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Sixth report on economic, social and territorial cohesion: Investing in Europe's Future

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Chapter 8: Cohesion Policy in 2014-2020

1. KEY ELEMENTS OF THE REFORM

A two-year negotiation on the reform of Cohesion Policy was concluded in December 2013. As a result, the Policy will invest around a third of the EU budget in key areas in line with the Europe 2020 strategy of smart, sustainable and inclusive growth. To this end, 11 thematic objectives corresponding to the Europe 2020 priorities have been defined in the new legal framework. To maximise the impact of investment, Member States and regions need to concentrate EU funding on a limited number of these objectives in the light of the specific territorial challenges they face and their development needs.

Ensuring a greater focus on the results of EU-supported investment by better indicators, reporting and evaluation is at the core of the reform. To improve performance, new conditionality provisions have been introduced to ensure that the necessary framework conditions for effective investment are in place and that the impact of cohesion funding is not undermined by an unsound macroeconomic framework.

Common provisions have been established for all EU funds supporting economic and social development (i.e. the ERDF, ESF, Cohesion Fund, EAFRD and EMFF) to improve coordination and harmonise the implementation of what are now termed the European Structural and Investment (ESI) Funds. This should also simplify their use by recipients and reduce the potential risk of irregularities.

More effective coordination between the ESI funds and other EU policies and instruments (such as the relevant country-specific recommendations under the European Semester, Horizon 2020, the Connecting Europe Facility and the Competitiveness of Enterprises and SMEs programme) is another important element of the reform and the Common Strategic Framework (CSF) is intended to provide guidance on how to achieve this.

To draw on EU funding, each Member State has to prepare a Partnership Agreement setting out its investment priorities and how they contribute to responding to the relevant country-specific recommendations under the European Semester and to reaching the Europe 2020 objectives, as well as the arrangements for managing the funds effectively. The procedures for programming, management, monitoring and control then need to be described in more detail in national or regional programmes.

To strengthen 'ownership' of the programmes on the ground, a new European code of conduct lays down the main principles of how Member States and regions should organise partnerships and gives guidance on how best to do this.

The new legislative and policy framework encourages further expansion and strengthening of the use of financial instruments as a more efficient and sustainable alternative to traditional grant-based financing in a number of areas. In addition, a number of new ways of implementing policy have been developed to tackle particular territorial development challenges, such as Integrated Territorial Investments (ITI), community-led local development (CLLD) and multi-fund programmes combining finance from the ESF, ERDF and the Cohesion Fund.

1.1. New geography and funding

Cohesion Policy provides financial support to help regions to overcome the obstacles to their development, whether these take the form of inadequate infrastructure or lack of capacity to innovate or to adapt to a changing global economic environment. These obstacles are present in all regions to varying degrees, though the level of financial support provided reflects their level of development and their need for financial assistance to tackle them effectively.

In the 2014-20 period, Cohesion policy funding will be directed towards two main goals: Investment for growth and jobs and European territorial cooperation. For the Investment for growth and jobs goal, EU funding will be concentrated (EUR 182.2 billion out of a total of EUR 351.8 billion at current prices) on the less developed regions with a GDP per head of less than 75% of the EU average, on 71 NUTS 2 regions with a population of some 128 million (i.e. 25% of the EU total), mainly located in the eastern and southern Member States (see Map 1).

In order to support regions no longer qualifying for support under the Convergence Objective, which could be adversely affected by the sudden reduction in EU funding, and all other regions with GDP per head above 75% of the EU average but below 90% of the average, a new category of Transition regions has been established. This covers 51 NUTS 2 regions mainly located in central Europe with 68 million inhabitants representing 14% of the EU population which together receive some EUR 35.4 billion of funding.

All other regions with a GDP per head of more than 90% of the EU average (151 regions with 307 million people or 61% of the total in the EU) will be part of a category of 'more developed' regions. These are mainly located in the central and northern EU Member States and receive EUR 54.4 billion.

The Cohesion Fund will continue to provide support to Member States with GNI per head of less than 90% of the EU average and to co-finance investment in environmental infrastructure and the trans-European transport networks. 14 Member States located in eastern and southern Europe, as well as Cyprus on a transitional basis, are eligible for support (Map 84) amounting to EUR 74.7 billion, of which EUR 11.3 billion is to be transferred to the Connecting Europe Facility[1].

[1] In addition, a specific allocation of EUR 1.6 billion is foreseen for the Outermost and northern sparsely populated regions. The financial allocation for the European Territorial Cooperation goal amounts to EUR 9.6 billion.

Box 1: The Connecting Europe Facility (CEF)

The Connecting Europe Facility is a new funding instrument for transport, energy and telecommunication trans-European networks (TENs) with a budget of EUR 33 billion. The largest share – EUR 26 billion – will go to transport, while energy and telecommunications will receive EUR 5 billion and EUR 1 billion, respectively. Additional investment from private and public sources will be leveraged through the use of innovative financial instruments, such as project bonds, and these could be extended after 2016 if the evaluation of the initial phase is positive.

Investment in transport is focused on the European core network which is to be completed by 2030 as a priority, while a comprehensive network is to be completed by 2050. Projects of common interest will be carried out in cross-border areas where transport links are missing, in areas where infrastructure is lacking, and where connections between different modes of transport are inadequate and to establish interoperability. Projects are also intended to reduce greenhouse gas emissions from transport. Priority will be given to multi-modal transport corridors and 'motorways of the sea'.

In the case of energy, the CEF will co-finance key infrastructure projects and those of common interest in order to create a power grid which can absorb the increasing amount of renewable energy required to reduce greenhouse gas emissions. A project can be of common interest if it involves at least two Member States, increases market integration and competition in the energy sector as well as security of supply, and contributes to meeting EU environmental and energy objectives.

In the case of telecommunications, the CEF will provide seed capital and technical assistance for projects to provide broadband networks and services. Most of the funding will support the provision of seamless cross-border public services such as e-Procurement, e-Health and Open Data. A minor part will be used for broadband projects in collaboration with the European Investment Bank (EIB). To be eligible, projects will need to incorporate state-of-the-art technology combined with either innovative business models or those which can be easily replicated.

In order to take account of the differential effect of the crisis on Member States and regions, a mid-term review of the allocation of funding between them is planned in 2016 on the basis of the then available statistics. Any modifications in the allocation will then be spread over the years 2017-20.

