Ripples in a Rising Tide:

Why Some EU Regions Receive More Structural Funds than Others

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Abstract

We investigate the distribution of EU structural funds across EU regions on level one and two of the NUTS classification. For this task we employ politico-economic considerations derived from literature on national intergovernmental grants, and adjust them to a two-levelled bargaining process in the European Union. Accordingly, bargaining on structural policy takes place (1) on the intergovernmental level between member states, and (2) on the level between regions and their respective national governments. We provide a new data set containing the distribution of Objective-1 and Objective-2 funds across EU regions, as well as economic, institutional and electoral variables. We test our hypotheses by using a Heckman-selection model that explicitly accounts for our two-stage rationale. The results provide evidence for the influence of sub-national authorities and local swing voters.

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1. Introduction[1]

Cohesion policy is one of the main redistributive instruments of the European Union. Next to agricultural subsidies, Structural Funds are the second largest item in the European budget. Since their creation, the financial volume of Structural Funds has grown immensely. When the European governments decided to establish the European Regional Development Fund it barely constituted 5 per cent of the European budget (Laffan 1997). With the negotiations of the Single European Act (SEA) the treaty obtained its own title for European structural policy, which was decisive in the structural policy's subsequent financial and institutional extension. Further financial improvements to Structural Funds were accorded by the 1988 Structural Funds reform, which nearly doubled their financial volume budget allocation. The Maastricht Treaty spurred an additional financial increase as a side-payment for reluctant governments who stood to lose from the creation of a single currency (Allen 1996). Eventually, after the Delors II budget reform in 1993 the Structural Funds expanded to more than a third of the EU's total expenditures.

With the importance of Structural Funds policy increasing, quarrels about who pays and who gains from Cohesion policy have become more pronounced than ever. Recently, governments of several European net payers suggested freezing the European Budget at 1 percent of the European GDP. The Commission along with net receivers immediately expressed their lack of understanding such moves. With the enlargement of the EU, negotiations on Structural Fund allocations risk protracted deadlock.

The high stakes of Structural Fund politics have also led to rather arcane decision-making processes. Their complexity has given rise to the concept of multi-level governance (Marks 1993, Hooghe 1995, Hooghe/Marks 1996). Actors of various political strata interact in order to allocate the funds. As a result, the policy field shows aspects of classical intergovernmental bargaining among the member states along with multi-level governance where the Commission interacts with national governments, local authorities, and social partners to design and monitor the Structural Funds.

Funded at the Paris Summit in 1974 as the *European Regional Development Fund*, the Structural Funds' official aim is to narrow the economic gap between European regions and to foster economic cohesion (Anderson 1995). There is a large body of literature dealing with the effectiveness of intergovernmental grants in achieving fiscal equalisation (i.e.

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redistribution),convergence in income, or both (cf. Boeri et al. 2002). Whereas some economists find evidence that structural funds have played a role in achieving higher growth rates in poorer regions, thereby fostering European economic cohesion (Cappelen et al. 2003), others argue that structural funds have not been very effective in achieving convergence. An alternative view maintains that structural funds are an EU-wide substitute for social policies (Rodríguez-Pose/Fratesi 2003), or a mechanism of compensating those regions that have not benefited from economic integration (Sutcliff 2000, Boeri et al. 2002: 47).

To sum it up, recent approaches have either dealt with efficiency or the governance structure of EU Structural Funds policy. However, the determinants of Structural Fund allocations among European regions have, so far, received less academic attention.[2] We know much about how Cohesion policy failed to foster economic convergence, but less so why some European regions receive significantly more funds per head than others, which have comparable socio-economic prerequisites. Generally, it is taken for granted that the official criteria are sufficient means to explain the distribution of transfers across regions. Since these criteria are often difficult to quantify, such reasoning is clearly not undisputed. This paper exclusively deals with giving a rationale for the regional distribution of Structural Funds.

For this reason we link a model of two-levelled bargaining with the politico-economic literature on fiscal transfers. We use both theoretical insights from European integration literature, and national fiscal-federalism literature. We argue that the allocation of Structural Funds follows a two-stage bargaining logic. In the first stage, Member States bargain with the Commission over the budgetary allotment, i.e. the Structural Fund amounts each country receives. Depending on this outcome, central governments bargain with their regions over the exact distributions of Structural Funds per region. The bargain in the second stage is dependent on the first stage's outcome.

For our empirical inquiries we use a new data set for the budget period 2000-06. This set not only contains the scheduled financial transfers to each EU region, but also information on economic, institutional and electoral indicators for each region. We use a specific econometric model to adjust for (Heckman) selection bias. Our results show that the allocation of both Objective-1 and -2 funds is predominantly shaped by the institutional competencies of European regions and by central governmental attempts to please regional swing-voters.

The paper is structured as follows: Section 2 gives a short description of the functioning of Structural Fund policy. Section 3 discusses the theoretical results of politico-economic approaches to inter-regional distribution, and how they might be applied towards EU

[2] Carrubba (1997) focuses on Structural Fund allocations on Members States' level.

structural policy. Section 4 describes the data set, which contains previously unreleased information. Section 5 presents and interprets the empirical results. Section 6 concludes the paper.

2. The design of structural policy in Europe

Compared to other policy areas, EU structural policy is a peculiar case on terms of decision making. Actors at three levels are involved in both the formulation and the implementation processes of Structural Funds. While intergovernmentalist accounts point to the strong role national governments have in the decision of the overall budget (Pollack 1995), 'multi-level governance' models stipulate that the Commission and sub-national authorities bypass national governments when determining Structural Fund politics (Marks et al. 1996). Moreover, the governance of Structural Funds has been evolving over the last two decades due to three major reforms in 1988, 1992-93 and 1999 (Bache 1998, Bailey/De Propris 2002).

The most recent reform, the so-called *Agenda 2000*, has pronouncedly altered the nature of the prime organising principles for Structural Funds. First and foremost, the reform has reduced the hitherto six Objectives to three. The new Objectives are: Objective 1 -providing for the development of regions that are lagging behind economically, Objective 2 -providing for regions with declining industrial and rural sectors, and Objective 3 –providing for regions in need of educational and employment restructuring. The Berlin summit of the European Council in 1999 set the financial perspectives for 2000-06 and induced further changes to the management of Structural Funds. Concerning Objective 1, eligible regions should have a per-capita GDP below the 75 percent average of the EU. Objective-2 regions are industrial regions with an unemployment rate above the EU-average with a declining employment rate in the manufacturing sector. The percentage of the EU-population covered by Objective 2 should not exceed 18 percent. The former Objective 6, which targeted regions with low population density, was integrated into Objective 1. This explains why some Swedish and Finish regions are eligible under the new regulations. Objective 1 is given clear financial priority.

