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The impact of the economic and financial crisis on the reform of Cohesion Policy 2008-2013

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> ABSTRACT

The economic and financial crisis of 2008-2013 triggered fundamental changes in European economic governance: coordination of economic policy (European Semester), strengthened fiscal discipline and surveillance, a new procedure addressing macroeconomic imbalances and reinforced EU-level supervision of the financial sector. This paper will argue that these changes had a profound effect on the reform of Cohesion Policy. The inclusion of macroeconomic conditionality became one of the keys to unlocking the final EU budget deal for 2014-2020 as Cohesion Policy was mobilised to support the EU's reform agenda in all regions. But the links between the new EU economic governance and Cohesion Policy in the current period go far beyond macroeconomic conditionality. They also include thematic concentration on key EU pro-growth priorities, stronger links to the European Semester and its country-specific recommendations as well as *ex ante* conditionalities to ensure the right framework for Cohesion Policy investment.

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1 INTRODUCTION

By 2007, when the first reflections on the future of Cohesion Policy for the period 2013-2020 were starting, the EU had experienced a long period in which disparities between regional economies had shrunk.

The economic and financial crisis of 2008-2013 brought this process to an end. It also triggered fundamental changes in European economic governance: economic policy coordination (European Semester), strengthened fiscal discipline and surveillance, a new procedure addressing macroeconomic imbalances and reinforced EU-level supervision of the financial sector. This paper will argue that these changes had a profound effect on the reform of Cohesion Policy.

The process of reforming Cohesion Policy had three distinct phases. The first period from 2008 to 2009 involved reflection and consultation, during which the Barca report [1], the World Bank's World Development Report 2009 on reshaping economic geography, and the Multiannual Financing Framework (MFF) budget review consultation were launched. These addressed in different ways issues that had emerged in the pre-crisis academic debate over the previous 10 years: the effectiveness of Cohesion Policy, its governance, the role of institutions, the trade-off between equity and efficiency, the role of agglomeration economies, and the provision of public goods through the EU budget. In a second phase, during the preparation of the proposals for the MFF and Cohesion Policy in 2010 and 2011, a new set of elements came to the fore, following the start of the Greek debt crisis in late 2009. These included a strong alignment of Cohesion Policy with the reforms undertaken in European economic governance and extended macroeconomic conditionality, administrative capacity building, and linkages to National Reform Programmes. Finally, in a third phase from 2011 to 2013, negotiations within the European Council, the Council and with the European Parliament, saw a wide ranging reform adopted.

This reform fundamentally changed the place of Cohesion Policy, reconnecting it with the broader economic policy framework of the European Union. Without the backdrop of the economic and financial crisis and the pressures it created, it is likely that many of the more radical proposals which emerged during the first phase – a stronger focus on results, concentration on key European priorities, a common strategic framework, institutional reform – would have been weakened. The inclusion of macroeconomic conditionality became one of the keys to unlocking the final budget deal of the MFF as Cohesion Policy was mobilised to support the EU's reform agenda in all regions.

From a pre-crisis perspective this evolution was unexpected: the role of Cohesion Policy had been to provide financial resources for convergence and competitiveness to support the priorities of the Lisbon Strategy; conditionalities in Cohesion Policy funds focused mainly on implementation, regularity and legality.

1 Barca, F., An Agenda for a Reformed Cohesion Policy, A place-based approach to meeting European Union challenges and expectations, Independent Report prepared at the request of Danuta Hübner, Commissioner for Regional Policy, April 2009.

The purpose of this paper is to assess how these changes took place. It first identifies the main elements of the new linkages between Cohesion Policy and European economic governance. It then assesses the introduction of these new elements into the policy debate, Commission proposals and the legal texts adopted by the Council and the European Parliament. It provides a first assessment of how these new elements have been applied and concludes with a description of the new framework and potential unfinished business.

2 THE MAIN ELEMENTS OF LINKAGE WITH ECONOMIC GOVERNANCE

2.1 A new approach to European economic governance

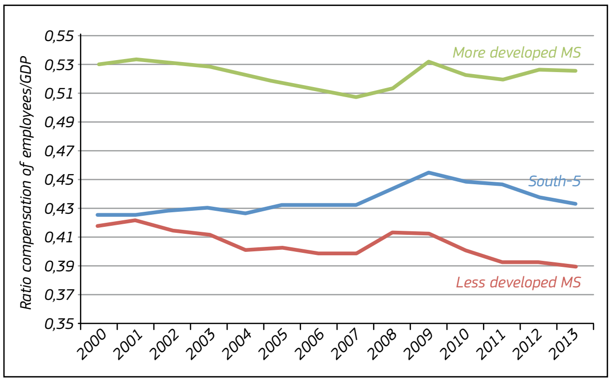
The scope of European economic governance before the economic crisis was much more modest than the governance structure which emerged after the crisis. It consisted, first of all, of a set of European rules on multilateral surveillance of fiscal and budgetary policies (the Stability and Growth Pact). Secondly, a loose system of macroeconomic policy surveillance and coordination was set up to foster economic growth and strengthen EU competitiveness [2].

The **Lisbon Strategy** was launched in 2000. It aimed at strengthening EU competitiveness in the face of global competition and as a response to social and environmental challenges. It was based on two main EU-wide targets (70% employment rate, 3% of GDP spent on R&D by 2010) and an open method of coordination of economic policies by Member States. The Lisbon Strategy was revised in 2005 and focused in particular on growth and jobs. A new governance structure based on a partnership approach between the Member States and the EU institutions was put into place. Its main instruments were 24 multi-annual Integrated Guidelines adopted by the Council, the National Reform Programmes prepared by Member States, annual country-specific recommendations and annual reporting on implementation of the Strategy [3].

2 The main instrument for macroeconomic policy coordination was the Broad Economic Policy Guidelines (BEPGs) adopted by the Council. Similar to the BEPGs, the European Employment Strategy comprised a set of guidelines for Member States' employment policies. The Open Method of Coordination, which is a non-binding benchmarking and peer review instrument, was used to evaluate national policies. The Lisbon Strategy partly unified these two instruments and set up a new, although limited and non-binding, economic governance structure. See Verhelst, S., The reform of European economic Governance: towards a sustainable monetary union?, Egmont Paper 47, June 2011.

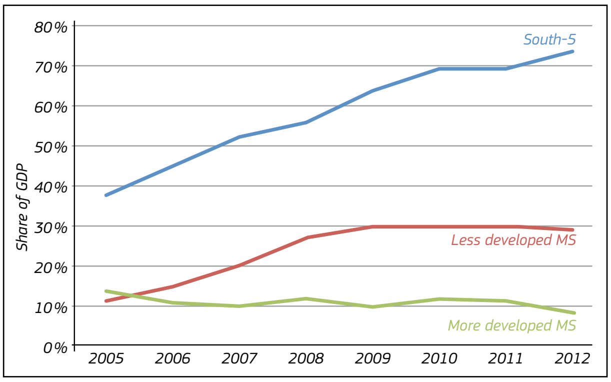
3 See: European Commission, Lisbon Strategy Evaluation Document, Staff Working Document, SEC(2010) 114.

Graph 1: Unit Labour Costs



Source: European Commission, DG REGIO

Graph 2: Net external debt



Source: European Commission, DG REGIO

The main tool for macroeconomic governance before the crisis was the **Stability and Growth Pact** (SGP), adopted in 1997 and revised in 2005. It was established to safeguard sound public finances, based on the principle that economic policies are a matter of shared concern for all Member States.

The SGP contains two arms – the preventive arm and the corrective arm. The preventive arm seeks to ensure that fiscal policy is conducted in a sustainable manner over the cycle. The main element of the preventive arm is the country-specific medium-term budgetary objective (MTO), defined in structural terms (i.e. in cyclically adjusted terms and net of one-off and other temporary measures). Member States outline their medium-term budgetary plans in stability and convergence programmes (SCP), which are submitted and assessed annually in the context of multilateral fiscal surveillance under the European Semester. The corrective arm sets out the framework for countries to take corrective action in case of excessive deficit. The corrective arm is made operational by the Excessive Deficit Procedure (EDP), a step-by-step procedure for correcting excessive deficits [4].

Non-compliance with the Pact can lead to the imposition of sanctions for euro area countries. In the case of the corrective arm, this could involve annual fines for euro area Member States and, for all countries, possible suspension of Cohesion Fund financing, if the Member State has not taken effective action to correct its excessive deficit.

The crisis that emerged in 2008 and unfolded over the following years created profound challenges for Europe. It led to significant output losses and to a fast increase in government debt which, combined with demographic change, would lead to a significant increase in fiscal burden in the long term. At the same time, the labour productivity gap between the US and the EU further deteriorated and price and cost competitiveness remained problematic.

To avoid stagnation, unsustainable debt trends and accumulated imbalances, and to ensure its competitiveness, the Commission argued that Europe needed to accelerate the consolidation of its public finances, the reform of its financial sector and to frontload structural reforms [5]. Indeed both the Commission and commentators considered that the crisis revealed longer-term problems that had not been addressed in the first years of the euro. Although the introduction of the euro had been a driver for continued growth and convergence, particularly in southern Member States, deep fiscal and structural problems had emerged: relatively high wage growth until 2009 had not been accompanied by improvements in productivity or product quality.

Furthermore, southern European countries had accumulated large stocks of either public or private debt (or both of them in some cases such as Greece and Portugal), with northern countries becoming external creditors. Structural divergences, particularly in relation to tradable goods production and current account balances, had increased significantly [6].

During 2009 it became increasingly clear that the policy framework for European economic governance that had been put in place was not sufficient to address the crisis. In particular:

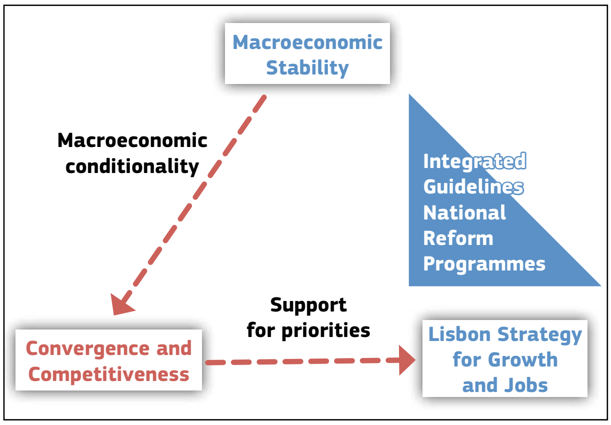
- the Stability and Growth Pact (SGP) was not sufficiently equipped to avoid the building up of unsustainable fiscal trends and positions before the onset of the Crisis;
- the Lisbon Strategy focused on common goals rather than necessary reforms to strengthen the European economy and both its effectiveness and governance were judged to be weak;
- there were no mechanisms to monitor and redress macroeconomic imbalances that had contributed to transforming a financial crisis into an economic crisis; and
- there was little conditionality applied to the EU's main investment instrument, Cohesion Policy (see section 2.2).

4 Excessive deficits refer both to a situation of excessive general government borrowing (exceeding 3% of GDP), but also to a government debt above 60% of GDP (and not diminishing sufficiently towards 60%).

5 European Commission, Annual Growth Survey: advancing the EU's comprehensive response to the crisis, COM(2010)11.

6 Pisani-Ferry, J., The Euro Crisis and Its Aftermath, Oxford University Press, 2014, p. 120-131.

The graphic below illustrates the links between Cohesion Policy and the pillars of European economic governance, macroeconomic stability and the Lisbon strategy before their reform.



