorer countries in the EU, Spain has attracted large sums of money through Cohesion Policy. However, strong economic growth over the last decade has closed the income gap with the EU reducing eligibility for funding while raising payments to the EU budget. Recent enlargement of the EU has added a raft of mostly poor countries in eastern and central Europe

Introduction

Spain has enjoyed substantial net inflows of money from the European Union (EU) since accession in 1986, contributing to a strong growth performance relative to other EU member states. Specifically, as one of the poorer countries in the EU, Spain has attracted large sums of money through Cohesion Policy (embodying the Structural Funds and the Cohesion Fund). However, strong economic growth over the last decade has closed the income gap with the EU reducing eligibility for funding while raising payments to the EU budget. Recent enlargement of the EU has added a raft of mostly poor countries in eastern and central Europe. Enlargement has transformed Spain's relative position to one of a middle-income country in the Union, placed new demands on cohesion funds and further eroded Spain's entitlement to funding. Any additional expansion of the EU beyond the existing twenty-five member states will add more low-income countries and exacerbate this position. Whatever the results of the present negotiations over the next EU financial perspective (2007-13), Spain will see its net surplus on financial transfers through the EU budget decline from around 1% of GDP to a figure closer to budgetary neutrality and its funding under cohesion policy shrink from over 1% of GDP to a figure closer to 0.5%. Spain will lose its entitlement to funding under the Cohesion Fund and a number of regions in Spain will lose their priority status under the Structural Funds.

Reduced funding, coupled with proposed reforms to cohesion policy, will have significant implications over the coming decade. For the model of economic development it presents the challenge of maintaining the strong record of growth established over the past two decades. It is likely to prompt a shift of emphasis away from major publicly funded infrastructure investment towards measures more directly supporting productivity. For domestic politics it will alter the nature of the dialogue between the central government and the regions. For Spain's European relations it will change the relationship between some regions and Brussels. At national level it will offer Spanish representatives a more flexible

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negotiating position to promote national interests. For public opinion it is likely to promote a more considered view of the European project.

The paper begins by describing the public financial transfers between the EU and Spain, especially the receipts associated with cohesion policy, and the significance of these flows in the economy. It then moves on to trace the evolution of Cohesion Policy in Spain, its integration into EU cohesion policy and the growth in the importance attached to this policy. An assessment is then made of the impact of cohesion policy in Spain in terms of regional development patterns. The discussion then turns to the aims and theoretical foundations of Cohesion Policy before outlining the proposals made by the Commission for the next financial perspective and for a reformed cohesion policy. Finally, the implications of a new funding relationship with Europe are assessed.

Golden Years of Cohesion Funding

In the period 2000-04 (inclusive) Spain received net transfers from the EU equivalent on average to close to 1% of GDP (see Table 1). Payments from the EU to Spain under Cohesion Policy have grown to represent over half of total receipts. The policy is funded through the three Structural Funds (the European Regional Development Fund –ERDF-, the European Social Fund –ESF– and the European Agriculture Guidance and Guarantee Fund-Guidance Section –EAGGF-G–) and the Cohesion Fund.

Table 1. Financial Transfers between the EU and Spain, 2000-04

	2000	2001	2002	2003	2004
Total payments to the EU	6.66	6.78	6.97	8.50	9.28
Total receipts from the EU	10.96	12.29	15.32	15.62	15.69
EAGGF	5.48	6.17	5.93	6.52	6.84
Cohesion Policy	5.33	5.96	8.95	8.76	8.51
ERDF	2.82	3.38	4.05	3.92	4.0
ESF	0.80	1.08	1.80	2.17	1.76
EAGGF-G, FIFG and other	0.52	0.63	0.98	1.48	1.26
Cohesion Fund	1.20	0.87	2.12	1.19	1.49
Other transfers	0.15	0.15	0.44	0.34	0.35
Net transfers	4.30	5.51	8.35	7.13	6.41
Net transfers as a % of GDP	0.71	0.84	1.20	0.96	0.82

Figures in billions of euros.
EAGGF: European Agriculture Guidance and Guarantee Fund.
EAGGF-G: European Agriculture Guidance and Guarantee Fund-Guidance Section.
ERDF: European Regional Development Fund.
ESF: European Social Fund.
FIFG: Financial Instrument for Fisheries Guidance.
Source: Ministerio de Hacienda, 2003a (except % of GDP which are author estimates).

Over a quarter of all funding for European cohesion policy has been directed to Spain, equivalent to over 1% of Spain's GDP each year. Under the present EU financial perspective (2000-06) some 194 billion euros (at 1999 prices) was budgeted to the Structural Funds, of which Spain was allocated just under a quarter (see Table 2). In addition, the Cohesion Fund was budgeted at around 18 billion, of which Spain was allocated over 60%. In absolute terms Cohesion Policy funding to Spain was almost twice as large as that to the next largest recipient (European Commission 2004a, p.180). In 2004, out of a total EU-25 budget of 99.7 billion euros in payment appropriations, the total allocation to Cohesion Policy was 30.8 billion (31%), some 28 billion being allocated to the Structural Funds and 2.8 billion to the Cohesion Fund (see Table 2). According to the Spanish Ministry of Finance, Spain should receive around 8.5 billion (25%). This is equivalent to over 1% of GDP, over 2% of public expenditure and slightly more than the 8.1 billion total

allocation by policy area to infrastructure in the General Consolidated Budget (PGE) for 2004 (Ministerio de Hacienda, 2003).

It is reasonable to assume that Community grants have translated into around 1% additional growth each year (see for example Beutel, 2002), easing the Spanish economy through its transition to a more liberal market economy and contributing to economic convergence with its European partners. More specifically, Cohesion Policy funding has supported infrastructure investment. Under the ERDF an average of 64% of project funding has come from the European Union. Under the Cohesion Fund the percentage rises to 80%. In the words of the Ministry of Finance (Ministerio de Hacienda, 2003, chapter IX, p.15) the current infrastructure programme could not be supported without EU funding.

Table 2. Cohesion Policy Funding for 2000-06 and EU-25 Budget Allocations for 2004

Heading	EU-15 Budget 2000-06 Col. A	Allocation to Spain Col. B	Allocation to Spain (%) Col. C	EU-25 Budget 2004 Col. D	Allocation to Spain Col. E	Allocation to Spain (%) Col. F
Structural Funds total (a to g)	194.0	45.1	23.2	28.0	7.0	25.0
(a) Objectives 1, 2 and 3	182.5	42.9	23.5	26.2		
(b) Objective 1	127.5	37.7	29.6	19.9		
(c) Objective 1 phasing-out	8.4	0.4	4.8			
(d) Objective 2	19.7	2.6	13.2	3.1		
(e) Objective 2 phasing-out	2.7	0.1	3.7			
(f) Objective 3	24.0	2.1	8.7	3.2		
(g) Community Initiatives, Peace Non-Objective 1 FIFG and other	11.6	2.2	19.0	1.9		
Cohesion Fund	17.8	11.2	62.9	2.8	1.5	53.6
Total	212.0	56.3	26.6	30.8	8.5	27.6
Total (% of GDP)		1.4			1.3	

Figures in billions of euros.
Sources: columns A and B, European Commission 2004a, p.180 (figures at 1999 prices for the EU-15); column D, figures for payment appropriations at current prices, European Commission 2004b; column E, Ministerio de Hacienda 2003.

This allocation of one-quarter of EU cohesion policy funding is now channelled to a country which is home to less than 9% of the EU-25 population, less than 11% of the 123 million people in the EU-25 living in regions with GDP per capita below 75% of the EU-25 average, and with a per capita income approximately equal to the average for the EU-25 and significantly higher than most of the 16% of the EU population living in central and eastern European states (for example, 80% higher than Poland). If enlargement proceeds to incorporate Romania and Bulgaria, close to 26% of the EU-27 population (accession states plus Greece and Portugal) will live in countries with lower per capita incomes than Spain. Spain will then house less than 6% (author estimate) of the 153 million people in the EU-27 living in regions with per capita incomes below 75% of the average (European Commission, 2004a).

All regions of Spain benefit from payments under Cohesion Policy, but funding has been channelled particularly towards regions with relatively low per capita incomes (see Table 3). Such regions are designated under the Structural Funds as Objective 1 regions (the least developed regions in which GDP per capita is 75% or less than the EU average). Under Agenda 2000 for the seven-year period 2000-06 some 70% of the EU Structural Funds was budgeted to these regions. In Spain 37.7 billion euro (at 1999 prices) was allocated to Objective 1 regions, 84% of the total 45.1 billion in the Structural Funds. In addition, Objective 1 regions in Spain have benefited from Structural Fund spending outside of Objective 1,

spending under the Cohesion Fund, under the Common Agricultural Policy (CAP) and from Spanish domestic solidarity fund transfers through the Inter-territorial Compensation Fund (*Fondo de Compensación Interterritorial,* FCI). A rough estimate of the distribution of funds across the regions is provided in Table 3. Andalucía is the leading recipient of funding, receiving an estimated 30% of Spain's Structural funding and 40% from the FCI (Tables 3 and 4). Thus EU cohesion policy and domestic solidarity fund (FCI) transfers are especially important to Objective 1 regions. Transfers from these funds alone (excluding other EU transfers notably through the CAP) amounting to between 2 and 4% of their GDP and of greater weight in their public expenditure.

