The macroeconomic situation in the EU over the 2007-2013 programming period

WP1: Synthesis report

Ex post evaluation of Cohesion Policy programmes 2007-2013, focusing on the European Regional Development Fund (ERDF) and the Cohesion Fund (CF)

APPLICA ISMERI EUROPA CEA CAMBRIDGE ECONOMIC ASSOCIATES

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May 2016

EUROPEAN COMMISSION

Directorate-General for Regional and Urban Policy
Directorate B – Policy
Unit B.2 Evaluation and European Semester

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(contract number 2014CE16BAT016)

Directorate-General for Regional and Urban Policy

2016 EN

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Luxembourg: Publications Office of the European Union, 2016

ISBN 978-92-79-61653-2
doi: 10.2776/63532

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Abbreviations

ERDF	European Regional Development Fund
EU	European Union
EU15	Member States which entered the EU before 2004
EU12	Member States which entered the EU in 2004 and 2007
NUTS	Nomenclature of territorial units
PPS	Purchasing power standard

Member states

BE	Belgium
BG	Bulgaria
CY	Cyprus
CZ	Czech Republic
DE	Germany
DK	Denmark
EE	Estonia
EL	Greece
ES	Spain
FI	Finland
FR	France
HR	Croatia
HU	Hungary
IE	Ireland
IT	Italy
LT	Lithuania
LU	Luxembourg
LV	Latvia
MT	Malta
NL	Netherlands
PL	Poland
PT	Portugal
RO	Romania
SE	Sweden
SI	Slovenia
SK	Slovakia
UK	United Kingdom

1 Introduction

The purpose here is to describe the macroeconomic conditions which existed in EU Member States over the 2007-2013 period and to indicate their potential impact on the programmes that were planned to be undertaken. This is important to take account of when assessing both the way that the programmes were implemented and their outcomes as well as the changes which occurred over the period to what was initially planned.

The economic situation which has prevailed across most of the EU over the period during which the 2007-2013 programmes have been carried out has been very different from what it was at the time they were formulated. In 2007, after several years of fairly continuous and relatively high growth in all but one or two countries, which in many cases stretched back to 2000 and before, it was natural to assume that this would persist over much of the programming period. Instead, the EU has gone through the worst economic recession since the inter-war years, employment has declined and the number of people out of work has risen to levels not seen in a generation. Although there was some economic recovery in some Member States following the global recession in 2008-2009, this was by no means general and most of the countries concerned slipped back into recession or experienced very little growth in 2012-2013. Others, especially those in the south of the EU, suffered an almost continuous decline in GDP over the 5 years 2008-2013. In the two years 2013-2015, there was again some economic recovery virtually throughout the EU, in the sense that GDP increased, but it was slow in most countries.

In this context, nearly all countries have experienced problems of public finances. The economic recession in the early years of the programming period led to government revenues from taxes falling and an increasing need for social expenditure to provide income support for the many losing their jobs or unable to find work. At the same time, special measures implemented to counter the downturn in economic activity and to try to assist sectors hard hit by the financial crisis (banking and construction, in particular), or by the collapse in global demand (such as the car industry), as well to help keep people in jobs (such as short-time working schemes) added to government spending. While the increased public expenditure and reductions in taxation were successful in moderating the extent of the economic downturn and avoiding a prolonged recession – at least in most countries – they reinforced the effects of the downturn itself on public finances and led to large budget deficits and mounting levels of government debt.

The reaction of governments across the EU to these, under pressure from financial markets, added a further twist to the way the economic situation evolved. In all but a few countries, governments took action to curb growing budget deficits and rising debt by cutting public expenditure in particular and, to a lesser extent, raising tax rates (or reducing tax allowances and concessions). Such fiscal consolidation measures had the effect of dampening any growth tendencies and of making it more difficult for recovery to occur, especially since the measures were implemented in unison and accordingly served to reinforce each other given the close trade links between Member States. In particular, they reduced the finances available for public investment both directly and indirectly by cutting transfers from central government to regional and local authorities which across much the EU have a large amount of the responsibility for carrying out development expenditure. As such, they also made it more difficult for the authorities concerned to find the co-financing needed to carry out Cohesion policy programmes and to absorb the EU funding available.

At the same time, fiscal consolidation measures, allied to the persistence of zero or near growth, imparted an additional element of uncertainty among enterprises about future economic prospects, so increasing their reluctance to invest in a context in which there were already difficulties of obtaining the financial resources to do so. The consequence has been in many cases much lower demand for support from the ERDF to help finance such investment than anticipated when the programmes were drawn up, and as planned as part of development strategies, so adding to the problems of absorbing the funding

available and giving rise to widespread delays in Member States in spending the resources allocated to them.

2 Outline of analysis

The concern in what follows is to describe in more detail the above features of the economic context in which programmes co-financed by the ERDF and Cohesion Fund were implemented over the period, the extent to which they differed, or were similar, across countries and their potential effect on both the programmes themselves and their implementation. It considers in turn:

- the changes in GDP which occurred over the period in different Member States;
- the labour market developments – specifically as regards employment and unemployment rates – which were largely a consequence of these changes;
- the state of public finances which reflects the macroeconomic policy pursued as well as the underlying economic circumstances;
- the changes to public expenditure, and more particularly to public investment, which were made to a large extent as part of the macroeconomic policy pursued and in response to the underlying economic situation;
- the scale of the financial resources provided by the ERDF and Cohesion Fund in relation to overall Government expenditure on development.

3 Changes in GDP over the programming period

In the years leading up to the 2007-2013 programming period, growth of GDP in the EU as a whole, averaged close to 3% a year, following the slowdown in the early part of the decade resulting from the bursting of the 'dotcom' bubble. The rate in the EU12 countries (the 10 which entered the EU in mid-2004 and Bulgaria and Romania which entered at the beginning of 2007) was much higher than this, at over 5% a year and around twice the rate in the EU15 Member States (Table1). Indeed, the growth rate in all the EU12 countries, apart from Cyprus, Malta and Hungary (where macroeconomic problems were already present before the global recession), averaged well over 5% a year over the three years 2004-2007. The growth rate in Ireland was much the same as that in the EU12, but this was the only country in the EU15 where the rate was over 4% a year. At the same time, growth was less than 2% a year only in Portugal and Italy over this period.

In sum, therefore, high rates of growth were a feature of nearly all EU12 countries in the run-up to the 2007-2013 programming period, while with only a few exceptions, growth rates in EU15 Member States, though lower than in the EU12, were also relatively high by the standards of the previous 25 years or so.

