TOGETHER OR APART? STRUCTURAL FUNDS AND REAL CONVERGENCE IN THE NEW MEMBER STATES

Alexe Ileana
Academy of Economic Studies in Bucharest, Faculty of International Business and Economics

Tatomir Cristina Flavia
Academy of Economic Studies in Bucharest, Faculty of International Business and Economics

The objective of this study is to analyze the relationship between the structural funds provided by the European Union (EU) and the real convergence of the New Member States that joined the EU in 2004. We also assess the effect of the crisis on this. According to the empirical studies in this area, the impact can be both negative and positive. Furthermore, in the latter case, the correlation is not very strong and depends on several factors. To meet the research objective, we have structured this paper into five parts. In the first part, we make a short presentation of the Cohesion policy and its evolution in time. In the second part, we explore the importance of the subject in the economic literature. In the third one, we explain the methodology used in this paper. We contribute to the literature by creating a Real Convergence Index (RCI) and by assessing the evolution of this index and of the structural funds payments from 2004 until 2010 in five New Member States (Hungary, the Czech Republic, Poland, Slovakia and Slovenia). The fourth part describes the results obtained. The structural funds payments reached a maximum level in 2007 in all the countries, with the exception of Slovenia. After this point, they recorded decreasing levels, mainly because of the economic and financial crisis. Within this group of countries, Poland and Slovakia recorded an increase in RCI during 2009 and 2010, even though the amounts of payments started decreasing. The highest level of structural funds payments and the maximum level of RCI are not synchronized, with the exception of the Czech Republic. This could come as a result of the lagging effects of structural funds on the economic convergence. The fifth part of the paper summarizes the conclusions of our research. The analysis confirms the previous work in this field. Specifically, it does not provide us with a clear result regarding the relationship between the absorption of structural funds and the real convergence. The implications for Romania are not very encouraging. This means that the efforts for increasing the absorption rate of EU funds will not necessarily lead to a faster real convergence process. Consequently, the effectiveness of the Cohesion policy remains under question.

Keywords: Structural Funds, Cohesion policy, Real Convergence Index, New Members States, European Union

JEL codes: F15, F43, O47

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1. Introduction

It is very well known that the process of European integration does not lead to uniform benefits, due to the very different initial levels of national development. In this context, the EU designed the Cohesion policy as an instrument to support the convergence process within the Union. This policy should help to bridge the gaps of economic development between regions and countries, in order to achieve real convergence.

The Cohesion policy dates back to the creation of the European Economic Community. However, the first multi-financial programming period, between 1988 and 1992, was mainly created to smooth the integration of three peripheral countries: Greece, Spain and Portugal. Later on, the Treaty of Maastricht (1992) introduced the Cohesion Fund, the Committee of Regions and the principle of subsidiarity for the next programming period (1994-1999). The amounts allotted to the Cohesion policy increased with time. In 2000, this policy was adjusted according to the priorities established by the Lisbon Strategy (growth, jobs and innovation) and to the forthcoming accession wave of 2004. For the 2007-2013 period, the Cohesion policy brought new changes, in terms of simplified rules and structures, more transparency, stronger focus on jobs and growth (European Commission, Regional Policy, 2012). The financial instruments through which the EU supports the economic and social development of the countries and regions are represented by the structural funds (mainly The European Fund for Regional Development and the European Social Fund) and by the Cohesion Fund.

The enlargement process of 2004 and 2007 has added a growing challenge on the EU as a whole. It has led to more discrepancies in terms of economic development and income distribution within the Union. However, the EU funds received through the Cohesion policy does not automatically drive to real convergence. First of all, the effects of the EU funds on real convergence remain uncertain. Secondly, the absorption capacity of the New Member States puts additional pressure on the effectiveness of the EU funds. Marinaş (2007) even supports the view that because of the absorption deficiencies, the discrepancies between the EU regions have remained relatively constant and, furthermore, those within the EU Member States have increased.

2. The effectiveness of the Cohesion policy

There have always been contrasting views regarding the potential of the EU funds to boost growth and real convergence.

