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EU FUNDS PROVIDED TO THE NEW MEMBER STATES: RELEVANCE FOR ODA AND ACHIEVING THE MONTERREY CONSENSUS

■ Jaroslaw Pietras

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EU Funds Provided to the New Member States: Relevance for Official Development Assistance (ODA) and Achieving the Monterrey Consensus[1]

Jaroslaw Pietras Ph.D.
University of Warsaw

Contents:

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I. Introduction

The Monterrey Consensus addresses several sets of issues including ways and means for mobilizing domestic financial resources which could be used for development, enhancing foreign direct investments and other private capital flows which could contribute to development, accelerating international trade as an engine for growth as well increasing international financial and technical cooperation aiming at accelerating development. The Conference on Financing for Development in Monterrey addressed the two issues of the necessary "means" (i.e. financing) and the most effective "ways" (i.e. aid effectiveness) of achieving the internationally agreed development goals including the objectives of the Millennium Declaration. These are two mutually reinforcing objectives, and progress should be made on both.

These two objectives – even if Monterrey consensus covers more aspects – have been visible and still are valid concerns of the European Union not only in its relationships with developing countries but also in relation to its closest neighbours. Therefore, there might be a valid question whether and to what extent the experience of the EU obtained while assisting the transformation of the former centrally planned economies and helping them to adjust to the requirements of accession could give any indication how relatively substantial amounts of assistance can be effectively used by recipient countries. The EU's former and current neighbours do not represent a uniform group of states. Some of them have already become members of the EU while some others, even being in geographic proximity, are far from the EU in political terms. Therefore, the sort of ties linking these countries with the EU differs very substantially, not only in formal or legal terms, but also as to extent, scope and instruments of the assistance. It is interesting to note however, that the EU has a similarly complex approach to different groups of countries, always attempting to insure coherence between the various mechanisms affecting the pace of development. Direct applicability of this experience to the Monterrey process is not possible, but some observations concerning the factors which contributed to the success of transformation, association and accession might have more universal meaning.

The EU contributed to the positive result of the Monterrey Conference, through the so-called "Barcelona commitments" which included:

- Commitments on Official Development Assistance (ODA), in terms of volume and sources – increased ODA volumes, innovative sources of financing, initiatives concerning GPG and debt relief for Heavily Indebted Poor Countries (HIPC);

- Commitments on aid effectiveness assuming closer coordination of policies and harmonisation of procedures, untying of aid, trade-related assistance (TRA), and the reform of the International Financial System.

In order to assist poorer countries worldwide, the EU has created the European Development Fund (EDF). This became the major tool for financial support of development at the EU level. It doesn't means that the EU as a whole does not finance specific actions or projects also directly from the EU budget, however generally these other sources are of lesser importance and they address more specific needs. This is the case, for example, of humanitarian assistance or similar EU budget lines. Moreover, the European Development Fund should be seen as a supplement to the assistance offered separately by the EU member states. The proportion of aid originating from individual EU members is a number of times bigger when compared to amounts contained in EDF or other EU funds offered as development aid. This is not the case of the countries around the EU because bilateral aid donated by the individual member states is quite modest.

Current financing of EDF covers the period from 2008 to 2013 and provides an overall budget of EUR 22.7bn. Of this amount, EUR 21.9bn is allocated to the ACP countries and EUR 430 million to the Commission as support expenditure for programming and implementation of the EDF. The amount for the ACP countries is divided accordingly: EUR 17.7bn to the national and regional indicative programmes, EUR 2.7bn to intra-ACP and intra-regional cooperation and EUR 1.5bn to Investment Facilities. This should be compared to the overall amount of EU ODA which in the year 2006 only reached the amount of EUR 48 billion thus representing a ratio as high as 0.42% of EU ODA to EU GNI. It confirms that the bilateral aid of particular member states constitutes the biggest part of all the assistance by the EU and its member states combined. Moreover there is significant differentiation between the engagement of the EU members and those who actually are major internal beneficiaries of the EU policies are obviously having distinctly lower shares of their participation in ODA. Among the most generous donor Member States is Sweden (which allocates 1% of its GNI to aid), Luxembourg (0.89%), the Netherlands (0.81%) and Denmark (0.80%). Some other financing of can be found under different chapters of the EU budget as well. Most of the additional facilities can be found under its humanitarian aid policy. The Commission using general budget provides assistance to the victims of natural or man-made disasters in non-European Union countries on the sole basis of humanitarian needs. In 2007 the Commission's response to humanitarian crises in more than 70 countries was channelled through 85 financing decisions for a total amount of EUR 768.5 million. Within the framework of the comprehensive reform of the Union's external assistance programmes, the new European Instrument for Democracy and Human Rights was established in 2006. In terms of financial scope, it provides for EUR 1.104 billion in support funds for human rights, democratisation and rule-of-law-related assistance activities in non-member countries over the period 2007–13. In 2007 47 % of the funds were allocated to NGOs, 42 % to UN agencies and 11 % to other international organisations.

It is therefore important to realise that the assistance offered to the EU new member states, countries around the European Union and its prospective members, compared to funds offered as support to development, is differently motivated and it is not surprising that it can be fund in a different part of EU financial recourses, that is differently managed and subject to a different legal regime. Here are also many differences between situations of particular countries. Those who recently became members of the EU participate fully in internal policies and programmes that the EU finances from the regular budget. They also contribute to this budget and take part in decisions concerning the shape of EU policies. Prospective members of the EU (either those already negotiating or those having a realistic hope of becoming a member) do not participate in the decision making process nor they contribute to the EU budget, however they try to follow EU policies and implement EU legislation as a "*condition sine qua non*" of their future adhesion. For the EU it also means that assistance offered serves mainly the purpose of preparing these countries to better perform their future role within EU. There are also many other countries in the close proximity, who are not considering (and they are not considered) any future membership in the EU. But they might have or are in the process of elaboration of specific ties with the EU in a form of more or less advanced agreement (neighbourhood, cooperation, association etc.) In all these cases EU funds are offered because there is an additional motivation of political, economic, cultural or geographical nature. The sources of financing are located in different parts of the EU budget, most often completely in different places that the money offered for financing of development. Most of the money can be drawn from the Structural Funds and Cohesion Funds. These are funds allocated by the European Union for two related purposes: support for the poorer regions of Europe and support for integrating European infrastructure especially in the transport sector. Current financing runs from 1 January 2007 to 31 December 2013, with a €277bn budget for the Structural Funds, and €70bn for the Cohesion Fund. Together with the Common Agricultural Policy, the structural and cohesion funds make up the great bulk of EU funding, and the majority of total EU spending. It should be noted that the share of the EU budget in EU GDP is currently below the 1%, which is a bit more then two times higher then share of EU official development assistance.

II. The approach of achieving progress via integration with EU funds in the case of the New Member States, associated countries with the EU, and other countries of the region using EU funds as an instrument for enhancing cooperation.

