

HIGH LEVEL GROUP REFLECTING ON FUTURE COHESION POLICY

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PRESENTATION OF CONCLUSIONS OF THE FIFTH REPORT ON ECONOMIC, SOCIAL AND TERRITORIAL COHESION

STRENGTHENING PERFORMANCE THROUGH CONDITIONALITY AND INCENTIVES

This document has been prepared by DG Regional Policy as the basis for a discussion with experts as part of a general reflection process on the future of cohesion policy. It does not prejudge in any way the final position of DG Regional Policy or the Commission on these questions

1. INTRODUCTION

The Fifth Cohesion Report states that the improvement of the performance and effectiveness of cohesion policy is a central question for the debate on its future.

The report puts forward a number of ideas in this direction building on previous Commission's documents, and in particular the EU Budget Review¹ adopted on October 19th and those related to the discussion on the strengthening of the economic governance of the EU².

This paper examines, in particular, one idea presented in the Cohesion Report under the section on "conditionality and incentives":

(1) *"First, to support the new economic governance system new conditionality provisions would be introduced creating incentives for reforms.*

[...] specific binding conditionality in the areas directly linked to cohesion policy would be agreed with each Member State and/or region — depending on the institutional context — at the beginning of the programming cycle in the programming documents (i.e. the development and investment partnership contracts and the operational programmes), in a coordinated approach with all relevant EU policies."

The thinking behind this proposal is twofold. On the one hand, the effectiveness of cohesion policy interventions depends on sound framework conditions. In the sectors where cohesion policy invests, appropriate institutional and regulatory mechanisms are necessary preconditions to ensure that the added value of EU support is fully realised. These preconditions may often be in place before the new generation of cohesion policy programmes are adopted. However, in some cases, depending on the specific regional and national context, further reforms or adjustments might be necessary.

On the other hand, the debate on the strengthening of the EU economic governance has shown that while the EU budget may be deployed *"as a complementary leverage in terms of ensuring respect of the key macro economic conditions of the SGP [Stability and Growth Pact]"*, action is necessary to help Member States at an early stage to address structural and institutional weaknesses.

¹ http://ec.europa.eu/budget/reform/library/communication/com_2010_700_en.pdf

² http://ec.europa.eu/economy_finance/articles/euro/documents/com_2010_367_en.pdf

Finally, in the context of cohesion policy, which seeks to promote sustainable growth, a stable fiscal and macro-economic framework is essential. While this discussion concerns the EU budget as a whole, this paper presents briefly some options for the implementation of financial sanctions and incentives linked to the SGP.

2. STRUCTURAL PRECONDITIONS FOR EFFECTIVE INVESTMENT

In many fields, successful policy outcomes are the result of the combination of a robust regulatory framework, effective institutions and soundly managed public investment.

In line with the strong focus on sound financial management, many of the conditionalities in cohesion policy in recent programming periods have targeted the management and audit of EU funds through mechanisms such as the compliance assessment. While continuing to improve the legality and regularity of expenditure, it is now important to also focus on regulatory and institutional weaknesses that may undermine the effectiveness and EU added value of cohesion policy investments.

The need to make cohesion policy more effective and clearly focused on performance and results calls for greater coherence between investment priorities and necessary regulatory and institutional changes. In areas where investment, regulation and institutional arrangements are closely linked in delivering the targets and thematic priorities of Europe 2020, cohesion policy can play an important role in encouraging and incentivising the associated institutional and regulatory changes.

The Commission considers that it is possible and necessary to introduce in the future organisation of cohesion policy new arrangements aimed at clearly improving its performance and effectiveness.

2.1. The concept

In a modern policy for economic and social development, "structural preconditions" are basic principles – set *ex-ante* – on how to design institutions and on how those responsible for policy implementation should design their interventions. Their aim is to foster cooperation, partnership, learning, institutional innovation, and outcome-oriented policy making. They should allow authorities to take ownership of the policy, to develop innovative approaches to policy design and delivery, and to adopt the changes required to achieve the desired outcomes.

These “conditionality principles” should thus focus on “how” to design interventions – building on the experience accumulated through past successes and failures and through evaluation – on what institutional issues must be tackled and what mistakes must be avoided in the institutional design in order to reduce the chance of policy failures.

They should not describe what the policy should achieve, or the content of the interventions or the institutions that should be designed, and they should be designed in such a way to leave room for adjustments to reflect different institutional, cultural and social contexts.

For these principles to be effectively implemented, four requirements need to be satisfied.

First, they must be **enforceable**. This means that they must be written in a way which can indeed allow *ex-post* verification. The arrangements for monitoring and assessing progress towards their respect have to be effective, simple and transparent.

Second, they must be **non-prescriptive**. They must not describe specific solutions or prescribe “best practices”, but rather ensure that users of cohesion policy funding have tackled in a reasonable way the problems that past experience has proved to be of particular relevance in policy implementation. Moreover, their definition and the associated regulatory and institutional changes in a given Member State must reflect the constitutional and statutory division of responsibilities and legal competences.