To ensure that the principle of co-financing is respected but that national contributions are set at an appropriate level, maximum rates of EU co-financing have been fixed according to the level of economic development of the regions or Member States concerned. As regards the Structural Funds, these rates vary from 50% in the more developed regions to 85% in the less developed ones (Map 86).

Box : The European Union Solidarity Fund (EUSF)

The European Union Solidarity Fund (EUSF) was set up in the wake of the severe floods in Central Europe in the summer of 2002 to assist regions in both EU Member States and accession countries hit by major natural disasters which have serious effects on living conditions, the natural environment or the economy.

A natural disaster is regarded as 'major' if it causes damage in excess of a particular level of costs, which is specified for each country, or if it affects the majority of the population in a region and is considered to have serious and lasting consequences for economic stability and living conditions there.

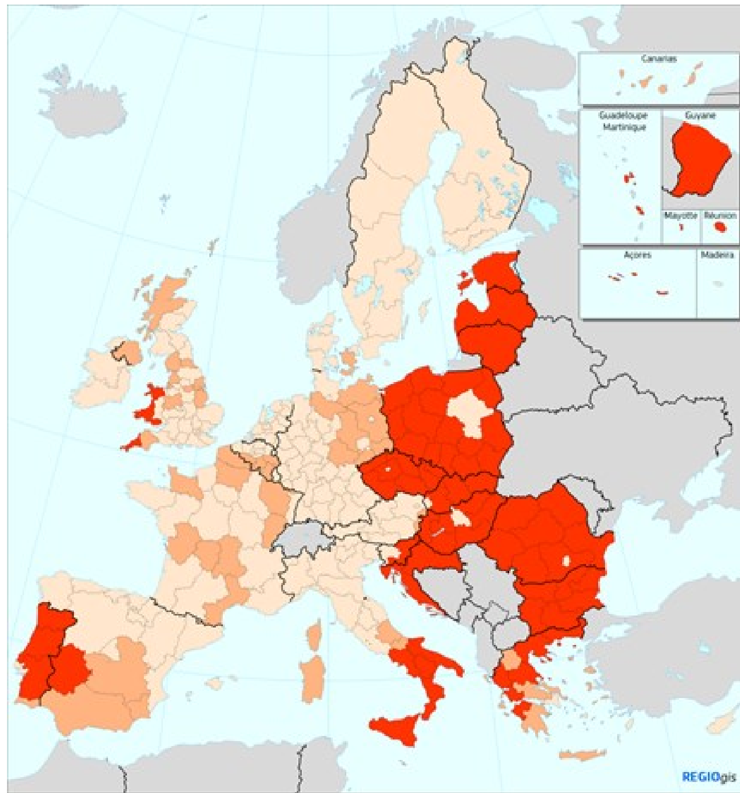
The EUSF helps to finance emergency operations, such as the restoration of essential infrastructure; the provision of temporary accommodation and the cost of emergency services to meet the immediate needs of the population as well as of preventative measures, such as the construction of dams or dykes, to stop the situation from becoming worse.

Since 2002, the Fund has provided support totalling EUR 3.6 billion to help those affected by 56 disasters, including floods, forest fires, earthquakes, storms and droughts, in 23 Member States. For the 2014-2020 period, Solidarity Fund aid can be mobilised up to a maximum annual total of € 500 million. New rules have been introduced to facilitate faster and simpler access, such as the provision of advance payments on request, to allow for quicker reaction and presence in the areas struck by disasters and to encourage Member States to implement more effective risk prevention measures. Eligibility for support has also been clarified, particularly in the case of regional disasters.

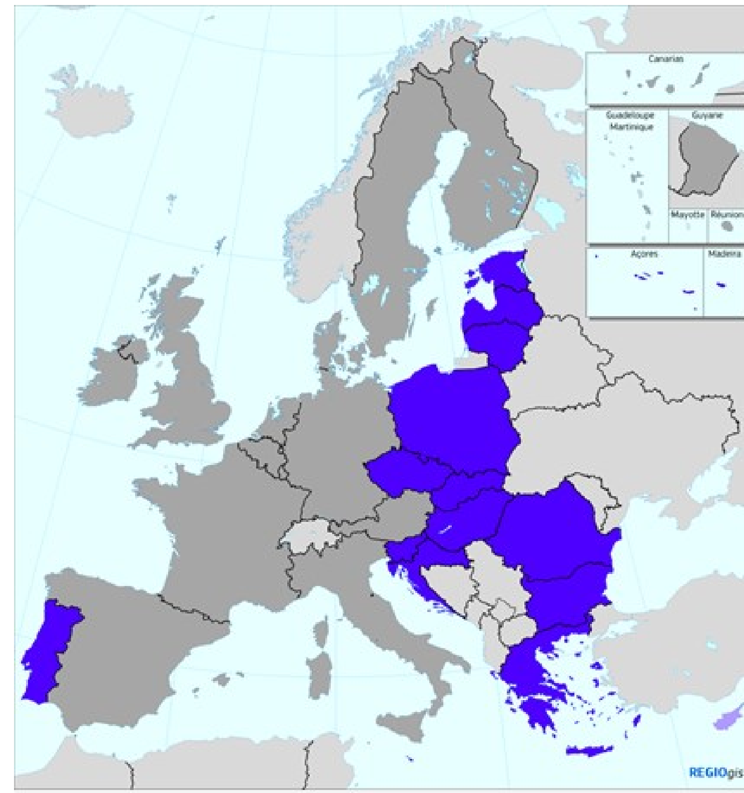
A particular focus is put on minimising the risks of disaster and investing in prevention. The benefits of this approach have been demonstrated frequently – most recently, by the floods in central Europe in 2013 which were larger in extent than those 12 years ago, but caused far less loss of life and damage thanks to the preventive measures taken. According to the World Bank, one Euro invested in prevention on average saves between 4 and 7 Euros in damage.

In the 2007-2013 period, more than EUR 5 billion was invested under the Cohesion Policy in risk prevention and for 2014-2020, it is among the thematic objectives of Cohesion Policy. In addition, a 'floods' Directive is to be implemented and disaster management legislation is to be revised, including better risk monitoring and closer cooperation on both prevention and response.