Table 3. Objective 1 Regions in Spain, 2000-6

Objective 1 Regions	Assistance Rates 2000-06	Obj. 1 Funding (€bn)	%	Population	% of Population in Obj. 1	Area (sq km)
Andalucía	(50%)	11.3	30.0	7,357,558	30.5	87,268
Asturias	(40%)	1.9	5.1	1,062,998	4.4	10,565
Canary Islands	(50%)	2.7	7.1	1,694,477	7.0	7,273
Cantabria	Transitional assistance	0.4	1.1	535,131	2.2	5,289
Castilla y León	(40%) except Burgos 35%, Palencia 37%, Segovia 37% and Valladolid 35%	4.6	12.1	2,456,474	10.2	94,147
Castilla-La Mancha	40% except Guadalajara 30%	3.1	8.1	1,760,516	7.3	79,230
Ceuta & Melilla	(40%)	0.2	0.5	137,916	0.6	32
Extremadura	(50%)	3.1	8.1	1,058,503	4.4	41,602
Galicia	(40%)	4.9	13.1	2,695,880	11.2	29,434
Murcia	(40%)	1.6	4.3	1,197,646	5.0	11,313
C. Valenciana	(40%) except Castellón 35% and Valencia 37%	4.0	10.5	4,162,776	17.3	23,305
Total in Objective 1		37.7	100	24,119,875	100	
Spain				40,847,371		504,750
% of Spain				59.0		77.1

All regions listed above were classified as Objective 1 from 1986 to 1999; funding figures at 1999 prices.
Population figures from INE 2003a.
Funding figures and percentages for each region are rough author estimates based on the funding allocated to Objective 1 regional development programmes plus an equal percentage of the funding to horizontal programmes. The figure for C. Valenciana is probably an underestimate. The total funding figure for Spain comes from European Commission, 2004a.

Table 4. Allocation of Funds through the Inter-territorial Compensation Fund 2004

Region	Allocation (€mn)	Percentage
Andalucía	398.82	40.06
Asturias	44.67	4.49
Canary Islands	45.24	4.54
Cantabria	8.91	0.89
Castilla-La Mancha	78.92	7.93
Castilla y León	70.06	7.04
Extremadura	81.27	8.16
Galicia	163.94	16.47
Murcia	41.75	4.19
C. Valenciana	61.99	6.23
Total FCI Regions	995.57	100.0
Melilla	7.82	50.0
Ceuta	7.82	50.0
Total FCI Autonomous Cities	15.64	100.0
Total	1011.21	

Note: There is also a special fund for investment in infrastructure and business in the province of Teruel (*Fondo de Teruel*). The region of Aragón does not receive assistance from either the Structural Funds or the FCI even though the province of Teruel has a low level of development. In the period 2000-06 the Fund will provide 30 million euros a year, 50% from the central government and 50% from the region of Aragón.
Source: Ministerio de Hacienda, 2003.

Outside Objective 1 regions, other regions (including Cataluña, Madrid, and País Vasco) with above EU average GDP per capita have attracted significant funding through Objective 2 programmes, other Structural Fund programmes and spending under the Cohesion Fund. The result is that throughout Spain there is impressive visual evidence of the financial benefits of EU membership in physical infrastructure projects and urban regeneration. Less visible are the businesses that have been supported by public assistance. Clearly, the prospect of reductions in payments to Spain and changes in the overall budget position with the European Union are critical issues for the financial authorities both in the central government and the regions (see for example Crawford, 2004).

Cohesion Policy in Spain

Cohesion Policy in Spain, as in Europe, has its roots in regional development policy. State sponsored rural development schemes date back to the eighteenth century (Bradshaw, 1975). The tradition of irrigation, colonisation and rural development continued in the 1950s, the two most important schemes being in Badajoz and Jaén (Naylon, 1966), and thence remained an element of future development programmes. A more deliberate regional policy emerged in the 1960s under the First National Development Plan (1964-67). This relied on industrial development poles (*polos de desarrollo* and *polos de promoción*) to spread development into surrounding regions (Richardson, 1975). Huelva was the major recipient of assistance under this scheme (García Álvarez, 1981). In the Third National Development Plan (1972-75) the designation of assisted areas was widened to cover Large Areas for Industrial Expansion (*Grandes Areas de Expansión Industrial*), which by 1985 covered almost half the population and almost three-quarters of the area of Spain. Apart from these measures, numerous other industrial development initiatives were introduced contributing to an uncoordinated package. Policy had developed within the framework of a highly centralised state incorporating a 'top-down' development philosophy. National economic growth objectives dominated over regional equity on the neo-classical growth assumption that development would spread outwards from the more rapidly growing areas. In sum, regional development measures were confused, under-funded and lacked effective local control. Despite this, by the mid-1980s a significant degree of regional convergence had been achieved. But the explanation for this lay outside regional policy (Alcaide Inchausti, 1988a; Cuadrado Roura *et al.*, 1999).

Transition to democracy and the emergence of regional government in the early 1980s revolutionised the political context and set the stage for reform of regional development policy (Alonso Teixidor and Hebbert, 1982; Hebbert, 1985; Sáenz de Buruaga, 1983). Not only was there now an administrative structure at the regional level to design and implement policy, a commitment to regional policy was enshrined in the Spanish Constitution under Articles 40.1 and 138.1: 'the public authorities will promote a more equitable regional distribution of income' and 'the State will seek an adequate and just economic equilibrium between the diverse parts of the whole territory' (BoE 1978, Constitución Española). To express this commitment to inter-regional solidarity, the Inter-territorial Compensation Fund (FCI) was set up in 1982. Of greater significance for patterns of regional development were higher levels of public expenditure and public sector

transfers. In 1975 public expenditure amounted to 25% of GDP and by 1994 it had risen to 45%. Moreover, the creation of regions with their own regional capitals and the devolution of authority to regional governments were powerful mechanisms counteracting the attraction of Madrid and Barcelona.

Radical revision of regional policy was precipitated by membership of the European Community in 1986. The European Community had developed its own regional policy embodied in the European Regional Development Fund (ERDF; *Fondo de Desarrollo Regional, FEDER*). Spanish regional policy had to be remodelled to qualify for assistance under this European framework (BoE, 1986). The first Spanish regional development plans (*Programas de Desarrollo Regional*) drawn up under this new regime were launched in the period 1987-90. Key changes in the policy framework included a revision of designated areas and policy instruments, a switch towards local responsibility and participation in the planning and development process, multi-annual plans and increased financial resources. Spanish regional policy was now enmeshed in the evolving European regional development and Cohesion Policy.

From Regional Development to Cohesion Policy

European Cohesion Policy has grown out of a number of policy initiatives and derived its legitimacy from a number of legal sources. It has also been modified in the light of experience and continuously adapted to meet the changing demands of member states in an evolving European Union. In financial terms the volume of funding available has increased substantially. Spain has been in a position to promote this increased funding and to leverage it in its direction.

European Cohesion Policy has undergone continuous change since its inception in the form of the European Regional Development Fund (ERDF) in 1975. Important modifications were made to the ERDF commencing in 1985 (the New Regulation, 1984). Then, beginning in 1989, the ERDF was coordinated with the other European Community structural funds (the European Social Fund –ESF–, the European Agriculture Guidance and Guarantee Fund-Guidance Section –EAGGF-G– and the Financial Instrument for Fisheries Guidance –FIFG–) and with funding through the European Investment Bank (OJ, 1988a and 1988b). At the February 1988 European Council it was agreed to double in real terms the commitment appropriations for the Structural Funds by 1993 as compared with the 1987 level. These increases were made in response to the expansion of the Community to embrace Portugal and Spain (doubling the population living in low-income regions) and to fears that increased competition from an integrated European market would adversely effect these poorer member states. A similar argument was used to justify a two-thirds real term increase in Structural Funding between 1993 and 1997 (the Delors II package) and the establishment of a new fund –the Cohesion Fund– subsequent to the Treaty on European Union (1992) that launched the drive towards European economic and monetary union (EMU). There was, however, no historical evidence that integration had widened the differences between member states (pinpointing some fundamental theoretical weakness behind the policy, see section 6). Further modifications were made to the Structural Funds after the incorporation of the Nordic countries in 1995 (new Objective 6), and again as part of Agenda 2000 (reduction in the number of Objectives from six to three), which recognised the likely further enlargement of

the Community. The prospect of enlargement to incorporate new states –most of which have low per capita incomes and considerable structural, production and infrastructure weaknesses–, new European policy objectives and the opportunity provided by the forthcoming financial perspective (2007-13), led to proposals for yet a further revision to the whole system of structural and cohesion funding now dealt with under the umbrella of Cohesion Policy.