Among member states of the region of Central and Eastern Europe there are number of different situations that could be categorised as follows:

- New Members
- Prospective members

- Negotiating countries
- Associated countries
- Neighbouring countries
- Countries having a Cooperation Agreement
- Countries negotiating or renegotiating a cooperation Agreement
- Countries having any other type of Agreement

What is common to all of them is that they have an opportunity to use EU funds offered rather not as development assistance but being justified and financed differently. Most often they have the possibility to use regular budget of the EU and not EDF located outside the EU budget lines. These countries also differ in terms of legal status, state of political cooperation, intensity of economic ties or even geographic proximity. But the degree of intensity of aid may significantly depend not only on the formal status but also on the aims of such a assistance that can vary from:

- Humanitarian
- Alleviation of natural disasters
- Development
- Strengthening of Democracy
- Transformation/ restructuring
- Enhancement of cooperation
- Creating strong ties with the EU
- Preparation for accession
- Cohesion within EU

The more developed aims the bigger amounts of EU funds are involved. However it should be noted that the EU has always affected the process of restructuring by applying complex set of measures which constitute also a core mechanism of delivery of benefits of European integration. EU funds are only one of the components of this mix of measures which when put in practice simultaneously and coherently can bring about serious economic benefits.

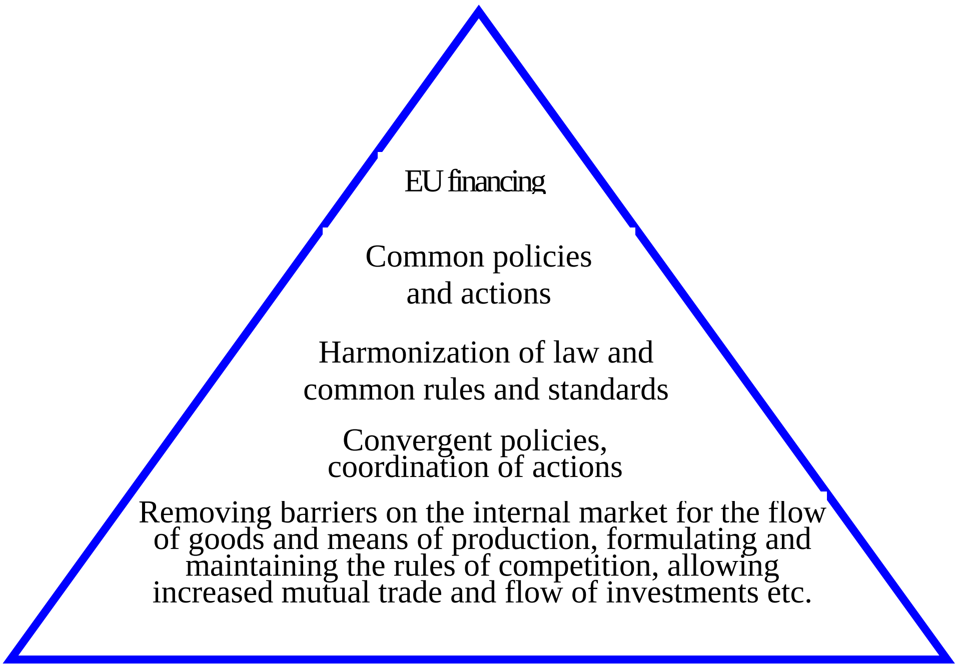
One of the most important methods of reaching EU objectives is to rely on the processes of market integration. While carrying out their economic activity, enterprises take advantage of the potential of the single market and as a result of the scale of that market; all Member States reach clear economic effects. The single market, in order to function effectively, should create the conditions for undisturbed competition in all areas. Only in the situation of an open competition, the economically justified choices are made and benefits accrue which result from the allocation of resources between the most effective uses. It is for this reason that there are provisions contained in the EU Treaty concerning the free flow of goods, services, capital, employers and the establishment of enterprises, etc.

Simplifying the situation, one could say that the biggest advantages for the European economy as a whole result from the ban of disturbing competition by the authorities of the respective Member States. In order for the single market to function effectively, a close cooperation of the governments of the Member States is needed, so that they would conduct a convergent economic policy. The coordination of the policy, both implied and agreed among the Member States and taking place de facto as a result of a similar perception onto the economic processes is therefore a necessary completion of the integration based on the market processes. Coordination is enhanced by community mechanisms and the jointly undertaken activities and programmes. This is served by the Open Method of Coordination based on the review of policies which enables the promotion of positive examples of an effective economic policy; setting out convergent objectives to be reached in the economic processes enhances the development potential of the entire EU economy.

The EU creates as well common and mutually binding economic law. It can determine minimum standards and points of references or describe in a precise and unequivocal fashion the existing rules of the functioning of enterprises on the single market as well as economic authorities of the Member States. In some areas, the EU conducts joint policies, although with a varying degree and extent of the instruments used, which are undoubtedly an advanced instrument for reaching the desired goals in the scale of the EU. It is only against that background that one should perceive the use of budgetary means of the EU as one other means of supporting the impact of all dimensions and processes of European integration.

Undoubtedly the single internal market has the highest significance for the economic development of the EU Member States (and as a result for the entire EU). For the single market to function effectively, the removal of barriers for economic activity is essential. It means limiting regulatory powers of the Member States, so that the national borders would not become barriers for the flow of goods, services, capital and persons. It also amounts to the limiting of the possibility of the respective states influencing their own economies (not only by regulation but also by providing financial assistance to the enterprises) if it makes the functioning of the single market difficult.

The hierarchy of the importance of integration instruments for
the economic development of the EU



The competition on the single internal market allows for the benefits to be achieved in the entire EU economy which result for example from the effects of scale. Unfettered competition is always more easily approved by mature economies. Therefore the creation of the single market has always required (instead of guaranteeing these freedoms in the treaties) being complemented with common rules, standards, coordination of policies or common policies and instruments of financial support. When presenting in November 2007 the document „ *A single market for 21st century Europe*", the President of the European Commission J.M. Barroso argued that the single market brings benefits at the level of about 500 euro annually for each citizen of the EU which is several times more than the volume of the European budget. Even if the benefits of a single market are not evenly distributed it becomes quite clear that for New Member States the advantages of the internal market exceed a number of times the direct transfer of EU funds. Moreover, effective absorption of EU funds depends to a large extent on the implementation of internal market rules by a given new member or associated state and access of this country to internal market of the whole EU.

Removing barriers for the single market is precisely the reason for supplementing liberalization measures by assisting financially weaker countries in order to allow development of market infrastructure. All of these mechanisms and instruments of cooperation are integrally tied with each other and their efficiency becomes apparent only when they are made operational together. EU funds can ease the coordination of policies and actions of the Member States, make the good practices more widely accessible, ease the coordination of actions or the application of generally binding principles. They also serve the financing of a part of activities within the scope of common policies. EU funds serve, although to a differing degree and depending on the type of policy and sector of the economy, to make easier the functioning of the single market and tighten cooperation in all its forms and at all levels.

Taking this into account means that the synergy between various channels and mechanisms of integration can ensure the overall significant outcome. Such synergy is visibly present among members of the European Union where all the mechanisms of market integration, cooperation in various policy fields as well as common funds. It is less clear in the situation of countries which are still outside of European Union. However, also in this case, the financial assistance is closely related to liberalization of trade and also to assurance of stable conditions for establishment of companies creating thereby conditions for more intensive flow of foreign direct investments. This is precisely the content of agreements or treaties with the different degree of commitments to liberalization and to approximation that were negotiated and applied between particular countries of the region. Generally the higher commitments to protect foreign investments, making mutual trade free, and approximate local legislation and standards to those of the EU, the bigger are amounts offered as assistance to restructuring of these countries.

