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on the contribution of cohesion policy to the economic recovery: linking crisis exit policy with long term growth and structural change

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The impact of the crisis has been territorially asymmetric. There are countries as well as regions and cities that have suffered more than others. Across Europe, the crisis aggravated structural weaknesses of the economy, adding to what had been generated or petrified by stagnating economic growth of the last decade. It has also made it clear that relying simply on relatively favourable macroeconomic conditions to ensure growth, jobs and competitiveness is not enough. It is legitimate to ask from where the growth that Europe needs can come. It is also legitimate to say that the European economy is facing a decade of deep structural adjustment aimed at both removing barriers to growth and exploiting new business opportunities.

1. Cohesion policy: linking exit strategy and long term growth

Cohesion policy is an important public policy instrument which can be turned against the crisis and address short term demand stimulation while at the same time investing in the long term growth and competitiveness. In this context four issues are relevant.

First, cohesion policy long term programs for 2007-2013 have been fixed with a strong focus on what is today seen as priorities in the context of opportunities created by the crisis and of the EU2020 Strategy. This includes: investment in development of new skills, energy efficiency and renewable energy, investment in public works such as transport infrastructure but also smart infrastructure – broadband, sustainable urban transport, investment in sustainable economy at all levels of European governance, investment in measures supporting SMEs and eco-innovations , investment in water efficiency and in new forms of funding for SMEs, including risk capital schemes and new forms of guarantee schemes.

Second, companies with good growth potential that are innovative and future-oriented do not appear attractive to a banking sector contaminated by risk aversion. Banks rather favour politically protected sectors and companies. Victims of this approach are exactly those companies which Europe needs most to generate long term sustainability of growth, jobs and competitiveness. In a time when banks constrain their credit provision in such ways, cohesion policy provides innovative business a secured source of funding.

Third, in many respects this crisis provides countries with the opportunity to reconsider their development trajectories and devise new policies and instruments to accompany the change. Then the question is how we can devise interventions striking the right balance between sheltering existing jobs while creating new ones. How can we help firms to face the crisis and prepare to go the distance? Many of these issues can be best addressed through place based policy approach. It is legitimate to ask whether central governments know enough, whether we can target investment from policies decided and designed in the capitals. It is essential to understand local preferences and use local knowledge in order to channel public resources towards the most productive investment. That is why the regional dimension of the cohesion policy can allow to better target public resources on growth enhancing investments.

Fourth, to facilitate the contribution of cohesion policy to crisis exit strategy, the European Commission has proposed to address specific concerns related to the implementation of programs. These are important resources. While during the financial perspective 2007-2013 negotiations cohesion policy funding available to individual member states has been capped, at local and regional level, structural funds are often the major source of public investment funding. This is very much in line with observed trend of growing public investment at sub-national level accompanying declining public investment at national level.

2. The contribution of cohesion policy to the European economic recovery package

At the end of 2008, in the context of the financial and economic crisis, cohesion policy was facing three major challenges. First, overcoming the liquidity constraints in a number of Member States and regions. These hampered the pre-financing of projects in the regional (multi-regional, national) development programmes under cohesion policy. Second, facilitating and accelerating investments in Member States and regions. Third, improving productive capacity and competitiveness.

The crisis related amendments to cohesion policy management system as reflected in the European Economic Recovery Package[1]. were set up to offer greater flexibility in the use of the European Regional Development Fund and the European Structural Fund, give regions a head start and target expenditures on smart investment with a view to lead and facilitate the structural transformation through new investment patterns.

Giving regions a head start has been addressed by increasing cash flow through increased advance payments to 2007-2013 programs. As a result, in 2009 an additional EUR 6.25 billion[2] for investment was provided. The entire advances paid in 2009 rose to EUR 11.25 billion and those paid since 2007 to nearly EUR 30 billion. Resources to Jaspers (Joint Assistance in Supporting Projects in European Regions) were increased by 25% to help Member States prepare major projects. The management and acceleration of intermediate payments for major projects was facilitated. Simplified state aid rules allowed to make advances to state aid schemes eligible up to 100% and it clarified admissible guarantees in case of advanced payments to state aid schemes. It put in place a temporary framework under the state aid rules, providing for 2009-2010 a lump sum of aid up to EUR 500,000, state guarantees for loans at a reduced premium, subsidized loans for green products, and risk capital aid up to EUR 2.5 million per SME per year (instead of current EUR 1.5 million) in cases where at least 30% (instead of 50% now) of investment cost comes from private investors.

