

**The EU Added Value Test to Justify EU  
spending: What Impact for Regions and  
Local Authorities?**

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## Executive summary

This note examines the concept of EU added value and its implications within the current economic and political context. While outlining the variables needed to appraise the added value of EU spending, the paper stresses the need to re-consider how the concept can be applied in the present debate on the next Multiannual Financial Framework (MFF). In particular, the paper looks at how to obtain the highest possible added value by prioritizing across and within policy areas.

While the EU Budget Review had stressed the importance of EU added value as a guiding principle for EU spending, it has remained a very elusive concept. Moreover, it has been often used as an *ex post* justification for current policies. This paper suggests a three step process to assess the added value of EU financing: 1) defining the rationale for policy action; 2) deciding on the best governance structure (level of government, form of cooperation and/or integration); 3) choice of the most effective policy tool.

After outlining a range of possible rationales for EU action, the paper looks into where money spent by the European Union can concretely add value from an economic perspective: the delivery of European public goods and intervention in case of market failures. This process allows priorities to be clearly defined; however, EU objectives still need to be submitted to a subsidiarity test - i.e. verify which level of government is best able to respond to the challenge - to be transformed into policy and financial instruments. With regard to these instruments, the paper outlines the variables to consider when choosing the best mechanism(s) for implementation.

This ‘method’ is then applied to cohesion policy, indicating paths for re-directing the policy in line with the principle and the dimensions of added value, i.e. making the best possible use of scarce resources. Taking into account the current economic context, the analysis of cohesion policy suggest the following main points:

- **There is a strong rationale for EU action aimed at supporting the poorest regions:** the difficult economic situation of the poorest regions reinforces the solidarity and redistributive rationales of cohesion policy;
- **The immediate impact of the crisis needs to be addressed** to safeguard European common goods and achieve the common objectives of the European Union (including a well-functioning Single Market);
- **In order to continue facilitating European integration, and as the most visible outcome of it,** cohesion policy has to exploit cross-border synergies and build capacity across the EU; and
- **The effectiveness and efficiency of EU cohesion policy can be enhanced (e.g. through smart specialization, by better responding to changing investment needs),** ensuring more added value from cohesion spending.

Within the current economic context, making the best possible use of scarce resources has become an even stronger imperative. An analysis of added value to determine how to prioritise spending not only within but between policy areas should have been the starting point for a fundamental review and reform of the main expenditure items.

However, it is unlikely that next MFF negotiations will result in major changes to EU expenditure in this direction, i.e. re-prioritisation. But even if such a fundamental reform is not on the cards, an analysis of added value as set out in this paper can help determine priorities within policy areas, as well as highlighting how effectiveness and efficiency can be improved.



# Introduction

This note has been produced by the European Policy Centre (EPC) under its Framework Contract with the Committee of the Regions (CoR), on the basis of which CoR is receiving expert support on issues related to the future budgetary resources of the Union, viewed with a territorial perspective. It aims to analyse possible policy options for the next Multi-Annual Financial Framework (MFF), highlighting the importance of multilevel governance for the future EU budget. The analytical support provided is composed of a series of studies and analysis as well as a workshop on better spending and multilevel governance.

This note takes a closer look at how to assess EU added value, and discusses the need to re-think the operationalisation of this concept. The proposed renewed approach is then illustrated by making an assessment of cohesion policy, which has particular relevance to regional and local authorities (RLAs).

EU added value has become a central term of the EU budget debate. The European Commission set out in the EU Budget Review (European Commission, 2010b) that the concept of added value should be used as “key test to justify spending at the EU level”. It is argued that EU money can add value as it “can plug gaps left by the dynamics of national policy-making, most obviously addressing cross-border challenges in areas like infrastructure, mobility, territorial cohesion or EU research cooperation – gaps which would otherwise damage the interests of the EU as a whole. It can open the door to leveraging a much wider range of public and private resources than available at the national level alone.” (European Commission, 2010b, p.5)

While there is a clear need to exploit ‘EU added value’, the real implications of the concept remain elusive (EPC and Committee of the Regions, Workshop, 2011). So far, the discussions around the future of the EU budget have not seriously investigated the determinants of added value, nor has use of the concept resulted in a re-consideration of policy instruments. This is despite a clear support for the use of this approach in the EU Budget Review: many stakeholders participating in the public consultation<sup>1</sup> ‘underlined that the guiding principle should be “EU added value”. EU spending should offer clear and visible benefits for the Union and its citizens that could not be attained by spending at national/regional/local levels’.

Two elements are embodied in such a definition of EU added value: 1) EU spending should be targeted at goods which can provide the most ‘benefit’; and 2) the EU should focus only on those public goods that it can produce more efficiently/effectively than Member States alone - i.e. European public goods.

Against this background, a tool which could be used to assess EU spending should consist of: first, a re-consideration of rationales of public (EU) action; second, a decision on which level of government can best achieve the objectives; and third, an exploration of which financial instruments are the most appropriate.