This synergy allows for a better use of domestic growth potential and also increases the flow of FDI not only from the EU member countries but also from worldwide sources. The countries of the region in order to accomplish their transformation, to grow more rapidly and to catch up with the level of development with rest of the EU need more investments. EU funds cannot be used extensively for the productive purposes, since it could distort markets and provoke *crowding-out* effects. Private capital both domestic and foreign should have the major role to play in the development of business. Public funds – EU funds are the public funds sui generis – should be mostly used to deliver public goods. The inflow of FDI is of paramount importance as representing not only additional capital necessary for development but because it brings as well additional benefits like skills of different types (managerial, technical knowhow etc.). Better management, organisation and knowledge of market conditions allow more efficient operation of economic entities not only on the local market, but also on external markets. The inflow of modern technology is not widely possible without FDI as they are often embodied in overall business structures. FDI also offers access to foreign markets in practical terms and they can effectively use opportunities created by any liberalisation measure applied to trade. Market access in a modern economy is based on networks and FDI can deliver links to networks of sales covering a large number of countries. It is also possible to expect from the FDI that it takes more seriously account of environmental or similar commitments (protection of health, protection of consumers etc.). There is already a well established international literature on the transfers and benefits created by FDI. In this context it is important to note that there is a clear distinction between the market based development for which EU funds play only an auxiliary role as provider of better public goods, more suitable infrastructure and generally as “catalisator” of change creating opportunities for development and unleashing economic potential.

Therefore the notion of public goods[2] that has to be visible when implementing EU spending policy is the major motive of decisions concerning the direction and purpose of use

[2] See W.E. Oates, *Fiscal Federalism and European Union: Some reflections*, SIEP, Pavia 2002

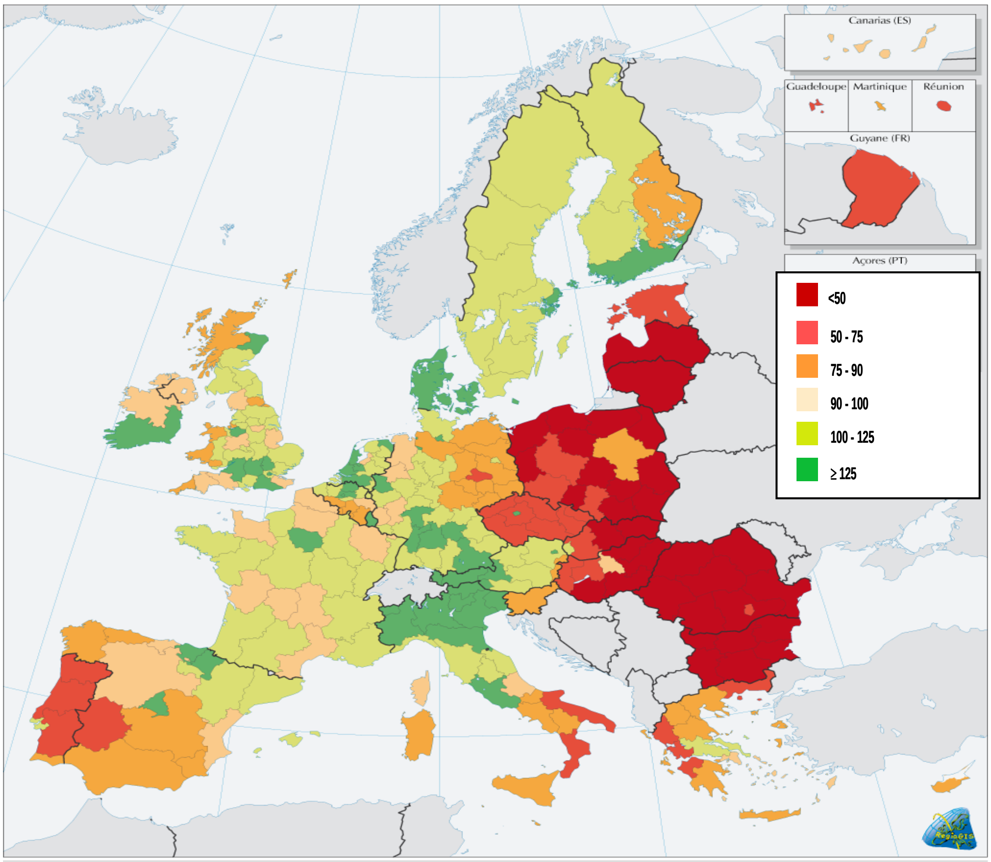
of the EU funds. This also goes further to include only these situations that the EU funds can make a real difference as compared to public funds that can be raised and spent locally. It therefore leads to another important notion of the European value added as the outcome of spending of EU funds. It has a bigger application to countries which are already within the EU and less to countries which are outside, but it can be seen less directly in the philosophy included in association or cooperation agreements.

The recourse to the European value added is most visible in the EU's cohesion policy. Very often the applicants for projects financed, even partly, from the European funds, have to demonstrate to what extent the projects will create value added not only to their country or region but also to the EU at large. In the practice of the assessment of the respective EU instruments, it is difficult to apply the concept of the European added value as an explicit criterion. The concept of the value added of expenditures made on the territory other than one's own state, is increasingly present in the literature on public finances[3]. In the situation of a globalizing economy, it is increasingly importantly for all, also those states who cannot afford it, to undertake activities which are a response to the contemporary threats. The possibility and with the passage of the time also the need to compensate expenses incurred by some states so that they would be able to provide "global public goods". An analytical instrument which could be applied in some cases can be based on the concept of incremental costs. It allows defining the additional funds needed so that the given country can make a choice in favour of a more expensive solution from its point of view but bringing an additional benefit in the global context[4].

When putting forward a draft of the financial perspective in 2004, the European Commission attempted to draw more attention to the efficient accumulation of resources in the EU. It has made reference not only to the concept of the European added value but pointed as well to the premises which could be a source of overcoming barriers in the EU at large. It has pointed in particular to the necessity of complementing the functioning of the single market by linking up the disjointed national systems in areas such as infrastructure and the system of transport services, energy, IT technology, financial services, etc. It has suggested the existence of external effects of national actions which do not represent a sufficient political and financial return and do not enjoy a sufficient national financing although they have a substantial transfrontier dimension. In many cases a synergy effect takes place according to the Commission when objectives are implemented at the Union and at the national level with an organized and systemic complementarity of actions. EU investments are nevertheless needed in the missing interconnections between the national systems, so as to reach the effect of scale by putting together the dispersed expenditures, complementing and facilitating the national expenditures. As a result, when assessing whether the submitted

[3] See P.Jones, *Taking self-interest into account. A public choice analysis of international cooperation*, [w:] *The New Public Finance. Responding to Global Challenges*, ed. I. Kaul, P. Conceicao, Oxford University Press 2006.
[4] See K.King, *Compensating countries for the provision of global public services. The tool of incremental costs*, [w:] *The New Public Finance...*,

components of the 2007-2013 financial perspective, the Commission verified in particular the efficiency of those expenditures and the synergy effect[5].



GDP per head in % of the EU27 average in 2003 (purchasing power parities)

Source: European Commission Website of DG Regio

The differences between different EU regions persist and regional differentiation is one of the most significant reasons for the EU to assist poorer members to catch-up with the level of development. The map (above) illustrates the magnitude of this phenomenon. With the associated countries of Eastern Europe or Balkans the picture would be even more diverse.

