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SYMPOSIUM

STRUCTURAL AND COHESION FUNDS: Background and Some Issues

JOE DURKAN
Department of Political Economy, University College, Dublin

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1. INTRODUCTION

The *European Regional Development Fund* (ERDF), the *European Social Fund* (ESF), and the guidance element of the European Guidance and Guarantee Fund (EAGGF) associated with the Common Agricultural Policy (CAP) constitute the Structural Funds of the European Community.

Each of these Funds was begun separately and was designed to meet particular needs. For example, the Regional Fund was originally designed to mitigate the effect on regions of the Community of existing inequalities by region, adverse effects resulting from the operation of the Rome Treaty, and a natural tendency to centralisation and the effects this has on the periphery, while the Guidance section of the European Guidance and Guarantee Fund was focused on structural improvement in farming.

The Act establishing the *Single Market* (the Single European Act) required that these funds be reorganised to become more effective. The 1988 Community budget settlement agreed that the ERDF and the ESF should increase, with the level of spending in 1993 double that of 1987, and with a concentration of spending in poorer regions. This was taken further in 1989 when Heads of State and Government, taking not only the ERDF and ESF but the EAGGF (Guidance Section) and the European Investment Bank (EIB), established the Community Support Framework (CSF) - namely the set of reorganised Structural Funds, designed, as the name implies, to support development in areas whose own resources were inadequate to reduce inequalities between regions within the EC.

The issue of inequalities between regions and countries within the EC has been the subject of much theoretical debate - Krugman's annexe in the Padoa-Schioppa report remains the clearest statement of the issues. There has been much less discussion of the numbers and what lies behind them. The most recent data for income per head is given below by country.

GDP per Capita 1989

	ECU (1)		PPS (1)		Differences %
Belgium	13,982	(103/75)	17,444	(101/91)	+24.8
Denmark	18,528	(137/100)	18,478	(107/96)	-0.3
Germany	17,421	(129/94)	19,244	(117/100)	+10.5
Greece	49,241	(36/27)	9,353	(54/49)	+89.9
Spain	8,924	(66/48)	13,324	(77/69)	+49.3
France	15,497	(114/84)	18,703	(109/97)	+20.7
Ireland	8,760	(65/47)	11,534	(67/60)	+31.7
Italy	13,669	(101/74)	17,841	(104/93)	+30.5
Luxembourg	16,907	(125/91)	22,311	(129/116)	+32.0
Holland	13,684	(101/74)	17,605	(102/91)	+28.7
Portugal	4,199	(31/23)	9,452	(55/49)	+125.1
UK	13,283	(98/72)	18,402	(107/96)	+38.5
EC	13,551	(100/73)	17,229	(100/90)	+27.1

(1) Figures in brackets are per centage of average/per centage of highest - excluding Portugal.

It can be seen that the crude income per head adjusted for PPP leaves Ireland's relative income per head almost unchanged at two thirds the EC average, though there are significant differences for some countries, notably Portugal. However, adjusting crude income figures for relative purchasing power addresses only one dimension of inequalities between states in the EC. There are also major differences in the composition of the denominator, i.e., population, between member states as a result of differences in participation rates in the labour force, family size, and unemployment rates. These differences reflect choices, whether conscious or unconscious, that the society makes either through its institutions or custom and practice. To the extent that inequalities reflect these differences it is not obvious that others should expect to transfer resources to lower income countries.

The next logical exercise is to decompose the differences in income per head into the constituent elements and answer the simple questions:

	Crude Participation Rate % (1989)	Household Size No. (1990)	Unemployment Rate % (1990)
Belgium	39.6	2.63	8.0
Denmark	56.1	1.71	8.1
Germany	47.9	2.30	4.4
Greece	40.7	2.92	-
Spain	38.0	3.40	15.9
France	44.7	2.61	9.2
Ireland	37.9	3.31	14.7
Italy	41.4	2.77	10.0
Luxembourg	42.4	2.65	1.8
Holland	45.6	2.48	7.3
Portugal	46.9	2.99	4.0
UK	50.9	2.50	7.8
EC	44.9	2.62	8.4

How much is due to differences in

- Output per head?
- purchasing power?
- participation rates?
- family size?
- unemployment rates?