Source: European Commission, DG REGIO

The policy framework to address these weaknesses was the new Europe 2020 strategy and its main tool – the European Semester – adopted by EU leaders in June 2010. The revised framework also included a legislative package strengthening fiscal discipline and addressing macroeconomic imbalances – the 'six-pack', complemented by the 'fiscal compact' and the 'two-pack'.

The **Europe 2020 strategy** aimed at achieving smart, sustainable and inclusive growth in the EU. It had five headline targets – relating to employment, innovation, education, social inclusion and climate/energy – to be reached by 2020 [7]. The Europe 2020 strategy envisaged strengthening economic governance and improving co-ordination of national and EU policies, mainly through a yearly cycle of economic policy coordination called the European Semester. It provided a more integrated surveillance framework for the implementation of fiscal policies under the Stability and Growth Pact as well as the implementation of structural reforms through national reform programmes.

The **European Semester** starts when the Commission adopts its Annual Growth Survey, usually towards the end of the year. This document sets out the broad EU economic priorities to boost job creation and growth for the year to come. In the further course of the European Semester, the Commission analyses the economic situation of Member State, their possible economic imbalances and reform agendas. On the basis of this analysis, country-specific recommendations are prepared by the European Commission on the basis for each Member State. They provide tailored policy advice on measures that it should adopt over the coming 18 months (and beyond) based on currently expected outcomes. They cover the particular challenges that the Member State is facing in a broad range of areas: the state of public finances, reforms of pension systems, measures to create jobs and to fight unemployment, education and innovation challenges, efficiency of the public administration, competition, etc. The final adoption of country-specific recommendations prepared by the Commission is by the Ecofin Council in June or early July.

The economic and financial crisis triggered also a significant number of reinforcements to the Stability and Growth Pact legal framework. The new legislative packages on economic governance became known as the 'six-pack', and the 'two-pack' while an intergovernmental agreement was adopted under the form of the Treaty on Stability, Coordination and Governance, known as the 'fiscal compact'.

The **'six-pack'**, which entered into force in December 2011, was made up of five regulations and one directive and applies to all EU Member States with some specific rules for euro area countries, especially regarding financial sanctions. It included measures enforcing greater budgetary discipline within the Stability and Growth Pact, by adding in the preventive arm an expenditure benchmark to avoid unsustainable expenditure trends, and by operationalising the debt criterion of the Treaty. Furthermore, the focus shifted from correction to prevention – in the future Member States must focus more on medium- and long-term sustainability and correct unsustainable policies as soon as they are identified, before acute problems arise.

In addition to fiscal surveillance, the 'six-pack' also introduced **macroeconomic surveillance** under a new Macroeconomic Imbalance Procedure, a prevention and correction mechanism for excessive macroeconomic imbalances. The objective was to detect underlying structural weaknesses in the economy as a whole, rather than just budgetary overruns, and thus identify the causes of persistent economic divergences within the EU. Sanctions are also envisaged in case of non-compliance by Member States.

The **'fiscal compact'** complemented and enhanced key provisions of the Stability and Growth Pact at the national level. It was signed in March 2012 and entered into force on 1 January 2013. Signatories to the Treaty agreed to implement a balanced budget rule in their national legislation through permanent, binding provisions, preferably of a constitutional character [8].

The **'two-pack'** entered into force in May 2013 and comprises two regulations designed to further strengthen fiscal coordination and surveillance in the euro area. Its first Regulation aims to improve budgetary coordination by introducing a common budgetary timeline for the euro area Member States and the possibility for the European Commission to assess national budgetary plans prior to their adoption. A second Regulation sets out clear and simplified rules for enhanced economic and financial surveillance for Member States facing severe difficulties with regard to their financial stability, those receiving financial assistance, and those exiting a financial assistance programme [9].

Finally, the European financial sector supervision and crisis resolution mechanism also had to be substantially strengthened in response to the financial crisis. It included, first of all, the creation of the **European Supervisory Authorities**, which are in operation since 2011. To complement these

7 See: http://ec.europa.eu/europe2020/index_en.htm

8 The Fiscal Compact requires Member States to enshrine in national law a balanced budget rule with a lower limit of a structural deficit of 0.5% GDP, centred on the concept of the country-specific medium-term objective (MTO) as defined in the SGP. It was signed by 25 EU Member States (all but UK and Czech Republic).

9 http://europa.eu/rapid/press-release_MEMO-13-457_en.htm

authorities, the European Systemic Risk Board (ESRB) is tasked since 2011 with the macro-prudential oversight of the EU financial system to prevent and mitigate systemic risks to financial stability in the EU. The ESRB is hosted by the European Central Bank.

In 2012 the euro area countries established a new and permanent crisis resolution mechanism for the countries of the euro area, the **European Stability Mechanism** (ESM) replacing the European Financial Stability Facility (EFSF). The ESM issues debt instruments in order to finance loans and other forms of financial assistance to euro area Members States and has a maximum lending capacity of EUR 500 billion [10].

Since the crisis highlighted the potentially vicious circle between banks and sovereign debt, EU leaders committed to a banking union in June 2012. The **banking union** is made up of the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM), both of which are mandatory for all euro area Member States and open to all other countries in the EU. In November 2013, about one year after the Commission had proposed to set up a single banking supervision mechanism in the euro area, the Single Supervisory Mechanism Regulation entered into force. It aims to ensure the safety and soundness of the European banking system, to increase financial integration and stability and to guarantee consistent supervision. A year later, the European Central Bank fully assumed supervisory tasks and responsibilities [11] The second pillar of the banking union, the Single Resolution Mechanism to govern and finance the restructuring of troubled banks, is under ratification by the participating Member States [12].

2.2 The integration of new linkages within Cohesion Policy

In the previous programming period 2007-2013, the main role of EU Cohesion Policy was to **provide financial resources** for convergence and competitiveness to support the priorities of the Lisbon Strategy [13]. Earmarking a part of Structural Funds on expenditure related to Lisbon strategy helped indeed mobilise considerable investments in its support. However, Cohesion Policy funding was broadly distributed among the spectrum of Lisbon strategy priorities without being concentrated on its key priorities.

There was **little economic conditionality** applied to Cohesion Policy. Macroeconomic conditionality applied only to the Cohesion Fund, and had never been used in practice until 2012. There were no *ex ante* conditionalities. The lack of such conditionalities were increasingly seen by the Commission to reduce the effectiveness of Cohesion Policy funds as they ensure that the impact of these funds is not undermined by unsound economic policies or institutions.

Cohesion policies before 2014 remained also **weakly integrated** into the EU's broader economic governance. The links between National Strategic Reference Frameworks, defining regional policy priorities, and National Reform Programmes, defining reform needs of Member States 'could have been further developed', according to the evaluation paper [14].

In contrast, the final legal framework of 2014-2020 Cohesion Policy funds, adopted by the European Parliament and the Council in December 2013 on the basis of the Commission proposal of 2011, created many **new linkages between Cohesion Policy and the new European Economic Governance**. Much of the political and academic debate has focused on **macroeconomic conditionality**: the possibility to suspend funds in the context of the Excessive Deficit Procedure and the new Macroeconomic Imbalances Procedure. This extends the provision foreseen for the Cohesion Fund in previous periods to the European Regional Development Fund and the European Social Fund.

However, the changes are far more wide-ranging than this. They not only link Cohesion Policy to (1) preventive and corrective action in relation to credible and balanced fiscal consolidation (with the link to the Excessive Deficit Procedure) and addressing potential macroeconomic imbalances (with the link to the Macroeconomic Imbalances Procedure), but cover as well (2) deep and front loaded structural reforms to boost jobs, growth and competitiveness (with the link to country-specific recommendations (CSRs) and introduction of *ex ante* conditionalities) and (3) targeted investment as part of smart fiscal consolidation (with the requirements on thematic concentration).

First, provisions contained within the legislative framework for Cohesion Policy complement mechanisms to avoid negative fiscal, monetary and macroeconomic spillovers between Member States by requiring the Commission to propose suspensions of part of the European Structural and Investment (ESI) Funds under the programmes concerned. Under the **Excessive Deficit Procedure**, the Commission is obliged to propose a suspension of parts of ESI funding when certain steps of this procedure are reached [15]. Under the **Excessive Imbalances Procedure** (EIP) [16], the triggers for suspension are failure to submit a satisfactory corrective action plan after two successive recommendations from the Council and failure to take corrective action as recommended by the Council after two successive decisions. The Common Provisions Regulation (CPR) [17] also foresees the possibility of suspension for

10 http://www.esm.europa.eu/#

11 https://www.bankingsupervision.europa.eu/home/html/index.en.html

12 The Single Resolution Mechanism is based on an intergovernmental agreement signed in 2014 by 26 EU Member States (all but Sweden and the United Kingdom).

13 European Council, Presidency Conclusions, Brussels, 22 and 23 March 2005: *'The Union must mobilise to a greater degree all appropriate national and Community resources – including the cohesion policy – in the Strategy's three dimensions (economic, social and environmental) so as better to tap into their synergies in a general context of sustainable development'.*

14 European Commission, Lisbon Strategy Evaluation Document, *op.cit.*

15 The trigger for suspension is a decision by the Council either under (i) Article 126 (8) TFEU establishing no effective action in response to a Council recommendation to put an excessive deficit to an end under Article 126 (7) TFEU or (ii) Article 126(11) TFEU establishing that a euro area member has failed to comply with the notice given by the Council under Article 126 (9) TFEU).

16 The Excessive Imbalances Procedure (EIP) is a procedure under the corrective arm of the Macroeconomic Imbalance Procedure (MIP). It may be opened by the Council, following a recommendation of the Commission, against a Member State which has severe or excessive imbalances that may jeopardise the proper functioning of the Economic and Monetary Union.

17 Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006.

countries benefitting from financial assistance mechanisms [18]. The Commission can also request Member State to reprogramme programmes to support the implementation of recommendations from the Commission in the context of the preventive and corrective arm of the Macroeconomic Imbalances Procedure where these are relevant in the context of the ESI Funds. It can also request reprogramming to maximise the growth and competitiveness impart of the ESI Funds in Member States benefiting from financial assistance under an EU mechanism.

A second set of mechanisms provide support through Cohesion Policy to the delivery of **structural reforms** recommended in the context of the European Semester. Within the broader set of country-specific regulations Cohesion Policy targets those that it is appropriate to address through multiannual investments within the scope of the ESI Funds [19]**.** In practice, this has meant that Cohesion Policy has provided support in the context of labour market, public administration, business, research and development, energy and education policies.

It is a requirement to address these **country-specific recommendations** (CSR) in the Partnership Agreements and operational programmes. In 2012, the Commission adopted Country Position Papers which set out the priorities for funding in relation to these CSRs. The CPR also foresees the possibility for the Commission to request the modification of adopted Partnership and operational programmes where this is necessary to support a new CSR. It should be noted that since structural reforms address long-term problems, it is anticipated that such changes will be rare. Frequent reprogramming could prove disruptive to multiannual investment strategies.

A final area where a much closer link was made between Cohesion Policy and structural reforms was in the introduction of ***ex ante* conditionalities**. The purpose of the introduction of *ex ante* conditionalities was to identify a range of factors in relation to regulatory, strategic and administrative capacity which should be in place before the programming period started to ensure that investments were effective. In practice, there was a close overlap between the steps required to fulfil many of these *ex ante* conditionalities and the need to undertake further structural reforms:

- In areas such as SME competitiveness, labour mobility, self-employment, active ageing and adaptation of workers and employers to change, investment needs to be accompanied by administrative actions to establish services or adopt legislation.