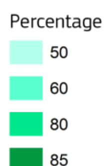
Map 1 Structural Funds (ERDS and ESF) eligibility 2014-2020



Map 2 Cohesion Fund eligibility 2014-2020



Map 3 Investment for growth and jobs goal: maximum co-financing rate for Structural Funds support, 2014-2020



1.2. Thematic concentration in support of Europe 2020

In the 2014-20 period, Member States and regions need to concentrate financial resources on a limited number of policy areas which contribute to the pursuit of Europe 2020 strategy in order to maximise the impact of EU investment. This is a

response to the experience of earlier periods, which showed that the impact of EU funding was more limited than expected due to resources being too widely spread.

This was due in large part to the broad scope of priorities from which Member States could select, but also to their reluctance to concentrate resources on a small number of priorities where they could have a significant impact. While the introduction of 'earmarking', requiring that a certain proportion of funding was allocated to the Lisbon priorities to ensure greater focus on common EU policy objectives was a step forward in 2007-13, the results have been mixed.

Two requirements for 'thematic' concentration have been introduced for 2014-20. First, EU funds have to be focused on key areas which are line with the Europe 2020 strategy for smart, sustainable and inclusive growth and, more particularly, with the country specific recommendations issued by Council in the context of the European Semester. Secondly, fund-specific regulations stipulate how much funding should be allocated to certain objectives.

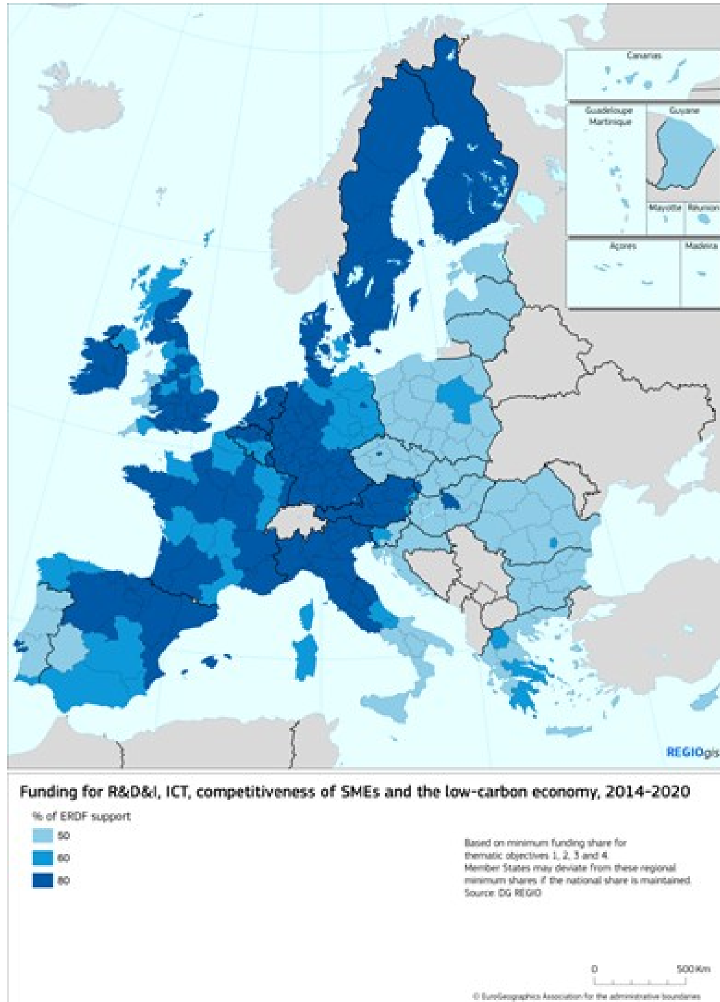
1.2.1. Targeting resources at key areas of growth

Investment financed by the ERDF has to be concentrated on four key priorities: R&D and innovation, the digital agenda, support for SMEs and the low-carbon economy. The minimum level of funding to be allocated to these is differentiated according to the level of development of the region concerned. In more developed regions, it is at least 80%, in transition regions, 60% and in less developed regions, 50%. In addition, within these amounts, at least 20% has to be allocated to a low carbon economy in more developed regions, 15% in transition regions and 12% in less developed regions (Maps 87 and 88).

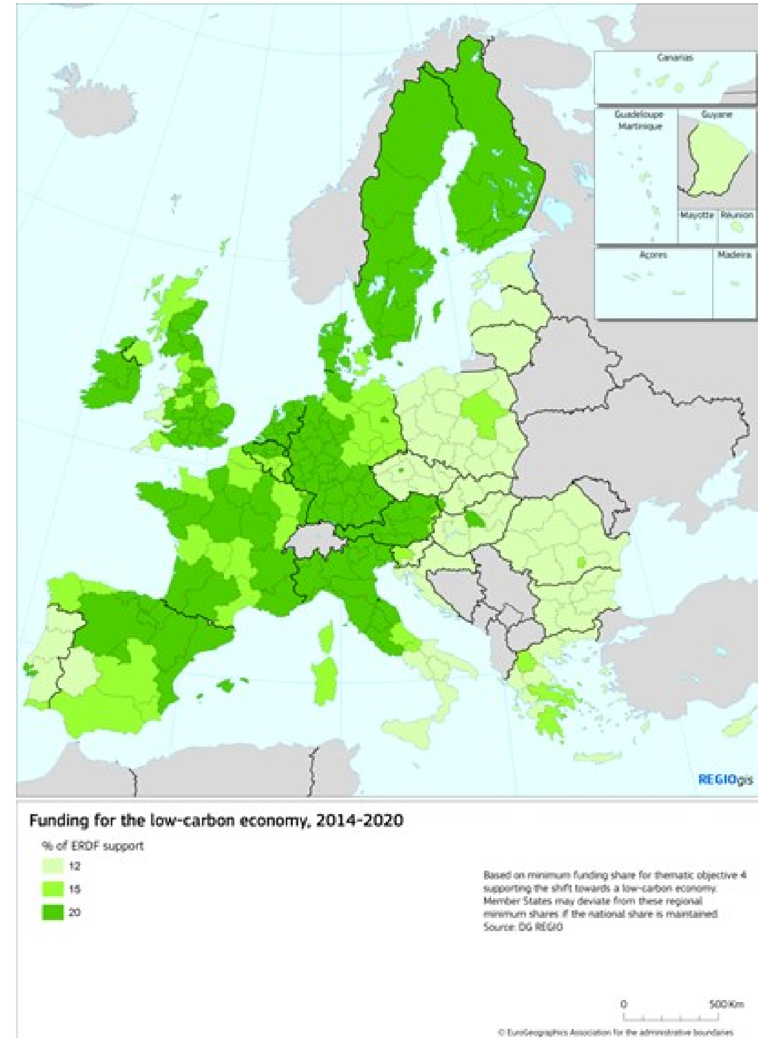
In the case of the ESF, allocations have to be concentrated on up to five investment priorities under the relevant thematic objectives relating to employment, social inclusion, education and institutional capacity building. This should help to achieve more from the funding provided across the EU. It should also ensure a clearer link with the European Employment Strategy and the Integrated Guidelines on Employment.