Next to targeting specific objectives, a second major principle of structural policy is 'additionality'. It requires that Structural Funds' spending not supersede national regional aid. This principle mandates regional co-financing for Funds eligibility. The third principle is 'partnership'. It states that planning procedures for structural funds should be developed in cooperation with sub-national authorities, which constitute local governments, as well as social partners (Evans 1999). The national governments are free to select their sub-national

partners, with the result that the partner principle implementation varies across EU member states (Sutcliffe 2000).

The partnership principle served as the catalyst that spurred on the concept of multi-level governance. Local authorities not only co-operate with national governments in the planning and monitoring stages, but intervene in the policy process via a host of formal and informal committees like ECOFIN, the Informal Council of Regional Ministers, or the Committee of Regions and Local Authorities. The 1988 reform, however, granted a strong position to the Commission in the structural funds policy area. As demonstrated below, the Commission approves the Objective-1 and 2 status of the regions (Hooghe/Keating 1994). Given the complex political interactions in Structural Funds politics the question of what determines the final fund allocations remains to be answered.

The two-stage decision procedure was detailed in the Council Regulation (EC) 1260/1999 of 21 June 1999. After roughly allocating funds for each Objective by the Council, the Commission makes an indicative breakdown of Member States of the Commitment Appropriations. Article 7 (3) of the Council Regulation requires that the Commission uses 'transparent procedures' such as eligible population, regional prosperity, national prosperity and severity of structural unemployment for Objectives 1 and 2. It does not come as a surprise that the multitude of soft procedural criteria gives the Commission considerable bargaining leeway at this stage of the process. This is especially true for the 'phasing out' of regions which lose their Objective-1 status. A list of exemptions serves as 'phasing out' criteria, which are nowhere clearly stated. The financial means for 'phasing out' are a striking example of the bargaining game at this stage.

After the breakdown by the Commission the Member States develop a plan for Objective 1 and 2 in close co-operation with regional authorities and social partners (Article 15). According to Article 16 the plans include a description of a region's structural deficits, a description of the appropriate strategy and the priorities, and an indication of the planned use and form of the financial contribution. Article 13 (1 and 2) states that the Member States must compile a selection of eligible Objective 1 and 2 regions with corresponding financial allocations. Sub-national authorities have a say in both the selection of the regions and the elaboration of the plans, as Article 15 (3) accords them the right to express their views within a certain period of time. The plans' elaboration constitutes the second step in the bargaining process between central governments and the regions.

In sum, Member states set the budgetary allotment and decide, based on broad financial outlines, which contributions each state must fulfill. Then, the Commission allocates the

funds to each Member State and approves regional selection. Finally, the central governments bargain with their regions over the distribution of the funds by elaborating on their plans. The formal criteria, however, which structure the bargaining process, are surprisingly 'soft'. The next section discusses the theoretical contributions from political economy to highlight the debate over what factor/s drive the final distributive patterns.

3. The Political Economy of Intergovernmental Grants

Given the regulative procedures regarding the distribution of structural funds across European regions, it is astonishing that little attempt has been made to gather insight from the relevant literature on national political systems. Though there are good reasons to believe that EU fiscal transfers are different from those within nation states, tapping into this literature may reveal important aspects of the political economy of transfers between different layers of the multi-level EU system.

Both the political science and economic literature on national federalism have traditionally focused on normative issues, such as the task of revealing what forms of governance are inefficient (Scharpf 1988, Oates 1999). In recent years, however, more and more positive explanations for intergovernmental grants have been sought (Inman 1988). The reason for this trend is that the issues of grant effectiveness and their political determinants are mutually dependent, i.e. one cannot tax the former without taxing the latter. The fundamental question of these approaches asks, correspondingly, why some regions are more successful in receiving grants than others? Numerous studies on the European level aim at explaining the distribution of cross-country transfers as an outcome of intergovernmental bargaining (Kandogan 2000, König 2001). Little, however, is known about the local politics of regions in this process. Therefore, we will briefly survey the theoretical and empirical contribution for national fiscal federalism, before we concern ourselves with the European level hypotheses.

The prime point of departure for most theoretical contributions is a model with one central government allocating grants and facing a number of local governments lobbying for these. If one assumes a one-dimensional policy space, the median voter theorem applies, i.e. contending parties will approach the political middle.[3] Assuming that central governments depend on local electoral support or money, national politicians will allocate funds toward those regions where the difference between parties' support is smallest, or the number of opportunistic voters is highest (Dixit/Londregan 1998). A problem with this, so-called, swing-

[3] For a more detailed discussion cf. Hinich and Munger (1997).

voter hypothesis is that it does not seem to fit all democratic systems alike. In multiparty or multidimensional settings, a median voter is less likely to exist, thereby increasing the numbers of swing-voters.

A second major approach characterizing the bargaining power of some regions is to use special interest groups as recourse. Cadot et al. (2002), for instance, argue that asymmetrically distributed lobbying groups can attract higher transfers to their regions by making campaign contributions to local politicians who, in turn, press for increased grants on the national level. A concentration of political power in the hands of a few minority groups can increase the grants, whereas in perfectly pluralistic systems such lobbying does not lead to distorted group results (e.g. Becker 1983). This lobbying influence is heightened, since interest groups are involved in the implementation of grant-based projects on the local level and frequently inform politicians of the demand for such projects.

A related approach focuses on the role of spill-over effects from one region to another. The normative theory of fiscal federalism suggests that the existence of spill-overs should necessitate costlier transfers. The reason is straightforward: since some of the benefits of grants flow to other regions without any costs, these externalities lead to distortions across regions. Therefore, higher central government involvement is a way of internalising these externalities for the union as a whole (Oates 1999: 1126). If, however, regions lobby for increased grants at the central government level, spill-overs might prove detrimental for them. This is attributed to the fact that the electoral benefit of a regionally targeted grant is low, therefore, a central government is likely to be reluctant to transfer money to this region (Borck/Owings 1999).

A quick survey of the empirical literature shows that, though all of these factors are found to be relevant, the nature of the political system determines which factor of influence prevails. In France, for instance, Cadot et al. (2002) show that the allocation of central government grants earmarked for infrastructure investments are indeed dependent upon the impact of powerful lobby groups, and to a lesser extent on party politics.[4] Contrary to this, Germany, being a more consensus-oriented and corporatist country, does not appear to favour such private pork-barrel on intergovernmental grants. Rather, party politics seem more influential, in as far as partisan congruence is concerned (Kemmerling/Stephan 2002): in those federal states where the same partisan composition of governments prevails, grant size is significantly higher than in other regions. For the United States, Grossman (1994) shows that the size of

[4] There is a large literary body on the importance of swing voters in US elections. Commercial firms recently provided detailed information on these voters for political parties.

local government bureaucracy and the strength of local unions are important determinants of intergovernmental grants. In addition, Crain and Oakley (Crain/Oakley 1995) find evidence that voter volatility and legislative stability are important predictors of regional transfer size. Finally, Borck and Owings (1999) demonstrate that, in the case of California, a spill-over effect's size is indeed negatively related to the amount of grants received from central governments.