Cohesion Policy has thus grown steadily in importance from the mid-1980s, both in legal and budgetary terms. In legal terms, the achievement of economic and social cohesion in Europe was upgraded from just a mention in the preamble of the Treaty of Rome to becoming Title XIV (currently Title XVII) after the passing of the Single European Act in 1986 (Rodríguez-Pose and Fratesi, 2004). In the proposed European Constitution it is covered in Article III-116: '*In order to promote its overall harmonious development, the Union shall develop and pursue its action leading to the strengthening of its economic, social and territorial cohesion. In particular, the Union shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions. Among the regions concerned, particular attention shall be paid to rural areas, areas affected by industrial transition, and areas which suffer from severe and permanent natural or demographic handicaps such as the northernmost regions with low population density, and islands, cross-border and mountain areas'* (this last sentence being added in the final negotiations in June 2004; European Commission, 2004c). In budgetary terms, development policies have grown from representing 10% of the European Communities budget and 0.09% of the EU-15 GDP in 1980 to over 30% of the EU-25 budget in 2004 (in payment appropriations, excluding pre-accession payments; European Commission, 2004b) or some 0.3% of EU-25 Gross National Income (GNI). Spain has been a major beneficiary of this upgrading of cohesion policy.

Patterns of Regional Development in Spain

Cohesion policy funding has contributed to strong growth in Spain and to real economic convergence with the EU. But it has been less successful in reducing inter-regional disparities (a characteristic noted across other states in the EU; Giannetti, 2002). Equally, large intra-regional disparities remain, as does polarisation on the state capital. What is unclear is whether these disparities would have widened and polarisation gained momentum without cohesion funding.

One of the principal objectives of cohesion policy is to achieve economic convergence between member states. Spain recorded continuous convergence with the EU-15 in terms of Gross Domestic Product (GDP) per capita at purchasing power parities over the period 1994 to 2003, from only 78.6% of the EU-15 average to 87% of the average (see Table 5). This reflected the strong relative growth of Spain in relation to the EU-15, averaging over one percentage point higher growth per year from 1995 to 2004. It also reflected a Europe-wide pattern in which 'Disparities in income and employment across the European Union have narrowed over the past decade and, most especially, since the mid-1990s' (European Commission, 2004a, p.2). According to the European Commission, convergence was particularly apparent in the Cohesion countries (which include Spain; *ibid*, p. ix). Over a longer period, however, convergence has

not been a steady continuous process. Historical evidence dating back to 1960 describes a path of convergence interrupted by reversals, notably in the early 1980s and early 1990s. Data from the European Commission and Eurostat (see Table 5) indicate that the gap between the Spanish economy and the rest of the EU narrowed to 81% in 1975, then widened to only 72% in 1985. Strong growth in Spain during the late 1980s narrowed the gap again to around 77% in the early 1990s, whence it slipped back briefly before recovering to 79% in 1994.

Table 5. GDP per Capita in Spain in Relation to the EU-15 Average of 100

	1960	1975	1985	1990	1994	1995	2000	2001	2002	2003
Spain	59.6	81.1	71.8	77.8	78.6	79	83.4	84.3	86.1f	87.2

GDP in purchasing power standards.
Source: Commission of the European Communities and sequence 1994 onwards from Eurostat, 2004a.

Convergence appears to have been pro-cyclical, a feature of periods of European-wide growth (or arguably of more intense integration, Alberola, 1998), while disparities have opened up during periods of stagnation (Armstrong, 1995; Rodríguez-Pose, 1999; Tsoukalis, 1991; Zaldívar and Castells, 1992). The economic cycle has been more pronounced in Spain than for the EU as a whole, with higher than average levels of growth and deeper troughs. At the turn of the century this pattern appeared to have either changed or been delayed. Continued strong consumer demand and public investment maintained growth and convergence from 2001 to 2004 despite the environment of very low growth across Europe. Part of the explanation for this exceptional performance may be attributed to cohesion funding. This has helped underpin public investment, which in turn has added to economic growth during upswings in the economic cycle and maintained the momentum of public investment, and of domestic demand, when European growth has slowed.

Within Spain the evolution of disparities between regions is more difficult to read, although the data suggest that since the mid-1980s relatively little convergence has occurred. One of the difficulties in identifying trends lies in the designation of regions for the purposes of Cohesion Policy as the 17 administrative regions of Spain plus the city regions of Ceuta and Melilla (recognised under the EU hierarchy of territorial units as NUTS Level II regions). These administrative regions vary enormously in geographic, economic and population size, from La Rioja, with an area of only 5,000 square kilometres, less than 1% of national GDP and a population of a quarter of a million, to Andalucía, with an area of over 87,000 square kilometres, some 14% of national GDP and a population of 7.5 million (see Table 3). Within these areas there are often contrasting patterns of development.

A second difficulty in reading inter-regional income disparities centres on the conversion of global figures to per capita ones, rendering the figures sensitive to population movements and to economic activity rates. During the Francoist period a number of authors have concluded that Spain was dominated by inter-regional convergence (Alcaide Inchausti *et al.*, 1990; Cuadrado Roura, 1988): 'Regions in the southern and western Spanish peripheries were catching-up with the more developed regions of north-eastern Spain and Madrid' (Rodríguez-Pose, 2000, p.89). Equally, there appears to be agreement that convergence came to a stop in the late 1970s and early 1980s, reflecting the picture at the national level (Alcaide

Inchausti, 1988a; Cuadrado Roura *et al*., 1999; Villaverde, 1999). These patterns were partly attributable to large out-migration flows from the poorer regions and large inflows into Barcelona and Madrid, and to the cessation of these flows in the mid-1970s (Alcaide Inchausti, 1988a). From the early 1980s to the mid-1990s, Rodríguez-Pose (2000, p.92) suggests that there was a slowdown in convergence across Spanish regions. Most recently (from 1995-2002) the regions with lower per capita incomes in the south –Andalucía, Castilla-La Mancha, Ceuta and Melilla, Extremadura and Murcia– plus Castilla y León and Navarra have all experienced growth rates of GDP above the Spanish average (INE, 2004a). In 2002 and 2003 Murcia, Navarra and Andalucía were the three fastest-growing regions (at close to 3% or above, against a Spanish average of 2.4%; INE, 2004b). The performance of the regions in the south is particularly impressive, since these have to grow more quickly than those in the north in order to offset their generally faster growing populations. In relation to commuter movements and the age structure of the population, all the Eurostat data on GDP per capita come with warnings that areas with high volumes of net in-commuting show relatively high GDP per capita figures (and vice versa), while areas with a large proportion of non-economically active people (notably retirement areas) show relatively low figures.

A third problem arises from the data used in measuring real convergence. A variety of indicators can be used including income, infrastructure, production and unemployment. Each has its own merits and limitations. For example, while the intensity of production is best measured by GDP per capita, affluence and poverty are better measured by disposable household income per capita. The latter show a significant degree of inter-regional convergence around the Spanish average between 1967 and 1985, from a range of 81 points in 1967, to 58 in 1985, but thence close to only 51 points in 2001 (see Table 6). As mentioned above, at least part of the explanation for convergence lay in population change through to the mid-1970s and increased public expenditure (and public transfers) in the early 1980s. 'On comparing gross and disposable regional incomes, a small but significant change [over the period 1981-92] can be noted. In poorer regions the differences between disposable per capita incomes and gross per capita income is positive, while in richer regions the results are negative' (Moreno 2002, p.401). These data corroborate the assumption that direct taxes and public sector transfers have contributed to reducing regional income inequalities (Ayala, 1994). In terms of unemployment, inter-regional variations opened up in the 1970s as national unemployment rates escalated to over 21% in 1985. National rates declined in the late 1980s and then rose again in the early 1990s. In 2004 spatial variations in unemployment remain wide, eg, from 23% in the province of Cádiz to 3.4% in the province of Teruel (EPA, 2004; see also Table 10), even though unemployment rates have fallen substantially since the highs of the mid-1990s.

Table 6. Ranking of Regions in Spain by Gross Disposable Household Income per Capita

Region	Gross Disposable Household Income Index 2001	Rank 2001	Rank 1985	Rank 1977	Rank 1967
País Vasco	125	1	8	4	1
Navarra	122	2	7	5	5
Balearic Islands	122	2	1	3	4
Madrid	119	4	2	1	2
La Rioja	117	5	4	6	7
Cataluña	113	6	3	2	3

Aragón	111	7	6	7	9
Cantabria	103	8	9	10	6
Spain	100	–	–	–	–
Castilla y León	100	9	12	11	11
C. Valenciana	97	10	5	8	9
Asturias	93	11	10	9	8
Canary Islands	93	11	14	14	14
Ceuta y Melilla	92	13	11	–	–
Murcia	86	14	13	13	13
Galicia	85	15	15	12	12
Castilla- La Mancha	85	15	16	15	16
Andalucía	81	17	17	16	14
Extremadura	74	18	18	17	17

Sources: Index and 2001 figures from INE, 2003b; 1977 and 1985 data from Banco de Bilbao, 1988, p.72; 1967 figures from Alcaide Inchausti, 1988b, p.658.

Considerable intra-regional contrasts also remain and these tend to be much greater than inter-regional ones. Long-term decline in primary activities has left many interior rural areas with a weak economic base. Traditional manufacturing industrial areas have also generally been in decline or experienced significant restructuring since the 1970s (for example, in Asturias, around Barcelona and in the País Vasco). In contrast, areas that have been able to take advantage of growth in service industry, especially leisure and tourism, have grown. Two axes of growth have been apparent, the Ebro valley (to Pamplona and Vitoria) and the Mediterranean coast (including the island archipelagos). In addition, there has been a long-term polarisation of growth on the region of Madrid. Growth has also been a feature of regional and provincial capital cities and some towns with specific geographic or economic advantages. The administrative regions conceal these patterns of contrasting growth. For example, in Andalucía, GDP in nominal terms grew by 40% in 1995-2001, but growth varied from 54% and 49% in the two coastal provinces of Almería and Málaga, respectively, to only 32% in the landlocked province of Jaén (INE, 2003b). Even within the province of Málaga there is an enormous contrast between the urban sprawl that clings to the coast in the 'cosmetropolis' of the Costa del Sol and the interior. There are not so much lagging administrative regions, but a mosaic of sub-regions and localities each facing their own specific challenges and resources. Equally, growth regions are not necessarily confined to single administrative regions.

