Financing Poorer Countries Leads them to Fall Behind?

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Abstract: The regional policy of the European Union (EU), which is frequently referred as Cohesion Policy, aims to reduce disparities between countries. Although all the EU regions benefit from the funds dedicated to regional development, during the 1980s and 1990s, the main beneficiaries of the funds were Spain, Greece, Portugal and Ireland.

In the last quarter century, these four European countries, Spain, Greece, Portugal, and Ireland received almost fifty billion euros in cohesion funds to increase their economic competitiveness and serve as a stimulus for economic growth. However, not only has this objective failed, but also transparency and economic freedom have declined in these countries. In fact, the countries that benefited (in relative terms) most from cohesion funds, grew less in economic terms.

Keywords: Southern Europe; Competitiveness; European funds; Transparency; Economic Freedom; Economic Growth.
JEL: F00 General; F02 International Economic Order and Integration.

INTRODUCTION

Several authors analyze the impact of EU Cohesion Policy and EU funds absorption on the economic growth rates of the European countries [(Leonardi, 2006); (Hagen & Mohl, 2008); (Albulescu & Goyeau, 2013); (Pellegrini et al., 2013) (Berkowitz, Monfort & Pieńkowski, 2019); (Rauhut & Humer, 2020)].

In the European Union there are four types of central funds: ERDF, ESF, EAFRD, and EMFF which all countries can receive for several areas: agriculture, fishing, human capital, etc.; and then there is a fifth one, the cohesion fund, aimed at Member States whose Gross National Income (GNI) per inhabitant is less than 90 % of the EU average [(Barnier, 2003); (Zoltán, 2016)].

According to the European Commission, it aims to reduce economic and social disparities and to promote sustainable development. That is, its goal is to promote convergence through sustainable development [(Sergej, 2016); (Martinez & Potluka, 2015)].

During the last quarter of century, there were and by decreasing amount, four recipients: Spain, Greece, Portugal, and Ireland. Other countries also benefited from the cohesion fund namely Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, and Slovenia. However, one will focus on the former EU-15, to allow for a longer period of analysis. As seen in Figure 1 (the year of 2020 was excluded to avoid the effect of Covid crisis), during that period those four countries received almost fifty billion euros: Spain ± 25, Greece ± 11, Portugal 10,1 and Ireland 2,125.

Cohesion funds	
Countries	**Total amount in the period (1994-2019) – in million euros**
Spain	24.470
Greece	10.560
Portugal	10.089
Ireland	2.125
Total	**47.244**

Fig. (1).
Source: European Commission.
Notes:
1) Value received until the 20th of August 2019.
2) Spain and Ireland received the last payment from cohesion funds in 2015.

To analyse the results, let's divide the answer in three parts: 1) growth; 2) economic competitiveness; 3) and other variables such as transparency and economic freedom.

ECONOMIC GROWTH

Fig. (**2**) analyzes for each country, the percentage that the amount of cohesion funds represented in national income (black line) and the yearly growth rate (average compound) of national income in the period (dotted line). As can be concluded they are almost inversely related, countries where the cohesion funds represented a larger percentage of the national income, grew less; and vice-versa.

