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European Cohesion Policies: The Need for Reform

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INTRODUCTION

Policy does mainly act via public expenditure, which makes the funding of the European Union a non-trivial matter. Although the EU budget is only about 1% of European Gross National Product, by forcing member states to co-finance EU-funds, EU policies are far more important than it seems. This is especially true of the Common Agricultural Policies (CAP), but also of cohesion policies. In the Multiannual Financial Framework (MFF) for the 2014–2020 period about 370 trillion euros (38.5% of total budget) are designed for CAP, while a further 325 trillion euros (34.0% of the total budget) are reserved for cohesion policies. The current proposition by the EU Commission for the forthcoming budgetary period (2021–2028) implies only small changes with respect to relative figures.

However, the ongoing negotiations over the forthcoming MFF should be used to fundamentally reform EU policies and their fiscal consequences. Of course, most recipients of EU funds are not really interested in a fundamental reform as this might imply lower payments; the same seems to be true of the EU Commission, as large funds also imply high political influence. But even the objective of deeper integration among EU member states does not necessarily imply higher expenditure if the structure of the budget does not support this (as it is at least doubtful with respect to CAP). With respect to increased difficulties to handle a European Union of 27 states with different interests, it seems to be more important for the EU to concentrate on expenditures that are suitable to generate a "European value added". The most interesting question, therefore, is how to define such a European value added and which funds are necessary to create it without restricting national competences in a way that is not compatible with the existing European legal framework – which still can be characterized by the fundamental principle of "subsidiarity" as defined in Article 5(3) of the Treaty on European Union (TEU).

This following paper deals with one important element of European Policies, namely cohesion policies. While the objective of "balancing" the regional standards of living in all member states and their respective regions has been constitutive for European policies almost since the beginning (although it substantially gained importance when UK and Ireland joined the EU in 1973, and again after the enlargement of the EU by Central European States in 2004), meanwhile all regions (irrespective of their relative level of wealth) are supported by European cohesion policies. Therefore, the question arises of whether cohesion policies do still follow the original concept of supporting the poorest regions (on an EU-scale) and whether a reform is necessary.

The remainder of this paper is organised as follows: the next section gives an (descriptive) overview of the actual institutional setting of EU cohesion policies, followed by an assessment in light of fundamental principles for the assignment of political responsibilities. It ends by drawing some (political) conclusions with respect to the design of future cohesion policies in the EU.

THE INSTITUTIONAL SETTING OF EUROPEAN COHESION POLICIES

Based on Article 174 of the Treaty on the Functioning of the European Union (TFEU), the European Union supports regional development policies in individual member states in order to promote the "economic, social and territorial cohesion" of the EU. Although the main objective is to reduce "disparities between the levels of development of the various regions and the backwardness of the least favored regions", cohesion funds have been increasingly used since 2007 to achieve the EU's general growth objectives (2000-2010: "Lisbon strategy for sustainable growth and employment", from 2010: "Europe 2020 strategy for smart, sustainable and inclusive growth"). As a result, EU regional funding has been made available to all regions since then, irrespective of their specific economic situation, but in varying amounts and intensities.

The EU Structural Funds (since 2014 collectively known as the Structural and Investment Funds, or ESI Funds for short) include:

- the European Regional Development Fund (ERDF)
- the European Social Fund (ESF)
- the Cohesion Fund
- the European Agricultural Fund for Rural Development (EAFRD)
- and the European Marine and Fisheries Fund (EMFF).

The ERDF's objective is "to help to redress the main regional imbalances in the Union through participation in the development and structural adjustment of regions whose development is lagging behind and in the conversion of declining industrial regions" (Art. 176 TFEU); the use of ERDF funds within the framework of the EU's growth strategy is only "supportive" (regulated in Art. 175 TFEU). The ESF, according to Art. 162 TFEU, aims "to render the employment of workers easier and to increase their geographical and occupational mobility within the Union, and to facilitate their adaptation to industrial changes and to changes in production systems, in particular through vocational training and retraining". In this respect, the ERDF serves as an instrument of a "placed-based policy" (support for disadvantaged regions), while the ESF is interpreted as an instrument of a "people-based policy" (support for disadvantaged people).