These findings are important in understanding the politics of EU Structural Funds, although some caveats apply. Certainly, the EU is not even closely comparable to a national political system. As mentioned in the previous section, the European Commission has achieved quite some discretionary leeway in allocating funds. But, we argue that the assumption of a unitary actor is not relevant when addressing the pork-barrel politics of EU Structural Funds. Even if national governments were to be exclusively decisive in allocating structural funds across regions, they are still vulnerable to lobbyists from their own sub-national political entities. Hence, the same logic still applies even with a politically fragmented, supranational entity as long as the number of EU regions is high, and competition among them prevails. In this case, regions do not completely internalise the fiscal burden of higher transfers and, therefore, might have an interest in lobbying.

Critics may reply that regions within one country are not necessarily exposed to competition if they manage to overcome collective action problems and lobby as a group. Indeed, the literature on intergovernmental grants has traditionally neglected strategic issues of block-building and coalitions. In Europe this issue could be crucial, since regions within a country may force their national governments to act on their behalf. We do not have a definite answer to this problem, but it suffices to say that incentives for intranational cooperation are low given the governance structure of the EU Structural Funds. The reason is that most efforts of national representatives in, say, the Council of Ministers would spill-over to other non-lobbying regions as well: 'a rising tide lifts all boats.'[5] This contribution does not deal with the general trend, the rising tide of EU structural policy, but with the 'ripples' between winning and losing regions in this process.

More important than the issue of coalition-building is the presence of profound institutional differences within European member states. As mentioned earlier, electoral

[5] The discussion on the so-called statistical effect in the verge of enlargement is a good example. There is arguably an incentive for East German Bundesländer to cooperate against their own government in order to maintain their grants. However, the outcome will affect all regions with a similar GDP-level. Hence, cooperation between regions is more likely if the total amount of EU structural policy is concerned, but less so if the distribution of these funds is affected.

systems differ across the EU-15, but institutions of fiscal federalism vary throughout Europe as well. Hence, the outlined arguments of political economy are filtered through a very heterogeneous institutional system. For example, as is frequently stated in the literature, German Bundesländer have a much higher political clout than, say, French Départements.

Finally, most structural funds are conditional grants mainly in the form of matching grants. That means that the respective region has to contribute a defined share to the overall sum. This is the principal reason why take-up of these grants varies strongly across countries and at times makes forecasting EU financial statements fairly difficult. Theoretically, Dixit and Londregan argue that matching grants favour those who have a high salience for local, vis-à-vis central – in our case EU-level – politics.

With these caveats in mind, the last step of the analysis aims at fusing the EU-specific literature on multi-level governance with the political economy of intergovernmental grants. We submit the following (non-formal) model of a 2-level bargaining process with private sector involvement. On the first level, as in the intergovernmental literature (Hug/König 2002, Moravcsik 1999), national governments bargain with their counterparts on the total size of structural funds for each country. The outcomes of this bargaining depend on both formal and informal criteria, such as the 75 percentage threshold for Objective-1 regions, or the budgetary position of a country. These determine which regions will gain access to funds. Yet, it is no coincidence that these criteria are not rigorously implemented, or easily quantifiable. What is crucial to this stage is that the Commission suggests which percentage of a country's population receives Objective 2 Funds. For the current budget period the Commission reduced the population share in receipt of Objective-2 funding to an EU average of 18 percent. The share for single countries varies between 31 percent (France, Finland) and 10 percent respectively (Denmark). This allows for a further reduction of eligible Objective-2 regions.

In the second stage the Member States react to the Commission's decisions and allocate their general Structural Fund shares to their regions after having cooperatively developed grant plans. These plans, of course, are not only a matter of technical implementation, but serve as the first stage in the bargaining process of Fund allocation for each region. This corresponds to a simple two-level bargaining model (Putnam 1988). Regional influence seems dependent on the constitutional competencies they have (Jeffrey 1996, Ansell/Parsons/Darden 1997). The argument is that regions are most successful if they manage to craft a strategic alliance (Bomberg/Peterson 1998). The capacity of local governments to get access to grants

depends on the characteristics of the national political system; namely, the presence of institutions of federalism and multi-party competition.

Our primary concern lies with the consequences of the first (intergovernmental) level filtering the outcomes for the second (regional) level. The bargaining at the first stage is dependent on other budgetary positions, namely in the area of CAP: countries receiving high amounts of CAP transfers, for example, will obtain less structural funds than others. Hence, bargaining processes on the intergovernmental level lead to well-documented cases of package- and compensation-deals. However, since agriculture plays a dominant role in many Objective-1 areas, such compensation will be difficult to observe. Therefore, the prime package deal seems to be that rich countries receive higher Objective-2 funds upon giving poor countries Objective-1 money.

The central governments' response to regional lobbying activities should depend on a number of political factors. The narrower, for instance, the gap is between the vote shares of a region's two largest parties, the more a central government will be tempted to divert structural funds to that region to lure swing-voters. This holds true for traditional majoritarian party systems with few major parties. In proportional systems the number of effective parties is usually higher, and therefore, the interest of central governments in transferring money to specific local governments decreases. Alternatively, central governments might transfer more money into those regions where resilience against European affairs is highest. This means that regions with strong Eurosceptic parties will attract more structural funds than others, since central governments tend to be pro-European and have to convince local voters of their position.

A final factor enhancing a specific region's political clout is the influence that is exerted by private sector firms via lobbying. Highly organized private firms will manage to attract additional funds by offering support to either central or local governments, or both. This outcome should be conditional based on the extent of the spill-over effect across regions. The reason given is that these regions are less attractive for central governments, since the benefit of additional structural funds is dispersed across several regions. Table 1 summarizes our hypotheses derived from the literature.

4. Data on structural funds and their determinants

We provide a new data set containing information on EU structural funds, as well as some socio-economic and political variables on the level of EU regions. Data on structural funds

originates from the EU Commission DG Budget, and represents the financial perspective of the distribution of structural funds for the years between 2000 and 2006. We extracted information on funds for Objectives 1 and 2, which are the only fiscal transfers that can be attributed to individual regions. The data, however, does not report the structural funds on the same aggregation level for all countries, but uses in some instances NUTS 1, NUTS 2 or even the national level.[6] This is attributed to the administrative structure of each member state. Ireland, for instance, managed to get accepted as a single Objective-1 region, whereas the German Länder (NUTS 1) are basic Objective-1 subjects. In France, recipients of Objective-1 funds are the Départements (NUTS 2). Appendix 3 depicts the corresponding NUTS-levels for Objective-1 and 2 regions in each member state. All together, we gathered information for a total of 135 regions of the EU.