- Successive audits by the Court of Auditors and evaluations have highlighted systemic weaknesses in some Member States administrative capacity in relation to the application of public procurement and state aid and environmental assessment rules. These have an effect not only on the implementation of Cohesion Policy, but also on the efficient functioning of product markets. The failure to implement anti-discrimination and gender legislation effectively can lower participation rates.

- In areas such innovation, research, education, integration of young people into the labour market, energy and transport, the lack of appropriate strategic capacity undermines the capacity to effectively deliver policy objectives.

In many areas therefore, *ex ante* conditionalities are powerful tools to encourage institutional change to support structural reforms.

Third, compared to previous programming periods, funds under Cohesion Policy are much more tightly focused on priorities linked to targets established in the context of the Europe 2020 strategy and European Semester. The purpose of this **'thematic concentration'** is to target resources on those areas which are likely to bring the highest return in terms of growth, jobs and competitiveness in the context of growth-friendly fiscal consolidation. The regulatory framework therefore sets out a thematic menu that directs support towards European priorities in areas of R&I, the digital agenda, small business, climate change mitigation and adaption, network infrastructure, employment, social inclusion and education. These are closely linked to the Europe 2020 targets [20] as articulated through each Member State's National Reform Programme. Further concentration is achieved through earmarking (minimum amounts) of resource for innovation, broadband, SMEs, energy efficiency and the fight against poverty.

In the new period, Cohesion Policy is expected to contribute more to **administrative capacity building**. The quality of public administration has a direct impact on the economic environment and is thus crucial to stimulate productivity, competitiveness and growth. Administrative reforms are also needed in certain Member States in the areas of judicial reform, business environment, anti-corruption, public procurement and absorption of ESI Funds. In 2014-2020 period both the ERDF and the ESF can contribute to institutional capacity building under one of the eleven thematic objectives. This highlights the importance attached to this activity and can support actions to reform structures and processes, human resource management and service delivery.

Financial instruments represent a potentially resource efficient way of improving the access of firms to capital in the context of the crisis by providing support for investment through loans, guarantees, equity and other risk-bearing instruments. In order to encourage the use of financial instruments, the new framework increases the extent to which EU funding can be used to support them. Standardised, 'off-the-shelf,' financial instruments are also being provided for Member States with less experience with them, with pre-defined terms and conditions to facilitate rapid roll-out. The Commission and the EIB are jointly setting up a new risk-sharing instrument which combines financing from ESI Funds, Horizon 2020 and the COSME programme with EIB loans to generate additional lending to SMEs (the 'SME Initiative').

18 European Financial Stabilisation Mechanism (EFSM), the Balance of Payments Mechanism (BoP), the European Financial Stability Facility (EFSF), or the European Stability Mechanism (ESM).

19 CPR Art. 2 (35) definition of relevant country-specific recommendation.

20 See: http://ec.europa.eu/europe2020/europe-2020-in-a-nutshell/targets/index_en.htm

The *ex ante* and mid-term verifications of **additionality** [21] of the programming period 2007-2013 revealed a number of problems. First and foremost, the verification was not aligned to the ups and downs of the economic cycle and was therefore not automatically adapted to the varying economic circumstances of Member States. Additionality was not aligned to the economic governance of the EU as it was verified in isolation from the Stability and Convergence Programmes submitted by Member States and, in addition, it was verified on an 'ad-hoc' basis using sources of information and indicators which are not part of the European System of Accounts. As a result, the results were not fully comparable across Member States and required considerable resources both in the Member States and the Commission.

To address this problem, the Commission proposed to reform the verification of the additionality principle in 2014-2020. The aim was to establish a direct link between additionality and the Stability and Growth Pact in order to tackle the 'trade-off' between additionality and the need to reduce public deficits in a transparent and public framework and to render the verification system simpler, more comparable and less burdensome.

It was decided to use the information on public investment (Gross Fixed Capital Formation) from the Stability and Convergence Programmes (SCPs) for the verification of additionality. It enables Member States to use for the verification of additionality the information they report to the Commission in the context of their Stability and Convergence Programmes and makes the results fully comparable across Member States because they are fully based on statistics published by Eurostat. In addition, the additionality baseline is expressed as a share of GDP (and not in nominal terms as in previous programming periods), which means that it is more adapted to the economic cycle and the specific economic situation of the Member State.

These linkages between Cohesion Policy and the new European economic governance are summarised in the table below:

Policy Objective	Legal/policy framework	Instrument	Integration into Cohesion Policy	Legal instrument
To avoid fiscal, monetary and macroeconomic spillovers between Member States	Stability and Growth Pact Six Pack Two Pack Fiscal Compact Balance of Payment Regulation European Financial Stabilisation Mechanism Regulation	Corrective arm – EDP Corrective arm – EIP	Commission can propose to suspend commitment where a Member State has not taken sufficient action to: • Correct an excessive deficit • Submit a corrective action plan for imbalances • Implement a corrective action plan for imbalances • Implement an adjustment programme • Implement a macroeconomic adjustment programme	CPR Art 23.9 (a) CPR Art 23.9 (b) CPR Art 23.9 (c) CPR Art 23.9 (d) CPR Art 23.9 (e)
To support structural reforms	European Semester Macroeconomic adjustment programme	Annual Growth Survey National Reform Programmes Country-specific recommendations Excessive Imbalances Procedure Memorandum of Understanding	Integration of CSRs in programming *Ex ante* conditionalities linked to structural reforms Commission can request Member State to modify programmes to support implementation of relevant CSR, relevant Council recommendations in the context of the EIP, or macroeconomic adjustment programme	CPR Art 15.1 (a) (i), CPR Art 18 & CPR Art 96.2 (a) CPR Art 19 CPR Art 23.1 (a) and (b)
To encourage targeted investment as part of smart fiscal consolidation	European Semester Macroeconomic adjustment programme	Annual Growth Survey National Reform Programmes Country-specific recommendations Excessive Imbalances Procedure Memorandum of Understanding	Thematic concentration Linkage to delivery of targets in National Reform Programmes Commission can request Member State to modify programmes to maximise impact of ESI Funds on growth and competitiveness To improve the quality of public expenditure To increase the mobilisation of private sector resources through financial instruments To use uniformly available data to verify requirements on additionality	CPR Art 15.1 (a) (i), CPR Art 18 & CPR Art 96.2 (a) CPR Art 15.1 (a) (i), CPR Art 18 & CPR Art 96.2 (a) CPR Art 23.1 (c) CPR Art 9 (11) CPR Art 37-46 CPR Art 95

Source: European Commission, DG REGIO

21 The additionality principle says that the support from EU Funds 'shall not replace public or equivalent structural expenditure by a Member State'.

3 THE MAIN PHASES OF THE INTEGRATION OF EUROPEAN ECONOMIC GOVERNANCE WITHIN COHESION POLICY

3.1 Phase 1: Reflection and consultation 2008-2009

The early unfolding of the crisis

The financial crisis that started to emerge in summer 2007 was without precedent in post-war economic history. In its early stages, the crisis manifested itself as an acute liquidity shortage among financial institutions as they experienced ever stiffer market conditions for rolling over their debt. In this phase, concerns over the solvency of financial institutions were increasing, but a systemic collapse was deemed unlikely. This perception dramatically changed when Lehman Brothers defaulted in September 2008. Confidence collapsed, investors massively liquidated their positions and stock markets went into a tailspin. From then on, the EU economy entered the steepest downturn on record since the 1930s.

The transmission of financial distress to the real economy evolved at record speed, with credit restraint and sagging confidence hitting business investment and household demand. Aware of the risk of financial and economic melt-down central banks and governments in the EU embarked on massive and coordinated policy action. Financial rescue policies focused on restoring liquidity and capital of banks, and provision of guarantees to get the financial system financing again [22].

In response to crisis and based on a coordinated European Economic Recovery Plan proposed by the European Commission in November 2008 [23], a fiscal stimulus of some 2% of GDP was released in 2009 and 2010 – to support demand and ease social hardship. In addition, the Stability and Growth Pact was applied in a flexible and supportive manner, so that the automatic fiscal stabilisers in Member States were allowed to operate fully.

Impact of the crisis on Cohesion Policy

The economic and financial crisis hit the cohesion programmes planned for 2007-2013 period early on. Although Cohesion Policy is designed as a long-term structural policy, action was required to adapt to a widely different economic context and to respond to unexpected challenges.

Cohesion Policy therefore became **part of the European Economic Recovery Plan**. A series of measures, both legislative and non-legislative, were taken to accelerate the disbursement of the Structural and Cohesion Funds, to make them more flexible and to speed up project implementation on the ground, recognising the fiscal difficulties of some Member States.

In particular, the Commission provided additional advance payments of EUR 6.25 billion in 2009 to improve the cash flow of managing authorities [24]; it accepted immediate funding for major projects without prior approval by the European Commission; it simplified advance payments through state-aid schemes for small and medium-sized enterprises (SMEs), it extended the scope of EU funding (i.e. grants for energy efficiency improvements in housing across the EU were rendered eligible); and it removed the automatic decommitment rule from the 2007 commitment tranche to limit the risk of loss of EU funding.

Evolution of the reflection on Cohesion Policy post-2013

Given the long lead times needed to achieve agreement on European policies, the Commission started the debate on the future Cohesion Policy post-2013 with the publication of the 4th Cohesion Report in May 2007 [25], i.e. before the financial crisis hit the European economy.

The report launched a **public consultation**, which triggered more than one hundred responses from national, regional and local authorities, economic and social partners, civil society, and the academic community. The results of this consultation were summarised in the Fifth Progress Report on Economic and Social Cohesion published in June 2008. The consultation showed a continuing strong interest from stakeholders in the continuation of Cohesion Policy post-2013. Many replies underlined the important role of Cohesion Policy not only as an instrument to address the significant disparities in the enlarged European Union, but also as a policy to foster the competitiveness of all European regions and to promote sustainable development throughout the European territory [26].

To support its reflection on the future Cohesion Policy, the Commission intensified its contacts with **academic society** and **international organisations**. The objective was to provide new perspectives on the economic rationale

22 See: European Commission: Economic crisis in Europe, Brussels, 2009. http://ec.europa.eu/economy_finance/publications/publication15887_en.pdf

23 European Commission, A European Economic Recovery Plan, COM(2008)800. See also: http://ec.europa.eu/economy_finance/articles/eu_economic_situation/article13502_en.htm

24 See: http://europa.eu/rapid/press-release_MEMO-08-740_en.htm?locale=en. Another EUR 775 million also intended to improve liquidity for Member States were provided in 2010.

25 See: http://ec.europa.eu/regional_policy/sources/docoffic/official/reports/cohesion4/index_en.htm

26 See: http://ec.europa.eu/regional_policy/sources/docoffic/official/reports/interim5/com_2008_371_en.pdf

of Cohesion Policy, to define its goals more precisely and to identify the best ways to achieve these goals.

The most important strand of this reflection built upon the analysis of OECD which demonstrated that opportunities for growth exist in all types of regions and whether growth takes place or not crucially depends on how well regions mobilise their assets [27]. Fostering regional development therefore requires an integrated, geographical or 'place based' approach [28]. Such an approach sought to address criticisms, particularly from the New Economic Geography, that regional policies were by their nature inefficient due to their targeting of resources where economic returns were lower [29].

