Chapter 4
The Role and Function of Structural and Cohesion Funds and the Interaction of the EU Regional Policy with the Internal Market Policies

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A. Introduction

The European Regional policy should contribute to increasing growth, competitiveness and employment by incorporating the Union's priorities for sustainable development as defined at the Lisbon European Council and at the Göteborg European Council. Article 174 of the Treaty on the Functioning of the European Union (TFEU) provides that, in order to strengthen its economic and social cohesion, the EU is to aim at reducing disparities between the levels of development of the various regions and the adverse economic conditions of the least favoured regions or islands, including rural areas. Article 175 TFEU requires this action to be supported by the Structural Funds, the European Investment Bank (EIB) and the other existing Financial Instruments.

The Regional Policy of the European Union is one of the most important instruments in creating a genuine common market without disparities. The notion of *region* corresponds to the territorial division of Member States in accordance with their own administrative arrangements. Regions cover local authorities and municipalities, in as much as the latter belong, or exercise powers, within the relevant territory of a Member State. Regions thus cover sub-sections of Member States where the need for European intervention is needed in order to correct existing or persisting disparities.

Regions across Europe perform in distinctively variable manners, with productivity, employment and economic growth indicators reflecting systemic problems of structural adjustment. As early as the first transitional period of the European integration process in 1969, regional disparities posed a significant concern for subsequent enlargements and accession agreements. In this chapter, the role and function of the Structural Funds as special instruments to promote Regional Policy in the EU is examined, in conjunction with the ever-increasing interrelation of the EU Regional Policy with policies of the internal market such as procurement, state

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aid and the financing of services of general interest in an attempt to create a level-playing field for regional economic growth.

The EU Regional Policy directs funding and investment at the regions of Europe, through the Member States governments, or designated Regional Development Agencies, which have the task of allocating, monitoring and assessing the impact of the funding. Although it might not look in alignment with the principle of subsidiarity, regions and other territorial authorities cannot directly access funds and benefit from the thrust of the EU Regional Policy. This is a shortcoming in governance terms that the Committee of the Regions needs to address in the future.

B. The Legal Basis of EU's Regional Policy and the EU Structural Funds

The Single European Act (SEA) has been the cornerstone for the establishment of Regional Policy in the European Union. Title V Part III of the Treaty created three separate priorities for Community Institutions; firstly, a better cohesion between economic and social policy; secondly, the harmonious development of economic activity in conjunction with regional adjustments, and thirdly, the harmonious development of economic activity with welfare and employment opportunities.

Article 174 TFEU second paragraph allows for the European Union to promote measures aiming at reducing disparities between the various regions and at combating the disadvantageous economic condition of the least-favoured regions. This emphasis is also evident in Articles 176–178 (first paragraph) TFEU and in the Declaration, annexed to the Final Act on the adoption of the Single European Act, concerning Article 130D (now article 177 TFEU). In the Declaration, particular emphasis is paid on the Integrated Mediterranean Programmes (IMPs).[1] The new Articles 174 first paragraph TFEU, 177 and 178 second paragraph TFEU provide for the ability to promote employment opportunities independently of the regional concerns of Member States (for example in the cases of richer regions experiencing major unemployment, adaptation of vocational training and long-tem unemployment, combating youth unemployment and long-term unemployment) and to achieve better adjustment of agricultural policy in comparison to the structural development in other sectors of the economies of the Member States.

Article 175 TFEU is the modern foundation of the EU's Structural Funds. It allows the European Union to support the achievement of regional policy objectives by the action it takes through the Structural Funds (the European Agricultural Guidance and Guarantee Fund, the European Social Fund and the European

[1]See Regulation 2088/85, O.J. 1985 L 197/1; see also see Decision 88/258, O.J. 1988 L 107/39 as an example of an IMP. Portugal and Spain did not come under the IMPs but other programmes were set up, see Regulation 2053/88 (O.J. 1988 L 185/21) setting up the Portuguese European Development and Investment Programme (PEDIP) for Portugal.

Regional Development Fund), the European Investment Bank (EIB) and the other existing financial instruments. Parts of these financial instruments also relate to aspects of economic and social cohesion different from regional aspects. Article 175 TFEU stipulates that the objectives mentioned therein are not merely guidelines for the economic policy of Member States but they reflect on a vision for the Regional Policy envisaged in the Title XVII of the Treaty, as an essential method of completing the internal market and maintaining its proper functioning.

The technical and substantive implementation of Article 175 TFEU (former 159 EC) is Regulation 2052/88[2] which has been the outcome of the comprehensive proposal submitted by the European Commission under Article 161 EC (current 177 TFEU). This Regulation was designed, in the words of former Article 130D EC, “to make such amendments to the existing operational and structural rules of the existing provision of structural financial support . . . as are necessary to clarify and rationalise their tasks in order to contribute to the achievement of the objectives set out in Article 130A and Article 130C, to increase their efficiency and to coordinate their activities between themselves and with the operations of the existing financial instruments”. Five priority objectives have been identified for this purpose:

- Promoting the development and structural adjustment of the regions whose development is lagging behind
- Converting the regions, frontier regions or parts of regions (including employment areas and urban communities) seriously affected by urban decline
- Combating long-term unemployment
- Facilitating the occupational integration of young people
- With a view to the reform of the common agricultural policy, (a) speeding up the adjustment of agricultural structure, and (b) promoting the development of rural areas

Regulation 2052/88, which was entered into force on 1 January 1989, divided the implementation of each of these priorities to the various Funds. The comitology for assisting the European Commission, which is responsible for implementing the Regulation and all amending instruments, varies:

- For the dispensation of financial instruments for the development and structural adjustment of EU regions whose development is lagging behind the rest of the EU and for the conversion of EU regions seriously affected by industrial decline, an Advisory Committee composed of representatives of the Member States has been set up.
- For the dispensation of financial instruments for the combating of long-term unemployment and the facilitation of the integration into working life of young people and of persons exposed to exclusion from the labour market, as well as the facilitation of the adaptation of workers to industrial changes and to changes

[2] See O.J. 1988 L 185/9. See O.J. 1988 L 374 and the International Agreement on Budgetary Discipline and Improvement of Budgetary Discipline (O.J. 1988 L 184/33, point 17).

in production systems, the speeding up of the adjustment of agricultural and fisheries structures in the framework of the reform of the Common Agricultural Policy and the administration of the European Social Fund, a Management Committee composed of representatives of the Member States being set up in accordance with Article 163 TFEU.
- Implementing Commission Decisions under Article 178 TFEU are adopted laying down provisions governing operations under each Structural Fund.

There has been a shortcoming in understanding the effect of the new Title V of the Treaty, as a result of the introduction of the Single European Act, when compared with the wording of Articles 175 and 177 TFEU. On the one hand, the latter Articles refer to existing funds and other existing financial instruments, including the European Investment Bank; on the other hand, Article 177 TFEU is the legal basis for a one-off rationalisation measure relating to the specified Structural Funds (the European Agricultural Guidance and Guarantee Fund, the European Social Fund and the European Regional Development Fund). In order to avoid the need to have recourse to Article 308 TFEU, Regulation 2052/88 included a review clause for the Council of Ministers to review the Regulation 5 years after its coming into force, acting in accordance with the procedure of Article 177 TFEU. This solution allowed the symbiotic co-existence of Structural Funds and various other existing financial instruments, and allowed for the future creation of new financial instruments relevant to regional development policies of the EU.