The overall outcome of the cohesion policy translates into increased and accelerated development for the countries covered by these policy measures. For Poland, for example, the estimated impact of the cohesion policy on the development of the country is considered as substantial, particularly in a longer-run perspective. Some of the researchers suggest that the possible impact of the EU funds for New Member States can reach ½ percentage point of GDP growth for each 1 percent of GDP of additional funds[6]. The relative size of EU transfers to the New Member States reaches 4-5% of GDP annually, if agriculture expenditures are also taken into account. Generally the poorer a New Member State is the higher the share of EU transfers of the country's GDP. In Poland the assessment of the impact of EU transfers is

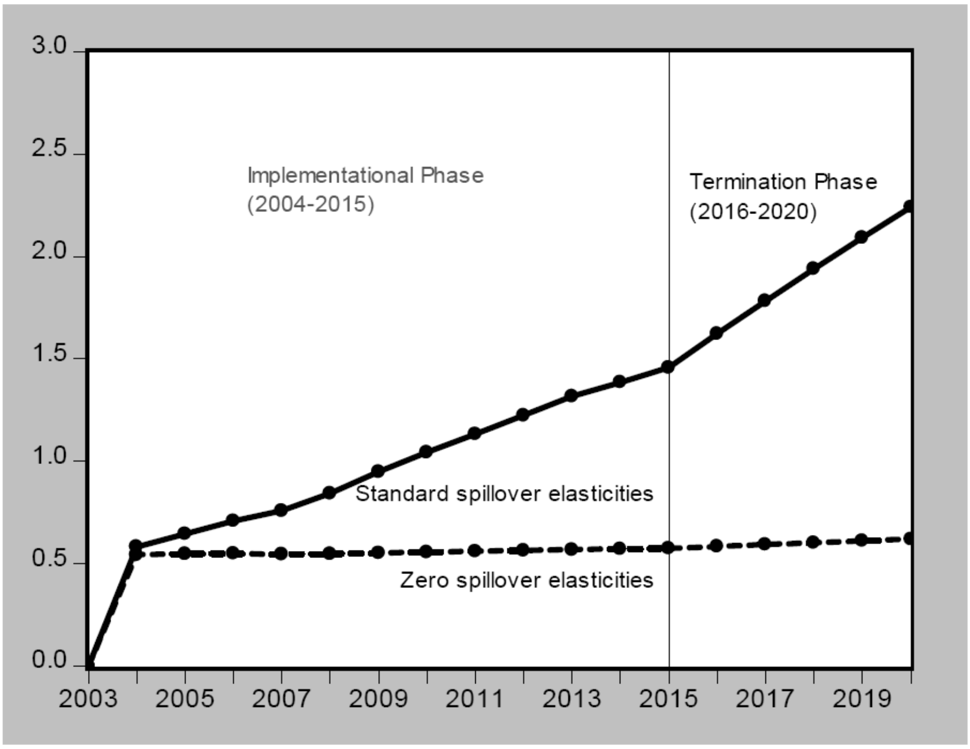
[5] See Communication From the Commission to the Council and the European Parliament, Financial Perspective 2007-2013, Brussels, 14.7.2004, COM(2004) 487 final

[6] See review literature on this issue in the Christoph B.Rosenberg and Robert Sierhej, Interpreting EU Funds Data for Macroeconomic Analysis in the New Member States, IMF Working Paper, April 2007

regularly done by using the HERMIN model which gives results indicating a very substantial impact on long term growth (see graph below). Results of other models are not as impressive, however all of them indicate a substantial contribution towards augmentation of GDP growth.

HERMIN: Cumulative Multiplier of cohesion policy interventions - Poland

Cumulative Impact defined as: Cumulative GDP (Impact)/ Cumulative cohesion policy (GDP)



Source: John Bradley, A contribution to the Round Table on the Future of EU Cohesion policy, Warsaw April 2008.

When evaluating the efficiency of cohesion policy, particularly when measured by the distance in the level of national income *per capita,* it is not always possible to distinguish the immediate and sizeable impact of that policy on diminishing differences in the levels of development. Bridging differences in development cannot be assessed exclusively by the level of GNP generated or such parameters as the growth of total demand in a short period of time or the impact on the supply in the longer run. Ex ante assessment in which the HERMIN model was used has generally shown a significant impact of those funds on the growth of cohesion countries. However, in some other studies, the important contribution of the funds on growth and development has not always been confirmed[7]. However, the targeting of EU funds leads to a situation in which their impact on the process of generating GNP is much

[7] See for example P. Butzen, E. De Prest, H. Geeroms, *Notable trends in the EU budget,* NBB Publications, Economic Review, September 2006

smaller and they enable to a larger extent the less developed regions to create infrastructure, take care of the environment, etc. which cannot be immediately and directly translated into production activity. Socio-economic cohesion concerns more than equipping the given country additional public goods and increasing their accessibility to the citizens. The Commission's Cohesion Report devotes a lot of attention to the qualitative indicators of differentiation inside the European Union. In the case of funds designed to assist in the catching up process and preventing differences in economic development, it is clear which is the direction of the financial flows, from the richer states and regions to the ones which have a lower level of development. Even if part of those transfers returns to the richer states in the form of orders for services or equipment of various type, the stream of funds will always be treated as an expression of European solidarity. The motivation of pure solidarity in the situation of a growing number of countries which are behind in their level of development is also not without limits. Hence, when the European Commission made its proposal in the initial documents for the 2007-2013 financial perspective negotiation to link up cohesion with growth and employment, it aimed to demonstrate that the objectives of the policy can be met in the course of a parallel process.

When understood in a simplified manner, cohesion policy is often reduced exclusively to thinking along the lines of bridging the gap in the levels of development[8]. Hence the frequent assessment of the efficiency of that policy through the prism of the dynamics of changes in the level of national income and the process of convergence of income and possibly levels of employment[9]. Cohesion policy contributes as well to other effects, including benefits for the neighbouring countries or even the entire EU (construction of Trans-European transport corridors, etc.), as well as those which have to do with equipping poorer regions with infrastructure with an impact on the quality of life and only indirectly on economic growth. It acts towards an appropriate regulatory and institutional environment in regions with delays in development. Effective absorption depends to a large extent on the institutional sphere. Cohesion funds, in particular after the last enlargement, are increasingly directed towards projects which enhance the institutional texture and human capital. The effects of investment in those areas are generally apparent in the longer time-frame.

Cohesion policy funds make it possible for less prosperous countries and regions to finance projects which have to do with important EU objectives (apart from economic growth) such as the environmental ones, concerning climate change or increase in the share of energy from renewable sources[10]. The financing of such actions – to some extent required by the EU – could have an adverse impact on the perspectives for growth of those countries and would not be undertaken without external support. Utilization of EU funds cannot be seen in a one-dimensional way as an instrument of redistribution between the more and less prosperous regions in the EU only. Such approach makes it difficult to consider this policy as playing a

[8] See for example: H.L.F. de Groot, *Assessing the effectiveness of the EU cohesion policy*, Netherlands' Bureau for Economic Policy Analysis, Presentation made at a conference in Ljubljana, Challenges of the EU Budgetary Reform, 2007.
[9] See for example S. Ederveen, J. Gorter, R. de Mooij, R. Nahuis, *Funds and Games. The Economics of European Cohesion Policy*, CPB Netherlands' Bureau for Economic Policy Analysis, April 2002
[10] Such is among others a recommendation of a report by Stephen Hale and Stuart h. Singleton-White, Investing in our future: a European budget for climate security, Green Alliance, London , October 2007

function as an instrument of transforming certain areas of economic and social life of the regions so that they are able to better meet the challenges facing the entire EU and its viscinity. Reducing cohesion policy to the question of redistribution is in opposition to the conditions attached to the spending of those resources, determining objectives to be met and precise programming and tight monitoring of the European Commission when it comes to fulfilling the objectives (not only economic rationality and correctness in the accounting for the expenses).