The paradigm to a place-based approach to regional development is based on the assumption that market failures create inefficiencies and persistent social exclusion in specific places. These deficiencies can be addressed by tailoring interventions and economic institutions to local conditions, by extracting and building on local knowledge and by fostering bottom-up development.

A central element of this approach is that the responsibility for policy design and implementation is allocated among different levels of government supported by contractual relations. While upper policy levels governing the intervention set the priorities, rules and general objectives for using the funding provided, regional or local levels of government have the task to implement these principles according to the specific characteristics of the respective 'place'. Consequently, a place-based approach allows policies to be tailored to local conditions [30].

The place-based approach was supported by an independent report from an Italian expert, Fabrizio Barca, focusing on the rationale and delivery of Cohesion Policy [31]. The **Barca report** which was issued in April 2009, argued that a place-based approach is particularly suitable for Cohesion Policy due to its multi-level governance system whereby the EU sets the framework for policy intervention while national, regional and local authorities have the responsibility for designing and implementing investment programmes and selecting the projects to be supported.

The Barca report contained a set of practical recommendations which shaped the debate on the reform of Cohesion Policy post-2013 and eventually became part of its reform, most notably:

- Concentrate financial resources on a limited number of core EU priorities to maximise the impact of investment; this was a response to the experience of earlier periods, which showed that the impact of EU funding was more limited than expected due to financial resources being too widely spread. In the 2014-2020 legal framework this was translated into a 'thematic concentration' requirement for EU funding.
- Establish contractual relationships between the Commission and Member States focused on performance and verifiable commitments through better indicators, reporting and evaluation. This was triggered by the experience that the implementation of Cohesion Policy focused in some places more on spending and management than on performance in terms of reaching specific objectives. In the 2014-2020 policy framework the contractual relationships were eventually translated into partnership agreements together with greater result and performance orientation.
- Setting of conditionalities by the Commission for national authorities as a requirement to allocate funding to specific priorities and assessment of the progress in meeting these conditionalities by the Commission. This was based on the experience that the effectiveness of Cohesion Policy funding depends on a sound strategic, institutional and regulatory framework. The proposal was eventually transformed into the concept of *ex ante* conditionalities in the 2014-2020 legal framework.
- Strengthen the strategic dimension of Cohesion Policy through a regular high level political debate in order to monitor the implementation of the policy and to discuss its achievements.
- Verify the principle of additionality (i.e. that EU funding does not replace national funding) by establishing a direct link with the Stability and Growth Pact.
- Provide greater scope for innovation, policy risk and experimentation, particularly at local level with direct involvement of the Commission.

In April 2009 Danuta Hübner, EU Commissioner for Regional Policy, presented her **reflection paper on future Cohesion Policy** [32]. The paper set out orientations regarding the rationale, goals and delivery mechanisms of Cohesion Policy post-2013. It reflected many proposals of the Barca report. In addition, it raised three issues which also became central for the reform of Cohesion Policy post 2013:

- With regard to the architecture of Cohesion Policy, the paper argued that there is a need to move towards a sliding support mechanism, which is stable, smooth and fair. The threshold effect of 75 % GDP/head eligibility criterion separating the convergence regions from the other categories of regions in 2007-2013 was considered to be inefficient and unfair.
- The paper suggested increasing the coherence between the different EU funds promoting economic and social

27 See OECD: Promoting growth in all regions, Paris, 2012.

28 See OECD: Investing for Growth: Building innovative regions. Policy Report, Meeting of the Territorial Development Policy Committee at Ministerial level (31 March 2009), GOV/TDPC/MIN (2009)1 and Background Report: Territorial Development Committee, Meeting at Ministerial Level (31 March 2009), GOV/TDPC/MIN (2009)2. Paris.

29 See World Bank, World Development Report 2009.

30 Factors responsible for lagging development vary from region to region. Depending on the region, the policy mix may need to focus on investments in innovation, human capital, infrastructure, institutions, or, more usually, on some mix of these. The OECD, for example, emphasised that investment in transport infrastructure needs to be accompanied by other measures to improve the productivity of the firms in the regions which is being made more accessible, in order to avoid it losing more of the local market to producers elsewhere than it gains from being able to export more easily to other regions. See OECD: How regions grow: trends and analysis, Paris, 2009.

31 See Fabrizio Barca: An Agenda for a reformed cohesion policy: A place-based approach to meeting European Union challenges and expectations. Independent report prepared at the request of Danuta Hübner, Commissioner for Regional Policy, April 2009.

32 See: http://ec.europa.eu/regional_policy/archive/policy/future/pdf/reflection_paper_future.pdf

development arguing that the diversity of rules led to the fragmentation of investment and complicated the take-up of EU funding by beneficiaries.

- With a view to increasing leverage and impact of Cohesion Policy the paper also proposed to strengthen the role of financial engineering instruments building on the JEREMIE/JESSICA initiatives. The two initiatives established for the programming period 2007-2013 aimed to improve access to finance for SMEs (JEREMIE) and to support sustainable urban development (JESSICA) through loans, guarantees or venture capital funds, thus offering a more sustainable alternative to the assistance traditionally provided through grants [33].

To support its work of developing the building blocks of Cohesion Policy post-2013, the Commission established a **High Level Group** bringing together Commission services and high level government experts from the 27 Member States. The group met for the first time in October 2009. Its task was to discuss different policy directions, to ensure transparency between the Commission and Member States, and to offer a possibility for Member States to contribute to the preparatory process by bringing in relevant expertise.

Two months later, the new Commissioner for Regional Policy Pawel Samecki presented his **orientation paper** on future Cohesion Policy. Among others he proposed (i) to concentrate Cohesion Policy funding on a limited number of priorities in line with the forthcoming Europe 2020 strategy, which was supposed to be adopted in spring 2010; (ii) to increase coherence and coordination between Cohesion Policy and sectoral policies at national and EU levels and (iii) to move toward a simpler, more efficient and transparent management and control system [34].

3.2 Phase 2: A new policy framework for economic governance: Preparation of proposals 2010-2011

Continuing economic difficulties and a governance reform

While the EU as a whole started returning to positive GDP growth from the beginning of 2010, recession continued in several Member States. However, a problem which had emerged in the banking sector began to affect governments increasingly as markets worried that some countries would not be able to rescue their banks which were in trouble. Investors started to fear sovereign default due to rising private and government debt levels. Market uncertainty led to costly and eventually impossible government borrowing operations, especially for the three most affected countries Greece, Ireland and Portugal. This led to speculation of further contagion to other European countries and a possible break-up of the euro area [35].

Greece was the first euro area Member State to lose access to the international bond markets. This led in May 2010 to the launch of a financial assistance programme worth EUR 110 billion. The Commission also established a Task Force for Greece. The objective of the Task Force was to coordinate international assistance, to help Greece to deliver its economic adjustment programme and to accelerate the absorption of EU funding.

In December 2010 an economic adjustment programme was also agreed for Ireland which covered financial assistance worth EUR 85 billion, followed by an adjustment programme for Portugal in May 2011 comprising financial assistance of EUR 78 billion. Under the EU's Balance of Payments facility financial assistance was also provided to Latvia and Hungary, and a precautionary programme was set up for Romania.

The financial and economic crisis revealed shortcomings in the architecture of the economic and monetary union itself. In response, European leaders took a wide range of measures to safeguard the euro area's financial stability and to strengthen the institutional architecture of the euro area and of the EU as a whole. They agreed on a **comprehensive reform of EU economic governance** to increase coherence between economic, financial and fiscal policies (see section 2.1). At EU level, policy coordination between Member States was reinforced. As highlighted above, in 2011 the Council and the European Parliament adopted a legislative package on economic governance, called the 'six-pack'. The new instruments and procedures, together with the Europe 2020 strategy, which focuses on the creation of growth and jobs, were aligned in a single coordination cycle – the European Semester. These reforms would spillover into the reflection on the development of Cohesion Policy.

Cohesion Policy in support of troubled economies

With regard to Cohesion Policy, it became clear that the measures adopted in the context of the European Economic Recovery Plan were not sufficient to address the impact of the crisis. To increase absorption, the Commission proposed in 2010 a reduction in **national co-financing** by temporarily increasing EU co-financing rates by 10 percentage points for Member States with the greatest budget difficulties (the so-called 'top-up' for countries with adjustment programmes). The 'top-up' provision enabled payments to be made to these countries at an earlier time than originally anticipated, so easing the pressure on national budgets and providing much-needed liquidity. By the end of 2013, almost EUR 2.1 billion had been paid as 'top up'.

Moreover, almost 13% of the total funds (EUR 45 billion) were **shifted** from one policy area to another as of 2009 to meet the most pressing needs and to strengthen particular interventions which had shown themselves to be effective. The main increases in funding were for R&D and innovation, generic business support, sustainable energy, roads and the labour

33 For JEREMIE see: http://ec.europa.eu/regional_policy/thefunds/instruments/jeremie_en.cfm; for JESSICA see: http://ec.europa.eu/regional_policy/thefunds/instruments/jessica_en.cfm

34 See: http://ec.europa.eu/regional_policy/archive/newsroom/pdf/pawel_samecki_orientation_paper.pdf

35 http://ec.europa.eu/economy_finance/explained/the_financial_and_economic_crisis

market, in particular measures to increase youth employment. The main reductions were on ICT services, environmental investment, railways, training, education and capacity building.

Preparation of Cohesion Policy post-2013

A few months after the launch of the Europe 2020 strategy, in October 2010, the Commission published its Communication on the **review of the EU budget** [36]. With regard to Cohesion Policy, the Commission argued that it should support the overarching priorities common to the whole of Europe rather than focusing only on reducing the gap between poorer and richer regions. EU funding should also deliver on the Europe 2020 objectives through a 'menu' of related investment priorities. A performance reserve should be introduced to be allocated on the basis of progress made by national and regional programmes towards Europe 2020 objectives.

Member States should present their development strategy in their National Reform Programmes to ensure ownership of EU priorities at national and regional level. A Development and Partnership Contract between the Commission and the Member State containing quantified and measurable targets should reflect these commitments. The contract should also establish a limited number of conditionalities linked to the reforms needed to ensure effective delivery.

The budget review paper proposed a single strategic framework covering the different EU funds (i.e. Cohesion Fund, European Regional Development Fund, European Social Fund, European Agricultural Fund for Rural Development and European Fisheries Fund) to improve coherence between their interventions. It also emphasised the need to carry out institutional and administrative reforms in Member States as poor governance can slow down investment and reduce the leverage effect of Cohesion Policy [37].

The proposals of the budget review were spelled out in more detail in the 5th Cohesion Report, which the Commission adopted in November 2010 [38]. Reflecting the ongoing work to strengthen the fiscal surveillance and enforcement provisions of the Stability and Growth Pact, the report also proposed to extend the existing macroeconomic conditionality provisions of the Cohesion Fund, i.e. a possible suspension of the Cohesion Fund (CF) in case of non-effective action by a Member State to correct an excessive budget deficit, to all other EU funds as a complementary leverage to ensure the respect of key macroeconomic conditions of SGP.

The **5th Cohesion Report** also argued in favour of a new architecture of Cohesion Policy based on three groups of regions: (i) less developed and (ii) more developed regions, as well as a new category of (iii) transition regions. Financial support should be differentiated between these three groups according to their level of economic development (measured by GDP per capita).

In the subsequent **public consultation**, the Commission received over 400 contributions from Member States, regional and local authorities, economic and social partners, and European interest organisations. The Commission published the results of consultation in May 2011. The proposal that Cohesion Policy should promote the objectives of the Europe 2020 Strategy was overwhelmingly welcomed by respondents. Greater coordination between the different funds was considered to be important. Many contributors also supported the introduction of incentives linked to the performance of Cohesion Policy [39].