In the first two years of the programming period, however, the EU was hit by the global recession which followed the financial crisis in 2007-2008 and GDP fell on average by 2% a year, most of the fall occurring from mid-2008 to mid-2009. The reduction in GDP was especially marked in countries which had experienced a housing market boom in the years before – in Ireland and the three Baltic States, in particular – where, as a result, there was a virtual collapse in the construction industry. Interestingly, however, GDP fell by much less in Spain, where the experience was similar and where construction also declined markedly, though this led to a larger reduction in employment than elsewhere, as indicated below.

Only 5 Member States escaped a reduction in GDP over these two years taken together (though not in 2009 if taken separately) – Poland, most notably, Cyprus, Malta, Bulgaria and Romania, though in the last three the growth rate was barely positive. Indeed, in Bulgaria and Romania, a high rate of growth in 2008 was followed by a substantial decline in GDP in 2009 of 5% in the first and 7% in the second. The experience was

similar in Slovakia too, where the decline in GDP over the two years was only marginal, but where GDP fell by over 5% in 2009.

Table 1 Changes in GDP (at constant prices), 2004-2015

	2004-07	2007-09	2009-11	2011-13	2013-15	2006-15	2006-15
	Annual average % change						*% change*
EU27	2.7	-2.0	1.9	-0.1	1.6	0.7	6.0
Poland	5.5	3.3	4.4	1.4	3.5	3.6	37.1
Slovakia	7.7	-0.1	4.0	1.5	3.1	3.0	30.8
Malta	2.5	0.4	2.7	3.5	5.0	3.0	30.6
Luxembourg	5.3	-3.1	4.1	1.7	4.5	2.5	24.4
Romania	6.8	0.4	0.1	2.1	3.4	2.1	20.2
Lithuania	8.2	-6.5	3.8	3.7	2.3	1.8	17.8
Bulgaria	7.1	0.6	0.8	0.8	2.3	1.8	17.6
Ireland	5.6	-3.9	1.5	0.8	6.5	1.6	15.6
Sweden	3.8	-2.9	4.3	0.5	3.2	1.5	14.0
Czech Republic	5.9	-1.1	2.1	-0.7	3.1	1.3	12.7
Germany	2.2	-2.3	3.9	0.4	1.6	1.1	10.6
UK	2.7	-2.3	1.8	1.7	2.6	1.1	10.2
Belgium	2.9	-0.8	2.2	0.1	1.3	1.0	9.4
Austria	3.0	-1.2	2.4	0.5	0.6	0.9	8.5
Estonia	8.4	-10.2	5.0	3.4	2.0	0.7	6.4
Netherlands	2.8	-1.1	1.5	-0.8	1.5	0.7	6.1
Slovenia	5.2	-2.4	0.9	-1.9	3.0	0.6	5.9
France	2.3	-1.4	2.0	0.4	0.7	0.6	5.9
Latvia	10.2	-9.1	1.1	3.5	2.6	0.5	4.6
Hungary	3.4	-2.9	1.2	0.1	3.3	0.4	3.7
Spain	3.7	-1.3	-0.5	-2.1	2.3	0.0	0.4
Finland	4.0	-3.9	2.8	-1.1	-0.1	0.0	0.3
Denmark	2.4	-2.9	1.4	-0.2	1.2	0.0	-0.3
Cyprus	4.5	0.8	0.9	-4.2	-0.5	-0.2	-1.4
Portugal	1.7	-1.4	0.0	-2.6	1.2	-0.4	-3.2
Italy	1.5	-3.3	1.1	-2.3	0.2	-0.8	-6.9
Greece	3.6	-2.3	-7.3	-5.3	0.2	-3.0	-23.8
Croatia	4.5	-2.8	-1.0	-1.6	0.6	-0.5	-4.5

Note: Countries ranked by GDP growth 2006-2015

Source: Eurostat, National accounts

In the following two years, there was some recovery in output in the EU as a whole, averaging almost 2% a year, still less than in the pre-recession period and not quite making good the reduction in the previous two years. The recovery, however, was by no means general across countries. In Germany and Sweden, the growth rate exceeded that in the 2004-2007 period, but these were the only Member States where this was the case. In Greece, GDP declined sharply and it also fell in Spain, while in Portugal, it remained flat. In Ireland and Cyprus too, the other two countries in which special rescue programmes were implemented to support financial markets, growth averaged only around 1% a year. This was also the case in Italy, where financial instability was also a major problem.

In the EU12, recovery was most marked in Estonia, Lithuania and Slovakia, countries in which the decline in GDP had been particularly pronounced in 2009, while the growth rate was also well above average in Poland where there had been no fall in GDP. In Romania, on the other hand, growth was barely positive over these two years, and in Bulgaria, Hungary, Slovenia and Latvia, where GDP had also declined substantially in

2009 (by 8% in the third and as much as 14% in the last), it averaged only just over 1% a year.

Over the next two years, 2011-2013, there was a renewed fall in EU GDP, though on a much smaller scale than in 2007-2009, followed by modest growth in 2013-2015. The fall over the first two years was largely concentrated in the southern Member States, in Cyprus and Slovenia as well as those in the EU15. In Greece, the reduction in GDP was less than over the preceding two years, but it still averaged 5% a year. In Cyprus, GDP declined by over 4% a year, in Spain, Portugal and Italy, by 2-3% a year and in Slovenia, by only slightly less.

A number of more northerly Member States, however, also experienced a reduction in GDP over these two years, most notably the Netherlands and Finland, where GDP fell by over 1% a year. In the rest of the EU15, moreover, growth averaged less than 1% a year in all countries apart from the UK and Luxembourg, and in most cases, much less than 1% a year, even in Germany, where growth had averaged 4% a year over the previous two years.

In the EU12, GDP declined too in the Czech Republic, while there was no growth at all in Hungary and growth was less than 1% in Bulgaria. Only in the three Baltic States was growth much above 2% a year, most notably in Latvia, where recovery had lagged slightly behind that in the other two countries.

In the following two years, 2013-2015, there was renewed recovery though growth averaged less than 2% a year in the EU as a whole and GDP declined in both Finland (marginally) and Cyprus and remained almost unchanged in Italy and Greece. Only in Hungary, Romania, Poland, Luxembourg, Malta and Ireland was growth much more than 3% a year. Apart from Malta and Ireland, the growth rate was less than over the pre-crisis period even in these countries, as it was in all other Member States.

