LESSON 5 - EU GROWTH AND COHESION[1]

1. Introduction

The economic substrate is undoubtedly an essential factor for the growth and development of societies.

At European level, a very important part of the investments made by the Member States is supported, if not directly financed, by the different European funding mechanisms, in particular by the different Structural Funds. Despite this, it is an almost unknown issue.

In order to try to alleviate this ignorance and put these financing policies to their full value, in this lesson we will introduce the European Structural and Investment Funds (EIE), their history, relevance and the latest developments:

[1] Dr Jorge Núñez Ferrer, Senior Research Fellow, CEPS.

2. Historical development of the Structural and Cohesion Funds

The European Structural and Investment Funds (ESI Funds) is the present correct term for what are still referred to as “Structural Funds”, although these are not synonyms.

The ESI Funds are a combination of different Funds targeting regions, which have now all been put under one regulatory framework to ensure coherence and better coordination, and no overlaps.

These are divided into:

1. The Structural Funds, which were developed to support regions, and include:
   - 1.1 The European Regional Development Fund (ERDF), active since 1975 for the poorest areas in the EEC member states. There was also a need to tackle infrastructural challenges and to stop the decline of certain regions and help to the restructuring of their economies. The main initial beneficiaries were Italy followed by the UK.
   - 1.2 The European Social Fund (ESF), the oldest of all, created under the Treaty of Rome in 1957, to tackle the lingering poverty and unemployment of the post-war years. It was meant to address the social challenges in European countries, coupled with industrial decline and restructuring.
2. The Cohesion Fund, established in 1994, with the entry of Spain and Portugal, where there was a need to address infrastructural weaknesses at cross-national level, across regions. Beneficiary member states are those with a GDP per capita below 90% of the EU average. The Cohesion Fund was created to address transnational transport, energy and telecommunications infrastructures, which are crucial for a country to develop, and to allow poorer regions the access to national and EU central markets.
3. The European Maritime and Fisheries Fund (EMFF) and the European Agricultural Fund for Rural Development (EAFRD) which addresses sectoral structural and competitiveness problems and are not regionally pre-allocated. These were added to the ESI Funds overarching structure to respond to a need to coordinate better, as some areas overlapped with other funds.

Putting them all under one overarching regulatory framework aims to ensure coherent strategies. Today, however, there are still some challenges left with the coordination of the fisheries and rural development structural operations with the other funds, specially in the areas of vocational training for non-sectoral specific skills and some local infrastructures.

3. Areas financed by the EU budget

Source: European Commission (further illustrated by author)

What is the position of the ESI Funds within the EU budget? For the seven year Multiannual Financial Framework (MFF) for 2014 to 2020, the budget was about 1 trillion Euro or just over 140 billion a year on average. The EU budget in total is 1% of member states GDP or 2% of overall public expenditure.

34% of the EU budget is dedicated to economic, social and territorial cohesion which includes five funds:

1. European Regional Development Funds (ERDF)
2. European Social Funds (ESF)
3. Cohesion Funds
4. The European Agricultural Fund for Rural Development (EAFRD), and
5. The European Maritime and Fisheries Fund (EMFF)

These five funds are managed by member states under "Shared Management", which means they manage them and report to the European Commission, which is ultimately the body responsible for the overall use of the EU budget. Thus the national authorities have a shared responsibility with the European Commission, hence "Shared Management".

These Funds are, however, not the only funds intervening in the economic and social development of regions and countries. There are the funds that are not under shared management that the EU provides.

These are under the Competitiveness for growth and jobs heading, coordinated and managed by the European Commission.

This is funding projects that are run across Europe, supported directly by the European Commission.

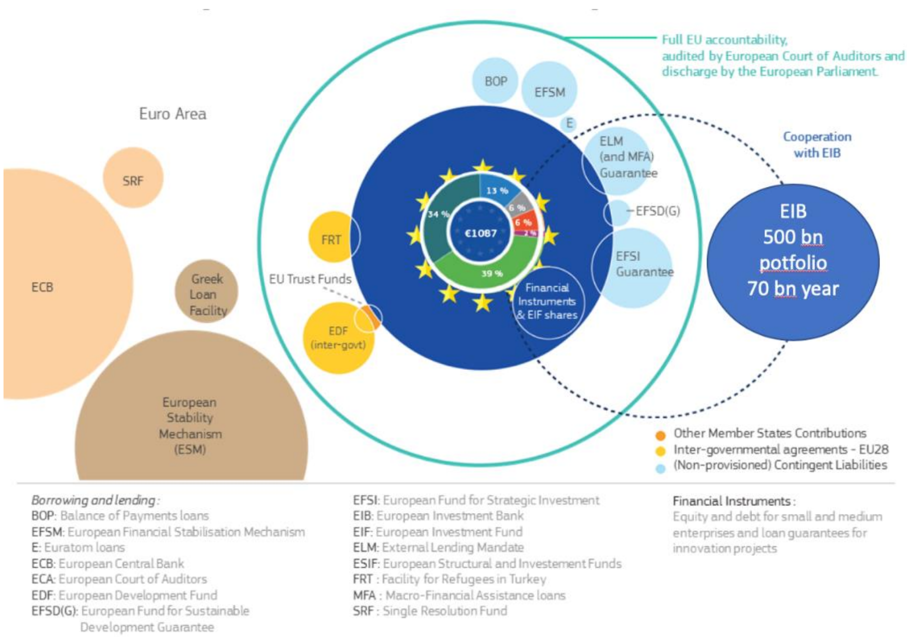
The target areas are similar, but the objectives are not the local put the pan European impacts. If you look at the Cohesion Policy, we have some Research & Innovation in the structural funds, but it is focused on capacity building. At EU level we have the Horizon 2020 project based on excellence and financing projects, not the capital costs of buildings or costs of human capital development which is part of Cohesion Policy support.

Here it is possible to see the synergies: Cohesion policy supports with the research & innovation investment the building of capacity to participate at the European level in Horizon 2020 projects.

The information/communication technology at regional level can be supported by the connections that are financed by the Cohesion Fund at national level which then in turn can be connected to the projects in the Connecting Europe Facility to the rest of Europe. There are thus links between the shared and centrally managed funds.