In accordance with the data on structural funds, we compiled a data set on potential determinants of EU structural funds for the regional level. We distinguish between independent variables of the first and second stages. First stage variables determine the eligibility of a region for Objective-1 or 2 funds.[7] The major selection criterion for Objective-1 regions is GDP per capita (GDP/CAP).[8] A further determinant is the unemployment rate (UNEMP) as a proxy for economic prosperity or the decline of a region. A third independent variable is European agricultural funds per capita (AGRAR/CAP). The rationale behind this variable is that either Objective-1 or -2 funds might serve as a means of compensation for agricultural subsidies. Ideally, one would also want to model a compensation deal between Objective-1 and -2 funds, but for econometric reasons this was not possible.[9] The data are from Eurostat (2001). These three variables apply for both Objective-1 and -2 regions in the selection stage.

Our second stage variables predict the fund allocations for those regions which qualified for eligibility in the first stage. For both Objective-1 and -2 regions we employ the percentage

[6] The NUTS-classification (Nomenclature des Unités Territoriales Statistiques) distinguishes between three hierarchical regional levels, which do not necessarily coincide with real adiminstrative units: NUTS 1 represents the highest administrative level, i.e. Länder in Germany, Z.E.A.T. and DOM in France, and Government Office Regions in England. They comprise a population between 3 and 7 Mio. NUTS 2 entail 0.8 to 3 Mio. inhabitants. It corresponds to Regierungsbezirke in Germany, Régions and DOM in France, and Counties in England. The lowest level is NUTS 3 with 0.15 to 08. Mio. inhabitants. These are German Kreise, French Départements and upper tier authorities, or groups of lower tier authorities in England.

[7] Most regions get either Objective 1 or 2 funding. Only Scotland, Wales, South West, North West and Merseyside and Yorkshire-Humbar receive both Objectives. The correlation between Objective 1 and 2 regions in the full sample is – 0.302.

[8] Contrary to EU criteria GDP data is not adjusted to purchasing power parities due to consistency in the data. Even GDP in PPP is an imperfect indicator of regional wealth since it does not, for example, correct for the size of vertical or horizontal government intervention (cf. Eurostat 2002). Moreover, GDP in nominal and in PPP-terms are substantively correlated..

[9] The reason is that since very few observations receive both transfers.

of workers in manufacturing industries (MANUEMP) as proxy for industrial regions, and the wages and salaries in the manufacturing sector (WAGMAN) depicting the productivity of industrial activity. Both variables serve as our economic baseline model for stage 2, and are coded from Eurostat (2001). Moreover, we use net migration (NETMIG) as a measure to control for regional spill-over effects. We created a federalism index (FED) using the measures of federalism by Huber, Colomer and Schmidt (Schmidt 1997). All three measures are ordinal scaled between 0 and 5. Factor analysis confirms that the three variables all measure the same theoretical construct. We weighted each variable by its factor loading and summed them up into a single indicator (cf. Appendix 2).

In addition, we gathered regional information about the most recent elections to the European Parliament, in June 1999. To our knowledge, no such data has been available thus far. We have not managed to find compatible information for the Netherlands, Finland and Portugal. This gives us a total of 117 out of the 135 regions for which we actually dispose of these data. We constructed 8 categories: one for each of the eight factions represented in the European Parliament, plus one category for parties that are not aligned with any faction. For each region we then summed up all the shares of parties belonging to the same faction. Next, we calculated the difference between the two largest parties in each region (DIFF) as a proxy for the number of swing-voters, or more broadly, as a degree of electoral competition. We also used information on the share of the largest party (LPART). In order to measure the dispersion of the party system, we calculated the 'effective number of parties' (ENP) using the Herfindahl index for the 8 plus 1 categories.[10] Finally, we included the percentage share of Eurosceptic parties (ESCEP). The variable sums up the shares of the following six groups, which run for EP elections: The Confederal Group of the European United Left/Nordic Green Left, Europe for a Union of Nations, Group for a Europe of Democracies and Diversities, Technical Group of Independent Members, and factionally independent EP members. If not otherwise stated, all variables are values for 1999 as the last year before the package 2000-2006 began. Appendices 1 to 3 give an overview of the statistical summary, and the bivariate correlations of the variables.

Using data for EP election is clearly not beyond criticism. Ideally, one should use data for national elections on the regional level as well, since EP elections are haunted by low political salience, and often act as the playground for exerting political protest against incumbent governments (van der Eijk/Franklin/Oppenhuis 1996). Nevertheless, we presume that using

[10] ENP is defined as the number of effective parties. The corresponding formula is $1/\sum i^2$, where i depicts the percentage share of each party (Pennings et al. 1999).

EP data is the best alternative on hand. First and foremost, it is the only way of guaranteeing comparability: elections take place at the same time and most parties belong to an identifiable faction in the EP. Second, given the nature of structural funds as matching grants and the objectives of political actors, we at least expect EP elections to be of some political relevance (Mattila 2001). This should hold true for both voters and interest groups affected by structural funds. A final objection seems to lie in the fact that when the Berlin Council decided on the *Agenda 2000* it preceded the European Parliament elections. However, according to the literature, incumbent politicians are likely to anticipate potential outcomes and will try to influence them.

Before beginning an inferential inquiry into the causes of structural funds allocation, a brief look at the data for structural funds for regions produces crucial insights. Only 49 out of 137 Objective-1 regions are eligible for structural funds between 2000 and 2006. The number of Objective-2 regions is even smaller (39). This prompts the first question, which criteria are to be met in order to qualify for Objective-1 or 2 eligibility? In the former case the choice should be simple, as only those regions below a threshold of 75 percent of average GDP per capita qualify. If this were to be perfectly true, little reason would exist to push the issue further, since ex post, room for political influence should no longer remain. A look at Figure 1 however, discounts this idea.[11] The figure plots the structural funds per capita for each Objective-1 region against its GDP per capita. First of all, no points representing individual regions should lie beyond the orthogonal line indicating the 75 percentage point. Second, all points should be associated to the straight regression line indicating a strong relationship between GDP per capita and structural funds per capita. Inspection of the figure, however, shows that having a low GDP per capita is a necessary, but not sufficient condition for obtaining high structural funds. This is illustrated in Figure 1 with a high deviation from the simple regression line in cases with low GDP, but a small deviation in cases of a high GDP. Moreover, there is an outlier among the richer Objective-1 regions which is Ireland. So the question remains, what other sources drive the distribution of Objective-1 regions, if the official criterion is insufficient?

