
The European Union and Its “Cohesion” Policies: An Evaluation

The traumas of two devastating wars and the Great Depression moved Europe’s leaders to undertake the most radical experiment in international relations since the Treaty of Westphalia ushered in a world of modern nation-states. Europe’s purpose was nothing less than forging a new cooperative framework to transcend the nation-state. Nations would not disappear, but barriers between them would be dismantled, and new supranational institutions would be established. Over time, member-states would devolve responsibilities to these institutions for the common good of Europe.

Among the many goals that the European Community defined at its creation was the reduction of disparities among its members. Because no one knew how to achieve that goal, and because other objectives—notably, eliminating barriers to trade—assumed a higher priority, little attention was given to this issue in the beginning, other than establishing two institutions—the European Social Fund (ESF) and the European Investment Bank (EIB)—to promote economic development and also try to reduce inequalities.

A decade later, as the European Union accepted new members, Jacques Delors, the president of the European Commission, began to reshape its institutions and provide significant additional funds to reduce disparities. By the time the Union faced the post-Cold War challenge of incorporating Eastern Europe, the modest effort to reduce disparities had grown so large that EU officials proudly compared it in scope and magnitude to the Marshall Plan—only on a permanent rather than an emergency basis.

In this chapter, we will examine the European Union’s institutions and review the evolution of its “regional” or “cohesion” policies so that we

might assess its effectiveness and draw lessons that might be of use in North America.

Europe's Designs

The Treaty of Rome, signed by six European governments on 25 March 1957, established the European Economic Community to “lay the foundations of an ever closer union among the peoples of Europe.” The goals were explicit:

- “to ensure the economic and social progress of their countries by common action to eliminate the barriers which divide Europe;
- “to strengthen the unity of their economies and to ensure their harmonious development . . . ; [and]
- “to pool their resources to preserve and strengthen peace and liberty . . .”¹

Although the aims were lofty, Europe embarked on a practical, step-by-step journey, mainly because European leaders were divided on the ultimate goal—whether their Community should be a family of nations, a confederation of states, or a unified European government. For that reason, the member-states have had great difficulty relinquishing their veto powers and accepting a decision-making process that would permit more rapid consolidation of the unit. Although the European budget has grown, and European institutions extended their domain, the EU budget only amounted to 1.27 percent of EU GDP by 1996, as compared with the central-government expenditures of its members, which ranged from 28.4 percent of GDP (in Greece) to 44.6 percent (France) in 1998.²

Nonetheless, at critical moments in the European Union's evolution, when paralysis bred crises, the governments did overcome their parochial interests and made the difficult decisions that permitted the experiment to advance.³ The leaders narrowed the scope of the “unanimity rule,” by

1. Preambles to the Treaties Establishing the European Communities, in *The European Union: Readings on the Theory and Practice of European Integration*, ed. Brent F. Nelsen and Alexander C-G. Stubb (Boulder, CO: Lynne Rienner Publishers, 1998).

2. For the European Union, see <http://www.europa.eu.int/comm/budget/en/financementbudget/index.htm>. For the range of European government expenditures, see World Bank, *World Development Report 2000/2001* (New York: Oxford University Press, 2001), table 14, 300-01. Also see European Commission, *First Report on Economic and Social Cohesion, 1996* (Luxembourg: Office for Official Publications of the European Commission, 1996), 6.

3. For the development of this thesis, see Andrew Moravcsik, *The Choice for Europe: Social Purpose and State Power from Messina to Maastricht* (Ithaca, NY: Cornell University Press, 1998).

which all decisions required a consensus. More decisions were made in more areas based on majority voting, and they pressed forward to a Single European Market. On 7 February 1992, the 12 European governments signed the Treaty on European Union in Maastricht, the Netherlands, to establish an economic and monetary Union with a common citizenship and a common foreign and security policy. By then, the European Court held sway throughout the region, and people could seek redress from their governments by appealing to the Court. The European Parliament, directly elected since 1979, attracted politicians of greater stature, who insisted on greater accountability by the Commission.

Some politicians, like Margaret Thatcher, complained that “the Brussels bureaucracy” was making decisions for the member-states and reintroducing the kinds of economic controls that she had removed in the United Kingdom. Complaints about the EU bureaucracy were chronic, and some were justified. The bureaucracy, after all, did not get smaller, and although some agencies outlived their usefulness, they did not disappear. This is, of course, the iron rule of bureaucracy, and it is especially applicable to international organizations.

Nevertheless, the EU Commission was manned by some of the most sophisticated civil servants in the world. They were sensitive to Thatcher’s concerns and enlisted national and subnational officials for various projects.⁴ To address concerns of a “democratic deficit” (the lack of accountability by international civil servants), the Union adopted the principle of “subsidiarity,” whereby decisions would be made as close to the people as possible. Perhaps the EU Commission’s most useful contribution was its most modest—the compilation of data and analyses on all European sectors and issues. The data permitted the national leaders to visualize Europe-wide and cross-border problems from a continental rather than just a national perspective.

From Goals to Programs

The Treaty of Rome included references to two instruments that would define Europe’s initial approach to the problem of reducing disparities within the Community. The European Investment Bank would make loans in lagging regions, and the European Social Fund would provide money for vocational training and for facilitating movement by workers into other areas or jobs. The European Agricultural Fund (different from the Common Agriculture Policy, or CAP) began providing grants to farmers in 1968 to help them to modernize their equipment and operations, and

4. For Thatcher’s view of Europe as a “family of nations” and Jacques Delors’ contrasting view of “a necessary union,” see Nelsen and Stubb, eds., *European Union: Readings*, 49-68; and for a condensed version of the Maastricht Treaty, 69-70.

in subsequent years to develop rural areas. Until 1973, most of the resources were funneled into Southern Italy.