The costs and benefits of implementing *acquis communaitaire* for the economy and the national budgets can not be unequivocally singled out. For example the construction of transit roads with a jointly defined durability to the weight of heavier vehicles is a task which is realized as part of the regular activity of the state as the manager of the transport infrastructure.

Perhaps, without joint EU decisions, roads with these parameters would not be built in some states but only the difference in expenditure to the roads with a higher durability could be considered an expense on behalf of the Union at large. Therefore we do not find in the budgets of the Member States the relevant items concerning the financing of European objectives and policies, except for the contribution and some other elements such as funds for co-financing or pre-financing of projects implemented from EU funds. The change which the European Union introduces has to do with reordering the preferences in public expenditure and making some objectives of the policy priority objectives which they would not have become without having subscribed to the common decisions at the European forum. Adopting costly EU regulation concerning labour standards, consumer's rights, environment etc. may in a longer run prove to be very beneficial not only for the quality of life, but also for cost of medical care, absenteeism at work, etc.; these are also likely to have a positive impact on long term growth.

In this context an assessment of cohesion policy should be made in the context of the EU striving for objectives not only in an economic sense but also in relation to solving other problems which all Member States face. It is natural that the less prosperous Member States will shape their priorities differently than the more prosperous ones. If climate change is currently such an important objective, it is clear that in the less prosperous regions goals which have to do with economic growth are undoubtedly more urgent. All the more so that those states often spend a larger part of their national income on other objectives than the prosperous states at a similar point in their development. This means that adjusting priorities of economic policy to the objectives seen as important by the EU as a whole can take place more easily in the situation in which they are accompanied by external support. The limitation of such a support will inevitably lower the ability of those states to subscribe to ambitious objectives which the EU agrees within the various areas of its policy. Even if at the political level those states for various reasons share the common objectives[11], in practice making them operational or implementing them outright could face enormous difficulties and delays. In the longer term, this can lead to a degree of political frustration as a result of the difference

[11] As for example when it came to the target of energy produced from renewable sources agreed by the Spring 2007 European Council at the level of 20 percent by 2020.

between the potential of a given country and the political ambitions of other Member States of the EU. It is difficult to imagine cohesion of the EU when it comes to economic, ecological, social and other objectives without an effort to increase the cohesion of the economies of the Member States. At the same time the situation is even more aggravated when it comes to countries outside of the EU which are linked with it by an association or other type of agreement. They try to implement EU goals, however to a different degree, and emulate EU policies which can be less adapted at their stage of development. EU funds in such a situation are instrumental to solidify choices which otherwise would be less likely.

The fact should be noted that differences in the level of development concern not only the urgency of the objectives but also change the whole cost structure of their implementation. For example, in countries with a well-developed transport infrastructure consisting of a dense network of roads, railways, areas of industrial activity, the delimitation of protected areas – the so-called Natura 2000 areas – has a different impact on the economic activity than is the case of less developed regions. In countries having less dense road infrastructure, the delimitation of protected areas precedes the period of infrastructural development which means that roads, railways and areas of industrial activity must be adjusted to the existing protected areas and not vice versa. Instead of locating the roads so that they cover the shortest possible distance (as for example that of the Warsaw - Vilnius railroad), or in place of an economically more justified location, they must meander between the ecologically important areas. The implementation of the same objectives in a country which is late in its development must take place with increased costs.

The recommendations of the latest „Cohesion Report"[12] of the European Commission should be noted in this context, especially when it comes to actions which take into account the association overall European goals, community policies and cohesion. The Commission notes the need to incorporate more broadly objectives of the Lisbon Strategy and the need to fight climate change. In its opinion, instruments of cohesion policy are the most appropriate ones to be used for the purpose. Similarly, the need to fulfill objectives concerning a reduction in the level of greenhouse gas emissions and other objectives in this area as well as to implement the *acquis* will lead to the necessity of substantial investments. The European Commission does not suggest it directly but indirectly for the EU funds should constitute an adaptative mechanism. As a result, the Commission refers here to the concept of cohesion policy as a policy which can take advantage of the synergy of financial operations from the EU budget and performing on the other hand a function which improves the adaptive capacity. Ambitious objectives concerning economic development are contained in the various EU proposals while at the same time a number of non-economic obligations are undertaken which could inhibit that process. The eventual adaptive mechanism contained in cohesion policy would make it possible to bring about both of those objectives simultaneously. This notion extends beyond cohesion policy and might be part and parcel of the expectations formulated towards associated countries or even all who benefit from the EU funds.

[12] *Growing regions – Growing Europe*. The Fourth Report on Economic and Social Cohesion, Communication of the European Commission, May 2007.

The EU extends the aim of enhancing economic and social cohesion not only for the countries within but outside EU. This means preserving within the EU funds the priority of supporting measures addressed towards the less prosperous regions. It should be related to the expectations that EU funds are applied to a larger extent to finance actions which have to do with the new challenges such as globalisation, climate change, growing energy process and demographic problems. Those challenges are currently in the centre of EU attention realizing that most of New Member States and particularly less developed associated or cooperating countries do not have the same ability to effectively react given the asymmetric impact of those challenges. The taking up of additional measures towards the aforementioned challenges could in a different fashion impact on the economic and social situation of the regions. The less prosperous regions of the EU can benefit from the available instruments of cohesion policy which have not necessarily been directed towards tackling those challenges. Climate change, if it is not a criterion for the financing as part of the EU policy, can lead to placing a lasting burden in the form of the backward installations being financed from the EU funds while it should endeavour to eliminate climatic effects and the technological gap simultaneously. Similarly in the area of energy, EU funds can and should be directed towards desired changes in other areas of EU policy.

When it comes to funds, where the accepted EU rules require obligatory co-financing, the close connection can be seen between expenditures from the national budgets and those from the EU budget. The intention of the principle of obligatory co-financing is to limit the risk of EU funds being wasted for projects which do not bring substantial effects, to generate better results from the limited EU funds by means of engaging national resources of the Member States, to increase the sense of responsibility of national authorities for expenses covered by the EU public money. These are important arguments but they reflect precisely the close connection between public funds at the EU level and those of the local budgets. They confirm that the EU budget ties in national expenditures with the community priorities and objectives[13]. The use of EU funds tends to require reorientation of national expenditures and a *de facto* reorientation of priorities of the national system of public finances[14]. All the more so that national funds in those countries are particularly limited and the needs of public investments greater than in the prosperous states. Therefore making resources from the EU budget available facilitates the reaching of objectives decided at the EU level. Given that spending those funds requires national resources, there are important shifts in national policy priorities. In Poland, for example, resources had to be generated within the state budget following accession to the EU for the pre-financing and co-financing of EU funds. This phenomenon concerns not only the central but also regional and local budgets. It has led to a transitory increase in the budget deficit of the country starting in 2004. In practice, this means very often a change in the proportion of expenditure for different objectives, for example an increase in the expenses for transport infrastructure, environmental installations or new and more environmentally friendly technologies of production with a simultaneous reduction of

[13] *Multiplication effects of EU direct and indirect instruments to complement national funding*, Study report, ALMENARA Project No IP/D/FINP/ST/2005-06

[14] See Chapter 3 of the Fourth Report on Economic and Social Cohesion, European Commission, May 2007.

spending (or the growth of spending) on restructuring of some industries, health care or education. In reality, not only a reorientation takes place between the different objectives of the various areas of public spending but also shifts within relatively uniform groups of expenses. For example, at the local level, the building of a ring road or a bridge could absorb to such an extent the local public funds that expenses would be limited when it comes to maintaining other roads and their renovation. The building of a sewage system or a purification plant, obviously very necessary, may absorb the local budget to such an extent that financing equally important public works is withheld.