The Competitiveness for growth and jobs are driven by wider EU objectives, for example strengthening EU research & innovation, improving cross-border operations and strengthening the single market, or supporting lending where needed for SMEs. It is run at European level. It is therefore not part of regional policy even if regional actors can apply for those funds.

4. The EU Financial Spheres



Source: European Commission (amended by author)

This graph is meant to give a feeling on how the EU budget compares or relates to other parts of the European Union finances. There are in fact many more financial areas of the EU. The EU budget can be seen in the blue circle.

The green circle is how the EU, as institutional system, is operating (e.g. the European Parliament, the Court of Auditors, the European Commission).

There are a number of funds that are guaranteed by the EU budget, but are not covered by it. It is money that is there, but where the member states can intervene if this money has to be raised. (Light blue boxes)

These include:
- Balance of payments (BOP) which supports countries that are not in the Eurozone, when they face some crisis.
- The European Financial Stabilization Mechanism (EFSM) to support Eurozone countries

These funds exist to back up financial operations. There are more of kinds of guarantees, such as:
- The EFSI (European Fund for strategic Investments) (or Juncker plan) offering guarantees and equity to the European Investment to finance projects and attract other investors.

Inside the EU budget, there are also other Financial Instruments, which are fully covered by the ESI Funds.

In short, in the dark blue circle, you have the EU budget, then within the green circle you have what the budget guarantees.

The two yellow bubbles are national funds under the accountability of the European Parliament:
- The European Development Fund (EDF) and the Trust Funds, i.e. additional inter-governmental funding provided by Member States, which is under the control of the European institutions.
- The Facility for the Refugees in Turkey (FRT), which is also partially funded by the budget, although not totally, but is also under the control of the European insitutions.

Outside the green circle, there is the EIB Group, which of course is part of the European institutions, but is independent from the European Commission. Some of its operations are fully under EU budgetary control, because they are covered by the EU budget.

The EIB Group has its capital base covered directly by the Member States so it is not part of the EU budget, but there are operational links, and of course the EIB cannot operate against EU objectives.

The EIB is divided into parts:
- The EIB, which addresses big investments in infrastructure projects, and manages research at its own level, with its own programmes
- The European Investment Fund (EIF), which lends to businesses and is there to support banking in the areas where banking does not like to lend, because of the risks in the private sector for the SMEs.

The EIB has a 500bn Euro portfolio of projects, and lends 70 bn Euro a year.

One can say that the size of the European structural operations is overall much larger than the funds in the economic, territorial and structural cohesion heading. In addition much is co-financed by member states and economic operators, creating a lot of leverage for EU objectives.

The same for the EIB, which never finances a full project with their loans, they give up to 50% to any given operation, and therefore it means that the overall financial intervention and influence of their presence can be much higher when the other financial institutions that participate in the investments are added.

Then we have other areas of the EU finances, such as:

- The recently set up European Financial Stabilisation Mechanism (EFSM), which is backing with hundreds of billions a support mechanism to act in case of an economic crisis. It is a kind of guarantee.
- The European Central Bank (ECB), with its own operations, and
- The Greek Loan Facility

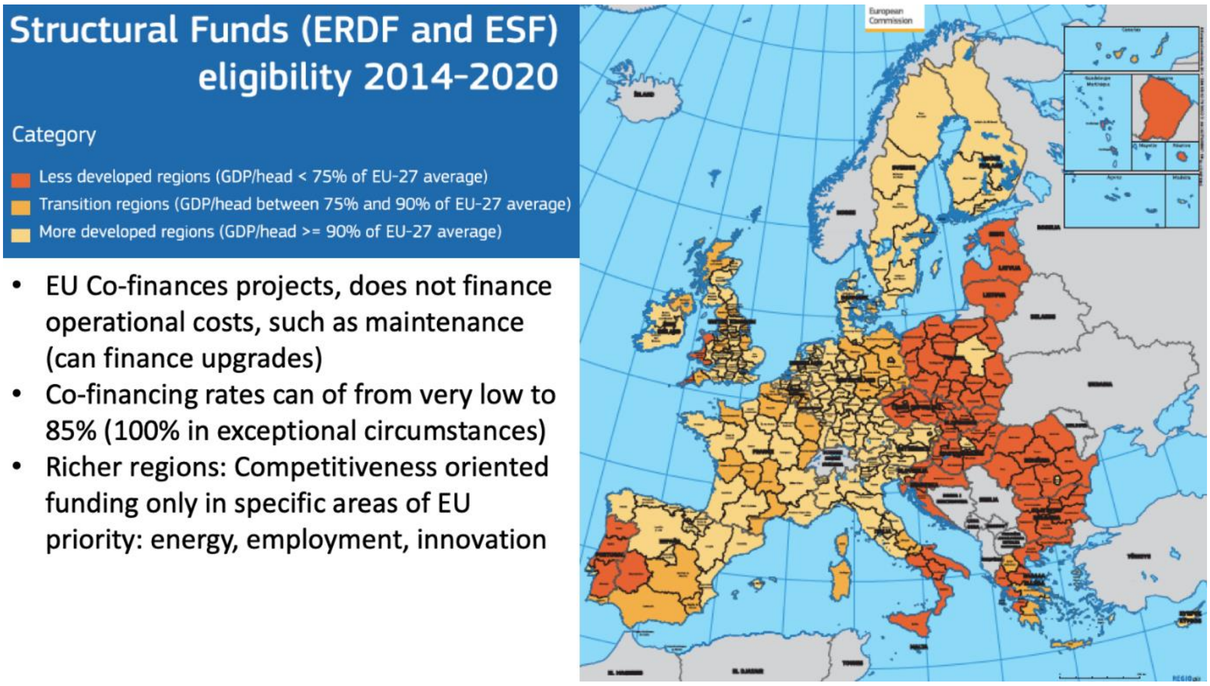
Borrowing and lending:
BOP: Balance of Payments loans
EFSM: European Financial Stabilisation Mechanism
E: Euratom loans
ECB: European Central Bank
ECA: European Court of Auditors
EDF: European Development Fund
EFSD(G): European Fund for Sustainable Development Guarantee

EFSI: European Fund for Strategic Investment
EIB: European Investment Bank
EIF: European Investment Fund
ELM: External Lending Mandate
ESIF: European Structural and Investement Funds
FRT : Facility for Refugees in Turkey
MFA : Macro-Financial Assistance loans
SRF : Single Resolution Fund

Financial Instruments:
Equity and debt for small and medium enterprises and loan guarantees for innovation projects

One can therefore see that the EU budget is just but one element of many, while very often it is presented as if it were the only EU financial tool.