EAFRD and EMFF are part of the Common European Agricultural and Fisheries Policy under Article 42 TFEU. In this respect, they are primarily sector-specific motivated, but are also used for regional economic purposes, since they may also contribute to a sustainable development of rural areas, taking into account the objectives of the Europe 2020 Strategy. Finally, the Cohesion Fund provides a financial contribution "to projects in the fields of environment and trans-European networks in the area of transport infrastructure" (Article 177 TFEU). In contrast to the above funds, the Cohesion Fund is restricted to member states whose gross national income (GNI) per capita is less than 90% of the EU average; in this respect, it is relevant only for Greece, Portugal and Cyprus as well as the 10 Eastern European EU member states. Furthermore, the restriction to infrastructural investment is a difference to other funds, as these include direct payments to firms, albeit in the framework of national support programmes.

From a regional economic point of view, beside the Cohesion Fund the ERDF and the ESF are particularly important. Throughout the EU, the ERDF and ESF are mainly used to achieve the objective of "Investment in growth and employment", as well as for projects supporting cross-border cooperation between EU countries to a lesser extent. Although the funds provided by the EMFF and the EAFRD are subject to the basic principles of the Common European Agricultural and Fisheries Policy, they are also of regional economic importance due to their integration into the Europe 2020 strategy and concentration on rural areas, which are typically lagging behind. This is particularly true of the EAFRD, as the EAFRD can also finance rural development programmes.

The distribution of funds from the ERDF and the ESF under the "Investment for growth and employment" objective is described in detail in Article 90 and Annex VII of Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013. It first categorises the regions at NUTS level 2 according to their GDP per inhabitant in PPS (currently: average for 2007-2009) in "less developed regions" (GDP per inhabitant less than 75% of the EU average), in "transition regions" (GDP per inhabitant between 75% and 90% of the EU average) and in "more developed regions" (GDP per inhabitant higher than 90% of the EU average). While most funds are allocated to less developed regions (52.5% of the resources available for the ERDF, ESF and Cohesion Fund, 164 billion euros in 2014-2020), all other regions are supported as well: transition regions receive 10.2% of all available funds (32 billion euros in 2014-2020), and 15.7% of total funds are reserved for higher developed regions (49.1 billion euros in 2014-2020). On a per capita base, however, there is a clear preference for support for the less developed regions, as most of EU's population is living in more developed regions.

Within the group of less developed regions, funds are allocated according to the level of national per capita GDP, reflecting the relative prosperity of the member state in which the eligible region is situated (Annex VII of Regulation EU No 1303/2013). So, there is a clear preference in favour of poor regions in poor states, reflecting the "balancing objective" of regional policies. Additionally, there is a "bonus" for regions with high unemployment rates. For transition regions, funds are allocated by means of an interpolation mechanism that takes into account the region specific level of per capita GDP. Finally, within the group of more developed regions, the distribution of funds follows a complex system using different socio-economic indicators. In addition to the unemployment rate and GDP per capita, it also includes indicators that are considered relevant for the European Union's growth strategy (e.g. the employment rate, number of university graduates, number of early school leavers). So, since there is no need for regional policy action in the more developed regions in accordance with Art. 174 sentence 2 TFEU, the funds from the ERDF and the ESF under the "Investment in growth and employment" objective in these regions are used solely to support the global growth and employment objectives set by the EU in line with the logic of EU cohesion policy.

A constitutive principle of EU cohesion policies is that there is no direct support of specific projects, but only a co-financing of national (or regional) programmes. The latter, however, have to fulfill a number of criteria that are defined by the EU Commission – so it is not quite clear whether the EU co-finances national programmes; or whether national policies co-finance EU programmes. The consequence is that national authorities are forced to design their (regional) policies in a manner that is compatible to the policy objectives of the EU; otherwise financing via EU funds is not possible. To this end, a total of 11 "thematic objectives" (alternatively: priority axes) were defined by the EU Commission in advance, under which the funding strategies of the regions must be subsumed.[1] In most regions, the "operational programmes" for the ERDF concentrate on objectives like the strengthening of research, technological development and innovation, the improvement of competitiveness of SMEs and cli-