A few weeks later in June 2011 the Commission presented its proposal on the **Multiannual Financial Framework** (MFF) 2014-2020 [40]. In deciding on the overall amount to propose for the next MFF, the Commission took account of the views of the European Parliament that 'freezing the next MFF at the 2013 level...is not a viable option … [and that] … at least a 5% increase of resources is needed for the next MFF' [41]. It also considered the conclusions of the European Council that it is essential that 'the forthcoming MFF reflects the consolidation efforts being made by Member States to bring deficit and debt onto a more sustainable path. [It is necessary] to ensure that spending at the EU level can make an appropriate contribution to this work' [42].

The overall amount proposed by the Commission for the period 2014-2020 amounted to EUR 1 033 billion in commitments (1.08% of the EU GNI) and EUR 988 billion (1.03% of EU GNI) in payments as compared to EUR 994 billion in commitments (1.12% of EU GNI) and EUR 943 billion (1.06% of EU GNI) in the period 2007-2013 [43]. For Cohesion Policy EUR 339 billion was allocated, i.e. 4.2% less than in the period 2007-2013.

36 See: http://ec.europa.eu/commission_2010-2014/president/pdf/eu_budget_review_en.pdf

37 See, Rodriguez-Pose, A. and Garcilazo, E., Quality of Government and the Returns of Investment: Examining the Impact of Cohesion Expenditure in European Regions, OECD Regional Development Working Papers, No. 2013/12.

38 http://ec.europa.eu/regional_policy/index.cfm/en/information/publications/reports/2010/fifth-report-on-economic-social-and-territorial-cohesion-investing-in-europes-future

39 http://ec.europa.eu/regional_policy/archive/consultation/5cr/pdf/5cr_result_sec2011590.pdf

40 See: A budget for Europe 2020. http://ec.europa.eu/health/programme/docs/maff-2020_en.pdf

41 See: European Parliament Resolution of 8 June 2011on investing in the future: a new MFF for competitive, sustainable and inclusive Europe.

42 Conclusions of the European Council of 29 October 2010.

43 These figures include amendments proposed by the Commission on 6 July 2012 to take account of the EU accession of Croatia in 2013.

Allocations for Cohesion Policy 2007-2013 vs. Commission proposal 2014-2020, mio EUR, 2011 prices	MFF 2007-2013	2014-2020	
		Commission proposal June 2011/updated July 2012	MFF 2007-2013 compared to Commission proposal
Convergence / Less developed regions	201 840	163 561	-19.0 %
Phasing-out, phasing-in / Transition regions	25 555	36 471	42.7 %
Competitiveness regions / More developed regions	44 078	55 419	25.7 %
Outermost and Northern regions	2 756	925	-66.4 %
Cohesion Fund	70 711	70 740	0.0 %
Territorial Cooperation	8 902	11 878	33.4 %
Total	**353 842**	**338 994**	**-4.2 %**

Source: European Commission, DG REGIO

The MFF proposal focused on conditionality, in particular with regard to Cohesion Policy, 'where Member States and beneficiaries will be required to demonstrate that the funding received will be used to achieve EU priorities. The Commission will ensure coherence between the Union's overall economic policy and the EU budget, in particular to avoid situations where the effectiveness of EU funding is undermined by unsound macro-fiscal policies.'

In view of rising unemployment and poverty levels, the Commission also proposed to strengthen the role of the European Social Fund (ESF) including by establishing a minimum share of 25 % of the budget allocated to Cohesion Policy, i.e. EUR 84 billion. Since the fiscal situation and limited room for manoeuvre had made it more challenging in some Member States to provide national co-financing, and with a view to strengthen the absorption of EU funding, the Commission proposed to limit the annual transfer of EU funding to less developed Member States to a maximum of 2.5 % of national GDP (as compared to a maximum of 3.8 % of national GDP in 2007-2013) and to extend the temporary increase in the EU co-financing rate for Member States receiving financial assistance from the Union.

The detailed **legislative proposal** of the Commission on **Cohesion Policy post-2013** followed on 6 October 2011. It established a full-fledged system of macroeconomic conditionality provisions which covered:

- five funds (ERDF, ESF, CF, rural development and fisheries fund) instead of one (CF) in 2007-2013;
- four economic governance procedures (i.e. country-specific recommendations issued by the Council in the European Semester; Council recommendations in the Excessive Deficit Procedure, the Macroeconomic Imbalance Procedure, and for countries receiving financial assistance from the Union) instead of one (i.e. Excessive Deficit Procedure) in 2007-2013;
- the obligation for Member States and regions to address the challenges identified in the relevant country-specific recommendations with sufficient funding levels in their cohesion programmes 2014-2020;
- the power for the Commission to request Member States and regions to adjust their programmes in view of new emerging economic and social challenges as specified in the recommendations issued by the Council;
- for countries receiving financial assistance from the Union, the possibility for the Commission to be become directly involved in the management of cohesion programmes;
- the power for the Commission to suspend both commitments and payments if the Member States concerned does not comply with a reprogramming request or in case of non-effective action in economic governance procedures; in 2007-2013 only commitments of the Cohesion Fund could be suspended; and
- a more automatic decision-making process leaving less room for political discretion when deciding on the suspension of EU funding [44].

3.3 Phase 3: Confirming the role of Cohesion Policy in the new framework for economic governance: Negotiations 2011-2013

New European economic governance structures

After a short recovery, GDP growth in the majority of the EU became negative again in 2012. The southern Member States were the most affected, and more rescue operations had to be launched. In July 2012 the Eurogroup agreed to provide up to EUR 100 billion to Spain for the recapitalisation and restructuring of its financial sector. In April 2013, the European Commission, the European Central Bank and the International Monetary Fund agreed an economic adjustment programme with Cyprus. The programme which covers the period 2013-2016 amounts up to EUR 10 billion. It aims to address the financial, fiscal and structural challenges facing the economy [45].

44 A slightly revised version of this proposal can be found at: http://www.europarl.europa.eu/registre/docs_autres_institutions/commission_europeenne/com/2012/0496/COM_COM%282012%290496_EN.pdf

45 http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/op149_en.htm

At the same time EU leaders continued their reform of the architecture of the economic and monetary union and the related governance procedures. The Fiscal Compact signed in March 2012 complemented and enhanced at the national level key provisions of the SGP in some areas. A new legislative package (the 'two-pack') entered into force in May 2013 with an objective to improve budgetary coordination and surveillance in the euro area. In addition, the euro area countries started establishing a banking union (see section 2.1 for more details).

Another proposal, which triggered a lot of attention but was not implemented, concerned structural reform contracts. According to this proposal, euro area countries would sign contracts with the EU. Each contract would detail the structural reforms that a Member State commits to undertake in the coming years, including the timeline for these reforms. The structural reforms would for example aim to liberalise the labour market and remove restrictions to the provision of goods and services in the country. In order to become a balanced instrument, the structural reform contracts would include a financial incentive for countries that meet their contractual commitments. This financial incentive was to offer a compensation for the short-term costs attached to the reforms [46].

Implementation of Cohesion Policy during the crisis

The crisis continued to affect the implementation of Cohesion Policy programmes. The Commission accepted the reduction of national co-financing for many Member States in the period 2011-2013 to take pressure off national budgets. This reduced the national public spending requirement significantly from EUR 143 billion to EUR 118 billion at aggregate level (-18%). This measure decreased the overall amount of public investment, but helped to secure the completion of projects already planned and to improve cash flow in the countries concerned. To secure and accelerate the completion of projects, action teams were set up in eight Member States (Ireland, Italy, Latvia, Lithuania, Portugal, Slovakia, Spain and Greece) in February 2012 with representatives of national authorities and Commission officials [47].

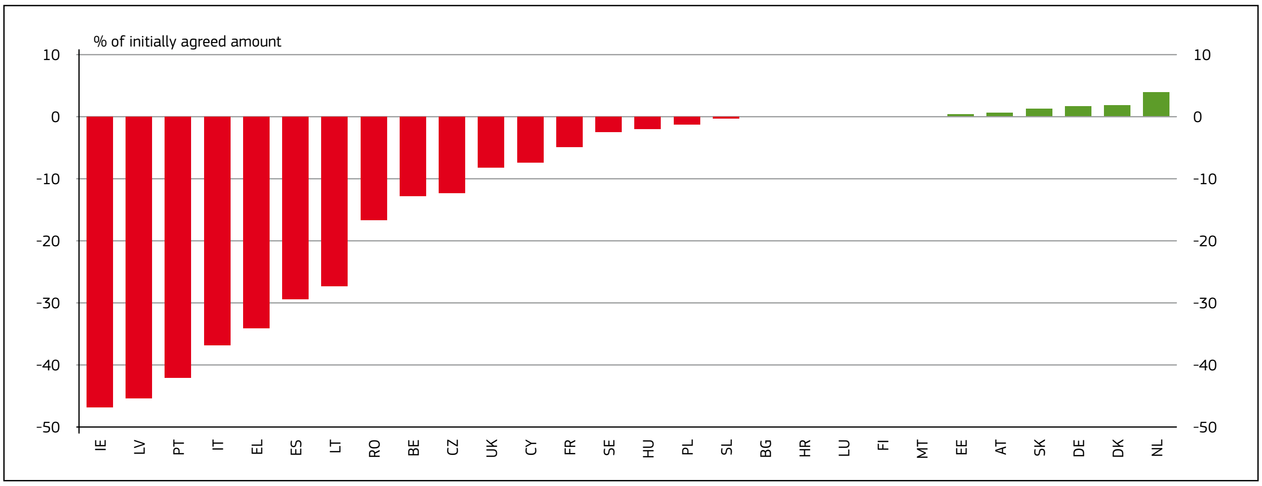
In March 2012 the strengthening of EU economic governance also led to the suspension of the Cohesion Fund in Hungary. Based on a Commission proposal the Council decided to suspend EUR 495.2 million (or 0.5% of nominal GDP of Hungary), taking effect as of 1 January 2013. This measure followed a decision of the Council in January 2012 deeming action taken by Hungary to correct its excessive deficit to be insufficient [48]. This was the first time that the macroeconomic conditionality provision enabling the suspension of commitments had been invoked since the Cohesion Fund was established in 1994. The suspension was then lifted in June 2012, after it was found that Hungary had taken the necessary corrective action.

Preparation of post-2013 programmes: Commission's position papers

In parallel to the negotiations of 2014-2020 Cohesion Policy programmes, the Commission prepared in autumn 2012 the **position papers** for the development of Partnership Agreement for each Member State. The role of these papers was to present the Commission's views on the main challenges and funding priorities of the Cohesion Policy funds in each country.

The analysis of challenges and priorities in the position papers was coherent with the Commission's assessment of Member States in the country-specific recommendations and the related staff working documents adopted earlier in 2012 [49]. In particular, the CSR relevant for Cohesion Policy investment were included among the funding priorities in the position papers.