In the scope of the European Economic Recovery Plan, the European Commission also proposed some changes to such existing instruments as the European Globalisation Adjustment Fund (EGF) and the framework for state aid measures.

3. The response of regions and cities to the crisis

Policy response to the crisis at local and regional level has gone beyond the instruments of European cohesion policy, even though, as we can see in available surveys[3], in most regions and cities recourse to EU policy instruments was significant. Most of the regions have

[1] "A European Economic Recovery Plan" COM(2008)800. Available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52008DC0800:EN:NOT

[2] Data as referred to in this section received from the European Commission, Directorate-General for Regional Policy.

[3] Committee of the Regions survey "European Economic Recovery Plan in Regions and Cities: One Year On", January 2010

introduced anti-crisis measures, adopting comprehensive anti-crisis (regional or local) strategies or action plans, while others have made extensive use of existing policy instruments.

Concern for rising unemployment has translated into emergency measures to maintain existing jobs and/or provide financial support for SMEs. A lesson that is emerging from the crisis exit policies is that there is a need of a better coordination between different levels of government. Local and regional authorities also express expectations about better information on available anti-crisis policy tools. Surveys[1] indicate that the actions undertaken by the second layer of governance in Member States have been of great importance in overcoming the economic crisis. Actions to promote growth and employment carried out across all regions include, among others:

- public investment: investment in regional infrastructure not only gives regions the opportunity to boost the economy but also to emerge from the crisis stronger than they were before. In this context many regions are engaged in investment in renewable energy and the construction of energy efficient buildings. This type of investment not only facilitates job creation but also the improvement of regional competitiveness.

- SMEs' access to finance: SMEs are particularly concerned with this problem due to their heavy dependence on bank credits and limited recourse to financial markets. Their situation is particularly difficult in case of small companies as their capacity to scale down employment to reduce costs is very limited or does not exist at all.

- investment in skills: many regions support and further develop the skills of employees and currently invest in the employment of young people.

- facilitating access of consumers and employers to information on job opportunities. Often specific communication strategies are set up related to the crisis and growth opportunities.

With their tailored strategies, regions answer to specific needs within their territories that are otherwise not sufficiently addressed at the European or national levels. While national recovery plans mainly target large companies and the financial system, regions focus on the real economy and take into account their territorial specificity. In fact, by supporting entrepreneurship and SMEs and by boosting their innovation capacity, regional actions can contribute to turning this crisis into an opportunity to strengthen regional economies and safeguard jobs.

4. The impact of cohesion policy “on the ground”

As regards the implementation of new projects on the ground, EUR 93 billion was allocated by the end of 2009 to specific projects, representing 27% of the total financial volume for the period 2007-2013. Many of them were pre-financed through the advances paid to Member States and regions. In addition, reimbursement claims by Member States to the Commission increased significantly in 2009.

[1] Ibid.

The major injections of funds and highest rates of absorption are observed in the countries which were particularly hit by the economic downturn. Investment declined by more than 35% in all of them and consumption by more than 10%, also among the highest in the EU. The payments of the policy accounted for more than 4% of the national GDP in Lithuania, close to 4% in Estonia and 2.5% in Latvia, and to more than 2% of GDP in Hungary and Poland.

Some sectoral Operational Programmes of 2007-2013 in Latvia, Lithuania and Ireland, focused on innovation, business support and human capital witnessed particularly fast implementation in 2009: around 30% of the total allocations of these programmes for the whole period were already paid to the final beneficiaries thus contributing to counter the effects of the crisis during its worse moment. Similarly, at regional level, most of the ERDF Operational Programmes in Germany, which underwent one of the deepest declines of GDP in 2009, played an important role in avoiding a collapse of demand and employment with absorption rates above 25% in all cases.