The first institution that focused exclusively on the problem of regional disparities was the European Regional Development Fund, which was established in 1975 after the Union was enlarged to include Denmark, Ireland, and the United Kingdom. The ERDF's purpose was "to help to redress the main regional imbalances in the Community."⁵ Roughly 85 percent of ERDF-funded projects in the 1970s and 1980s were used for infrastructure, and 91 percent of its funds went to the poorest regions in five countries—France, Germany, Italy, Greece, and the United Kingdom. Member governments cofinanced the projects. The budget increased eight-fold in the first 10 years of the program (1975-84), but that only amounted to an eighth of what was spent for the Common Agricultural Policy.

The enlargements of the 1980s (Greece, Spain, and Portugal) coincided with the leadership of Jacques Delors, the president of the European Commission, who used the moment to transform the mandate, the programs, and the amount of funds devoted to the task. The Single European Act of 1986, which he shepherded to eliminate roughly 300 intra-Union barriers by 1992, included a new concept and a more precise set of goals under the title of "Economic and Social Cohesion" (Article 130A-E):

In order to promote its overall harmonious development, the Community shall develop and pursue its actions leading to the strengthening of its economic and social cohesion. In particular, the Community shall aim aid at reducing disparities between the levels of development of the various regions and the backwardness of the least favored regions, including rural areas.⁶

The premise of the European Community was that its people shared fundamental interests, and therefore progress should be measured in terms of *lifting the entire community* in a fair and equitable manner. "Imbalances," the EC report on cohesion writes, "do not just imply a poorer quality of life for the most disadvantaged regions . . . [but also] an under-utilisation of human potential and a failure to take advantage of economic opportunities which could benefit the Union as a whole."⁷ The operational definition of "economic cohesion" was convergence of basic incomes, rates of employment, and competitiveness. "Social cohesion" could be measured in universal systems of social protection and mutual support. This would mean a reduction of the incidence of poverty and improvements in productivity and the quality of life. Under the "Delors I" 5-year plan (1989-93), adopted by the Community in 1988, the budget for

5. Reiner Martin, *Regional Policy in the European Union: Economic Foundations and Reality* (Brussels: Centre for European Policy Studies, 1998), 81-83.

6. European Commission, *First Report on Economic and Social Cohesion*, 1996, 13.

7. *Ibid.*, 13.

Structural Funds for the poorer countries would gradually double in real terms, to 60 billion ECUs. By the end of the plan, the regional funds would amount to almost 30 percent of the total budget and about 0.3 percent of EC GDP.

The end of the Cold War and the negotiations for the Maastricht Treaty led to Delors II (a 6-year plan, 1994-99), which boosted funding for cohesion by 50 percent, up to 0.46 percent of the EU GDP. The Maastricht Treaty also created two more cohesion instruments: the Cohesion Fund for the four poorest countries—Greece, Ireland, Portugal, and Spain—and the European Investment Fund for poor regions. The Cohesion Fund would also be used to help poor countries stabilize their economies so that they might be able to qualify for economic and monetary union. In addition, a new Committee of the Regions (Article 198-C) was established to permit Europe's regions to have direct representation in Brussels.

The proliferation of funds necessitated reorganization, and the Union divided them into two groups. The largest share was devoted to Structural Funds, which included the ERDF (50 percent of total Structural Funds), the European Social Fund (30 percent), Agriculture (17 percent), and Fisheries (3 percent). The Structural Funds were grants and amounted to 170 billion ECUs during the 1994-99 period, or about a third of total Community spending. The Union also allotted 15.5 billion euros for the Cohesion Fund's four poor countries for grants for projects during a 7-year period, rising from an annual level of 795 million euros in 1993 to 2.8 billion euros in 1999. This, however, represented only about 10 percent of the money allocated to the Structural Funds. The total budget for 2000-06 amounts to 195 billion euros (at 1999 prices). This represents 1.27 percent of the EU GDP in 1999 (table 3.1).⁸

The Structural Funds aim at six different targets or areas: (1) regions where development is lagging (70 percent of total Structural Funds); (2) regions suffering from industrial decline (11 percent); (3) long-term and youth employment (5 percent); (4) training for workers (5 percent); (5) adjustment in agricultural (rural) and fisheries sectors (9 percent); and (6) adjustment for sparsely populated areas (0.5 percent).⁹

The process of deciding on the distribution of the funds is, needless to say, complicated and shaped by a multitiered political process.¹⁰ The objectives are sufficiently diverse that most member-states are eligible for some aid. Indeed, the Structural Funds are distributed to more than half

8. For the data, see http://www.europa.eu.int/comm/regional_policy/activity/funds/funds_en.htm.

9. *Ibid.*, 9.

10. For a description of the Structural Funds and the political process by which the funds are allocated, see Andrew Evans, *The EU Structural Funds* (New York: Oxford University Press, 1999).

Table 3.1 EU Structural and Cohesion Funds, 1992-2006

Funds	Percent of total fund established	Date established	Objective	Funds 1992-93 (billions of EUR)	Funds 1994-99 ^{ab} (billions of EUR)	Funds 2000-06 ^{bc} (billions of EUR)	Total, 1992-2006
Structural Funds	100	1995 ^d		26.7	170.0	195.0	391.7
European Regional Development Fund	50	1975	Economic development	11.1	85.0	97.5	193.6
European Social Fund	30	1957	Training, wage subsidies	9.7	51.0	58.5	119.2
European Agricultural Guidance and Guarantee Fund	17	1957	Agriculture	5.9	28.9	33.2	68.0
Financial Instrument for Fisheries	3	1993	Fisheries		5.1	5.9	11.0
Cohesion Funds	100	1993	Poor-country development	n.a.	15.5	18.0	33.5
European Investment Bank*	100	1958	Economic development	17.7 ^f	133.1	n.a.	

n.a. = not available

a. For the Cohesion Funds, figures are for 1993-99.

b. Amounts for each subfund are estimates based on the percentage of the total Structural Fund budget they usually receive.

c. Predicted.

d. The four funds listed below were consolidated under Structural Funds in 1995.

e. Figures are for loans.

f. Number is for 1993 only.

Sources: European Union, http://www.europa.eu.int/comm/regional_policy.htm; Hix, *The Political System of the European Union* (New York: St. Martin's Press, 1999); and European Investment Bank Web site, <http://www.eib.org/loans.htm>.