[1] Cf. Art. 9 EU-Regulation 1303/2003: In order to contribute to the Union strategy for smart, sustainable and inclusive growth, each ESI Fund shall support the following thematic objectives:

1. Strengthening research, technological development and innovation;
2. Enhancing access to, and use and quality of, ICT;
3. Enhancing the competitiveness of SMEs
4. Supporting the shift towards a low-carbon economy in all sectors;
5. Promoting climate change adaptation, risk prevention and management;
6. Preserving and protecting the environment and promoting resource efficiency;
7. Promoting sustainable transport and removing bottlenecks in key network infrastructures;
8. Promoting sustainable and quality employment and supporting labour mobility;
9. Promoting social inclusion, combating poverty and any discrimination;
10. Investing in education, training and vocational training for skills and lifelong learning;
11. Enhancing institutional capacity of public authorities and stakeholders and efficient public administration.

REFORM MODEL

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mate protection; the ESF's funding focuses on the promotion of sustainable and high-quality employment and the promotion of social inclusion and the fight against poverty and investment in education, training and vocational training.

To a lesser extent (2.7% of the total ERDF, ESF and Cohesion Fund, equivalent to 8.9 billion euros in 2014-2020), cohesion policy also supports cross-border projects under the European Territorial Cooperation Objective (ETC). ETC aims to support joint actions and policy exchanges between national, regional and local actors from different member states.

EAFRD funding is used to promote the competitiveness of agriculture, increase sustainability in the management of natural resources, improve climate protection and achieve balanced spatial development in rural areas. From a regional policy point of view, the latter objective is particularly relevant, as measures for infrastructure development and the mobilization of local groups of actors can also be financed.

Currently, it is not yet clear how cohesion policy after 2020 will be organised. On the one hand side, with the UK's announced withdrawal from the EU the available budget for cohesion policy will decrease; on the other hand, many regions are concerned that regional support measures can no longer be financed without the support of the EU. This particularly applies to those regions where, due to the statistical effect of the Brexit or a relatively favourable development in the past, GDP per capita exceeds the underlying threshold values for classification as eligible regions. These regions might lose their previous funding status, leading to an increased risk that the convergence process will come to an end unless support will be continued. Actual proposals by the EU Commission provide for a reduction of around 10% in available funds compared to the previous funding period; in addition, the funds are to be concentrated on five (instead of the previous 11) thematic priorities, of which high European added value (with a view to the Europe 2020 Strategy) is expected. But, according to the EU-proposals, threshold values for the definition of transition regions shall be increased. However, a discussion of the fundamental justification of EU cohesion policy in its current form seems necessary. This is the topic of the next section.

ASSESSMENT OF EU COHESION POLICIES

In its original design, being formulated in Art. 174ff. TFEU, cohesion policy aims at reducing regional disparities with respect to income levels, productivity and employment perspectives – so it is mainly regional policy. Of course, it is dubious whether a specific regional competence of the EU is justified at all; however, as this specific EU competence had been agreed upon by political decisions, science has to accept this. However, this does not necessarily require extensive state aid programmes: Theoretically, a deeper integration of the EU member states and a convergence of poorer regions can also be achieved by international trade or by improved mobility of labour and capital, leading to the catching-up of the more backward regions. Since the general cost level in structurally weaker regions is lower than in the more developed regions, these regions are more competitive in terms of export prices and more attractive to investors; in this respect, above-average growth in gross domestic product (per capita) and, as a result, convergence with the more developed regions would occur as a result of market conditions. In fact, however, experience shows that such convergence processes either take a very long time or are completely absent due to the existence of increasing returns to scale, leading to "path dependencies". For example, it is plausible to assume that the more advanced regions can also invest more in research and development due to their initially higher productivity and thus even increase their lead in productivity, while the less developed regions necessarily have to specialize in rather simple and thus less productive productions; the result would be divergence (instead of convergence). Such divergence processes can also be exacerbated by the fact that well-qualified mobile workers migrate to the wealthier regions as a result of existing wage differentials; this brain drain subsequently further worsens the growth prospects of the backward regions. So, under the conditions given, cohesion policies (by financial support for less prosperous regions) might be justified also by theoretical reasons. The concrete design of regional policy aid at EU level can then, of course, only take place on the basis of a uniform EU-wide standard of comparison - for which the regional GDP per inhabitant in relation to the EU average is to be used in accordance with EU Regulation No. 1303/2013. The result would be that EU funds could only be made available to the poorest regions.

