REPORT

Verification of Additionality in Objective 1 regions for 2004-2006 in Member States that joined the EU on 1 May 2004
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1. BACKGROUND

The principle of additionality stipulates that in order to achieve a genuine economic impact, the appropriations of the Funds may not replace public or other equivalent structural expenditure by the Member State. As a general rule, the national level of public or equivalent national expenditure (hereinafter "national structural expenditure") should be at least equal to the amount of average annual expenditure in real terms achieved in the previous programming period. Article 11 of Council Regulation (EC) 1260/1999 sets out the details for the verification of the principle of additionality.

In 1999 the Directorate-General for Regional Policy, which is responsible for the assessment of principle of additionality in Objective 1 regions, in cooperation with the Directorate-General for Economic and Financial Affairs, published Working Paper n°5, which provides some guidelines to Member States for the verification of the principle of additionality in the 2000-2006 programming period.

This report covers those Member States that joined the European Union on 1st May 2004 with the exception of Cyprus, which was not eligible to Objective 1 in years 2004-2006. As Structural Funds and the Cohesion Fund were available for these countries from 2004 onwards, the principle of additionality for the period 2004-2006 had to be verified. At the time of the assessment for the old EU-15 Member States, it was agreed that the ex-post verification for the new Member States would take place during 2007. This report provides an analysis of the results of this exercise. It has to be seen as complementary to the report adopted in October 2006 which summarises the conclusions of the verification of the additionality principle for the old EU-15 in the 2000-2006 period.

Structural Funds (the Cohesion Fund is excluded from the additionality tables) have accounted for a small part of the total structural expenditure in the analysed new Member States for this period due to (a) the gradual introduction of financial support under European cohesion policy and (b) the higher share of the Cohesion Fund in these countries. The Structural Funds accounted for barely EUR 1 billion out of around EUR 17 billion spent overall in the eligible areas.

2. ASSESSMENT PROCESS

The exercise of the additionality assessment has been carried out by the Commission in close cooperation with Member States. This cooperation required frequent written consultations on technical and methodological issues. The process was initiated by the Commission with a letter sent to Member States in June 2007.

The process of assessment included four main stages:

(1) the Commission’s request addressed to Member States for data submission
(2) submission of data by Member States
(3) assessment of the data by the Commission
(4) communication of the results of the assessment to the Member States.
The key data for establishing compliance with the principle of additionality was the structural expenditure incurred between 2004 and 2006 in the Objective 1 regions.

The analysis considered the sources of expenditure, methods and assumptions used by Member States, as well as the deflators used (in general the GDP deflator) and the exchange rate (fixed conversion rates apply for Member States in the euro area).

The Member States and the Commission determined the level of structural expenditure to be maintained at the time of the adoption of the Community support framework or a single programming document for 2004-2006. Additionality is considered to be respected if the annual average of national structural expenditure incurred by a Member State in years 2004-2006 has at least reached the level of structural expenditure agreed beforehand.

Structural expenditure includes all sources of finance at national, regional and local level as well as spending undertaken by other public service bodies, which are not part of those sources. Expenditure of public enterprises can be included, though Member States were not obliged to do so. In any event, Member States needed to explicitly state which administrative levels and public enterprises have been included or excluded from the calculations.

Where a Member State was eligible to the Cohesion Fund, the national co-financing of Cohesion Fund projects was eligible expenditure and must have been included. This owes to the fact that the national structural expenditure, regardless of whether it co-finances or not the Community contribution, has to be included once it has been incurred in the eligible areas.

For the process of ex-post verification of the principle of additionality, the same methodology was used as the one approved for the ex-ante assessment exercise for the 2004-2006 period. The reference years serving as a basis for setting additionality targets for the perspective 2004-2006 were individually agreed by the Commission and the Member State concerned. They varied between two or three subsequent years selected from the period of 1999-2002.

3. **RESULTS OF THE ASSESSMENT**

3.1. **Overview**

Seven out of nine Member States concerned complied with the principle of additionality. Only Malta and Poland failed to fulfil the requirements of this principle even though by a small margin in both cases.