Table 3.2 Distribution of Structural and Cohesion Funds, 1989-2006

Group or country	Total funds (annual average) (millions of ECUs)	Funds as a percent of GDP ^a
Cohesion countries		
Spain	111,564.0 (6,198.5)	1.1
Portugal	46,283.4 (2,571.3)	2.5
Ireland	16,000.8 (895.1)	1.6
Greece	50,922.0 (2,829.3)	3.1
Other EU countries		
Austria	3,096.0 (258.1)	0.11
Belgium	4,753.8 (264.1)	0.10
Denmark	1,818.0 (101.0)	0.06
Finland	3,459.6 (288.3)	0.26
France	36,275.0 (2,015.3)	0.13
Germany	58,181.0 (3,232.3)	0.14
Italy	61,905.6 (3,439.2)	0.30
Luxembourg	255.0 (14.2)	0.08
Netherlands	6,035.4 (335.3)	0.09
Sweden	3,153.6 (262.8)	0.12
United Kingdom	33,827.4 (1,879.3)	0.16

ECU = European currency unit.

a. GDP for 1996.

Sources: European Commission, *First Report on Economic and Social Cohesion* (Brussels, 1996); European Union, http://www.europa.eu.int/comm/regional_policy/; and Simon Hix, *The Political System of the European Union* (NY: St. Martin's Press, 1999).

the regions in the Union because every state has poor regions. This means that the biggest donors are among the largest recipients. Other than Spain, the two countries that have or are programmed to receive the most Structural Funds since 1989 are Italy and Germany, receiving 61.9 billion euros and 58.2 billion euros, respectively. France also received 36.3 billion euros in Structural Funds; and the United Kingdom, 33.8 billion (table 3.2).

The Cohesion Fund, which delivers the grants directly to central governments, was the product of a bargain struck at Maastricht by the Spanish prime minister. In exchange for receiving what would grow to become the most funds transferred to a single country—111.6 billion euros from 1989—Spain agreed to sign the treaty. The Cohesion Funds are spent on the environment, infrastructure, and research and development in the four countries whose per capita GDP is less than 90 percent of the EU average (Greece, Ireland, Portugal, and Spain). The decision on the amount allotted to each state is made by all the states. The EC Commission then decides on the specific projects in collaboration with the subnational governments.¹¹

11. For a political analysis of the decision making that led to the various Structural and Cohesion Funds and how they are allocated, see Gary Marks, "Exploring and Explaining Variation in EU Cohesion Policy," in *Cohesion Policy and European Integration: Building Multi-level Governance*, ed. Liesbet Hooghe (Oxford: Oxford University Press, 1996).

The European Investment Bank has made loans for regional development to all member-states, and the amounts are significant. In 1999, the EIB approved loans of 33.4 billion euros,¹² but these loans are not considered part of the Structural or Cohesion Funds. The Union claims that the total amount allocated for Structural and Cohesion Funds amounted cumulatively to 6.5 percent of annual EU GDP during the decade 1989-99. In comparison, Marshall Plan aid during the period 1948-51 amounted cumulatively to 4 percent of annual US GDP.¹³ But the comparison is misleading, both on statistical and substantive grounds. The EU aid was a 10-year total, and the Marshall Plan was for 4 years, but the denominator in both cases is the GDP in just the first year of the program. Also, the Union transferred the funds to itself, often to the same countries.

Nonetheless, in an age when foreign aid has been declining precipitously, the EU transfers represent a significant effort. In just the period from 1992 through 2006, the Union has or will transfer roughly 425.2 billion euros (table 3.1). What motivated the Union? First, equity and solidarity are goals that are mandated in the EU treaties. Second, if regions endured a shock or even a slow decline, the rest of Europe felt the negative consequences and therefore had an incentive to buffer the downturns in the poor countries. Fiscal transfers spread the burden of adjustment and assisted the adversely affected countries. Third, growth in the poor countries often readily translated into fast-growing markets for the goods of the rich countries. And fourth, the transfers shored up political support in the poor areas where the Union is unpopular or the government is weak.¹⁴ With each enlargement, the strong EU countries felt it necessary to offer increasing funds to the poor applicants. Some view the side payments as necessary for the strong countries to secure the wider market.¹⁵

The dynamic of the bargain is pertinent to the contemporary challenge that the European Union faces in its negotiations with 12 Central and Eastern European governments (CEEs), which are poorer than any of the member-states. If the criteria for the CAP and Structural and Cohesion funds were to remain unchanged after these countries join, the Union would have to double or triple the funds. "No previous enlargement is comparable," Michel Barnier, the EU commissioner for regional affairs, told the European Parliament in February 2001. "This time the Union's

12. For data and background on the European Investment Bank, see <http://eib.eu.int/>.

13. European Commission, *First Report on Economic and Social Cohesion*, 1996, 9.

14. Clifford J. Carrubba, "Net Financial Transfers in the European Union: Who Gets What and Why?" *Journal of Politics* 59, no. 2 (May 1997): 469-96.

15. This contrasts with the case of Mexico and most of Latin America, which evidently believe that they gain more from entry into a free trade area with the United States than Washington does.

surface area and population will grow by a third, but its gross domestic product by just 5 percent."¹⁶ The income gap between the Union's poorest and richest regions would double. The Union therefore faces some hard choices. At a meeting of heads of state and government in Berlin in March 1999, its leaders discussed these issues in the framework of the Agenda 2000 package that would define its policies in the period 2000-06. The leaders agreed to an appropriation of 213 billion euros for regional policy (divided between 195 billion euros for Structural Funds and 18 billion euros for the Cohesion Fund). They also tightened the objectives and revised the criteria for allocations under Objective 1 (lagging regions), which receives 70 percent of the Structural Funds so that only regions whose per capita GDP was less than 75 percent of the EU average would receive funds.¹⁷