Graph 3: Reduction in national co-financing for the 2007-2013 period, end-2013



Source: European Commission, DG REGIO

46 Stijn Verhelst: Don't complicate it even further: Macroeconomic Conditionality as a Substitute for new Structural Reform Contracts, May 2013: http://www.egmontinstitute.be/wp-content/uploads/2013/10/EPB15.pdf

Herman van Rompuy: Towards a Genuine Economic and Monetary Union, December 2012: http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/134069.pdf

European Commission: A Blueprint for a Deep and Genuine Economic and Monetary Union: Launching a European Debate, November 2011: http://ec.europa.eu/commission_2010-2014/president/news/archives/2012/11/pdf/blueprint_en.pdf

47 See European Commission, 6th Cohesion Report, July 2014: http://ec.europa.eu/regional_policy/sources/docoffic/official/reports/cohesion6/index_en.cfm

48 http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/128917.pdf

49 http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/2012/index_en.htm

However, the funding priorities in the position papers go beyond the CSRs and reflect a broader scope of investment needs. The funding priorities proposed in the position papers combine three main factors: the priorities of the Europe 2020 strategy, with its focus on smart, sustainable and inclusive growth; the principles included in the Multiannual Financial Framework proposal (such as thematic concentration and an integrated approach between funds); and the specific needs and challenges of each country. In practice, the proposed funding priorities in the position papers are grouped into three to five broad categories such as business environment, employment, and efficient use of resources; in the less developed regions network infrastructure and administrative capacity are also used.

Negotiations of post-2013 Cohesion policy

The negotiation on the MFF and Cohesion Policy post-2013 was driven by different camps, on the one hand 16 Member States forming the **'Friends of cohesion'** [50], on the other hand, 8 Member States forming the **'Friends of better spending'** [51]. While the friends of better spending comprised a smaller group of countries, they enjoyed considerable leverage since they were the net contributors to the EU budget. Consequently, they had less to lose if no quick agreement on the MFF 2014-2020 was found. For the Friends of cohesion, all net beneficiaries of the EU budget, any delay would have had serious repercussions since the work of preparing the next round of cohesion programmes required a significant lead time. No deal on the MFF would have meant that no new programmes for 2014-2020 could be adopted due to lack of financial resources and a related legal basis.

Besides insisting on freezing EU spending, the Friends of better spending firmly stood behind macroeconomic conditionality. This was made clear in a joint letter from the French President Nicolas Sarkozy and the German Chancellor Angela Merkel to the President of the European Council Herman Van Rompuy which said: 'Structural and cohesion funds should be used to support essential reforms to enhance economic growth and competitiveness in the Euro Area. Macroeconomic conditionality of the Cohesion Fund should be extended to the structural funds. They should be targeted at improving competitiveness and reduction of imbalances in the member states receiving recommendations in the excessive imbalance procedure. In programme countries, the European Commission should automatically check to ensure that structural and cohesion funds provide the optimum support for the macroeconomic adjustment programme, and to be involved in the selection and implementation of projects. In the future, payments from structural and cohesion funds should be suspended in Euro Area countries not complying with recommendations under the excessive deficit procedure' [52].

The Friends of cohesion, on the other hand, were sceptical of macroeconomic conditionality. If introduced, it 'should apply to future commitments (not payments), after a decision of the Council on violation of economic governance rule, be subject to equitable capping and should ensure equal and fair treatment of the Member States' [53].

A first attempt of the heads of state and government to reach an agreement on MFF and related macroeconomic conditionality provisions failed in November 2012. With a view to find a consensus in the beginning of 2013, the European Council gave its President together with the President of the European Commission a mandate to continue the work and pursue consultations [54].

When country leaders met for the second time in February 2013, they were able to reach an **agreement on the MFF 2014-2020**. In view of the difficult economic situation in Europe, there was for the first time a real cut in the EU budget compared to the previous period. Compared to 2007-2013 both commitments and payments were cut by ca. EUR 34 billion (compared to the period 2007-2013), resulting in the overall ceilings of EUR 960 billion for commitments (1.0% of EU GNI) and EUR 908 billion for payments for 2014-2020 (0.95% of EU GNI). The budget allocated for Cohesion Policy amounted to EUR 322 billion, i.e. 9% less than in 2007-2013 [55].

Allocations for Cohesion Policy 2014-2020: Commission proposal vs. final deal, mio EUR, 2011 prices	2014-2020		
	Commission proposal June 2011/updated July 2012	Final MFF	Final compared to Commission proposal
Convergence / Less developed regions	163 561	164 279	0.4%
Phasing-out, phasing-in / Transition regions	36 471	32 085	-12.0%
Competitiveness regions / More developed regions	55 419	49 084	-11.4%
Outermost and Northern regions	925	1 387	49.9%
Cohesion Fund	70 740	66 362	-6.2%
Territorial Cooperation	11 878	8 948	-24.7%
Total	**338 994**	**322 145**	**-5.0%**

Source: European Commission, DG REGIO

50 This group consisted of Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Greece, Hungary, Latvia, Lithuania, Malta, Poland, Portugal, Romania, Slovakia, Slovenia and Spain.

51 This group consisted of Austria, Denmark, Finland, France, Germany, Netherlands, Sweden, and the UK.

52 http://www.ambafrance-uk.org/French-and-German-leaders-defend

53 http://www.euinside.eu/en/analyses/friendly-fire-in-the-negotiations-on-the-eu-2014-2020-budget

54 http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/133723.pdf

55 http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/135344.pdf

To take account of the particularly difficult economic situation of Greece and other countries suffering from the crisis, the European Council introduced a review clause in Cohesion Policy. According to the clause, the Commission will review in 2016 all Member States' allocations for 2017-2020. The total net effect of this review can however not exceed EUR 4 billion. It also approved a higher pre-financing of Cohesion Policy programmes as well as the extension of top-up provisions (i.e. reimbursements by the Commission exceeding the allowed maximum co-financing rate by 10%) for countries receiving financial assistance from the Union.

In view of the high unemployment levels among young people, the European Council also agreed on a new Youth Employment Initiative with a budget of EUR 6 billion to support young people not in education, employment or training.

To ensure better spending, it approved a strong performance orientation of Cohesion Policy and the application of macroeconomic conditionality leaving the original Commission proposal largely intact. The European Council introduced however four important changes compared to the Commission proposal:

- Decisions on the suspension of EU funding for a given Member State in case of non-compliance with a recommendation in the context of EU economic governance procedures should be taken by the Council based on a Commission proposal (instead of the Commission);
- The possibility for the Commission to be become directly involved in the management of Cohesion Policy programmes in countries receiving financial assistance from the Union was dropped;
- The suspension of EU funding should be subject to a ceiling expressed as percentage of national GDP to protect the big beneficiaries of EU funding and to ensure equal treatment between Member States; and
- Macroeconomic conditionality should not apply to the UK as a consequence of the Protocol number 15 annexed to the EU Treaty.

Finally, the European Council emphasised the need to increase overall EU financial support to leverage-based financial instruments for SMEs in 2014-2020, at least doubling support in countries where conditions remain tight. In particular, it requested the expansion of joint risk-sharing financial instruments between the Commission and the European Investment Bank (EIB) to leverage private sector and capital market investments in SMEs, with the aim of expanding the volume of new loans to SMEs across the EU[56].

The agreement between the heads of state and government led to difficult negotiations between the Council, the European Parliament and the Commission. The European Parliament (EP) was opposed to macroeconomic conditionality and proposed to delete this provision from the new regulation altogether[57]. The EP considered it to be a punishment tool through which regional and local authorities would be penalised for mistakes made at national level. It also highlighted the risk of banks becoming even more reluctant to finance projects if they would not have the guarantee of EU funding following through[58].

A **compromise on the financial and regulatory framework 2014-2020** between the three institutions could only be reached in November 2013 after 70 'trilogue' sessions. The EP finally accepted the introduction of macroeconomic conditionality in post 2013 framework. However, it achieved several important concessions. First, it will be able to exercise its right of scrutiny over all decision-making procedures affecting the suspension of funds in a structured dialogue with the Commission. However, it will not have the power to stop such a procedure. Second, a number of mitigating factors were included in the regulation which adjust the level of the suspension of EU funding in line with the social and economic circumstances of the Member State concerned (economic recession, high levels of unemployment or poverty, etc.).

3.4 Conclusion

The table below summarises and illustrates how the economic and financial crisis came to shape the evolution of the debate on Cohesion Policy. It led not only to a progressive integration of elements of economic governance within the policy framework but also an adaptation of concepts that had emerged in the preparatory phase such as thematic concentration, quality of public expenditure and use of financial instruments.

56 https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/139197.pdf

57 http://www.europarl.europa.eu/meetdocs/2009_2014/documents/regi/pr/937/937861/937861en.pdf

58 http://www.socialistsanddemocrats.eu/sites/default/files/1210_MFF_EN.pdf

http://europolitics.eis-vt-prod-web01.cyberadm.net/sectoral-policies/ep-continues-to-oppose-macro-conditionality-art343908-19.html

Policy Objective	Integration into cohesion policy	Barca Report	Business environ-ment	Samecki Orien-tation Paper	Budget Review	Fifth Cohesion Report	Condi-tional-ity Task Force	MFF proposal	Cohesion Policy Proposal	European Council Agree-ment on MFF	Adoption of leg-islative package
		Apr 2009	Apr 2009	Dec 2009	Oct 2010	Nov 2010	Feb 2011	Jun 2011	Nov 2011	Feb 2013	Dec 2013
		Emergence of the Eurozone Crisis			Establishment of new European Economic Governance				Negotiation of new framework for Cohesion Policy		
To avoid fiscal, monetary and macroeconomic spillovers between Member States	Commission can propose to suspend payments for ESI funds where Member State has not taken sufficient action to:										
	• Correct excessive deficit										
	• Submit a corrective action plan for imbalances										
	• Implement a corrective action plan for imbalances										
	• Implement an adjustment programme										
	• Implement a macroeconomic adjustment programme										
To support structural reforms	Integration of CSRs in programming										
	Ex ante conditionalities linked to structural reforms										
	Commission can request Member State to modify programmes to support implementation of relevant CSR										
To encourage targeted investment as part of smart fiscal consolidation	Thematic concentration										
	Linkage to delivery of targets in National Reform Programmes										
	Commission can request Member State to modify programmes to maximise impact of ESI funds on growth and competitiveness										
	To improve the quality of public expenditure										
	To increase the mobilisation of private sector resources through financial instruments										
	To align the requirements on additionality with the stability and growth pact										

Source: European Commission, DG REGIO

4 THE IMPACT OF THE CHANGES

The changes set out above reflect a major change to the policy framework for Cohesion Policy. While it is too early to assess the overall impact of the new framework, a first assessment can be made first of the changes in the relationship between Cohesion Policy and economic governance and secondly on the negotiation of the partnership agreements and operational programmes [59].

4.1 A greater relevance of country-specific recommendations (CSRs) for Cohesion Policy

As seen above, a key part of the new EU economic governance structure under the Europe 2020 strategy is the country-specific recommendations (CSRs) adopted every year, since 2011, by the Ecofin Council after being endorsed by the European Council. The CSRs, based on a thorough analysis of the economic policies by Member State, provide tailored advice on necessary economic reforms aimed at boosting and supporting long-term growth and job creation, while maintaining sound public finances [60]. In recent years, CSRs have become increasingly relevant for Cohesion Policy.

An assessment of CSRs adopted in 2014, the first year of the new programming period, indicates that out of a total number of 157 recommendations [61], **more than two thirds** – 110 CSRs – **are relevant for Cohesion Policy**. This includes 56 CSRs which are relevant for the ERDF and Cohesion Fund and 74 CSRs relevant for the European Social Fund; 20 CSRs are relevant for both of them. In particular, four Member States (Croatia, Czech Republic, Italy and Romania) have specific recommendations to improve their management of EU funds. The other relevant recommendations refer to the areas in which Cohesion Policy funds may intervene. The areas relevant for the ERDF and Cohesion Fund and the most frequently covered in the CSRs are energy and natural resources, public administration and R&D and innovation (see table below). In case of the ESF, the fields the most frequently covered in the CSRs are labour market policy and education.