Estonia and Latvia more than doubled the expected level of public national investment in the eligible areas. It owed principally to the sound macroeconomic scenario which was much better than envisaged beforehand. All the other Member States exceeded the target level by different degrees compared to the reference level defined ex-ante (see table 1 and chart 1).
The aggregate level of national structural expenditure maintained in these Member States as a result of the principle of additionality was almost EUR 16 billion per year in the reference period 2004-2006.

Globally the national structural expenditure exceeded slightly 4% of the aggregate GDP of the analysed Objective 1 regions\(^1\) (see table 2). However, it varied rather significantly for individual Member States. A markedly high level of expenditure was registered in Estonia followed by Hungary and Latvia. In the Slovak Republic, Poland, Lithuania and the Czech Republic national structural expenditure was below the EU-9 average relative to their GDP.

\(^1\) The eligible regions cover the concerned Objective 1 countries excluding Prague region in the Czech Republic and Bratislava region in the Slovak Republic.
Table 2 - Additionality in Objective 1 regions: eligible population and national public expenditure

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<tbody>
<tr>
<td>CZ*</td>
<td>2.120</td>
<td>9,1</td>
<td>233</td>
<td>3,9</td>
</tr>
<tr>
<td>EE</td>
<td>887</td>
<td>1,3</td>
<td>682</td>
<td>10,1</td>
</tr>
<tr>
<td>HU</td>
<td>3.974</td>
<td>10,1</td>
<td>394</td>
<td>6,8</td>
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<tr>
<td>LT</td>
<td>584</td>
<td>3,4</td>
<td>172</td>
<td>3,8</td>
</tr>
<tr>
<td>LV</td>
<td>597</td>
<td>2,3</td>
<td>259</td>
<td>5,5</td>
</tr>
<tr>
<td>MT</td>
<td>163</td>
<td>0,4</td>
<td>408</td>
<td>4,3</td>
</tr>
<tr>
<td>PL</td>
<td>6.207</td>
<td>38,2</td>
<td>162</td>
<td>3,2</td>
</tr>
<tr>
<td>SK**</td>
<td>643</td>
<td>4,8</td>
<td>134</td>
<td>3,5</td>
</tr>
<tr>
<td>SI</td>
<td>750</td>
<td>2</td>
<td>375</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>15.925</strong></td>
<td><strong>71,6</strong></td>
<td><strong>222</strong></td>
<td><strong>4,1</strong></td>
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</table>

* excluding Prague
** excluding Bratislava

The eligible population for the analysed Objective 1 regions exceeds 71 million people, which represents 97.6% of the total population of the countries concerned. The highest national structural expenditure per head was observed in Estonia, Malta and Hungary. In Slovenia, Poland and Lithuania the per capita spending remained below the average of EUR 223.

Obviously, the respect of additionality is largely determined by the economic performance of the country in the period concerned. Indeed, the target level of national structural expenditure per head is set on the basis of the forecasts on GDP growth available ex-ante. Member States which expect higher GDP growth rates tend to envisage higher investments as their economy leaves more room for additional structural expenditure.

Over the period 2004-2006 the real GDP growth exceeded the initial forecasts in all the Member States concerned by this document. Higher GDP growth meant additional financial resources available for the public sector and, therefore, more room to undertake new investments not planned when the target level of expenditure was set.

Chart 2 shows the national performance presented in a ratio\(^2\) aimed at capturing to what extent unexpected GDP growth was devoted to new investments not planned beforehand\(^3\). Ratios higher than 1 suggest a substantial relative investment effort whereas those below 1 reveal a relatively lower effort.

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\(^2\) The quotient of this ratio is a result of dividing the relative increase in structural investment compared to the initial target by the relative increase of the GDP growth compared to the initial forecasts of DG ECFIN. The results obtained using national forecasts of GDP growths are very similar.

\(^3\) GDP growth forecasts of DG ECFIN in autumn 2003 were used. For the year 2006, the forecasts used are those of autumn 2004 as that year was not a part of the forecasts in 2003.
The results unveil that the Baltic States made the most of the improvement of the economy. In addition, this ratio suggests a substantial investment effort in Member States where the absolute variation is not among the highest, such as Hungary and Lithuania. It means that an important part of unexpected GDP growth was devoted to investments in the real economy in these countries. Other Member States, such as the Czech Republic, are in the opposite situation.