This decision, however, reflected, more or less, the status quo. The leaders had dodged the most difficult questions. The first issue was what to do about the CAP, which accounts for half of the EU budget. If the CEEs join, the Union would either have to elevate taxes or shut down the program. The CAP not only posed a problem for the budget but also for multilateral trade negotiations. A second issue was what to do about regional policy. Given the economic growth in the four poor countries, some in the European Commission had proposed that much of the regional funds should be set aside for the new applicants, but the Spanish prime minister protested vehemently. He was beginning an election campaign, and he could not afford to extract less from the Union than had his predecessor.¹⁸

Without a decision to reduce the Cohesion Fund, the French were not willing to contemplate a reduction in the CAP, particularly because the British insisted on keeping a rebate on their transfers. The German chancellor, who was hosting the event, also felt vulnerable politically because of a series of missteps after taking office, and he could not afford to have a summit meeting break up in disarray. It was far better for everyone to emerge reasonably satisfied than to have any member-states rail at the outcome. This, of course, was a recipe for inaction, and that was the result. Instead of making the hard but necessary decisions to reduce the CAP and begin to transfer the Structural and Cohesion funds into a much larger fund to facilitate the transition of new members, the EU leaders postponed the decisions. They did, however, allocate roughly 2.5 percent

16. Peter Norman, "Enlarged EU May Need to Boost Aid," *Financial Times*, 1 February 2001, 14.

17. European Union, "Reform of Structural Policy: Results of the Berlin Summit," *Newsletter* 62, March 1999.

18. This case is assembled from many interviews that the author had in March, June, and July 1999 in Brussels, Paris, Madrid, Cologne, and Frankfurt.

of the Structural Funds for “cross-border cooperation,” which would be infrastructure projects between the Union and the CEEs.

A historically long, 5-day summit meeting in Nice in December 2000 affirmed the European Union’s determination to complete a significant enlargement by 2004. They agreed to extend majority voting to 29 new policy areas, but each major power insisted on retaining a veto in critical areas.¹⁹ No progress was made to break up the logjam on cohesion policy in Nice,²⁰ nor at a subsequent meeting in Brussels in May 2001.²¹

Evaluating EU Regional Policy

Economists agree that countries benefit from trade, but they divide on whether trade narrows or widens the gap between winners and losers—between countries and among groups within countries. To simplify, “convergence theories” (based on the Heckscher-Ohlin-Samuelson model) predict a convergence of factor incomes because capital will invest and deploy technology where it can gain greater returns. Conversely, “divergence theories” suggest that trade will widen existing disparities as firms locate in the same area to minimize the costs of their inputs. Moreover, rich countries devote more resources to developing their human capital (education, training) and investing in physical capital; thus, they can grow faster than those with fewer resources. This trend widens the gap for still another reason: Factors, especially labor, are not as mobile and prices are not as flexible as the convergence theories assume. The EU experience offers a good opportunity to test the two theories.

A World Bank analysis looked at income differences since the Benelux Union (Belgium, the Netherlands, and Luxembourg) was established in 1947 and concluded that the data “clearly shows an almost continuous convergence . . . Income differences narrowed by about two-thirds over the period [1947-81], due mainly to the more rapid growth of the lower income countries.”²² The European Commission focused its analysis on the four poor “Cohesion” countries, but in its first *Cohesion Report* in 1996,

19. Suzanne Daley, “European Union Reform: After 5 Days, A Yawn,” *New York Times*, 12 December 2000, A8.

20. In his summary presentation to the European Parliament on the Summit Meeting, Romano Prodi, president of the European Commission, expressed disappointment that “little or no progress was made on cohesion, tax, regulation, and social legislation, all sensitive areas in which the Conference came up against the intransigence of some Member States.” His speech can be found at <http://www.europa.eu/int/rapid/start/cgi/gu>.

21. “What’s Ours Is Ours,” *The Economist*, 24 May 2001.

22. World Bank, *Trade Blocs: A Policy Research Report* (New York: Oxford University Press, 2000), 51-52; see also fig. 3.8.

it found the evidence mixed as to whether the disparities in income and employment between the rich and poor member-states had narrowed. In its *Sixth Report* issued in February 1999, however, the Commission declared: "The evidence is now unambiguous: the GDP, or output, per head of poorer regions is converging toward the EU average." During the period 1986-99, per capita GDP in the four Cohesion countries *rose* from 65 to 78 percent of the EU average. As for the regions, per capita GDP in the 10 poorest regions *increased* from 41 to 50 percent of the EU average; and in the 25 poorest regions, from 52 to 59 percent.²³ The countries moved to close the gap considerably faster than the regions, but the narrowing of the differences within the regions was hardly trivial.

Although the disparities in income declined, the unemployment picture did not improve. Europe's economy recovered in 1994, but unemployment remained at 10 percent overall for the Union in 1998, and long-term unemployment—those out of work for a year or more—stood at almost half (49 percent) of the unemployed. In the 25 regions with the highest unemployment rates, the long-term unemployed accounted for 60 percent of the total unemployed.²⁴ Growth is unlikely to solve this problem, but the good news is that the poor regions experienced a relatively greater improvement in productivity, as indicated by the reduction of the gap in income.

Another way of looking at the unemployment problem is to realize that the poor regions, particularly those in the poorest states, had historically high levels of underemployment and flimsy safety nets—if they had any at all. As these poor states were integrated into the European Union, new investments tended to be more capital and technology intensive, meaning that jobs were created. But they were fewer and better jobs than what the regions had before. At the same time, the countries approved social legislation to assist the jobless.

In the summer of 1999, I sought answers to the puzzle of why unemployment increased in the face of accelerated development in Andalusia, one of Spain's poorest provinces with the highest unemployment. With considerable EU funding, Andalusia has built one of the most modern highways in Europe, a state-of-the-art telecommunications system, new colleges and universities, and fast-growing industries based on tourism. In the past, Andalusians traveled to northern Europe for jobs, but today, they will not even look for work in central Spain. Why not? The answer is that the area's development and Spain's democratic progress have created options for workers to find occasional, "informal" work and collect unemploy-

23. European Commission, *Regional Policy and Cohesion: Sixth Periodic Report on the Social and Economic Situation and Development of the Regions of the European Union* (Luxembourg: Office for Official Publications of the European Commission, 1999), i, 9.