The net result of the experience over the crisis period is that in 2015, GDP in the EU as a whole was only 6% in real terms above what it had been 9 years earlier in the year before the programming period began. In most countries, 15 of the 27, it was less than 10% above what it had been in 2006, implying a growth rate averaging less than 1% a year. In 5 countries, Denmark, Cyprus, Portugal, Italy and Greece, GDP was lower than it had been 9 years earlier – in Greece, 24% lower – while in another two countries, Spain and Finland, it was much the same as it had been.

In Croatia, which was not a member of the EU until 2013 and accordingly not a recipient of the ERDF or Cohesion Fund over the period but which did receive pre-accession funding from the EU, if on a relatively small scale, there was also a decline in GDP over the period and one which, at around 5% in real terms, was significant.

4 Labour market developments over the period

4.1 Falling employment

A major outcome of the virtual stagnation of GDP or decline across most of the EU has been significant job losses coupled with a marked decline in the rate of job creation, which has meant that those losing their jobs and young people entering the labour market have found it difficult to find work. The number in employment, therefore, fell over the four years 2007-2011 both in absolute terms and relative to population of working age in most countries and although there was some recovery in employment in the subsequent 4 years, the employment rate in 2015 was only marginally above what it had been in 2007 at the start of the period. (Table 2)[1].

[1] It should be noted that the age group 20-64 has been taken to represent working-age population in order to be consistent with the Europe 2020 target, which related to this age group. Taking the age group 15-64, which is the conventional definition of working-age population, but which includes those aged 15-19 most of whom are still in education, does not alter the picture significantly, other than reducing the rates

In consequence, the number employed in this age group stood at only around 70%, well short of the Europe 2020 target of 75%, implying that the rate would need to increase by around 1 percentage point a year over the following 5 years to reach the target. (To put the likelihood of this happening into perspective, in the 5 years up to 2007 when growth was relatively high, the rate increased by only around 3 percentage points, only just half of what needs now to happen.)

Table 2 Employment rates of working-age population (20-64), 2004-2013

	% of population 20-64				Percentage point change			
	2003	2007	2011	2015	2003-07	2007-11	2011-15	2007-15
EU27	67.1	69.9	68.6	70.1	2.8	-1.3	1.5	0.2
Netherlands	75.2	77.8	76.4	76.4	2.6	-1.4	0.0	9.2
Malta	57.8	58.6	61.6	67.8	0.8	3.0	6.2	6.6
Germany	68.3	72.9	76.5	78.0	4.6	3.6	1.5	5.1
Portugal	72.9	72.5	68.8	69.1	-0.4	-3.7	0.3	5.1
Czech Republic	70.8	72.0	70.9	74.8	1.2	-1.1	3.9	2.8
Slovenia	68.1	72.4	68.4	69.1	4.3	-4.0	0.7	1.6
Poland	57.1	62.7	64.5	67.8	5.6	1.8	3.3	1.5
Hungary	62.4	62.3	60.4	68.9	-0.1	-1.9	8.5	1.3
Luxembourg	67.2	69.6	70.1	70.9	2.4	0.5	0.8	0.7
Finland	72.3	74.8	73.8	72.9	2.5	-1.0	-0.9	0.4
UK	74.7	75.2	73.5	76.9	0.5	-1.7	3.4	0.4
France	69.8	69.9	69.3	70.0	0.1	-0.6	0.7	0.1
Estonia	69.6	76.9	70.6	76.5	7.3	-6.3	5.9	-0.4
Belgium	64.7	67.7	67.3	67.2	3.0	-0.4	-0.1	-0.5
Bulgaria	58.0	68.4	62.9	67.1	10.4	-5.5	4.2	-1.3
Austria	72.0	72.8	74.2	74.3	0.8	1.4	0.1	-1.4
Sweden	77.9	80.1	79.4	80.5	2.2	-0.7	1.1	-1.9
Cyprus	75.2	76.8	73.4	68.0	1.6	-3.4	-5.4	-2.2
Denmark	77.3	79.0	75.8	76.5	1.7	-3.2	0.7	-2.5
Lithuania	68.9	72.7	66.9	73.4	3.8	-5.8	6.5	-2.7
Slovakia	64.8	67.3	65.0	67.7	2.5	-2.3	2.7	-3.3
Romania	63.7	64.4	63.8	66.0	0.7	-0.6	2.2	-3.4
Italy	60.0	62.7	61.0	60.5	2.7	-1.7	-0.5	-3.5
Ireland	70.6	73.8	63.8	68.8	3.2	-10.0	5.0	-5.0
Spain	64.3	69.7	62.0	62.0	5.4	-7.7	0.0	-7.7
Latvia	67.8	75.2	66.3	72.5	7.4	-8.9	6.2	-8.8
Greece	63.6	65.8	59.6	54.9	2.2	-6.2	-4.7	-10.9
Croatia	58.5	64.0	59.8	60.5	5.5	-4.2	0.7	1.7

Source: Eurostat, European Labour Force Survey

Whereas over the three years 2004-2007, there were only two countries in which the employment rate failed to increase – Romania and Portugal and in both cases, the reduction that occurred was marginal – over the next two years when the global recession hit, it declined in 20 of the 27, most notably in the three Baltic States, Ireland and Spain (where it fell by around 6 percentage points or more). It is worth noting that in 4 of the 7 countries in which the employment rate rose over these two years – Germany, Austria, the Netherlands and Luxembourg – GDP fell, which would usually be associated with a decline in employment. Al of these four countries, therefore, maintained employment levels during the recession, accepting a reduction in productivity, and in profits (or increased losses), in order to keep people in jobs. (In Germany and Austria, special short-time working schemes were in force, funded by the

government, to help employers do this.) The opposite was the case in Spain, where as noted above, the fall in GDP over these two years was relatively modest but the employment rate fell markedly implying a significant increase in productivity instead of a fall, which is the reverse of what happened over the years preceding the recession when there was hardly any growth of productivity at all.

In the subsequent two years, employment continued to decline, though at a slower rate than before. Consequently, in 2011, the employment rate in the EU as a whole was 1.3 percentage points below what it has been 4 years earlier in 2007 and only in 5 countries – Austria, Germany, Poland, Malta and Luxembourg – was the rate higher. The reduction in the rate was substantial in all three Baltic States (around 6 percentage points in Estonia and Lithuania and 9 percentage points in Latvia) as well as in Greece (6 percentage points), Spain (8 percentage points) and, most especially, in Ireland (10 percentage points).