5. Structural Funds (ERDF and ESF) eligibility 2014-2020



Graph 4 shows the Structural Funds (ERDF and ESF) and the eligibility of the regions, in terms of how much support they can receive, i.e. the intensity of the support.

There are three categories:

1. The less developed regions, or "convergence regions" (GDP/head < 75% of EU-27 average), with the highest intensity of support of the EU budget.
2. The Transition regions, and (GDP/head between 75% and 90% of EU-27 average). In this category, some regions may be improving, but others are declining.
3. The Most developed regions (GDP/head > 90% of EU-27 average). These regions also get support, but for very specific issues.

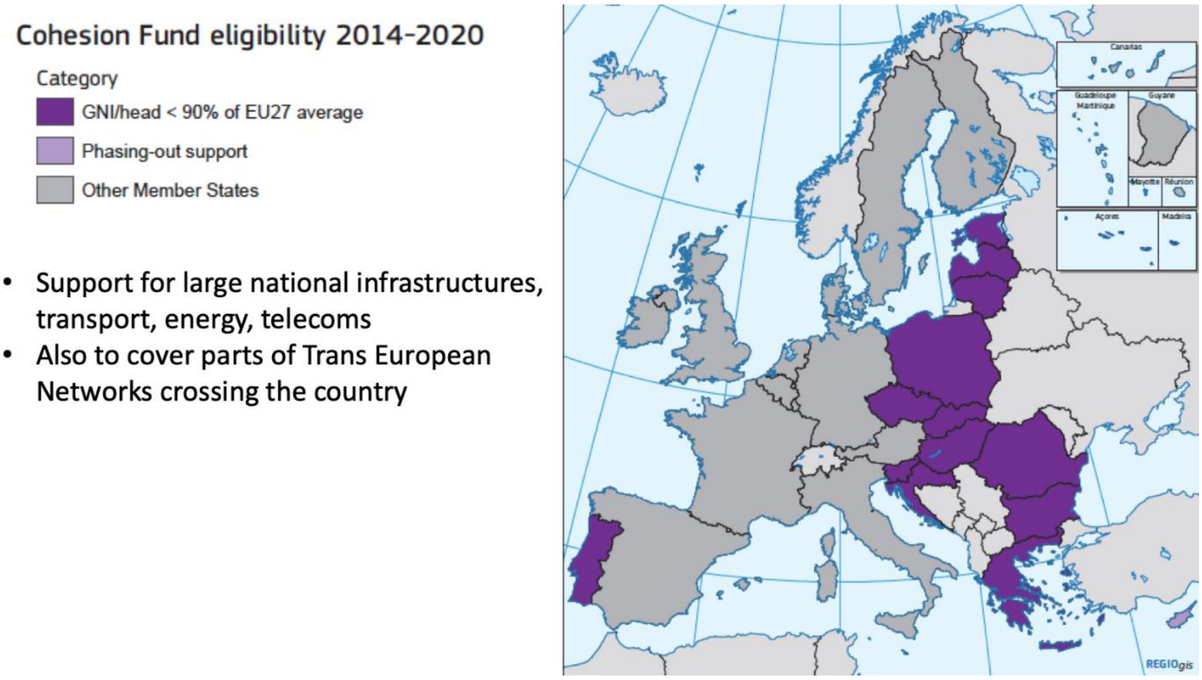
Note that this image, which comes from the European Commission, is ahead of Brexit and mentions the "EU-27", while the UK is still part of the EU at the moment of this presentation and part of the picture.

- The EU co-finances projects, but does not finance operational costs, such as maintenance. It is important to be aware of this fact, and regions should take into consideration the operational costs of what they build and avoid 'prestige projects' exceedingly large infrastructures with large operational costs which are then underutilized. The EU can finance upgrades and replacements, but not repairs, maintenance and running costs.
- Co-financing rates: How much the EU can give really varies very much between the kind of interventions. The highest limit of support of the structural funds for a grant to the private sector would never go over 50%, but for private infrastructure that is co-financed by public funds it has reached 85% in the poorest regions (exceptionally due to the crisis, some regions were granted full 100% EU finance).
- The co-financing rate (up to the limit allowed by the regulations) is decided by the regions to choose whether they want to do more projects with lower

EU co-finance from the EU budget, or less projects with higher EU co-finance. Of course, it is preferable that this decision is taken with an understanding how much the public budget and the private sector can contribute, so that there is no over-subsidisation with the EU budget when it is unnecessary, to maximise the use of the funds. In very exceptional cases, there has been a 100% funding. This was the case during the depth of the crisis in Greece, where there was absolutely no funding, and it was useless for the EU to advance payments that needed co-financing, when there was no co-financing capacity on the other side. So there are exceptions, where there is 100% coverage especially aimed at important social projects in specific areas

- In the richer regions funding is competitiveness-oriented, and only covers specific areas of EU priorities, such as energy, employment, innovation. Thus it does not have the large scope that it has in poorer regions.

6. The Cohesion Fund eligibility 2014-2020



The criteria of eligibility for the period 2014-2020 are as follows:

- Under 90% of EU average of GNI/head, you have the “transition countries” (in purple in the slide)
- In a lighter shade of purple, one sees the “phasing-out support” countries, such as Cyprus

The Cohesion Fund gives support for country-wide infrastructure, i.e. large national infrastructures, such as transport, energy, telecoms. And a percentage of it goes also to support parts of the Trans European Networks also supported by the Connecting Europe Facility for operations that improve interconnections between EU member states. It thereby reduces somewhat the pressure on the funding of the Connecting Europe Facility, which is a too small in relation to the needs.