The current difficult economic context requires the application of the added value principle as a means to prioritise: to decide on the best available spending options when dealing with scarce resources. The consequence of such an operationalization of added value might well be a need to reconsider current priorities.

In order to elaborate concrete policy recommendations which could indicate new directions for EU spending, the paper firstly builds up an outline method to appraise added value of European policies. Secondly, the method is applied to cohesion policy and recommendations for spending priorities in this policy area are made.<sup>ii</sup>

## What is EU added value?<sup>iii</sup>

As outlined in the introduction, assessing added value entails a three steps process, going from the definition of political priorities and rationales to the choice of the best implementation instruments. A debate on the added value of EU funding cannot be constructive if there is uncertainty about the objectives it should achieve. The effectiveness of policy instruments can be judged only against clear political priorities.

Specifically, the appraisal method should consist of:

- **Definition of rationales of EU action**, resulting in an allocation of spending priorities with respect to the added value attached to the objectives;
- **Determination of the level of government** best able to achieve the objectives, i.e. a subsidiarity test<sup>iv</sup>; and
- **Choice of the most effective/efficient policy and financial instrument(s).**

Each of these steps represents a different dimension of EU added value. While the concepts of prioritisation (allocation of resources) and efficiency are often used interchangeably when discussing added value, in reality they concern two different aspects of the concept: we first need to decide what we want to do (prioritisation) and only second to see how we do it (choice of instruments in terms of efficiency and effectiveness). At EU level, there has to be an intermediate step to determine that taking action at EU level is justified (subsidiarity test).

The EU Budget Review was meant to present such a throughout analysis of European Union spending, in particular as far as the underlying rationales of spending are concerned ('a policy-driven budget'). However, such an exercise has not been carried out and the focus has mainly been on efficiency and effectiveness, with little consideration of how to reprioritize spending more fundamentally. This is a missed opportunity - the discussion of EU rationales can prove very relevant in deciding how to get the most from EU policies as outlined in this note through the example of cohesion policy.

## The rationales for EU action

As a starting point, getting the most out of the EU budget requires a political decision on what is to be achieved. In this respect, the discussion on EU added value is strictly linked to the concept of a policy-driven budget (Zuleeg, 2009).

Both concepts represent a focus on concrete outcomes of EU spending, rather than attaching most value to achieving further integration and coordination at the EU level for its own sake. A focus on added value and a policy-driven budget should also lead to more attention being paid to implementation and delivery, including the appraisal, monitoring and evaluation of policy outcomes.

With the EU budget review, the European Commission has emphasised the objective of having a policy-driven budget, albeit with mixed results as this logic is not decisively applied across policy areas. This can contrast with previous approaches to the EU budget: deepening integration has often been the overarching (or even only) principle for budgetary decisions at EU level, while the consideration of impacts, outcomes and drawbacks has been coming further down the line (Zuleeg, 2009).

The main obstacle lies in the approach of a number of stakeholders, who are mainly driven by vested interests. As a result, dramatic reforms are difficult to achieve, as the need for negotiation among these different interest leads to minimalist compromises. Moreover, as underlined in our previous notes (Zuleeg, Molino, 2011a and 2011b) there is a status quo bias in the budget negotiation process, implying that it will be difficult to envisage changes going beyond incremental adjustments.

Despite these limitations, a discussion on how to add most value with future EU spending is still useful at this stage, to allow any potential adjustments which can still be made to be the most efficient, helping us to determine how to better re-allocate scarce resources, within a difficult economic and political context.

As a starting point, spending chapters of a policy-driven EU budget should be based on solid European rationales for action. There are several rationales which could be a driver for EU funding allocations.

### *Values and principles*

Values and principles can be a motivation for EU action. European integration - 'an ever closer union among the peoples of Europe' (European Communities, 1957, Preamble) - can be a value in itself, based on the belief that European integration can overcome conflict and division. Barriers to EU integration, and a lack of cooperation and common action, stand in the way of achieving this goal. While integration can be achieved through 'low politics' mechanisms (principally economic integration), here, realising economic benefits is not the final goal of EU policy and spending. Policy spillovers from low politics - knock-on effects leading to further integration in other areas - can be an underlying rationale for action in economic policy fields (Zuleeg, 2009).

If taking this point of view, economic objectives can be sacrificed for the greater good of further integration, potentially justifying, for example, the introduction of funding mechanisms to encourage more reluctant member states to integrate further (Zuleeg, 2009).

### *Treaty obligations and objectives*

Obligations and objectives of the EU Treaty can act as rationale in two ways. Firstly, the Treaties state general guiding principles, such as ‘territorial cohesion’, which require to be horizontally integrated across policy areas. Secondly, the Treaties can lay down legal obligations, triggering the development of specific policy instruments that do not necessarily correspond to cost/benefit calculations.