The CSF is primarily directed at the first of these factors, by enhancing human and physical capital.

2. PRIORITY OBJECTIVES OF THE CSF

The Community Support Framework establishing five priority objectives, and indicated those elements of the Structural Funds designed to meet the objectives. They are as follows:

Objective 1 Promoting the Development and adjustment of those regions which are lagging behind.
Funds: ERDF, ESF, EAGGF (Guidance).

Objective 2	Conversion of regions, frontier regions or parts of regions affected by serious industrial decline. Funds: ERDF, ESF.
Objective 3	Combating Long-Term Unemployment. Funds: ESF.
Objective 4	Occupational Integration of Young people. Fund: ESF.
Objective 5	Promoting Rural Development and Structural Adjustment in Agriculture given the need to reform the CAP. Funds: EAGGF - Guidance, ESF, ERDF.

For purposes of the CSF Ireland is considered a region (an Objective 1 region) though clearly there are internal sub-regions in the country also.

The purpose of the CSF is to narrow the income gap between regions of the Community. However the CSF and its associated Structural Funds were not designed as pure income supports - the objective was, and remains, to transfer financial resources which would be used to increase the long-run productive capacity of the regional economy, and thus narrowing income differentials between regions.

The total amount allocated to the CSF for the 1989-1993 period was 59,165 million Ecu. Published data on the CSF in relation to allocations and payments to individual countries by programmes are inadequate for purposes of analysis. There is much administrative data, but it needs organisation in a manner that would permit analysis.

3. THE IRISH POSITION

The National Development Plan 1989-1993 published in 1989 set out the Irish Government's submission for Structural Fund financing. Associated with the National Development Plan were a series of Operational Programmes, 12 in all, built around the areas of:

(i) Agriculture, Fisheries, Forestry, Tourism, Rural Development;
(ii) Industry and Services;
(iii) Peripherality;
(iv) Human Resources.

Each Operational Programme was a detailed document setting out the role of the Programme within the National Development Plan, the issues facing the area, the objectives of the programme, the strategy of the programme, the criteria to be adopted by the detailed measures implemented, and a detailed listing of measures/expenditures/sub-programmes, and individual projects. For example, the "Operational Programme on Peripherality - the Roads and Other Transport Infrastructure 1989 to 1993" runs to 175 pages. The objectives of this programme are clearcut: to reduce the costs of internal and access transport, by

- the provision of a network of national primary roads linking urban areas, ports and airports;
- the improvement of air and port infrastructure;
- the provision of cost effective road and rail services;
- the implementation of a flexible regulatory environment.

This programme enhances other programmes - for instance, it will support tourism by improving access to Ireland in the first instance, and then, by improving the internal transport network, link together the main tourist areas. It will have similar effects on other programmes, though obviously less so in the case of the Human Resources programme. The peripherality programme is primarily directed at reducing costs.

The Human Resources Programme was designed to improve the human capital of the labour force. However, Human Resource expenditure is not confined just to this programme as the Industry Programme has a significant Human Resource content.

The Industry and Services Programme itself is directed at that part of the economy that is involved in international trade. The objective is to strengthen existing firms by enhancing their management and the provision of skills believed to be lacking.

Both the Human Resource and Industry Services Programmes can be seen as capacity expanding. The objective is to improve the quality and quantity of both labour and capital in the economy.

The remaining area is that of Natural Resource development in its broadest sense, where the objective is to develop Ireland's perceived comparative advantage in natural resources, plentiful water supply, low population density and clear environment - subject to the constraint imposed by the reform of the CAP.

One published study has been carried out analysing the impact of Structural Fund Expenditure, and was undertaken by the Economic and Social Research Institute on behalf of the European Commission (DGXVI). It involved the use of the ESRI's model to evaluate the impact on macro aggregates of the Structural Fund expenditure associated with the CSF, and attempted to assess the impact prior, to the completion of the programme and, of course, prior to the period when supply side effects could legitimately be expected.