Regions and Member States will have to make clear choices on their objectives and the concentration on a limited number of these should enable a critical mass of resources to be reached, ensuring a meaningful impact on the areas concerned in terms of growth and jobs.

Map 4 Funding for R&D&I, competitiveness of SMEs and the low carbon economy, 2014-2020



Map 5 Funding for the low-carbon economy, 2014-2020



1.2.2. Promoting employment, education and social inclusion

In order to promote employment, education and social inclusion throughout Europe, the ESF will receive at least EUR 80 billion, slightly up in money terms on the 2007-2013 amount. The shares allocated to each Member State have been determined in terms of a proportion of the combined ESF and ERDF support which it is considered that they should receive under the Investment for Growth and Jobs goal (see Table 31). These shares reflect the differing investment needs of Member States which are partly determined by their level of development. In general, less developed Member States have a wide range of infrastructure investment needs, including, for example, improved transport links, whereas for more developed ones, there is more of a need for investment in human capital.

Within the ESF allocation, at least 20% has to go to furthering social inclusion and combating poverty and discrimination.

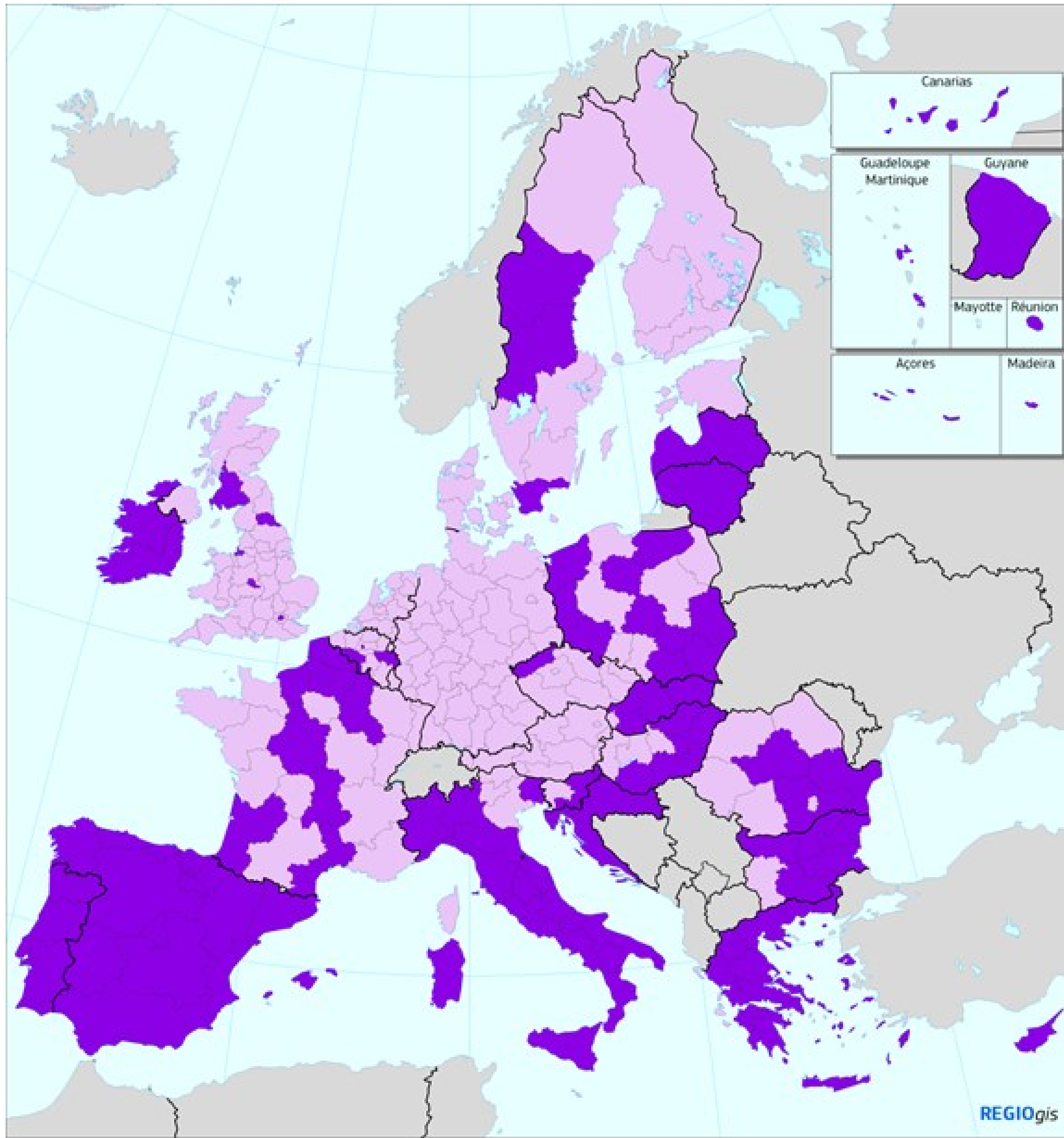
Table 31: ESF minimum shares per Member State of ESF and ERDF support under the Investment for Growth and Jobs goal

ESF minimum share (% of ERDF/ESF)		ESF minimum share (% of ERDF/ESF)	
Belgium	52,0%	**Lithuania**	24,2%
Bulgaria	28,7%	**Luxembourg**	50,7%
Czech Republic	22,1%	**Hungary**	24,0%
Denmark	50,0%	**Malta**	21,6%
Germany	36,8%	**Netherlands**	50,0%
Estonia	18,0%	**Austria**	43,5%
Ireland	51,7%	**Poland**	24,0%
Greece	28,1%	**Portugal**	38,5%
Spain	27,7%	**Romania**	30,8%
France	41,7%	**Slovenia**	29,3%
Croatia	24,6%	**Slovak Republic**	20,9%
Italy	26,5%	**Finland**	39,5%
Cyprus	30,7%	**Sweden**	42,5%
Latvia	20,7%	**United Kingdom**	45,9%

Given the urgent priority of tackling high levels of youth unemployment in many Member States, a new Youth Employment Initiative co-financed by the ESF has been launched to help young people into employment or to receive the education and training necessary to improve their chances of finding a job. The measures included involve support for apprenticeships, self-employment and business start-ups as well as for work experience and for continued education and training. Regions eligible for support under the Initiative are those with youth unemployment rates of more than 25% in 2012 and those with rates of over 20% which are in countries where the rate increased by more than 30% in 2012 (see: Map 89).

