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EU COHESION POLICY: SOME FUNDAMENTAL QUESTIONS

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Highlights

- This paper asks key questions about the impact of the European Union's cohesion policy both in terms of economic efficiency and redistribution to needy areas of the EU.
- The paper illustrates with data the confusion created by the multiple objectives of current EU cohesion policy and by the political horse-trading over levels of aid granted to different member states and regions.
- The paper shows how a significant part of EU structural funds involves – in net economic terms – simply transferring funds between individuals within one and the same region.

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EU COHESION POLICY

Some fundamental questions

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OBJECTIVE

The main objective of this note is to highlight some of the key issues still left unresolved by current EU cohesion policy. The operational goal of the paper is to stimulate debate on future reforms in the framework of the ongoing EU Budget Review and the forthcoming negotiations on the next EU financial framework (the so-called 'financial perspectives'). The questions posed do not have a right or wrong answer, are deliberately left open and are meant to contribute to the debate on the state-of-play and on the future of cohesion policy.

While my focus is mainly on efficiency and redistributive considerations, these questions should be considered in the broader context of other EU policies, competencies and instruments, as well as, of course, existing political and financial constraints.

The note is organised as follows. First, I describe the main features of cohesion policy, focusing on the *de jure* and *de facto* objectives and instruments. Second, I use the information provided by member states during the EU budget review consultation process to flesh out some of the potential areas of disagreement in future negotiations over cohesion policy. Third, I focus on structural funds (leaving aside the cohesion fund) where there are a number of key issues for discussion. Fourth, I highlight two additional dimensions that are critical for the future of EU cohesion policy, namely the Lisbon agenda and crisis management. Finally, I propose three questions for the conference discussion.

COHESION POLICY: OBJECTIVES, INSTRUMENTS AND RATIONALE

On objectives and instruments

Reducing welfare differences across the EU's regions and countries has been one of the EU's main objectives since its foundation. EU cohesion policy has three key financial arms: the European fund for regional development (ERDF), the European social fund (ESF) – in this note grouped as 'structural funds' – and the cohesion fund (CF). While the first two are allocated to regions, the third is targeted at lagging countries. Structural funds (SF) and the cohesion fund represent on average 29 percent and seven percent of the EU budget, respectively, in the period 2007-2013.

Is unconditional convergence in per capita income across regions a feasible policy objective? Are there better measures of disparity?

The ERDF mainly supports infrastructure development and productive investment; the ESF facilitates the integration of the unemployed and disadvantaged into the labour market; and, finally, the Cohesion Fund targets trans-European transport networks and environmental projects.

These financial instruments are used to

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accomplish three broad objectives: 1) convergence, which accounts for 81.5 percent of total funds and focuses on the least-developed regions; 2) regional competitiveness and employment, which amounts to 16 percent of total funds and targets regions outside the convergence objective and is stated to encourage innovation, entrepreneurship and environmental protection, as well as to accommodate structural change; and 3) European territorial co-operation, amounting to 2.5 percent of total funds and comprising trans-national programmes (Table 1).

Table 1: Structural and cohesion funds: objectives and instruments, 2007-2013

Convergence	ERDF, ESF, CF
Regional Competitiveness and Employment	ERDF, ESF
European Territorial Cooperation	ERDF

Source: Bruegel based on DG Regio

More specifically in terms of objectives, the current financial framework sets boosting growth, jobs and innovation as the main priorities of cohesion policy in the framework of the renewed Lisbon strategy. But there is really a cacophony of objectives for EU cohesion policy (Annex 1). This makes policy design and assessment a very complex affair.

How can the overall objective of EU cohesion policies be made more operational?

Moreover, as a result of this structure, all EU regions, rich and poor, are eligible for structural funding, and all regions are targeted by all financial instruments. Since there is no one-to-one correspondence between objectives and instruments, growth and redistribution policies are served by the same funding instruments.

Should all regions be eligible for structural funds?

Is there a tension between growth and redistributive objectives? How can one best think about possible trade-offs?

