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Linking Cohesion Policy to European Economic Governance: an Idea Up for Improvement

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The idea of linking cohesion policy to EU economic governance has received the support of several EU institutions. The nature of such link is still to be agreed upon and is likely to lead to intense discussions. This Policy Brief argues that while the Commission's envisaged proposal has its merits, it would nevertheless result in a partial and inconsistent link between the cohesion policy and EU economic governance. A more flexible and coherent approach is proposed.

Introduction

European economic governance aims to support the functioning of the EU by ensuring that national fiscal and economic policies are sound. The persisting eurozone debt crisis has shown that the rules in place were insufficient. Making economic governance effective has therefore become a key goal of EU policymakers.

A major weakness of European economic governance lies in its inability to ensure compliance by the Member States. As a response to this problem, a reform of the economic governance rules will introduce new sanctions[1]. Policymakers doubt however whether these sanctions will be sufficient.

In order to complement the sanction 'toolbox', the Commission proposes to make parts of the EU's expenditure conditional on respecting the EU economic governance rules. As cohesion policy is a major EU expenditure, it is a prime candidate for such conditionality.

Another important point of discussion is the difficulty some Member States have in taking-up the cohesion funding they are entitled to, as they lack the financial means to the co-finance cohesion policy projects. Therefore, facilitating some countries' access to cohesion policy funds is also taken into consideration.

Changes to the cohesion policy would be adopted as part of the EU 2014-2020 financial framework, even if some elements could possibly be introduced earlier on. The idea to link cohesion policy to EU economic governance has also gained traction in the Commission, the Council and the European Central Bank[2]. Importantly, French President Sarkozy and German Chancellor Merkel support the idea as well[3]. The Parliament for its part is still divided on the issue.

Given the importance of cohesion policy, it is clear that the reform will be highly controversial. Each year, the EU spends approximately EUR 50 billion on its cohesion policy[4]. Cohesion funding is used mainly, though not exclusively, to provide grants to projects that aim to reduce disparities in the levels of development of the various regions[5]. The assistance is provided by means of three funds. The Cohesion Fund allocates about 20% of the cohesion budget to the least prosperous Member States. The remaining 80% is allocated on a regional basis by two other funds, which together are known as the Structural Funds[6].

This brief assesses the proposed linking of cohesion policy to European economic governance. First, the rationale for linking the two policies is considered (§1). Such a linkage is already in place to some extent, as is described afterwards (§2). Subsequently, the paper outlines the Commission's proposal (§3) and discusses its shortcomings (§4). Finally, an alternative approach is put forward (§5).

1. The rationale behind the idea

The prime reason for linking cohesion policy to EU economic governance is to improve the enforceability of the economic governance rules. Making cohesion funding conditional on abiding by these rules would have two advantages over other foreseen sanctions. Most importantly, the sanction would in theory be easier to put into practice. Other sanctions entail a financial transfer from a Member State to the EU. This would not be the case for sanctions based on cohesion policy, as they imply withholding EU funding. The sanction thus does not result in a direct deterioration of the Member State's budget. As a second advantage, each of the 27 Member States could be concerned by the sanction. The other meaningful sanctions only concern the eurozone countries.

The Commission stresses that linking cohesion policy to economic governance is also beneficial for cohesion policy itself. The recent crises have shown that fiscal and macro-economic imbalances can limit the usefulness of cohesion policy. On the one hand, substantial parts of cohesion funding were not taken up by troubled Member States, as they were simply unable to provide the co-financing necessary. On the other hand, fiscal and economic imbalances can stand in the way of long-term economic growth and thus limit the usefulness of cohesion funding. Closer attention to the economic governance rules could prevent some of these difficulties.

2. The current link

Under the EU 2007-2013 financial framework, cohesion policy is to a minor extent conditional on abiding by the rules of economic governance. This conditionality only applies to the Cohesion Fund, not to the Structural Funds. Furthermore, the use of the Cohesion Fund has only been made dependent on a country's fiscal performance, not on macro-economic criteria.

According to the rules, a Member State's cohesion funds can be suspended if it fails to take the necessary corrective actions when under an Excessive Deficit Procedure[7]. Such a decision should be made by a qualified majority in the Council and on a proposal by the Commission. Both the Commission and the Council enjoy a large level of discretion, as they are in no way obliged to take measures. A suspension can be reversed once the Council rules that the Member State has taken sufficient corrective action. In that case, the suspended cohesion funds would again be available to the Member State. An annulment of the funds is not foreseen[8].