Manzella and Mendez (2009) make a short review on the criticism regarding the Cohesion policy. They state that a lot of analysts, academic people or even European governments continue to question nowadays the rationale behind this policy and its effectiveness. The debate focuses on the unclear mission of the policy, its insufficient concentration on growth, inadequate policy instruments, its complexity and bureaucracy. Furthermore, after decades of intervention, the contribution of the Cohesion policy to economic growth and development remains uncertain. The literature reports diverging results, ranging from positive correlations between structural funds and growth (Beugelsdijk and Eijffinger, 2005) to even negative correlation between the two of them (Miderlfart and Overman, 2002; Martin, 1999). Another study of Ederveen, Gorter, De Mooij and Nahuis (2003) analyzed the relationship between Gross Domestic Product (GDP) per capita evolution and cohesion support, but there was no consensus regarding the impact of the Cohesion policy on real convergence.

Marinaş (2007) supports the perspective of a weak Cohesion policy capacity to bridge the income and structural gaps between nations and regions. The first reason pointed out is the lack of coordination between Community's projects and the local policies. The second one refers to the existence of a national structure based on a center-periphery model, which encourages the concentration of benefits in the urban agglomerations.

There are also empirical studies focusing on a conditional view of the structural funds effects on real convergence. Martin (2003) analyzed the impact of the EU's structural and cohesion funds on real convergence and concludes that the funds can foster growth and real convergence if there is a stable macroeconomic environment and if the institutional and microeconomic structure are leading to growth. Stierle (2005) reported a possible substantial impact of the EU Cohesion policy on the catching-up process. However, he puts forward several factors necessary to

positively influence the effectiveness of structural funds in the real convergence process: stronger spatial concentration, better thematic concentration and more effective use of funds.
However, even though there are three main official objectives of the Cohesion policy (convergence, regional competitiveness and employment, European territorial cooperation), Tarschys (2008) identifies at least 32 goals of the Cohesion policy, which further question the effectiveness of the policy.

Table no.1 - Coping with 27 Member States and multiple goals of the Cohesion Policy

32 goals of the Cohesion Policy	
Solidarity	Urban development
Convergence (countries)	Retraining of the unemployed
Convergence (regions)	Fighting social exclusion
Regional growth	Integration of vulnerable groups
Regional competitiveness	Gender equality in labour market
European growth	Boosting small & medium enterprises
European competitiveness	Inter-regional network-building
Administrative modernisation	Inter-regional learning
Institutional development	Linking regional elites to Brussels
Environmental protection	Trans-frontier cooperation
Climate policy	Compensation for internal market
EU visibility to citizens	Compensation for monetary union
EU legitimacy	Making enlargement acceptable in some areas of the Old Member States
European identity	Making enlargement acceptable in disadvantaged regions of the New Member States
Redistributive justice	Territorial cohesion
Rural development	Cohesion (sense of community)

Source: Tarschys, Daniel. "The Budget Review and the Committee on Budgetary Control: Coping with Multiple Agents and Multiple Goals", 2008.

In this paper we study the impact of the structural funds (European Regional Development Fund, European Social Fund, The Guidance Section of the European Agricultural Guidance and Guarantee Fund, The Financial Instruments for Fisheries Guidance) on the real convergence of several countries that became EU Member States in 2004. We chose Hungary, the Czech Republic, Poland, Slovakia and Slovenia because they are the main regional competitors of Romania. In our analysis, we consider only the structural funds paid under the convergence objective.
In comparison with the majority of the studies that employ the GDP per capita indicator, we study the absorbed structural funds in correlation with a Real Convergence Index, made up of the GDP per capita at at purchasing power parity (PPP) and the productivity per hour worked during 2004 – 2010. Productivity is an important engine driving the real convergence process. These Central and Eastern Europe countries can provide some useful empirical results for Romania, for which we cannot yet provide the same analysis, due to its late accession in 2007.

We also enrich the economic literature on the relationship between structural funds and real convergence with new findings for the New Member States. The study assesses the impact of the financial crisis as well.

3. Data and Methodology

In this paper, we build a real convergence index (RCI). RCI comprises 2 sub-indicators: GDP per capita at PPP and labor productivity per hour worked, as percentage of the EU average. Values below 100 point to levels lower than the EU. The EU average is set to equal 100. When computing RCI, each of the sub-indicators is given the same share of 50%.

