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What Direction Should EU Cohesion Policy Take?

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There is little the European Union today needs more urgently than cohesion, unity and solidarity. From this perspective, it seems almost like a miracle that cohesion (earlier known as regional) policy has existed for over 60 years, an exercise in solidarity, building on the financial resources of the EU Structural Funds. Of course, the motives for this kind of policy were quite practical at the outset. The European Social Fund (ESF) was set up in 1957 as a means for providing the booming German and French economies with guest-workers from the unemployment-stricken Italian economy. The European Fund for Regional Development (ERDF) was created in 1975 to compensate the then new entrant Britain for being in a net-payer position *vis-à-vis* the Common Agricultural Policy (CAP). Moreover, the EU funds originally were used solely for refunding the member states for certain costs incurred by them as a result of the EU Treaty; and the EU institutions themselves had no say in this. However, the budgets for this kind of policy increased substantially by a factor of at least 40, or from a share of less than 0.1 percent of EU GDP to over 0.5 percent. For single regions in need, the funds may even amount to up to 4 percent of their GDP. Over the years, the thrust of this type of policy has changed considerably, as has the influence of various central EU institutions on its design and implementation. Now, going into a new programming period 2021-2027 and with Brexit, revived nationalism and general unrest among some member states shaking the very foundations of the European Union, it is time to think about how to further adjust and thereby sustain this element of European unity.

WHY DO WE NEED AN EU COHESION POLICY?

Nowadays the basic cohesion motive guiding the EU cohesion policy and the financial instruments assigned to it, known together as the European Structural and Investment Funds (ESIF),[1] is stated in the Treaty on the Functioning of the European Union (TFEU 2007) Article 174: "in order to promote its overall harmonious development, the Union shall develop and pursue its actions leading to the strengthening of its economic, social and territorial cohesion. In particular, the Union shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions". Nonetheless, cohesion policy always was, and still is, at the centre of divergent interests in terms of its purpose, and of contradictory arguments in terms of its conception.

Various Interests Trying to Appropriate the Structural Funds

During most of its history, EU cohesion (or earlier regional) policy mainly aimed to reduce regional economic disparities within the Union and cushion economic adjustment processes; in other words it had convergence-oriented redistributive objectives. But even in its early days, cohesion policy was organised according to two different policy threads with different aims and by different European actors, namely the cohesion policy proper under the responsibility of the EU DG Regional Policy and EU state aid control under the responsibility of the EU DG Competition. The latter in particular strived for rule-based EU policy coherently coordinated with the regional policies of member states. Since 2007, cohesion policy has been influenced by a third thread, namely the EU strategic agendas under the joint responsibility of the EU Council and the EU Commission. With the former Lisbon Strategy ('turning the EU into the most competitive and dynamic knowledge-based economy in the world') and the current Europe 2020 Strategy ('smart, sustainable and inclusive growth'), cohesion policy was therefore formally subjected to a largely growth-oriented approach (in line with Art. 179 of the TFEU).[2] Further objectives are also to be observed, *inter alia*, strengthening R&D, expanding ICT infrastructure, supporting SMEs, enhancing cross-border relations, protecting the environment, fighting unemployment, promoting social inclusion, preserving cultural heritage. Occasionally, the idea has been put forward of adding a fourth thread focusing on macroeconomic stability, whereby the ESIF would be utilised for a fiscal policy of balancing business cycles and avoiding currency crises in the European Monetary Union. Cohesion policy might lack coherence and reliability if it is thus torn by various actors into varying directions without clear-cut responsibilities.

[1] These include besides ESF and ERDF: the EAFRD (European Agricultural Fund for Rural Development, former EAGGF/Guidance – European Agricultural Guidance and Guarantee Fund, Section Guidance, launched in 1962); the CF (Cohesion Fund, launched in 1993); the EMFF (European Maritime and Fisheries Fund, former FIFG – Financial Instrument for Fisheries Guidance, launched in 1993); and the FEAD (Fund for European Aid to the Most Deprived, launched in 2014).