A similar observation can be made for the case of Objective-2 regions. Since Objective 2 consists of several hard to measure goals, it is much more difficult to think about a dominant criterion. Due to the scarcity of other data, we chose the regional unemployment rate as the 'prime suspect'. Figure 2 shows that, although there is evidence that regions with higher unemployment receive more funds, the relationship is much weaker than in the previous

[11] Admittedly, this statement is too harsh, since we do not use the GDP indicator in PPP (cf. fn. 8).

chart. Again the question stands out, what other determinants are driving the results? In order to help solve this puzzle, the next section addresses the results of inferential statistics.

5. Empirical Analyses

The previous section has shown that only about a third of all EU regions receive Objective-1 funds, and that the proportion of Objective-2 regions is even lower. For empirical estimations this observation would not be disturbing if the causes for the choice of certain regions differed from the causes of various levels of regional funding. However, we argue theoretically that the selection process of regions (first level of bargaining) and the political influence process of regions (second level of bargaining) are intertwined. Hence, information regarding a region's participation matters when determining the size of prospective transfers. This is a clear example of sample selection bias in political science (Hug 2003).

Since we dispose of information for the selection process we use a Heckman selection model, consisting of two stages; one for each level of the political bargaining process.[12] In such a model, the selection process determining whether a region receives structural funds is estimated using a probability distribution. The results of the first stage are used for estimating a corrected second stage regression, leading to efficient and unbiased results (Plümper et al. forthcoming). The incidence of selection bias can be tested by examining whether the error terms of regressions in the first and second stage are statistically correlated. The log-likelihood ratio can be interpreted as the appropriate test statistic, and will be shown along with the results. Since a standard R^2 is not computable, a Wald test is shown instead in order to tax the 'goodness of fit' for the whole model.

Results for Objective-1 Regions

The regression results for Objective-1 regions are depicted in columns 1-3 of Table 2. The dependent variable for all three different models is the log of structural funds for Objective-1 regions per capita. The variables in the first (selection) stage remain the same for all five analyses. The results for this stage are roughly stable. In all five regressions (the log of) GDP per capita is inversely related to structural funds as expected. To make comparisons with

[12] More specifically, we use STATA 7.0 procedure of maximum-likelihood estimation for selection bias. The first stage consists of a probit estimation, whereas the second uses an ordinary regression corrected for the selection bias. In addition, we initially controlled for the fact that some countries cannot be disaggregated into regions (e.g. Ireland). Our dummy for countries with no regions, however, did not yield significant results in any of the following regressions, and therefore was deleted in the final estimations.

Objective-2 regions we also included the unemployment rate in the first stage, but it is insignificant across all models. There is also a negative complementarity visible between Objective-1 structural funds and national tranches of CAP cash: the more CAP cash a country gets, the less structural funds it receives. This is astonishing since Objective 1 is, at least partially co-funded by CAP cash. One might interpret the finding as a sign of package deals across countries. The effect fades, however, once we proceed to model 3.

Turning to the second stage, the three models use different specifications. We start with a baseline model (Model 1) that only includes average wages for the manufacturing sector as a proxy for the productivity of a region, and the share of manufacturing employees of total employment. It demonstrates that regions with a weak base of manufacturing receive, as expected, more funds. The coefficients remain rather stable across all models with the exception of model 3. Included spill-over effects in the form of net migration do not change the results, hence we do not report the results here. Similarities are applied for the size of the largest 'party'[13] in a region, which we use as an imperfect proxy for local government stability. The vote share of Eurosceptic parties is not significant here. But if one adjusts for the extent of federalism in a political system, Euroscepticism does play a strong role (model 2). A similar observation holds for the number of effective parties. The variable is negatively related to receiving structural funds, but improves the impact of Euroscepticism.

We interpret the relationship between Euroscepticism and institutions (party system, federalism) as follows: Eurosceptic parties can only have an influence on national politics if they have some sort of legal veto-playing power. Hence, political systems that are centralised, or have only two dominant parties offer no political platform for Euroscepticism on the regional level. Case studies have found similar relationships between Euroscepticism and institutional features of the political system (Lees 2002). Unfortunately, for reasons of multcollinearity we could not include our variable for Euroscepticism in the last model (no. 3), which includes the full swing-voter model. As expected, the smaller the difference between the two largest parties of a region, the higher the amount of structural funds that region receives. This is a strong corroboration of the swing-voter idea and to the best of our knowledge the first one to be found on a European level. The effect is, however, conditional on the number of effective parties. If we exclude the latter (results not shown) the difference itself does not matter. This is indicative of the kind of conditional effect we are interested in.

[13] For reasons of simplicity we use the term party where it would be more appropriate to speak of the cumulative share of parties belonging to a specific EP faction.

Moreover, this explains why swing-voter models seem to matter in some countries, but not in others.

Finally, the overall results of the models are reliable. The test statistic for the overall model (Wald $?^2$) is highly significant in all cases.[14] More importantly, we find a negative correlation (rho) of the error-terms in both stages. The LR-test shown in the table corroborates the idea that – at least for specification 1 and 2 – our selection model is necessary, as simple estimates would be biased and inefficient. We calculated the variance inflation factor of the independent variables and found no multicollinearity problems.

Results for Objective-2 Regions

The estimation results for the Objective-2 funds reveal a different pattern (Table 2, columns 4-7). The dependent variable is the logarithm of Objective-2 funds per capital. The fit of the Heckman estimations lends confidence to the results. Rho and Wald $?^2$ are highly significant in all models. In addition, we tested for multicollinearity. Our results show that the estimation models do not suffer form multicollinearity.

The first stage estimates the selection's likelihood of a region to get Objective-2 status. The independent variables here are again the same as with Objective-1 funds. The first difference is the role of per capita GDP for Objective 2-eligibility. In models 4 to 7, per capita GDP has a positive sign and is highly significant. As expected, regions with higher economic prosperity have a better chance of qualifying. This is not a surprise as being an industrial region is one of the preconditions for Objective 2. The second difference is more striking. The unemployment rate enters with a negative sign and is significant. Contrary to Figure 2, unemployment does not seem to be a good predictor for the selection process of Objective-2 regions. Although Objective 2 is created for industrial regions in decline, there are obviously determinants for eligibility other than unemployment present. This might be attributed to the fact that Objective-2 funds are so called matching grants, which require regional co-financing. Those with high unemployment are less able to provide the necessary resources for co-financing funds.