24. *Ibid.*, i.

ment compensation. In a study of unemployment in Europe, Tsoukalis found that the high rates tended to reflect “seasonal labor patterns” usually associated with tourism or economies with high service components. He argues that productivity, which was improving in many of the poor countries, was a better indicator of convergence than unemployment.²⁵ So the unemployment figures might be inflated; instead of reflecting a widening gap in the quality of life, they might actually disguise a narrowing one.²⁶

There is additional evidence that the figures on unemployment may mask more positive trends. Illegal migration into the EU countries (according to the European Commission) has been soaring—from about 40,000 in 1993 to an estimated 500,000 in 2000. Increasing numbers of undocumented migrants have come from Morocco to Spain and Portugal.²⁷ If unemployment were as severe as the figures suggest, these new migrants would have had difficulty finding work, and the unemployed would have migrated to rich areas of Europe. In fact, migration from one country to another within the European Union has declined. Only about 2 percent of EU citizens seek work in Europe outside their own countries. In comparison, Americans move from state to state more than five times as often as EU citizens change countries.²⁸

Although all four Cohesion countries (Greece, Ireland, Portugal, and Spain) have made substantial economic progress since entering the Union, an analysis of the differences in their rates of growth might be a useful vehicle for assessing the effectiveness of EU regional policies (table 3.3). Ireland has been the most successful. Although burdened with a weak infrastructure and educational system, it took quick advantage of the Union and achieved the highest growth rate of any member-state in the first programming period (1989-93), averaging 5 percent annually, as compared with an EC average of 1.7 percent. In the second period (1994-99), it had 7t percent annual growth. Its inflation, balance of payments, and ratio of budget deficit to GDP also were better than the community average.²⁹ The result was a breathtaking advance: Ireland’s per capita

25. Loukas Tsoukalis, *The New European Economy Revisited* (New York: Oxford University Press, 1997), 174.

26. Eduardo Moyano Estrada y Manuel Perez Yruela, eds., *Informe Social de Andalucía (1978-98)* (Cordoba: Instituto de Estudios Sociales Avanzados de Andalucía, 1999), esp. VI, Mercado de Trabajo y Estructura Ocupacional, 361-424.

27. Roger Cohen, “Illegal Migration Increases Sharply in European Union,” *New York Times*, 25 December 2000, 1.

28. Suzanne Daley, “Despite European Unity Efforts, There’s No Country Like Home,” *New York Times*, 12 May 2001.

29. European Commission, *The Impact of Structural Policies on Economic and Social Cohesion in the Union, 1989-99* (Luxembourg: Office for Official Publications of the European Communities, 1997), 71.

Table 3.3 Growth of GDP in the Cohesion countries, 1986-99

Measure	Year(s)	Greece	Spain	Ireland	Portugal	EU 4 ^a	EU 11 ^b	EU 15 ^c
Annual average percent change in GDP	1986-96	1.6	2.8	6.2	3.5	2.9	2.0	2.1
	1986-91	2.2	4.3	5.3	5.1	4.1	2.8	3.0
	1991-96	1.0	1.3	7.1	1.8	1.7	1.5	1.5
	1996-99	3.8	3.6	9.2	3.8	4.1	2.6	2.8
Annual average percent change in population	1986-96	0.5	0.3	0.3	-0.1	0.3	0.4	0.4
	1986-91	0.5	0.2	-0.1	-0.3	0.2	0.4	0.4
	1991-96	0.4	0.4	0.6	0.1	0.4	0.4	0.4
	1996-99	0.5	0.1	0.9	0.1	0.2	0.3	0.3
GDP per head (PPS) EU 15 = 100	1986	59.2	69.8	60.8	55.1	65.2	107.7	100.0
	1987	57.4	71.5	62.5	56.7	66.3	107.4	100.0
	1988	58.3	72.5	63.8	59.2	67.6	107.1	100.0
	1989	59.1	73.1	66.3	59.4	68.3	106.9	100.0
	1990	57.4	74.1	71.1	58.5	68.8	106.8	100.0
	1991	60.1	78.7	74.7	63.8	73.1	105.5	100.0
	1992	61.9	77.0	78.4	64.8	72.7	105.6	100.0
	1993	64.2	78.1	82.5	67.7	74.5	105.2	100.0
	1994	65.2	78.1	90.7	69.5	75.3	105.0	100.0
	1995	66.4	78.6	96.8	70.1	76.3	104.8	100.0
	1996	67.5	78.7	96.5	70.5	76.6	104.8	100.0
1997 ^d	69.2	77.8	96.4	70.7	76.3	104.8	100.0	
1998 ^d	68.6	78.6	102.1	71.1	77.1	104.7	100.0	
1999 ^d	69.3	79.6	105.1	71.8	78.2	104.5	100.0	

PPS = purchasing power standards, a formula for reducing the distorted effect of exchange rates in order to compare the relative income of people in different countries.

- a. EU-4 is Greece, Spain, Ireland, and Portugal.
- b. EU-11 is the other 11 richer nations of the EU.
- c. EU-15 is the 15 nations of the EU.
- d. Numbers for 1997-99 are projections.

Source: Eurostat, calculations DGXVI; European Commission, *Sixth Periodic Report*, February 1999.

GDP rose from only 61 percent of the EU average in 1986 to 105.1 percent in 1999.³⁰

The growth, however, was not evenly distributed within Ireland. Most of it was concentrated in the eastern part of the country, particularly in the service sector around Dublin. But there were other benefits to EU membership. Because agriculture remained an important part of the relatively undeveloped Irish economy, EU price supports helped Irish farmers modernize. With advice from EU financial advisors, the Irish government cut spending, privatized its state companies, and reduced interest rates,

30. European Commission, *Sixth Periodic Report*, 9.

and this stimulated both domestic and foreign investment, which helped lift the entire economy and made “the Irish success story” a model for others.