Whilst the European Agricultural Guidance and Guarantee Fund have found a specific legal basis in Article 40(3) TFEU and the European Social fund in Articles 162 and 165 TFEU, this was not the case with the European Regional Development Fund (ERDF). Even Article 176 TFEU (previously Art. 160 EC) did not provide for legal basis, merely containing a detailed description of what the ERDF (which was set up under Article 308 TFEU) is intended to do. This is "to help to redress the main regional imbalances in the Union through participation in the development and structural adjustment of regions whose development is lagging behind and in the conversion of declining industrial regions". This description indicates that the ERDF is not only concerned with the more economically backward regions (the southern parts of the Union, Ireland and the northern part of the United Kingdom) but also with areas elsewhere in the Union where industrial development is in decline (e.g. industrial or mining areas which became obsolete or are in structural recession). Because Article 176 TFEU does not afford a legal basis for a substantive action or policy of the European Union, any changing of the detailed description of the tasks of the ERDF and other rules relating to its working would have to take place either on the basis of Article 177 TFEU or on the basis of Article 308 TFEU. The co-ordination required by Regulation 2052/88 has been based on Article 178 TFEU.

Article 175 TFEU stipulates that the regional aspects of the European Union must be taken into account in the conduct and co-ordination of economic policies of Member States, the implementation of all parts of Union common policies and the implementation of the internal market. This infers to the complementarity of regional policy and the function of the Structural Funds with other policies and legal frameworks of the Union, including Article 39 TFEU (Common Agricultural Policy), Article 96 TFEU (Common Transport Policy), Article 107(3) TFEU (the possibility of exempting aid to regional development from the general prohibition) and 174 TFEU (the tasks of the European Investment Bank).

Article 23 TFEU contains a clear rule in relation to the establishment and function of the internal market. However, the inherent powers of European Institutions and the obligations conferred upon Member States by virtue of Article 23 TFEU could create problems in the implementation of the EU Common Commercial Policy and, in its execution, the danger of continued regional differentiation. Besides the primary legal bases already mentioned under the Treaty Articles, Regulation 2088/85[3] made provision for the Integrated Mediterranean Programmes (IMPs) on a temporary basis (until 1992) in order to place the southern regions of the Community of Ten to adjust to the new situation created by Spanish and Portuguese accession by improving their economic structures under optimal conditions. IMPs were partly financed by contributions of 2,500 million ECU from existing Funds, partly by an additional budgetary contribution of 1,600 million ECU (both from the Community budget) and partly in the form of an estimated 2,500 million EU as loans from the European Investment Bank or under the new Regulation. Regulation 2088/85 can be seen as a sort of (partial) precursor of the Regulation 2052/88.

The ERDF has been governed by Regulation 1787/84[4] which came into force on 1 January 1985. The task of the ERDF has been to contribute, in proportion to the degree of under-development of the areas concerned, to the realisation of national as well as specific Union development programmes. The ERDF is assisted by the Regional Policy Committee set up by Decision 75/185,[5] although the primary task of that Committee is to contribute to the co-ordination of national regional policy. Attempts have been made to replace project financing (under Articles 5–14 of Regulation 1787/84) by financing integrated national and Union programmes, which have to be submitted to the Commission by the Member States. For Union programmes, which as a rule involve more than one Member State, the initiative is taken by the Commission which must reach agreement with the Member States concerned. Besides the above-mentioned programme financing (contributions of up to 50–55% of the public financing of the project or set of projects), Regulation 1787/84 also provides in Articles 17–23 for special help for the development of small and medium-size undertakings in industry, in the crafts or services sector or in infrastructure; here, there are varying funding levels, depending on the size of the project, but the concept is again of funding a percentage of the contribution of a

[3]See O.J. 1985 L 197/1.

[4]See O.J. 1984 L 169/1, as amended by the Act of Spanish and Portuguese Accession, Reg. 3634/85 (O.J. 1985 L 350/6) and Reg. 3641/85 (O.J. 1985 L 350/40).

[5]See O.J. 1975 L 73/47, corrigendum in O.J. 1975 L 117/22, as amended by Dec. 79/137 (O.J. 1979 L 35/9).

public authority or equivalent body.[6] Feasibility or viability studies may also be part-financed under Article 24 of Regulation 1787/84.

The impact of the Single European Act was to crystallise the primary legal instruments in order to codify the appropriate measures for launching the European Regional Policy. Article 174 TFEU, together with Article 2 and the fifth recital to the preamble of the Treaty, placed emphasis on regional policy with a view to reducing disparities between various regions and the assistance of regions facing decline. Major and persisting socio-economic disparities between different regions of the European Union are attributed to a number of factors, including industrialisation, productivity, specialisation, inward investment and social cohesion. Often, different tiers of development and growth have emerged within Member States reflecting on a real threat to the economic and social cohesion of the European Union. In order to implement economic and social cohesion objectives envisaged in the Treaty, the European Commission has created the Structural Funds and, a decade after the introduction of the SEA, the Cohesion Fund as legal and financial instruments to promote regional and horizontal operations in the Member States. The Structural Funds and the Cohesion Fund provide the main method by which the EU encourages greater economic and social cohesion and uniformity of living standards across its area.

C. The General Principles of Structural Funds

The principles that underpin the function and operation of the Structural Funds have been harnessed over the years and formalised in four major themes:

I. The Principle of Programming

The principle of programming was introduced in 1988 and carried through subsequent reforms of the legal instruments and involves the preparation of multi-annual development plans by Member States. It is undertaken through a partnership-based decision-making process, in several stages, until the measures are taken over by the public or private bodies entrusted with carrying them out. Under the General Regulation on the Structural Funds, the programming period is

[6] Two most interesting ERDF projects are RESIDER programme (Reg. 328/88, O.J. 1988 L 33/1) and the RENAVAL programme (Reg. 2506/88, O.J. 1988 L 225/24) for the steel and ship building sectors respectively. As an example of the overlap between regional policy and high technology see Reg. 3300/86 (O.J. 1986 L 305/1) setting up the STAR programme and of the overlap with energy policy see Reg. 3301/86 (O.J. 1986 L 305/6) setting up the Valoren programme.

usually 7 years, although adjustments will be possible depending on the mid-term review.

Initial development plans are first submitted by the Member States. These plans are based on national and regional priorities and include a precise description of the current situation in the region (disparities, lagging behind development, overall development potential); a description of the most appropriate strategy for achieving the stated objectives; and indications as to the use and form of the contribution from the Funds. Member States submit full programming documents to the European Commission. Programming documents can take the form of either support frameworks which are translated into operational programmes; these are documents approved by the Commission in agreement with the Member State concerned, which contain both the Member State and the Funds' strategy and priorities for action, their specific objectives, the contribution from the Funds and the other financial resources; or single programming documents (SPDs) comprising a single document, approved by the Commission and combining the data contained in a support framework and operational programme (integrated regional programme containing the programme's priorities, a short description of the proposed measures and an indicative financing plan). The European Commission negotiates with the Member States on the basis of their programming documents and makes an indicative allocation from the Funds to each form of assistance for each Member State.

II. The Principle of Partnership

Utilisation of funding from the Structural Funds channeled to mitigate regional disparities presupposes a partnership approach by Member States to include the regional and local authorities, the economic and social partners and other competent bodies. The partnership approach complements the programming principle in as much as by involving the partners at all stages the approval of the development plan could be ascertained, prior to the submission of the full programming documents of the European Commission by Member States.

III. The Principle of Additionality

This principle requires Union assistance to be additional to national funding and not to replace it. Member States must maintain their own public expenditure at least at the level it was at in the preceding period and supplemented with funding matched by the Structural Funds. Additionality as a principle introduces an element of joint investment by Member States and the European Union, in regions where disparities threaten socio-economic cohesion. In doing so, the actions of Member States are immune from state aid regulation.

IV. The Principle of Authentication

In order to utilise their availability and draw down funding from the Structural Funds, Member States must appoint a managing authority for each programme. Its tasks cover the implementation, correct management and effectiveness of the programme (collection of statistical and financial data, preparation and transmission to the Commission of annual reports, organisation of the mid-term evaluation, etc.). Monitoring Committees are also set up, which fall under the responsibility of Member States. These Committees, chaired by a representative of the managing authority, ensure the efficiency and quality of the implementation of the structural measures.