On rationale

What types of spending are desirable at the EU level? Economic rationalisation of EU-level intervention traditionally points at market failures – notably economies of scale/scope and externalities – since they are associated with under-provision of public goods in the absence of government intervention. In the case of economies of scale and scope, EU intervention promotes efficiency because scaled-up production leads to reduction in the long-run average unit costs (scale), and because the increase in the number of policies administered at the EU level creates synergies in production and distribution (scope). Similarly, in markets where there are significant externalities, ie benefits or costs that accrue not only to the individuals in a country directly involved in the transaction but also to others in the EU, centralisation can allow for the appropriate distribution of compensations and costs. For instance, significant economies of scale/scope and externalities are thought to be present in R&D and defence policies.

The appropriate role of the EU across policy domains, especially in redistribution, has been debated for many years. Redistribution from richer to poorer countries is often seen as an EU public good since it fosters convergence, creating major benefits for the rest of Europe in the form of new and wealthier markets and steadier democracies.

But sub-national redistribution is more divisive. Subsidiarity, horizontal equity across countries, transaction and information costs and the need for coherence with national macroeconomic policy, all suggest that national governments are best placed for this task, provided they do not violate state aid rules. New member states are a case in point. These countries allocate most structural funds to thematic rather than regional programmes, ie to infrastructure or research. While this does not prevent countries from decentralising project implementation and evaluation, it emphasises the need for the EU to use country-level criteria for allocation of funds. Moreover, politically, it should be much easier to convince citizens of the desirability of policies that redistribute income across countries in Europe rather than among individuals, groups or regions, since there is likely to be a higher sense of solidarity in the former (Tabellini, 2003).

What are the advantages of EU involvement in regional policy? Are structural funds the best instrument available?

In which areas is the tension between cohesion policy and sectoral policies stronger? How can this better be addressed?

WHAT DO MEMBER STATES DISAGREE ABOUT?

If one uses the official positions put forward by member states during the EU Budget Review as a basis for analysing their views on cohesion policy, some important insights arise. First, views vary widely across countries, not only in terms of cohesion policy, but also in terms of the overall EU budget and policy priorities.

Second, within cohesion policy, most disagreements are related to regional expenditures, in particular, whether funds should go to all regions regardless of the country, only to poor regions or – stricter still – only to poor regions in poor countries (Table 2).

Table 2: Member states' positions in the EU Budget Review: structural funds for which regions?

Only poor regions	Only poor regions in poor countries	All regions
Finland	Bulgaria	Austria
Latvia	Czech Republic	Cyprus
Lithuania	Denmark	France
Romania	Estonia	Germany
	Hungary	Greece
	Ireland	Italy
	Netherlands	Malta
	Portugal	Spain
	Sweden	Luxembourg
	United Kingdom	Poland (?)
	Slovakia (?)	

Source: Bruegel, based on member states' position papers submitted to DG Budget during EU Budget Review

What reforms are possible from a political standpoint?

EU budgetary negotiations involve major inter-country transfers. A significant part of these are fundamentally side-payments that help to get agreements finalised. Structural funds in particular – given their *ex-ante* geographic allocation – play a key role in this respect, to the detriment of policy quality (see Santos (2008) for a detailed discussion of this issue). Many of the disagreements discussed above, therefore, and those in other EU policy areas, are reflected ultimately in the distribution of structural funds. Annex 2 presents the additional allocations of structural funds included in the European Council agreement of December 2005 on the current financial framework. Provisions added only to the final agreement are purely selective and discretionary in nature since they come on top of the original funds assigned according to the pre-established eligibility criteria. They are a clear example of side-payments needed to ensure the required unanimous agreement.

Adding up the provisions included only in the final agreement, these side-payments account for 1.5 percent of total cohesion spending between 2007 and 2013, but have a widely differing impact for individual member states. While Hungary receives 0.6 percent of total cohesion spending through the extra money, it represents as much as seven percent of total cohesion spending in Spain, nine percent of total cohesion spending in Sweden and 11 percent of total cohesion spending in Austria for the period under consideration.