7. Method of programming the funds

- The ESI Funds have to be in line with EU 2020 objectives
- Countries prepare a Common Strategic Framework
- The country and the Commission sign a partnership agreement
- Countries prepare operational programmes

  (thematic of regional)

This graph introduces the strategic logic behind the method:

- The ESI Funds have to be in line with the overall European strategy, namely the Europe 2020 Strategy, which is the brainchild of the Lisbon Strategy (which started in the beginning of the century, when it became clear that the member states needed to invest more to keep up with global competitiveness challenges).
- Countries have to prepare a common strategic framework, where they describe what are the targets of their strategy, and how they will achieve European goals within their national policies.
- So, with the Common Strategic Framework done, and the descriptions of how they will implement it, a Partnership Agreement with the European Commission is signed. Here the member states commit themselves to follow the strategy. Then the member states will also and align their operational programmes with to this agreement.
- The operational programmes describe the implementation, i.e. how they will achieve the goals and how much money is attributed to which actions. The operational programmes can be be either thematic or regional. They can have also national coverage, e.g. in small countries that do not have regions, they would for example have one programme per sector, i.e. a sector thematic programme. In some regions, instead, they have regional programmes that cover several sectors. This depends on the multi-level governance structure of a country. The operational programmes also have to be approved by the European Commission.

8. Thematic objectives

These are 11 objectives that regions are required to focus on, and that their policies are coherent with. Regions and countries can choose whether to focus more on one than another, the weight given to each is a matter of national decision. Some of these objectives are quite wide, and follow a strategic order.

1. *Strengthening research, technological development and innovation*. The strategic order of the objectives stresses innovation, rather than building infrastructure (which was in the past primary priority). Now there is more emphasis on development and innovation, and the rest to be built around it.
2. *Enhancing access to, and use and quality of, information and communication technologies (ICT)*.
3. *Enhancing the competitiveness of SMEs, of the agricultural sector (for the EAFRD) and of the fishery and aquaculture sector (for the EMFF)*.

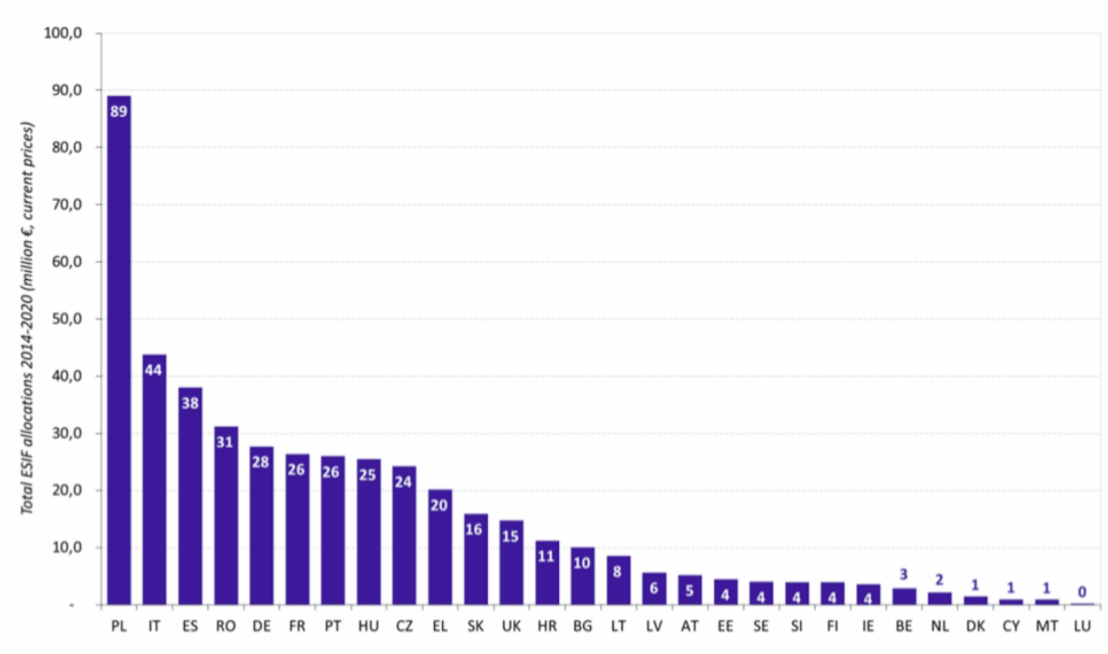
   (Competitiveness is not only important in businesses and SMEs, it goes beyond subsidies and seeks to promote structural reforms.)
4. *Supporting the shift towards a low-carbon economy in all sectors*.

   (This also includes energy efficiency in buildings for example.)
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 infrastructure*.
8. *Promoting sustainable and quality employment and supporting labour mobility*.
9. *Promoting social inclusion, and combating poverty and all forms of discrimination*.
10. *Investing in education, training and vocational training for skills and lifelong learning*.
11. *Enhancing the institutional capacity of public authorities and stakeholders and efficient public administration*

    (This includes dealing more efficiently with the Funds as well.)

These objectives are very important, because they are the backbone of the operational programmes. The member states have to prepare their strategies based on these.

9. ESI Funds allocation by member state



Source: European Commission.

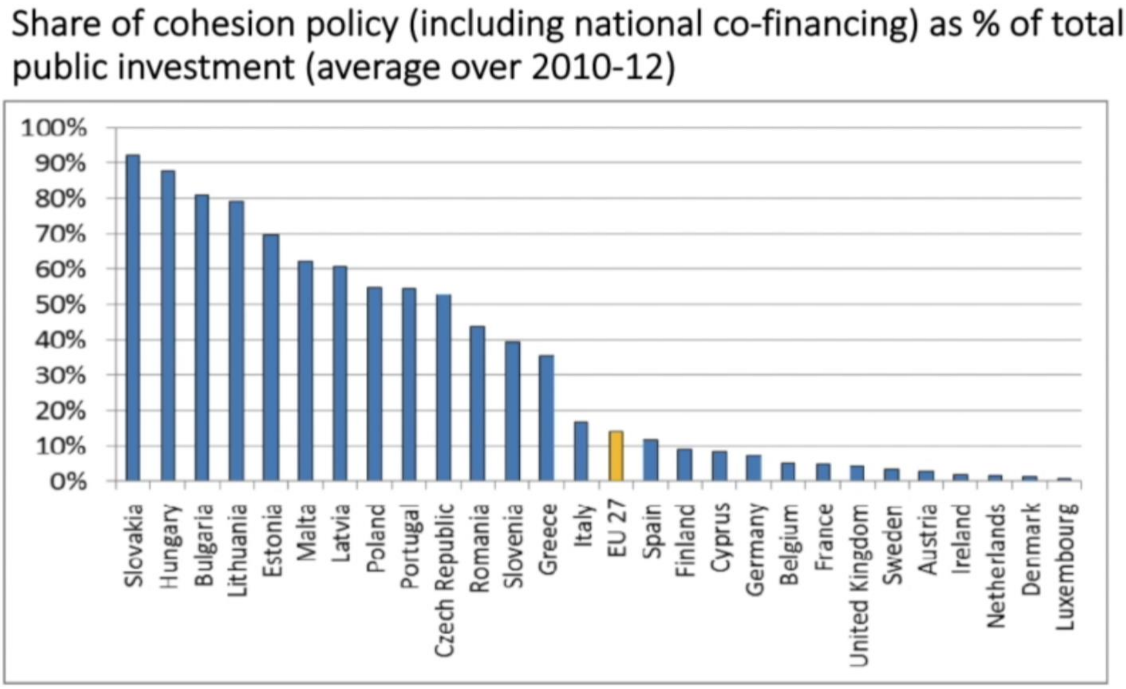
This graph shows the ESI Funds allocation by member state.