There exist three types of authentication procedures, *ex ante*, mid-term and *ex post* with clear demarcations of responsibility for each one. The *ex ante* authentication is the responsibility of the competent authorities in the Member States, whereas the mid-term authentication must be carried out by the authority managing the programme in collaboration with the Commission; finally, the *ex post* authentication is the responsibility of the Commission, in collaboration with the Member State and the managing authority. All reports must be made available to the public.

V. The Principle of Probity

Member States and the Commission conclude a financial contract whereby the Commission undertakes to pay annual commitment appropriations from the Structural Funds on the basis of the adopted programming documents. Each Member State appoints a payment authority for each programme to act as intermediary between the final beneficiaries and the Commission. The payment authority, in collaboration with the managing authority, monitors the expenditure of the final beneficiaries and ensures that the Union rules relating to the application and use of Structural Funds are observed. The physical movement of funds (i.e. payment appropriations) from the European Union to Member States actually happens when the Commission reimburses the actual expenditure of the final beneficiaries, approved and certified by the payment authorities.

The increased decentralisation of programme management under the principle of authentication reflects the need for improved checking arrangements, which are the responsibility of Member States. The European Commission itself ensures the effectiveness of the arrangements set up by the managing and payment authorities. Detailed checks, such as on-the-spot checks and financial audits, must be made on 50% – as a minimum – of expenditure under each programme. When irregularities are found, Member States are responsible for making financial corrections by cancelling all or part of the financing of the operations concerned. In practice, this could create significant legal problems within the systems of Member States, as for example, contracts with relevant providers or contractors would have to be amended or cancelled, bringing into play contractual and non-contractual liability issues on both parties. The funds thus released by the Member States can be re-used; those recovered by the Commission are withdrawn and are not reusable. The most significant control mechanism for the function of the Structural and Cohesion Funds rests with the Member States themselves, in particular their obligations to observe and comply with European law. The European Commission *ab initio* requires a detailed set of procedures to monitor and evaluate the impact of the funding to the regions and insists on the utilisation of open and transparent procedures for the selection of the relevant private sector partner who will deliver the modalities of the regional aid programme in question. The European Commission might use compliance procedures under Art. 260 TFEU, if it is not satisfied that the regional aid programme has been dispensed or monitored correctly.

D. The Function of Structural and Cohesion Funds

The EU Regional Policy provides traction for the solidarity principles amongst the people of the European Union. It helps to achieve one of the fundamental objectives laid down in the Treaty: the strengthening of the EU's economic and social cohesion by reducing developmental disparities between its regions. It has a significant impact on the competitiveness of the regions and on the living conditions of their inhabitants, mainly by co-financing multiannual development programmes.

These programmes are supported by four Structural Funds: the *European Regional Development Fund* (ERDF) for infrastructure and investments, generating jobs and SMEs, the *European Social Fund* (ESF) for training, social integration and employment, the *European Agricultural Guidance and Guarantee Fund* (EAGGF) for rural development and aid to farms, and the *Financial Instrument for Fisheries Guidanc*e (FIFG) for the adaptation of the fisheries sector. In addition, the *Cohesion Fund* was introduced in 1994, in order to promote economic, social and territorial convergence in the European Union.

The Structural Funds absorb approximately one third of the EU budget. Their allocation for the 2000–2006 is EUR 195 billion for the EU 15, plus 15 billion for the new Member States between 2004 and 2006. The Cohesion Fund receives EUR 25.6 billion for the EU 25. Financial assistance from the Structural Funds has concentrated on seven Objectives, which have focused attention on the regions and groups in society most in need of assistance. These objectives are:

1. Objective 1: to promote the development and structural adjustment of regions whose development is lagging behind the rest of the EU
2. Objective 2: to convert regions seriously affected by industrial decline
3. Objective 3: to combat long-term unemployment and facilitate the integration into working life of young people and of persons exposed to exclusion from the labour market
4. Objective 4: to facilitate the adaptation of workers to industrial changes and to changes in production systems

5. Objective 5(a): speeding up the adjustment of agricultural and fisheries structures in the framework of the reform of the Common Agricultural Policy
6. Objective 5(b): facilitating the development and structural adjustment of rural areas
7. Objective 6: assisting the development of sparsely-populated regions (Sweden & Finland only)

For 2007–2013, the Commission proposes to concentrate its priorities in three areas, with a global budget of approx. EUR 336 billion. The Structural Funds will concentrate in the future on three priority areas: catch-up for regions lagging behind in development (Objective 1), socio-economic conversion of industrial, urban or rural zones or zones which are dependent on fisheries (Objective 2), and improved training and job opportunities (Objective 3), (Objective 1 region's programmes already include measures of this kind). Aid is also granted by four Initiatives which encourage cross-border, transnational and interregional cooperation throughout the EU (INTERREG III), the regeneration of cities and neighborhoods in crisis (URBAN II), equality in the labour market (EQUAL) and the development of rural areas (LEADER+). Finally, the Innovative actions support experimental regional programmes.

I. The European Regional Development Fund

The European Regional Development Fund (ERDF) contributes to the financial assistance of regions whose development is lagging behind and those undergoing economic conversion or experiencing structural difficulties. The European Regional Development Fund is currently the largest financial instrument of European Union's Regional Policy, which is intended to narrow the development disparities among regions and Member States. Since 1975, it has provided support for the creation of infrastructure and productive job-creating investment, mainly for businesses; ERDF resources are mainly used to co-finance the following priorities: productive investment leading to the creation or maintenance of jobs; infrastructure; and local development initiatives and the business activities of small and medium-sized enterprises. In practice, most regional development areas are covered, including transport, communication technologies, energy, the environment, research and innovation, social infrastructure, training, urban redevelopment and the conversion of industrial sites, rural development, the fishing industry, tourism and culture.

ERDF regional policy support measures have been concentrated on five strategic areas.

1. Objective 1 Measures: Development of the Least Favoured Regions

Objective 1 financial support from the Structural Funds is the main priority of the European Union's cohesion policy. In accordance with the Treaty, the Union works to "promote harmonious development" and aims particularly to "narrow the gap between the development levels of the various regions". More than 65% of the appropriations of the Structural Funds (EUR 135 billion) are allocated to helping areas lagging behind in their development ("Objective 1") where the gross domestic product (GDP) is below 75% of the Union average. The entire Objective 1 regions exhibit negative economic indicators and, in particular: low levels of investment; a higher than average unemployment rate; lack of services for businesses and individuals; and poor basic infrastructure.

More than 50 regions, representing 22% of the European population, have been covered by Objective 1 support measures in the period 2000–2006. The Structural Funds have supported the improvement of economic activities in these regions by providing the basic infrastructure they lack, whilst adapting and raising the level of trained human resources and encouraging investments in businesses.

2. Objective 2 Measures: Conversion of Regions Facing Difficulties

Objective 2 financial support from the Structural Funds aims to revitalise all areas or regions facing structural difficulties, whether industrial, rural, urban or regions dependent on fisheries. Although situated in regions whose development level is close to the Union average, such areas are faced with different types of socio-economic difficulties that are often the source of high unemployment. These include: the evolution of industrial or service sectors; a decline in traditional activities in rural areas; a crisis situation in urban areas; and difficulties affecting fisheries activity.

3. Interreg III: Measures of Interregional Cooperation

Interreg III is an initiative which aims to stimulate interregional cooperation in the EU, particularly during the period 2000–2006. It is financed under the European Regional Development Fund (ERDF). This phase of the Interreg initiative is designed to strengthen economic and social cohesion throughout the EU, by fostering the balanced development of the continent through cross-border, transnational and interregional cooperation. Special emphasis has been placed on integrating remote regions and those which share external borders with the candidate countries.