Recognising entirely the importance of the additionally principle and cofinancing in the case of EU funds, one ought to note that this is also a mechanism which supports the effective implementation of objectives of integration. Lack of such a mechanism would not only make it more difficult to finance some projects but it would also mean that the national, regional and local priorities would be different from the objectives of European policy. It is therefore also a mechanism for facilitating, especially when it comes to less prosperous states and regions, undertaking efforts in restructuring of industries, transformation of economy, liberalization of trade and investments as well as making an effort to integrate more closely with the EU.

III. Rules and experience of absorption of EU funds as an aid to transform new member states, associated countries with the EU as well as countries of the region using EU funds as instrument for enhancing cooperation

The concept of absorption capacity has to be seen in number of contexts eg. economic (macro and micro), financial, and institutional. Economic absorption capacity can be expressed in terms of proportion of inflow of EU funds to GDP and understood as the ability of an economy to absorb transfers of a given size without negative effects over the aggregate demand, aggregate supply, volume of economic activity, rate of exchange external balance etc. It is therefore more concerned with the ability to absorb macroeconomic effects of the transfers of EU funds then transfers as such. In order to avoid macroeconomic turbulences due to absorption capacity of a given Member State within the EU, an upper limit of transfers was introduced. This limit is defined as percentage of GDP which should be treated as maximum even if due to the agreed principles and objective circumstances more funds could be allocated to a given country.

There is also a microeconomic absorption capacity that should not be overstretched. The inflow of public funds could result in suboptimal reactions of enterprises in the process of utilisation of EU funds and therefore have a negative impact on their functioning of the market.

Financial absorption capacity is generally defined as the ability to pre-finance, and co-finance of EU supported project on the local and national level. Financial absorption requires the ability to generate indispensable matching funds for the execution of the project, which is a formal requirement of the EU legislation. Financial capacity to absorb foreign funds in a microeconomic level also involves the ability to support maintenance and running of the executed project.

Administrative capacity is understood as the sufficient ability of central or regional and local authorities to develop required plans, programmes and projects, to ensure swift execution either directly or through coordination of different agents who are involved in the process, as well as to perform all the management and controlling tasks during and after spending EU funds.

It is interesting to note that the resemblance of the legal system, economic mechanism, institutional cooperation, especially when being part of overall integration process make a significant difference to modalities of the controls of spending patterns and practise. The closer ties, the more likely future membership the bigger approximation of the legal system brings more likelihood of less strict control over spending of the EU funds. And the differences can stretch from:

- Full and ex ante control and direct management
- Full control shared management
- Partially delegated control and shared management
- Partially delegated control and decentralised management
- Ex post control and decentralised management

This to a large extent depends on the level of approximation of the legal system to that of the EU and the confidence that the practise is quite similar within the beneficiary and donor countries. Again here the situation may differ starting from:

- Full application of acquis
- Adaptation of legal system towards compliance with the acquis
- Sectoral or selective adjustment of regulation to the EU law
- Similarities between major rules in some areas in economic regulatory framework
- No major additionally initiated resemblance of the legal framework

EU applies a number of guiding principles that are vital for preparing and managing utilisation of EU funds. The most elaborated and distinctly applied (more or less obligatory) are the principles applied to cohesion policy. However there is clear impact of these principles on the use any other funds offered as transfers to New Member States as well as associated or other countries of the regions. These principles include the issue of:

- Concentration - meaning that the activities should address the most important issues and therefore be focused on the least developed or most problematic regions, where obviously there is the greatest need for external funds. This is based on assumption that irrespective of the overall amounts EU funds would never be able to cover all the needs or all the regions even if it would be fully justified,

- Additionality – which seems to be the most important principle but also most difficult to maintain in the practice of using EU funds. It says that the EU funds should not merely replace the national public or private money, but to the contrary they should only supplement existing public expenditure. The increased EU aid should not diminish spending from other sources, therefore after allocation of EU funds overall expenditure for targeted purpose should not become smaller than the sum of up to the moment local public expenditure and EU ones. It should obviously take macroeconomic considerations into account as well as objective development of the area of intervention. However it EU funding should always be treated as added to national funding so the country with EU assistance could be able to overcome the limits of its own financial capacity. Consistently EU funds cannot lead to saving of national expenditure for a given purpose. The national budget is not supposed to save on own allocations since they are responsible for the development of areas in difficulty or problems of a long term nature. The national budget should also be able to continue to address these issues once EU funds are no longer available.
- Programming – which is a requirement to place any specific decision in a wider context of the changes and development of the sector, region or country. Decisions on the use of the funds should be planned well before and programmed in relations to the expected results in a direct and indirect sense. In the case of cohesion policy this includes a requirement of having a multiannual, medium-term development plan. The long-term strategic objectives should be established and programming should allow for making progress in achieving them. The multiannuality provides for the greater predictability in the use of EU funds, for security in initiating new and consecutive actions, and for coherence of actions over time. The programming process generally should have a number of stages and should engage different levels of the government. The programming ensures cooperation between these levels of government as well as allowing other partners, like the private sector, non-governmental organisations or civil society in a wider sense, to become involved in this process. The EU budgetary process makes the programming easier by operating a multiannual financial framework which currently stretches to seven years. Programming has also an impact on the ways how EU funds are involved in creating a capacity to manage in a similarly consistent manner financial resources originating in a given country or region.
- Partnership – requires effective cooperation between EU institutions and the recipient of the EU funds. It starts with the choices being made for the strategic aims of the use of the funds and continues through the design of programs,

activities, instruments of delivery and their implementation up to control and ex-post evaluation. Close involvement of private sector and social partners, as well as local and regional authorities ensures better targeting the needs and more strict control over actual use of EU funds. It results in initiating a project which is more needed with a wider dissemination of the benefits.

- Efficiency – which is one of the major aspects of any assessment of the projects financed by the EU funds. Efficiency is understood not only as effective use of the funds in bringing desired results but also as a way of verification of the achievement of the assumed outcomes. Taking care of the efficient implementation is always an obligation of the recipient entity, but it is always monitored by the designated authorities of the recipient countries as well as by European institutions (mainly European Commission and Court of Auditors). There are a number of ways to increase efficiency; first and foremost by close monitoring and by encouraging the replication of other projects already successfully implemented. Frequently, as a way to encourage and increase effectiveness, the material incentives for the recipients are created in a form of a special performance reserve.
- Subsidiarity – which, when applied to the use of EU funds, means the role of the EU institution is limited to aspects that require supranational intervention. Therefore the European Commission concentrates its assessment on the benefits related to the European priorities and rules, whereas the administrative capacity is in the hands of local, regional or national administrations.

Appling all these rules in practice and particularly ensuring their consistent implementation requires the development of a quite heavy institutional machinery. Institutions responsible for utilisation of EU funds have to operate on all levels of administration: European, national, regional, sub-regional, and local. All these institutions should be guided not only by similar set of rules but also their activities should be regulated by similar legal provisions, in particular related to programming, procuring, bookkeeping, monitoring, evaluation, audit and control. Therefore, if the local legislation is different form the EU one, the degree of details supervised directly by the EU institutions becomes much more significant. If an approximation of legal framework of the beneficiary country is close to that of the EU, the decentralisation of programming, spending and even controlling of the EU funds is possible.