Poland is the main beneficiary, followed by Italy and Spain, then Romania, Germany, France, Portugal, etc.

The allocation is related to the level of development and the size of the country.

One can then see why Poland is making many efforts to effectively use the funds and distributing the evaluation results. It is very important to prove that the funding has been used, in order to show that the EU budget expenditure on cohesion is effective.

10. Share of cohesion policy –including national co-financing– as % of total public investment (average over 2010-12)



Source: European Commission (2013) "EU Cohesion Policy contributing to employment and growth in Europe"

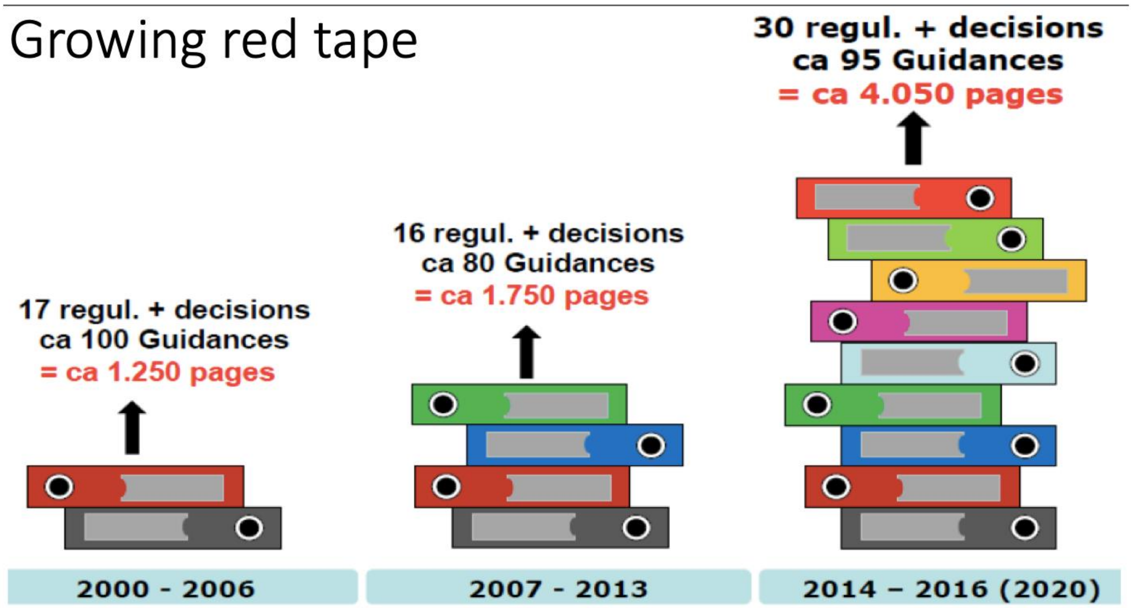
The graph shows the share of cohesion policy (which includes the national co-financing – meaning that it is not the EU funding alone). It shows how much funding overall public *investment* (does not include current expenditures) is directly linked to the EU budget funding.

One can see that from the total investment in the countries, the EU budget and the power of it to direct investment is enormous: E.g. in Slovakia the estimation was that over 90% of investment in the country has something to do with the Cohesion Funding they have received. This is similar in Hungary, and many other countries depend a lot on this funding. When looking at local authorities and local funding, the EU budget is in fact one of the few sources of funding they have lately, because with the financial crisis, the local funding got in such big trouble that as a result the EU funding has become absolutely crucial for investment.

This graph is very revealing on how powerful and influential the EU budget is, and how dependent a number of countries in the poorest EU regions are on it.

Also important not to underestimate is the influence on governance. The EU budget operates under strict rules. Thus every country using the funds needs to fulfill the management and recording methods of the EU. The EU budget influences as a result all of the national management for public expenditure.

11. Challenge



Source:Rossbacher J. (2016), "Panel 3: 'Further simplification of Cohesion Policy & the future perspectives', presentation.