Finally, the gradual process of convergence between regions overlies evidence of continued polarisation, especially on Madrid. The region housing the national capital has increased its contribution to national GDP from less than 12% in 1960 to 17.5% in 2003 (INE, 2004b). This long-term process appears to be continuing. Preliminary estimates put the increase in the proportion of Spanish GDP generated in Madrid at 0.7 percentage points over the period 1995-2003, the largest regional proportional increase in Spain (*ibid*). In the second quarter of 2004 the region of Madrid accounted for 14.3% of the total occupied population in Spain, up from 12.4% in 1985 (INE, 1985 and 2004c). In terms of population, in 2003 the region housed 13.4% of the population compared with 12.4% in 1986 (INE, 2004d). Recent polarisation has been associated with continued physical and structural integration of the national economy, globalisation and the transformation of Madrid from a national capital to more of a world city. Madrid has retained its position as the dominant focus of national corporate headquarters and attracted the bulk of foreign direct investment. According to Eurostat (2004b) Madrid is now the fourth largest city in Europe. Thus the strength of polarisation

forces on the state capital have outweighed the countervailing pressures of political decentralisation, regional identity and public sector transfers including cohesion funding.

It appears evident that inter-regional disparities in Spain are deep-seated and cannot be changed by existing policies. The process of polarisation on Madrid continues. With the exception of Aragón, the same eight regions were recorded as having an average disposable household income per capita above the national average in 2001 as were recorded in 1967 (see Table 6). Equally, with the exception of Asturias, the same regions continued to record the lowest figures. Andalucía and Extremadura recorded the lowest disposable household incomes per capita in 1973 and remained in that position in 2001. Such a conclusion echoes that reached by Hitiris (2003, p.236) for the European Union: 'Although convergence through integration has occurred and the gap between the rich and the poor regions has narrowed, the ranking of EU regions in terms of GDP per head has changed little'.

Policy Aims and Theoretical Foundations

Before turning to proposals for the reform of Cohesion Policy and the new financial framework within which it will work it is worth re-examining the aims, strategies and theoretical foundations of a policy that accounts for such a large proportion of European Union spending, second only to that under the Common Agricultural Policy. This is especially relevant since pressure on reducing the spending proposals made by the Commission for the next financial perspective is likely to be directed specifically at this policy area.

Cohesion Policy has multiple and ambitious aims embracing growth, cohesion and solidarity. It seeks to promote economic growth in the EU, while at the same time reducing economic and social disparities between member states and between regions within member states. The purpose of Cohesion Policy is described in the Third Cohesion Report: 'cohesion policy… 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' (European Commission, 2004a, p.xxv). The key assumption is that regional disparities must be reduced in order to accelerate growth: 'Growth and cohesion are two sides of the same coin...' (statement by European Regional Commissioner Michel Barnier, European Commission, 2004d).

Beneath the overall purpose of Cohesion Policy a number of subsidiary economic and social aims are described in the Third Cohesion Report (European Commission, 2004a).

In economic terms Cohesion Policy is designed to:

- Realise the growth potential of the EU by involving 'all its regions… and all people living in the EU' (p. vii).
- Achieve a more balanced spread of economic activity across the EU (p. viii).

- Overcome the disparities in output, productivity and employment which persist between countries and regions, stemming from structural deficiencies in key factors of competitiveness: inadequate endowments of physical and human capital, a lack of innovative capacity, of effective business support and a low level of environmental capital (p. vii).
- Reduce the risk of bottlenecks as growth occurs and lessen the likelihood of inflationary pressure bringing growth to a premature end.
- Develop the comparative advantages of countries and regions in order for them to be able to compete in the internal market and outside (p. vii).
- Achieve sustainable development (Gothenburg Council objective, June 2001, p. xxv).
- Contribute towards full employment.
- Contribute towards the creation of the most successful and competitive knowledge-based economy in the world by 2010 (Lisbon Council objective, March 2000, p. xxv).

In social terms Cohesion Policy is designed to:

- Prevent people being disadvantaged by where they happen to live or work in the Union (p. 27).
- Enable all citizens to share in the prosperity of Europe and achieve their potential.
- 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 cohesion (p. viii).
- Promote social integration and reduce poverty and social exclusion (p. x).

No single policy is capable of delivering on all these aims to the same degree or of achieving all of them without sacrificing the degree to which any single one can be met. Specifically, there is a trade-off between 'growth and efficiency' and regional equity, which has led some to suggest that Cohesion Policy is too ambitious (Martin, 1999, p. 21; Rodríguez-Pose and Fratesi, 2004, p. 98). However, Cohesion Policy can be viewed as being consistent with Europe's 'social-market' model of development, where there is an attempt to balance growth and equity. Equally, the political reality is that multiple aims provide something for everyone, the political compromise at the heart of the European Union.

There are some questions over the strategies adopted to achieve the aims of Cohesion Policy. The principal strategy involves redistributing income from rich to poor member states and regions (a demonstration of solidarity). All member states pay into the EU budget essentially according to the size of their economy and are then allocated funding according to the criteria associated with each Cohesion Policy programme. The fundamental principle adopted is that funding should be concentrated on the poorest regions not just for reasons of equity but also for reasons of overall EU growth. Thus, under existing policy 70% of the Structural Funds are channelled to the least developed regions. This focus would be increased under the Commission proposals for 2006-13 to 78% of all Cohesion Policy funding. The crucial questions are whether this is a sufficient concentration of funds to achieve the intended outcomes and how these least developed regions are designated.

Concentrating resources is tempered by a recognition that regions other than those with relatively low per capita incomes also face development problems. Thus declining urban and industrial regions and remote regions also attract assistance. An argument can even be made that if growth in the EU were the principal policy objective then addressing those factors that inhibit growth in core areas deserve at least as much attention as the least developed regions (see for example the writings of Michael Porter on the importance of clusters of economic activity in promoting growth: Porter, 1990 and 2003). It would seem to be a question as much about politics as economics. Too wide a definition of regions eligible for assistance risks diminishing the impact of Cohesion Policy. Too narrow a definition risks losing the widespread involvement implicit in the policy. It is also legitimate to ask why relatively wealthy states should receive European assistance for their own regional development problems. This question goes straight to the heart of the debate over the nature of the European project.

A second element of strategy stresses an active policy of fomenting competitiveness and employment in promoting growth in the least developed regions as opposed to a passive redistribution of income. This argument helps bridge the apparent contradiction between state intervention (and the distortion of competition) and an openly competitive single market. Thus state subsidies are permitted within the framework of Cohesion Policy as a means of increasing the competitiveness of regions and of the businesses within them. The European Commission argues that 'strengthening regional competitiveness will underpin the growth potential of the EU economy as a whole' (European Commission, 2004a, p. xxvii). But there are risks of shielding businesses from competition over relatively long period of time, which are well-documented in discussions of protectionism. In Spain economic activities in Objective 1 regions have had access to public funding stretching back over 20 years to before the country acceded to the EU. A generation of businesses have developed, and others been sustained, in an environment of public subsidies. The risk is that public assistance to businesses has cushioned them from competitive pressures, creating a climate of dependence and contributing to low productivity. This may have left regions more vulnerable to future competition (Rodríguez-Pose and Fratesi, 2004, p. 110).

A third element of strategy lies in the type of projects on which Cohesion monies are spent. Within the poorest countries and regions a large proportion of expenditure has been directed towards infrastructure projects. According to the European Commission, in the period 2000-06 41.3% of all Structural Fund expenditure in the poorest regions (Objective 1) is allocated to infrastructure (European Commission, 2004a, p. 182). In Spain the allocation is 48% (*ibid.*). If expenditure in Spain under the Cohesion Fund is added, then the total amount of cohesion funding spent on infrastructure probably rises to closer to 60%, with around half this amount going to transport.

There are questions over the value of emphasising infrastructure investment (Comfort, 1988; Martin, 1999; Rodríguez-Pose, 2000; Rodríguez-Pose and Fratesi, 2004). Vickerman (1991) notes that infrastructure is a necessary but not a sufficient base for development. Cambridge Econometrics (2003, p. 7.3) in a study of regional competitiveness in the EU concluded that 'infrastructure effects…

showed little or no correlation with productivity levels'. Martin (1999, p. 21) points out that that while infrastructure projects have a short-term employment and demand effect 'because infrastructure has an impact on transaction costs and therefore on the location decision of firms, the long-term supply effect on the region may be the opposite to the short-term effect'. Inter-regional transport infrastructure increases the accessibility of regions both to and from other regions. Similarly, intra-regional transport projects improve the accessibility of areas within regions to and from other parts of the region. In both cases transfer costs are lowered and scale economies made more attractive, strengthening the attraction of large-scale business units and agglomeration. Rodríguez-Pose (2000) suggests that the favouritism attached to infrastructure projects is partly associated with their political and administrative attraction. They are visible to the electorate and easier to design and implement than the promotion of endogenous resources and support for the restructuring of local firms (*ibid.*, p. 111).