An additional area of disagreement relates to the flexibility of funds. For example, funds cannot be transferred to capital cities, where, in new member states in particular, national authorities want to direct more resources as expressed in the official documents presented for the consultation on the EU budget. Recent measures announced by the European Commission, allowing for more flexibility in the use of structural funds to help member states weather the global economic crisis, give some legitimacy to those concerns.

'Intra-regional redistribution is twice as large as redistribution between regions in the same country. For all countries, structural funds largely redistribute resources among individuals within one and the same region.'

Do all countries need the same degree of decentralisation in structural funds?

What is the optimal degree of flexibility in the assignment of structural funds within countries?

Since most discussions relate to the regional dimension of cohesion policies, I focus on this aspect next.

STRUCTURAL FUNDS: EFFICIENCY AND REDISTRIBUTION[1]

Overall, the evidence regarding the impact of structural funds on growth is mixed[2]. The literature on this topic has three main limitations that make identifying causal effects difficult. First, the effects on growth of these policies may take time to become apparent. Second, it is difficult to make a causal interpretation of results, as structural funds are not allocated randomly. Third, SF-associated opportunity costs are not taken into account. EU taxpayers' money could be used elsewhere. The relevant question from a policy perspective is if structural funds boost overall growth above what it would have been without the structural funds.

The structural funds' contribution to growth may be curtailed by several factors. The literature points to the displacement of national regional aid, or to regions' strategic behaviour as they implement projects that have other objectives besides growth, either to pursue rent-seeking activities or to retain their SF eligibility. Similarly, the potential lack of coherence with national policies is also cited as a limitation (Santos, 2008).

But three other factors should be highlighted. The redistributive role of structural funds channels resources away from economic centres – reducing growth potential – instead of focusing first on the efficient use of funds. Furthermore, with the EU's eastern enlargement, regional policy resources are thinly spread. The population of regions where GDP per capita is 75 percent or less of the EU average increased from 68 million to 116 million (or from 18 to 25 percent of the EU27 population). Finally, the nature of the redistribution that takes place through structural funds also limits the growth potential of structural policies.

On average, poorer regions receive more structural funds per inhabitant net of their contribution to the policy. This relationship is stronger among convergence regions but, on average, a regional per capita GDP increase of €100 is associated with a decrease of €7 in net structural fund aid per capita. Regions in cohesion countries, under one and the same structural fund objective, benefit more from structural policies than regions in non-cohesion countries, as do regions in countries that have a more unequal per capita income distribution.

In 2000-2006, 27 percent of SF flows were inter-country transfers. But, of the rest, three quarters were intra-regional. With enlargement, inter-country transfers rose for 2007-2013, but intra-regional redistribution is still twice as large as redistribution between regions in the same country. That is, for all countries, structural funds largely redistribute resources among *individuals within one and the same region*.

Two examples may help illustrate the above findings. For Spain, a net beneficiary of structural funds during the 2007-2013 period, 19 percent of SF received originates from other EU countries. Of the remaining 80 percent, two thirds of the money spent in each region comes from that region. The UK, meanwhile, is a net contributor to structural funds. Of the SF received by each UK region, 97 percent was simply contributed by local taxpayers.

1. This section comes from Santos (2008).

2. See Enderveen *et al.* (2002) for a review of this literature.

This exercise reveals two additional points. Two regions with similar per capita income, but located in different countries, can benefit very differently from structural funds. Take, for example, Hainaut (Belgium) and Galicia (Spain), both under the convergence objective. Both have a GDP per capita (PPP) of €17,400, but while Hainaut is a net contributor (€388 per capita) Galicia is a net beneficiary (€949 per capita). This difference arises because, while structural fund benefits depend on regional income, contributions depend on how much the country as a whole contributes to the EU policy. If a region's GDP per capita is very different from the country's regional average, there can be a mismatch between what it receives and what it has to contribute to structural funds.