Some caveats should be added to this analysis. It is not always easy to assess unambiguously which CSRs are relevant for Cohesion Policy and which are not. This distinction is easier when the recommendations refer to investment measures, for instance in energy, transport or SME support. But most of the CSRs point at the necessary structural reforms or other regulatory measures. In these cases, the Cohesion Policy investment may support the domestic reforms, but additional analysis is needed to better understand whether the given recommendation is fully relevant or a specific priority for Cohesion Policy or not. In some cases national programmes may be used rather that EU co-funded programmes. Analysis of the relevance of EU programmes may sometimes be found in the Staff Working Document accompanying the CSRs and in the 2012 position papers (see the next section).

Another caveat is that the programming cycle of Cohesion Policy covers seven years, while the CSRs are updated every year and may indicate short-term policy priorities; although in practice, there is a lot of continuity in CSRs for each country as the challenges are addressed over several years. Finally, some CSRs are long and include several priorities, so only some parts of the recommendations may be directly relevant for Cohesion Policy.

4.2 Partnership Agreements and programmes

On the basis of the position papers, Member States drew up and negotiated with the European Commission the Partnership Agreements (PAs), which are strategic plans with investment priorities covering five ESI Funds [62], one agreement per Member State. Between May and November 2014, all 28 Partnership Agreements were signed between the Commission and national authorities. As the next step, the Commission negotiated with the Member States the programmes breaking down the investment priorities and objectives of the Partnership Agreements into concrete actions. By end July 2015, 306 out of 399 Cohesion Policy programmes [63] were adopted.

Prior to the submission of draft PAs and programmes by Member States, the Commission drafted a template and guidelines for their contents [64]. According to these guidelines, the programming documents need to include an analysis of needs and growth potentials taking account of the relevant country-specific recommendations, as well as the thematic objectives selected on the basis of development needs and funding priorities.

In the course of the negotiations of PAs and programmes, the Commission services worked with Member States to duly factor Europe 2020 objectives and the country-specific recommendations into these documents.

An analysis of Partnership Agreements shows that altogether, for all five ESI Funds, around EUR 160 billion – 38% of total Cohesion Policy financial envelope [65] – will be invested in 2014-2020 for four thematic objectives considered as **the most relevant for stimulating growth** in line with the Europe 2020 strategy: innovation and R&D; ICT; SME support; and low-carbon economy (see graph below). This represents a shift of funding priorities; in the previous programming period the share of these four thematic objectives was 31%. For ERDF,

59 More detailed analysis is presented in the Commission non-paper 'Effectiveness and Added Value of Cohesion Policy: Non-paper assessing the implementation of the reform in the programming for cohesion policy 2014-2020' at the Informal meeting of Ministers responsible for Cohesion Policy held in Riga, 9 June 2015.

60 CSRs can be found at http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm

61 In 2014 there were altogether 157 CSRs for 26 Member States. Two countries under the Economic Adjustment Programmes, Greece and Cyprus, did not get CSRs to avoid duplication with the programme measures. We do not take into account the recommendations for the euro area.

62 European Structural and Investment (ESI) Funds include five funds covered by a single set of rules: European Regional Development Fund (ERDF), European Social Fund (ESF), Cohesion Fund (CF), European Agricultural Fund for Rural Development (EAFRD) and European Maritime & Fisheries Fund (EMFF).

63 Out of 284 Cohesion Policy programmes adopted so far, 249 are 'mainstream' programmes (i.e. within the Investment in Growth and Jobs goal) and 35 ETC (European Territorial Cooperation) programmes.

64 http://ec.europa.eu/regional_policy/information/guidelines/index_en.cfm#1

65 Excluding technical assistance.

Table: Overview of 2014 country-specific recommendations relevant for the ERDF and the Cohesion Fund (coloured boxes indicate application of CSR per country)

	EU funds management	Energy, resources, climate	Business environment	Public administration, civil justice	R&D and innovation	Transport, digital services	Health care	Education, training, childcare
AT								
BE								
BG								
CZ								
DE								
DK								
EE								
ES								
FI								
FR								
HR								
HU								
IE								
IT								
LT								
LU								
LV								
MT								
NL								
PL								
PT								
RO								
SE								
SI								
SK								
UK								

Source: European Commission, DG REGIO

the share of these four priorities is much higher, around 64 % of total in 2014-2020 ERDF funding [66]. Around 25 % of the total Cohesion Policy financial resources will be devoted to the ESF and invested in employment, education, social inclusion and administrative reform in line with the recommendations set out in the Annual Growth Survey.

An assessment of ***ex ante* conditionalities** shows that they have been fulfilled in a majority of programmes and Member States. Around two thirds of the thematic *ex ante* conditionalities (i.e. those that relate to a particular sector or policy, such as R&I or social inclusion) applicable at programme level were fulfilled at the time of programmes adoption. As regards general *ex ante* conditionalities (i.e. those relevant to all sectors, such as on public procurement or anti-discrimination rules), around three quarters of the conditionalities assessed at Member State level were fulfilled at the adoption of programmes.

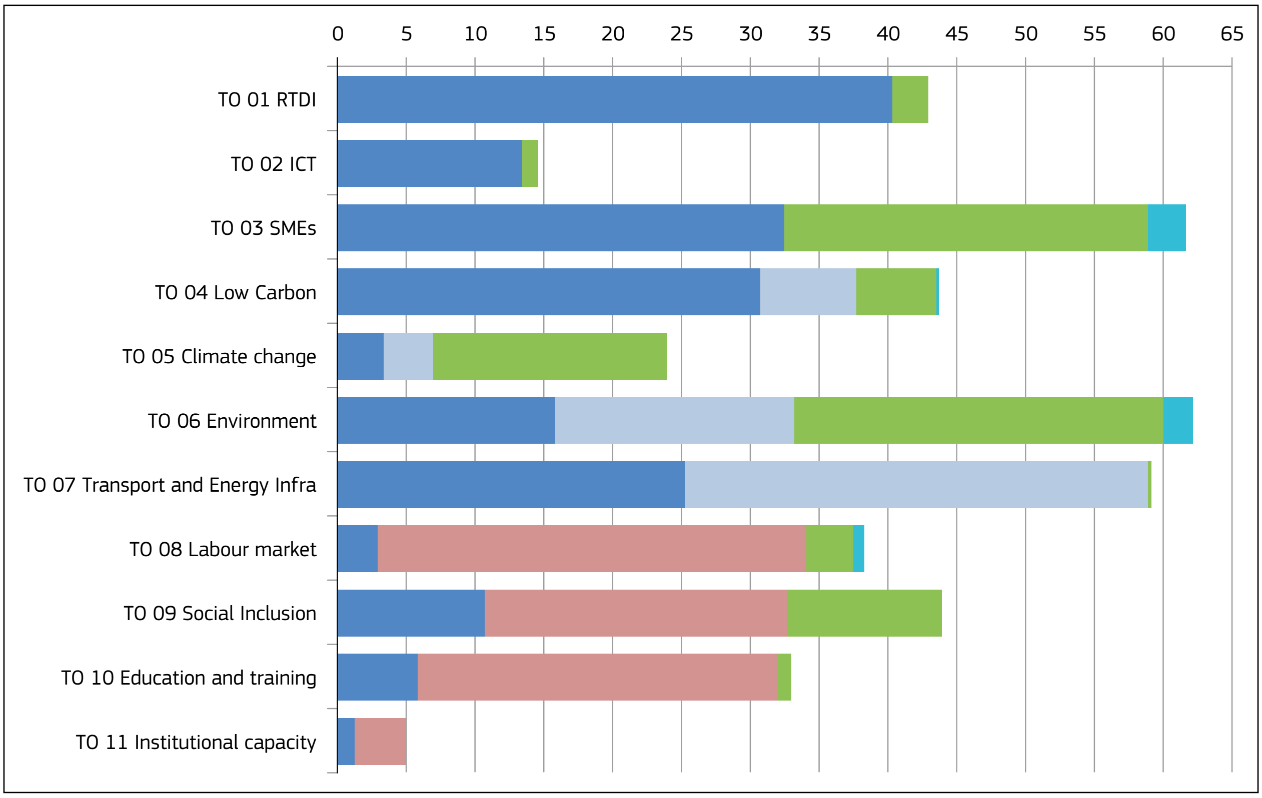
66 See: European Commission, Sixth Report on Economic, Social and Territorial Cohesion, 2014.

However, there were major variations in the degree of fulfilment of *ex ante* conditionalities: in 10 Member States, more than half of applicable thematic *ex ante* conditionalities were partially or non-fulfilled at the time of programme adoption.

The assessment of *ex ante* conditionalities also indicates areas where further work is necessary for effective investment in European priorities and for the effective delivery of the policy. The share of non-fulfilled *ex ante* conditionalities was particularly high in some policy areas such as environment, transport infrastructure, research & innovation, social inclusion. These fields tend to coincide with policy areas where evaluations and the European Court of Auditors reports had already identified some weaknesses, for instance: lack of transport master plans, inappropriate water pricing policy, poor waste management and prevention programmes.

Overall, the weaknesses created by the non-fulfilment of *ex ante* conditionalities have been addressed by action plans, which have in many cases already led to improvement of the situation since the adoption of programmes.

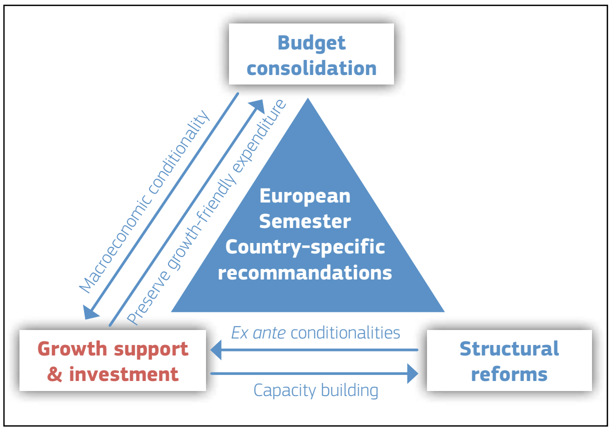
Graph 4: Funding priorities 2014-2020, ESI Funds (■ ERDF, ■ ESF, ■ CF, ■ EAFRD, ■ EMFF) EUR billion, without technical assistance



Source: European Commission, DG REGIO

5 CONCLUSION

It has been argued in this paper that as a result of the changing economic and policy environment **Cohesion Policy has become much more closely integrated with the new European economic governance**. It can be argued that it has become the **investment pillar** of the new European Semester policy framework supporting structural reforms through capacity-building and *ex ante* conditionalities and preserving growth friendly expenditure in the context of budget consolidation. At the same time, it has become part of the bigger structure of incentives and sanctions which are part of the implementation (but also the political economy) of the new economic governance.



Source: European Commission, DG REGIO

This contrasts with the earlier Lisbon model which saw Cohesion Policy as essentially a funding instrument for supporting job creation and competitiveness.

The proposed changes have faced criticism from the European Parliament which have been addressed in the negotiations process by introducing a number of safeguards ensuring a balanced designed of macroeconomic conditionality. The political focus on these elements should not distract from the fact that the other elements of the alignment constitute fundamental changes to the Cohesion Policy.