The third variable of the selection stage offers an additional answer to the puzzle. Agricultural subsidies per capita provided by the Guarantee Fund have a strong influence on Objective-2 eligibility. The sign of the variable is negative and highly significant suggesting

[14] We also estimated the same models with Robust standard errors. The significance of most coefficients would increase, once corrected for heteroscedasticity, but the Wald statistic is no longer computable. Therefore, we report only the normal standard errors, accepting the statistical problems this might imply.

that regions belonging to member states with low agricultural subsidies have a better chance at qualifying as an Objective-2 region. This result shows that there is a close link between Common Agricultural Policy and Structural funds. Seemingly, Objective-2 funds serve as a compensation scheme for agricultural subsidies.

In the second stage we estimate four models. Thirty out of 124 regions qualified for Objective 2. Model 4 illustrates our baseline model for the final Objective-2 regions. Wages in the manufacturing sector have a negative sign. We interpret this as a measure of relative decline in industrial regions. Once a region gets access to Objective-2 funds, its relative income determines the financial amounts it receives. Interestingly, the number of employees in the manufacturing sector enters significantly and positively into the regressions. Again, being an industrial region is a determinant for Objective-2 funding. But since this not only holds true for the first and second stage, we view this as weak evidence that firms in traditional industrial regions still exert lobbying power in Brussels politics. [15]

Model 5 adds net migration to the baseline variables. It is negative and significant. As expected, spill-over effects seem to work against regions, but we do not take this as conclusive evidence, as net migration is a crude proxy for such effects. Whatever the reason, it is interesting to note that the negative coefficient implies inefficiency. Regions with large flows of emigrating labour should receive more, rather than less Structural Funds.

Further understanding of the political rationale behind Objective-2 funding is presented in model 6. Both the effective number of parties and the difference between major parties is negative and significant as predicted (cf. Model 6, Table 2). The smaller the number of elected parties in the 1999 EP elections, and the smaller the difference between the two strongest of the elected parties, the more likely an eligible region receives Objective-2 funds. As for Objective 1, we interpret this result as swing-voter politics. Again, both variables should be interpreted as interacting. Only in those cases where the number of effective parties is low, i.e. where few large parties share all the votes, the swing voters become an important target for political pork-barrelling.

In contrast to the strong influence federalism exerts on the distribution of Objective-1 funds, it has no predictive power for Objective-2 funds (cf. Model 7). A reason for this may be that Objective-2 regions are not congruent with sub-national units as is the case with Objective-1 regions. Objective-2 regions can be designed according to the shape of industrial regions in decline, which hardly coincides with sub-national administrative boundaries. This

[15] We also experimented with a number of traditional measures of asset specificity and the lobbying power exerted by high technology firms. None of these indicators caught a significant proportion of the variation to be explained.

is why the competencies of sub-national units have much less visible influence on the distribution of Objective-2 funds in comparison to Objective-1 funds.

Summarily, once a region qualifies for Objective-2 status, it can maximise funds if it suffers from economic decline, and if it harbours crucial swing-voters. The degree of Euroscepticism in a region, however, does not significantly contribute to higher Objective-2 funds. This might be explained because Eurosceptic parties have strong regional backing. Their electoral success, therefore, accounts for Objective-1 regions, but less so for Objective-2 regions, which have a narrower shape than sub-national units. Providing Objective-2 funds to 'fight' strong regionalism could prove less efficient than Objective-1 funds.

6. Conclusion

This paper started with the initial suspicion that the seemingly inefficient allocation of structural funds might be attributed to other political rationales rather than what economic analyses would suggest. This led us to investigate the ways structural funds are distributed across regions of the EU. However, neither in the field of political science nor economics have such attempts been made. Approaches of multilevel governance, for instance, are much more focused on describing the division of labour between key EU actors in the field of structural funds. Models of bargaining usually focus on general budget positions or treaty revisions.

Nevertheless, some of the approaches to our problem are applied to national political systems. We therefore proposed to base models of multilevel bargaining on the arguments from the political economy of intergovernmental grants. Applying this literature to the case of the EU leads to several corrections. To simplify matters we distinguished between the levels of central or national governments and EU regions. The impact of regions on the distribution of structural funds depends on a number of political factors all determining their bargaining power, such as the existence of strong federalist institutions in a country. To test our derived hypotheses we constructed a data set that is new in two respects: first it compiles information on the distribution of structural funds for Objective-1 and 2 regions for the period 2000 and 2006; second it is a collection of political data for these regions and, in particular, data on the last elections to the European Parliament.

Our main findings corroborate the idea of a two-level bargaining process with an intergovernmental and an interregional component. First of all, socio-economic criteria such as the well-known 75-percent threshold are not sufficient to explain the final distribution of

structural funds. Whether regions get theses funds depends to a large extend on the entire package of financial transfers a country yields in intergovernmental negotiations. Second, on the interregional level pork-barrel politics plays a strong role in determining the size of structural funds. Whereas we could not find substantial evidence for a direct involvement of private sector lobbying, other political factors indeed influenced the distribution. Federalism, for example, has been frequently assumed to matter when voicing the interest of specific European regions. We find some evidence that federalist countries have stronger regions getting higher funds. Furthermore, more 'obstinate' regions – with a high percentage of Eurosceptic parties – also receive more structural funds. Most importantly, the swing-voter model holds in a refined version. High party competition in elections weighs predominantly in majoritarian party or unitarian systems.

We think that this finding is also insightful for research on the national level, as it might explain the cross-national differences found in empirical studies on the political economy of intergovernmental grants. For the research on the EU transfer policies, we hope that further research will show the links between national political economy approaches, and theories of European integration.

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Table 1 Hypotheses

Theory	Hypothesis
Intergovernmentalism (package deals)	*H1*: The more a country receives agricultural subsidies, the fewer regions it gets accepted for Objective 2.
Multi-level governance (federalism)	*H2*: The more political competences a region has, the more it receives Objective-1 or -2 transfers per capita.
Political economy (electoral competition)	*H3*: Regions with groups of swing-voters receive more Objective-1 or -2 funds per capita.
Political economy (Private sector lobbying)	*H4:* Regions with strong industrial lobbies receive more Objective-2 funds.
Efficiency vs. Political Economy (regional spill-overs)	*H5*: Regions negatively touched by spill-overs receive more/ less Objective-1 or -2 funds per capita.
Political economy (Euroscepticism)	*H6*: Regions with higher shares of Eurosceptic parties receive more Objective-1 or -2 funds per capita.