To justify public intervention a necessary (but not sufficient) condition is that a market failure is clearly identified. In such a case, Rodríguez-Pose and Fratesi (2004) argue that the most economically effective strategy is to intervene at the source of the failure. For example, encouraging mobility of labour and increasing agglomeration spill-overs to benefit the whole of Europe through enhanced telecoms and education infrastructure. In their assessment of European Structural Funds in Objective 1 regions these authors conclude that policy should become more innovative with region-specific development strategies coupled to institutional capacity building and accountability (*ibid.*, p. 110). This appears to have been recognised by the European Commission (2004a, p. xi) who suggest that two complementary sets of conditions need to be satisfied for regions in the Union to sustain economic development and employment in a competitive environment: (1) regions must have suitable levels of both physical infrastructure and human capital; and (2) the capacity to innovate and to use both existing know-how and new technologies effectively and to follow a development path that is environmentally sustainable. 'To achieve both requires an effective institutional and administrative framework to support development' (*ibid.*, p. xi).

Turning to the theoretical framework underpinning Cohesion Policy it is apparent that there are inherent weaknesses associated with the lack of a single theoretical perspective that captures the full complexity of the notion of 'regional competitiveness' (see, for example, Cambridge Econometrics, 2003) and conflicting analyses of the regional development process. The competitiveness of a region arises from the competitiveness of its firms and the wider assets and attributes of the region. The causes of competitiveness are attributable to an aggregate of factors. Therefore, the possibility of isolating the precise effects of an individual factor is limited. In respect of the development process, policy in Spain in the 1960s rested on neo-classical theory. Under this there was no conflict between focusing on national growth and achieving balanced regional development. According to the theory, competition and market forces would tend to equalise factor returns across the country by drawing production and employment to the regions of highest returns ('convergence' or 'catch-up'). Unemployment rates would smooth themselves out as unemployed labour moved to areas of higher employment demand (which certainly occurred with large movements from the south to Madrid and the north of Spain as well as cross-

border movements to other countries in Europe). Similarly, capital would flow to areas where returns were greatest (a phenomenon seen for example in the flood of foreign investment into Spain in the late 1980s). In the long-run, regional inequalities would be self-correcting. There were two problems intrinsic to this argument. The first lay in the empirical fact that all countries display spatial variations in development. The second lay in the fact that national markets are never perfect. For a variety of reasons, labour and capital are not perfectly mobile. This is true at the regional, national and European Union level. For supporters of neo-classical theory the policy solution is to concentrate on removing obstacles to competitive markets rather than to engage in government intervention. Those who view this position as flawed seek policy directions in an alternative theoretical framework.

Cohesion Policy draws its theoretical legitimacy from the argument that market forces tend to exacerbate regional divergence and lead to polarisation and increasing spatial specialisation. Underpinning this argument is the 'new economic geography', raised to prominence by the writings of Paul Krugman (1991a, 1991b and 1995). In this framework, economic integration creates new opportunities for economies of scale and specialisation. There are increasing returns to scale to be gained in agglomeration and cumulative growth in the already prosperous regions, which encourage greater spatial agglomeration and localisation in regional activity (Krugman, 1991b, 1993; Porter, 1990 and 2003; Storper, 1997; Scott and Storper, 2003) and greater divergence. Thus each round of integration in the European Union (formation of the European Economic Community, the Single Market Act, the Act of European Union and Economic and Monetary Union) has prompted measures to counter the risk of widening regional economic inequalities. However, there appears to be little evidence for greater regional specialisation (other than that occurring through the hollowing-out of primary and manufacturing industry in more-developed economies as a result of technological change and globalisation). Moreover, Brauerhjelm *et al*. (2000) have argued that regional specialisation may also result in regional convergence.

Thus, Cohesion Policy is flawed by multiple aims, questionable strategies and contested theoretical foundations. There is an argument for a less costly policy focused on funding the least developed regions in the least wealthy countries, leaving the more wealthy countries to manage their own regional development problems. In its defence it reflects the political reality of contemporary Europe. It is inclusive, providing incentives for European involvement across a range of administrative organisations, businesses and individuals. Where sufficient resources have been concentrated, as in the case of Spain, it has contributed to economic convergence at the state level and eased the path of economic transition. This is an important example for the eastern and central European states.

The Next EU Financial Perspective, 2007-13

The EU financial perspective for 2007-13 will determine the financial framework within which cohesion policy is resourced. Negotiations over the perspective are scheduled for completion by June 2005 but may not be completed until the Austrian European Council presidency in the first half of 2006. Tough negotiations lie ahead before the budget is agreed, with the main paymasters seeking to

contain the size of the European budget in the context of sluggish EU growth, pressure on their own domestic budgets, the problematic issue of Britain's budget rebate and disagreement over the distribution of cohesion funds.

In February 2004 the European Commission presented its budget proposals for an enlarged Europe of 27 member states (see Table 7). The Commission plans some 1,000 billion euro spending over seven years (1,025 billion in commitments, 929 billion in payments at 2004 prices). According to the Commission, the average annual amounts in payment appropriations would represent 1.14% of Gross National Income (GNI) over the period (European Commission, 2004e). However, in December 2003 the main paymasters of the EU (including Britain, France and Germany) urged that the budget should be kept at current expenditure levels of 1% of GNI, which would be equivalent to a total budget of close to 900 billion euros (815 billion in payments). This would result in an annual budget (payments) of 16 to 17 billion a year less than the Commission consider necessary and imply at least some 5 billion euros a year less for Cohesion Policy. Clearly the overall budget is going to be tight. An outcome in line with the Commission's proposals would raise overall budget (payments) by 27%, from 105 billion in 2003 (for the EU-25 in the last full year of EU-15) to an average of 133 billion in 2007-13. This compares with an increase in population of 19% in EU-25 and of 27% in EU-27. The step-up in funding between the final year of the current financial perspective in 2006 and the first year of the new perspective in 2007 is scheduled to be 8.6%, rising to 25% in 2013 (see payment appropriations in Table 7). This additional funding would come essentially from higher EU-15 contributions since the ten new member states will add only 5% more to GDP (6% in an EU-27 with Bulgaria and Romania; European Commission, 2004a). Given that the demands from the new member states will be considerable, financial resources will be diverted away from the EU-15.

Within the proposed overall budget, the allocation to heading 1b 'cohesion for growth and employment' represents between 32% and 38% of commitments over the period (34% on average, see Table 7). But if heading 1a 'competitiveness for growth and employment' (actions to promote the competitiveness of enterprises, strengthen European efforts in research and innovation, strengthen EU communications and energy networks, improve the quality of education and training in the Union and help European society anticipate and manage change; European Commission, 2004e, pp. 6-14) is added, plus the element of development in heading 2 'preservation and management of natural resources', then the total set aside for development spending rises to well over 50%, with the possibility of a larger share of this broader package of spending going to more developed states than under heading 1b.

Table 7. Proposed European Union Financial Perspective 2007-13 and Cohesion Policy Funding

Commitment Appropriations	2006	2007	2013	2007-13	% 2007-13
1. Sustainable growth	47.582	59.675	76.785	477.665	46.6
1a. Competitiveness for growth and employment	8.791	12.105	25.825	132.755	13.0
1b. Cohesion for growth and employment	38.791	47.570	50.960	344.910	33.6
2. Preservation and management of natural resources	56.015	57.180	57.805	404.655	39.5
(Agriculture market related expenditure and direct paym	43.735	43.500	42.293	301.074	29.4
Other headings	17.091	16.705	23.860	142.715	13.9
Total EU Budget appropriations for commitments	120.688	133.560	158.450	1.025.035	100.0
Total EU Budget appropriations for payments	114.740	124.600	143.100	928.700	

Figures in billions of euros.
Source: European Commission, 2004e, p. 29.

Reform of EU Cohesion Policy

Proposals from the European Commission on reform of Cohesion Policy were set out in the Third Report on Economic and Social Cohesion published in February 2004. On 14 July 2004 the Commission adopted a proposal for five new regulations for renewed Structural Funds and instruments (including a general regulation laying down a common set of rules for all instruments and specific regulations for the ERDF, the EFS and the Cohesion Fund. A new regulation to establish a European grouping of cross-border co-operation was also suggested (European Commission, 2004f). These proposals are scheduled for implementation from January 2007.

The Commission has taken the view that 'an ambitious cohesion policy should be an essential element of the total [European policy] package' and that Cohesion Policy 'is one of the pillars of the European construction along with the single market and monetary union' (European Commission, 2004a, p. xxv). To reflect the importance attached to Cohesion Policy the Commission proposed that the budget allocation for this policy should be enhanced (by over 40%) in the 2007-13 financial perspective, from around 234 billion euros (at 2004 prices) in the period 2000 to 2006 for the EU-15 to 336.3 billion for the enlarged Union (344.9 billion including administrative expenditure and the Solidarity Fund –a small fund set aside for dealing with emergencies in member states–; see Table 7). According to the Commission the new budget figure equates to 0.41% of EU-27 GNI (or 0.46% before transfers to the proposed single rural and fisheries instrument; *ibid.*, p. xxxvii). Under the present financial perspective 2000-06, 'cohesion for growth and employment' (Structural funds, Cohesion Fund and Solidarity Fund) is allocated 38.8 billion euros in 2006 (see Table 7). Under the new financial perspective a 23% increase is proposed to 47.6 billion in 2007 (commitment appropriations at 2004 prices; European Commission, 2004e). Set against the objectives of Cohesion Policy, the increase in the number of people living in the least developed regions (from 75 million in the former EU-15 to 123 million in the EU-25 –a 64% rise– and 153 million in the EU-27 –a 104% rise–, figures from European Commission, 2004a), and the considerable economic, environmental, social and political challenges still to be met in eastern and central Europe, the proposed budget looks modest.

