

# **Reforming Policies for Regional Development: The European Perspective**

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## **Abstract**

This article assesses the outcome of the recent reform of European Union policies supporting investment in growth and catching up of the less developed Member States and regions with the rest of the European Union. It shows the major novelties introduced by the reform, such as ex-ante conditionalities, reinforced macroeconomic conditionality and performance measurement systems and outlines the factors which are critical for the reform to be successful. It offers new opportunities for public and private investment to support growth, employment and structural transformation in Central, Eastern and Southern Europe provided by the new multi-annual financial framework of the European Union in the period 2014-2020.

**JEL classification numbers:** O2

**Keywords:** investment, growth, entrepreneurship, policy reform, effectiveness

## **1 Introduction**

Growing economic disparities between and within countries is a challenge for policy makers worldwide. This challenge is accentuated by the current European context of austerity and slow economic recovery. Recent positive growth trends in many European economies give rise to optimism, but the challenge remains to achieve growth which is sustainable. Alongside sound fiscal policies and productivity-enhancing structural reforms, investments in growth and employment are necessary to create the conditions needed for sustainable growth and catching up of less developed regions and Member States with the rest of the Union.

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## 2 Sizeable Financial Flows

New opportunities for investment in growth have emerged with the recently agreed seven-year Multiannual Financial Framework (MFF) to cover the period 2014-2020. While the size of the overall budget has been reduced amid a climate of fiscal consolidation compared to the 2007-2013 MFF, it still offers important opportunities for public investment.

Apart from the instruments supporting research, education programmes, and cross-border infrastructure in transport, energy, and information and communication technologies (ICT)—which experience an increase in their budget compared to 2007-2013—the cohesion policy, which supports investments to stimulate national and regional growth, will amount to EUR 317.341 billion (at 2011 prices), and counting the funds for rural development and fisheries and the transfer to the Connecting Europe Facility from the Cohesion Fund, the budget for investment funds reaches EUR 416 billion. In several European Union (EU) Member States in Central, Eastern, and Southern Europe, cohesion policy represents an important source of investment ranging between 40% and 90% of the total public investment in the country. It provides important opportunities to foster structural transformation, incentivise structural reforms, and reduce the backlog in terms of infrastructure and research and innovation performance. Will the opportunities be seized?

Table 1: Cohesion policy financial allocation by Member State  
*million EUR, 2011 prices*

<b>Member State</b>	<b>2007-2013</b>	<b>2014-2020</b>
Austria	1,490	1,093
Belgium	2,313	1,985
Bulgaria	6,929	6,670
Czech Republic	27,385	19,487
Croatia	-	7,283
Cyprus	665	467
Denmark	625	488
Estonia	3,504	3,178
Finland	1,755	1,298
France	14,593	13,799
Germany	26,869	17,054
Greece	20,874	13,616
Hungary	25,725	20,427
Ireland	933	992
Italy	29,387	28,605
Latvia	4,687	3,969
Lithuania	6,986	6,015
Luxembourg	67	56
Malta	872	643
Netherlands	1,943	1,241
Poland	69,023	68,440
Portugal	21,939	18,906
Romania	19,842	20,250

Slovakia	11,896	12,324
Slovenia	4,284	2,719
Spain	36,135	24,517
Sweden	1,928	1,824
United Kingdom	10,848	10,311
Connecting Europe /Cohesion Fund	-	10,000
<i>Total EU</i>	353,496	317,341

