COHESION POLICY

Where Does Europe 2020 Leaves Cohesion Policy?

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In the Europe 2020 Strategy, the major focus is on competitiveness, which is identified mainly in terms of research, development, innovation and similar indicators. This is at the expense of cohesion, defined inter alia in terms of providing funds to beneficiary Member States and regions for catching up to the European Union (EU) average in per capita Gross Domestic Product (GDP), and other related purposes. Competitiveness – the promotion of which better serves the interests of more developed Member States – may conflict with the bolstering of economic growth and catch-up, from which less developed countries benefit. As a consequence of this bias towards competitiveness, new and less developed EU Member States may be handicapped by the Europe 2020 Strategy, since they are not able to benefit fully from measures associated with, and funds allocated for, the improvement of competitiveness. In the present state of affairs, Cohesion Policy cannot compensate for this deficiency fully. In order to reconcile various interests, a more differentiated approach is needed in both the Europe 2020 Strategy and Cohesion Policy (which is currently under revision).

Reconciling diverging interests

The objectives of the Europe 2020 Strategy are in line with the factors of potential output and potential economic development. On one hand, the strategy identifies competitiveness mainly with research and development – as well as with the technology-intensive economic development path associated with research and development (R&D), such as education and training. On the other hand, it reflects an economic approach that corresponds to the needs of developed market economies – which are characterised by relatively slow GDP growth, significant R&D capacities and a rather low investment rate (that has been sufficient for the implementation of the necessary structural changes). In developed countries, the role of R&D and innovation in economic growth is undoubtedly significant. In contrast to competitiveness, as interpreted in terms of R&D and innovation, less importance is attached to cohesion. The Europe 2020 Strategy mentions cohesion, but the catching-up of the new Member States does not receive proper attention and weight.

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In less developed Member States, economic catching-up requires infrastructural and other sorts of investments, including in industry and / or machinery. In these countries, the major driving force of economic growth will be investment rather than research and development, for the foreseeable future. This conclusion is supported by the findings of the Fifth Cohesion Report of the European Commission. In addition, with the last enlargement, regional differences widened in the EU, and a new category of very "backward" regions appeared in some of the new Member States, with per-capita GDP amounting only to some 30% of the EU average. The economic catching-up of these regions requires strategies, approaches and methods that are quite different from mainstream ones and that have few features in common with the Europe 2020 Strategy.

Based on these considerations, a more differentiated approach is necessary. It would include, firstly, investments or capital accumulation in a broader sense among the sources of sustainable economic development amended by total factor productivity. Second, the new approach should reflect the interest of the new Member States in economic catching-up. This may take the form of a broadly defined Cohesion Policy. Even present Cohesion Policy treats regions differently, taking into account their specific features and needs and avoiding "one-size-fits-all" approaches. In this context, more funds should be allocated to cohesion, and the funds should be spent more efficiently. The elaboration of a cohesion index that reflects efficiency requirements would also be an asset. All of this, together with competitiveness, appears in the Lisbon Treaty on the Functioning of the European Union. It should be noted, furthermore, that cohesion is related to the enlargement of the Economic and Monetary Union. If no appropriate response is given to the problems outlined, the European Union may move towards two-speed integration.

Implications for EU financing

In order to finance the Europe 2020 Strategy and to improve efficiency in the allocation of EU sources, a modification of the profile of EU funds and of the European Investment Bank is necessary, with the overhaul of the existing funds and the setting up of new ones. Financial sources allocated for the development of widely defined infrastructure (transport, the energy sector including security of supply, environmental protection together with climate change), which is not financed exclusively according to market principles and which serves economic growth in the long-term, should be channelled into an Infrastructure and Regional Development Fund or Economic Catching-Up Fund, comprising the existing Cohesion Fund and Regional Development Fund. The exclusive task of the European Investment Bank would be the provision of repayable financial sources to the business sector in order to finance projects related to economic development (research and development, innovation and competitiveness).