EUR 6.4 billion has been allocated to the Initiative, at least EUR 3.2 billion of which comes from targeted investment from the ESF national allocations and the remainder from a specific EU budget line. These amounts could be increased following the mid-term review of the EU budget in 2016.

Map 6 Youth employment initiative, 2014-2020



Youth Employment Initiative, 2014-2020

Eligible NUTS2 regions

eligible

not eligible

Sources: Eurostat, DG EMPL

0 500 Km

© EuroGeographics Association for the administrative boundaries

1.3. Strengthening the effectiveness of investment

The effectiveness of Cohesion Policy funding depends on sound macroeconomic policies, a favourable business environment and a strong institutional framework. In many sectors, a combination of strategic and regulatory conditions and public investment is necessary to tackle bottlenecks to growth effectively.

Studies, however, suggest that inappropriate policies as well as administrative and institutional constraints have limited the effectiveness of EU funding in the past. Gaps also remain as regards the implementation of EU legislation into national law in areas directly linked to Cohesion Policy. Although there were attempts in the past to establish 'conditionalities' linked to the strategic, institutional and administrative arrangements in place, their application remained discretionary and unsystematic.

Ex-ante conditionalities have therefore been introduced in the 2014-20 period to ensure that the effectiveness of EU investment is not undermined by unsound policies or regulatory, administrative or institutional bottlenecks. These conditionalities are limited in number and focus on the framework conditions that are perceived as being most relevant for investment. They are built on existing obligations that Member States have to comply with, so avoiding adding to these or going beyond requirements which already exist.

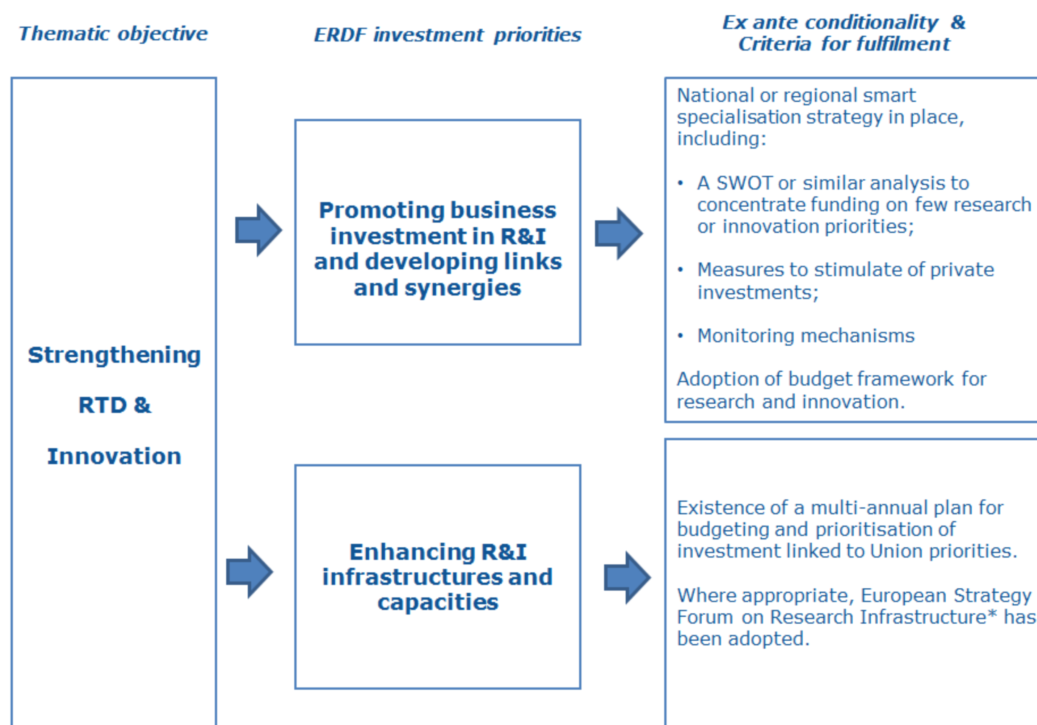
There are two types of *ex-ante* conditionality:

- Those which are connected to each of the 11 thematic objectives and the related investment priorities of funds. The identification of the conditionalities which are applicable in this respect depends on the objectives and priorities that the programme in question has selected to focus on. They are linked to specific areas of intervention of the ESI funds and relate to effective policies being pursued, EU law affecting the implementation of the funds being transposed and adequate administrative capacity being in place (see Box 1).

- More general ones linked to horizontal aspects which apply to all programmes to ensure that minimum requirements are in place with regard to anti-discrimination, gender equality, disability, public procurement, state aid and so on.

In case *ex-ante* conditionalities are not fulfilled at the stage of programme adoption as assessed by the Member States themselves and subsequently by the Commission, Members States are required to prepare action plans demonstrating how the necessary conditions will be put in place in due time so as not to impede the effective and efficient implementation of the funds. Failure to carry out the action plan by the end of 2016 could lead to a suspension of EU payments. Non-fulfilment of critical elements which puts effective spending at serious risk could already lead to a suspension of EU funding at the stage of programme adoption by the Commission.

Box : Criteria for fulfilment of ex-ante conditionality in the area of R&D and innovation



** The European Strategy Forum on Research Infrastructures is a strategic instrument to develop the scientific integration of Europe and to strengthen its international outreach. The competitive and open access to high quality Research Infrastructures supports and benchmarks the quality of the activities of European scientists, and attracts the best researchers from around the world. See http://ec.europa.eu/research/infrastructures/index_en.cfm?pg=esfri*

1.4. Achieving and demonstrating results

In the past, the implementation of Cohesion policy support has focused in some places more on spending and management than on performance in terms of reaching specific objectives. Programmes have often not been sufficiently precise about the objectives they aimed to achieve and the way in which they would do so, which made it difficult to monitor them and to evaluate their performance.