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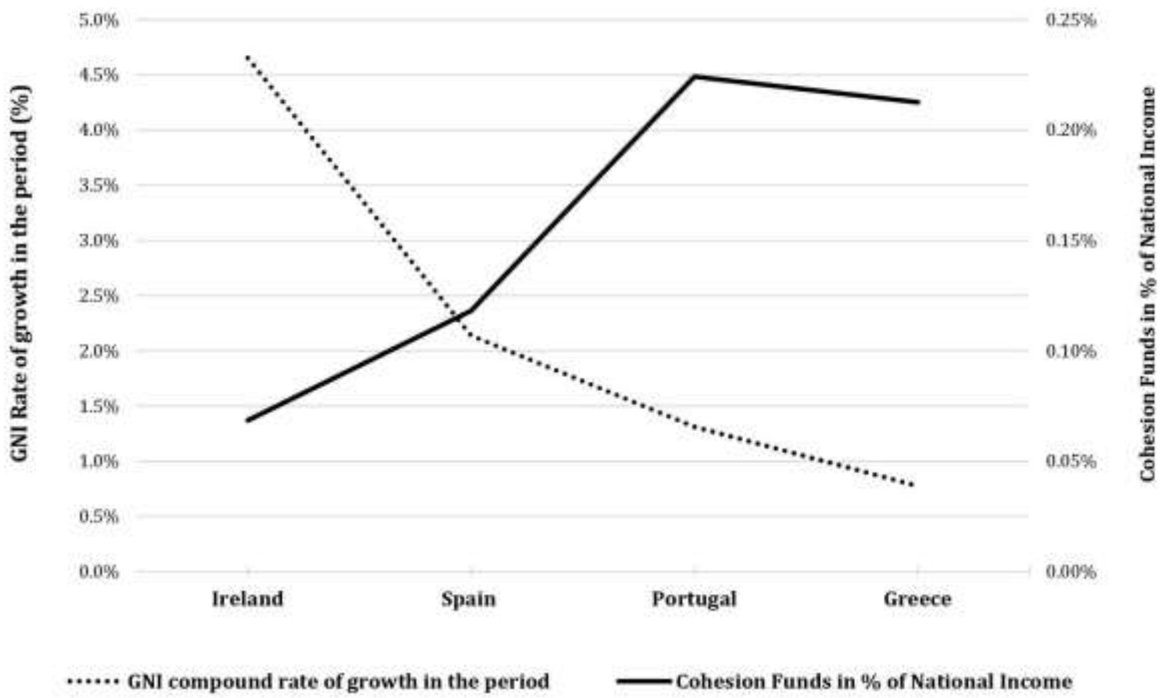

Notes:
1) Value received until the 20th of August 2019.
2) Spain and Ireland received the last payment from cohesion funds in 2015. Therefore, to calculate the average amount received per year both for Spain and Ireland, one considered 22 years instead of 26. The same is done for the gross national income: only the years from 1994 until 2015 were considered for the average national income and the annual growth rate.
3) Gross National Income at constant prices
Source: European Commission

Fig. (2). Period 1994-2019: Comparing growth rate with % of cohesion funds in national income.

Then, if we compare the income of each country in the beginning and at the end of the quarter of a century (1994-2019), as per Fig. **3**, the result is that in 1994 all countries were below 80% of the former EU-15 average and in 2019 Ireland is the only one above average (almost 10%).

The other three countries remain below the average: Spain at 85% of the EU-15 average (it converged ± 8%, between 84,5 – 76,6), Portugal about the same (converged 1,5%, between 70,4 and 68,9) and Greece diverged (from 75,5% to 63,3% of the EU-15 average).

Country	1994	2019	Difference 2019-1994
Ireland	78,9	108,4 (1)	+29,5
Greece	75,5	63,3	-12,2
Spain	76,6	84,5	+7,9
Portugal	68,9	70,4	+1,5

Fig. (3). GNI per capita PPS, EU-15 = 100.

Source: AMECO (2020).

Note: (1) Ireland GNI corrected equals

$$\frac{total\,GNI\ corrected}{total\,GNI} \times GNI\ per\,capita\,PPS\,(EU-15=100)$$

Three aspects are noteworthy regarding figures two and three: two surprises and a word of caution. There is no surprise that the poorer countries in 1994, Portugal, Greece, and Spain (in Fig. **3**) received every single year a larger amount of cohesion funds than the richer ones: both in total amount (Fig. **1**) and percentage of national income (black line in Fig. **2**).

That is nothing but natural: as the purpose of the cohesion funds is to promote competitiveness, they should go to those countries which were further behind.

However, what is surprising is that those countries which received more cohesion funds grew less than those which received less cohesion funds; and there is an inverse relation regardless of if one accounts for the cohesion funds in percentage of national income (Fig. **2**): the poorer, despite receiving more, grew less.

And a second surprise is that during a quarter of a century, Portugal converged almost nothing with the EU average (only 1,5% per Fig. **3**) and Greece diverged more than 12% (from 75,5 to 63,3% in Fig. **3**). As a word of caution, no causation is suggested here since there are three ways to read the data.