### *Specific political interests*

As in all political system, the definition of objectives in the EU can be linked to specific vested interests. This can include the economic, environmental or social interests of certain groups (for example, bureaucrats, farmers, environmental pressure groups or businesses) who are electorally powerful or have developed mechanisms to influence policy-making (e.g. lobbying). Vested interest of a wide range of actors can create inertia in the budget: once a policy with attached spending is created, any reform or change will be strongly opposed by those directly benefiting from it (Zuleeg, 2009). In the current context, this path dependency is particularly risky, as it strengthens the status quo bias.

The politicisation of EU decision-making can also lead to less cost effective choices. The political power gained by the European Parliament, where MEPs respond to their territorial/national constituency as much as they do to Brussels, can impact on the efficiency of European wide solutions. In addition, the composition of the European Commission (i.e. one commissioner per Member State) and its changing role within the institutional structure has obliged the Commissioners to take up a far more political role in the debate, not always coinciding with the ‘general interest’ they should represent. Last but not least, the openness of the system to stakeholders can create, or foster, powerful vested interests.

### *Common objectives*

Further to the definition of shared values and principles, Member States might agree on a series of objectives representing the way forward for the Union (in economic, social and/or political terms). Europe 2020 represents an example of

such willingness to seal their commitment with an overarching strategy. As a consequence, policy instruments and financial tools will need to be consistent with such objectives and be geared towards their achievement.

### *'State' interests*

The European Union can be effective in tackling specific problems, where Member States by themselves do not have enough resources, or political weight. Especially in the international scene, acting as a bloc (i.e. trade negotiations), acting together provides for a more powerful position (Zuleeg, 2009).

The cross-border nature of certain policy areas also makes it difficult for individual Member States to act on their own. Combating international terrorism, dealing with organized crime, managing cross-border pollution, infectious diseases and natural disasters all require a degree of European and/or international coordination (Zuleeg, 2009).

### *Economic reasons*

Similar to the 'state' interests discussed above, high economic interdependence of national economies often necessitate cooperation and/or integration. A bigger market requires cooperation because of the advantages coming from positive externalities, economies of scale and cost saving opportunities. The realisation of an EU-wide market necessitates the need to develop mechanisms to deal with EU-wide market failures, which will be discussed in greater detail later in this note.

### *Environmental and social rationales*

Finally, action might also be based on environmental and social objectives. Reducing income disparity (between and within countries) by redistributing funds from richer to poorer member states and regions is already present at EU level: Cohesion policy is, in part, a transfer from richer parts of the EU to poorer ones, aiming to achieve higher growth in poorer regions. Overall, at European level, this transfer should increase 'utility' (the satisfaction or benefit derived from consumption) as poorer regions will gain more utility than the richer ones will sacrifice (Zuleeg, 2009).

At European level, this argument is often couched in the term of 'solidarity', with the aim of ensuring that all parts of Europe develop economically. This argument has also been applied internationally to spending on international development aid. There is a clear redistribution element in these transfers, aiming for equity rather than economic efficiency (Zuleeg, 2009).

### *Complementary and overlapping rationales*

Most EU policies tend to be the results of a compromise between several rationales, often encompassing political, environmental, social and economic considerations.

Cohesion policy is an example of overlapping and changing rationales. Besides solidarity considerations, there are also economic reasons for this spending, as the interdependence of EU economies means that the stimulation of economic development in one area will have positive knock-on effects on others (Zuleeg, 2009). Danuta Hübner, the former Commissioner for Regional Policy, has claimed in the past that the main aim of cohesion policy is to provide public goods: ‘The aim of a modern cohesion policy is to provide ‘public goods’ aimed at improving skills, innovation capacity, entrepreneurship, sustainability, employment and accessibility, to enable all European territories to realise their full potential.’ (Hübner, 2008).

Moreover, new rationales can be added over time to the ones which originally justified the introduction of the policy instrument. In some cases, specific interests can be created overtime, hampering change even when the economic rationale does no longer hold (e.g. the importance of the Common Agricultural policy (CAP) as far as food shortage was concerned in the sixties, the changing international economic context, and the difficulty of reforming the market related measure because of the strong interests involved). In other cases, shifting rationales can trigger reform, as for instance the emergence of environmental consideration (e.g. the greening of the CAP).

There are thus a range of different reasons for having EU policies and for spending money at EU level. Economic objectives, such as effectiveness and efficiency, are not the sole reason for EU action in many policy areas (Zuleeg, 2009). It follows that EU added value cannot be solely measured in monetary terms, i.e. as the most cost-efficient solution. There might be objectives requiring more ‘costly’ mechanisms of delivery, and for which achievement cannot be evaluated in terms of pure financial return. However, economic objectives are at the heart of many policy areas, with the justification for spending being that the funding produces European public goods which are not produced (enough) by the market. This is examined in more detail below.