The Europe 2020 Fund, based on the European Social Fund, should finance the accomplishment of the objectives of the Europe 2020 Strategy (with the exception of economic development) by providing beneficiaries non-repayable resources (with appropriate contributions from those countries) in order to promote employment and the development of human capital. Finally, in the long run, a stability and crisis-management fund should be set up and institutionalised in order to help EU and Economic and Monetary Union (EMU) Member States cope with liquidity and solvency problems. This is likely to be the European Financial Stability Mechanism to be set up in the eurozone as of mid-2013, the successor to the European Financial Stability Facility.

Funding from the three EU financing sources should be based on the separation of "competitiveness policies" (particularly R&D) and "catching-up policies" and their combination, since the catching-up policy for competitiveness must facilitate the implementation of the Europe 2020 Strategy in less developed EU Member States. Obviously, the EU itself should allocate more resources for "competitiveness policies" in the next decade, but it is also necessary to elaborate qualitative "catching-up policies" for those still lagging behind, yet willing to accept the conditionality for their catching-up process. These policies can give real opportunities to less developed Member States and regions to accelerate not only their quantitative development in terms of GDP per capita, but their qualitative development as well. This was the case of Ireland, Spain and other states.

Implications for the EU budget

At present, the elaboration of the new EU budget (Multiannual Financial Framework – MFF) as well as the reform of the EU budget are on the agenda for the period 2014-20. On one hand, the major bottleneck of financing the Europe 2020 Strategy is the present budgetary period that is going to expire in 2013, in which there is a grey zone from 2010 to 2013. In this grey zone, the present financial commitments are in effect, and no funds are allocated for the financing of the initial phase of the Europe 2020 Strategy. Consequently, in 2011 and in the subsequent two years, no funds will be available for funding the Europe 2020 Strategy in the EU budget. (The funding of Cohesion Policy is ensured in the current budgetary period.) This is counterbalanced partially by the increased space for manoeuvring in the budget, and more specifically by the fact that the Treaty of Lisbon cancelled the distinction between compulsory and non-compulsory expenditures. Furthermore, the objectives approved in the Europe 2020 Strategy determine the expenditure side of the EU budget to a large extent. Based on these considerations, the objectives of the Europe 2020 Strategy should be connected with the priorities of the next financial perspectives of the EU.

The Europe 2020 Strategy and the Cohesion Policy, as interpreted in this paper, both presuppose the reform of the EU budget. This reform makes necessary the reconsideration the EU's vision of the future, as well as an overhaul of the EU's general political and economic strategy. As a result of this, EU resources should be subordinated to existing and future EU policies rather than the opposite, as has been the case until recently.

Although the reform of the EU budget is on the agenda, discussion of the Europe 2020 Strategy and Cohesion Policy had to be separated from the debate over the new financial perspectives of the EU. At the same time, the approval of the Europe 2020 Strategy may determine strongly the size and the structure of the new EU budget, to be launched in 2014.

In order to avoid tensions that have stifled progress in the past (in budgets and in integration in general), and to achieve a reform of the EU budget in line with the requirements of the Europe 2020 Strategy and Cohesion Policy, a bottom-to-top approach to individual policies is proposed. This approach is based on the identification of common objectives and existing and future policies, to which the budget is subsequently subordinated. It is the size and the structure of the budget that should be determined according to the requirements of the policies and not the other way round, where policies are derived from the resources available. This practice is the most substantial barrier to the reform of the EU budget. The identification of objectives and policies makes sense only if public goods of sufficient quantity and quality are available at the level of the EU that represent added value created by European integration.

In the formulation of the bottom-to-top approach, the funding side of the EU budget must also be considered in order to avoid the imposition of excessive taxes on economic actors. The procedure of achieving the final objective and stressing the primacy of policies over funds should be based on scenarios designed to reach an acceptable balance between projected budgetary expenditures and revenues. Restructuring and streamlining expenditures, such that they are in line with the requirements of internal and external challenges to serve EU policies, implies the radical reduction of redistribution policies (like the common agricultural policy) and the diversion of freed resources to existing policies and new ones (for example, enlargement, climate change, European neighbourhood policy, energy supply and ageing).