The first is that countries performing worse, received more: which corresponds to putting (more) money into a problem. The other is that those countries which receive more… (tend to) grow less. And finally, the third reading is that there is no

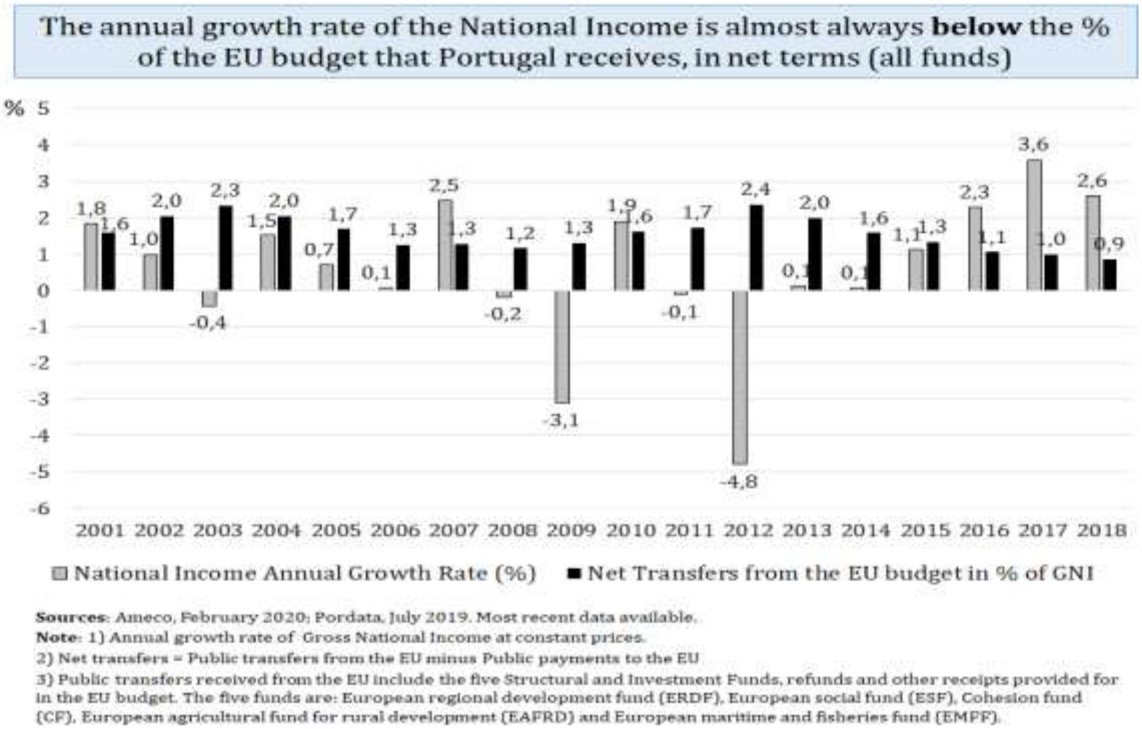

Fig. (4).

causation whatsoever, but a simple association between growth and cohesion funds. A mere coincidence, being both variables' consequences of a third common cause, whatever that may be.

But whatever the interpretation of the results one cannot escape disappointment, a conclusion further reinforced if one compares how much each year a country received in funding with how much its economy grew: year after year.

To bring home the point, let's use Portugal as an example and add to the cohesion fund, the other four types of funds: 1) European regional development fund (ERDF), 2) European social fund (ESF), 3) European agricultural fund for rural development (EAFRD) and 4) European maritime and fisheries fund (EMFF).

The sum of all is shown in Fig. (**4**) which indicates how much in this millennium Portugal received in EU financing in percentage of national income (in black) and how much its income grew (in grey), every single year.

As can be seen in twelve of the eighteen years (2/3), Portuguese national income grew less than it received in EU funding: the first year 2001 was an exception, but years 2002, 2003, 2004, 2005, 2006, etc. were the rule.

ECONOMIC COMPETITIVENESS

Let us now analyse the performance of these countries in terms of economic competitiveness, measured by an index developed by the Institute for Management Development. A negative number represents an improvement in competitiveness and a positive one a worsening in this index.