Moreover, even with similar regions in countries with comparable income, there is variation in the net benefits they derive from structural funds. For instance, Guadeloupe (France) and Sicily (Italy) have a GDP per capita of approximately €14,000, yet the former receives – net per capita – 33 percent more funds. An immediate implication of this result relates to the logic behind redistribution in structural funds.

If the goal is regional convergence, should *net* benefits (and not only benefits) be determined on a regional basis?

How should one account for non-income factors that disadvantage one region more than others?

Moreover, even if one were to agree that the EU should play a role in redistribution among regions, the calculation of the amount of structural funds to be received should not depend on the pre-tax and pre-transfer income but rather on the regional disparities that are left after accounting for national redistribution policies.

One subject discussed above re-emerges here. If most of the funds received by a region originate from that same region, it is hard to imagine that they can have significant 'added-value' growth effects. To really measure the impact of structural funds one needs to show that they generate benefits above and beyond what those resources would have accomplished if there were no structural funds.

This points to the main difficulty in assessing the real impact of cohesion policy, especially structural funds, on growth. Proper evaluation of the policy remains an elusive and daunting challenge since it is difficult to separate empirically what effects are due to cohesion policy and what to other policies or initial conditions. While policy evaluation of specific projects and programmes is possible, that of cohesion policy as a whole is more difficult. One possibility is to move in the direction of randomised experiments, taking advantage of the wide range of initial conditions and programmes to test what works and what does not and under what conditions. The difficulty, however, is in generalising findings, since what may work in one specific setting may work differently in others, or effects may change when projects or programmes are scaled up.

What role does randomised experimentation have in evaluating cohesion policy, especially structural funds?

In this note, I have so far focused on those areas of EU cohesion policy where the debate is most heated. I have, therefore, largely ignored other aspects where cohesion policy also plays a role. Improving regions' management culture, fostering cross-regional and international partnerships, spreading good practice and improving citizens' attitudes towards the EU are often cited as benefits of cohesion policy.

While these elements of cohesion policy have their value, the question is ultimately if EU cohesion

'If a region's GDP per capita is very different from the country's regional average, there can be a mismatch between what it receives and what it has to contribute to structural funds.'

policy is the best instrument to achieve them. While regional policies may be needed to achieve those objectives, it is not evident that this implies a *European* regional policy. EU involvement must be justified by improving outcomes in comparison to other delivery and policy alternatives.

How should other benefits of cohesion policy be taken into account, such as improving regions' management culture, fostering cross-regional and international partnerships or spreading best practices and improving citizens' attitude towards the EU?