Ireland also received significant resources from the Union. For the decade beginning in 1989, it received 10.2 billion euros from both Structural and Cohesion funds, and the government matched that amount with counterpart investments. (Another 6 billion euros are programmed for the next 6 years.)³¹ In addition, it received \$10.4 billion in private investment linked to the projects funded by the Union—for a total of 31 billion euros. The Union transferred resources that were equivalent to 2.8 percent of Ireland’s GDP. National counterpart funding raised the total investment to 5 percent of GDP.³² This undoubtedly provided a significant boost to Ireland’s development. Of the 10.2 billion euros in grants, about 35 percent went to education and training, 25 percent to infrastructure (roads, rails, and ports), and the rest to small and medium-sized enterprises and environmental projects.

EU technical advisers also helped Irish government officials fashion an outward-oriented development strategy, and they also encouraged the Irish central government to give greater attention to the views of officials at lower levels than they had ever done before. Indeed, the EU *modus operandi* served to mobilize local community groups to get involved in defining and implementing projects, and to encourage the central government to consult these groups regularly.³³

The Economic and Social Research Institute in Dublin did an intensive analysis and evaluation of EU programs in Ireland and concluded that “no single factor can explain the economic turnaround.” But it did identify three mutually reinforcing variables: the gradual accumulation of human capital, fiscal control and the maintenance of wage competitiveness, and a sharp increase in EU Structural Funds. These funds began to arrive in 1989, just when there was a substantial backlog of projects and urgent infrastructural needs. “Without the support of the structural funds,” the report concludes, “congestion in public infrastructure and constraints in third level education would have limited the recovery.”³⁴ Using several different models, the institute concluded that the combined effect in the period 1995-99 was to raise the level of GNP by 3-4 percent above what it would have been without EU funding.³⁵

31. See table 3.2.

32. European Commission, *The Impact of Structural Policies*, 73-75.

33. Brigid Laffan, “Ireland: A Region Without Regions—The Odd Man Out?” in *Cohesion Policy and European Integration: Building Multi-Level Governance* (Oxford: Oxford University Press, 1996), 320-41.

34. Patrick Honohan, ed., *EU Structural Funds in Ireland: A Mid-Term Evaluation of the CSF, 1994-99* (Dublin: Economic and Social Research Institute, 1997), xv-xxi.

35. *Ibid.*, xviii.

Ireland's trajectory was astonishing, but the three other poor countries—Greece, Portugal, and Spain—also made progress. All three Southern European governments slowly opened their economies and began to emerge from their authoritarian, protectionist shells in the early 1960s. As tariffs declined, foreign investment arrived, and the result was that the three countries witnessed important economic growth and an increase in real wages during the decade 1963-73: 6.4 percent in Spain, 6.8 percent in Portugal, and 7 percent in Greece. The labor force began to move out of agriculture and into the industrial and service sectors. Between 1974 and 1976, the dictatorships ended, and the European Community, which insisted they become democratic before becoming members, began to discuss the terms of their entry.³⁶

Despite its growth during the previous decade, Spain's infrastructure and educational base were significantly below the EC average. Its per capita GDP rose from 70 percent of the EC average in 1986 to nearly 80 percent in 1999. Like Ireland's, Spain's growth was uneven—with the most prosperous areas in Madrid and Catalonia reaching the EC average by 1996.³⁷ The scale of EU transfers to Spain tripled between the two periods (1989-93 and 1994-99), and it is programmed to continue a high level of aid until 2006. By that time, Spain would have received 111.6 billion euros—about the same as the other three Cohesion countries combined, and double the next highest recipient. Adding both the national-counterpart funding and the private-sector financing for the EU projects, the total amount of EU resources mobilized constituted about 1.5 percent of Spain's average annual GDP in 1989, and 3.4 percent for the years 1994-99.³⁸ The investments were concentrated in infrastructure, primarily roads, but attention and resources were also devoted to telecommunications. Within 5 years of its entry into the European Union, foreign businesses tripled their direct investment in Spain, giving rise to suggestions that it was "turning into the continent's Sun Belt."³⁹

During the past decade, Portugal has grown faster than Spain and the European Union as a whole—but of course it started from a lower base. Its GDP per capita increased from 55 percent of the EC average in 1986 to 72 percent in 1999. With a weaker economy, Portugal was affected much more severely by the recession in the early 1990s, and its development has been more unbalanced. Most of the country has remained poor, but the

36. See Otto Holman, *Integrating Southern Europe: EC Expansion and the Transnationalization of Spain* (New York: Routledge, 1996).

37. European Commission, *Sixth Periodic Report*, 10.

38. European Commission, *The Impact of Structural Policies*, 45.

39. Stephen Greenhouse, "With Spain in Common Market, New Prosperity and Employment," *New York Times*, 15 January 1989, 1, 9; and Alan Riding, "Spain Aims for a Competitive Edge in a Unified Europe," *New York Times*, 14 June 1992, F11.

average income of its two urbanized regions—Lisbon and Norte—now approaches the EU average.⁴⁰ EU aid of 46.3 billion euros from 1989 to 2006 will amount to about 4 percent of Portugal's GDP at the 1994 level, or 7.2 percent when central-government and private-sector funding are included. As in Spain, the EU emphasis on infrastructure was key to its development. During the past decade, the EU has financed and constructed or improved nearly 4,000 kilometers of roads, or almost half of all the roads in Portugal. It has also constructed or improved 640 kilometers of railroad and modernized almost the country's entire telephone network.⁴¹ Also, as with Ireland and Spain, foreign investment transferred new technology and created higher-paying jobs.⁴²

Greece, the poorest EU member-state, initially made the least progress after its entry into the Union because it had chronic fiscal and current account deficits for a decade. In 1994, its budget deficit as a percentage of GDP was 12.1 percent, but it sharply reduced the deficit since then, and its economy began to grow. Its per capita GDP rose from 60 percent of the EU average in 1986 to 69 percent in 1999. As its trade barriers declined and its macroeconomic policies improved, the income gap between Athens and the rest of the country began to widen, much as it did in the other Cohesion countries.⁴³

Notwithstanding the Greek government's flawed economic policies, the European Union nearly doubled its aid in the second period, so that from 1989 to 2006, the Union will transfer 51 billion euros to Greece. Together with national and private funds, the total amount represented 4.5 percent of the average annual GDP in the 1989-93 period and 7.2 percent for 1994-99—quite a substantial amount. Repeated and credible reports of corruption have impeded Greek development, but the Union has helped the government address the problem to expedite critical projects on infrastructure (roads and subways) and telecommunications.