Source: European Commission, Directorate-General for Regional and Urban Policy

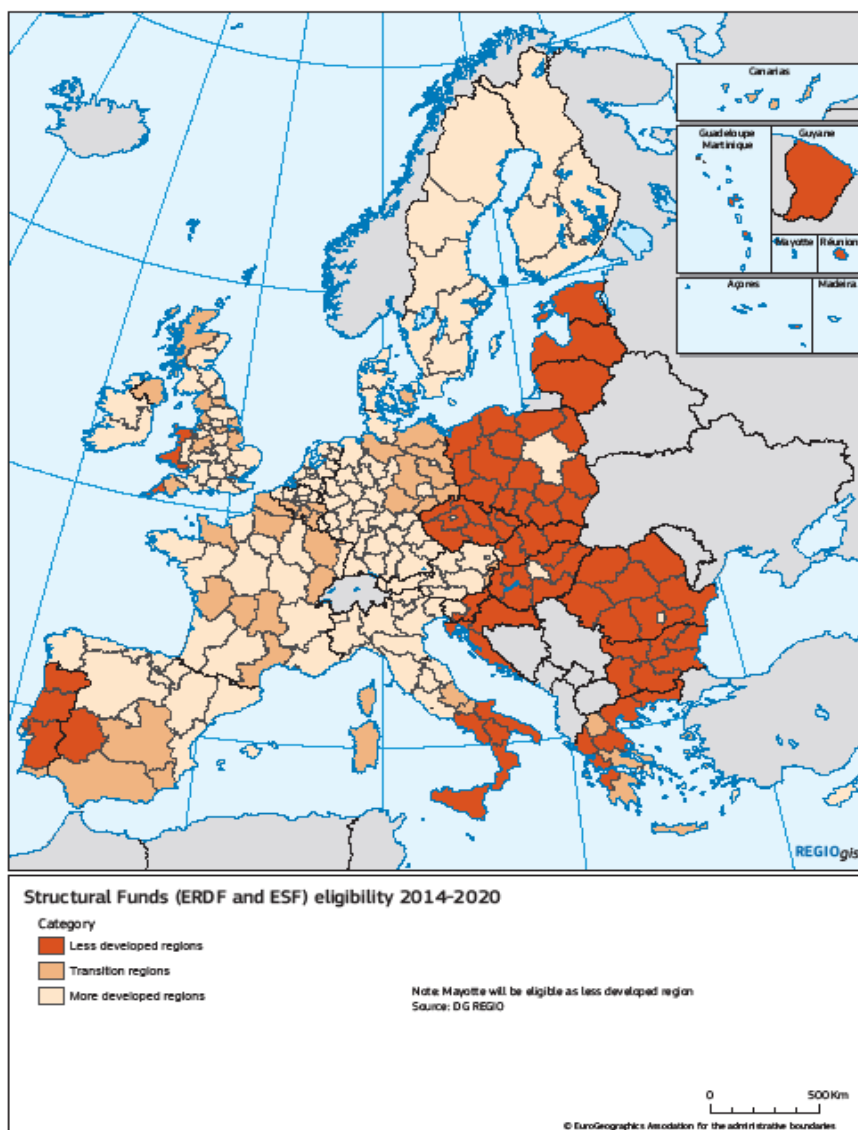


Figure 1: Eligibility of EU regions

Source: European Commission, Directorate-General for Regional and Urban Policy

### 3 Fundamental Policy Changes

The pressing need to exit the economic and social crisis, achieve sustainable growth, improve competitiveness, and enhance the quality of spending in a context of tight fiscal constraints has called for important policy changes. The policy needed to shift away from compensating for structural weaknesses to investing in competitive advantages and economic and social potential. These circumstances largely prompted the proposal presented by the European Commission in October 2011 to reform the policy. Co-legislators have reached final agreement on the reform in November 2013 [1]. A number of important changes have been agreed to i) prioritise investments in growth, competitiveness and job-creation; ii) introduce the major novelty of *ex-ante* conditionalities, iii) reinforce macroeconomic conditionality to embed the policy in the context of the growing EU economic governance and iv) better measure and monitor progress towards results.

#### *Prioritising investments in growth, competitiveness and job creation*

Investments to support competitiveness, growth, and employment in areas such as research, innovation, ICT, entrepreneurship, low carbon economy, and jobs and inclusion are being prioritised with pre-set requirements for concentration of funding. While the intensity of concentration varies between the different categories of regions (less developed, transition and more developed regions according to their level of GDP/per capita); the bulk of funding will be invested in the aforesaid areas through a place-based approach and multi-level governance [2, 3]. The post-crisis world is likely to be innovation-driven and each region needs to find its place in the innovation landscape; some regions need to tackle their chronically uncompetitive position. Access to finance is gaining a prominent role with a continued shift from grants to loans and guarantees with the aim of leveraging additional private investment. Changing the name of the funds to “European Structural and Investment Funds” shows the shift in the policy paradigm underlining the investment component.