![Chart 2 - Relative investment effort](chart.png)

Another interesting finding is a significant correlation between the relative investment effort and the burden of the public debt. Table 3 shows the ratio of public debt in the Member States and how it evolved over the reference period. When comparing this table with chart 2, figures suggest that the investment effort tended to be less significant in Member States with higher public debt rates. The only exception seems to be Hungary. Whereas this country performs well in terms of the relative investment effort, it bears the highest public debt among the analysed Member States.

<table>
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<th>Table 3 - General Government debt as% of GDP</th>
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<td>SK</td>
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<td>SI</td>
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Source: ESTAT
3.2. Assessment by country

Czech Republic

The annual average of national structural expenditure in the reference period exceeded by 61% the ex-ante reference level. The main reason for this significant difference was the robust economic growth of the Czech economy during the reference period. Therefore, the Czech Republic complied with the principle of additionality in the programming period 2004-2006.

The expenditure taken into account to construct the additionality tables includes the state budget, all local budgets and the relevant state funds. It was decided not to include the relevant expenditure of state-owned enterprises.

As the Prague region was not eligible to Objective 1 in the period 2004-2006, expenditure incurred in this region was excluded using some estimations.

Estonia

The annual average of national structural expenditure for the 2004-2006 period exceeded the ex-ante reference level by more than 136%. This difference stems mainly from higher national expenditure opportunities due to the higher economic growth than expected at the moment when the reference level was set up.

All the structural expenditure originating from the budgets of the State, regional and local authorities in the eligible areas was identified to build the additionality tables. Funds of some public bodies having their own independent budgets (e.g. state-owned enterprises) were also included. Expenditure committed during the 2004-2006 period but incurred at the later stage was not taken into account for the verification.

All the Estonian territory was eligible to Objective 1 in the programming period 2004-2006.

Hungary

Hungary complied with the principle of additionality in the reference period 2004-2006 as the annual average of national structural expenditure exceeded by more than 32% the reference level set at the stage of the ex-ante verification.

The additionality tables for the ex-post verification of the principle of additionality were constructed on the basis of consolidated figures of the budgets of the central administration, the local authorities and extra-budgetary funds and some funds of the Social Security. In agreement with the Commission structural expenditure of public enterprises was not included in the calculations.

All the Hungarian territory was eligible to Objective 1 in the programming period 2004-2006.
**Lithuania**

The annual average of national structural expenditure for the 2004-2006 period exceeded the ex-ante reference level by more than 52%. Hence, Lithuania has complied with the principle of additionality in this period. The main reason was the impressive GDP growth of the Lithuanian economy in the reference period (the average growth rate was over 7% every year). This growth rate was not predictable at the time of the ex-ante verification for the period 2004-2006.

The data used to build the additionality tables include the State budget expenditure. Spending of state-owned enterprises is not taken into account.

All the Lithuanian territory was eligible to Objective 1 in the programming perspective 2004-2006.

**Latvia**

Latvia's annual average of structural expenditure incurred in years 2004-2006 exceeded by far (more than 130%) the reference level set at the ex-ante verification for this period. Therefore, Latvia complied with the principle of additionality.

The information of the annual State budget was used to construct the ex-post additionality tables. The tables include also the expenditure of the public enterprises.

All the Latvian territory was eligible to Objective 1 in the programming period 2004-2006.

**Malta**

The annual average of national structural expenditure undertaken in the reference period 2004-2006 was by 1,1% lower than the target level defined ex-ante. The main reason for this was the lower than expected expenditure (-35.3%) in the area of human resources. In consequence, Malta failed to comply with the requirements of the principle of additionality in the 2004-2006 period. The margin has been however very small.

All the structural expenditure was identified to construct the additionality tables. This included also off-budget spending of public enterprises.

All the Maltese territory was eligible to Objective 1 in the programming period 2004-2006.