### *European public goods and European Market failures*

‘European public good’ is often used synonymous with the term ‘EU added value’ (Zuleeg, 2009). The focus of the EU budget on those goods that cannot

be efficiently provided at national level, and are under-produced by the market, has been a central element raised in the consultation process on the EU Budget Review. Many examples have been put forward to describe what ‘EU public goods’ are, such as safety, high environmental standards, ecology, animal welfare, rural development, and competitiveness. However, this broad use of the term ‘EU public good’ shows that there is a lack of exact definition of the term.

In economic terms, a public good is one of a range of market failure, i.e. a situation where markets do not function properly. Such failures can be addressed by ‘state’ intervention<sup>v</sup>. At the EU level, specific ‘European’ public good exist, which might justify the intervention of policy-makers. In addition, the European Union could have a role in tackling other market failures if these have implications beyond national borders.

- *European Public goods*

Economics provides a precise definition of public good: non-rival, non-divisible and non-excludable<sup>vi</sup>. Only few goods match all three characteristics at the same time; and at EU level it is even more difficult to identify possible cases. Some internal and external security policies might fulfill the conditions of ‘European public goods’, with the majority of such goods at EU level likely directly derived from broad EU-wide objectives, for example the realisation and functioning of the Single Market.

- *European common and club goods*

Different from public goods, club goods are non-rival but excludable. Consumption of such goods is linked to membership of a ‘club’. Within the European Union, membership to the Eurozone could potentially be an example, providing benefits such as price stability which other Member States cannot benefit from.

Common goods are non excludable but rivalrous. Such goods require state intervention because the consumption of the good by one person can hamper the consumption of another, for example in the case of water resources.

- *Merit goods*

Education and health are typical examples of ‘merit goods’, where the individual consumption can have positive effects on society as a whole; health spending not only provides benefits on a personal level, but it can also impact on the overall reduction in healthcare costs for the government. In the presence of such goods, state intervention is required for the society to get the highest possible

return. While undoubtedly such merit goods are present in the EU budget debate (for example, private investments in innovation), the question needs to be raised which level of government (European, national, regional) is best adapted to efficiently encourage provision of such goods.

- *Externalities*

Externalities<sup>vii</sup> are often brought forward in European stakeholders' discourse, as main economic reasons for common action in areas such as research and pollution reduction. The effects of national policies (or their lack thereof) have cross-border implications, which can be efficiently exploited at European Union level.

- *Coordination failures*

Coordination failures occur when different networks or technical systems are incompatible. However, when looking at the EU, such failures can also be present in the cooperation among different levels and diverse administrative systems. Within this context, cooperation (or integration) in one field may require further collaboration in other policy domains, to cut down adaptation and administrative costs linked to implementation and management.

- *Market power and structure*

Situations such as monopoly and abuse of dominant position require a public intervention in order to preserve the fairness of the market, as regards to competition and consumer protection. At EU level, the development of competition policy is a key component of the establishment of the Single Market.

- *Information failures*

Information failures are linked to asymmetries, which can result in market failures. Differences of information levels might lead to moral hazard, where one actor exploits such unevenness to his advantage. Public intervention is therefore needed to mitigate differences and avoid moral hazard situations.

The market failures we listed above require the intervention of public authorities to be solved. Together with the rationales, they set out the potential reasons for EU action and should help in setting the main strategic priorities.

## Choosing the level of government, i.e. the subsidiarity test

Once the priorities for EU action have been defined - i.e. the question 'What to do?' is answered - it still needs to be evaluated whether the European Union level is the best suited to respond to the identified challenges.

As underlined above, there are several market failures for which a European approach is needed, as their implications go beyond national frontiers (i.e. cross-border externalities) or simply because a well-functioning Single Market requires an EU wide approach. These market failures represent therefore rationales for EU action, and may justify the creation of instruments aimed at dealing with the provision of a specific public good or the correction of such a European market failure.

This implies that the potential objectives and rationales of the EU must be checked against the principle of subsidiarity. This is another crucial component of the EU added value test, as money should only be spent at European level when local and/or national governments are not able to efficiently deal with the provision of the good or to respond to the market failure<sup>viii</sup>.

Conducting a subsidiarity test means to evaluate, for instance, whether a specific good or service produces cross-border externalities. Moreover, the European level can step in where synergies from cross-border cooperation can be better exploited or where failures of cross-border coordination occur.

This second step is necessary in order to narrow down the concrete policy objectives that the EU should pursue.

## What instruments to use?

Where the European level is likely to add the most value to fix a problem or to respond to a challenge, a final decision has to be taken on how to deliver effectively and efficiently.

Action at EU level can vary from cooperation to integration, and each form of political cooperation can translate into several policy and financial instruments. While funding can represent an effective solution for the achievement of many objectives (i.e. leveraging investments for growth), monetary transfers are not a panacea. In particular, there are many areas requiring EU intervention in the form of regulatory means (e.g. setting standard for products; regulating fair competition) and/or through market measures (e.g. the ETS).