Fig. (**5**) leads us to two main conclusions (and again regarding the last quarter of century of 1994-2019):

First, Spain, Portugal, and Greece, all worsened in terms of their competitiveness ranking: Spain declined from 26th to 36th in the world; Portugal from 32nd to 39th; and Greece from 36th to 58th. And second, the exception is Ireland which improved from 10th to 7th, being Ireland precisely among all four countries the one which received less funding (as per figures one and two): ± 20% of Portugal's and Greece's amounts and less than 9% that of Spain. However, both Ireland and Spain stopped.

Years / Countries	1995	2019	Difference
Spain	26th	36th	**+10**
Greece	36th	58th	**+22**
Portugal	32nd	39th	**+7**
Ireland	10th	7th	**-3**

Fig. (5). Competitiveness world ranking.

Source: International Management Development (2019).

Thus, cohesion funds failed to improve the competitiveness ranking of the recipients with the single exception of Ireland, precisely the country which benefited less from those funds.[1]

1 There are two reasons why it is preferable to use the **ranking** than the **rating** (the absolute grade which varies from 0 – bad to 100 – excellent) also supplied by the Institute for Management Development:
First: the ranking provides for comparison, while the rating, being absolute values, do not account for the overall evolution of all countries over time, either inflation or deflation.

How is that possible? Could it be that despite the considerable funding received, there are factors working against the progress of the country's beneficiaries of the cohesion funds?

THE IMPACT ON OTHER VARIABLES: ECONOMIC FREEDOM AND TRANSPARENCY

Heritage Foundation (in Washington) and Transparency International (in Berlin) are two NGOs which produce worldwide rankings in terms of economic freedom and transparency, respectively. Fig. (**6**) shows what happened to the rankings of the four countries in terms of these variables, economic freedom, and transparency: the ranking of all countries worsened in both indexes, with again the single exception of Ireland, and only regarding economic freedom, but not transparency. Once more it should be noted that the number of countries analysed increased in transparency (from 41 in 1995 to 180 in 2019) and in economic freedom (from 101 in 1995 to 180 in 2019). However, in the first year of analysis there were already 41 and 101 countries analysed, respectively, covering the OECD countries, with whom European countries should be compared to, and not with third world ones.

Indeed, Spain worsened 4 positions in transparency and 23 in economic freedom; Greece 30 in transparency and 64 in economic freedom; Portugal 8 in transparency and 24 in economic freedom; finally, Ireland's ranking decreased 7 in transparency but (the single exception in eight) improved 14 in economic freedom.

Countries by order of funds received	Transparency Ranking		Economic Freedom	
	1995	2019	1995	2019
Spain	26th	30th	34th	57th
Greece	30th	60th	42nd	106th
Portugal	22nd	30th	38th	62nd
Ireland	11th	18th	20th	6th

Fig. (6).

Sources: Transparency International (2020); Heritage Foundation (2020).

Second: a potential disadvantage of using the ranking could however be, that the number of countries analysed increased with time: in 1995 47 countries were analysed and in 2019, 63 countries.

However the majority of the new 16 countries which were included in the analysis do not belong to the first world, to the OECD group. Those 16 countries are: Bulgaria, Croatia, Cyprus, Kazakhstan, Latvia, Lithuania, Mongolia, Peru, Qatar, Romania, Saudi Arabia, Slovak Republic, Slovenia, Turkey, UAE and Ukraine. Of these, only five (Latvia, Lithuania, Slovak Republic, Slovenia and Turkey) are part of the OECD.

In any case, even if one takes into account the inclusion of new countries and thus one divides each country's ranking by the total number of countries analysed, thus creating a ratio whose value the lower, the better (lower ranking near the top in the numerator and greater total number of countries analysed in the denominator), the conclusion is that from 1995 to 2019 Portugal ratio *improved only slightly* (from 0,68 in 1995 to 0,62 in 2019), that of Spain remained basically *constant* (0,55 and 0,57) and that of Greece *worsened* (from 0,77 to 0,92).

Transparency is important because (as put by Milton Friedman), corruption is a tax on economic development. Corruption prevents that the allocation of resources be optimized, that is, their use by firms which are most productive, in terms of quality, quantity and time. It allocates resources sub optimally to less competitive firms [(Zakutniaia & Hayriyan, 2017); (Nilsson, 1999)].