In the following 4 years up to 2015, the employment rate increased on average by slightly more than it fell over the preceding 4 years despite the relatively slow growth of GDP, implying that there was little growth in productivity. (In practice, there was a significant shift to part-time working, even among men, so that it terms of GDP per hour worked, the increase in productivity was more than it seems at first sight.) Indeed, the employment rate fell in only 4 Member States over this period – Italy, Finland, and, above all, Greece and Cyprus (by around 5 percentage points in both cases).

In the majority of Member States (15 of the 27), the employment rate in 2015 was below what it had been in 2007 at the start of the programming period and in another four countries, it was less than 1 percentage point higher. In only 5 Member States – the Netherlands, Malta, Germany, Portugal and the Czech Republic – was the employment rate over 2 percentage points higher in 2015 than in 2007. In both Portugal and the Netherlands, in the former of which GDP fell over this period and in the latter, it increased relatively little, the implication is that productivity – in terms of GDP per person employed at least – declined markedly and was significantly lower in 2015 than 8 years earlier.

The reduction in the employment rate was particularly large in Spain, Latvia and Greece. In the last, the rate declined by 11 percentage points, reducing it to 55%, well below the level it was 20 years earlier. Given the substantial fall in GDP, however, this still implies that overall productivity fell markedly over the programming period, in contrast to the implied growth in productivity in both Spain and Latvia. In Croatia, the employment rate rose over the period despite the decline in GDP, again implying that there was a fall in productivity.

Accordingly, there is no general relationship between GDP growth and employment across countries . There are countries in which GDP rose by relatively little or even fell where the employment rate increased, and those in which GDP rose relatively significantly where the employment rate fell, Slovakia being a prominent case in point. Much depends on the attitude of both the government and employers to keeping people in work – as well as the regulations in place to protect workers – which in both cases is affected by the costs involved in maintaining employment or conversely of making workers redundant.

It also depends on expectations about the future development of the economy and the length of time the slow rate of growth is expected to last. In Germany, therefore, the expectation in 2009 seems to have been that the loss of output would be temporary and so employers were willing to maintain jobs in order avoid having to recruit new people when the upturn came. In Italy, the legislation makes it difficult for medium-sized and large employers to dismiss workers. In Spain, by contrast, no quick upturn was expected and employers responded very quickly to reduce the size of their work force.

The apparent reduction in productivity which has occurred in a number of countries as employment has been maintained in the face of little or no growth in GDP raises a question over how much employment is likely to increase in the future if GDP growth

resumes given the seemingly excess number of people at present in work. Accordingly, given past levels of productivity, the existing work force appears capable of producing much more than they do now, so that it is possible that GDP could rise significantly without the need to take on more workers. This seems to be the case in particular in Hungary, the Czech Republic and Italy, in each of which, on past trends, employment would have been expected to decline by much more than it has so far given the depressed state of GDP. There is, therefore, additional pressure on Governments in these countries especially, though in a number of others as well, to increase the rate of GDP growth in order not only to stimulate job creation directly but also to generate the income needed to sustain the various measures of employment support which are in force. This has equally been the case over the last few years of the programming period.

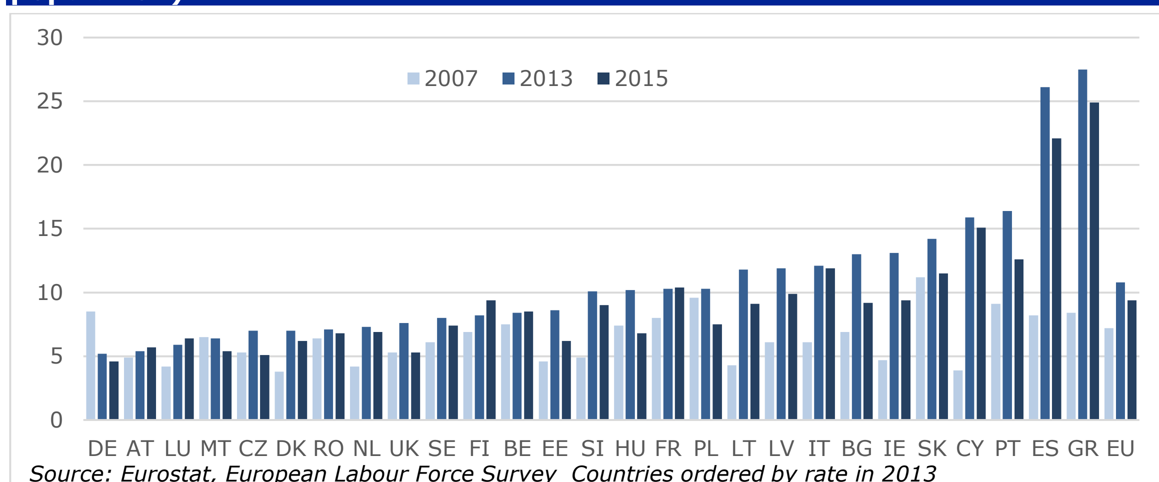
4.2 High unemployment

The decline in employment rates across the EU over the earlier part of the programming period led to sharp increases in the number of unemployed and to persistently high rates of unemployment in subsequent years in most countries. These led in turn to an increase in poverty and social deprivation among the working-age population as well as among children dependent on them. Accordingly, getting unemployment down became an increasingly important objective of government policy as the period went on.

In the EU as a whole, unemployment averaged close to 11% of the labour force (defined as those employed plus those unemployed) in the EU in 2013 as against only just over 7% at the beginning of the period in 2007 (Figure 1). In 13 Member States – 8 of them EU12 countries and the other 5, the four southern EU15 countries together with Ireland – unemployment was over 10% in 2013. In Spain and Greece, over a quarter of the people who were economically active were unemployed (26% and 28%, respectively), three times the proportion 6 years earlier.

In Croatia (not shown in Figure 1), where unemployment was well above the EU average before the recession (just under 10% in 2007), the rate had risen to over 17% in 2013, when it joined the EU, higher than in any other Member State, apart from Spain and Greece.