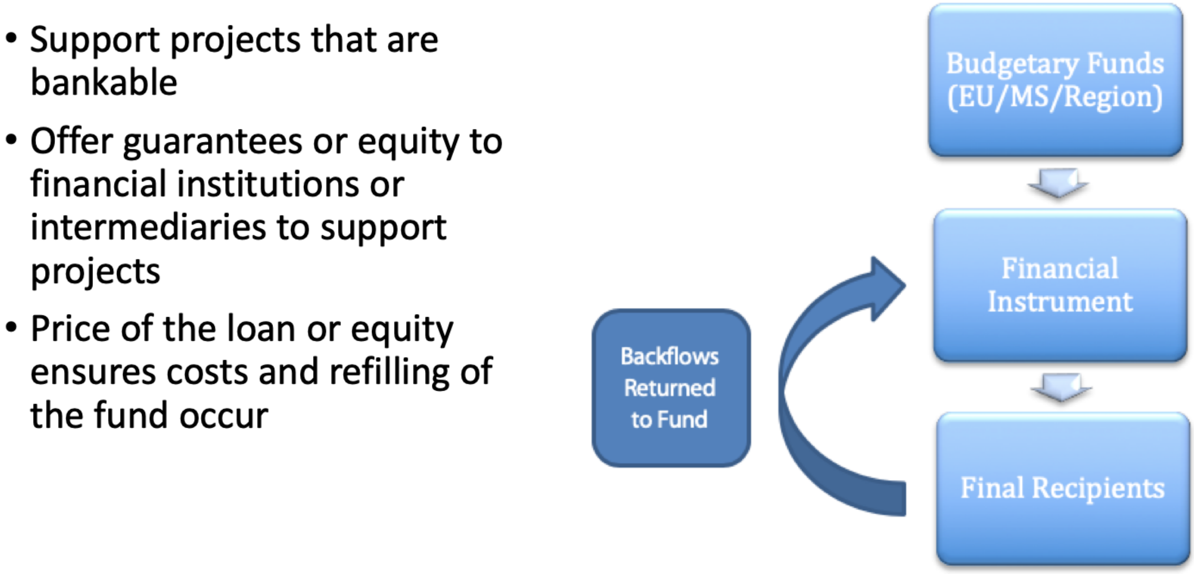
One of the challenges faced as a result of enlargement and ensuing complexity due to breadth of operations, number of areas, the need to be efficient and effective, is that the regulatory weight on this funding has very much increased. Since 2000, we witness a multiplication by 4 in number of pages of guidelines and regulations produced by the European Commission. This has reached such as level that even advanced regions have problems to follow the procedures and avoiding mistakes, given the level of complexity of these procedures.

The challenge is therefore to reduce these procedures to something that is effective, efficient, and less cumbersome.

12. Financial instruments in the ESI and EFSI Funds

Financial instruments are becoming increasingly important and are expanding. Financial instrument are guarantees, loans and equity which benefit from EU budget support.

12.1. Logic of financial instruments

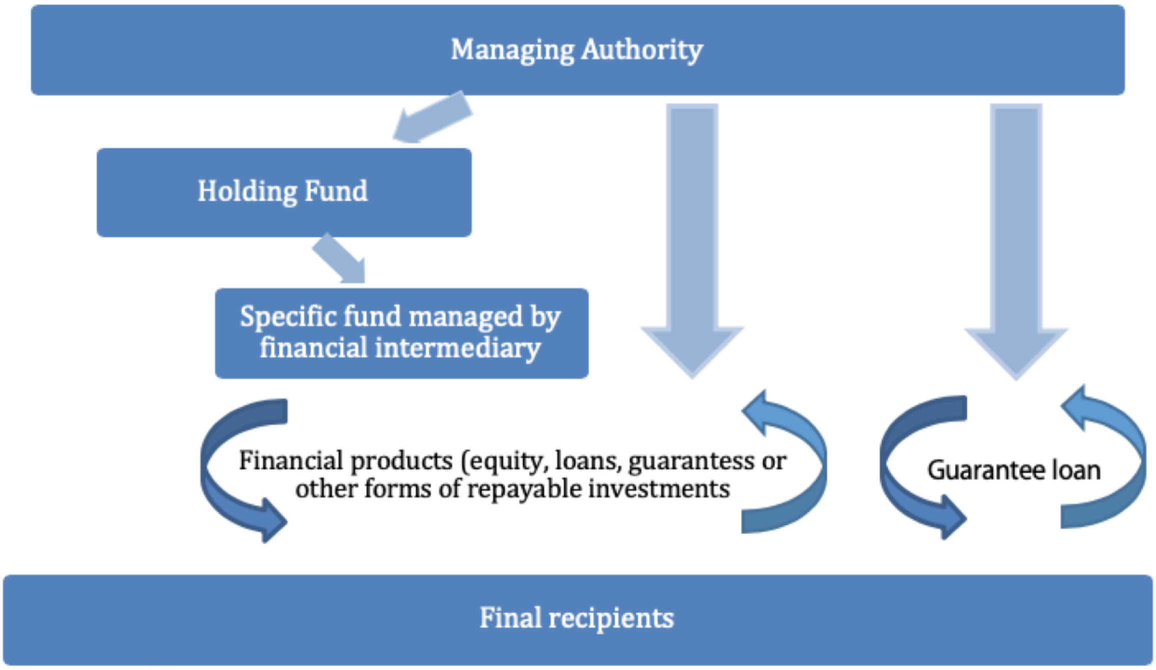


Source: INTERACT

Although there are many different financial instruments, the underlying logic is as follows:

- The EU supports projects that are bankable by offering guarantees or equity to financial institutions or other intermediaries to support e.g. innovative projects, the setting up of businesses, public infrastructures or loans to SMEs.
- The money is provided by the Structural Funds, to be introduced into the financial system to create leverage, i.e. to attract private banking as well to finance with lending (not with grants) businesses and bankable operations.
- Some of these loans will collapse, as these operations represent a risk. However, as the loans are priced (i.e. linked to the payment of interests - it is still possible to cover the operations and refinance the fund. As shown in the image, there are thus backflows returning to the fund through repayment and interests

12.2. Financial instruments in the 2014-2020 period

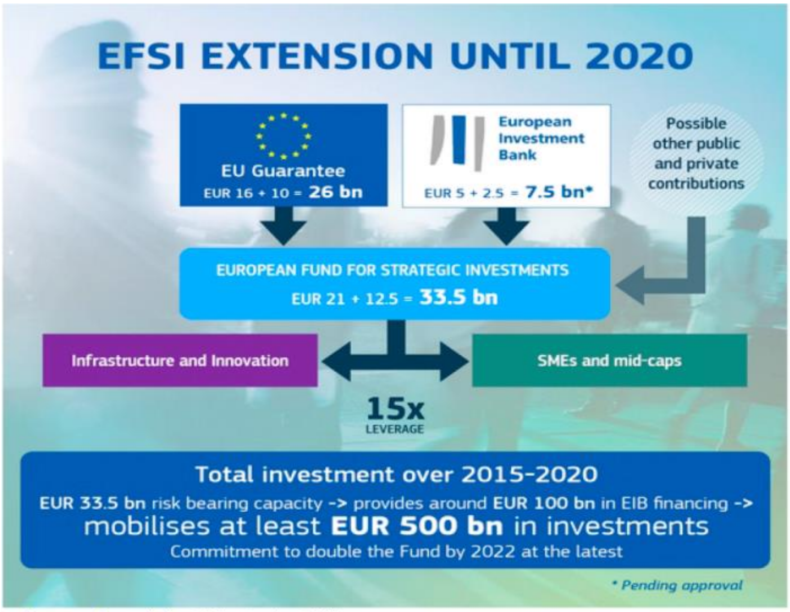


Source: EC (2016d).