In some cases Member States were reluctant to set targets or they set targets that that they knew would be easy to achieve and therefore were not meaningful ones against which outcomes could be assessed. This in turn has limited the ability of evaluations to measure the effects of interventions and to understand better which measures were most effective and why.

Against this background, a greater focus on results through better indicators, reporting and evaluation is at the core of the reform of Cohesion Policy.

The focus on results needs already to be built in at the stage of designing programmes. The design has to be based on a clear intervention logic starting with identifying development needs and the changes the programme is intended to bring about in order to meet these needs and going on to demonstrate how the spending planned helps to do this.

Each programme must set ‘specific objectives’ to define the results that are intended to be achieved while taking into account the needs and characteristics of the area to which it relates. Programme specific indicators with clear baselines and targets have to be defined to measure the deliverables which are expected to contribute to the

intended changes. They have to be accompanied by common indicators to be used by all programmes which will make it possible to aggregate achievements at both national and EU level.

In order to monitor progress towards achieving the objectives and targets and in order to promote and reward good performance, a performance framework needs to be defined for each programme, consisting of milestones to be attained by 2018, targets established for 2023 and a performance reserve to be allocated in 2019 if the milestones are achieved.

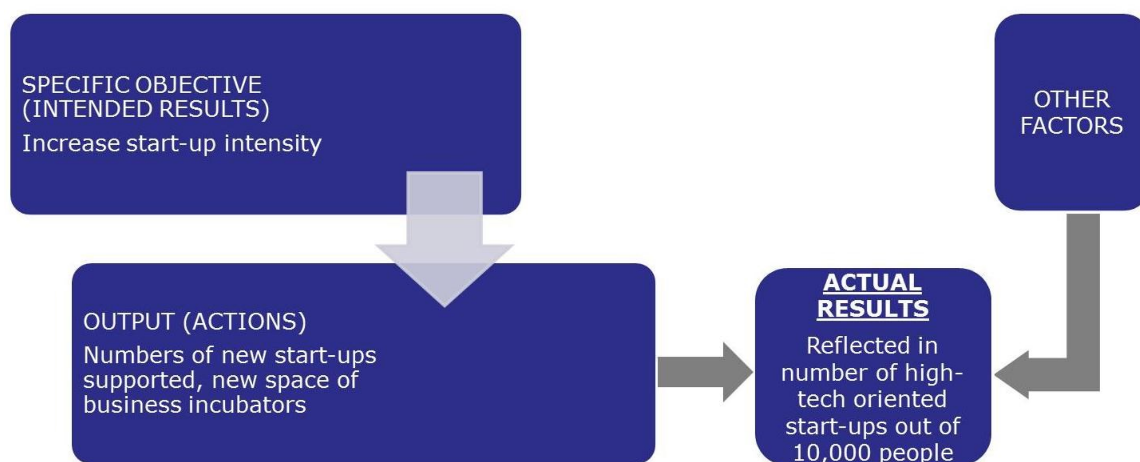
The performance reserve amounts to the equivalent of 6% of national allocations by Member State, fund and category of region, EUR 20 billion in total. The key challenge for Member States and regions is to identify clear and measurable milestones and targets which are both realistic and sufficiently ambitious to be meaningful.

Box : Intervention logic of Cohesion policy in 2014-20 – Example for supporting the high-tech sector in a more developed region

Description of specific objective

The most northern region of Germany, Schleswig-Holstein, wants to increase the number of knowledge-based and technology-oriented start-ups. The *result indicator* in respect of this objective is defined as the average number of high-tech oriented start-ups relative to every 10,000 people of working age in the region who are economically active. Measured in this way, the *baseline value* in the knowledge-and technology-oriented sector in the region was 4.45 in 2011[2], which is significantly below the national average.

Target for result indicator: The region aims to increase the number of high-tech oriented start-ups relative to every 10,000 economically active people of working age to 4.85 by 2023. The ERDF co-financed programme will be one of the ways of doing this. In addition, there will be a start-up friendly policy pursued by the region as well as private investment (‘other factors‘).



Description of possible action to take

There are many different ways a region could support a high level of start-ups in the high-tech sector. By analysing the weaknesses of the region and from past evaluations, policy makers concluded that the key problems were obstacles to funding and knowledge gaps.

2 Derived from an analysis carried out by the Centre for European Economic Research (ZEW Start-ups panel).

As a consequence, the region decided to adopt two *courses of action*:

- to reduce barriers to finance in order to support knowledge sectors and attract venture capital;
- to support measures for reducing infrastructure barriers to technology as well as incubator centres.

Appropriate *output indicators* for these courses of action are the number of enterprises receiving support and the amount of private investment which arises to match public funding. These happen to be included in the list of common indicators as defined in the ERDF Regulation. In addition, four specific output indicators will be used in order to assess the number of projects supported, the number that lead to an enterprise being successfully set up, the number of knowledge-based and technology-oriented start-ups and the amount of space rented in technology and incubator centres.

Source: Draft of Operational Programme Schleswig-Holstein, adapted.

1.5. Aligning EU investment with the European semester

The new policy framework establishes a close link between ESI funds and the European semester. Relevant country-specific recommendations (CSRs), i.e. recommendations relating to structural changes which it is appropriate to bring about through multi-annual investment and which fall within the scope of ESI fund support, need to be taken into account by Member States and regions in the preparation of 2014-20 programmes.

Many CSRs do not directly concern ESI funds (such as those relating to taxation, fiscal frameworks, public finances related to pensions or health costs, regulatory reform of social security or internal market measures). While some of these reforms are indirectly relevant for setting the right framework conditions for ESI funds, implementing them requires policy responses other than from EU investment.

However, the 2013 CSRs also contained a significant number of recommendations which are relevant for the ESI funds. These include measures for improving research and innovation, increasing SME access to finance and business start-ups, raising energy efficiency and modernising energy networks, improving waste and water management, increasing labour market participation, upgrading education systems and reducing poverty and social exclusion.