**Poland**

Poland's annual average of structural expenditure in the 2004-2006 period was by 1,2% lower than the reference level set ex-ante. Although the initial level of national expenditure - as claimed by the Polish authorities - was above the target level, the final outcome takes into consideration deflators suggested by the Commission in order to reflect better the inflation rate of the Polish economy over the reference period.
The main reason for the shortfall is the much lower expenditure of public enterprises due to the rapid privatisation process in years 2004-2006. The state-owned enterprises had not been included within the calculations of additionality, Poland would have largely complied with the requirements of this principle.

The data used to build the additionality tables include the public expenditure incurred by the Ministries, State special purpose funds (e.g. National Road Fund), governmental agencies and other off-budget entities of the public sector as well as the expenditure of the local self-government units. This expenditure was estimated on the basis of a representative sample identified by the Central Statistical Office (CSO) in Poland.

All the Polish territory was eligible to Objective 1 in the programming period 2004-2006.

**Slovenia**

The annual average of national structural expenditure in the 2004-2006 period exceeded by more than 28% the reference level set at the ex-ante verification. Therefore, Slovenia complied with the principle of additionality in the reference period.

The data used to construct the additionality tables were those provided by the annual financial statements of the national budget, those submitted to the Ministry of Finance by municipalities and spending of five extra-budgetary funds relevant for the eligible areas. In addition, the expenditure undertaken by the Motorway Company of the Republic of Slovenia was also included as it was considered as the entirely eligible public expenditure in the area of transport.

The whole Slovenian territory was eligible to Objective 1 in the programming period 2004-2006.

**Slovak Republic**

The Slovak Republic's annual average of structural expenditure was by 23% higher than the reference level set up at the point of the ex-ante verification. It can therefore be stated that the Slovak Republic reached the necessary level of expenditure to comply with the requirements of the principle of additioality.

The additionality tables include the expenditure of ministries, the budget of the higher territorial units and municipalities, as well as expenditure of those state-owned firms which have not been privatised and of new state-owned enterprises (e.g. the National Motorways Company).

All the Slovak territory was eligible to Objective 1 in the programming period 2004-2006 with an exception of the capital region of Bratislava. Therefore, a geographical correction was made in order exclude from the additionality tables the expenditure incurred within this region. To this end, the Slovak authorities used some estimations based on a number of assumptions made in relation to the different spending areas.
4. **COMPOSITION OF STRUCTURAL EXPENDITURE**

On average, basic infrastructure represents the bulk of the national structural expenditure incurred during the programming period 2004-2006 (see table 4). In relative terms it was more important in these nine new Member States (58.63%) than in the old EU-15 Member States\(^4\) (47.3%) during the reference period.

At the same time, it is worth noting that the composition of expenditure co-financed by the Structural Funds differs substantially from the composition of the national structural expenditure. More than seven out of ten euros from the Structural Funds were allocated to areas other than purely basic infrastructure, with a considerable concentration on the productive environment (over 40%).

### Table 4 - Composition of national structural expenditure and structural funds (annual average 2004-2006, % of total)

<table>
<thead>
<tr>
<th></th>
<th>National structural expenditure</th>
<th>Structural funds aid</th>
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<tbody>
<tr>
<td>Basic infrastructures</td>
<td>58.7%</td>
<td>28.6%</td>
</tr>
<tr>
<td>Human resources</td>
<td>21.9%</td>
<td>19.8%</td>
</tr>
<tr>
<td>Productive environment</td>
<td>15.7%</td>
<td>42.5%</td>
</tr>
<tr>
<td>Others</td>
<td>3.8%</td>
<td>9.1%</td>
</tr>
</tbody>
</table>

The composition of structural expenditure varies significantly also across Member States (see charts 3 and 4). For example, with regard to the Structural Funds aid, investments in the basic infrastructure in Malta and, to a smaller extent, Latvia overtook the productive environment. Meanwhile the national structural expenditure in basic infrastructure fell behind the human resources area in Estonia, Latvia and the Slovak Republic. When comparing two diagrams significant variations can be observed in the relative weight of the different categories between countries, as well as within the Members States themselves. This proves a rather poor alignment between the national structural expenditure and the Structural Funds aid in the 2004-2006 programming period.

Chart 3 - Composition of national structural expenditure by Member State (% shares of the total)

Source: DG REGIO calculations

Chart 4 - Structural Funds aid by Member State (% of the total)

Source: DG REGIO calculations