For purposes of incorporating the Structural Fund expenditure within the framework of their model of the economy the ESRI reclassified expenditure as follows:

	% Total Expenditure
Human Resources	42
Physical Infrastructure	26
Farm Income Support	10
Agricultural Investment	8
Other - Grants to Industry and Aids to Marketing and R&D	4
Total	100

In nominal terms, the ESRI envisage expenditure over the five years of the current CSF of just over I£5bn of which IR£2.8bn represents the transfer from the Community. There is a requirement that there must be matching domestic resources for most projects. The level of EC funding by project/programme varies between 35 per cent and 75 per cent. In their assessment the ESRI estimate, in the first instance, the demand effects which occur immediately and then the supply side effects. However, as indicated above, the supply side effects are not clearcut. In much of the analysis, the ESRI assumed rates of return on CSF funded investment, and this in turn produced the macro estimates of the impact of the programme as a whole. In order to deal with the time element of the supply side measures, the ESRI estimated the impact by the year 2000, assuming that the CSF funding would continue until then. In estimating the impact the ESRI took, as a measure of the impact, what the outcome for the economy was with the CSF, less what the outcome for the economy would have been without the CSF, but with the same level of Government expenditure. One could think of alternative counterfactuals.

The ESRI carried out a detailed analysis using the separate headings identified earlier, but this is too detailed to report in full. In aggregate terms, the effect on the macro economy is given in the table below.

The Human Resources programme is the driving force in these estimates. It is the largest single programme and is directed at improvements in human capital and also at increasing the effective labour participation of those disadvantaged within the society (long-term unemployed, young people etc.). If the assumed rates of return are correct then the impact on GNP and employment is likely to be realised, but it must be stressed that these were assumed rates of return. It is still too early to assess the supply side impact of the CSF. It is my belief that this assessment will require, not a model of the economy, but detailed ex-

	Impact Effect 1989	Cumulative Effect 2000
GNP/GDP	1.0%	2.6%
External Balance % GNP	-	0.8%
Budget Balance % GNP	-	0.4%
Debt/GNP ratio (% points)	-	-5.0%
Employment	+8,000	+31,000
Unemployment rate (% points)	-	-1.0%
Inflation	-	-

post analysis of projects. This rarely seems to be done.

4. THE MAASTRICHT TREATY AND THE EDINBURGH SUMMIT

The Maastricht Treaty obliges the EC, as did the Treaty of Rome, to reduce differences in the levels of development between the various regions. While member states are supposed to consider this in their economic policies, the EC directly is involved and the Maastricht Treaty envisaged a continuation of its direct role via the continued use of Structural Funds, but it also established a separate fund - the Cohesion Fund - to upgrade environmental and transport standards in the four poorest countries in Ireland, Spain, Greece and Portugal.

The Edinburgh Summit (concluded 13 December 1992) established the amounts of the Structural Funds and the Cohesion Funds for the seven year period 1994-2000. In constant 1992 prices the total amount of financial resources to be transferred to the poorer countries is IR£72 billion - made up of IR£59bn in Structural Funds and IR£13bn in Cohesion Funds. The amounts are set to increase in real terms over the period, driven primarily by increases in ERDF funding.

The amounts received by Ireland over the seven years are a matter of negotiation. Currently the position is that Ireland will receive between 7 and 10 per cent of the Cohesion Fund, or between IR£0.9bn and IR£1.3bn, and if the existing share of Structural Funds, taken at 13.5 per cent is maintained, about IR£7.2bn in Structural Funds. However there is some dispute about this share and conceivably it could be over 10 per cent over the seven year period, thus reducing this element of support to IR£6bn. Thus, at its lowest, ,the financial transfer to Ireland could be IR£6.8bn or IR£975mn per annum on average, equivalent to 3.5 per cent of 1993 forecast GNP, while at its maximum it could be IR£ 9.3bn or IR£1.3bn per annum on average, which is equivalent to 4.6 per cent of 1993 forecast GNP. In both cases, the amounts represent a significant increase in the absolute amount of transfers and in their relative importance in GNP. The annual average amount received to date has been IR£600mn, so that the new programme represents close to a doubling of transfers in the "best" case. The time profile of the transfers involves an increase in real terms over the period of the programme. The funds devoted to Objective 1 have been set to increase by over 50 per cent between 1993 and 1999.