Member States that received Country-Specific Recommendations (CSRs) in 2013 related to energy, R&D and innovation

(Sub-)sector CSR	Member State	Number of Member States
Energy networks, renewables and energy efficiency	Bulgaria, Czech Republic, Estonia, Spain, Italy, Lithuania, Latvia, Malta, Poland, Slovakia, Germany, Finland	12
R&D and Innovation	Estonia, France, Luxembourg, Netherlands, Poland, Slovakia	6

Another important area covered by the 2013 CSRs concerns public administration, the judiciary and public service provision. Those issued included a number which specified the need to improve the effectiveness and efficiency of public administration, to increase the quality and independence of the judicial system, to combat corruption more effectively and to ensure the sound implementation of public-procurement legislation and, in some cases, more than one of these recommendations (all four in the case of Bulgaria and Greece).

Examples of Country-Specific Recommendations (CSRs) in 2013 related to quality of public administration and good governance

(Sub-)sector CSR	Member State	Number of Member States
Improving the effectiveness and efficiency of the public administration	Bulgaria, Cyprus, Czech Republic, Spain, Greece, Croatia, Italy, Romania, Slovakia	9
Judiciary reform	Bulgaria, Greece, Spain, Hungary, Latvia, Malta, Romania, Slovenia, Slovakia	9
Improve the business environment	Bulgaria, Greece, Spain, Hungary, Italy, Poland, Romania	7
Anti-corruption	Bulgaria, Czech Republic, Greece, Croatia, Hungary, Italy	6
Public procurement	Bulgaria, Greece, Hungary, Croatia	4
Absorption of ESI funds	Bulgaria, Romania, Slovakia	3

Since the modernisation of public administration has become a cornerstone for the successful implementation of the Europe 2020 Strategy, the new legal framework puts a particular emphasis on institutional capacity building and administrative reform. The aim is to create institutions which are stable and predictable in their relations with the public, but also flexible enough to react to societal challenges, open to dialogue with the public and able to introduce new policies and provide better services.

1.6. A strategic approach to Public Administration reforms

Institutional capacity is not just a technical matter of training civil servants, it relates to how public authorities interact with businesses and people and deliver services to them. *Good governance*[3]" is both the basis for, and the ultimate objective of, institutional capacity building, creating trust and social capital. Countries with a high level of social capital also tend to perform better economically.

Context factors are key to the design of a comprehensive strategic approach to public administration reform. They include institutional stability, stakeholder involvement, alignment of goals and effective cooperation between the various parties involved[4].

Building on these factors, the conditions for success are:

- the existence of a customised, country-specific approach that clearly identifies the main weaknesses of administrations as well as the main policy areas that require administrative support;
- sufficient focus on the regional and local dimension;

[3] This can be defined as "*the manner in which power is exercised in the management of a country's economic and social resources for development*".

[4] SEOR, 2006, *Evaluation of the ESF support to Capacity Building*, Rotterdam, the Netherlands.

- the need for the process of capacity building to follow a framework of coherent reforms as opposed to being *ad hoc*[5].

Member States need to adopt a strategic approach to the modernisation of public administration, as indicated in the Common Provisions Regulation of the ESI funds, based on 'principles of excellence'[6] (see figure 90).

Figure 1: Principle of excellence

1.7. Sound economic governance

Investment supported by ESI Funds must take place in a sound macroeconomic framework for its impact to be maximised. This is why there needs to be a close link between ESI funding and the economic governance procedures of the Union. Since both policies have the same ultimate objective – sustainable, sustained and balanced growth – it is important that they are closely aligned.

ESI Funds are mainly targeted at public investment and at tackling the economic and social challenges confronting Member States. Public investment, however, cannot be effective if public finances are not sustainable and economic policies are not sound. For instance, when countries are cut off from financial markets or forced by stringent financing conditions to introduce difficult economic reforms, it is more difficult when planning programmes to pursue a long-term investment strategy, to secure the involvement of the private sector or to ensure an appropriate level of public investment.

Where national governments fail to put in place sound economic policies or to carry out necessary structural reforms, it is likely to reduce the effectiveness of investment supported by the ESI Funds. Consequently, the new policy framework establishes a direct link between the implementation of the Funds and respect for EU economic governance -or, more specifically, action taken at national level to put

5 European Commission, 2005, *Strengthening institutional capacity and efficiency of public administrations and public services in the next programming period (2007-2013*), Working Note. DG Employment and Social Affairs.

6 Principles of Excellence. Source: European Institute of Public Administration.

in place sound fiscal policies, to respond to changing economic circumstances and to carry out key structural reforms ('macroeconomic conditionality').

In this regard, it should be emphasised that the economic and fiscal policies carried out at regional level cannot be seen in isolation from those implemented at national level. The targets set for the latter at EU level apply to all tiers of government. Ensuring proper coordination between them is therefore essential to ensure consistency of the overall fiscal policy stance and equitable burden-sharing between levels of government. Macroeconomic conditionality, therefore, increases the incentive for all tiers of government to manage public finances prudently and there is a collective responsibility to ensure this.

Box - The link between the macroeconomic framework and the effectiveness of ESI funds

Article 175 TFEU requires Member States to conduct their economic policies and coordinate them in such a way as to attain economic, social and territorial cohesion objectives, so establishing a clear link between national economic policies and Cohesion Policy. There are many channels which link the achievement of Cohesion Policy objectives with Member State economic and budgetary policies.

First, Cohesion Policy is aimed at fostering growth and development, notably by helping to establish favourable conditions for investment in physical and human capital and technology. Macroeconomic imbalances can jeopardise this by, for example, deterring private investment because of high inflation or high government borrowing. Secondly, according to the principle of additionality, Cohesion Policy is supposed to add resources to those invested by Member States and to complement national efforts in this respect. This implies that governments need to ensure that it is possible to maintain levels of public investment in the areas covered by Cohesion Policy. This can be seriously compromised if the need to reduce budget deficits leads to public investment being reduced.

The empirical link between the macroeconomic framework and the effectiveness of ESI funds has been examined in a recent analytical paper[7], which estimates the relationship between macroeconomic policy and indicators of development objectives using standard econometric techniques to show that:

(i) sound fiscal policy, and more specifically smaller government deficits and debt levels relative to GDP, contribute to socio-economic development and the achievement of EU objectives in this regard;

(ii) higher government current expenditure, including on debt interest, can impede socio-economic development, while public investment (measured in terms of net fixed capital formation) is positively associated with an improvement;

(iii) the ESI funds contribute to achieving EU socio-economic objectives;

(iv) but their effectiveness is greater when government debt levels and net foreign liabilities are low.