4. Urban II: Measures of Sustainable Development of Urban Areas

Urban II is an Initiative of the European Regional Development Fund (ERDF) for sustainable development in the troubled urban districts of the European Union for the period 2000–2006. As a follow-up to Urban I in 1994–1999, Urban II aims more precisely to promote the design and implementation of innovative models of development for the economic and social regeneration of troubled urban areas. It will also strengthen information and experience-sharing on sustainable urban development in the European Union.

5. Innovative Actions – Development of Innovative Strategies to Make Regions More Competitive

The innovative actions of the European Regional Development Fund (ERDF) were laboratories of ideas for regions to develop innovation policies. As the opportunities for experimentation were often limited under the main support of the Structural Funds, the innovative actions provided regional actors with the "risk space" needed to respond to the challenges set by the new economy. During the period 2002–2006, the programmes funded measures relating to one or more of the following three strategic themes: knowledge-based regional economies and technological innovation; e-EuropeRegio: the information society and regional development; and regional identity and sustainable development. Regional programmes for innovative actions will not be co-financed by the structural funds as distinct operational programmes for the period 2007–2013.

The Instrument for Structural Policies for Pre-accession (ISPA)[7] was developed by the European Commission to help the central and eastern European countries comply with Union environmental and transport standards. With an annual budget of EUR 1,040 million, ISPA's approach is similar to that of the Cohesion Fund.

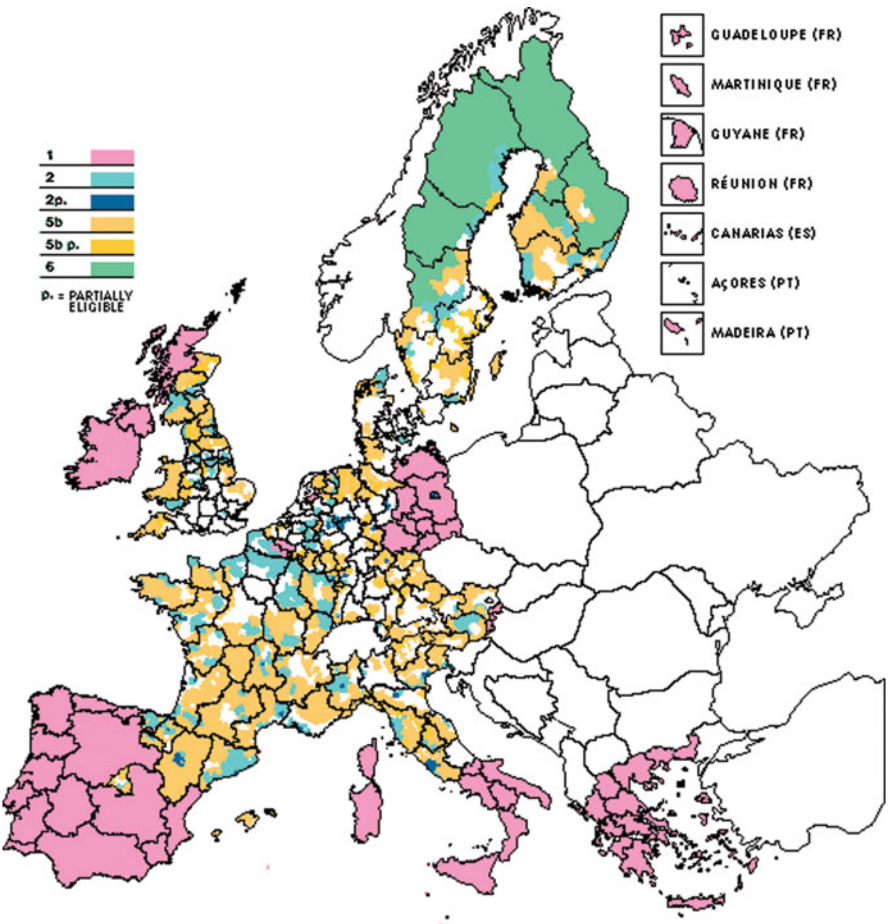
The average GDP in the central and eastern European Countries (CEECs) is considerably lower than that of the Member States of EU 15. Out of 105 million people living in these countries, more than 98 million are in regions where per capita GDP is less than 75% of the projected average for the enlarged EU. CEECs have a substantial deficit to make up in all socio-economic sectors – industry, services, transport, the environment, agriculture, skills levels. Transport

[7]For the period 2000–2006, EUR 1,040 million a year (at 1999 prices) has been made available for this instrument. During its first 4 years of implementation (2000–2003), ISPA grant-aided over 300 large-scale infrastructure investments in the ten (at that time) candidate countries of Central and Eastern Europe (Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia). Assistance amounted to EUR 7 billion for an investment value of over EUR 11.6 billion (current prices). After the EU enlargement in 2004, the remaining ISPA beneficiary countries were Bulgaria and Romania (until 2007), the other beneficiary countries having become eligible to the Cohesion Fund. Since 1 January 2005, Croatia benefits from ISPA as well.

infrastructure provision is well below average levels in the Union, in terms of both quantity and quality. In particular, a huge amount of work is needed to develop national networks and connect them to the trans-European networks.

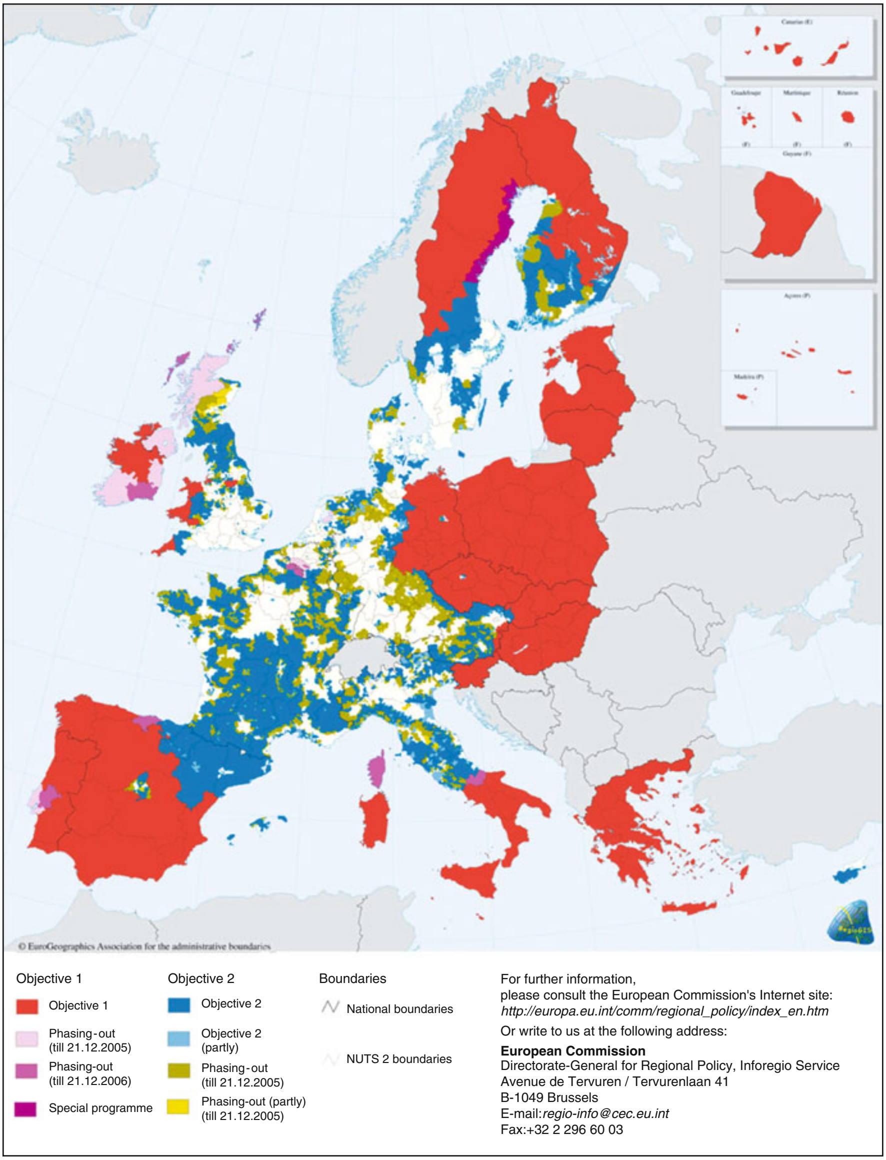
As far as environmental law and policy compliance is concerned, the worst problems are water pollution, waste management and air pollution. Some 40% of the population in the applicant countries do not have running water and only 42% of liquid waste is treated, and then rarely to EU standards.