The Commission proposes (2004a) that:

- There should be a new architecture for policy.
- The Lisbon and Gothenburg priorities (relating to a knowledge based economy and protecting the environment/sustainable development, respectively) should be incorporated into core priority themes.
- The Cohesion Fund should be strengthened.
- The key principles of Cohesion Policy –programming, partnership, co-financing and evaluation– should be retained but reforms to the delivery system should be introduced to encourage a more strategic approach to programming, further decentralisation of responsibilities to partnerships in member states, more rigorous monitoring mechanisms and a simplified and more transparent management system (p. xxxiv).

- Investment is concentrated on a limited number of Community priority themes reflecting the Lisbon and Gothenburg agendas. For regional programmes the proposed core list is: (1) innovation and the knowledge economy; (2) environment and risk prevention; and (3) accessibility and services of general economic interest. For employment related programmes the focus will be on: (1) progress towards full employment; (2) improving productivity; and (3) promoting social inclusion and cohesion. These priorities would be completed and expanded to take account of the needs of the least developed regions and member states (for example in infrastructure and institutional capacity building; p. xxvii).

In the Commission proposals, pursuit of the priority themes would be organised around a new policy architecture with future programmes grouped under three objectives (see Table 8):

(1) **Convergence (78% of funding)**. Supporting growth and job creation in the least prosperous member states and regions leading to real convergence would be the top priority for the Community. It would be pursued principally through the modernisation and diversification of economic structures, basic infrastructure development, environmental protection, more efficient administration, better quality labour market institutions, education and training systems, and the optimal use of human resources. Eligible regions would be primarily those Nuts II level regions in which GDP per capita is less than 75% of the Community average (the definition currently used for Objective 1 regions). Transitional support would apply to those regions where GDP per capita would have been below 75% in the EU-15 (the so-called statistical effect of enlargement). Support 'would be higher than decided in Berlin in 1999 for the so-called "phasing out" regions of the current generation [of Objective 1 regions]' (p. xxvii). This support would end in 2013.

(2) **Regional competitiveness and employment (18% of funding)**. Regional and national programmes (financed respectively by ERDF and ESF funding) outside the least prosperous member states and regions that would help anticipate and promote economic change by strengthening competitiveness and attractiveness. From a resource allocation viewpoint, two groups of regions would be distinguished:

   (a) Regions currently eligible for Objective 1 not meeting the criteria for the convergence programme 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.

   (b) Regions of the Union covered neither by the convergence programmes nor by 'phasing in' support (p. xxx). In contrast to the previous Objective 2, there would be no delineation of eligible geographical areas at the level of municipalities by the Commission (p. xxxvii). Concentration of resources would take place at two levels: thematic concentration would be stronger outside the

'convergence' regions and there would be rules on the minimum financial volume of programmes and priorities. The allocation of resources to this Objective would take account of criteria reflecting the relative disadvantage of regions with geographical handicaps.

(3) **Territorial cooperation (4% of funding)**. Ensuring a harmonious and balanced development throughout the Union by supporting cross-border and transnational cooperation. Actions would be financed by the ERDF and focus on integrated programmes in pursuit of the key Community priorities. In principle, all regions (defined at Nuts level III) along the external and internal borders, terrestrial as well as maritime, would be concerned (p. xxx).

Table 8. Instruments and Objectives of EU Cohesion Policy, 2000-06, and Commission Proposals, 2007-13

2000-06	2000-06	2007-13	2007-13
Objectives	Financial Instruments	Objectives	Financial Instruments
Cohesion Fund Objective 1	Cohesion Fund ERDF ESF EAGGF-Guidance FIFG	Convergence and Competitiveness (78% of funding)	Cohesion Fund ERDF ESF
Objective 2 Objective 3	ERDF ESF ESF	Regional Competitiveness and Employment (18% of funding) • regional level • national level: European employment strategy	ERDF ESF
Interreg.	ERDF	European Territorial Cooperation (4% of funding)	ERDF
Urban Equal Leader+	ERDF ESF EAGGF-Guidance	Absorbed into above Objectives Absorbed into above Objectives Absorbed into above Objectives	
Rural development and the restructuring of the fisheries sector outside Objective 1	EAGGF-Guidance FIFG		
9 Objectives	6 Instruments	3 Objectives	3 Instruments

Notes:
Least Developed Regions: These would essentially be regions in which GDP per capita is less than 75% of the Community average measured in purchasing power parities and calculated on the basis of the Community figures for the last three years available at the moment the designation decision is taken. Territories with permanent geographical handicaps should benefit from an increase in the maximum Community contribution (European Commission, 2004a, p. xxxii).
EAGGF-G: European Agriculture Guidance and Guarantee Fund-Guidance Section.
ERDF: The European Regional Development Fund would provide support for modernising and diversifying economic structures, physical infrastructure, protecting the environment and reinforcing institutional capacity.
ESF: The European Social Fund would continue as the main financial instrument for supporting the European Employment Strategy.
FIFG: Financial Instrument for Fisheries Guidance.
Cohesion Fund: This would apply to member states with a Gross National Income lying below 90% of the Community average (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 relative importance of the Fund would be enhanced to represent one-third of the financial allocations for the new member states concerned. Allocation would take account of the needs of each member state. The Fund would provide finance for transport and environment programmes. As at present there would be a mid-term assessment of eligibility.
Source: European Commission, 2004a, p. xlii.

Areas with particular geographical or natural handicaps, the outermost regions, islands, mountainous areas, sparsely populated areas in the north of the EU and urban areas should be accommodated within the proposed architecture of Cohesion Policy. In relation to urban areas each member state should propose a list of cities which would benefit from a specific action within the Objectives outlined above. The number of cities covered would probably be greater than the 70 covered by the current 'Urban' initiative in the EU-15 (p. xxxii).

Current instruments linked to rural development would be grouped into a single instrument under the Common Agricultural Policy (CAP). The current rural development programme Leader+ would be absorbed into mainstream programming. Similarly, actions supporting the restructuring of the fisheries sector would be grouped under a single instrument. Financial resources would be transferred from Cohesion Policy to these instruments. Resources transferred from Cohesion Policy would continue to be concentrated on the least developed regions and countries.

The Cohesion Fund would be enhanced to represent one-third of the financial allocation for the new member states concerned. Eligible states would be those with a GNI per capita below 90% of the Community average, with a mid-term assessment of eligibility. The Cohesion Fund should strengthen its contribution to sustainable development. Trans-European transport networks and environmental infrastructure would remain the central priorities.

A number of reforms to the delivery system have also been proposed. The Commission proposes that an overall strategic document should be adopted by the Council before 2007 defining priorities for member states and regions. On the basis of this strategy document each member state would prepare a policy document, negotiated with the Commission, on its development strategy, which would constitute the framework for preparing the thematic and regional programmes. The Commission would then adopt national and regional programmes on the basis of this policy document. Programmes would be defined at a high priority level only; additional detail currently contained in the 'programme complement' would be abandoned. The number of funds would be limited to three (ERDF, ESF and Cohesion Fund) compared with the current six. National rules would largely determine the eligibility of expenditure. There would be greater management control and responsibility at the member state level, encouragement for a more strategic approach to programming, further decentralisation of responsibilities to partnerships in member states, more rigorous monitoring mechanisms and a simplified and more transparent management system.

It is difficult to foresee how these proposals would change the relationships between the various parties involved in the development process in Spain, particularly between the regions and the central government. But further delegation of responsibilities down to the level at which projects are implemented and less European assistance would suggest that changes in Cohesion Policy would add to regional autonomy.

Leaving aside the debate over the coherence of Cohesion Policy itself, the key questions in the proposals are over the distribution of funding (especially under the cohesion objective), exactly what criteria will be used to designate qualifying regions and how much money will be allocated to transitional regions. The Commission has indicated that roughly half of all cohesion funding should be allocated to the EU-15 and half to the accession states. Others (notably Britain) have argued for smaller total financial resources with a greater concentration on eastern and central Europe.

Financial Implications of the New Cohesion Policy Environment

In the next EU financial perspective, the balance of financial transfers between the European Union and Spain will fall closer to budgetary neutrality. Assuming the Spanish economy maintains its relatively high rate of growth it will be required to contribute more to the EU budget. Simultaneously, receipts from the EU will fall as funding under the two major spending policies –the Common Agricultural Policy and the Cohesion Policy– is diverted towards central and eastern Europe.