TWO MORE ISSUES FOR THE FUTURE

Lisbon priorities

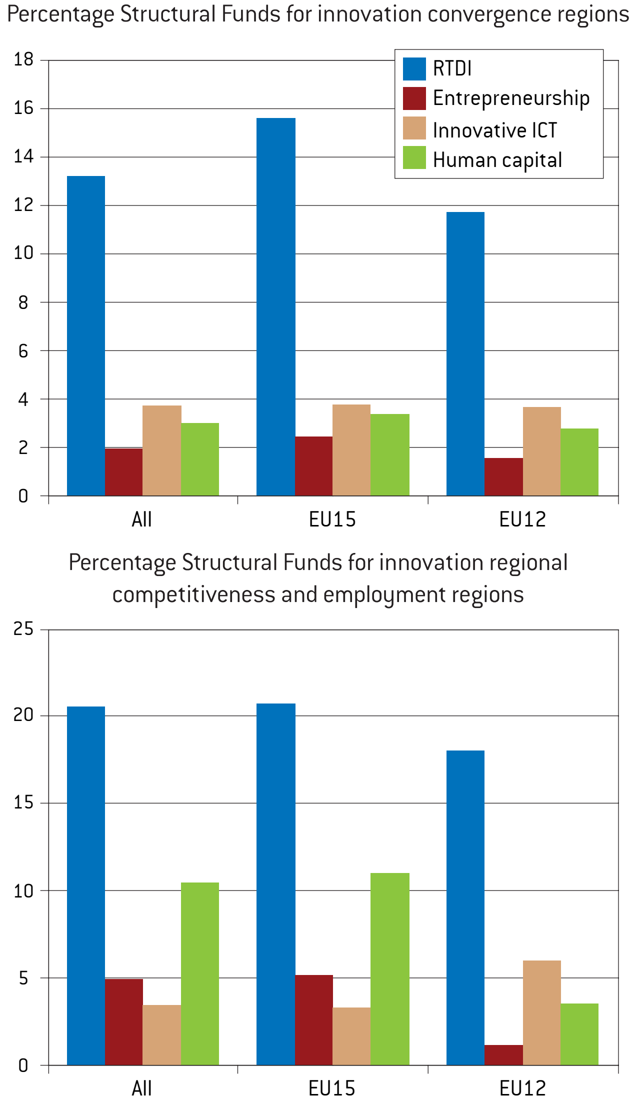
The Lisbon strategy aims at making Europe the most competitive and dynamic knowledge-based economy with sustainable economic growth, more and better jobs and greater social cohesion. The Commission's proposal for the financial framework 2007-2013 envisaged increasing the share spent on competitiveness from 7.5 percent of the budget in 2006 to 13 percent on average between 2007 and 2013. The final agreement, however, lifted this share to an annual average of only 8.6 percent.

In cohesion policy, the strategy followed the same lines, with a desire to make cohesion policies an important instrument for achieving the Lisbon goals. This shift in priorities translated into a quarter of the resources for the 2007-2013 financial period being earmarked for research and innovation and about 30 percent being allocated to environmental infrastructure and measures to combat climate change.

Re-orientation of structural policies so as to align them with the Lisbon objectives in the last budgetary negotiations was a step in the right direction. Lisbon policies whose benefits are not limited to the spending country – namely transport and energy networks, as well as research – have a clear EU dimension and are good candidates to boost growth.

The main concern is whether focusing on the Lisbon agenda leaves enough room for regions and countries of different levels of development to focus on the appropriate priorities. There seems to be an indication, however, that member states and regions do have different approaches, for example, to innovation (Figure 1).

Figure 1: Innovation in cohesion policy and economic development



Source: Bruegel, based on SEC (2007) 1547 Commission Staff Working Document, Regions delivering innovation through cohesion policy

Is concentration on Lisbon goals appropriate for all regions?

What should and should not count as Lisbon expenditure?

Economic crisis

We have seen that the effects of the economic crisis are asymmetric and that vulnerabilities are heterogeneous both across countries and across regions in the EU. In light of the global economic crisis, the European Commission has recently decided to increase flexibility in the use of structural funds[3]. The measures taken include the extension of the deadline for member states to use up their structural fund allocations from the 2000-2006 financial period. In particular, the Commission has asked regions to concentrate resources in 'high-return' projects, especially those that can create green jobs, foster energy efficiency and develop clean technologies. In addition, the proportion of funds that can be reallocated between spending priorities has been increased from two to ten percent, also leading to more flexibility in the use of funds.

What other alternatives exist for the role of structural and cohesion funds in periods of crisis?

What does the need for increased flexibility at this time tell us about the desired role and design of structural policies?

BOILING IT DOWN: THREE BROAD QUESTIONS FOR DEBATE

While the issues are many and varied, three overarching dimensions seem useful for the debate:

1. **Impact:** What specific conclusions can one draw from the existing evidence about cohesion policy? What specific policies, in which settings, seem to work best? For which objectives is the policy best suited?

2. **Subsidiarity:** While there seems to be a consensus on the importance and role of cohesion funds, the same agreement does not exist for structural policies. Who should benefit from structural funds? In what form?

3. **Evaluation:** How can we better evaluate cohesion policy?