Based on this procedure, funding for Greece could have been suspended in 2010[9]. However, this did not take place, as it was not proposed by the Commission. The Council for its part did not request a proposal from the Commission. It was not considered appropriate to take such measures.

3. Outline of the Commission proposal

In a number of publications, the Commission has put forward the main elements of its plan to link cohesion policy to European economic governance. Detailed legislative proposals will be published during the course of 2011[10].

The Commission proposes a twofold link between cohesion policy and economic governance. Firstly, the Commission suggests expanding the use of cohesion policy as a way of sanctioning violations of the EU economic governance rules. Secondly, the Commission seeks to put in place rules that allow easier access to cohesion funds for countries that receive emergency EU financial assistance[11].

With regard to the latter, the Commission proposes easing co-financing requirements. This would be possible for both eurozone and non-eurozone countries that require emergency financial assistance by the EU[12]. In August 2011, the Commission already proposed less stringent co-financing requirements for the countries having received EU financial assistance in the recent past, i.e. three eurozone countries (Greece, Ireland and Portugal), as well as three non-eurozone countries (Hungary, Latvia and Romania)[13]. By changing the relevant legislation, it would be possible to ease co-financing requirements for all countries that request EU financial assistance in the future.

Regarding the use of cohesion policy as a means of sanctioning Member States, the Commission envisages several changes to the current rules. As a first modification, the Commission proposes making all cohesion policy funds conditional on abiding by the economic governance rules[14]. This implies expanding the current conditionality, so that it covers both the Cohesion Fund, as well as the two Structural Funds.

Secondly, the Commission seeks to introduce a more gradual sanctioning mechanism. This would replace the current approach, where the suspension of cohesion funding is only foreseen at the final stage of the Excessive Deficit Procedure. A partial suspension could be introduced first, before stepping-up the sanctions. This gradual approach would be similar to the sanctions foreseen in the economic governance reform.

While initial sanctions would be modest in nature, the final sanction in cases of non-compliance would become more severe than what is currently foreseen. Ultimately, a Member State could be denied access to the cohesion funding.

Additionally, the Commission proposes reducing the scope for political bargaining when applying a sanction. This implies introducing a so-called reversed qualified majority voting procedure. This voting procedure would make it more difficult for the Council to block a sanction and would therefore increase the clout of the Commission[15].

In its proposals the Commission focuses on linking cohesion policy to the economic governance's fiscal rules. Macro-economic governance could be included to some extent by making cohesion policy dependent on structural reform. Yet, a direct link to the macro-economic governance rules is not envisaged.

4. The shortcomings of the proposal

The idea of linking cohesion policy to economic governance rules has provoked mixed reactions[16]. Indeed, while the idea has its merits (see §1), it is also subject to several drawbacks. Four problems are worth noting.

As a first problem, limiting cohesion policy funding can be seen as an improperly targeted sanction. Structural Funds are allocated on a regional basis, while central governments carry most of the responsibilities for respecting economic governance rules. Expanding economic governance conditionality to the Structural Funds could therefore sanction the regions for matters that are outside of their scope of competence[17]. Furthermore, cohesion policy funds are largely aimed at the less-prosperous Member States. These countries would thus be the prime targets of the proposed conditionality. This can be seen as unjust[18].

A second problem concerns the counterproductive nature of financial sanctions. When a country breaches the economic governance rules, its public finances are likely to be in poor shape. By reducing the country's cohesion funding, the Member State would be left with two options. On the one hand, the Member State could decide to finance the project itself. In that case, the Member States' budget deficit would increase further. Alternatively, projects could not be carried out, which would impair economic growth. In both instances, the sanction therefore aggravates the Member States' difficulties.

Thirdly, the Commission's proposal focuses heavily on making cohesion policy conditional on the fiscal side of the economic governance rules. Little attention is given to rules pertaining to macro-economic and competitiveness issues. The problems in Ireland and Spain have shown that macro-economic evolutions can undermine the functioning of the EU and the monetary union. Furthermore, macro-economic derailments can also be detrimental to the effectiveness of cohesion funding.