The final amount of funding available to Spain through Cohesion Policy in the period 2007-13 will depend on the size of the budget finally allocated to this policy, to the distribution criteria and to the claims that Spain can place on the budget. Negotiations are likely to be difficult and long drawn-out. For Cohesion Policy the Commission has proposed to allocate a sum equivalent to 0.41% of the GNI of the EU-27, corresponding to 336 billion euros (at 2004 prices) over the period 2007-13 (see Table 9). The indicative allocation of this amount among the three priorities would be 78% (262 billion) for the convergence priority (least developed regions, 'statistical effect regions' and the Cohesion Fund). The relative importance of the Cohesion Fund would be enhanced to represent a third of the financial allocation for the new member states concerned. The regions concerned by the 'statistical effect' (the effect of the reduction in EU average GDP per capita by 12.5% on enlargement from EU-15 to EU-25) would benefit from a specific, decreasing allocation under the convergence objective to facilitate their 'phasing-out' (the resources allocated to this are still to be determined). Around 18% (61 billion euros) of funding would be allocated to the 'regional competitiveness and employment priority' and around 4% (13 billion) to the 'territorial cooperation priority' (European Commission, 2004a, p. xxxiv). For the distribution of funding the Commission proposes to apply the method based on the criteria used at the time of the Berlin Council (1999) for the convergence priority, primarily GDP per capita less than 75% of the EU average. Resources for the regional competitiveness priority 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 'territorial cooperation' priority (*ibid*, p. xxxiv).

Table 9. Expenditure on Cohesion Policy, 2007-13, proposed by the European Commission in February 2004

Heading	EU-27 Total	EU-15 Total	EU-12 Total
Structural Funds	**270** (a)		110 (a)
Objectives 1, 2 and 3 and FIFG	183.6		
Objectives 2, 3 and FIFG			
Convergence Priority (Objective 1, Cohesion Fund and 'statistical effect' regions)	**262.3** (78%)		
Regional Competitiveness and Employment Priority	**60.5** (18%)		
Territorial Cooperation	**13.5** (4%)		
Community Initiatives			
Other Initiatives			
New Cohesion Fund	**60** (a)		
Cohesion Fund	18.0		
Cohesion Policy 2007-13 (2004 prices)	**336.3** (100%)	180 (a)	160 (a)
Cohesion Policy 2000-06 (1999 prices)	235 (a) 213		

(a) author estimates.
Notes:
The 'Convergence Priority': This would emphasise the new member states with a cap on financial transfers to any one member state of 4% of GDP (as at present). Under this priority regions concerned by the 'statistical effect' of enlargement would benefit from a specific, decreasing allocation to facilitate their 'phasing-out'. This support would end in 2013.
The 'Regional Competitiveness and Employment' Priority: For cohesion policy outside the least prosperous member states and regions the Commission proposes (1) regional programmes (in industrial, urban and rural areas) and (2) national programmes. Outside the phasing-in regions the distribution between the regional programmes financed by the ERDF and the national programmes financed by the EFS would be 50-50.
Allocation of Financial Resources: Financial resources would be allocated to member states on the basis of the criteria used at the Berlin Council (1999), 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' will be allocated between member states on the basis of Community economic, social, and territorial criteria. Resources for the objective 'territorial cooperation' will be guided in their distribution by the size of the population living in the relevant regions and relative socio-economic conditions (*ibid*, p. xxxix).
Rural Development: This has a more prominent place in the new CAP (agreed by the Council in June 2003). In 2000-06 some 10% of CAP expenditure is directed towards rural development (49.5 billion plus 2 billion from the ERDF Leader+). Under the new CAP there will be an effective transfer of funding from market measures to development (modulation up to 5%). The distribution of this additional 'modulation' funding will be made on Cohesion Policy criteria. In addition the rate of Community co-financing of agri-environmental measures has been increased to 85% in Objective 1 regions and to 60% elsewhere (Third Cohesion Report, p. 127).
Source: European Commission, 2004a, p. .xxix and pp. .xxviii-xxxix.

The claims that Spain can place on the cohesion funds under the ‘convergence objective’ depend largely, but not exclusively, on statistical calculations relating to the GDP per capita of Spain and its regions in relation to the rest of the European Union. The results of the calculations will depend on the final criteria that are used and the particular three years over which any calculations are spread. Table 10 illustrates the current position. The number of qualifying regions is likely to range between one and four. Based on 25 member states in 2001, four regions and the autonomous cities of Ceuta and Melilla would qualify. A calculation based on 27 member states cuts this number to only two regions. Using data from 2003, the number of qualifying regions is only two based on an EU-25 average and possibly only Extremadura on an EU-27 average. In contrast to the GDP figures, the unemployment data show that fourteen of the regions have above EU-25 average unemployment (see Table 10).

Where qualifying status is lost the Commission proposes that transitional support will be available for both Objective 1 and 2 regions. Support will be greater where disqualification results solely from the statistical effect of enlargement. In addition, the Canary Islands would continue to qualify for some funding under the concept of ‘outermost regions’.

In contrast to the uncertainty over funding under the ‘convergence objective’ Spain will no longer qualify for monies from the Cohesion Fund, whichever years are used in the calculation (see Table 10). Any transitional funding under this Fund would have to be shared with Greece, possibly Portugal and all the new member states (a population of between 85 and 117 million excluding Spain).

Table 10. Gross Domestic Product in Spain and its Regions, EU Comparisons

Region	GDP per capita 2001 Col. A	EU-15 2001 Col. B	EU-25 2001 Col. C	EU-27 2001 Col. D	EU-25 2003 Col. E	Unemployment Rate (%) Col. F
EU-15	23,338	100				8.1
EU-25	21,288		100		100	9.0
EU-27	20,310			100		
Madrid	26,246	112.6	123.3	129.2	128	6.5
Navarra	24,794	106.2	116.5	122.1	121	4.7
Balearic Islands	24,614	105.5	115.7	121.2	115	9.1
País Vasco	24,553	105.2	115.4	120.9	119	9.2
Cataluña	23,520	100.8	110.5	115.8	113	9.2
Rioja, La	22,631	97.0	106.3	111.4	108	4.8
Aragón	21,136	90.6	99.3	104.1	103	5.2
Cantabria**	19,305	82.7	90.7	95.1	93	10.2
C. Valenciana*	18,935	81.1	89.0	93.2	91	9.8
Canary Islands*	18,473	79.2	86.8	91.0	89	12.7
Castilla y León*	18,211	78.0	85.6	89.7	89	10.7
Asturias*	16,900	72.4	79.4	83.2	81	10.4
Murcia*	16,632	71.3	78.2	81.9	83	10.6
Ceuta y Melilla*		68.0	74.7	75.8	81	15.1
Castilla-La Mancha*	15,676	67.2	73.7	77.2	77	8.6
Galicia*	15,527	66.5	73.0	76.5	76	14.0
Andalucía*	14,737	63.1	69.2	72.6	72	17.4
Extremadura*	12,491	53.5	58.7	61.5	62	17.8
Spain	19,669	84.3	92.4	96.8	95	10.9

Figures are for estimated GDP per capita (euro) in purchasing power standards.
(*) Current Objective 1 regions.
(**) Objective 1 transitional support region.
Using an average GDP per capita in PPS based on 1999-2001, the 75% threshold separates the same regions in Spain as for 2001 in column B. On the figures for 1999-2001, 50 of the 55 NUTS level II regions in the ten new accession states fall below the 75% threshold, as would almost all of Rumania, Bulgaria and Turkey.
Sources:
Columns A and B: Krueger, 2004a and 2004b (except figure for Ceuta and Melilla).
Column C: European Commission, 2004a, Third Cohesion Report.
Column D: Figures for the EU-27 calculated from the GDP per capita (PPS) for the EU-27 in Krueger, 2004b, and from GDP per capita (PPS) for the Spanish regions in Krueger, 2004a.
Column E: INE, 2004d, and Eurostat, 2004c.
Column F: Unemployment rates for Spain from the quarterly survey of employment (second quarter 2004, INE, 2004c). The EU-15 and EU-25 figures are for May 2004 (Eurostat, 2004d).

During the current funding period Spain will receive some 38 billion euros (at 1999 prices) for eleven regions that qualify for Objective 1 status plus 11 billion (at 1999 prices) from the Cohesion Fund (see Table 3). In 2004 the Ministry of Finance has

budgeted for a total allocation of 8.5 billion euros (1.1% of GDP; see Table 12). These figures provide a measure against which to assess the change in funding under the next financial perspective.

The easiest way to estimate Spain's entitlement to funding under the 'convergence objective' is to relate the proportion of people living in the regions of Spain qualifying for funding to the total EU population living in such regions (see Table 11). Possible allocations range from 13% to less than 1% depending on the number of qualifying regions and the number of member states. The most likely outcome is for two regions to qualify, Andalucía and Extremadura, which would point to between 7% and 8% of all funding for the 'convergence objective'. If these figures are set against the monetary amount budgeted for this objective shown in Table 10, then the financial allocation to Spain for 'convergence' over the seven-year period lies between 1.8 and 27.8 billion euros. Qualification of the two regions would point to an allocation of around 16 billion euros, an average of 2.3 billion a year at 2004 prices (this allocation and alternatives are shown in Table 12). This would be only around one-third of Spain's allocation under the present financial perspective.

An alternative method of estimating the financial outcome is described in Table 12 starting from the funding to Spain in 2004 and then applying allocations according to current Objective 1 funding to the Spanish regions. A similar outcome to that using the above method is obtained (compare Columns E and G).