The RCI index is computed as follows:

$$\mathrm{RCI}_{\mathrm{i,EU}} = \mathrm{GDP/capita} \times 0.5 + \mathrm{Labor\ productivity} \times 0.5, \quad (1)$$

where RCI $_{\mathrm{i,EU}}$ – real convergence index of country *i* with the EU.

The data used in the paper come from the Eurostat database and cover the period of time between 2004 and 2010.

We compare the level of structural funds payments, more exactly the amounts received by the countries, with the real convergence index which measures the degree of convergence with the EU.

4. Empirical results in the case of the New Member States

Almost all the territory of the 5 considered countries is under the convergence objective. More exactly, in the case of Poland and Slovenia, the whole countries are covered by this objective.

Out of these 5 countries, Slovenia reached the highest level of convergence, with an RCI of over 80 percentage points. Slovakia and the Czech Republic follow it with around 74% of the EU average. Poland's RCI amounts to only 58% even though it has received the highest share of funds from the countries analyzed.

As a general remark, the figures below emphasize that the maximum amount of structural funds payments was reached in 2007, with the exception of Slovenia. Since then, we notice a significant drop in the level of payments, the most important reason being the economic and financial crisis.

Taken separately, Hungary entered into the EU in 2004 with a Real Convergence Index of almost 60 percentage points that has slightly fluctuated around the same value and only in the recent years attained over 62 percentage points (Figure no.1). The structural funds payments increased until 2007, when they reached the maximum value. After this point, the amounts decreased significantly to 0.2 mil. Euro in 2009, while the RCI increased slightly. Consequently, we cannot assess a clear relationship between the two of them.

In the case of Poland, we observe a direct relationship between structural funds payments and RCI between 2004 and 2007, but the trend reverses starting with this year. After 2007, the amounts received by Poland from structural funds decreased constantly, but the RCI level increased to over 58 percentage points in 2010 (Figure no.2).

Figure no.1 – The case of Hungary

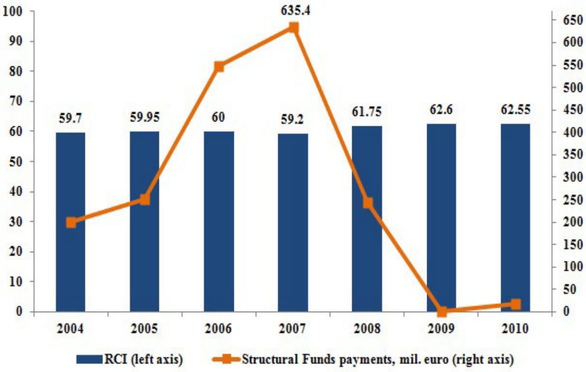
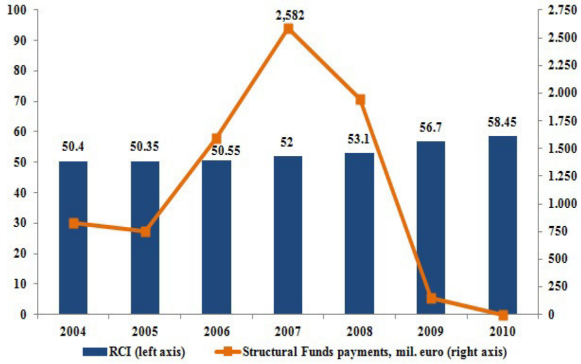


Figure no.2 – The case of Poland



Source: Authors' work.

As regards the Czech Republic, again there is no clear relationship between structural funds and RCI. Besides the year 2007, when the two of them reach a maximum value, we cannot assess a definite positive or negative relation (Figure no. 3).