Figure 1 Unemployment rates, 2007, 2013 and 2015 (% of economically active population)



Source: Eurostat, European Labour Force Survey Countries ordered by rate in 2013

The only country in which unemployment was lower in 2013 than in 2007 was Germany, where as indicated above, the employment rate rose by more than in any other country in the EU apart from Malta. The latter was the only other Member State not to experience a rise in unemployment between the two years, the large increase in the employment rate here being a result of large numbers of women becoming economically active over the period for the first time. (Malta had by some way the lowest rate of women participating in the labour force in the EU but this is changing rapidly) In

simplistic terms, the additional jobs created over the period, therefore, went to people entering the labour market, especially women, who were not previously there rather than to those already in the market (and recorded as looking for employment).

The experience in Malta illustrates the important point that increases in employment rates do not necessarily translate directly into reductions in unemployment in a context where the number of people who are economically active, and so part of the labour force, among the working-age population is increasing. This is the case in many EU countries, most especially those in the south of Europe, where traditionally many women have not worked, as well as in the centre and east of Europe, where under the former communist regimes, people tended to retire at relatively early ages. Rates of participation in the work force were tending to increase in virtually all EU Member States before the global recession struck as more women became employed and more older people remained longer in work.

The subsequent downturn in economic activity had two conflicting effects. First, it increased the pressure on women, as well as older people, to be in employment in order to compensate for job losses or reduced earnings among other members of the household, so leading to increased participation rates. Secondly, it reduced job availability, so deterring people from looking for work because of a belief that there were no jobs to be found and, accordingly, leading to lower participation rates. Which of the two effects predominated varies in some degree between countries, in part reflecting the extent of income support provided by the social protection system. In countries with relatively developed systems, people needed actively to look for work in order to claim unemployment benefits, whereas there was no such need in countries where they were unlikely to receive benefits anyway.

While there is a reasonably close relationship, therefore, between increases in employment rates and reductions in unemployment, the relationship, as in the case of that between changes in GDP and employment, is not uniform across countries. In some countries, the unemployment rate rose by more than the reduction in the employment rate because of more people becoming economically active, in others, it rose by less as people withdrew from the labour force, at least as this is measured. This, however, does not necessarily mean that the scale of the problem was any less in the latter countries than in the former. It may simply mean that it was more disguised and not so apparent, especially if the policy focus was on the unemployment figures rather than on employment and the rate of job creation. Nor does it mean that bringing down unemployment was easier in the latter than the former, in the sense that a lower rate of employment growth would be needed to achieve a given reduction in unemployment. As employment opportunities increase, people in the latter group of countries who had withdrawn from the labour force might well return because of the increased chance of finding a job, so that the rate of employment growth needed to bring down unemployment might be little different.

In practice, unemployment fell in most countries with the increase in employment rates over the two years 2013-2015. Nevertheless, in 2015, unemployment still averaged 9.4% in the EU and remained above 10% in 7 Member States - the four southern EU15 countries together with Cyprus, Slovakia and France. In Spain, it was still well over 20% and in Greece, around 25%. Moreover, only in Germany was the rate less than 5% and only in Germany, Malta, the Czech Republic, Hungary and Poland was the rate lower in 2015 than at the beginning of the period.

Accordingly, creating jobs to bring down unemployment remained a political priority for nearly all governments throughout much of the period, especially from 2009 on.

5 Public sector finances

5.1 Expansionary budgets followed by budget tightening

In most EU Member States, government budgets were either roughly balanced or in deficit in the period preceding the global recession. In a few countries, Greece and Hungary, the deficits were relatively large (Table 3). Although the scale of the deficit in the former only came to light sometime later, in Hungary, it led to restrictive measures being taken when elsewhere in the EU GDP growth was still relatively high. The aim was to contain the build-up of government debt, which had reached 66% of GDP, over twice the level in any other mainland Central and Eastern European Member State. In Belgium, Italy and Greece, debt levels were much higher than this, though in these countries, high debt levels had persisted for some time. These were the only three countries in the EU, however, where government debit amounted to over 70% of GDP.

The onset of the global recession in 2008 prompted most governments to take expansionary measures in order to counter the contraction in economic activity. These were supported by the implementation of a package of measures at EU level designed in part to assist the construction industry which was particularly hard hit by the financial crisis. In 2009, therefore, the budgets in all Member States went into deficit as public expenditure increased, partly automatically as unemployment rose and with it he need for income support, though more importantly because of a reduction in tax revenue as incomes declined.

Only the three Nordic Member States and Luxembourg had budget deficits of less than 3% of GDP, in each case, reflecting the fact that they had sizable surpluses before the recession. In Latvia, Lithuania and Romania, the deficit amounted to around 9% of GDP, in Portugal, the UK and Spain, around 10-11% of GDP, in Ireland, 14% and in Greece, over 15%, though in the last, this was not known at the time. (In Ireland and Spain, it should be noted, the budget had been in surplus before the recession struck, even if only marginally so in the former. It is difficult, therefore, to argue that fiscal policy was excessively expansionary before 2008 in these two countries, a charge which has sometimes been made against some countries which were in deficit even when economic growth had been relatively high for some years.)

Table 3 Government financial balance and accumulated debt, 2007-2015

	Budget balance (% GDP)				Government debt (% GDP)			
	2007	2009	2011	2013	2007	2009	2011	2013
EU27	-0.9	-6.7	-4.5	-2.4	57.9	73.1	81.1	85.2
Luxembourg	4.2	-0.7	0.5	1.2	7.8	16.0	19.1	21.4
Germany	0.2	-3.2	-1.0	0.7	63.5	72.4	78.3	71.2
Estonia	2.7	-2.2	1.2	0.4	3.7	7.0	5.9	9.7
Sweden	3.3	-0.7	-0.1	0.0	38.3	40.4	36.9	43.4
Lithuania	-0.8	-9.1	-8.9	-0.2	15.9	29.0	37.2	42.7
Czech Republic	-0.7	-5.5	-2.7	-0.4	27.8	34.1	39.9	41.1
Romania	-2.8	-9.5	-5.4	-0.7	12.7	23.2	34.2	38.4
Cyprus	3.2	-5.5	-5.7	-1.0	53.9	53.9	65.8	108.9
Austria	-1.3	-5.3	-2.6	-1.2	64.8	79.7	82.2	86.2
Latvia	-0.7	-9.1	-3.4	-1.3	8.4	36.6	42.8	36.4
Malta	-2.3	-3.3	-2.6	-1.5	62.4	67.8	69.9	63.9
Netherlands	0.2	-5.4	-4.3	-1.8	42.4	56.5	61.7	65.1
Hungary	-5.1	-4.6	-5.5	-2.0	65.6	78.0	80.8	75.3
Bulgaria	1.1	-4.1	-2.0	-2.1	16.2	13.7	15.3	26.7
Denmark	5.0	-2.8	-2.1	-2.1	27.3	40.4	46.4	40.2
Ireland	0.3	-13.8	-12.6	-2.3	23.9	61.8	109.1	93.8
Belgium	0.1	-5.4	-4.1	-2.6	87.0	99.6	102.3	106.0
Italy	-1.5	-5.3	-3.5	-2.6	99.8	112.5	116.5	132.7
Poland	-1.9	-7.3	-4.9	-2.6	44.2	49.8	54.4	51.3