While the broad outline for the seven year period was set at Edinburgh, the details of the shares of the four poorest countries have yet to be agreed by the European Commission. The results are not predetermined, and it is conceivable that the share to Ireland could be at the lower end of the range. This has already been indicated by the European Commission officials. However, this is as much a matter of negotiation as the application of objective criteria.

A new National Development Plan is due to be submitted to the European Commission by the Spring - widely interpreted as March/April. This will be prepared by the Department of Finance. The Department of Finance itself recently commissioned a major study, not yet completed,

- to evaluate the existing CSF;
- to develop a strategy for the 1994-1997 CSF;
- to advise on coordination within and between programmes;
- to quantify the growth and employment benefits of the proposed strategy.

Strictly, the strategy development should be carried out by the Government rather than by a team of consultants. This suggests that there is a lack of innovation and thought within official bodies. This may be an inevitable consequence of devoting human resources to obtaining grants rather than directing these resources to the formulation of policy.

In addition to this study the Department has of course the plans of all spending departments and agencies. These have been working assiduously over the past year on projects designed to enhance their organisations. This suggests that Structural Fund expenditure will be very similar over the new seven year programme to that of the first programme. However there are real concerns, already indicated, about many of these programmes. To what extent are they simply income transfers rather than true capacity expanding expenditure. The new Cohesion Fund has opened up new avenues of expenditure - two projects raised here by the Minister for Finance relate to the cleaning up of Dublin Bay from environmental pollution and the expansion and improvement of the rail network - in Dublin, extending the commuter system to new towns and the airport, and improving the Dublin-Belfast rail link.

Bord Fáilte has already a draft plan "Developing Sustainable Tourism" predicated on the new funding from the EC budget and intends to increase its marketing expenditure, while still promoting capacity expansion in the sector.

The old Department of Labour was seeking increased funding for training, involving

(i) a transfer from Government funding of a Social Employment Scheme to the Structural Funds rather than a new programme;
(ii) an increase in the proportion of the costs of apprenticeships funded by Structural Funds; and
(iii) an expansion of programmes for those unemployed.

The proposals do not indicate any major analysis at the centre of Government. They relate to the perceived needs of spending agencies by these agencies themselves, and the extent to which their programmes accord with the conditions and philosophy behind the CSF. The basis of the CSF is the extent to which increased Structural and Cohesion fund expenditure enhances the capacity of the economy to grow by improving the quantity and quality of the labour force and the stock of capital.

5. CONSTRAINTS ON DEVELOPMENT

Traditionally we have attempted to identify the real resource constraints that inhibit the development of an economy as skill constraints, domestic savings constraints and balance of payments constraints. The issue was to identify the operational constraint and deal with it. External finance made the situation easier, even if the problem was a skill constraint, as once the skill constraint was overcome one of the remaining constraints then became operational. However when we look at the Irish economy it would be difficult to maintain that there is a shortage of skills, or that domestic savings are inadequate, or that the balance of payments is a constraint. The underlying assumption is that markets work efficiently, but the labour market does not work effieicntly in our circumstances, for reasons I have discussed elsehwere.

This suggests that the application of structural and cohesion funds to enhancing the stock of human and phsycial capital will do little to reduce the level of unempleoyment, though it will increase output per person. These funds should be directed at producing a more efficient labour market outcome. There are various ways this could be realised:

(i) labour subsidies, based on the annual flow of transfers;

(ii) debt reduction by the amount of annual transfers, followed by reductions in taxes to reduce the cost of labour;

(iii) direct employment, by redirecting structural and cohesion funds into direct labour projects and abandoning much of the existing programmes.

Without measures such as these it is difficult to see how the resources directed to Ireland can lead to any marked reduction in differences in income per head between Ireland and richer EC countries. It is not enough to claim that the Commission will not allow changes in programmes. There is a model of development underlying current practice which is inappropriate and it simply needs to be changed. One only has to look at Northern Ireland to realise that throwing money at problems diverts resources to attracting more money. It is difficult to see how creating a national dependency culture will enhance development.