European Regions benefiting from Structural Funds – up to 2000. Source: Eurostat



European Regions benefiting from Structural Funds – 2004–2006. Source: Eurostat

Regional policy in the enlarged Union
Structural Funds 2004-2006:areas eligible under Objectives 1 and 2



II. The European Social Fund

The European Social Fund provides assistance under the European Employment Strategy, to promote measures aiming at employment policies. The European Social Fund (ESF), which was set up in 1958, contributes to the integration into working life of the unemployed and disadvantaged sections of the population, mainly by funding training measures. The European Social Fund aims to prevent and combat unemployment, as well as developing human resources and promoting integration into the labour market. The main fields of applications of European Social Fund include: occupational integration of the long-term unemployed; occupational integration of young unemployed persons; occupational integration of persons excluded from the labour market; promoting equal opportunities for all in accessing the labour market, through the EQUAL Initiative; specific actions to improve women's access to the labour market; improving education and training systems; and promoting a skilled workforce and boosting human potential in the field of research and development.

ESF Contributions per Member State – 2000–2009. Source Eurostat

	ESF co-funding breakdown			Total (€)
	EU (€)	National (€)	Private[a] (€)	
Austria	524,412,560	549,921,560	110,000,000	1,184,334,120
Belgium	1,073,217,594	1,155,010,157	91,656,855	2,319,884,606
Bulgaria	1,185,459,863	209,198,799	0	1,394,658,662
Cyprus	119,769,154	29,942,289	0	149,711,443
Czech Republic	3,774,521,428	661,259,283	0	4,435,780,711
Denmark	254,788,619	169,989,437	84,799,182	509,577,238
Estonia	391,517,329	51,514,377	18,775,822	461,807,528
Finland	618,564,064	801,836,655	0	1,420,400,719
France	5,394,547,990	3,692,289,165	1,188,416,953	10,275,254,108
Germany	9,380,654,763	4,786,130,114	1,499,483,428	15,666,268,305
Greece	4,363,800,403	1,362,266,800	0	5,726,067,203
Hungary	3,629,088,551	640,427,395	0	4,269,515,946
Ireland	375,362,370	981,757,963	3,000,000	1,360,120,333
Italy	6,938,007,896	8,382,975,181	0	15,320,983,077
Latvia	550,653,717	85,691,846	20,612,487	656,958,050
Lithuania	1,028,306,727	105,884,641	75,822,521	1,210,013,889
Luxembourg	25,243,666	25,243,666	0	50,487,332
Malta	112,000,000	19,764,705	0	131,764,705
Netherlands	830,002,737	467,973,207	407,350,315	1,705,326,259
Poland	9,707,176,000	1,713,031,059	0	11,420,207,059
Portugal	6,512,387,865	2,697,500,732	0	9,209,888,597
Romania	3,684,147,618	651,225,177	0	4,335,372,795
Slovakia	1,499,603,156	264,635,856	0	1,764,239,012
Slovenia	755,699,370	133,358,718	0	889,058,088
Spain	8,057,328,822	3,243,162,467	125,323,084	11,425,814,373
Sweden	691,551,158	691,551,158	0	1,383,102,316
United Kingdom	4,474,917,728	4,134,516,286	215,162,274	8,824,596,288
	75,952,731,148	37,708,058,693	3,840,402,921	117,501,192,762

[a]Private expenditure: any eligible expenditure contributing to the financing of operations whose origin is not the public budget, for example own expenditure from private bodies benefiting from ESF support

The EQUAL Initiative supersedes two previous human resources initiatives ADAPT and EMPLOYMENT. The EQUAL budget for 2000–2006 has been EUR 2,847 million. The main aim of EQUAL is to promote new ways of tackling all forms of exclusion, discrimination and inequality in relation to the labour market. Although eligible areas include all EU Members, in order to ensure optimum cost effectiveness, funding has been concentrated on a limited number of large-scale projects run by several partners. The EQUAL Initiative priorities cover three large strands:

- Strand A: tackling discrimination and inequalities linked to the labour market. Projects run under this strand of the initiative must reflect the priorities agreed between the Member States and the Commission under the European Employment Strategy. These are carried out by public and private partners and associations through transnational cooperation.
- Strand B: networking projects at national level to enable information exchanges and the dissemination of best practice.
- Strand C: joint work by the Commission and Member States to learn the lessons of good practice and take into account in policy development the priorities to be implemented through the EQUAL initiative.

The Commission has set out an indicative financial allocation per Member State for each priority strand taking into account factors including the level of employment and training inequality in access to the labour market, the level of poverty and the number of asylum seekers.

ESF contributions to member states from EQUAL programme. Source: Eurostat

Indicative financial allocation per Member State	EQUAL € m
BE	70
DK	28
D	484
EL	98
E	485
F	301
IRL	32
I	371
L	4
NL	196
A	96
P	107
FIN	68
S	81
UK	376
Networks	50
EUR15	2,874

III. The European Agricultural Guidance and Guarantee Fund

The European Agricultural Guidance and Guarantee Fund (EAGGF), set up by Regulation 25/1962 on the financing of the common agricultural policy[8] consumes a large part of the general budget of the European Union. The EAGGF is composed of two sections, the Guidance section and the Guarantee section. Within the framework of European economic and social cohesion policy, the EAGGF supports rural development and the improvement of agricultural structures. The main fields of application of EAGGF include: investment in agricultural holdings (modernization, reduction in production costs, product quality, the environment, etc.); aid for the setting up of young farmers and vocational training; aid for early retirement; compensation for less-favoured areas; agri-environmental measures; processing and marketing of agricultural products; development and optimal utilisation of forests; and development of rural areas through the provision of services, support for the local economy, encouragement for tourism and craft activities. In Objective 1 regions, these measures are financed by the EAGGF-Guidance section, with the exception of compensatory allowances, aid for early retirement, agri-environmental measures, and measures for the development of forests, which are financed by the EAGGF-Guarantee section. Outside Objective 1 areas, all measures are financed by the EAGGF-Guarantee section.

The European Agricultural Guidance and Guarantee Fund Guidance Section provides financial assistance for the development and the structural adjustment of rural areas whose development is lagging behind by improving the efficiency of their structures for producing, processing and marketing agricultural and forest products. The Fund's Guarantee Section finances, in particular, expenditure on the agricultural market organisations, the rural development measures that accompany market support and rural measures outside of Objective 1 regions, certain veterinary expenditure and information measures relating to the CAP. The Guidance Section finances all other rural development expenditure which is not financed by the EAGGF Guarantee Section.

The Fund is administered by the Commission and the Member States, cooperating within the EAGGF Committee. The Fund Committee consists of representatives of the Member States and of the Commission. The financial resources required to cover EAGGF expenditure are made available to the Member States by the Commission by means of advances on the provision for expenditure incurred. In effect, the Commission reimburses expenditure incurred (pre-financed) by the Member States. In addition, working capital can be made available to the Member States for the implementation of rural development programmes. At the end of the financial year, the Member States forward to the Commission their annual statement of expenditure in addition to an attestation regarding the completeness, accuracy and veracity of the accounts transmitted. The Commission clears the accounts of the paying agencies before May. Its decision covers the completeness, accuracy and veracity of the accounts submitted. This clearance of accounts decision does not

[8] Amended by Regulation 728/70 and subsequently superseded by Council Regulation 1258/1999 of 17 May 1999 on the financing of the common agricultural policy [O.J. L 160 26 June 1999].

prejudice the adoption of subsequent (*ad hoc*) decisions excluding expenditure from Union financing if it has not been incurred in compliance with Union rules. The amounts concerned (financial corrections) are recovered from the Member States.