Application of the above mentioned principles serves a multi-fold purpose but is crucial to the effective absorption of EU funds and using them to the full extent in order to satisfy the local, regional or national development needs. There are a number of consequences of the consistent application of the above mentioned principle bearing on the areas and focus of the funds provided by the European Union. One also has to see the certain logic of gradual involvement of the EU funds which allows the next stage to achieve better results thanks to the development of the absorptive capacity. Generally the beginning the most important engagement of EU funds is in assistance to policy formulation and in building-up the administrative capacity. Most often this is the major bottleneck for the efficient utilisation of

EU funds. The development and improvement of infrastructure is seen only as the next step in the process. This more clearly enhances economic activity as well as economic and social cohesion. The next step therefore is generally composed of all initiatives aimed at improving competitiveness of the local economy. This includes action (however always to a limited extent) directly linked to the development of economic potential. What comes as a parallel thread in this process is the improvement to environmental standards as generally pollution is a transnational issue and has obvious externalities. The principles like polluters pays and other ways of internalising external effects are frequently parallel to other EU instruments. Some of the funds are directed to specific sectors or areas which are the cause of problems. These might be areas of industrial decline, or rural areas. Finally the EU devotes a lot of attention and money to strengthening of human resources which is vital for successful development in a longer perspective.

IV. Final remarks on the applicability of experience concerning EU assistance offered to New member States from Central Europe or associated countries from Eastern Europe to the Monterrey process.

The cohesion policy of the EU has proved to have had a significant impact on the countries concerned. The degree to which this policy has contributed to convergence can still be disputed; however this policy cannot be reduced to a pure transfer of EU funds. This policy requires a transformation of recipient countries, particularly their public institutions, public finances, and legislative regime not limited to the EU funds in direct manner. EU funds have to be seen only as a tip of a pyramid of policies and measures which generate benefits for the countries in questions (access to internal and liberalisation of markets, common standards and legislation etc.). EU funds are instrumental in achieving approximation of regulatory frameworks, adjusting to EU requirements and EU policies, and achieving convergence. This is probably the most significant difference between EU funds transferred to the New Members or associated countries and Official Development Assistance.

There are number of additional important differences to the rules applied to Official Development Assistance and the aid offered to the New Members of the EU, prospective members or associated countries. But surely the most important distinction is the discrepancy in the political context and motivation of the aid offered to these two groups of countries.

Even accounting for differences between various categories of countries having formal ties with the EU (New Member States, negotiating, associated, countries covered by neighbourhood and/or cooperation agreement etc) the gap between these groups of countries and all other developing countries is substantial. However, it has to be noted that sometimes in relative terms ODA might represent a quite high share of the beneficiaries' GDP; this is mostly in the case for very poor, highly indebted developing countries. Sizeable amounts of funds transferred between more wealthy EU members and poorer member or associated countries require a quite large administrative machinery able to programme these funds, prepare specific projects, ensure efficient contracting, putting projects into motion, monitoring their implementation, make ex-post evaluation and financial audit and control. In some cases this institutional back-up becomes very complex and involves large numbers of officials of European institutions, national governments, regional authorities and local administration. It can be observed, as a general rule, that the more widely EU acquis is transposed into national legal systems the more the decentralisation of management of EU funds is possible. This contrast with the rules applicable to ODA offered to developing countries. It is not expected that all the rules concerning these funds could be adopted so as to replicate the EU legal framework, especially those outside of the strict financial requirements. Therefore retention to a much larger extent of the management and control of EU ODA can not be surprising. Decentralisation and taking over responsibilities require introduction within beneficiary countries of a coherent and complex system (legal, institutional, budgetary) which can only be justified when the overall size of the transfers makes it sensible. The NMS and associated countries have to approximate their own legislation anyhow, so it is done independently of the size of EU funds received, which are greater relative to ODA.

What constitutes a real difference is not the relative size but the more demanding conditions and formal requirements related to transfers to the NMS and to the other EU associated countries compared with the flows of ODA. Within the first group the amounts transferred depend on the political and formal proximity to the EU. This however, has to be seen in the context of adaptation of EU rules regarding primarily public procurement, audit and control of expenditure, but also to a significant degree the adaptation of national legal and regulatory frameworks to the acquis communautaire of the EU. This is particularly the case of the NMS and candidate countries but to an increasing extent it is visible in the newer cooperation agreements. In this sense EU transfers are conditional depending on the willingness and capacity of these countries to emulate EU regulations. Conditionality in this sense allows integrating the positive impact of the funds, market access, commonality of standards and rules as well as all other benefits of the wide EU internal market. Therefore, the catching-up process is not only based on the transfers of money from richer EU members to poorer ones, but also on all the other mechanisms of European integration.

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Annex

Table 1 Financial Framework 2007–2013

Commitments appropriations	2007	2008	2009	2010	2011	2012	2013	Total 2007–2013
1. Sustainable Growth	51,267	52,415	53,616	54,294	55,368	56,876	58,303	382,139
1a. Competetiveness for Growth and Employment	8,404	9,097	9,754	10,434	11,295	12,153	12,961	74,098
1b. Cohesion for Growth and Employment	42,863	43,318	43,862	43,860	44,073	44,723	45,342	308,041
2. Preservation and Management of Natural Resources	54,985	54,322	53,666	53,035	52,400	51,775	51,161	371,344
Of which: market related expenditures and direct payments	43,120	42,697	42,279	41,864	41,453	41,047	40,645	293,105
3. Citizenship, freedom, security and justice	1,199	1,258	1,380	1,503	1,645	1,797	1,988	10,770
3a. Freedom, security and justice	600	690	790	910	1,050	1,200	1,390	6,630
3b. Citizenship	599	568	590	593	595	597	598	4,140
4. EU as a global player	6,199	6,469	6,739	7,009	7,339	7,679	8,029	49,463
5. Administration	6,633	6,818	6,973	7,111	7,255	7,400	7,610	49,800
6. Compensations	419	191	190					800
Total commitment appropriations	120,702	121,473	122,564	122,952	124,007	125,527	127,091	864,316
as percentage of GNI	1,10%	1,08%	1,07%	1,04%	1,03%	1,02%	1,01%	1,05%
Total payment appropriations	116,650	119,620	111,990	118,280	115,860	119,410	118,970	820,780
as percentage of GNI	1,06%	1,06%	0,97%	1,00%	0,96%	0,97%	0,94%	1,00%
Margin available	0,18%	0,18%	0,27%	0,24%	0,28%	0,27%	0,30%	0,24%
Own resources ceiling as percentage of GNI	1,24%	1,24%	1,24%	1,24%	1,24%	1,24%	1,24%	1,24%

Source: Official Journal of European Union, C 139/10 14.06.2006, Annex 1.