Table 11. Population in Regions Qualifying under the Convergence Objective

Regions	Population	% of EU-25	% of EU-27
Andalucía, Castilla-La Mancha, Ceuta and Melilla, Extremadura and Galicia	13.01	10.6	8.5
Andalucía and Extremadura	8.42	6.8	5.5
Extremadura	1.06	0.9	0.7

Based on a total population in regions with per capita incomes below 75% of the EU average in an EU-25 of 123 million and in an EU-27 of 153 million (population figures for the EU based on European Commission, 2004a, Third Cohesion Report).

Table 12. Financial Implications of Reformed Cohesion Policy under the 2007-13 Financial Perspective

Heading	EU-25 Budget 2004 Col. A	% Allocation to Spain Col. B	Allocation to Spain 2004 Col. C	Allocat. W Col. D	Allocat. X Col. E	Allocat. Y Col. F	Allocat. Z Col. G
Structural Funds Total (a to g)	30.8	22.7	7.0				
(a) Objectives 1, 2 and 3	26.2						
(b) Objective 1	19.9	(30)	(6)	3.7	2.4	4.8	2.3
(c) Objective 1 Phasing-out							
(d) Objective 2	3.1	(3)	(0.1)	0.1	0.1	0.1	0.1
(e) Objective 2 Phasing-out							
(f) Objective 3	3.2	(9)	(0.3)	0.3	0.3	0.3	0.3
(g) Community Initiatives, Peace Non-Objective 1 FIFG and other	1.9	(19.0)	(0.4)	0.4	0.4	0.4	0.4
Cohesion Fund	2.8	53.6	1.5	0	0	0	0
Total	33.6	25.3	8.5	4.5	3.2	5.6	3.1
Total (% of GDP)			1.1	0.6	0.4	0.7	0.4

Of total Objective 1 funding to Spain author estimate of 30% to Andalucía, 8% to Castilla-La Mancha, 8% to Extremadura and 13% to Galicia based on the cost of their respective Regional Development Programmes 2000-06.

Percentage of cohesion policy funding to GDP based on GDP in 2004 at 2003 prices of 760 billion euros.

Column A: 2004 figures for payment appropriations at 2003 prices in euro billion from the General Budget of the European Union for the financial year 2004 (European Commission, 2004b).

Column B: Percentages based on the figures from the Ministerio de Hacienda, 2003, in Column C; those in brackets are author estimates based on the allocation under the 2000-06 financial perspective.
Column C: Figures in billion of euros from Ministerio de Hacienda, 2003. Figures in brackets are author estimates based on Column A multiplied by the percentage figure in Column B.
Column D: Allocation W, Andalucía, Castilla-La Mancha, Extremadura, Galicia and Ceuta y Melilla qualify as Objective 1.
Column E: Allocation X assumes only Andalucía and Extremadura qualify as Objective 1.
Column F: Allocation Y assumes transitional payments to phasing-out Objective 1 regions of 50%.
Column G: Allocation Z assumes only Andalucía and Extremadura qualify as Objective 1, based on their populations as a proportion of all people living in the least developed regions in the EU.

Outside of the convergence priority, Spain would still attract funding under the other two priorities but the total volume of funding (some 74 billion euros) spread around twenty-five to twenty-seven member states would be relatively small (for example on a population basis in an EU-25 it would be 40/450 or 9%, eg, around 7 billion euros). Spain would also continue to benefit from other EU financial allocations including those under 'competitiveness for growth and employment' and the 'preservation and management of natural resources'. Overall, Cohesion Policy funding is likely to fall to between one-third and one-half of existing levels, but possibly closer to one half once transitional funding is included.

Hence, the financial implications for Spain under the new arrangements would be principally that:

- Transfers between the EU and Spain would fall closer to budgetary neutrality.
- Payments to Spain under Cohesion Policy would fall from the current level of over 1% of GDP to a figure closer to 0.5% of GDP.
- Spain would no longer qualify for funding under the Cohesion Fund.
- A number of the current Objective 1 regions would not qualify under the 'convergence' priority, with the most likely outcome being qualification by two regions, Andalucía and Extremadura.
- Seven of the existing eleven regions in receipt of Objective 1 funding (or Objective 1 transitional funding) would qualify for transitional support under the 'convergence' priority.
- The current level of infrastructure development could not be sustained through the public sector.

Other Implications of the New Cohesion Policy Environment
Apart from the direct financial implications of the proposed new Cohesion Policy environment, the consequent reduction in funding is likely to modify the existing model of development, especially at the national level and within those regions that lose their priority status. Crucially, there will be pressure on infrastructure budgets. Maximum use of available funding needs to be made in the next couple of years to implement infrastructure schemes while current levels of funding remain. Beyond this, a reappraisal of development strategies is also required. A model with an emphasis on predominantly publicly funded public works and a strong element of subsidies will no longer be viable. More imaginative solutions will be required at all administrative levels involving a greater range of development strategies, strategies tailored to particular requirements and with more emphasis on raising productivity.

Changes in European Cohesion Policy will also have implications for domestic political relations, especially those between the regions and the central government. European funding and the philosophy of 'bottom-up' development have added to the autonomy of regions and given the regions a European presence. Regions have representation on the European Committee of the Regions, have established offices in Brussels and deal directly with the authorities there. But Cohesion Policy has also required a dialogue and close working relationships with the central government. Less funding from Brussels, coupled with changes in policy delivery systems, will change the nature of this dialogue. In addition, the relationships between regions in Spain might shift as the regions eligible for different strands of funding change and in response to any revision of the domestic solidarity fund (FCI) to reflect a new Cohesion Policy environment.

Repercussions will also be felt in terms of Spain's relations with its European partners. Once negotiations over the next financial perspective and the revised Cohesion Policy are concluded, Cohesion Policy funding will become a less sensitive issue for Spain. Negotiators will be free to focus on other areas of European Union policy. Crucially, Spain may find its own interests better served by containment of the European budget.

Finally, on a broader political front, the nature of cohesion funding touches the fundamental question of the future political form of Europe and of popular support in Spain for European integration. By devolving responsibility down to the level of local communities, local authorities and regions, and by fostering cross-border cooperation, Cohesion Policy has enhanced the role of these tiers of administration complementing the process of government decentralisation. In the face of powerful globalising forces Cohesion Policy has reinforced the local and the regional and brought visible evidence of the benefits of the European project. A scaling-back of European funding coupled with higher contributions to Europe may shift sentiment towards a more considered view of the European project.

Conclusions

Inflows of financial resources through EU Cohesion Policy have contributed to Spain's achievement in successfully navigating a challenging economic and political transition. This transition has propelled the country from dictatorship to democracy, from centralised political power to a system of decentralised government, from a relatively isolated, opaque and protected economy with a large state sector and a domestic focus to an open, transparent and liberal economy with relatively little state-ownership, integrated into Europe and with a distinctive international projection. In the process Spain has achieved real convergence with its partners in Europe. Although differences remain between Spanish regions in terms of personal opportunities, economic structures, regional resources and development pathways, all regions have benefited.

Enlargement of the EU and the forthcoming financial perspective have provided an opportunity for a review of Cohesion Policy. The European Commission has put forward its proposals. These will be debated over the coming months. It has been argued here that both existing policy and proposed policy have many weaknesses. Increased spending in Spain has had little impact on the ranking of regions in terms of their GDP per capita. Polarisation on Madrid continues.

Nevertheless, despite the conclusion that disparities between regions cannot be eliminated by existing policy, that Cohesion Policy has ambitious goals, questionable strategies and theoretical foundations, it is still worth supporting. It has assisted Spain through an economic transition and stimulated growth in all regions. It can equally assist the new accession states through their even more challenging transitions. Cohesion Policy provides a valuable mechanism for promoting cooperation at a range of levels between member states, injecting additional life into regional and local government.

Critical negotiations remain, especially over the volume of financial resources to be allocated to this policy and over the targeting of funding. If policy is to be effective then the principle of concentration must be adhered to and not lost amid rival claims. There might also be a case for reviewing the relationship between cohesion funding, the European Investment Bank and the European Bank for Reconstruction and Development.

Proposed changes in Cohesion Policy require a reappraisal by the central government of its position on this policy. In a European context Spain is now a middle-income country. In a world context it is a wealthy one. Spain need no longer look for external financial assistance to support development. Instead it should look to promote the development of poorer countries not only as an expression of solidarity but also out of self-interest (not only economic but also including security and political stability interests). There is more to be gained from stimulating development in the least prosperous countries in Europe and in promoting new areas of European policy (including sustainable development and enhanced competitiveness) than there is in fighting for European Cohesion Policy assistance. In the European policy-setting context, giving ground on cohesion funding may enable other Spanish priorities to be achieved.

For Spain, and for some regions within Spain in particular, a new transition awaits, that from a model of development in which public works have played a major role and where public subsidies have cushioned economic activities, to a model underpinned by investment in human capital, research and development, greater flexibility, more efficient public administration and enterprise. As the challenges of competition from emerging economies both inside and outside Europe grow, the necessity for this shift in emphasis will become more pressing. Adapting to a new funding relationship with Europe and a reformed Cohesion Policy will require a rethinking of development policy if the momentum of convergence is to be maintained.

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