[2] Art. 179 of the TFEU reads: "the Union shall have the objective of strengthening its scientific and technological bases by achieving a European research area in which researchers, scientific knowledge and technology circulate freely, and encouraging it to become more competitive, including in its industry, while promoting all the research activities deemed necessary by virtue of other Chapters of the Treaties".

Trade-off between Equality and Efficiency

Moreover, given the broad array of objectives for cohesion policy, it is hard to imagine that there would be no conflict between them, particularly between equality (convergence) and efficiency (competitiveness and growth). The European Commission tends to neglect such conflicts and to argue that 'growth and cohesion are mutually supportive' (EU Commission SEC(2004)924). Economic literature, however, casts doubt on the harmony of this relationship. Theories like the new economic geography and the theory of endogenous growth argue that there is a substantial trade-off between growth objectives and convergence objectives.[3] Economic growth tends to occur on a spatially unbalanced basis and favour large agglomerations, particularly in the early stages of an integration process, that is, when trade costs are starting to decline and countries and regions that had been isolated from each other start to increase their economic interactions. Such agglomeration forces tend to be strong, thus all efforts to stop an often-observed exodus from peripheral backward regions have largely proven unsuccessful to date. Some degree of re-dispersion can only be expected in an autonomous self-contained process at later stages of the integration process, when trade costs are sufficiently low. Accordingly, growth for all regions is best promoted in prospering agglomerations, from where, while exacerbating regional disparities, it is expected to trickle down and to lift all boats in the end, thus benefitting the deprived periphery too. A convergence-oriented policy, by contrast, would impede overall growth, since it would diminish agglomeration incentives by supporting backward regions. From this point of view, policies should aim to provide people with opportunities to move to leading areas, and not to relocate production to lagging areas (World Bank 2009). Only very few measures are designed to prevent this trade-off, like boosting further integration in the hope of achieving the redispersion effect at low trade costs; or paving the way for technological progress to also reach the periphery.

Contrary to this argument, it has been pointed out that such trickling-down effects are difficult to verify to date on an empirical basis (OECD 2012), and that backward regions may well dispose of growth potential and may even overtake and replace former growth centres (Rodriguez-Pose 2017). This has been observed, for instance, for the German case of Bavaria or for the US sun-belt regions in comparison to the rustbelt regions.

[3] See the comprehensive overviews by Breinlich *et al*. (2014); Proost and Thisse (2015) and the literature cited there; see Redding and Rossi-Hansberg (2017) for an overview over empirical evidence on these theories.

Place-based versus People-based Policies

Closely related to this trade-off is the question of who should be the addressee of cohesion policy. Should it be the poor regions (place-based), regardless of whether some people in the location may be wealthy and privileged; or should it be the needy individuals (people-based) no matter where they live, and should these needy individuals simply be compensated for living in poor circumstances, or activated to discover new opportunities? According to the trade-off argument, people-based policies, specifically activating policies, would clearly be favoured over place-based policies, because the former could be targeted more precisely, and the latter would be deemed inefficient or even distortionary (Partridge *et al.* 2015).[4]

At the other end of the scale, it is argued that location-based policies may help to mobilise the region's own forces for a broad departure from poverty by improving the overall economic environment of a poor region. This approach acknowledges that people may not be as mobile as sometimes assumed. And it takes into account that economically depressed regions, if left on their own as 'places that don't matter', may 'take revenge' by becoming politically radicalized (Rodriguez-Pose 2017). In line with this view, place-based cohesion policies would help preserve democracy and unity in the EU.

Weighing up the arguments, it is the preferences of citizens that should set the yardstick for the appropriateness of policies. Passive redevelopment, the common fate of backward places that are running out of economic activities and inhabitants, may be caused by pull or by push factors. People may feel pulled to large agglomerations due to the higher income levels there and an inspiring urban atmosphere; or they may feel pushed out of their home due to poverty and unemployment. In the pull factor case, a place-based policy aimed at preventing outmigration, would clearly be misguided. In the push factor case, one could advocate some limited start-up support for people mobilising their energies in order to try to help themselves, and at least, no stoke must be put in their wheel.