IV. The Financial Instrument for Fisheries Guidance

Finally, the Financial Instrument for Fisheries Guidance[9] supports restructuring in the fisheries sector. Financial support is also given through the European Investment Bank and the Cohesion Fund.[10] The FIFG aims to contribute to achieving a sustainable balance between fishery resources and their exploitation. It also seeks to strengthen the competitiveness of the sector and the development of areas dependent upon it. The fields of application of FIFG include: adjustment of the fishing effort; fleet modernisation; aquaculture development; protection of marine areas; fishing port facilities; and processing and marketing of fishery products and product promotion.

V. The Cohesion Fund

With a view to facilitating economic, social and territorial convergence, the European Union set up a Cohesion Fund in 1994. The Cohesion Fund is intended for countries whose per capita GDP is below 90% of the Union average. The purpose of the Cohesion Fund is to grant financing to environment and transport infrastructure projects. However, aid under the Cohesion Fund is subject to certain conditions. If the public deficit of a beneficiary Member State exceeds 3% of national GDP (EMU convergence criteria), no new projects under the Cohesion Funds could be approved until the deficit has been brought under control.

For the period 2007–2013, the EU Budget has allocated to Regional Policy appropriations amounting to circa EUR 348 billion, comprising EUR 278 billion for the Structural Funds and EUR 70 billion for the Cohesion Fund. This represents 35% of the Community budget and is the second largest budget item, after the Common Agricultural Policy (CAP) appropriations.

The Structural Funds, as well as the Cohesion Fund will be utilised by the European Commission and Member States as financial instruments involving co-financing regional policy objectives between 2007 and 2013. The rates of co-financing may be reduced in accordance with the "polluter pays" principle or where a project generates income. A precondition for all projects receiving European funding under the

[9]The FIFG was not a Structural Fund, but it financed structural actions in the fisheries sector. It became a Structural Fund in the 2000–2006 programme period.

[10]The Cohesion Fund initially was only applicable to Greece, Spain, Ireland and Portugal under the provisions of the Maastricht Treaty, but cannot be used to finance projects that receive support from the ERDF, the ESF or the guidance section of the EAGGF.

Structural Funds and the Cohesion Fund is their compliance with EU competition legislation, particularly with regard to public procurement.

Between 2000 and 2007, Cohesion Fund the biggest beneficiaries include Spain, Portugal, Greece, Poland, Austria, Lithuania, Latvia and Cyprus.

E. The EU Regional Policy and the Structural Funds in the Twenty-First Century

Economic, social and territorial disparities at both regional and national level have increased in the enlarged European Union. The Funds providing assistance under the cohesion policy include the European Regional Development Fund (ERDF), the European Social Fund (ESF) and the Cohesion Fund. The rules applicable to each Fund are to be specified in implementing regulations adopted under Articles 148, 161 and 162 of the Treaty. The Cohesion Fund should be integrated into the programming of structural assistance in the interest of greater coherence in the intervention of the various Funds. The outermost regions should benefit from specific measures and additional funding to offset the handicaps resulting from the factors referred to in Article 299(2) of the Treaty.

To increase the outcomes of the EU Regional Policy, the intervention of the Structural Funds and of the Cohesion Fund should be concentrated on objectives seeking the convergence of the Member States and the regions, regional competitiveness and employment and European territorial cooperation. Within those three objectives, both economic and social characteristics and territorial characteristics of Member States should be taken into account. Objective criteria for designating eligible regions and areas have been established, where the identification of the priority regions and areas at Union level is based on the common system of classification of the regions established by on the establishment of a common classification of territorial units for statistics (NUTS).[11]

Financial assistance to the European regions through the Structural Funds and the Cohesion Fund should be dispensed having consideration to the principles of subsidiarity and proportionality. However, under Article 317 TFEU, in the context of shared management, the conditions allowing the Commission to exercise its responsibilities for implementation of the general budget of the European Union should be specified and the responsibilities of cooperation by the Member States clarified. The application of these conditions should satisfy the European Commission that Member States are using the Funds in a legal and regular manner and in accordance with the principle of sound financial management.[12] To that extent,

[11]See Regulation (EC) No 1059/2003 of the European Parliament and the Council of 26 May 2003.

[12]The Commission should establish the indicative annual breakdown of available commitment appropriations using an objective and transparent method, taking into account the Commission's proposal, the conclusions of the European Council of 15 and 16 December 2005 and the Inter-

contributions from the Structural Funds should not replace public expenditure by Member States, in order to ensure a genuine economic impact. Verification of the principle of additionality should concentrate on the regions under the Convergence objective because of the extent of the financial resources allocated to them and may result in a financial correction if additionality is not observed.

For the period 2007–2013, three new objectives should be pursued by the Structural Funds and the Cohesion Fund:

Firstly, the "convergence" objective with the view to accelerating the convergence of the least developed EU Member States and regions by improving growth and employment conditions. This objective is financed by the ERDF, the ESF and the Cohesion Fund. It represents 81.5% of the total resources allocated. The co-financing ceilings for public expenditure amount to 75% for the ERDF and the ESF and 85% for the Cohesion Fund. The Convergence objective is to cover the Member States and regions whose development is lagging behind. The regions targeted by the Convergence objective are those whose per capita gross domestic product (GDP) measured in purchasing power parities is less than 75% of the Union average. The regions suffering from the statistical effect linked to the reduction in the Union average following the enlargement of the European Union are to benefit for that reason from substantial transitional aid in order to complete their convergence process. This aid is to end in 2013 and is not to be followed by a further transitional period. The Member States targeted by the Convergence objective whose per capita gross national income (GNI) is less than 90% of the Union average are to benefit under the Cohesion Fund. Financial concentration on the Convergence objective should be increased because of the greater disparities within the enlarged European Union, the effort in favour of the Regional competitiveness and employment objective to improve competitiveness and employment in the rest of the Union should be maintained and the resources for European territorial cooperation objective should be increased in view of its particular value added.

Secondly, the "regional competitiveness and employment" objective to anticipate economic and social change, promote innovation, entrepreneurship, environmental protection and the development of labour markets which include regions not covered by the Convergence objective. It is financed by the ERDF and the ESF and accounts for 16% of the total allocated resources. Measures under this objective can receive co-financing of up to 50% of public expenditure. The Regional competitiveness and employment objective is to cover the territory of the Union beyond the Convergence objective. The regions eligible are those under Objective 1 in the 2000–2006 programming period which no longer satisfy the regional eligibility criteria of the Convergence objective and which therefore benefit from a transitional aid, as well as all the other regions of the Union.

institutional Agreement of 17 May 2006 between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management (O.J. C 139, 14 June 2006, p. 1) with a view to achieving a significant concentration on the regions whose development is lagging behind, including those receiving transitional support because of the statistical effect.

Thirdly, the "European territorial cooperation" objective to strengthen cooperation at cross-border, transnational and interregional levels in the fields of urban, rural and coastal development, and foster the development of economic relations and networking between small and medium-sized enterprises (SMEs). This objective is financed by the ERDF and represents 2.5% of the total allocated resources. Measures under the Territorial Cooperation objective can receive co-financing of up to 75% of public expenditure. The European territorial cooperation objective is to cover regions having land or sea frontiers, the areas for transnational cooperation being defined with regard to actions promoting integrated territorial development and support for interregional cooperation and exchange of experience.