Last but not least, when considered in their entirety the Commission's plans seem inconsistent. Under the Commission's proposal, a Member State that breaches the economic governance rules would see its cohesion funding cut. However, the situation would be reversed if the Member States' problems deteriorate to a point where it requires EU emergency financial assistance. Then, the Member State would be able to use cohesion funds more easily. The two hardly seem compatible[19]. The envisaged rules would result in an indirect incentive for troubled Member States to request emergency financial assistance, so as to access cohesion funds more easily. The rules also disregard the difficulties of other financially troubled Member States in finding the means to co-finance cohesion policy projects.

5. An alternative approach

Given the aforementioned shortcomings, it seems that the idea of linking cohesion policy to economic governance is far from perfect. Several Member States nevertheless favour making EU expenditure more conditional on Member States' economic and fiscal performances. Therefore, the idea is not likely to be abandoned. It is in all parties' interests to address the shortcomings of the Commission's plans as much as possible.

Unfortunately, linking cohesion policy to economic governance creates problems which prove difficult to overcome. In theory, the improper targeting of regions could be addressed by requiring a Member State to replace the EU's cohesion funding by national funding. Yet, this would only exacerbate the country's difficulties. The counterproductive nature of the sanctions for its part seems unavoidable, as is the case for any financial sanction. Gradual sanctioning can only partly overcome this problem. Non-financial sanctions could provide a solution, but there is no agreement on this matter among the Member States[20].

Nevertheless, other problems mentioned in this paper can be addressed by adopting an alternative approach. This approach would be different from the current proposal in two respects.

First of all, the current focus on the fiscal side of economic governance is erroneous. It wrongly signals that macro-economic rules are less important than fiscal ones. Cohesion funding should be made conditional in a similar manner to both the fiscal and the macro-economic side of economic governance. In both domains, a gradual approach is feasible[21].

In addition, the EU should avoid inconsistencies in the rules applicable to Member States that receive EU emergency financial assistance and other troubled Member States. Instead, a carrot-and-stick approach can be adopted for all countries that have a fiscal or macro-economic derailing. Cohesion funding would then be dependent on the Member States' willingness to tackle its problems. If a Member State commits to undertake the proper reforms - and carries them out-, co-financing requirements can be eased. Such easier access to cohesion funds would demonstrate the EU's confidence in the country's policies and would facilitate the return to normality. If, on the contrary, the Member State does not undertake the actions required by the EU, its cohesion funding can be cut. This signals the lack of confidence in the Member State's strategy for exiting its difficulties. It would also avoid the unproductive use of cohesion funds.

Conclusion

Linking cohesion policy to European economic governance has the potential to strengthen both. It can be an additional way to strive towards compliance with the economic governance rules, while sound fiscal and macro-economic policies can increase the effectiveness of cohesion policy.

Despite these advantages, the linkage envisaged by the Commission contains several shortcomings. Some of them seem hard to overcome, as they are more or less unavoidable when linking cohesion policy and economic governance. An alternative approach could however deal with two crucial problems, namely a) the inconsistency between the rules for Member States that receive EU emergency financial assistance and the rules for other troubled Member States, and b) the neglect of macro-economic governance rules.

Under the alternative approach proposed in this paper, cohesion policy would be linked in a similar manner to both the fiscal and macro-economic dimensions of economic governance. Furthermore, a carrot-and-stick approach would be introduced for countries that face a fiscal or macro-economic derailing. These countries' access to cohesion funding would be made dependent on the actions they undertake to resolve their difficulties. The suggested approach highlights the cohesion policy's role as an instrument for EU solidarity and would contribute to a better-functioning EU and eurozone – which is to the benefit of all Member States.

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Endnotes

[1] As part of the economic governance reform, deposits and fines can be required for eurozone countries that face a fiscal or macro-economic slippage.

[2] The Finance Ministers supported the idea in the Van Rompuy Task Force Report, see: Report of the Task Force on Economic Governance, 21 October 2010, p. 10. For the European Central Bank, see: ECB, Reinforcing Economic Governance in the Euro Area, 10 June 2010, p.7

[3] Letter of President Sarkozy and Chancellor Merkel, 17 August 2011, retrievable on: www.bundesregierung.de/Content/EN/__Anlagen/2011-08-17-dt-franz-brief-eng,property=publicationFile.pdf

[4] This is the annual amount spend during the period 2007-2013 (at 2011 prices).

[5] Article 174 of the Treaty on the Functioning of the European Union, hereinafter TFEU. Besides reducing disparities, the cohesion policy also aims at increasing the competiveness of the entire EU. Consequently, it finances projects in all the EU's regions.