Then, the economic freedom index signals market liberty, the number of competitors in each industry and the prevalence (or not) of market dominance by monopolies and oligopolies. The more of the latter, the less the incentive to competitiveness and the tendency to the abuse of power be it economically or politically [(Verner, 2015); (Bujancă & Ulman, 2015)].

Thus, the strong (co)relation among transparency, economic freedom, and competitiveness (measured by an index such as the one of Institute for Management Development), indicated in Fig. (**7**) (where all correlations are statistically significant at zero level): the correlation coefficients between economic competitiveness and economic freedom are 0,74 and 0,77 for ranking (ordinal values) and within brackets for rating (cardinal, absolute values). So, the fact that both values are positive and close to one, means that the variables (economic freedom and economic competitiveness) are strongly associated.

The same happens between transparency and economic competitiveness (correlation of 0,72 and 0,72) and between economic freedom and transparency (correlation of 0,69 and 0,71): economic freedom means strong competition in the markets, thus few monopolies, less firms with great market power and as it is known, if power corrupts, absolute power corrupts absolutely (Lord Acton) (Doucouliagos & Ulubasoglu, 2006).

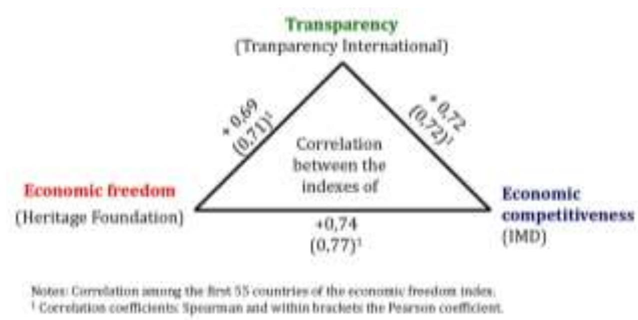

Fig. (7). The correlation between transparency, economic freedom, and competitiveness.

The fact that all three variables are associated [(Sturm & De Haan, 2001); (De Haan & Siermann, 1998)] means that they can constitute a virtuous circle (in this case a virtuous triangle): when one of the variables improves, it causes the others to move in the same sense; or a vicious circle (triangle): when one variable worsens, it brings the others downwards, too. Again, such an association does not mean causality. In this case it can be argued that the stronger causality is from transparency and economic freedom to economic competitiveness. However, it can also be reasoned that in most competitive countries, as people are richer… temptations are…lower.

CONCLUSIONS

The several figures presented on this article allow to extract distinct main conclusions.

First conclusion, regarding three countries and in real terms, Greece diverged, Portugal basically did not converge, and Spain converged slightly. However, in percentage of the European Union, Spain, Portugal and Greece improved. The reason being that to improve in real terms (in euros), it is not enough to grow more than the EU average, but one needs also to grow sufficiently more to offset the initial difference. As an example, let's say that a country's income per capita is, at the beginning of a period only (*e.g.*) 2/3 (66%) of the EU average (100); then if the country grows two percent and Europe in average grows by 1,5% at the end of the period the country improved 2 x 66% = 1,32 euros, but the average augmented 1,5 x 100 = 1,5 euros, which is obviously higher. So, to decrease the absolute difference in terms of acquisition power ("money in the pocket") a country that at the beginning of the period has an income of only 66% of the average must grow at a rate (%) which is $\frac{100}{66} = 1{,}5$ higher that of the average. If the average of countries grows 2%, the country must grow 1,5 times more: 1,5 x 2% = 3%. If the average grows 3% the country must grow at 1,5 x 3% = 4,5%. And so on.

Second and third conclusions are the single country which converged (Ireland) is precisely the one which received by far less funding (Figures 1 and 2) and in the one country analysed (Portugal), national income grew, in general, year after year, less than the amount of financing it received. From all five types of funds.

In general, countries worsened in the competitiveness of their economy, in terms of the ranking of transparency and in economic freedom.

Finally, the data suggests that in parallel with the cohesion funding to Greece, Spain, and Portugal, a vicious triangle occurred among (lack of) economic competitiveness, (ever lower) economic freedom and (decreasing) transparency. And so, all these conclusions can be summarized in a single word: disappointment.

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Received: Feb 15, 2024 Revised: Feb 18, 2024 Accepted: Feb 22, 2024