Table 2 : EU members Official Development Aid

	2003		2006	
	ODA € ml	GNI %	ODA € ml	GNI %
Austria	447	0,2	814	0,33
Belgium	1640	0,6	1568	0,5
Cyprus	2	0,02	3	0,02
Czech Republik	80	0,11	125	0,133
Denmark	1547	0,84	1716	0,82
Estonia	1	0,013	2	0,02
Finland	494	0,35	672	0,42
France	6420	0,41	8284	0,47
Germany	6005	0,28	7565	0,33
Greece	320	0,21	616	0,33
Hungary	19	0,03	27	0,03
Ireland	446	0,39	856	0,61
Italy	2153	0,17	4795	0,33
Latvia	1	0,008	5	0,037
Lithuania	2	0,01	14	0,07
Luxembourg	172	0,81	223	0,9
Malta	3	0,07	9	0,18
The Netherlands	3524	0,8	3947	0,8
Poland	24	0,01	227	0,1
Portugal	283	0,22	479	0,33
Slovak Republic	13	0,05	33	0,092
Slovenia	20	0,1	29	0,1
Spain	1736	0,23	3288	0,37
Sweden	2124	0,79	2819	1
UK	5560	0,34	8146	0,42
EU 15 TOTAL	**32871**	**0,35**	**45788**	**0,43**
EU 10 Total	165	0,04	474	0,09
EU 25 TOTAL	**33036**	**0,34**	**46262**	**0,42**

Source: Commission website

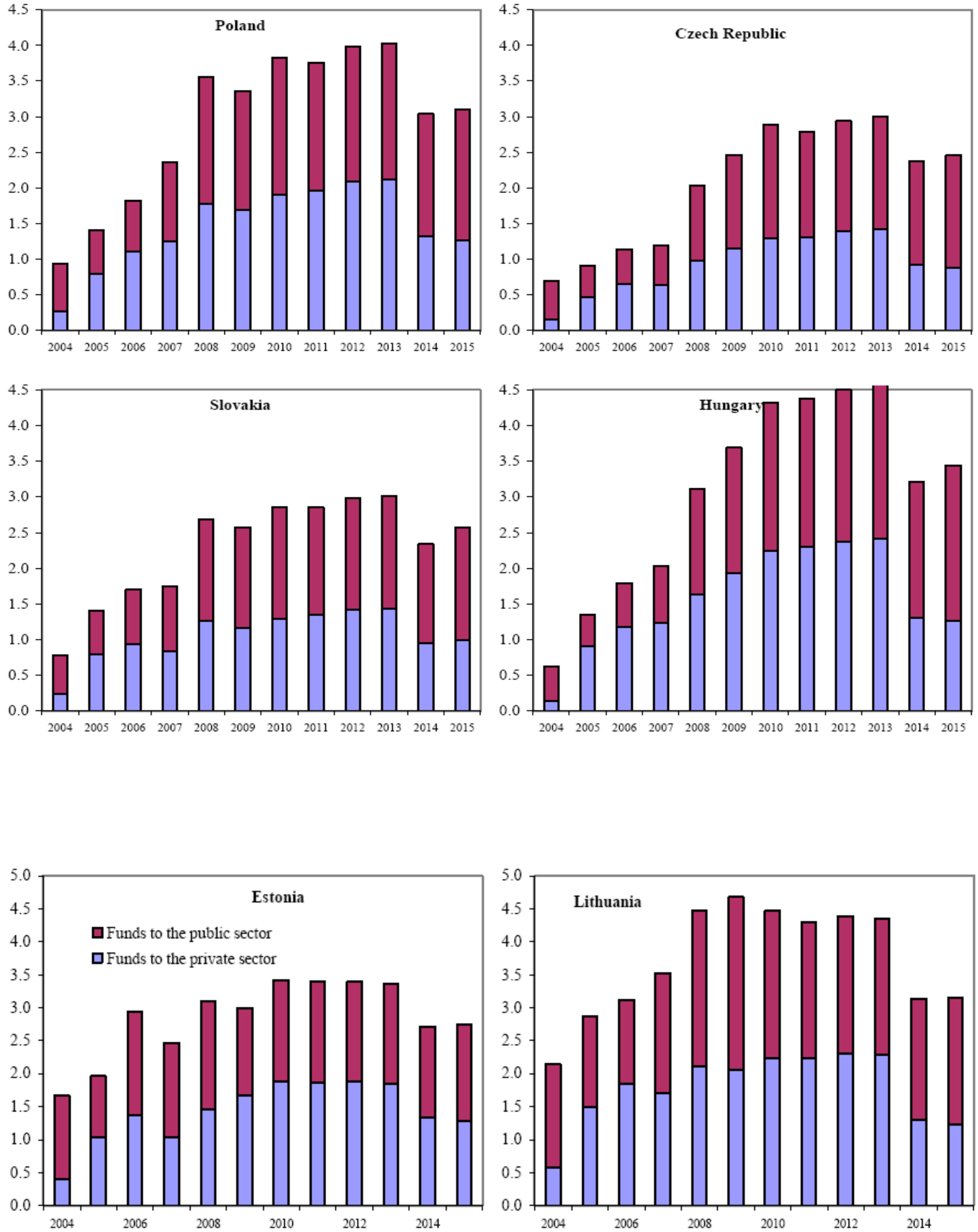
Table 3: Humanitarian aid financing decisions (2007 budget) by geographical area

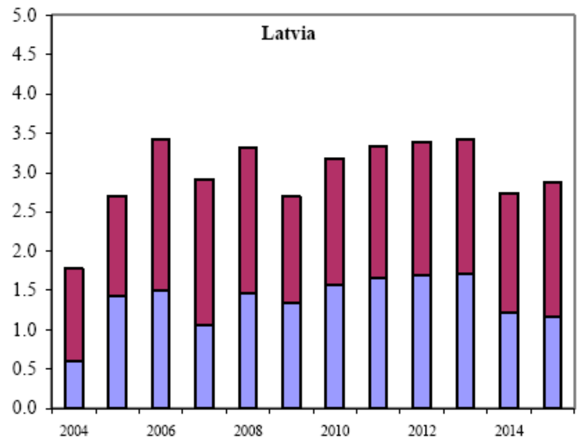
(EUR)

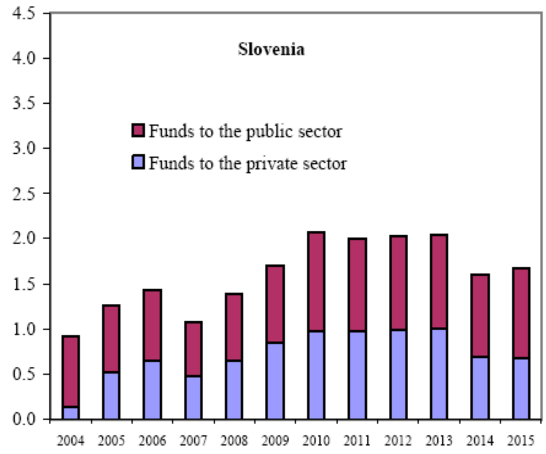
Operation regions	Amount decided for 2007
Africa, Caribbean and Pacific (total)	**422 760 000**
Africa	2 000 000
Horn of Africa	217 950 000
Great Lakes	89 500 000
West Africa	46 600 000
Caribbean, Pacific	16 310 000
Southern Africa, Indian Ocean	50 400 000
New Independent States, Middle East and Mediterranean (total)	**124 897 000**
NIS (Chechnya, Caucasus, Tajikistan, etc.)	25 807 000
Middle East, Mediterranean	99 090 000
Asia and Latin America (total)	**157 366 000**
Asia	117 301 000
Latin America	40 065 000
Thematic funding and grants	**28 900 000**
Technical assistance (experts and offices)	**25 400 000**
Other expenses (audits, evaluations, information, etc.)	**9 207 000**
Total	**768 530 000**

Source: Commission DG Budget website

Graph 1: Central Europe: Scale and composition of EU transfers in years 2004-2015
In % of GDP







Source: Republic of Poland. Selected Issues, IMF Country Report No. 08/131, April 2008