Finland	5.1	-2.5	-1.0	-2.7	34.0	41.7	48.5	63.1
Slovenia	-0.1	-5.9	-6.7	-2.9	22.8	34.6	46.6	83.2
Slovakia	-1.9	-7.9	-4.1	-3.0	29.9	36.0	43.3	52.9
France	-2.5	-7.2	-5.1	-3.5	64.4	79.0	85.2	95.8
Portugal	-3.0	-9.8	-7.4	-4.4	68.4	83.6	111.4	129.0
UK	-3.0	-10.7	-7.7	-4.4	43.5	65.7	81.8	89.2
Spain	2.0	-11.0	-9.6	-5.1	35.5	52.7	69.5	99.2
Greece	-6.7	-15.2	-10.2	-7.2	103.1	126.7	172.1	176.9
Croatia	-2.4	-6.0	-7.8	-3.2	37.7	49.0	65.2	86.7

Note: Countries are ordered in terms of the budget balance in 2015
Source: Eurostat, Government deficit and debt statistics

The large deficits had the almost inevitable effect of pushing up debt levels, with 7 countries having accumulated debit of around 80% or more of GDP as against three in 2007 (Austria, Hungary, France and Portugal joining Belgium, Italy and Greece) and another two (Germany and Malta) having a level of around 70% of GDP.

By 2011, all countries, apart from three – Hungary, Cyprus and Slovenia - had reduced the size of their budget deficits as expansionary policies were eased, fiscal consolidation measures began to be implemented and, in some countries, the resumption of economic growth increased tax revenues. The scale of the reduction, however, varied markedly between countries. It was particularly large in Latvia and Greece (over 5% of GDP), in the former, reflecting in part the growth of GDP, in Greece, the size of the tax increases and reduction in public expenditure programmes implemented. Indeed, in general, the reduction in the budget deficit owed much more to the fiscal consolidation measures introduced than to the resumption of GDP growth.

This is equally the case as regards the continued reduction in deficits between 2011 and 2015 when fiscal consolidation measures were generally intensified. By 2015, therefore, all but 5 of the 27 Member States had succeeded in reducing their budget deficits to 3% of GDP or below (the limit stipulated by the Stability and Growth Pact) and in all but one, Greece, to 5% ore below.

In Croatia, the budget deficit also increased over the programming period, pushed up by the depressed state of the economy, reaching almost 8% of GDP in 2011 but being reduced to only just over 3% of GDP in 2015 despite the depressed state of the economy.

As a reflection of the significant budget deficits run in most countries over much of the programming period, accumulated Government debt increased in nearly all cases. In 2015, debt exceeded the Stability and Growth pact limit of 60% in 16 of the 27 Member States, as well in Croatia, imposing an additional constraint on the public finances. In all 4 southern EU15 Member States, Government debt was close to 100% of GDP or above and in Greece, as much as 175% of GDP, in all cases, tightly limiting any expansion of government expenditure.

5.2 Government expenditure expanded then cut back

Fiscal consolidation has been achieved through reductions in Government expenditure programmes, in particular, or at least in their growth, though in most countries, spending increased over the programming period if to a relatively small extent. As noted above, public expenditure increased in nearly all countries over the initial part of the period as the EU economies were hit by the global recession. In all Member States, total government spending went up relative to GDP between 2007 and 2009 (Table 4). Although this is partly a consequence of the fall in GDP in many countries (i.e. in the denominator) which tends to distort the picture, government expenditure also increased in real terms in all countries apart from the UK and Sweden, rising on average in the EU by almost 4% a year over the period 2006-2009.

Over the subsequent 6 years, 2009-2015, total government spending remained virtually unchanged in real terms in the EU, declining by around 3% of GDP. It fell relative to GDP

in most Member States and in 11 of the 27 countries, in real terms as well. ,In Greece, the reduction averaged almost 4% a year, a fall of over 20% over the 6-year period.. There were reductions too in all the other southern EU15 Member States, as well as in Cyprus and Ireland. Even where Government spending increased in real terms over this period, only in Malta and Slovakia (where there was a substantial increase in 2015), was the rise more than 2% a year.

Over the 6-year period as a whole, overall government expenditure across the EU increased by 7% in real terms, or by just 1% a year or so, much less than during the pre-crisis period when it tended to rise at least in line with GDP (i.e. by some 2-3% a year). The growth rate in expenditure was over 2% a year only in 7 countries, 4 of them – Slovenia, Slovakia, Poland and Malta – being in the EU12. It was less than 1% a year in 11 countries, 7 of them being in the EU12 and three being the southern EU15 countries of Portugal, Italy and Greece (the other was Germany). In the last two countries, total government spending fell in real terms over the period, as it did in Lithuania, Romania, Hungary and Latvia.