The magnitude of the transfers to all four Cohesion countries is significant, but to what extent do these funds contribute to growth and to the reduction of income disparities? To answer that question, one needs to estimate what would have happened in the absence of the assistance and compare that to what occurred after the aid was invested. Aid affects an economy in four ways. First, it increases the income that a country can spend on goods and services. Second, through improvements in infrastructure and education, it increases a country's productive potential. Third, it encourages a country to reset its priorities toward essential long-

40. European Commission, *Sixth Periodic Report*, 10.

41. European Commission, *The Impact of Structural Policies*, 111-21.

42. Peter Gumbel, "Portugal: A Recovery That East Europe Can Emulate," *Wall Street Journal*, 1 May 1992, A11.

43. European Commission, *Sixth Periodic Report*, 10-11.

term investment. And fourth, it has a multiplier effect, coaxing additional funds from private investors.

Four different models—using different assumptions and emphases—have been used to try to assess the specific aid effects. Some, like the Beutel Model, focus on the demand side. Others, like the Pereira Model, examine the supply side. Still others, like the Hermin and the Quest II models, incorporate both demand and supply. All of them suggest that EU funds were responsible for some of the growth, though they differ on the proportion.⁴⁴

The difference between the uncommon success of Ireland and the initial stagnation of Greece underscores the importance of each country's policies—particularly macroeconomic policies, exchange rates, foreign investment policies, and the rule of law in constraining corruption. EU funds helped successful governments accelerate their growth. The European Union also helped reinforce the more responsible policymakers in weak governments.

A comprehensive, incisive study of the effect of regional and cohesion policies was done by Leonardi, who defines “cohesion” precisely and measures it among member-states and regions during the period 1970-91. Among the EU member-states, he finds, as others did, significant convergence. Using regression analyses, he tests various explanatory variables, including distance from the core countries, foreign investment, level of industrialization, unemployment, and EC funding. He finds that the best predictor of convergence is distance from the core countries, and the best explanatory variable is EC spending. Structural and cohesion aid, he concludes, “made a substantial contribution to economic investment and overall GDP in the three nations. [It] acted as a significant stimulus to the national economies, explaining in part the surge of these countries toward convergence.”⁴⁵

As to why Greece did not do as well as the other three Cohesion countries, Leonardi sees several factors. Greece joined the European Union at a time of a Europe-wide recession; and its weak infrastructure and notoriously corrupt administration led foreign investors to want to “remain aloof.”⁴⁶ He also finds the gap between industrial and developing regions to have narrowed, and he explains it by “significant upward movement of the bottom regions.”⁴⁷

44. These models are summarized or developed in European Commission, *Sixth Periodic Report*, 80-82; and Martin, *Regional Policy in the European Union*, 100-03.

45. Robert Leonardi, *Convergence, Cohesion, and Integration in the European Union* (New York: St. Martin's Press, 1995), 133, 170-76. See chapter 3 for his methodology. In the period he studied, 1970-91, Greece was the only one of the four cohesion countries that did not make progress.

46. *Ibid.*, 134-36.

47. *Ibid.*, 116. Leonardi looks closely at the southern Italian case and believes that the lack of convergence is due to excessive government involvement and a lack of a market economy (chap. 5).

Leonardi did not assess whether Structural Funds or the Single Market were more important in explaining the convergence of the poor nation-states. The Organization for Economic Cooperation and Development (OECD) did such a study in 1994, and it concluded that it was “difficult to find strong evidence the single market program has yet had sizeable effects on aggregate output.” The study estimated that the Single Market had improved GDP by perhaps 1.5 percent.⁴⁸ That is not exactly a trivial contribution to GDP, but it also does not compare with the kind of contribution that Leonardi attributes to the Structural Funds. The OECD study, however, suffered from the same problem as the others, including Leonardi: how to answer the counterfactual—what would have happened in the absence of the Single Market?

Of the Structural Funds, which policies and projects were most effective? Martin, in a report for the Centre for European Policy Studies, concluded that investments in two areas were most effective: infrastructure and human capital.⁴⁹ The European Union has emphasized these two areas, but it has also scattered considerable funds into projects in other areas, such as environmental protection, regulatory policies, new initiatives to provide low-interest loans to small and medium-sized businesses, and technical assistance.

The gap between rich and poor EU member-states narrowed faster than the gap between regions. A recent study by Boldrin and Canova failed to stress the distinction between these two gaps—among states and among regions—and as a result, *The Economist*, drawing from their report, concluded mistakenly that EU aid has not served a useful developmental purpose.⁵⁰ Boldrin and Canova’s analysis focuses on the 211 “regions” within the European Union between 1982 and 1996. The most significant regional and cohesion aid was only transferred at the end of that period. Although they claim to disagree with the EU’s analysis, in fact, their study confirms the EU reports’ main conclusions—first, that the evidence was ambiguous by 1996; second, that there was less convergence among regions; and third, that there was convergence in incomes among the rich and poor states. By 1999, the Union found clear evidence of convergence. Boldrin and Canova also argue that one of the possible reasons for the lack of convergence among regions is that EU subsidies to the poor regions may have served to impede migration from them to rich regions. This, I suggest above, may be true, but it substantiates the argument that EU

48. Cited by Tsoukalis, *New European Economy Revisited*, 75-76.

49. Martin, *Regional Policy in the European Union*, 66-72.

50. Michele Boldrin and Fabio Canova, “Inequality and Convergence in Europe’s Regions: Reconsidering European Regional Policies,” *Economic Policy* (April 2001), 207-53; and “What’s Ours Is Ours,” *The Economist*, 24 May 2001.

funds have lifted the poor regions to the level where people no longer exercise the option to emigrate.