Table 2 Results for Objective 1 and 2 Regions (Heckman selection model)

Variable	Objective 1			Objective 2			
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7
2. Stage							
WAGMAN	-0.049** (0.016)	-0.047* (0.021)	-0.082*** (0.019)	-0.134*** (0.032)	-0.083** (0.031)	-0.138*** (0.033)	-0.159*** (0.043)
MANUEMP	-0.005** (0.002)	-0.006** (0.002)	-0.005* (0.002)	0.006 (0.003)	0.0003 (0.004)	0.005*** (0.001)	0.003 (0.003)
NETMIG					-0.147* (0.059)		
ESCEP		1.817* (0.88)					0.044 (1.504)
FED		0.06 (0.057)	0.156** (0.054)				0.181 (0.097)
ENP		-0.396** (0.123)	-0.233** (0.085)			-0.709** (0.217)	
DIFF			-2.321** (0.864)			-4.988*** (1.227)	
Constant	1.483*** (0.352)	2.252 (0.522)***	2.312*** (0.49)	5.904*** (0.727)	5.939*** (1.082)	9.556*** (1.369)	6.381*** (1.058)
Rho	-0.744**	-0.775*	-0.639	1***	1***	1***	0.898**
Atanh Rho	-0.959	-1.033	-0.757	15.678	15.219	15.379	1.463
Lambda	-0.474	-0.391	-0.29	1.087	0.913	0.909	0.787
LR test of indep. Eqns. (H0: Rho=0), [Prob > chi2]	9.52** [0.002]	4.67* [0.031]	2.83 [0.093]	17.07 [0.000]	20.61 [0.000]	23.94 [0.000]	8.52 [0.004]
1. Stage							
GDP/cap (log)	-5.878*** (1.197)	-5.853*** (1.184)	-5.72*** (1.277)	2.227** (0.652)	2.512*** (0.519)	2.479*** (0.6)	2.266*** (0.609)
UNEMP	0.127** (.0438)	0.112* (0.054)	0.113 (0.059)	-0.087*** (0.019)	-0.095*** (0.017)	-0.089* (0.039)	-0.102* (0.044)
AGRAR/cap	-0.012* (0.005)	-0.008 (0.005)	-0.009 (0.005)	-0.009*** (0.002)	-0.007*** (0.001)	-0.016*** (0.003)	-0.01* (0.004)
Constant	15.683*** (3.509)	15.318 (3.518)***	15.064*** (3.822)	-5.467** (1.813)	-6.445*** (1.398)	-5.594** (1.841)	-5.382** (1.871)
N (Censored N)	125 (84)	116 (84)	116 (84)	124 (94)	124 (94)	121 (94)	121 (94)
Wald chi2	18.87***	51.26***	56.18***	19.43***	731045.73***	1.29e+07***	17.46**

*Coefficients at first place, standard errors in brackets. * p<0.05 ** p<0.01 *** p<0.005*

Figure 1 Eligibility of Objective-1 Regions

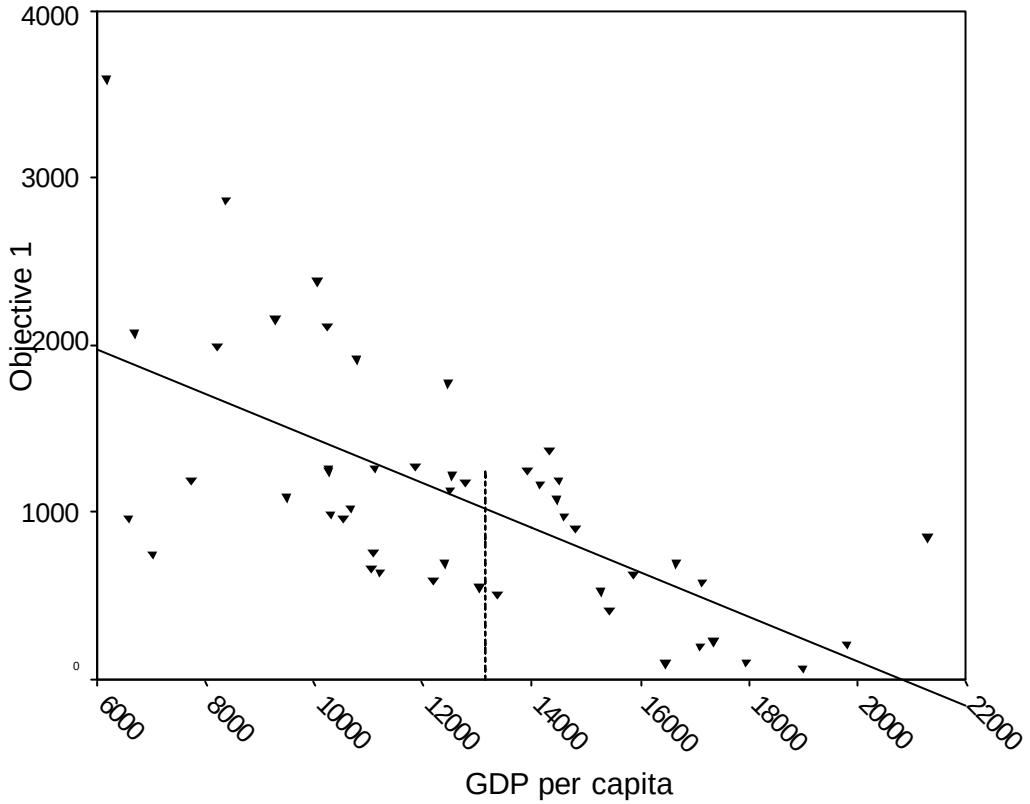
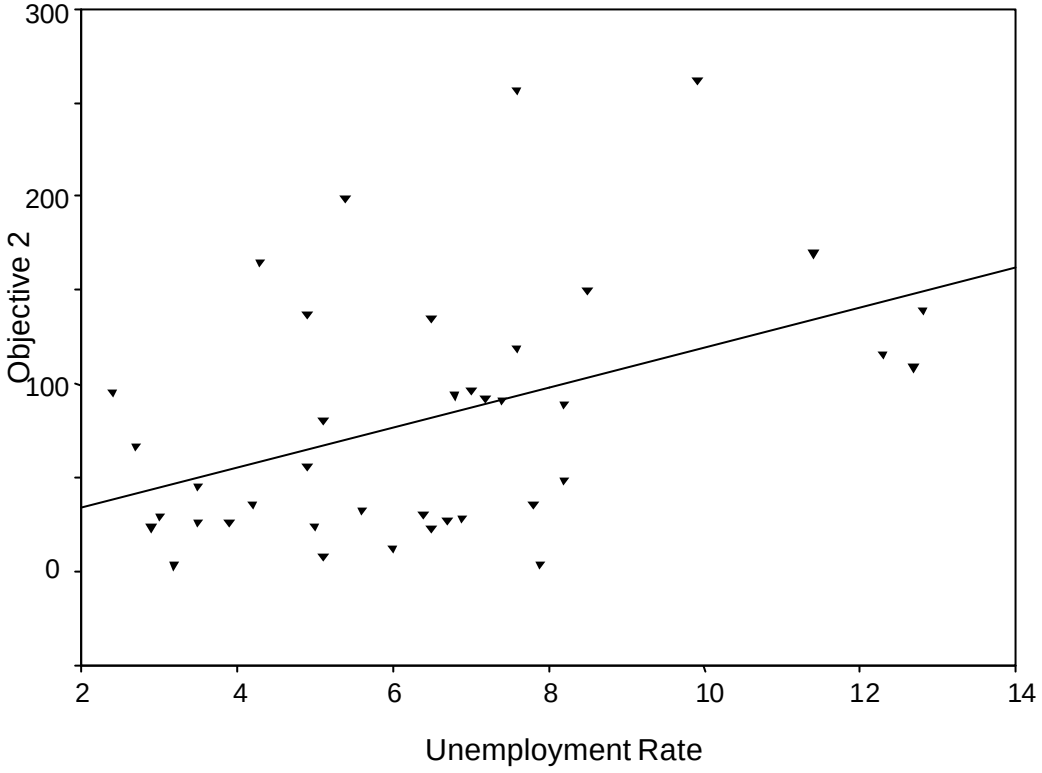