Three per cent of the Structural Funds appropriations allocated to Member States under the Convergence and Regional competitiveness and employment objectives may be placed in a national reserve for rewarding performance. The annual appropriations allocated to a Member State under the Funds should be limited to a ceiling fixed with regard to its capacity for absorption and should be indexed on a flat-rate basis for use in programming. With a view to improving complementarities and simplifying execution, the assistance of the Cohesion Fund and the ERDF should be jointly programmed in the case of operational programmes on transport and the environment and should have a national geographical coverage. Within the operational programmes co-financed by the ERDF under the Convergence and the Regional competitiveness and employment objectives, Member States, regions and managing authorities may organise sub-delegation to urban authorities in respect of priorities concerning the regeneration of towns and cities.

Programming should ensure coordination of the Funds between themselves and with the other existing financial instruments, the EIB and the European Investment Fund (EIF). Such coordination should also cover the preparation of complex financial schemes and public–private partnerships. Member States must ensure that improved access to finance and innovative financial engineering are available primarily to micro-, small and medium-sized enterprises and for investing in public–private partnerships and other projects included in an integrated plan for sustainable urban development. Member States may decide to set up a holding fund through the award of public contracts pursuant to public procurement law, including any derogation in national law compatible with EU law. In other cases, where Member States are satisfied that public procurement law is not applicable, the definition of tasks of the European Investment Fund (EIF) and the European Investment Bank (EIB) justifies that Member States award them a grant that is a direct financial contribution from operational programmes by way of donation. Under the same conditions, national law may provide for the possibility of awarding a grant to other financial institutions without a call for proposal. It is appropriate to define what expenditure in a Member State can be assimilated to public expenditure for the purpose of calculating the total national public contribution to an operational programme. For this purpose, Member States are referred to the definition and operational functions of "bodies governed by public law" as defined in the public procurement directives, since such bodies comprise several types of public or private body established for the specific purpose of meeting needs in the general interest not having an industrial or commercial character and which are controlled by the State, or regional and local authorities. The EU Regional Policy interacts with public procurement,[13] which represents not only the procedural framework of the contractual interface between public and private sectors[14] but it also reflects on the nature of activities of the state and its organs in pursuit of public interest.[15] In the epicenter of the debate regarding the relation between regional policy and public services within the internal market, public procurement has emerged as an essential component of understanding the complementarity of the objectives of the European Institutions and of the Member States. The existence of public procurement, as a system, verifies conceptual links, creates compatibility safeguards, and authenticates established principles applicable in state aid jurisprudence. Three per cent of the Structural Funds appropriations allocated to Member States under the Convergence and Regional competitiveness and employment objectives may be placed in a national reserve for rewarding performance.

In accordance with the principles of subsidiarity and proportionality, Member States should have the primary responsibility for the implementation and control of the interventions. The obligations on the Member States as regards management and control systems, the certification of expenditure, and the prevention, detection and correction of irregularities and infringements of EU law should be specified to guarantee the efficient and correct implementation of operational programmes. In particular, concerning management and control, it is necessary to establish the procedures by which Member States give the assurance that the systems are in place and function satisfactorily. The extent and intensity of Union controls should be proportionate to the extent of the Union's contribution. Where a Member State is the main provider of the financing for a programme, it is appropriate that there should be an option for that Member State to organise certain elements of the control arrangements according to national rules. In these same circumstances, it is necessary to establish that the Commission differentiates the means by which Member States should fulfill the functions of certification of expenditures and of verification of the management and control system and to establish the conditions

[13] See Bovis (2005), pp. 290–310. Also Communication from the European Commission to the Council, the European Parliament, the Economic and Social Committee, and the Committee of the Regions, "Working together to maintain momentum" 2001 Review of the Internal Market Strategy, Brussels, 11 April 2001, COM (2001) 198 final. Also, European Commission, Commission Communication, Public procurement in the European Union, Brussels, March 11, 1998, COM (98) 143. See Commission Interpretative Communication on the Community law applicable to public procurement and the possibilities for integrating social considerations into public procurement, COM (2001) 566, 15 October 2001. Also, Commission Interpretative Communication on the Community law applicable to public procurement and the possibilities for integrating environmental considerations into public procurement, COM (2001) 274, 4 July 2001.

[14] See Directive 2004/18, O.J. L 134, 30 April 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts and Directive 2004/17, O.J. L 134, 30 April 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sector.

[15] See Bovis (2003a).

under which the Commission is entitled to limit its own audit and rely on the assurances provided by national bodies. In addition to the suspension of payments where a serious deficiency is detected in the management and control systems, there are measures allowing the European Commission to interrupt payments where there is evidence of significant deficiencies in the operation of these systems.

F. The EU Regional Policy and the Internal Market Policies

During the past two decades, public procurement developed a correlation with regional policy and state aid regulation, in the sense of preferential purchasing favouring indigenous undertakings. Specifically allowed by the public procurement regime, but phased out since the completion of the internal market (1992), preferential procurement sought to accommodate liberalisation principles with secondary Community policies such as regional development, social cohesion and industrial policies.[16]

The frequently exposed nature of public procurement as the most significant non-tariff barrier for the functioning of the common market[17] and the presentation of the arguments in favour of an integrated public market across the European Union[18] have contributed to the debate that public purchasing is indissolubly linked with national policies and priorities.[19] In the history of European economic integration, public procurement has been an important part of the Member States' industrial policies. It has been utilised as a policy tool[20] in order to support indigenous suppliers and contractors and preserve national industries and the related workforce. The legislation on public procurement in the early days clearly allowed for "preference schemes" in less favoured regions of the common market which were experiencing industrial decline. Such schemes required the application of award criteria based on considerations other than the lowest price or the most economically advantageous offer, subject to their compatibility with EU Law in as much as they did not run contrary to the principle of free movement of goods and to competition law considerations with respect to state aid. Since the completion of the internal market (1992), they have been abolished, as they have been deemed capable of contravening directly or indirectly the basic principle of non-discrimination on grounds of nationality.

[16]See Bovis (2002).

[17]See European Commission, White Paper for the Completion of the Internal Market, (COM) 85 310 fin., 1985. Also Commission of the European Communities (1988). Also the report by Cecchinni (1988).

[18]See European Commission, Special Sectoral Report no 1, Public Procurement, Brussels, November 1997.

[19]See European Commission, *Public Procurement: Regional and Social Aspects* (*COM*(*89*) *400.*

[20]See Articles 29(4) and 29(a) of the EC Public Works Directive 71/305; also Article 26 of EC Public Supplies Directive 77/62.

There has been a great deal of controversy over the issue of the compatibility of preferential procurement with EU law. The justification of preference schemes to promote regional development policies have revealed the interaction of public procurement with state aid.[21] Preferential procurement reflects protectionism, and as such is regarded as a non-tariff barrier. However, protectionist public procurement, when strategically exercised, has resulted in the evolution of vital industries for the state in question.[22] Preferential public procurement can be seen through a multi-dimensional prism. First, it appears in the form of an exercise which aims at preserving some domestic sectors or industries at the expense of the principles of the European integration process. Impact assessment studies undertaken by the European Commission showed that the operation of preference schemes had a minimal effect on the economies of the regions where they had been applied, both in terms of the volume of procurement contracts as well as in terms of real economic growth attributed to the operation of such schemes.[23] Thus, in such format, preferential public procurement perpetuates the sub-optimal allocation of resources and represents a welfare loss for the economy of the relevant state. On the other hand, preferential purchasing in the format of strategic investment to the sustainability of selected industries might represent a viable instrument of industrial policy, to the extent that the infant industry, when specialised and internationalised, would be in a position to counterbalance any welfare losses during its protected period. In the above format, preferential public procurement, as an integral part of industrial policy could possibly result in welfare gains.[24]

Preference schemes have been indissolubly linked with regional development policies, but their interpretation by the European Court of Justice has always been restrictive.[25] Although the utilisation of public procurement as a tool of regional development policy in the form of state aid may breach directly or indirectly primary Treaty provisions on free movement of goods, the right of establishment, and the freedom to provide services, it is far from clear whether the European Commission or the Court could accept the legitimate use of public procurement as a means of state aid. Prior notification to the European Commission of the measures or policies intended to be used as state aid does not, apparently, legitimise such measures or absolve them from the well-established framework of the four freedoms. The parallel applicability of rules relating to state aid and the free movement

[21]See, Fernadez-Martin and Stehmann (1991).