The financial instruments have been evolving over the years. They started only for SMEs in the 1990s, then considerably increased into other areas such as infrastructure and innovation.

Financial funds from the Structural Funds go to the Managing Authorities in the member states, who put them for example into a Holding Fund, and then are redistributed into specific funds managed by financial intermediaries. The funds finally go to the final recipient in the form financial products such as equity, loans, guarantees or other forms of repayable investments.

12.3. Junker Plan – EFSI extension until 2020



:e: European Commission, 22 September 2016.

The Junker Plan is in its second phase and was extended until 2020. These funds are not pre-allocated funds coming from the Structural Funds, but funds from the EU budget which support the European Fund for Strategic Investments.

The European Investment Bank (EIB) also provides some funding out of its own capital to back up operations. The Junker Plan funds infrastructure and innovation, as well as SMEs and larger companies (called mid-caps companies). The leverage expected is that the funding will attract the private sector for 15 times the original investment of 33.5 bn. This is expected to mobilise at least 500 bn in investments by 2020 [30:26], and therefore represents a very important leveraging mechanism to raise funding and increase total investment. The EIB participation offers a certain guarantee to the private sector.

This is also important for the poorer regions, who can ask for finance. It is in this case a different system of financial support, but is open to requests by any private or public entity. It is being streamlined and adapted to more risky areas of intervention and EU regions lagging behind.

13. Next Financial Framework

13.1. 2000-2021: a period of deep reflection and change

The 2000-2021 period has been a time of deep reflection and change, including a number of challenges such as:

- The financial crisis, followed by
- The migration crisis, followed by

- Brexit
- Climate change and ensuing energy objectives are also part of this background.

These challenges, and in particular Brexit, have created considerable disruption and have important impacts on the EU budget.

The EU budget has had to become more flexible and more efficient to be able to adapt to new challenges in the middle of the programming period. The new MFF proposals have had to take these challenges into account, and therefore the future structural funds are being affected. It adds new instruments and changes the cohesion policy further.

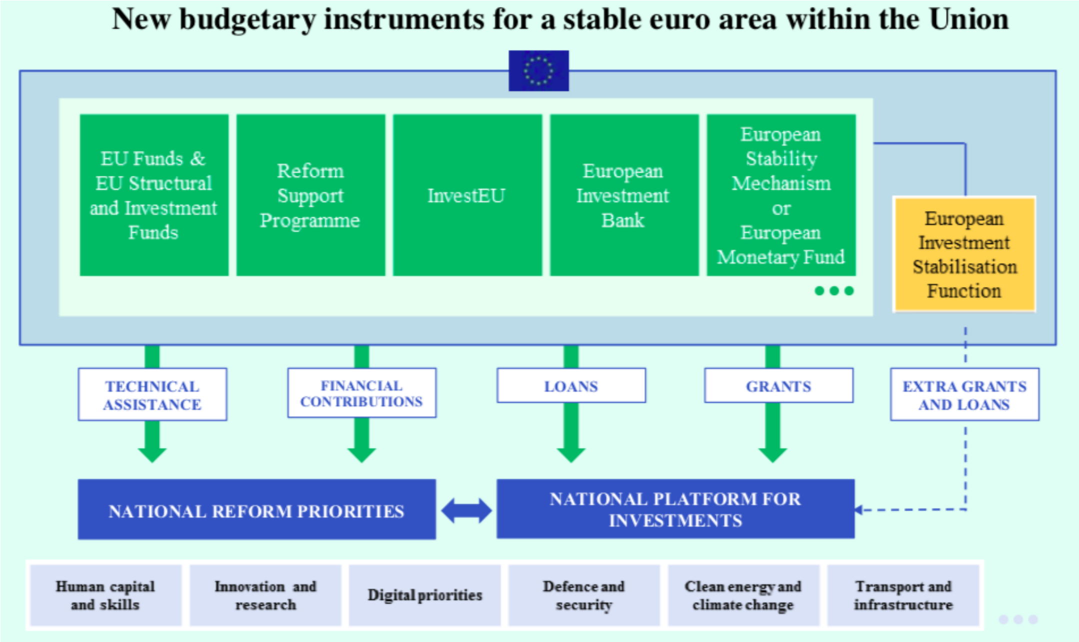
13.2. Commitment appropriations

All years (EUR million - current prices)

COMMITMENT APPROPRIATIONS	2017	Total 2014-20	
1. Smart and Inclusive Growth	**73 512**	**513 563**	
1a: Competitiveness for growth and jobs	19 925	142 130	166 303
1b: Economic, social and territorial cohesion	53 587	371 433	330 642
2. Sustainable Growth: Natural Resources	**60 191**	**420 034**	
of which: Market related expenditure and direct payments	44 146	308 734	254 247
3. Security and citizenship	**2 578**	**17 725**	55 157
4. Global Europe	**9 432**	**66 262**	108 929
5. Administration	**9 918**	**69 584**	
of which: Administrative expenditure of the institutions	8 007	56 224	
6. Compensations	**0**	**29**	
TOTAL COMMITMENT APPROPRIATIONS	**155 631**	**1 087 197**	1 134 583
as a percentage of GNI	1.04%	1.03%	1,11%
TOTAL PAYMENT APPROPRIATIONS	**142 906**	**1 026 287**	1 104 805
as a percentage of GNI	0.95%	0.98%	1,08%
Margin available	0.28%	0.24%	
Own Resources Ceiling as a percentage of GNI	1.23%	1.22%	

This table shows the next financial framework, with an overall increase in funding, but a decrease in "economic, social and territorial cohesion", which means that the cohesion policy has been weakened. We thus see a shift from cohesion to competitiveness, which has been resented by some. There is also a decrease on the direct payments of "market related expenditure" and agricultural policy. These decreases have happened in order to beef up "security" and external action, and also to protect the final value of the budget, which is still keeping in line to a certain extent with the previous budget.