Figure no.3 – The case of the Czech Republic

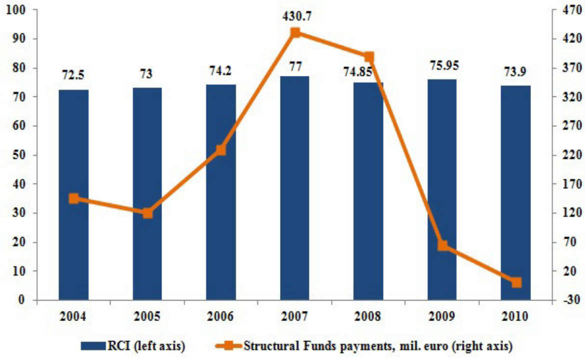
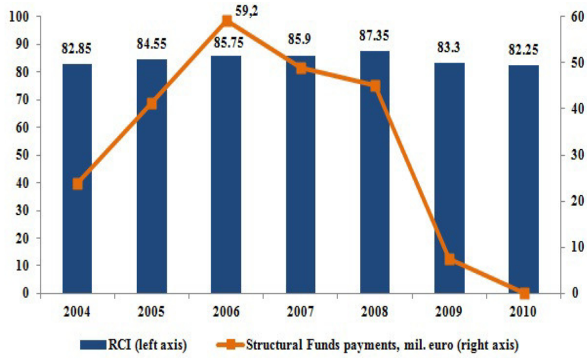


Figure no.4 – The case of Slovenia

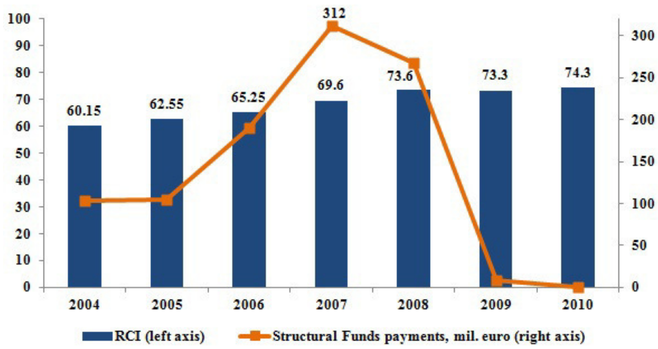


Source: Authors' work.

In comparison with the other countries analyzed, Slovenia recorded a maximum level of payments from structural funds in 2006. The highest level of RCI was reached two years later, in 2008, with 87.35 percentage points of the EU average (Figure no. 4). Again, there is no coherent relationship between structural funds and real convergence. However, in the case of the Czech Republic and Slovenia, during the last two years included in the analysis the real convergence decreased simultaneously with the amounts of payments received. This could indicate the need of a more important role of the Cohesion policy during bad economic times.

Finally, Slovakia recorded a permanently increasing RCI during 2004-2010, with the exception of 2009. The maximum level of 74.3 percentage points was reached in 2010. However, the payments had reached the highest level three years before, in 2007 (Figure no. 5).

Figure no.5 – The case of Slovakia



Source: Authors' work.

During the last two years of economic crisis, in 2009 and 2010, only Poland and Slovakia recorded increasing real convergence with the EU, while the amounts of payments decreased. This could also express lagging effects of the previous higher levels of the structural funds payments on the real convergence process. Hungary recorded almost the same RCI in 2009 and 2010, despite of the increase in the payments. In the case of the Czech Republic and Slovenia, the real convergence with the EU recorded lower levels during the crisis.

5. Conclusions and implications for Romania

Our study confirms the previous results of the economic research in the field of structural funds and real convergence. More exactly, the analysis on the five New Member States does not provide us with a clear answer regarding the relationship between the structural funds payments and the real convergence index computed in this paper.

However, there are four main conclusions derived from the study. First of all, with the exception of Slovenia, for all the other countries the payments from structural funds recorded the highest level in their fourth year of EU membership, in 2007. Secondly, the maximum level of structural funds payments does not match the maximum level of real convergence, with the exception of the Czech Republic. This may be due to lagging effects of the structural funds on the economic growth and development. Thirdly, there is a general decreasing trend of the structural funds payments in the second half of the analyzed period, with the exception of Hungary. Fourthly, during the economic and financial crisis in 2009 and 2010 only Poland and Slovakia recorded increasing values of the Real Convergence Index with the EU.

Romania currently records a very low absorption rate of the EU funds, of only 7%, and a real convergence index below 50% of the EU average. The challenge is very important on the medium and long term. However, the results of the current study are not very encouraging. There is no clear relationship between the absorption rate and the real convergence achievement. Consequently, a higher absorption rate of EU funds might not generate a faster real convergence process. This conclusion further questions the existence of the Cohesion policy of the EU.

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