Most of the countries mentioned above had a limited fiscal capacity to play a major counter-cyclical role. The size of their respective national recovery packages belonged to the smallest in the EU in terms of GDP. Cohesion policy accelerated payments and investments where a significant counter-cyclical stimulus was needed.

In some of the countries most affected by the crisis, cohesion policy accounted for a more than one half of the total public investment. Its role in supporting public investment is likely to be even more important in the coming years.

In 2009, the policy was representing already 90% of total public gross fixed capital formation in Lithuania and over 50% in other four Member States (Hungary, Portugal, Estonia and the Slovak Republic). It is estimated to have also contributed to more than 20% of the public investment undertaken in some Convergence regions of Spain, Germany and Italy and likely to increase in relative terms in the coming years.

In summary, despite the fact that cohesion policy is a development policy with a medium to long term orientation, and not a short term anti-cyclical policy, the advance payments and the acceleration of implementation on the ground in 2009 represented a significant injection of purchasing power into the economy and contributed to address the collapse of private consumption (-3%) and investment (- 15%) compared to 2008, and this in particular in those countries and regions which had suffered most from the crisis. This investment has followed the pattern envisaged by Lisbon Strategy-based earmarking.

5. Recommendations for the future cohesion policy and its role in EU2020

Need of enhanced coordination and better use of synergies between different levels of public governance and different policies.

Multilevel governance offers broader policy space allowing us to more effectively promote economic recovery in the EU. Cooperation between the local and regional authorities as well as partnership between these authorities and the private sector have proved successful in many instances in shaping urgent anti-crisis policy plans. However, there is still much to be improved in terms of cooperation between the local and regional, the national and the EU level.

Need of taking into account territorial specificities and asymmetric impacts of crisis when designing crisis exit policies.

The effects of the crisis might result in weakened territorial cohesion if it is not countered by policies targeting specific problems in a differentiated manner. The uneven impact of the crisis across regions reflects different competitive starting points and means different long-term outlooks as well as varying degrees of recourse to anti-crisis measures offered by the EU.

Need of aligning crisis exit investment patterns with long term growth priorities.

In order to reduce or avoid the risk of structural after-shocks, focusing the exit strategy on long-term sustainable growth should be the leading criterion for policy choices. From this perspective, the content of fiscal packages is essential. Policy choices should be made in accordance with medium to long term strategies which implies that public investment must be properly targeted, aiming at medium to long term impacts. Public investment in innovation, research, education, energy efficiency, new technologies is the way to go.

Need of strengthening local lending.

Regions will continue to gain in importance in driving the economic agenda of the EU. Regulation of the financial services industry should take into account the need of stimulating entrepreneurship and financing for SMEs. Cohesion policy can mitigate the impact globalisation on financial services. Local lending needs to be maintained or even strengthened. This can be stimulated through strong regional banks. Bank credit committees will be much more comfortable with providing working capital finance if they feel the strong backing of the EIF. The EIF should take on the role of mentor to selected groups of SMEs and have an active role overseeing the life of the credit file.

The financial support for SMEs in cohesion policy should move towards venture capital finance. This would allow greater involvement of the banking sector and a better use of structural funds.

Cohesion policy as the main delivery mechanism of the EU2020 Strategy.

We should try to realise each of the following issues: we should quickly implement those projects that have already been selected; we should speed up the selection of projects that can provide a contribution to the agreed objectives, including the facilitation of the exit from the crisis; and we should ensure that, despite growing budget pressures, the national co-financing needs are met in order to ensure the full utilisation of the EU budget.

Cohesion policy's strengths come from its three basic characteristics: it sets strategic guidelines that are conditions for the resources to be transferred and they are binding both for Member States and regions (unlike Open Method of Coordination); it leaves space for Member States and regions to tailor interventions to the specificity of places; and it has a machinery to monitor and support in achieving goals.

So if we reform the policy in the way we have discussed over the last 2-3 years, we will have an excellent delivery machinery for EU2020. This reform should embrace: concentration on the 2020 priorities, strengthening conditionality (earmarking), better results evaluation system, strengthening the role of the Commission, and giving the EP together with a dedicated Council, the competence to check the process.