The bottom-to-top approach based on the supremacy of policies over the size of the budget makes an overhaul of the funding side of the EU budget necessary as well. The introduction of supranational or EU taxes would alleviate the horse-trading by Member States over net positions, but it would not eliminate political struggles, as EU taxes affect Member States differently and with uneven redistribution effects. Nevertheless, correction mechanisms could mitigate the negative side effects. The introduction of a supranational fuel tax would both replace taxes on the use of roads and motorways (whose collection needs enormous investments) and raise funds for financing EU budget spending.

In order to achieve the objectives of the Europe 2020 Strategy, the EU budget must increase in size. As a minimum requirement, the size of the budget should be raised to at least 1.5% of the combined Gross National Income of the Member States from the current 1%. Nevertheless, stable financing would require a 5-6% proportion. A more substantial increase would most likely be opposed by the Member States.

The conclusion can be drawn from the Europe 2020 Strategy (among other initiatives) that the more developed, older Member States attach primary importance to the funding of future-oriented industries and activities (such as research and development, innovation, competitiveness, education and training). These activities lay the foundations of sustainable economic development, in contrast to Cohesion Policy and the common agricultural policy. However, the newer, less developed central and eastern European Member States are interested in approaching the EU average in terms of per capita GDP and rural development. As was pointed out above, the major driving forces of GDP growth include investments in countries with a medium level of economic development, whereas research and development, as well as innovation assume the role of nurturing economic growth only at a higher level of economic development. In this context, the new central and eastern European Member States are not interested in the reallocation of financial resources to areas that serve the interests of more developed Member States, because they may benefit from such a structure of EU spending only modestly. Although they should endorse the reform of the spending structure of the EU budget, they are actually interested in maintaining or even increasing the size of cohesion funds in order to promote economic catching-up. As a minimum objective, they should try to reach a balance in the financing sources of cohesion and future-oriented areas. In the latter field, they should make efforts to gain access to a certain share of EU resources.

New Member States preferring economic catching-up, where investments and exports are the major driving force of economic growth, are interested in maintaining or increasing the size of resources serving cohesion targets. In addition, they should make efforts to gain guaranteed access to a pre-determined share of EU resources of future-oriented fields (research and development, innovation, competitiveness, etc.) where they have competitive disadvantages *vis-à-vis* the old Member States. The preparation of the launch of the new strategy needs more time. Considering the time requirements, the proposed comprehensive strategy could start in 2014 at the earliest, following a transitional period of three years.

Policy recommendations to the Trio Presidency:

1. The Europe 2020 Strategy should be harmonised with Cohesion Policy, reducing the contradiction between competitiveness and economic growth and attaching more emphasis to the economic catching-up of less developed Member States.
2. The allocation of funds should be reformed by giving more room to market principles at the expense of bureaucratic coordination. This means that repayable loans with preferential conditions, loan guarantees, and interest subsidies, higher own resources, etc., serve the set objectives, rather than non-repayable grants awarded to those who fulfil certain detailed administrative preconditions devised by either by EU institutions or national governments. The stronger involvement of market principles includes the consideration of returns as well as higher risks for beneficiaries. Nevertheless, the risk should be lower than that taken in the market, but higher than that occurring in the case of bureaucratic

coordination. The modification of the profile of the EU funds and the European Investment Bank is necessary, with the overhaul of the existing funds and the setting up of new ones. Funding from EU financing sources should be based on the separation of "competitiveness policies" (particularly R&D) and "catching-up policies".

3. New and / or less developed Member States should be guaranteed fair access to funds aiming at the improvement of competitiveness.

4. The funding implications of the Europe 2020 Strategy and Cohesion Policy include an increase in the size of the EU budget, the application of the bottom-to-top approach in designing expenditures (the policy objectives determining the size and the structure of expenditures rather than the other way round) and the introduction of supranational or EU taxes in order to raise the necessary funds. A balance in the financing sources of cohesion and future-oriented areas has to be reached in expenditures.