Moreover, even where funding appears to be the best solution, still decision needs to be taken on how to spend the money most effectively and the most effective spending instrument. For some EU policy area, such as cohesion, many studies have assessed the efficiency and effectiveness of spending and there are clearly further margins for improvement to be explored (see next chapter). As we underlined in our previous note (Zuleeg, Molino, 2011d), EU grants do not always represent the best solution and they might be complemented (or substituted) by loans or other financial instruments. Ultimately, a discussion on financial instruments entails a debate on their efficiency and effectiveness, and possible ways to increase quality of outcomes.

So how could such an appraisal process be applied to EU spending? The following chapter outlines an assessment of EU cohesion policy, using the assessment of added value developed above.

## How to appraise EU policy: the example of cohesion policy

The previous chapter has set out the *contours* of what could represent an effective analysis of EU added value. Re-defining priorities and choosing the best available instruments should be an exercise to conduct across and within policy areas and, in the current economic climate, such an analysis becomes imperative. It is not sufficient to simply assess whether a particular policy has provided added value: in a world of severely constrained resources, the question must be whether the use of money is the best possible use, also when compared to alternative spending areas.

As the purpose of the paper is to focus on the impact the EU value added test can have on RLAs, we now turn to the operationalisation of the method we outlined above, using the example of cohesion policy.

It seems useful to take this policy as an example to analyse the potential impact on RLAs of applying the concept of EU added value as cohesion policy, and its role in the future MFF, is one of the key priorities for territorial entities. The purpose is to identify to what extent cohesion policy corresponds to the EU rationales, why an EU approach adds value, and whether the existing instruments are efficient in responding to the challenges of European territories. The answer to these questions will allow us to outline concrete policy recommendation to further enhance the added value of cohesion policy in the current economic context.

In the present MFF (2007-2013), cohesion spending has been constantly growing, and will reach around 36% of the total EU budget in 2013 (European Commission, 2010c). The results of the EU Budget consultation process have shown strong support for cohesion policy, especially as an instrument to reduce inequalities. The EU Budget Review has summarised the impact of cohesion policy on the EU economy (European Commission, 2010c): “over the programming period 2000-2006, (cohesion policy) is estimated to have contributed to economic growth and strengthened the capacity for growth in the EU as a whole”.

However, the percentage and focus of cohesion funding in the next MFF is up for debate. Even within the Budget Review, the European Commission has underlined how difficult it is to have a precise economic measurement of the policy effectiveness in terms of GDP/growth increase. Many national and local factors influence the efficiency of spending (e.g. co-financing capabilities,

administrative capacities), which should be addressed by the current proposals for reform. In fact, the debate on the financial envelope for cohesion in the next MFF is running in parallel with the reform process, aimed at enhancing the effectiveness of implementation.

With the publication of the 5<sup>th</sup> Cohesion policy report (European Commission, 2010a), the European Commission has opened a public consultation ([http://ec.europa.eu/regional\\_policy/consultation/5cr/index\\_en.cfm](http://ec.europa.eu/regional_policy/consultation/5cr/index_en.cfm)) aimed at collecting stakeholders' opinions on the possible options for cohesion after 2013. The reform proposal, due to come out in July after the MFF proposal, will be the final step of a discussion which has involved institutional and non-institutional actors since 2009<sup>ix</sup>. The main elements the reform are thought to be in introducing a stricter regime of conditionality and the creation of 'development and partnership contracts' between the EU and national governments (European Commission, 2010a). Europe 2020 and the current economic context are playing a significant role in the elaboration of the objectives and instruments of future cohesion policy.

## Determining the added value of cohesion policy

### 1) What are the rationales behind cohesion policy?

Following the appraisal method we outlined in the first chapter, we firstly look for rationales for cohesion policy and for the need of a common EU action. Cohesion policy finds its *raison d'être* in a number of EU rationales, and contributes to several specific and horizontal objectives which could not be achieved by member states acting alone:

- *Correcting market failures*

Cohesion funding plays an important role in exploiting the potential of cross-border cooperation, in sector such as research and infrastructure development. In this respect, it responds to the need to correct market failures arising from externalities. The consequences of such externalities cannot be dealt effectively at national and/or local level, but necessitate European action to be positively exploited.

- *Delivering European public goods*

There are number of European public goods that cohesion policy can potentially deliver. Given its cross-sectoral approach, EU spending through cohesion can, for example, contribute to economic growth, environmental protection and enhanced employability through education and vocational training. Moreover,

reducing inequalities and enhancing cohesion can be defined themselves as European public goods, to which funding can concretely contribute.

Also in this context, there is scope for the European involvement. EU investment in such public goods can supply missing territorial resources, but also leverage in further public and private investments (e.g. with Public Private Partnerships).

- *Responding to the political objectives of the Treaty and Europe 2020*

Cohesion has been enshrined as an objective in the Treaty since the beginning of the Communities. In addition, the founding principle of solidarity fosters such commitment for cohesion and, along with it, for the reduction of inequalities among territories. The reduction of disparities among levels of development remains the main objective of cohesion funding, which makes it the main redistributive policy instrument of EU budget. With the Treaty of Lisbon, the introduction of ‘territorial cohesion’ adds further weight to cohesion spending, creating an obligation to pursue local and regional cohesion through political and financial instruments.