Fiscal Federalism Ideas on Allocation of Tasks

Another question concerns the allocation of competencies for different layers in a multi-layer government system – specifically for the field of cohesion policy. What tasks and objectives should be pursued at the central EU level, as well as at a national or even local level? The theory of fiscal federalism offers some guidance as to an optimal allocation of tasks and responsibilities between these different

[4] Even then, the activating infrastructure, such as education facilities and transport means to promote mobility towards the growth centres, would need to be provided place-based.

layers – for recent overviews, see Oates (2005) and Weingast (2013). Accordingly, tasks should be assigned to the central level: (i) if there are economies of scale in the production of a respective public good; (ii) if there are strong externalities of public policy measures spilling over to neighbouring regions; (iii) if consumer preferences across the lower jurisdictions are relatively homogenous; and (iv) if accountability can be guaranteed better at the central than at the local level. These conditions, however, become less clear-cut, if the asymmetric information and selfish behaviour of principals and agents in the policy field are taken into account. In particular, it is difficult to decide whether the accountability of political actors is best achieved at the most central or the most local level. For several policy fields, the supremacy of the European level for fulfilling the tasks appears obvious due to the conditions (i) and (ii), like trade and competition policies that are indeed under the responsibility of the EU, or defence, foreign affairs and migration policies that are not.

Turning back to cohesion policy, redistribution as one of its objectives is also conceived as a central task due to economies of scale and externalities. Within-country redistribution, however, should be in the competency of the nation states (under some EU-wide rules preventing migration flows induced solely by social security differentials between member states). The EU level should primarily be responsible for between-country redistribution, even more so as this is often seen as a form of compensation for the regional inequality caused by the European integration process itself.[5] Similarly, growth policy may be understood as a central responsibility, if one believes in the necessity of supporting outstanding growth centres for the benefit of all. Moreover, as far as negative spill-over effects occur, a system of unit subsidies for internalising them would be coordinated most effectively at the central level. Centralised redistribution policies may also act as insurance against asymmetric shocks, in order to mitigate coerced pro-cyclical spending behaviour at the local level.[6] Some inter-jurisdictional transfers therefore seem to be required at the EU level, and the related flow of funds needs to be centrally organised, as is the case with the ESIF and EU cohesion policy.

A different question is whether the central EU level should also be responsible, and to what degree, for the implementation of redistributed funds in local projects. From the standpoint of preferences that are likely to be quite heterogeneous between different jurisdictions, local responsibility may seem more appropriate. At the local level there may be better information available on the preferences of a constituency, and the varying exigencies of different jurisdictions may be better matched than by a central all-purpose blend. A better informed and more closely engaged electorate may ensure a better accountability of implemented policy actions. Moreover, variation in public goods between local jurisdictions may allow for voting on foot, enabling people to sort themselves into more homogenous units. But local jurisdictions may, on the contrary, also be in danger of log-rolling due to some sort of local nepotism, and the temptation may arise to try to raid the commons. Centrally organised transparency and monitoring of local funding decisions may be required, as well as strict no-bail-out rules, to limit access by the lower authorities to the funds distributed from above.

CURRENT STATE OF EU COHESION POLICY

Considerable progress has certainly been observed in the objectives of cohesion policy. EU regions did grow as intended, and productivity increased – although perhaps not as swiftly as for some competitors. There was also some Europe-wide convergence between countries in terms of per capita income, productivity, and even industrial structures. At the same time, however, regional disparities within countries remained considerable, and even increased in some cases. Numerous influences may have driven these results, starting with an autonomous trend towards income convergence between countries observed worldwide. In addition, there are several policy fields other than cohesion policy interfering – by the EU as well as by member states – some of which, acting spatially-blind, that end up favouring agglomeration areas rather than the periphery (such as research policy, deregulations, bail-outs for endangered trusts and for banks during the financial crisis, etc.). It is thus difficult to assign cohesion success or failure to any specific cohesion policy.