The failure to reduce significantly the gap among the 211 regions in the European Union is troubling, particularly because transfers within member-states exceed the funds that are made available by the Union. The major cause of those disparities is evident from a map of Europe. The rich regions are all congregated around the largest cities, and the poor regions are rural. Of course, the urban areas conceal within their midst even wider disparities between rich and poor than can be found between the cities and the farms, and those differences resist convergence despite high levels of resource transfers for welfare, unemployment compensation, and transportation and education subsidies. (And sometimes the measurement of the gap does not include these transfers.) Although farmers' incomes cannot match those of most urban workers—and that explains why you cannot keep them down on the farm—the cost of living in rural areas is lower, and much rural income might be underreported because of barter and other “informal” business activity.

Boldrin and Canova offer still more reasons why the data on regional disparities might be mistaken. First, the regions are very heterogeneous in size and population, but most are too small to be considered independent economic areas. Second, there is often very little relation between the activities occurring in the region and the official data. For example, research and development (R&D) expenditures are usually associated with urban areas because that is where corporate headquarters are located, although R&D usually is not done at corporate headquarters. Also, a city has higher per capita income, but that may be overstated because much of its labor comes from outlying regions with lower income. So, in brief, the gap that separates the income of urban from rural residents might appear wider than it really is. This conclusion is different from—if not the opposite of—the view that there has been no reduction in the wide disparities among regions.

Lessons from EU Experience

Recognizing the distinct points of departure of the European Union and NAFTA, let us extract 10 lessons from EU experience that may be of use in contemplating the future of North America.

- 1. A declaration of goals.** From the beginning, Europe's leaders defined their mission in terms of community and solidarity. Their goal was that the people of Europe would cooperate in new ways to bring peace and well-being to all. Those leaders who were most committed to this goal used the ideal of community to press for its attainment.

The first lesson, then, is that a clear statement of goals is necessary but not sufficient to construct a community of nations.

2. **Limiting institutions.** The European Union established too many supranational institutions; NAFTA made the opposite mistake of establishing almost none that are serious. The Union established six different funds for “regional policies,” though many are duplicative or unnecessary. Inertia and vested interests make any changes in these institutions very difficult. The lesson is that policymakers should incorporate a “sunset” provision into every institution or funding mechanism, lest each assume a permanence that would diminish—not enhance—the region’s capacity to reduce disparities.
3. **Convergence and conditionality.** The spectacular reduction in the income gap between the rich and poor countries of Europe in a relatively short period of time (since 1986) offers hope that regional trading schemes could be an effective vehicle to lift up middle-income countries. Among the many factors responsible for narrowing the gap were the establishment of the Single Market, foreign investment, and the massive EU aid programs. There is a consensus that these three factors contributed to the reduction of disparities, but there is some disagreement as to which is most important. An analysis of the different growth rates among the four Cohesion countries leads to the inescapable conclusion that national policy is a fourth critical determinant, and that conditionality multiplies the contribution of EU aid. If a recipient government, for example, runs up an excessive public deficit, the Union suspends its loans until the government corrects the deficit. The Union also insisted on democracy as a criterion for membership. The lesson is to use the first three factors—Single Market, foreign investment, and aid—to induce the recipient government to adopt the appropriate economic policies and political structures that will allow it to make best use of the resources.
4. **The best projects for regional assistance.** The European Union has funded almost every imaginable kind of project through multiple channels, but the consensus among analysts is that the funds were most effectively employed in projects aimed at infrastructure and higher-level education.
5. **Emigration.** One effect of convergence in incomes and social policies was to reduce the level of emigration from the poor countries and regions in the European Union. Although the gap within the Union was much narrower than within NAFTA, the lesson is indisputable: A reduction in disparities will also reduce the pressures to emigrate.

6. **Reducing volatility.** Although convergence did occur between rich and poor countries, the poor ones did not follow a straight path upward. Rather, what occurred is that the Cohesion countries outperformed the EU average in the boom years and did worse than the EU average during recessions.⁵¹ The opportunities and the dangers of integration are much more serious for weak countries than for more advanced ones. Another study by Martin also found greater volatility among the weaker partners of an integration effort.⁵² The lesson is that rich countries need to find ways to cushion the swings that poor economies suffer. Macroeconomic policy coordination and financial “buffer” or “swap” arrangements should be undertaken to protect poor countries from foreign exchange crises.

7. **Growing inequality within the “successful” poor countries.** In many cases, rapid integration tended to coincide with accelerating inequality among the regions of a poor country. More often, this is not because the poor became poorer but because the prosperous regions—the ones tied to the European Union by both exports and inward flows of investment—sped ahead. The poor regions grew more slowly, or their growth just halted. The lesson is that governments should monitor the progress of all regions of poor countries and institute mechanisms to assist those regions that are falling behind or not growing fast enough.

8. **Funds for the affluent and gaps among regions.** More than half of all EU Structural Funds go to poor regions in the rich countries, and several of the rich countries (notably Denmark and France) obtain large subsidies from the Common Agriculture Policy, which is half the EU budget. (“Regional policies” take 30-35 percent of the budget.)⁵³ One study questions whether there has been any reduction in the disparities among the regions, and therefore concludes that EU funds serve the goal of redistribution, not development.⁵⁴ Although this critique has flaws (analyzed above), it would be more efficient and desirable to concentrate the funds in the poor states. Having an EU project in each country gives the citizens of that country a sense of the continued presence and contribution of the Union, but the proportion of funds going to the rich countries should be sharply reduced. The lesson is to find inexpensive, symbolic ways to give the

51. European Commission, *Sixth Periodic Report*, 9.

52. Martin, *Regional Policy in the European Union*, 53-61.

53. See Tsoukalis, *New European Economy Revisited*, 202-22.

54. Boldrin and Canova, “Inequality and Convergence in Europe’s Regions,” 207-53.