With regard to Europe 2020, there is a clear potential for cohesion policy to contribute to the achievement of all quantitative targets and to the realisation of smart, inclusive and sustainable growth. Significant cohesion funding can be the most effective way to incentivise regional and local actors to achieve the implementation of Europe 2020. This overarching strategy needs the support of all levels of government to be effectively implemented, while RLAs needs to be given precise objectives to achieve as well as necessary funding.

- *Support to EU integration and enhancing visibility*

Cohesion policy remains the most tangible dimension of EU policies for many citizens. Cohesion funding produces concrete results at local and regional level, potentially fostering widespread EU popular support. Moreover, cohesion policy supports the ‘products’ of EU integration, such as the Single Market. Intervention through cohesion funding can tackle a specific market failure, i.e. incomplete market integration.

- *Complementary rationales working as incentive to preserve cohesion policy*

At the event launching the debate on the future of EU cohesion policy, President Barroso said clearly: "we must ensure that expenditure is more efficient, European added-value is increased, and implementation is simplified. Of course,

we cannot ignore budget pressure. But I wish to make one thing clear: the basic principles of cohesion policy will not change. This policy is an expression of European solidarity, which is at the heart of our integration process." (EP press release, 5 October 2010)

By referring to the ‘principle’ of cohesion policy, the President of the European Commission acknowledges the need for a policy targeted at reducing economic inequalities. While mechanisms of delivery might need to vary to enhance spending effectiveness, an EU-level regional policy remains a tangible political proof of the European commitment to solidarity. Moreover, cohesion funding rationale is further enhanced by its link to Europe 2020 objectives: cohesion policy clearly constitute a thread across different targets. These have been endorsed at European level by all institutions, and they must be reflected in next MFF.

These political commitments must be reflected in the negotiations on the next MFF, including in quantitative terms. In this respect, a clear message should be sent by the Committee of the Regions on the need for the EU to take up these commitments at the highest possible level.

### *How does the current economic context impact on cohesion policy rationales and on the subsidiarity test?*

While an analysis within single policy areas cannot supply all elements necessary to take decisions on future EU spending, the appraisal of EU added value as a means to decide how best to re-allocate scarce resources also can have implications within existing policies. In particular, it can suggest path of reforms in line with both the policy’s guiding principles and with current economic realities.

As far as cohesion policy is concerned, the current economic context reinforces some of cohesion rationales and increases the need for common EU action. However, to add the most possible value, the key priorities of cohesion policy might need to be readjusted towards<sup>x</sup>:

- **Enabling funding to be used for core public services:** More than ever before, the social rationale of cohesion policy, aimed at reducing inequalities in levels of developments, justifies the existence of such instrument at the EU level for the poorest regions of the European Union but the scarcity of financial resources creates specific difficulties. Where national resources are so constrained that core public services such as education are under threat, cohesion policy can add significant value.

- **Alleviating the impact of the crisis.** Cohesion policy should help those EU countries which are still struggling with the consequences of the financial and economic crisis. In concrete terms, this would imply a prioritization of funding towards Eurozone members such as Greece, Ireland and Portugal. Beside the solidarity rationale, such a choice encompasses an economic justification: enabling investment in countries hit by the crisis can help them to recover and improve the EU economy as a whole. Leaving those countries in a challenging economic situation does not benefit the EU (or the Single Market/EMU) in the medium and long term, undermining this public good.
- **Focusing on facilitation.** For those member countries benefiting from stronger economies and healthier public finances, cohesion funds can play the role of facilitation. Enhancing territorial cooperation, exchanging of best practices and strengthening the capacity building component of policies, as well as facilitating access to new financial instruments, with small amounts of funding appears to offer significant added value.

In order to enhance the added value of EU spending, a more modulated approach is necessary: given different levels of development, uneven growth perspectives and specific challenges, EU funding has to be spent differently in different regions. The economic crisis has hit the most vulnerable EU countries. There cohesion policy can contribute to national recovery, balancing out the impact of severity measures. Stronger economies can benefit from (much smaller amounts of) cohesion funding to better deliver in terms of administrative capacities.

These 're-adjusted' priorities strengthen the justification of an European Union intervention through cohesion policy, as the impacts of the crisis cannot be dealt solely at national level. As we mentioned, economic difficulties in one member country can have significant externalities on the Single Market as a whole.

To achieve the objectives we listed above, the EU has to step in to preserve a well functioning market, but also to support the efforts local and regional authorities are making to improve the status of their financing or their administrative capacity. In the latter case, the European Union can serve as platform to exchange information and best practices among different entities.