[6] These two Structural Funds are the European Fund for Regional Development (ERDF) and the European Social Fund (ESF).

[7] Article 126(8) TFEU.

[8] Article 4 Council Regulation (EC) No 1084/2006 of 11 July 2006.

[9] In January 2010, the Council concluded that Greece had not taken sufficient actions to undo its excessive deficit. See: Council Decision 2010/291/EU of 19 January 2010.

[10] The legislative proposals are expected by the end of September 2011. For the main Commission publications on the subject, see 'further reading'.

[11] European Commission, A Budget for Europe 2020. Part I, COM(2011) 500, 29 June 2011, pp. 12-13.

[12] Eurozone assistance is provided by the European Financial Stabilisation Mechanism (EFSM) and the European Financial Stability Facility (EFSF). Both are to be replaced mid-2013 by the European Stability Mechanism (ESM). The ESM will be based on Article 136 TFEU (the specific paragraph is to be ratified by 2013). The assistance to non-eurozone countries is provided by the EU's Balance of Payments Assistance, see Article 143 TFEU.

[13] European Commission, Increasing Co-financing Rates for EU Funds - Boosting European Economic Recovery, Press Release, IP/11/942, 1 August 2011.

[14] The Commission has also proposed to link economic governance with the agriculture and fishery funds. While many of the considerations are similar to those for cohesion policy, these proposals fall outside the scope of this Brief.

[15] Under the current rules, the Council decides by qualified majority whether or not to apply a sanction proposed by the Commission. In contrast, the reversed qualified majority voting

procedure would imply that a sanction proposed by the Commission is automatically adopted, unless the Council opposes it by a qualified majority within a limited timeframe.

[16] European Commission, Results of the public consultation on the conclusions of the fifth report on economic, social and territorial cohesion, SEC (2011) 590 final, 13 May 2011. Dirk Ahner, Director-General of the Commission's Directorate-General for Regional Policy, also raised concerns, see: Conference of Peripheral Maritime Regions of Europe, Azores, Press Release, 6 June 2011, retrievable on: www.crpm.org/pub/presse/185_communiqu_bp_aores_en.pdf

[17] This argument is less relevant for the Cohesion Fund, as the Fund is allocated to the Member States. Yet, the Cohesion Fund represents only 20% of the EU's cohesion expenditure. Furthermore, the pertinence of the argument depends largely on the degree of autonomy of the regions, which differs considerably between the Member States.

[18] However, as a counterargument, most of the richer Member States are part of the eurozone and can therefore be sanctioned in other ways.

[19] This is of course different for countries that have already received financial assistance by the EU.

[20] France and Germany have suggested the suspension of voting rights, but no consensus was found on the matter. See: Franco-German Declaration, Deauville, 18 October 2010, retrievable on: www.elysee.fr/president/root/bank_objects/Franco-german_declaration.pdf

[21] For instance, a partial suspension of cohesion policy funding could be considered when a Member State does not take sufficient actions to meet its medium-term budgetary objective (see Article 6(2) of Regulation No 1466/97, OJ L 209, 2 August 1997, pp. 1–5). The same can be done when the Member State does not take sufficient actions to undo its imbalances in the preventive stage of the macro-economic surveillance procedure (see Article 6 of COM (2010) 527, 29 September 2010). More thorough sanctions or more flexibility can be envisaged when a Member State is under an Excessive Deficit or Imbalance Procedure.

Further Reading

- European Central Bank, Reinforcing Economic Governance in the Euro Area, 10 June 2010
- European Commission, Investing in Europe's future. Fifth report on economic, social and territorial cohesion, November 2010
- European Commission, Reinforcing economic policy coordination, COM(2010) 250, 12 May 2010
- European Commission, Enhancing economic policy coordination for stability, growth and jobs – Tools for stronger EU economic governance, COM(2010) 367, 30 June 2010
- European Commission, A Budget for Europe 2020, COM(2011) 500, 29 June 2011
- European Commission, Staff Working Paper accompanying the Communication 'A Budget for Europe 2020', SEC(2011) 868, 29 June 2011.
- VERHELST, S., The Reform of European Economic Governance: Towards a Sustainable Monetary Union?, Egmont Paper 47, June 2011
- Van Rompuy Task Force, Report on Economic Governance, 21 October 2010

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