The fundamental conflict in regional policies lies between "balancing" and "growth" objectives – redistribution in favour of structurally weaker regions means a (relative or even absolute) disadvantage for the stronger regions and can thus impair overall economic growth (either directly via redistribution to regions with lower marginal productivity or indirectly via the disproportionately large share of financing to be charged by the stronger regions). ESI funding attempts to alleviate this conflict by allowing all types of regions to benefit from the funding, albeit to varying degrees. Thus, the actual design of cohesion policies must be regarded as a "wide" interpretation of the provisions of Art. 174ff. TFEU, obviously being the result of a political compromise. Neither the degree of allocation of funds nor the specific usage is determined by objective considerations.

Furthermore, the actual arrangement reflects the fact that cohesion policies should not only reduce regional disparities, but should also support the objectives of the Europe 2020-strategy. This might lead to difficulties, as both objectives (the reduction of disparities and the growth objectives of the Europe 2020-strategy) are not necessarily compatible with each other. Therefore one might prefer a clear assignment: it would be more beneficial to use different instruments for growth and balancing objectives than to use only one instrument (cohesion policy) for both of them. ERDF funding, for example, could be concentrated in the structurally weakest European regions (balancing objective) only, while the growth policy objectives of the Europe 2020 strategy could be pursued in separate programmes (priority: under the European Research Framework Program (with a view to strengthening innovation results) or the ERASMUS programme (with the objective to improving the human capital base within Europe)). But even in this case, the thematic objectives of the Europe 2020 Strategy (cf. fn. 1) would also need to be reconsidered. A growth policy effect is most likely in the thematic objectives 1-3, 8 and 11, while the other priority areas mentioned are more likely to pursue other targets. The objectives of the ESF and EAFRD could be maintained, but should not be confused with the Europe 2020 objectives either.

A strict assignment of programmes to objectives would not only increase the transparency of EU funding policy, but would probably also improve the efficiency of funding. It seems likely that higher growth incentives (e.g. through support for research and development in firms and/or universities) would be achieved more effectively by concentrating on the agglomeration centers, while improved balancing results would not necessarily be triggered by limitation to the thematic fields of intervention of the Europe 2020 Strategy.

A second point is that Art. 4 TFEU defines a "shared" competence for cohesion policies only – which means that the principle of subsidiarity defined in Art. 5 (3) of the Treaty on European Union (TEU) has to be observed: The EU shall "act only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the member states, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level." Therefore, the question must be raised of whether the EU should continue to intervene in areas of government action, which could in principle, and perhaps more effectively, be dealt with at the level of the member states or their subordinate federal units.

In principle, the allocation of economic policy competences should be based on the scope of their effects. This lies at the heart of the principle of subsidiarity enshrined in Article 5(3) TEU. The reason for this is usually better knowledge of local problems; from an economic point of view. However, the concept of "external effects" is more convincing: only measures whose effects are felt throughout Europe (or at least in several member states) should therefore be allocated to the supranational level. Measures with effects that remain limited at a national or regional level can, however, in cases of doubt be better implemented by the individual member states or their local authorities. In addition to the above-mentioned information argument, this is particularly supported by considerations of connexity theory, because the preferences of citizens in their dual role as taxpayers and consumers of state services are more likely to be met when local tasks are fulfilled locally (and financed locally).