These findings provide support for linking ESI funds to economic governance through macroeconomic conditionality.

The link between EU funding and macroeconomic governance is not new. It has been acknowledged since the Maastricht Treaty and has been enshrined in the Cohesion Fund legal framework since its creation. Moreover, in the Eurozone, new commitments have recently been made in respect of the Stability and Growth Pact and broadening and reinforcing economic policy surveillance to cope with the economic crisis (through the adoption of what is known as the 'Six Pack').

The objective of the new legal provisions on macroeconomic conditionality is to ensure, on the one hand, that the effectiveness of the ESI Funds is not undermined by unsound macroeconomic policies and, on the other, that the Funds are directed to

[7] See: Mariana Tomova, Andras Rezessy, Artur Lenkowski, Emmanuelle Maincent 2013, *EU governance and EU funds - testing the effectiveness of EU funds in a sound macroeconomic framework* , Economic Papers 510, Directorate-General for Economic and Financial Affairs, European Commission.
http://ec.europa.eu/economy_finance/publications/economic_paper/2013/pdf/ecp510_en.pdf

tackling emerging economic and social challenges which are long-term and structural in nature rather than short-term and cyclical.

Macroeconomic conditionality is designed to be applied in a gradual and proportionate way. The suspension of ESI funding is regarded as a last resort when a Member State reaches a significant level of non-compliance under the various EU economic governance procedures. Any suspension will be linked to the seriousness of the breach to ensure that it does not go beyond what is necessary to ensure that funding is used effectively.

Macroeconomic conditionality consists of two strands:

(1) Reprogramming of ESI funds: this concerns amendments to the Partnership Agreements and programmes during implementation with a view to providing targeted support to European semester CSRs in order to respond to changing economic realities, structural reform needs or emerging imbalances or to maximise the impact of the ESI funds on economic development and competitiveness. Such amendments could, for example, cover:

- support for labour market reforms that will improve its functioning, for upgrading skills and lifelong learning and for measures to increase labour market participation;
- support for measures to foster competitiveness such as for improving education and training systems or for R&D and innovation;
- support for investment in to infrastructure;
- support for measures to meet climate and energy targets and objectives, such as for reducing greenhouse gas emissions, expanding renewable energy and increasing energy efficiency to reduce import dependency, lower costs and promote green growth;
- support for measures to improve the management of natural resources and the sustainability of transport systems;
- support for SMEs;
- support for measures to improve the quality of governance such as by improving administrative capacity and the data collected to monitor, assess and guide policy.

Failure of a Member State to comply satisfactorily with a request from the Commission to amend its Partnership Agreement and relevant programmes could lead to a suspension of part or all of the ESI payments to the programmes concerned. Suspended payments would be released without delay once the Member State responded satisfactorily to the Commission’s request. Member States would be able to continue submitting payment claims during the suspension period to avoid them losing EU funding due to the (n+3) de-commitment rule, so long as the suspension is lifted before the closure of the programme.

Box EU Budget: commitments vs. payments

The EU budget has two concepts of expenditure:

- commitments which are legal pledges that the EU will provide finance for specific programmes or initiatives, provided that certain conditions are met
- payments which are cash or bank transfers to the beneficiaries of programmes

Appropriations for commitments and payments often differ because multiannual programmes and projects are usually committed in the year they are decided but are paid over a number of years as the programme or project is carried out. Since not all projects are undertaken in practice or fully carried out, appropriations for payment tend to be less than for commitments.

(2) Non-compliance in the context of the Union's economic governance procedures: If a Member State (i) fails to take corrective action in response to a Council recommendation to eliminate its excessive deficit in the context of an Excessive Deficit Procedure, (ii) submits two successive insufficient corrective action plans or fails to take the recommended corrective action in the context of a Macroeconomic Imbalances Procedure or (iii) fails to comply with the policy conditionality linked to a macroeconomic adjustment programme, part or all of the commitments or payments for the programmes concerned will be suspended.

In these cases, the new policy framework gives precedence to a suspension of commitments rather than a suspension of payments so as to limit the adverse consequences for recipients of ESI funds while maintaining an incentive for economic adjustment. ESI payments will only be suspended when immediate action is sought and in cases of significant non-compliance. A suspension of commitments, moreover, will only apply to those for the next financial year. This should not directly affect programme implementation so long as payments can continue to be made against previous commitments, which remain open for a period of three years following the year to which the budget commitment relates.

During this period the Member State can implement measures to correct its excessive deficit or excessive macroeconomic imbalance or to implement and comply with its macroeconomic adjustment programme. As soon as it is established by the Commission that the necessary corrective action has been taken, the suspension would be lifted and the commitments concerned would be re-budgeted.

The level of suspension will increase gradually in line with the seriousness of the breach to ensure a proportionate response which takes account of the degree and persistence of non-compliance and does not go beyond what is necessary to ensure the effective use of ESI Funds. Equal treatment of Member States will also be ensured in line with the provisions set out in the Common Provisions Regulation.

In particular, the new policy framework provides for a ’double capping’ method so as to limit the level of suspension of commitments of ESI funds to (i) a particular proportion of the funds and (ii) a particular ratio of the GDP of the Member State concerned. This is considered to be the simplest and fairest approach to ensuring equal treatment given the large differences in the scale ESI funding in relation to GDP between Member States. It was also the approach applied in the case of Hungary which was subject to a suspension of Cohesion Fund commitments in 2012.

The specific economic and social circumstances of Member States will be taken into account when determining possible suspensions. On the one hand, all economic governance procedures include derogation or escape clauses that will be activated in the case of exceptional economic circumstances or events beyond the control of policy-makers. Consequently, macroeconomic conditionality can only be triggered if these escape clauses are not fulfilled.

In addition, the legal framework allows for the economic and social circumstances of the Member State concerned to be taken into account when determining the level and scope of a possible suspension in order to avoid adding an excessive burden on those already enduring difficult times. Mitigating factors are high levels of unemployment, poverty and social exclusion as well as a prolonged economic recession. Similarly, programmes which are considered to be of critical importance for tackling economic and social problems, such as those relating to the Youth Employment Initiative (YEI), poverty reduction or financial instruments for SMEs will be excluded from possible suspension.

Box : Gradual application of macroeconomic conditionality in case of non-compliance under the Excessive Deficit Procedure
(indicated timing is purely indicative)