## 2) What instruments for cohesion policy? Enhancing the added value of spending

The added value of cohesion policy can also be enhanced by enhancing the effectiveness and efficiency of spending. The 5th Report on Cohesion (European Commission, 2010a) has underlined how cohesion policy has contributed to enhance prosperity and growth across Europe, allowing for productive investments in less developed areas. However, the European Commission also points out the need to improve such policy, to make it a real ‘leading enabler for growth’, i.e. get the most added value from spending. In this respect, the Conclusions of the Report (European Commission, 2010a) suggest axes of action to ‘enhance European added value of cohesion policy’:

1. Reinforcing strategic programming, aiming at aligning cohesion policy with Europe 2020 and ensuring follow up and evaluation;
2. Increasing thematic concentration, by reducing the number of priorities and making them more flexible;
3. Strengthening performance through conditionality and incentives. In view of integrating EU funding within the enhanced economic governance structure, conditionality mechanisms could be used to trigger structural reforms;
4. Improving evaluation, performance and results, with the use of measurable targets and outcome indicators;
5. Supporting use of new financial instruments, by striking a new balance between grant and loan financing.

The reforms proposed under each of these headings are likely to have implications on the management of funds by RLAs. In this respect, the Committee of the Regions can add value by examining these proposals, in order to indicate ways of how best to enhance added value of cohesion spending.

More in general, the Committee of the Regions should discuss on how to minimize the main drawbacks of cohesion policy:

- **High administrative costs**, aggravated by inequalities in terms of resources and capacities of EU territories;

- **Inadequacy of financial instruments:** as we have underlined in a previous note (Zuleeg, Molino, 2011d), some of the objectives the policy aims to achieve might need different financial instruments than grants.

With regards to the points above, the following issues should be considered:

- **Funding: increasing effectiveness by smart specialisation**

The problem of funding relates to issues of co-financing, to the financial added value of EU grants, and to the need for specialisation.

In terms of co-financing, some regions and local authorities experience difficulties in benefitting fully from cohesion spending, because the required percentage of national funding cannot be allocated. While co-financing is important in ensuring co-ownership of territorial projects (European Commission, 2010c), some entities can find themselves in an unsustainable situation, which should be addressed by varying percentages of co-financing requirements. When looking at the current economic context and consequent budgetary austerity, this is not a side issue and could have significant consequences in terms of inefficiency in the post 2013 budget timeframe (under-spending of EU funds).

As far as financial instruments are concerned, our previous note (Zuleeg, Molino, 2011d) and the workshop (EPC and Committee of the Regions, Workshop, 2011) have underlined the need to explore alternative solutions to EU grants. Their contribution has proved to be valuable in some areas, but their effectiveness has been limited in other policy domains. Exploring new ways of financing is key to leverage public and private investments. The private sector should be further included in the financing of European public goods such as research and infrastructures.

Finally, the need for specialisation has become imperative for Europe's regions, and it could be regarded as a way to improve effectiveness and efficiency. To be smart, specialisation should allow each territory to benefit most from its existing comparative advantage, i.e. maximizing the amount of impact derived from limited funding. In the past, strategies for growth tended to be similar across different countries; the specificities of territories were not sufficiently taken into account.

In a budgetary austerity context, smart specialisation can enable local growth. There is a clear role to play for the European Union in this context, helping to elaborate solutions, targeting specific needs and leveraging the most productive resources into a given territory.

## - Enhancing added value of spending in poorer regions

Within the current debate, arguments have been put forward to re-nationalise cohesion policy. However, there is a societal, EU wide, benefit from investing in the development of poorer regions, even if they do not fully manage to catch up with the most developed ones. Public goods such as social inclusion, income equalities and healthy state of the economy as a whole are put under threat if there is no policy instrument for lagging behind territories.

However, while the general principles of the policy should be maintained, the current economic context might trigger changes in how the money is spent. Commonly, cohesion funding has not been used to supply basic public services, but rather to provide investments' facilities to 'second order' necessities, such as infrastructure. But the economic crisis has, in several regions, undermined public financing of essential policies, such as education. Against this background, and given the pressure exercised by the EU enhanced economic governance of structural reforms, a re-targeting of cohesion funding toward fundamental public policies would contribute to enhance EU added value in poorest territories.

## - Checking effectiveness

Current debates (e.g. European Parliament, REGI committee, 22 March 2011) underline the need to build solid mechanisms of evaluation. This goes into the direction of focusing on outcomes rather than inputs (EPC and Committee of the Regions, Workshop, 2011). However, it is still unclear what this would mean in practice for RLAs.

The proposal put forward by the Commission, concerning 'investment partnerships contracts' can be a way to enhance effectiveness. However, given that such contracts will be decided between the EU and national governments, they run the risk of not involving regions enough in the determination of targets for investment and objectives.

## - Evaluating changing investment needs

The economic crisis has put heavy pressure on public finances, as earlier discussed in this paper. Current budget austerity is triggering the exploration of alternative sources of financing and different financial instruments, but also the re-targeting of spending.