Among the thematic objectives mentioned by the EU in Art. 9 of the ESI regulatory framework, external effects are most likely to be expected under objective 1 ("Strengthening research, technological development and innovation"), since innovations are likely to have spillover effects across regions. Objective 3 ("Promoting efforts to reduce CO2-emissions in all sectors of the economy") also shows EU-wide benefits, although the intervention methodology provided by the ESI funds (namely the promotion of investments relevant to climate protection) is not necessarily the best solution. EU-wide external effects are also conceivable with regard to objective 7 ("Promoting sustainable transport and removing bottlenecks in important network infrastructures"). However, most of the intervention priorities defined by the EU under Article 9 of EU Regulation 1303/2013 are not expected to have cross-regional effects, which could just as easily be achieved through action at a national level.

The above arguments apply not only to the ERDF (and thus to the core area of regional cohesion policy by the EU), but to an even greater extent to the ESF, which, as a people-based policy, has no cross-regional objectives. The same applies to EAFRD financed programs that support the supply of public services and rural development, which also have primarily locally limited effects. Moreover, spatial external effects are hardly to be expected, even in view of the low mobility of labour (otherwise unemployment would hardly occur). At the same time, Article 153 TFEU allows the Union to play a supportive and complementary role in social policy only. In this respect, the further influence of the EU on the design of social policy measures in individual member states achieved through the ESF must be critically questioned.

An additional argument in favour of centralization could be the existence of economies of scale - namely when synergy effects and thus productivity increases may be achieved through, for example, specialization advantages. In the case of EU structural fund support, however, this does not take place at all, because the support measures continue to be implemented by the member states or the authorities downstream of them on the one hand, and an additional administrative level is involved through the coordination and monitoring tasks of the EU Commission on the other. Therefore, at least in the current organizational form, there are additional costs compared to exclusively decentralized (or even fully centralized) task completion.

Thus, the relevant ESI regulatory framework seems to undermine the principle of subsidiarity by pointing out that the objective of strengthening economic, social and territorial cohesion "cannot be sufficiently achieved by the Member States (…) but can rather be

better achieved at Union level", because of the "extent of the disparities between the levels of development of the various regions and the backwardness of the least favoured regions and the limit of the financial resources of the Member States and regions" (EU-Regulation 1303/2013, number 129). Obviously, the EU's interventions are justified mainly by the insufficient financial means of the member states or their regions, but not by arguments based on allocative deficiencies. The justification given can only be convincing in this respect with regard to the promotion of structurally disadvantaged regions in economically weak member states; in the case of ESI promotion for regions in economically strong member states, however, the argument lacks credibility.

Another problem might be that the EU pursues objectives that do not necessarily correspond to the priorities of the member states or their subordinate federal levels. This would not be a problem if only EU funds were used. In reality, however, the EU funds only provide partial financing, with the remainder to be financed by the beneficiaries from their own funds. As a result, the use of EU funds at national level ties up funds that might otherwise have been better used. While there is no obligation to call on the EU's support programmes, it is difficult in the political process to reject EU funds, meaning that money is only spent because it is available. The associated restriction of own scope of action is thereby accepted and often not questioned any further.

This problem would only be ruled out in case of a complete congruence between national policy objectives and EU objectives. In such a scenario the EU would only provide funds to co-finance national programmes that otherwise would also be in effect, but the principle of subsidiarity would be strongly ignored.

Most regions nevertheless show a massive interest in an ongoing co-financing by EU funds – even those regions that must be regarded as net contributors to the EU budget (typically more developed regions as defined by the EU Commission). The EU is financed not only by customs revenues, but also by contributions from the member states to the EU budget. The latter are determined on the basis of the harmonized VAT base of each member state (currently: 0.3%, for Germany, Sweden and the Netherlands a reduced rate of 0.15% applies in the period 2014-2020) and on the basis of the gross national income of the individual countries (currently: 1.23%). In 2017, Germany's own resources paid to the EU from the federal budget amount to 24.1 billion euros (VAT own resources: 2.4 billion euros; GNI own resources: 21.7 billion euros). Thus, all European regions contribute (indirectly) to the EU budget through the taxes generated in these regions. That's one reason why even the wealthier European regions have an interest in recovering at least part of their implicit financial contributions through corresponding revenues from the EU budget in order to improve their position as a net contributor to the EU budget. However, at least due to administrative costs, it would be more efficient to reduce national contributions to the EU budget in line with backflows from the EU. If a reduction in the tasks (and thus in expenditure) assigned to the EU were also to reduce the member states' overall financial contributions, regions could possibly benefit more from this than by drawing on EU funds. However, it is not realistic to assume that this will happen; furthermore, in this case second-order changes in the distribution of tax revenues between the federal and state levels would be necessary – leaving the net effect for the different regions uncertain.