#### *Introducing ex-ante conditionalities and reinforcing macroeconomic conditionality*

The policy has been integrated into the context of the growing economic policy coordination at the European level and linked to country-specific recommendations formulated in the context of the European semester to foster the implementation of structural reforms. There has been growing recognition that the effectiveness of the policy is determined by a range of factors [4] which go beyond the nature of the investments themselves and relate to broader framework conditions such as the macroeconomic environment, the business climate, or the quality of the administration.

In order to ensure that such framework conditions are favourable to investments, the disbursement of the funds is linked to the fulfilment of certain conditions. *Macroeconomic conditions* are set aimed at ensuring sound fiscal policies and avoiding excessive deficits and excessive macroeconomic imbalances. Non-fulfilment of these conditions can lead to suspension of commitments and payments. Macroeconomic conditionality is not new in cohesion policy; however, in the past it only concerned one of the funds, namely the Cohesion Fund, while in 2014-2020 it is extended to all European structural and investment funds.

A major novelty of the reform is the introduction of *ex ante conditionalities* linked to strategic, regulatory, and institutional frameworks. All investments are conditional upon demonstrated administrative and institutional capacity; which in many national and

sub-national contexts is a key impediment to effective use of funding [5]. Measures to support access to finance for small- to medium-sized enterprises need to be accompanied by measures to reduce the time it takes to set up a business and the time needed to obtain licences, which are critical to foster entrepreneurship. Investments in health infrastructure need to contribute to a broader structural change in the health sector and ensure the sustainability of investments. Similarly, investments in transport and waste infrastructure need to be embedded in the context of broader sectoral strategies.

#### *Better measuring and monitoring of results*

Tight fiscal constraints have brought the question of the quality of expenditure to the forefront. Past performance of the policy in terms of achieving expected economic and social outcomes, however, has been mixed with national and regional variation, and limitations of performance measurement systems [6, 7, 8). To better measure the outcomes and results of investments, programmes follow a performance measurement system based on indicators and targets with a mechanism to measure and incentivise progress. Yearly EU-level reporting by the European Commission to the Council and the EP about the efficiency of the use of the funds is expected to lead to peer pressure being exerted on Member States.

#### *Increasing efficiency and cutting red-tape*

Finally, the rules governing the different funds—namely, the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development, and the European Fisheries Fund—have been simplified and harmonised. A number of tools have been introduced to ensure a better combination of different funding sources to support, for instance, the wide-ranging development needs in socially and economically backward micro-regions help to achieve effective place-based interventions. A number of measures will cut red tape and reduce the administrative burden and reinforce sound financial management of public funds.

## **4 Will the Reform Deliver?**

The debate in the Council and with the European Parliament lasted for more than two years. It is the first time that a co-decision process in European decision making took place for cohesion policy. Although, accentuated by the context of fiscal constraints, there has been a growing focus on the quality of public spending in European debates on the EU budget, achieving concrete results remains a challenge. The political economy of the negotiations has shown that beneficiary countries pleaded for the maximum flexibility with regard to the use of the funds to ensure the support of a broad range of investments. Macroeconomic conditionality and prioritisation of investments have generated the most difficult discussions. Nevertheless, European co-legislators have agreed to introduce stringent rules on both.

There is also scope for more debate at the national and regional levels as well as about the primary goal of the funds, in particular, their effect on the economy and society. Attention rather focuses on maximising the allocations which can be obtained from the EU budget and achieving their full financial absorption.

Member States are currently preparing their overall strategy for the use of the funds for the period 2014-2020 encapsulated in the so-called Partnership Agreements, which need to be agreed upon between the Member States and the European Commission, including commitments on how the funds will contribute to support national reform programmes. It

is critical that the Partnership Agreements and programmes are based on sound analysis of the social and economic situation and the challenges ahead and provide the policy mix which provides the maximum impact on growth and employment. Broad-based partnership is necessary to ensure social support. Political consensus on the main priorities for investment—beyond cyclical political elections—is essential.

## 5 Conclusion

The 2014-2020 cycle of the EU budget represents new opportunities to support structural change, growth, and employment in Europe. These opportunities should not be missed. Setting the right framework conditions for effective support from the outset is a critical factor for success. This relates to setting the overarching strategies for the effective use of the funds as well as ensuring a favourable macroeconomic and business environment for such use. Going beyond the rhetoric of "quality of spending" is necessary to achieve measurable, tangible, and sustainable results in terms of economic and social progress.

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