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3. EC, 'Commission increases flexibility of structural funds in response to the financial crisis', IP/09/310, Brussels, 24 February 2009, available at http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/310&format=HTML&aged=0&language=EN&guiLanguage=en

ANNEX 1.
GOAL CONGESTION: 32 OBJECTIVES OF COHESION POLICY AND COUNTING…

Solidarity
Convergence (countries)
Convergence (regions)
Regional growth
Regional competitiveness
European growth
European competitiveness
Administrative modernisation
Institutional development
Environmental protection
Climate policy
EU visibility to citizens
EU legitimacy
European identity
Redistributive justice
Rural development
Urban development
Retraining of the unemployed
Fighting social exclusion
Integration of vulnerable groups
Gender equality in labour market
Boosting small & medium enterprises
Inter-regional network-building
Inter-regional learning
Linking regional elites to Brussels
Trans-frontier cooperation
Compensation for internal market
Compensation for monetary union
Making enlargement acceptable in some areas of the old member states
Making enlargement acceptable in disadvantaged regions of the new member states
Territorial cohesion
Cohesion (sense of community)

Source: Tarschys (2008)

ANNEX 2. ADDITIONAL PROVISIONS, SUBHEADING COHESION, FINANCIAL FRAMEWORK 2007-2013

Luxembourg Presidency final negotiating box 15 June 2005	**European Council agreement 15 Dec 2005**
Special rates of assistance for "phasing-out" regions in a member state that represent at least one third of the total population of the regions fully eligible for Objective 1 assistance in 2006	Unchanged
Starting point in 2007 for those regions which were not eligible for Objective 1 status in the 2000-2006 period or whose eligibility started in 2004 will be 90% of their theoretical 2006 per capita aid intensity level …	Unchanged
Polish NUTS level II regions of Lubelskie, Podkarpackie, Warmínsko-Mazurskie, Podlaskie and Swietokrzyskie: additional funding of **10 euros per inhabitant per year** over the period 2007-2013	Additional funding of **€ 107 per inhabitant** over the period 2007-2013
Cyprus will receive “phasing-in” support in 2007–2013	Unchanged
“Phasing out” support for Itä-Suomi and Madeira	Unchanged
Outermost regions will receive additional funding of **€30** per inhabitant per year	Additional funding will amount to **€ 35** per inhabitant per year
Under the Territorial Cooperation Objective aid intensity for regions along the former external terrestrial borders will be 50% higher than for the other regions concerned	Unchanged
200 million euros will be allocated for the PEACE Programme in Northern Ireland	Unchanged plus “programme will be implemented in full respect of additionality”
	Közép-Magyarország shall be allocated an additional envelope of €140 million
	Prague shall be allocated an additional envelope of € 200 million
	The NUTS level II region of the Canaries will benefit from an additional envelope of € 100 million over the period 2007-2013
	Swedish regions falling under the Regional Competitiveness and Employment Objective shall be allocated an additional ERDF envelope of € 150 million
	Estonia and Latvia shall each be allocated additional funding of € 35 per capita over the period 2007-2013
	Austrian regions falling under the Regional Competitiveness and Employment Objective situated on the former external borders of the EU shall be allocated an additional ERDF envelope of € 150 million
	Bavaria shall be allocated a similar additional envelope of € 75 million
	Spain shall benefit from an additional allocation of € 2 billion under the ERDF
	Ceuta and Melilla shall be allocated an additional ERDF envelope of € 50m over the period 2007-2013
	Italy will be allocated an additional envelope of € 1.4 billion
	In recognition of the particular circumstances of Corsica (30) and French Hainaut (70), France shall receive an additional allocation of €100m over the period 2007-13 under the regional competitiveness and employment objective
	An additional allocation of EUR 225 m shall be allocated to the Eastern Länder of Germany which are eligible for support under the Convergence objective

Source: Neheider and Santos (2009), based on Council of the European Union (2005): Financial Perspective 2007-2013, Brussels, 15 June 2005, 10090/05, CADREFIN 130; Council of the European Union (2005): Financial Perspective 2007-2013, Brussels, 19 December 2005, 15915/05, CADREFIN 268.