To conclude, from a purely regional economics point of view, there are strong arguments against a widening of cohesion policies by the EU. However, beside regional cohesion, EU policies also aim to deepen the European Union, particularly by supporting the "Europe 2020 strategy for employment and smart, sustainable and inclusive growth". In this respect, it is a deliberate political decision to shift competences to the EU level, which cannot be assessed solely on the basis of subsidiarity criteria. Thus, EU competences could be justified (contrary to the principle of subsidiarity and in line with the objective of deepening the EU) if the projects and programmes supported by the EU generate a (politically defined) "European value added". However, the concept of "European value added" must be carefully assessed – it is not sufficient to postulate such added value for nearly each policy objective that the EU has defined, as is usually the case. It can be assumed (although it's not quite clear) that growth policies of the EU may create such a "European value added".

However, while the existence of a" European value added" is one of the relevant selection criteria for direct project funding by the EU, in the case of funding programmes such an assessment is only carried out in advance when the EU Commission approves the programme guidelines. A "European value added" is already taken for granted when the objectives set by the EU Commission (defined by the thematic priorities defined in Regulation 1303/2013) are addressed. In the concrete selection of projects, however, there is no further examination as to whether a "European value added" can be achieved. In many specific projects funded by the ERDF, ESF and probably also the EAFRD, however, the "European value added" is not immediately apparent, since their effectiveness is usually limited to the region in question (cf. paragraph 15 et seq.). Such an effect only seems to be plausible in the case of cross-border ETC-projects, as cooperation between partners from different countries is much more difficult to achieve than between partners from one country. However, even such cooperations are often on a rather small scale, and seem to have only a limited effect with respect to the objective of deepening EU integration.

CONCLUDING REMARKS

The European Union is currently in a serious crisis of legitimacy. Even if the advantages of European integration are obvious from a theoretical (and even practical) point of view, nationalist tendencies are gaining impetus in many countries that want to prevent a further "deepening" of the EU in favour of greater national autonomy. In this situation, there is a need for a fundamental agreement on how the European integration process is to be shaped in the future. This should include an agreement on the assignment of competences between the member states (and their regions) on the one hand and to the European level on the other. Obviously, this discussion has not been conducted in sufficient depth to date.

The final expression of the future distribution of tasks is the budget of the European Union. It is not without reason that the EU Commission's draft budget for the next seven years places a particular emphasis on expenditure that promises a "European value added", especially in fields where all member states share a common interest. At the same time, however, the Commission is bound by the European Treaties, which restrict the competences of the EU. In addition, a change in priority setting with a given budget volume requires cuts in other areas, which immediately create strong resistance on the part of the previous beneficiaries. In this respect, it is not surprising that the current draft of the EU Commission on the medium-term financial framework only makes gradual changes to previous budget estimates.

Agricultural expenditure remains the most important item in the EU budget, but it only benefits a quantitatively insignificant sector. Obviously, there would be the greatest potential for cutbacks here. However, expenditure on cohesion policy already takes second place. This paper takes takes a critical look at the current shape of cohesion policy. It appears that the current regulatory system is in need of reform not only in detail, but also in its basic orientation. The blending of different objectives (growth versus balancing) and the wide interpretation of the subsidiarity principle draw the sharpest criticism; and that restricts the efficiency of cohesion policies.

However, there is little time left for a fundamental reform before the next medium-term financial framework comes into force, especially since decisions on the future shape of European integration and the associated distribution of competences between member states and EU level must be taken beforehand. This will not be affordable until 2021. However, much would be gained if this discussion were to take place in the first half of the next decade, so that an appropriate distribution of tasks and expenditure may at least be achieved in the budget period 2028-2035.