Are EU Transfers Effective?

A vast number of reports and studies on the effects of the EU cohesion policy have been undertaken over the years, many of them commissioned by the EU DG Regio itself as a background to its various cohesion reports, and others independent of such commissions. The evidence that they provide is rather mixed.[7] Several studies, including the EU official reports themselves, find that cohesion policy has positive effects on the GDP of the assisted regions, or, a usually less pronounced impact on its employment. Some results suggest a peak for efficiency, beyond which further funding is useless (Becker *et al.* 2012; Cerqua and Pellegrini 2017). Other studies find few results or such that are

[5] The governments of member states could also agree on certain amounts of re-distribution among themselves. However, due to the impossibility of formulating complete contracts, it is useful to transfer the more detailed interpretation of it to a superordinate level, namely the EU.

[6] The ESIF are, at any rate, much too small to offer a really substantial effect of this kind. The best option for balancing business cycles would be a European tax policy, since it would allow for built-in flexibility *via* a progressive income tax.

[7] For comprehensive surveys of econometric evaluations see Hagen and Mohl (2009); Pieńkowski and Berkowitz (2016), and the literature cited there.

conditional to the availability of further determinants like human capital or good institutions (e.g. Rodriguez-Pose and Garcilazo 2015). A few studies find overall negative results. The ambiguity of these results seems due to the variation in the design of the studies, which differ considerably regarding approaches, observation areas and periods (Dall'Erba and Fang 2017). All in all, the results of cohesion policy do not seem very robust.

Moreover, even although the identification strategies of such studies have grown increasingly sophisticated, they still suffer from the difficulties of obtaining detailed time-series data and of defining the counterfactual situation. Several adverse effects related to the implementation of the policy are difficult to consider in such estimations. These effects include losses through the pocketing of funds for projects that would have been realised anyway; waste in the form of deserted industrial parks, for instance, due to a lack of absorption capacity in the assisted regions; unintended substitution effects when capital-intense production is boosted in regions plagued by high labour unemployment. The opportunity costs of alternative uses of funds are also hardly ever taken into account. All of these factors cast even greater uncertainty over the net benefit of cohesion policy measures.

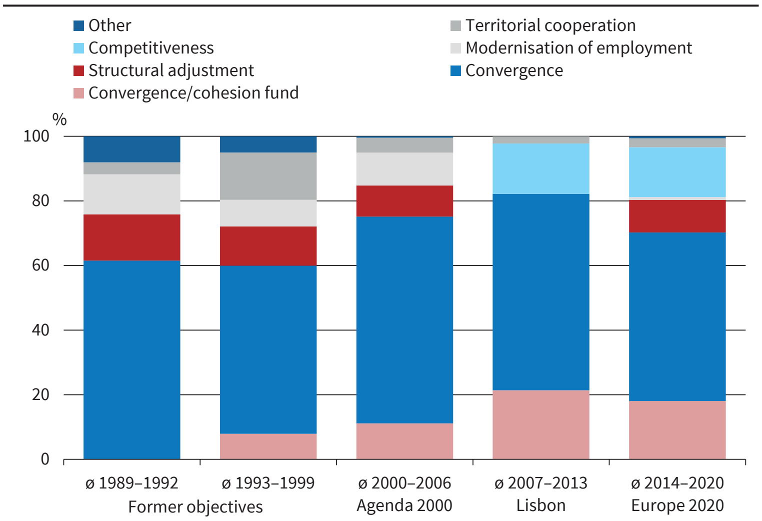
To What Extent Does EU Cohesion Policy Align with Its Own Explicit Objectives?