Figure 2 Eligibility of Objective-2 Regions



Appendix 1 Summary Statistics for Independent Variables

Variable	Obs	Mean	Std. Dev.	Min	Max
Obj 1/cap	49	1088.691	722.0772	60.2633	3591.593
Obj 2/cap	39	81.37205	66.95498	3.3119	262.367
GDP/cap	137	17663.56	6124.572	6161.833	42116.73
Unemp	135	10.61259	6.561687	2.4	36.5
Agrar/cap	137	109.0017	48.52087	53.44036	457.1353
Wagman	127	22.01024	7.226339	6.1	42.3
Manuemp	127	166.0805	101.0387	0	972.8382
Netmig	137	2.839416	4.93094	-7.8	24.2
Lpart	117	.3632299	.0981745	.1855	.64
Escep	116	.1953922	.1455398	0	.4755
Fed	137	4.618842	1.920977	.71213	9.1752
Enp	116	4.34525	1.411186	2.172086	7.86445
Diff	117	.1033581	.0911565	.0014	.438
PPE DE	117	.3326359	.1186886	.085	.64
PSE	117	.2645556	.089725	0	.538
ELDR	117	.0614872	.0858087	0	.362
VERTS ALE	117	.0826325	.0785667	0	.339
GUE/NGL	116	.0582888	.0627044	0	.258
UEN	116	.0512819	.0691374	0	.386
TDI	116	.0383517	.0578723	0	.259
EDD	116	.0234353	.0427545	0	.234
NA	116	.0240345	.0708016	0	.324

Appendix 2 Factor Loadings of Federalism Indicators

Variable	**Factor Loading**
Huber	0.61997
Colomer	0.71213
Schmidt	0.76936

Appendix 3 European Regions used for estimations

Region	NUTS Code	Region	NUTS Code
Burgenland	AT11	Thüringen	DEG
Niederösterreich	AT12	Greece	GR
Wien	AT13	Ireland	IE
Kärnten	AT21	Piemonte	IT11
Steiermark	AT22	Valle d'Aosta	IT12
Oberösterreich	AT31	Liguria	IT13
Salzburg	AT32	Lombardia	IT2
Tirol	AT33	Trentino-Alto Adige	IT31
Vorarlberg	AT34	Veneto	IT32
Bruxelles-capitale	BE1	Friuli-Venezia Giulia	IT33
Antwerpen	BE21	Emilia-Romagna	IT4
Limburg	BE22	Toscana	IT51
Oost-Vlaanderen	BE23	Umbria	IT52
Vlaams Brabant	BE24	Marche	IT53
West-Vlaanderen	BE25	Lazio	IT6
Brabant Wallon	BE31	Abruzzo	IT71
Hainaut	BE32	Molise	IT72
Liege	BE33	Campania	IT8
Luxembourg (B)	BE34	Puglia	IT91
Namur-Luxembourg	BE35	Basilicata	IT92
Denmark	DK	Calabria	IT93
Aland	FI12	Sicilia	ITA
Ita-Suomi	FI13	Sardegna	ITB
Vali-Suomi	FI14	Luxembourg	LU
Pohjois-Suomi	FI15	Noord-Nederland	NL1
Uusimaa (suuralue)	FI16	Oost-Nederland	NL23
Etela-Suomi	FI17	Flevoland	NL23
Ile de France	FR1	West-Nederland	NL3
Champagne-Ardenne	FR21	Zuid-Nederland	NL4
Picardie	FR22	Norte	PT11
Haute-Normandie	FR23	Centro	PT12
Centre	FR24	Lisboa e Vale do Tejo	PT13
Basse-Normandie	FR25	Alentejo	PT14
Bourgogne	FR26	Algarve	PT15
Nord-Pas-de-Calais	FR3	Acores	PT2
Lorraine	FR41	Madeira	PT3
Alsace	FR42	Galicia	ES11
Franche-Comté	FR43	Asturias	ES12
Pays de la Loire	FR51	Cantabria	ES13
Bretagne	FR52	Pais Vasco	ES21
Poitou-Charentes	FR53	Navarra	ES22
Aquitaine	FR61	La Rioja	ES23
Midi-Pyrénées	FR62	Aragon	ES24
Limousin	FR63	Madrid	ES3
Rhône-Alpes	FR71	Castillia y Leon	ES41
Auvergne	FR72	Castillia-La Mancha	ES42
Languedoc-Roussillon	FR81	Extremadura	ES43
Provence/Alpes/TCôte d'Azur	FR82	Cataluna	ES51
Corse	FR83	Valencia	ES52

Guadeloupe	FR91	Baleares	ES53
Martinique	FR92	Andalucia	ES61
Guyane	FR93	Murcia	ES62
Reunion	FR94	Ceuta y Melilla	ES63
Baden-Württemberg	DE1	Canarias	ES7
Bayern	DE2	Sweden	SW
Berlin	DE3	North East	UKC
Brandenburg	DE4	North West/Merseyside	UKD
Bremen	DE5	Yorkshire-Humbar	UKE
Hamburg	DE6	East Midlands	UKF
Hessen	DE7	West Midlands	UKG
Mecklenburg-Vorpommern	DE8	Eastern	UKH
Niedersachsen	DE9	London	UKI
Nordrhein-Westfalen	DEA	South East	UKJ
Rheinland-Pfalz	DEB	South West	UKK
Saarland	DEC	Wales	UKL
Sachsen	DED	Scotland	UKM
Sachsen-Anhalt	DEE	North Ireland	UKN
Schleswig-Holstein	DEF		