The need for national structural reforms has become imperative and it has been taken up in the economic governance package. Member States are bound to concentrate their efforts in creating the best condition for smart and stable growth. Therefore, public investment in items such as human capital (education, vocational training) and infrastructure are taking over other priorities. Cohesion funding can represent an effective tool to support and incentive such types of investment. However, in order to further enhance the effectiveness of EU funds aimed at enacting national structural reforms, member states and RLAs should be given a higher room for maneuver in deciding on financing priorities (i.e. more flexibility in EU funds implementation).

Cohesion policy can demonstrate added value of EU spending, because of its capacity to respond to current European-level challenges. However, this is not enough. The implementation of the policy has highlighted drawbacks, i.e. high administrative costs and inadequacy of financial instruments, which need to be minimised in order to obtain the most value added from the policy. As a consequence, quantitative and qualitative changes to EU cohesion funding might prove necessary.

## Conclusion

This paper discusses the concept of added value on the basis of the current EU debate and taking into account the results of the workshop (EPC and Committee of the Regions, Workshop, 2011). While acknowledging that a throughout debate on policy priorities will most probably not take place prior to next MFF proposal, the paper attempts to outline the principal dimensions of an EU policies appraisal tool. More in particular, the note sets out a three step process, which is then applied to cohesion policy: 1) defining the rationale for policy action; 2) deciding on the best governance structure (level of government, form of cooperation and/or integration); 3) choice of the most effective policy tool.

To be meaningful, the method of appraisal must take account of the present economic context, which might have changed the original rationales for spending on for example cohesion at EU level. While the note finds general evidence of the strategic and operational contribution of this policy to EU objectives and to the creation of European public goods, it also stresses that achieving most added value might only be achieved through a re-direction of cohesion policy priorities. Moreover, policy and financial instruments might need to be reviewed, taking into account the pressing needs of poorest regions and weaker national economies. Against this background, the note sets out some policy recommendation on how to re-design cohesion policy priorities and how to enhance its added value.

The next MFF is likely to be characterized by incremental adjustments to single policy areas. This resistance to major changes in the EU spending structure is matched by less than ambitious reform proposals as regards to policy and financial instruments. Cohesion policy is a case in point where a need for a more thorough analysis which would re-evaluate EU policy priorities is needed. As demonstrated, such a re-definition of priorities is inherent to the concept of added value, which in the current economic context requires making the best possible use of scarce resources. Deciding on priorities between policy areas is imperative, as well as within single policy instruments.

The analysis proposed in this note, and its consequent policy recommendations, have highlighted the need to assess EU added value more rigorously, within and between policy areas. The concept of EU added value should not remain an elusive concept, but should be operationalised in order to get the most from future EU spending.

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# Endnotes

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<sup>i</sup> The Commission's analysis of the consultation results can be found at [http://ec.europa.eu/budget/reform/issues/read\\_en.htm](http://ec.europa.eu/budget/reform/issues/read_en.htm)

<sup>ii</sup> The assessment of a single policy area does not allow for an assessment of whether cohesion policy offers the best added value when compared to other policy areas. For a thorough budget review, the comparison of added value should be carried out between policy areas as well.

<sup>iii</sup> The discussion on 'EU added value' and 'European public goods' is mainly drawn from previous Fabian Zuleeg article, Zuleeg, F., (2009), The rationale for EU action: What are European Public Goods?, Paper prepared for the BEPA Workshop on 'The political economy of EU public finances: designing governance for change', 5 February 2009

<sup>iv</sup> Please note that this does not only encompass 'negative' subsidiarity, i.e. those areas which should remain at the national level, but also 'positive' subsidiarity, i.e. areas where the EU is better suited than the national level to take action.

<sup>v</sup> It needs to be underlined that the necessary intervention of the state might not be sufficient to respond to market failures. The government needs to have the resources to effectively provide the public good (Zuleeg, 2009)

<sup>vi</sup> For a good to be non-rival, non divisible and non-excludable, it means that its consumption by one person does not prevent its utilisation from someone else. Moreover, the non-excludable feature implies that no one in the society can be excluded from its consumption. A good with such characteristic, i.e. a public good, can lead to a free rider problem: if there are not state provisions, the market will have no incentive in producing it.

<sup>vii</sup> We are in presence of externalities when some positive or negative aspects of the consumption of a good are not taken into account in its price. A typical example of negative externality is pollution, where the price system do not take into account the impact on society (Zuleeg, 2009)

<sup>viii</sup> This specifically refers to economic objectives. However the subsidiarity test needs to applied to social and environmental objectives as well.

<sup>ix</sup> See, for instance, the 'Barca Report' (Barca, 2009)

<sup>x</sup> The areas identified here appear to the authors to be the ones which offer most added value. This does not pre-suppose that other cohesion policy funding could not also add value. The key question here is whether they offer better added value than spending on other policy areas and/or whether a sufficient budget is available to finance additional cohesion policy funding at EU level.