As described above, the asserted cohesion objectives changed over time and became increasingly diverse. However, if one observes the allocation of the ESIF appropriations during several periods, it becomes obvious that the largest amounts of the ESIF were always dedicated to the convergence objective (including the 'cohesion fund' in Figure 1). Other objectives like modernisation of employment (including measures against long-term and youth unemployment), or help for regions under structural adjustment pressure (including regions affected by industrial decline or rural transition), or territorial cooperation across borders, gained much less attention. Under the Lisbon Strategy, after introducing with much ado the new growth and competitiveness objective, the allocations to the convergence objective even reached a maximum. They declined somewhat under the Europe 2020 agenda, due to the (re-)introduction of a youth employment initiative and some funding for transition regions, but still account for over 70 percent of all appropriations.

The idea of the Lisbon Strategy and the Europe 2020 agenda was, of course, to pursue growth-oriented targets, even while funding convergence regions under the convergence objective. A cumbersome planning and approval procedure between EU institutions and national and local decision-makers seeks to ensure that the implemented projects are in line with such predetermined objectives and targets. Whether this was successful hardly seems to have been rigorously tested to date. Looking at the lists of transfer beneficiaries, however, may give us a clue. The Commission publishes these lists in order to meet the transparency requirements;[8] but they are only available in the language of each respective country. The quality of the information provided differs considerably between the various countries, but often tends to be sparse. In Germany at least, most of the resources seem to go to enterprise investments, for 'environmental consulting and auditing', for hiring an 'innovation assistant', for 'acquiring a five-colour-offset printing machine', or simply for supporting a specific beneficiary (e.g. project 'Wühr Karl' for beneficiary Karl Wühr without any further explanation). Other resources go to communities and development agencies, e.g. in Britain, for 'highway construction', 'technology park and industrial estate development', 'urban renewal and development', 'waterfront projects', and 'broadband access'. In Spain, huge amounts of funding go to the central governance institution in each region, such as the Junta de Extremadura and the Generalitat de Catalunya, for all kinds of public investments, without offering any further details. Some bizarre examples

Figure 1

Objectives of ESIF Appropriation, 1989–2013[a]
Share in total appropriations



[a] For a better comparison across the programming periods, the objective aiming at broadly comparable objectives are aggregated.

Source: European Commission; own calculation. © ifo Institute

[8] See European Union online, *List of Beneficiaries*, http://ec.europa.eu/contracts_grants/beneficiaries_en.htm, and http://ec.europa.eu/regional_policy/en/atlas/beneficiaries/.

of funding concern the development of a particular opening sound for re-closable beer bottle caps in Flensburg, or the development of self-unfolding tents, or the worldwide first audio-tracking for a long-distance cycle path. In view of some of these examples, the claim that cohesion policy is oriented towards predetermined objectives sounds a bit hollow.

The Commission tries to further strengthen the alignment of the actual use of the ESIF with the cohesion policy's set of objectives and targets through installing conditionalities such as the 'de-commitment rule' (whereby any committed funding not spent within two years is lost to the respective programme), or the 'Lisbon earmarking' (which requires the allocation of at least 60 percent of expenditure to predetermined growth-oriented investment categories). Except for the de-commitment rule, however, such conditionalities have neither proven very effective nor particularly appropriate to their aim to date (Bachtler and Ferry 2015).

HOW TO ORGANISE FUTURE EU COHESION POLICY?

To conclude, financial transfers at EU level like the ESIF seem justified and necessary. In accordance with the EU principle of subsidiarity, these funds should continue to augment national policies in cases, where the respective problems are particularly strong so as to require EU-wide solidarity. EU cohesion policy, however, should be organised more coherently in terms of objectives and responsibilities, and more modestly and realistically in its claims. The processes could also be organised more straightforwardly and efficiently.

As far as objectives are concerned, contrary to current practice, mixing redistributive and growth policy objectives should be avoided, since these tend to be conflicting objectives. In line with this, the responsibilities for each type of this policy should be attributed more clearly to one EU actor, instead of the current mixture.