13.3. Next Financial Framework



The next financial framework goes further into policy integration. The proposal entails a much wider and solid structure, with enhanced coherence.

The new budgetary instruments for a stable euro area within the Union include:

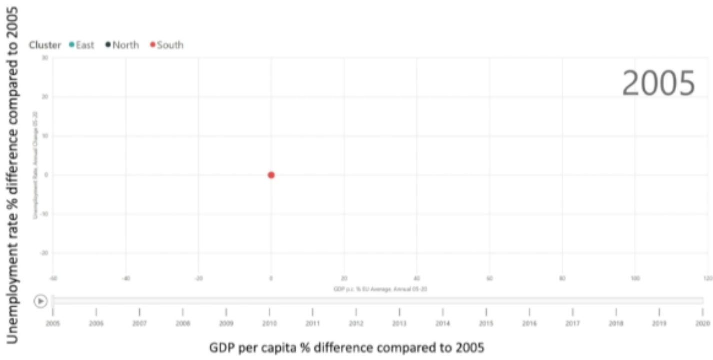
- The "EU Funds & EU Structural and Investments Funds", which are just one out of several pillars of support.
- A new "Reform Support Programme", which will hold 20bn Euros dedicated to intervene when countries need to carry out structural economic reforms. This is thus funding to support the government budgets, instead of projects was traditionally the case.
- The InvestEU is the combination of EFSI and centrally planned funding for equity and debt. It is therefore a very important large lending facility, covering numerous areas at the EU level of investment.
- The European Investment Bank own lending system, also becomes part of the support to overall operations
- The European Stability Mechanism (ESM) or European Monetary Fund

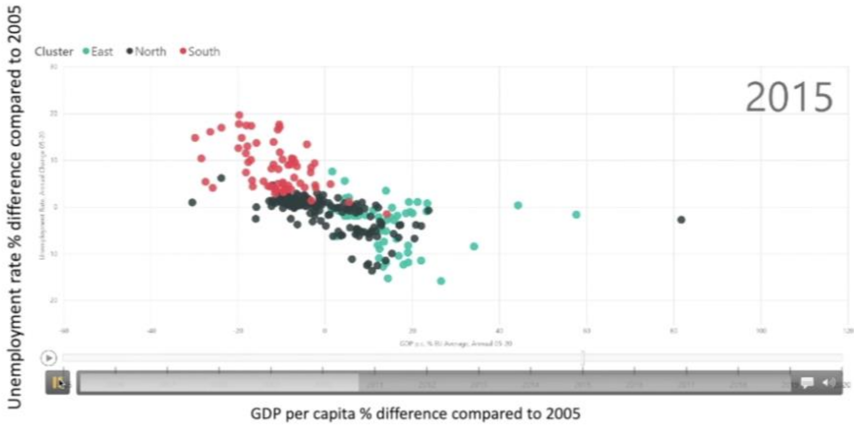
Much more so than in the past, they are now trying to link all these instruments, in order to make them increasingly coherent and give them a strategic direction.

An external fund is now being created, namely the European Investment Stabilisation Function (EISF), which foresees to stabilise the economy of a country that experiences a large asymmetric choc by using dedicated financial means from the EU budget.

All of these together should be able to [35:15] to support the investments, national reform priorities and regional programmes.

14. Evolution of unemployment and GDP per capita in the EU since 2005





The graphs show the changes in unemployment rate and GDP in the different regions of the European Union from 2005 and 2015. The Southern/Mediterranean part of Europe saw a sharp rise in unemployment rate, while GDP per capita has been decreasing. There is thus a quite obvious deterioration of the situation in that region.

During the same period, there has also been a deterioration and negative economic impacts in the European Central Northern countries, with a decrease in income per capita. However, the unemployment rate has remained much lower than in the Southern countries [37:34].

On the other hand, some regions from the center-periphery have very much improved, with a dichotomy increasing within the economies. The periphery has been improving, while the centre has been stagnant and losing GDP per capita.

When looking at the green dots, that represent Eastern European countries in the graph, one can see how all improved at various degrees, some of them significantly. From the point of view of employment, in most cases unemployment has been decreasing.

The graph shows how the crisis stating in 2006 affected the different regions, with a strong acceleration in the Southern European countries. These trends affect the thinking behind the new cohesion policy, and the proposals shift the weight because while growth is expected to continue in the new member states, the unemployment in the Southern European countries show a serious structural deficiency in the economy, which is not going to be easily reversed without intervention and setting targets.

ADDITIONAL CONTENTS

Documents of the European institutions:

- European Commission (2018), 'A Modern Budget for a Union that Protects, Empowers and Defends. The Multiannual Financial Framework 2021-2027 – Communication and Annex
- Comission staff Working document about a Modern Budget for a Union that Protects, Empowers and Defends The Multiannual Financial Framework for 2021-2027
- European Commission (2017), 'My Region, My Europe, Our Future, Seventh Report on Economic, Social and Territorial Cohesion'
- Committee of the Regions: Key challenges and opportunities for Cities and Regions and MFF post 2020
- European Parliament: The Instruments Providing Financial Support to EU Member States

CEPS reports:

- Alcidi, C., J. Núñez Ferrer, R. Musmeci, M. Di Salvo, M. Pilati (2018): 'Income Convergence in the EU: Within-country regional patterns', CEPS Commentary, 05 February 2018.
- Alcidi, C., J. Núñez Ferrer, R. Musmeci, M. Di Salvo, M. Pilati (2018): 'Income Convergence in the EU: A tale of two speeds', CEPS Commentary, 9 January 2018.
- Núñez Ferrer J., D. Rinaldi, M. Nesbit, A. Illes, Paquel K., A. Hassel (2017): 'MFF post-2020: Key challenges and opportunities for cities and regions',
- Rinaldi, D. and J. Núñez Ferrer (2017), "The European Fund for Strategic Investments as a new type of budgetary instrument", In-depth analysis, study for the Policy Department on Budgetary Affairs, European Parliament, reprinted as CEPS research report No 2017/07, April 2017.
- Gros D., Alcidi C. Núñez Ferrer, J., Rinaldi D. (2017). 'The Instruments Providing Financial Support to Member States', In-depth analysis, study for the Policy Department on Budgetary Affairs, European Parliament, reprinted as CEPS research report No 2017/06, March 2017.