As highlighted above, the policy is now **closely linked** to processes of **structural reform** and **targeting of investment** linked to the Annual Growth Survey and National Reform Programmes. On the one hand, this is fully consistent with the current consensus in economic development policy circles that **sound economic policies**, robust institutions and targeting of programmes on growth-enhancing expenditure are necessary **preconditions for sustainable long-term growth**. On the other hand, it raises new questions without providing answers to old ones. The Barca report, the papers of the two Commissioners and the work of the OECD in 2008 and 2009 sought to address the **potential trade-offs** between European priorities and regional needs, between the reduction of regional disparities and maximising national growth, between the redistributive and the allocative effects of the policy. This remains unfinished business. Finally, further reflection on the delivery mechanisms of the policy may be required if its role in structural reform and public investment is to be consolidated.

We should not be surprised that unfinished business remains. In the report on economic and monetary union in the European Community presented by Jacques Delors in April 1989, the committee recommended that to complete the final stage of Economic and Monetary Union:

> 'Firstly, there might need to be a further strengthening of Community structural and regional policies. Instruments and resources would be adapted to the needs of the economic and monetary union.
>
> Secondly, the rules and procedures of the Community in the macroeconomic and budgetary field would become binding. In particular, the Council of Ministers, in cooperation with the European Parliament, would have the authority to take directly enforceable decisions .... to apply to existing Community structural policies … terms and conditions that would prompt member countries to intensify their adjustment efforts [67].'

67 Committee for the study of Economic and Monetary Union, Jacques Delors Chairman Report on economic and monetary union in the European Community, presented on April 17, 1989.

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ANNEX : Timeline of key events in (i) economic and financial crisis (ii) reform of economic governance (iii) reform of cohesion policy[68].

Economic and financial crisis	Reform of economic governance	Reform of cohesion policy
2008		
September: Lehman Brothers, a major US investment bank, files for bankruptcy. Many other US financial institutions are under pressure. *September*: Ireland guarantees deposits and debts of its six major banks. *October*: US Treasury injects capital to troubled banks. *November*: EU and IMF provide balance-of-payment assistance to Hungary (loan of EUR 6.5 billion) in response to serious financial market turbulences in this country. *October-December*: It is the first quarter when GDP declined in the EU (by 1.6 % in comparison with the same quarter of the previous year).	*October*: Euro area leaders announce a concerted European action plan to ensure liquidity for financial institutions. *November*: The European Commission proposes the European Economic Recovery Plan with national and EU fiscal stimulus measures of EUR 200 billion.	*December*: European Commission's communication 'Cohesion Policy: investing in the real economy' proposes changes in cohesion policy programmes to support recovery effort such as accelerating the advance payments, modifying programmes to invest more in areas of high growth potential, broader use of flat rates and lump-sums costs. *December*: The Commission's 'Regions 2020' report concludes that the policy framework needs to be adapted to help regions to deal with globalisation, ageing populations, climate and energy challenges.
2009		
January: EU and international balance-of-payment assistance to Latvia (loan of EUR 4.5 billion). *June*: EU and IMF balance-of-payments loan to Romania. *January – June*: GDP decrease in the EU was the most significant in this period (by 5 % on the same period of the previous year). *October*: Greek public finance deficit expected to reach almost 13 % of GDP in 2009, which leads to deterioration of country's sovereign rating.	*February*: recommendations by de Larosière Group on cross-border financial supervision. *May*: The European Commission proposes stronger financial supervision in Europe. *December*: EU ministers of finance agree to create three European authorities to supervise banking, insurance and securities markets.	*February*: Commission's decisions giving Member States more flexibility in their use of the Structural Funds (between priorities) and extending the deadlines for old programmes. *April*: Commissioner Hübner's 'Reflection paper on future cohesion policy'. Establishment of a High Level Group reflecting on future cohesion policy. *April*: Fabrizio Barca's report with proposals how to reform cohesion policy for the period post 2013. *December*: Commissioner Samecki's orientation paper on future cohesion policy.
2010		
January – March: EU starts returning to positive GDP growth (+0.7 % on the 1st quarter of the previous year), but growth remains negative in several Member States. *May*: Three-year financial assistance programme to Greece including EUR 110 billion of bilateral loans from euro area countries and of IMF loans. *November*: Financial assistance to Ireland, financed from the EFSM, EFSF, IMF and bilateral loans (EUR 85 billion). *November*: Balance-of-payment assistance programme to Hungary ended.	*March*: The Commission adopts a proposal for Europe 2020, EU's long-term growth and jobs strategy, built on five targets to be met by 2020 and a stronger governance framework (European Semester). *May*: EU ministers of finance decide to create the European Financial Stability Facility (EFSF) and the European Financial Stabilisation Mechanism (EFSM) providing financial assistance in the form of loans to Member States in difficulties, with a total volume up to EUR 500 billion. *June*: Europe 2020 strategy adopted by the European Council. *September*: The European Commission proposes a 'six-pack', a package of legislative measures enforcing greater budgetary discipline within the Stability and Growth Pact and introducing the Macroeconomic Imbalance Procedure, a prevention and correction mechanism for excessive macroeconomic imbalances. Similar proposals were made by the Task Force on Economic Governance and endorsed by the European Council in October. *November*: Euro-area finance ministers agree to replace the EFSF by a permanent mechanism to safeguard financial stability in the euro area – the European Stability Mechanism (ESM).	*June*: The Commission adopts new measures simplifying management rules for the Structural Funds and Cohesion Fund, such as a single ceiling of EUR 50 million for all major projects; simpler procedure for revision of programmes; enhancing the use of financial engineering in clean energy projects. *June*: The Council conclusions ask the Commission to align future cohesion policy with Europe 2020 strategy and to explore possibilities for a better co-ordinated and simplified cohesion policy. *October*: The Commission's Budget Review presents the ideas for the EU budget beyond 2013. It suggests that cohesion policy must better support EU-wide priorities rather than focus on poorer regions; it should be implemented as development and investment partnership contracts with Member States. *November*: The Commission's 5th Report on Economic, Social and Territorial Cohesion proposes the directions of future cohesion policy: alignment with Europe 2020, stricter conditions, increased focus on results, incentives for more effective use of the funds dedicated to cohesion policy.

68 Adapted from Pisani–Ferry, J., The Euro Crisis and Its Aftermath.

Economic and financial crisis	Reform of economic governance	Reform of cohesion policy
2011		
May: EU-IMF economic adjustment programme for Portugal (EUR 78 billion). *July*: EU area leaders agree on a new financial support programme for Greece (EUR 109 billion), a voluntary contribution from the private sector (EUR 37 billion) and lowering of lending rates. *November*: Following downgrades of their ratings, Italian and Spanish government bond yields reach unprecedented levels. Italy's new government adopts a comprehensive package of reforms.	*January*: The implementation of the European Semester, a yearly cycle of coordination of Member States' macroeconomic, budgetary and structural reform policies within the framework of the Europe 2020 strategy, started. *January*: The European Systemic Risk Board (ERSB) responsible for the macro-prudential oversight of the financial system within the EU is set up. *June*: The Commission publishes for the first time 27 country-specific recommendations based on a thorough assessment of every Member State's National Reform Programmes and plans for sound public finances. *October*: 'Six-pack' adopted by the Council and Parliament; it enters into force in December 2011. *November*: The Commission proposes a 'two-pack', an additional legislative package aimed at strengthening budgetary surveillance in the euro area.	*January*: The Commission's communication on the role of cohesion policy in achieving 2020 sustainable growth goals. *June*: The Commission's proposal for 2014-2020 Multi-annual Financial Framework. Cohesion policy is to be focused on meeting Europe 2020 objectives, oriented on results and effectiveness, include new conditionality provisions and performance reserves. New 'transition region' category is introduced. *August*: The Commission proposes to increase EU share of co-financing of cohesion policy projects for the countries with financial assistance programmes. *October*: The Commission adopts draft common provisions regulation and specific regulations for the ERDF, the ESF and the Cohesion Fund. The proposals introduce Partnership Contracts with fewer investment priorities, and harmonised rules related to different funds, including rural development and maritime and fisheries funds.
2012		
January: Latvia's financial assistance programme ends. *June*: Financial assistance to Spain's banking system (up to EUR 100 billion) following financial difficulties and nationalisation of Bankia bank. *June*: Cyprus requests EU financial assistance due to the troubles of its financial system. *August*: The European Central Bank (ECB) announces that it may intervene on secondary sovereign debt markets, which contributes to calming down the situation on these markets.	*March*: 25 Member States (all except the UK and Czech Republic) sign a 'fiscal compact' aimed at stronger fiscal discipline (including balanced budgets requirement), stricter surveillance and more automatic sanctions. *June*: Euro area leaders agree to work on a single supervisory mechanism for banks as a pre-condition for direct bank recapitalisation by the European Stability Mechanism (ESM). *October*: The ESM entered into force. *November*: The European Commission adopts a 'Blueprint on a Deep and Genuine EMU' providing for a gradual strengthening of banking, economic and fiscal cooperation in the euro area, including financial support for reforms (Convergence and Competitiveness Instrument) and finally an euro area budget. Some of these proposals, such as on the Single Resolution Mechanism, are endorsed by the European Council in December, but not the proposals regarding the fiscal union. *December*: EU finance ministers agree to establish the Single Supervisory Mechanism (SSM) with the ECB having direct oversight of the main euro area banks; non-euro area countries may also participate in the SSM.	*March*: The Commission's proposal for the Common Strategic Framework for 2014 to 2020 period. *October-November*: The Commission presents its position papers for each Member State on their main challenges and funding priorities, as a basis for the development of Partnership Agreement and programmes for the period 2014-2020. The proposed cohesion policy legislation for 2014-2020 is under debate in the Council and Parliament.
2013		
May: EU-IMF three year Economic Adjustment Programme to Cyprus (EUR 10 billion). *December*: Spain and Ireland successfully exit from financial assistance programmes.	*May*: The 'Two-pack' aimed at strengthening budgetary surveillance in the euro area entered into force. *October*: Euro area countries are obliged for the first time to submit their draft budgetary plans for the following year to the European Commission for assessment.	*February*: An agreement in the European Council on the 2014-2020 Multiannual Financial Framework (subject to Parliament's consent). *June*: New, simplified Regional Aid Guidelines for 2014-2020 adopted by the Commission. They enter into force in July 2014. *July*: Preliminary agreement of the Council and Parliament on the majority of the reform package for Regional Policy; pending is an agreement on some issues like the performance reserve and macroeconomic conditionality. *November*: Multiannual Financial Framework for the years 2014 to 2020 finally approved by the Council and Parliament. *December*: New legislation governing the next round of EU cohesion policy for 2014-2020 is approved by the Parliament and the Council and enters into force.

Economic and financial crisis	Reform of economic governance	Reform of cohesion policy
2014		
January: Latvia, which was in deep crisis in 2008-2009, has overcome the difficulties and joins the euro. *June*: Portugal successfully exits its three year Economic Adjustment Programme.	*August*: a regulation on the Single Resolution Mechanism (SRM) enters into force. However, its key part, the Single Resolution Fund (SRF) to finance the restructuring of failing banks is not established yet as ratification of the relevant intergovernmental agreement is pending. *November*: The Single Supervisory Mechanism starts operations.	*May-October*: 27 out of 28 Partnership Agreements between the European Commission and Member States for 2014-2020 are prepared based on new rules and signed; 96 % of all Operational Programmes are submitted to the Commission, and six of them have been adopted. *July*: The Commission's 6th Report on Economic, Social and Territorial Cohesion.