Table 4 Total General Government expenditure, 2007-2015

	% GDP			*% change in real terms*		
	2007	2009	2015	2006-09	2009-15	2006-15
EU27	44.9	50.3	47.4	3.6	0.2	1.1
Greece	47.1	54.1	55.3	9.3	-3.8	-0.7
Italy	46.8	51.2	50.5	2.9	-0.5	-0.1
Hungary	50.1	50.7	50.7	0.2	1.5	0.2
Cyprus	37.7	42.3	40.1	7.7	-2.2	0.2
Portugal	44.5	50.2	48.3	5.4	-1.1	0.4
Latvia	34.1	43.7	37.2	9.5	-0.3	0.8
Germany	42.8	47.6	43.9	3.0	0.6	0.9
Netherlands	42.5	48.2	44.9	6.1	-0.4	1.1
UK	42.8	49.6	43.2	-2.2	-0.3	1.2
Denmark	49.6	56.8	55.7	5.2	0.5	1.2
Austria	49.1	54.1	51.7	5.0	0.4	1.2
Sweden	49.7	53.1	50.4	-1.5	1.8	1.3
Spain	38.9	45.8	43.3	8.6	-1.0	1.4
France	52.2	56.8	56.8	4.2	1.1	1.6
Slovenia	42.2	48.2	48.0	7.7	0.6	1.6
Czech Republic	40.0	43.6	42.6	8.6	1.1	1.8
Ireland	35.9	47.2	35.1	8.5	-2.0	2.0
Lithuania	35.3	44.9	35.1	13.5	-0.9	2.1
Finland	46.8	54.8	58.3	5.9	1.6	2.1
Romania	38.2	40.9	35.5	12.5	-0.5	2.2
Belgium	48.2	54.1	53.9	6.1	1.2	2.2
Estonia	34.1	46.1	39.5	12.8	0.8	2.5
Poland	43.1	45.3	41.5	5.2	1.6	2.7
Luxembourg	38.2	46.0	41.5	7.6	1.7	2.9
Malta	41.2	41.9	43.3	4.1	4.3	3.3
Bulgaria	37.4	39.5	40.2	16.8	1.6	3.8
Slovakia*	36.1	43.9	45.6	17.0	3.5	5.0
Croatia	45.0	47.6	46.9	5.6	-0.9	-0.1

Note: Countries are ordered in terms of the change in expenditure 2007-2013

** Real expenditure is reported to have increased by 13% in 2015 alone.*

Source: Eurostat, Government statistics

In Croatia, government expenditure also declined over the period (by around 6% overall), much of the reduction occurring in the second half, though spending fell too between 2007 and 2010.

5.3 Government investment at centre of cut-backs in many cases

The action taken by Governments to expand public investment to counter the impact of the global recession was reflected in an increase in real terms of over 5% a year over the three years 2006-2009 in the EU as a whole, though much of this occurred in the years before the onset of the recession. In three Member States, however, Ireland, Malta and Hungary – in the last of which fiscal consolidation was initiated well before the global recession hit – investment was reduced in real terms (Table 5). By contrast, the increase in investment was especially large in Slovakia, Romania, Cyprus, Poland and Bulgaria, as well as in Luxembourg (over 12% a year in each case).

Table 5 General Government fixed capital expenditure in real terms, 2007-2013

	% GDP			*Change in real terms, % a year*			*% change*
	2007	2009	2015	2006-09	2009-15	2006-15	2006-15
EU27	3.2	3.7	2.9	5.4	-2.7	-0.3	-2.4
Greece	4.9	5.7	3.8	2.8	-10.3	-7.2	-49.0
Ireland	4.6	3.7	1.8	-3.4	-8.5	-6.2	-43.9
Cyprus	2.9	4.0	1.9	12.3	-13.2	-6.2	-43.7
Spain	4.6	5.1	2.5	8.1	-11.6	-6.1	-43.0
Portugal	3.2	4.1	2.2	8.9	-10.7	-5.2	-38.0
Italy	2.9	3.4	2.3	6.0	-7.0	-3.6	-27.9
France	3.9	4.3	3.4	4.3	-2.4	-0.8	-6.8
Netherlands	3.9	4.3	3.5	5.3	-2.9	-0.8	-6.6
Latvia	5.9	4.9	4.4	2.3	0.8	-0.7	-5.8
Lithuania	5.4	4.4	3.6	4.9	-0.3	-0.1	-1.3
Estonia	6.0	6.2	5.3	6.6	0.8	0.6	5.4
Austria	2.9	3.4	3.0	8.1	-0.8	1.4	13.7
UK	2.6	3.4	2.7	2.0	-2.0	1.4	13.7
Romania	6.3	6.0	5.1	12.2	-0.9	1.8	17.8
Finland	3.5	4.0	4.0	7.0	0.8	2.0	19.1
Sweden	4.1	4.5	4.3	0.2	2.0	2.0	19.7
Czech Republic	4.6	5.5	5.2	11.0	0.3	2.0	19.8
Germany	1.9	2.4	2.2	6.6	0.6	2.1	20.2
Slovenia	4.5	5.0	5.1	10.5	0.9	2.6	26.4
Belgium	2.0	2.3	2.3	8.2	1.0	2.8	28.1
Denmark	3.0	3.1	3.8	3.0	4.1	2.9	29.4
Hungary	4.3	3.4	6.7	-11.8	13.3	3.3	34.0
Luxembourg	3.6	4.5	3.8	13.1	0.7	3.9	41.7
Malta	3.8	2.4	4.6	-11.6	15.4	4.6	49.9
Poland	4.5	5.1	4.4	13.2	0.7	4.6	50.1
Bulgaria	5.2	5.0	6.2	17.5	5.2	6.5	76.2
Slovakia*	3.1	3.8	6.2	12.1	11.8	8.9	116.2
Croatia	6.1	5.8	2.8	4.3	-11.9	-8.0	-52.8

Note: Countries are ordered in terms of the change in expenditure 2007-2013

**Real expenditure is reported to have increased by 67% in 2015 alone.*

Source: Eurostat, Government statistics

Over the subsequent 6 years when fiscal consolidation measures were introduced, cutbacks in fixed capital expenditure were a major part of these in many countries. Across the EU as a whole, expenditure was reduced by almost 3% a year in real terms between 2009 and 2015, with reductions occurring in 12 Member States and increases in investment being 1% a year in another 9 countries. Only in Denmark, Hungary, Malta, Bulgaria and Slovakia was the increase more than 2% a year over this period.

The reduction in Government investment were particularly large in the four southern EU15 Member States as well as in Cyprus and Ireland. As a result, the overall decline in

Government spending on fixed investment over the period 2006-2015 amounted to close to 50% in Greece, over 40% in Ireland, Cyprus and Spain, just under 40% in Portugal and well over quarter in Italy. In consequence, Government investment was reduced to be low 2% of GDP in Ireland and Cyprus in 2015 and to only just over 2% of GDP in Italy and Portugal. The reduction in real terms as even larger in Croatia than in any of the 27 EU Member States, Government investment being 53% less in 2015 than it had been in 2006.

On the other hand, in 5 EU12 countries, Hungary, Malta, Poland, Bulgaria and Slovakia, together with Luxembourg, Government investment was over a third higher in real terms in 2015 than it had been before the start of the period in 2006.