[22]See Bovis (1998a).

[23]European Commission, *Public Procurement: Regional and Social Aspects* (*COM*(*89*) *400*).

[24]See Commission of the European Communities (1992).

[25]See Case 84/86, *Commission v. Hellenic Republic*, not reported; Case C-21/88, *Dupont de Nemours Italiana S.p.A v. Unita Sanitaria Locale No.2 di Carrara*, judgment of March 20, 1990, [1990] ECR 889; Case C-21/88, *Dupont de Nemours Italiana S.p.A v. Unita Sanitaria Locale No.2 di Carrara*, judgment of March 20, 1990, [1990] ECR 889; Case C-351/88, *Lavatori Bruneau Slr. v. Unita Sanitaria Locale RM/24 di Monterotondo*, judgment of 11 July 1991; Case C-360/89, *Commission v. Italy*, [1992] ECR I 3401; Case C- 362/90, *Commission v. Italy*, judgment of March 31, 1992.

of goods, in the sense that national measures conceived as state aids must not violate the principle of free movement of goods, renders the thrust of regional policies through state aid practically ineffective. It appears that the Court has experimented with the question of the compatibility between state aid and free movement of goods in a number of cases where, initially, it was held that the two regimes are mutually exclusive, to the extent that the principle of free movement of goods could not apply to measures relating to state aid.[26] The acid test for such mutual exclusivity was the prior notification of such measures to the European Commission. However, the Court departed from such a position when it applied free movement of goods provisions to a number of cases concerning state aid, which had not been notified to the Commission.[27] Surprisingly, the Court also brought notified state aid measures under the remit of the provision of free movement of goods and reconsidered the whole framework of the mutual exclusivity of state aid and free movement of goods.[28]

The Court's jurisprudence on state aid has also revealed the catalytic position of regional policy consideration in the process of determining whether subsidies or state financing of public services represent state aids. The significance of the subject is epitomised in the attempts of the European Council[29] to provide for a policy framework of greater predictability and increased legal certainty in the application of the state aid rules to the funding of services of general interest. Along the above lines, public procurement rules have served as a yardstick to determine the nature of an undertaking in its contractual interface when delivering public services. The regulation of the award of public contracts has created a separate type of markets within the common market, often described as public markets. The funding of services of general interest by the state may materialise through different formats, such as the payment of remuneration for services under a public contract, the payment of annual subsidies, preferential fiscal treatment or lower social contributions. The most common format is the existence of a contractual relationship between the state and the undertaking charged to deliver public services. The above relationship should, under normal circumstances, pass through the remit of public procurement framework, not only as an indication of market competitiveness but mainly as a demonstration of the nature of the deliverable services as services of "general interest having non-industrial or commercial character".

[26]See case C-74/76, *Ianelli & Volpi Spa v. Ditta Paola Meroni*, [1977] 2 CMLR 688.

[27]See case C-18/84, *Commission v. France*, 1985, ECR 1339; case 103/84, *Commission v. Italy*, 1986, ECR 1759; also, case C-244/81, *Commission v. Ireland*, 1982, ECR 4005.

[28]See Bovis (1998b); Fernadez-Martin and Stehmann (1991)

[29]See the Conclusions of the European Council of 14 and 15 December 2001, paragraph 26; Conclusions of the Internal Market, Consumer Affairs and Tourism Council meeting of 26 November 2001 on services of general interest; Commission Report to the Laeken European Council on Services of General Interest of 17 October 2001, COM (2001) 598; Communication from the Commission on the application of the State aid rules to public service broadcasting, O.J. 2001 C 320, p. 5; see also the two general Commission Communications on Services of General Interest of 1996 and 2000 in O.J. 1996 C 281, p. 3 and O.J. 2001 C 17, p. 4.

There are three approaches under which the European judiciary and the Commission have examined the financing of public services: *the state aid approach, the compensation approach, and the quid pro quo approach.* The above approaches reflect not only conceptual and procedural differences in the application of state aid control measures within the common market but also raise imperative and multifaceted questions relevant to the state funding of services of general interest.

The State aid approach[30] examines state funding granted to an undertaking for the performance of obligations of general interest. It thus, regards the relevant funding as state aid within the meaning of Article 107(1) TFEU[31] which may, however, be justified under Article 106(2) TFEU,[32] provided that the conditions of that derogation are fulfilled and, in particular, if the funding complies with the principle of proportionality. The state aid approach provides for the most clear and legally certain procedural and conceptual framework to regulate state aid, since it positions the European Commission in the center of that framework.

The compensation approach[33] reflects upon a "compensation" being intended to cover an appropriate remuneration for the services provided or the costs of providing those services. Under that approach, State funding of services of general interest amounts to State aid within the meaning of Article 107(1) TFEU, only if and to the extent that the economic advantage which it provides exceeds such an appropriate remuneration or such additional costs. European jurisprudence considers that state aid exists only if, and to the extent that, the remuneration paid, when the state and its organs procure goods or services, exceeds the market price.

The *quid pro quo* approach distinguishes between two categories of state funding; in cases where there is a direct and manifest link between the state financing and clearly defined public service obligations, any sums paid by the State would not constitute state aid within the meaning of the Treaty. On the other hand, where there is no such link or the public service obligations were not clearly defined, the sums paid by the public authorities would constitute state aid.

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[30]See Case C-387/92 [1994] ECR I-877; Case T-106/95 *FFSA and Others* v *Commission* [1997] ECR II-229; Case C-174/97 P [1998] ECR I-1303; Case T-46/97 [2000] ECR II-2125.

[31]Article 107(1) TFEU defines State aid as "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods . . ., in so far as it affects trade between Member States".

[32]Article 106(2) TFEU stipulates that. . . "Undertakings entrusted with the operation of services of general economic interest . . . shall be subject to the rules contained in this Treaty, in particular to the rules on competition, insofar as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community".

[33]See Case 240/83 [1985] ECR 531; Case C-53/00, judgment of 22 November 2001; Case C-280/00, judgment of 24 July 2003.

G. Conclusions

European Law provides for specific financial instruments to promote Regional Policy as a means of state intervention in regions of the European Union that need assistance towards economic restructuring. The function of the Structural Funds has been instrumental in smoothing the ever-increasing disparities between regions that are diametrically different from each other, although they belong to Member States of the European Union that purports to have created a common market.

Over the past decades, the strategic funding and investment of the regions of Europe has made a significant contribution to the completion of the internal market in 1992 and the introduction of the EU Monetary Union and the single currency before the end of the millennium.

In addition, the symbiotic relation of the EU Regional Policy with policies of the internal market, namely public procurement and state aid regulation, reveals the flexibility embedded in the applicable regimes. In addition to the flexibility conferred to pubic authorities, Member States have a wide margin of discretion to introduce public policy considerations in dispersing public services. State aid, as regional development considerations, or as part of a national of EU wide industrial policy, is inherently a part of this symbiotic policy approach. This finding removes the often misunderstood justification of the pursuit of the EU Regional Policy as an economic exercise and places it in the heart of an ordo-liberal interpretation of the European integration process. On the other hand, the conceptual interrelation of Regional Policy considerations with the financing of services of general interest reveals the policy and jurisprudence links between public procurement and state aid regulation.

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