Accordingly, the *cohesion policy proper* should focus on redistributive objectives only. Given the low persuasiveness of cohesion policy effects in the empirical studies, however, it should not nourish high-flying illusions as to the extent of convergence to be achieved. Instead, a modest, perhaps 'old-fashioned' but realistic approach should be pursued. No funds should be directed into physical investment by enterprises, but rather into improvements in basic local infrastructure and local institutions, as well as into investment in human beings.

– The ERDF could thus be directed towards a place-based policy that funds public infrastructure for safeguarding the basic needs of existence and securing equity of opportunities for all European citizens, and in particular for each European child no matter where s/he is born. Minimum standards for education capacities, medical services, care for the elderly and care facilities, transport and communication means should be defined and ERDF funds should help to provide them everywhere in Europe. ERDF funds should also aim to improve public institutions. Projects that fight public fraud, waste and corruption should be given priority, and regions in need should receive training, mentoring, and monitoring.
– The ESF could complement these efforts with a people-based policy. One focus could be the support of unemployment programmes, particularly for activating young people who are already unemployed or in danger of becoming so. A lack of prospects for young and adolescent people in problem areas, and the violence resulting from this, has proven a problem not only of local or national, but of Europe-wide relevance; and European efforts to resolve it therefore seem completely justified. Another focus of engagement for the ESF could be the digitalization process and supporting the adjustments in labour markets that may be required in response to it. Finally, ESF funds should be used to support cross-border exchanges and face-to-face encounters of all kinds of European citizens, be they students, teachers, administrative staff, researchers, craftsmen, managers or from any other background. By getting acquainted and learning from one another, people can acquire that feeling of European unity and solidarity that seems so urgently missing these days.

The *competitiveness and growth policy*, by contrast, should not be pursued by cohesion policy, but rather by means of the Research Framework Programmes, ERASMUS, and similar. Generally, promoting growth is a challenging task in itself. Frequently, growth policies promote some activities or some 'clusters' of activities that are supposed to be of future relevance. However, by the time such future relevance is officially recognised, the respective activities are usually already widespread, able to grow on their own and do not require any more funding. By contrast, the true 'hidden champions of tomorrow', those that really could take advantage of growth support, are not yet known. Growth policy should therefore abstain from the idea of steering growth and should abandon the futile search for growth industries that are worth being funded. The best way to promote growth is to enhance education, particularly higher education, and (unspecific) research, particularly in places where these prosper, that is in agglomerations, and not in peripheral backward regions.

This said, there may be a case for putting a greater emphasis on competitiveness and growth policy by shifting more funds to EU activities supporting research and education, even perhaps at the expense of the ESIF. Moreover, the budget could be expanded at the expense of the Common Agricultural Policy, as was already demanded by the Kok report in 2004.

As far as processes are concerned, responsibility for implementing the transfers into concrete projects should remain largely at the local level, where information on what is needed is more readily available. This is largely the case with EU cohesion policy. But the planning and approval process preceding the implementation is too cumbersome and does not yield the desired results. Reducing it to the definition of a number of conditionalities on what is admissible and what is not may increase its efficiency – if these conditionalities are few, coherent and precise, and if compliance with them is strictly monitored after implementation.[9] Transparency and accountability are important tasks in improving the efficiency of cohesion policy – the monitoring elements of cohesion policy and the publication of beneficiaries' lists are therefore important steps in the right direction (although they should be published in further languages and the explanations should be more profound). Inefficiencies should, however, be disclosed and sanctioned more vigorously.

The little miracle of a cohesion policy based on solidarity is valuable in times of an EU whose members are becoming increasingly isolationist, and even nationalist. It must be maintained over the forthcoming budget negotiations. At the same time, it must be implemented in a way that does not discredit precisely this solidarity.

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[9] In my view, all funding should also be subjected to the pre-conditionality that the recipient country still adheres to the *Acquis Communautaire*. Should it fail to do so, cutbacks in ESIF allocations should be provided.