6 EU funding substantial relative to capital expenditure in many countries

Support from the ERDF and Cohesion Fund accounted for a substantial proportion of the public investment carried out by Member States over the 2007-2013 programming period. The importance of the two funds was accentuated in a number of cases by the reduction in Government expenditure on fixed investment which occurred over the period or the by the relatively small increase. Although there are no official figures which relate one to the other, a reasonable estimate can be made of the relative scale of the support by relating the amount of funding for the period to General Government capital expenditure – i.e. the sum of fixed investment and capital transfers – which was carried out in the years 2007-2013[2]. The latter can be regarded as a proxy for Government spending on development.

Overall, some EUR 261.2 billion was provided from the ERDF and Cohesion Fund for the period, which amounted to around 0.3% of EU GDP and 6.5% of Government capital expenditure in the EU over the years 2007-2013 (Table 6).

While the overall amount of support was largest in absolute terms in Poland, at EUR 57.2 billion for the period, which represents 2.3% of GDP, it was largest in relative terms in Hungary, at 3% of GDP.

Relating the support provided to Government capital expenditure, however, gives a clearer indication of its importance. In Hungary, it amounted to 57% of such expenditure over the period, implying that most of the expenditure carried out was co-financed by the ERDF and Cohesion Fund, while in Poland, it amounted to 41%, which with co-financing implies again that most of the capital expenditure undertaken by Government was related to Cohesion policy. Indeed, in another 6 EU12 countries, the support provided under Cohesion policy amounted to around 40% or more of Government capital expenditure and in the Czech Republic, to over a third.

Although in a further three countries, the share of expenditure over the period accounted for by support from the ERDF and the Cohesion Fund was less, it still amounted to around a quarter in Slovenia and Portugal and slightly more in Romania, and to almost 20% in Greece.

In the other countries, where, apart from Cyprus, most of the regions were supported under the Competitiveness Objective, the funding provided was much less, though in Convergence regions, it amounted to a significant proportion of Government capital

[2] Although the ERDF and Cohesion Fund for the 2007-2013 period can be spent up to the end of 2015 or the end of 2016 in some cases, i.e. for a further two or three years, the same applies to the funding for the 2000-2006 period, which in practice could be spent up to the end of 2009. Relating the amount available to expenditure over the same 7-year period, therefore, seems the most appropriate calculation to make to get an indication of its relative size. It should be noted, as described in the note to Table 1.4, that the figures for Government capital transfers have been adjusted to allow for support of organisations in financial difficulty during the crisis, which is not part of development expenditure.

expenditure (in Spain, perhaps close to 20% and in Italy close to 15%)[3]. The same applies to Convergence regions in other EU15 countries, especially Germany, where such regions account for less than 20% of national GDP and even though they might well account for a larger share of Government capital spending, it would still imply that EU support over the period might have amounted to around 10% of the latter[4].

Table 6 ERDF and Cohesion Fund support relative to GDP and Government capital expenditure, 2007-2013

	ERDF+ Cohesion Fund (EUR m)	% GDP	% Government capital expenditure
EU27	261 236	0.3	6.5
Hungary	21 281	3.0	57.1
Lithuania	5 747	2.7	52.1
Slovakia	9 999	2.1	52.1
Latvia	3 947	2.7	50.5
Malta	728	1.6	42.5
Poland	57 178	2.3	40.9
Estonia	3 012	2.6	39.4
Bulgaria	5 435	2.0	38.7
Czech Republic	22 146	2.0	34.3
Portugal	14 558	1.2	27.5
Romania	15 374	1.7	25.1
Slovenia	3 345	1.3	24.5
Greece	15 846	1.0	18.9
Cyprus	493	0.4	7.1
Spain	26 590	0.4	7.0
Italy	20 989	0.2	4.4
Croatia	706	0.2	3.9
Germany	16 100	0.1	2.5
Finland	977	0.1	1.7
France	8 051	0.1	1.1
Belgium	987	0.04	1.1
UK	5 387	0.04	1.0
Sweden	935	0.04	0.8
Austria	646	0.03	0.7
Ireland	375	0.03	0.7
Netherlands	830	0.02	0.4
Denmark	255	0.01	0.4
Luxembourg	25	0.01	0.2

Note: The first column shows the total decided amounts of funding for the 2007-2013 period as at end-2015. This is then related to aggregate GDP and Government capital expenditure over the years 2007-2013.
Government capital expenditure is the sum of General Government gross fixed capital formation plus capital transfers, the latter being adjusted approximately for abnormal transfers to banks and other companies during the crisis.
Source: Eurostat, Government statistics

[3]The lack of regional data on government expenditure means that it is difficult to calculate a precise figure and those given here are estimated on the assumption that expenditure in the Convergence regions is roughly in line with their GDP.

[4] In Croatia, where the scale of funding under IPA was much less than under the ERDF and Cohesion Fund, support amounted to only around 4% of Government capital spending.

7 Concluding remarks

The above has shown the extent of the change in the economic situation which occurred over the programming period. As a result, the circumstances in which the expenditure co-financed by the ERDF and Cohesion Fund was carried out being very different from what was envisaged when the programmes were formulated. This is particularly the case in many of the countries which were the major recipients of funding, especially in the EU12 countries, though with a few exceptions – Poland, Slovakia and Malta primarily It is also the case in the four southern EU15 Member States.

The effect of the depressed levels of economic activity on employment in these countries, but also in other parts of the EU, was to increase the importance of stimulating job creation, which became a growing priority over the period.

The effect was also to increase budget deficits and levels of government borrowing in nearly all countries, giving rise to financial market pressure to reduce government expenditure and raise tax rates to limit the increases. These measures added to the deflationary impetus, especially when taken simultaneously by EU Member States, and served to delay recovery further. Moreover, they were concentrated in many cases on government capital expenditure, which tends to be important for growth to be sustained. The extent of the reduction in capital expenditure was particularly large in a number of the countries most in need of growth – those in the south of the EU – or most in need of the infrastructure which the expenditure concerned goes to building.

The pressure on public finances which resulted from the depressed state of the EU economies and the fiscal consolidation measures taken increased the importance of EU funding as a source of finance for development expenditure, especially in the EU12 and southern EU15 countries. It also, however, increased the difficulty of finding the necessary co-financing for programmes as well as limiting the demand for funding because of the reduced need for investment, particularly among enterprises. As such, it contributed to delays in spending the funding available and led to increased pressure to allocate funding to areas and projects where it could be spent most quickly to avoid the risk of funding being withdrawn (i.e. of de-commitments). This could potentially have been at the expense of the more effective deployment of funding in terms of its impact on development or, more accurately, on alleviating the obstacles to development.

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KN-04-16-741-EN-N

doi: 10.2776/63532