Third, they must be **credible**. The description of conditionality principles and *ex-post* verification of their implementation must be undertaken in a manner which is accepted as fair, transparent and rigorous. For this purpose, DG REGIO intends to set up task forces bringing together expertise from geographical units, relevant sectoral DGs, and experts.

Finally, they should be **shared**. In other words, the agreed principles should be the result of a process of dialogue, exchange and verification between all of the institutions concerned. The changes required need to be clearly owned by the national and regional actors responsible for their implementation. They must embody the needs and priorities of the intended final beneficiaries; and, most importantly, they must reflect the demands of EU citizens for transparency and accountability in the use of EU funds, thereby guaranteeing that the EU budget will be used effectively in their interests.

2.2. How could the system work?

First, after an open and strategic debate, a number of “conditionality principles” would be selected and included in the regulations and/or in the Common Strategic Framework. These can be common to all priorities covered by cohesion policy, for example concerning the need to clearly identify policy objective or to select projects. But they can also, and most of them are, specific to the different thematic priorities covered by cohesion policy, for example to ensure that interventions reflect the sectoral guidelines that have been agreed at EU level.

Second, the conditionality principles fixed in the regulation and/or CSF would constitute the basis for the Member States and Regions to turn those principles into specific conditionalities to be introduced in their Development and Investment Contract and in their Operational Programmes. In practice a number of steps would be followed:

- Depending on the thematic priorities selected, identification of those thematic areas in which conditionalities would apply.
- An assessment of progress to meeting the cross-cutting and thematic conditionality principles defined in the relevant parts of the regulation/CSF would be undertaken. The Member State/Regions and the Commission would carry out this assessment on the basis of past experience, current progress, National Reform Programmes and thematic coordination. For those areas where the relevant conditionality principles had not been met or only partially met, the Member State would present in its strategy a series of verifiable commitments to implement the necessary changes and the action and timetable for their fulfilment. The Commission would present a similar assessment in its negotiating position.

- On this basis, the Commission, Member States and Regions would agree most of the conditions in the Operational Programmes (timetable, fulfilment criteria) and summarise them in the Contract. Those Member States and Regions which consider that they already have, for a given priority, the appropriate institutions and mechanisms in place can simply describe them and suggest that no adjustment is necessary.

Depending on the nature of the commitment, the fulfillment of the conditionality could be set as a precondition for starting expenditure/commitments in the relevant priority area(s), or expenditure/commitments could be allowed for a certain period and then stopped if sufficient progress had not been achieved by a defined date on the basis of a review.

The actual implementation of the commitments would be monitored throughout the programming period. This monitoring would be based on: the continuous working relation between national authorities and the Commission; a dialogue with the domestic institutional, political and social partners in the Monitoring Committees; and the self-assessment provided by the Member State in its Annual Report.

To support the implementation of the structural pre-conditions described above, cohesion policy could provide greater means to Member States to target support on specific institutional and structural reforms. This could be achieved by:

- extending the support under cohesion policy to support institutional and administrative reform to all regions;
- providing specific, flexible support to encourage reform in the form of a block grant. Such a facility could be created by allowing an additional [1 %] of technical assistance which would be linked to an action plan for regulatory and institutional change and outcomes rather than declaration of eligible expenditure;
- setting up special technical assistance facilities for Member States in particular need (access to which could also be potentially linked to the fulfilment of certain conditions).

Q1: What are the necessary structural preconditions for effective investment from ERDF and the Cohesion Fund?

Q2: How can ownership of the commitments undertaken in the context of structural conditionality be best ensured?

Q3: How can technical assistance be best used to support the necessary institutional and structural changes necessary to ensure effective implementation of ERDF and Cohesion Fund measures?

3. SANCTIONS LINKED TO THE STABILITY AND GROWTH PACT (SGP)

One of the main legacies of the crisis is the dramatic increase of public debt in the European Union. As a result the Union has agreed on a strong commitment to accelerated fiscal consolidation as stated by two COM Communications adopted in spring/summer 2010³. One of the major objectives of these Communications is to ensure adequate economic surveillance and the achievement of fiscal consolidation through the

³ COM (2010) 250 and COM (2010) 367

enforcement of “*appropriate sanctions and incentives*” beyond those existing at present, also by deploying “*the EU budget as complementary leverage in terms of ensuring respect of the key macro economic conditions of the SGP*”.

In the current legal framework of EU cohesion policy there is only a provision on sanctions related to the SGP⁴, whose main features are that:

- it only applies to the Cohesion Fund;
- the sanction can only be proposed to a country under Excessive Deficit Procedure which has not taken sufficient action following a Council Recommendation; and
- discretion is given to the Commission and the Council to decide whether to apply the sanction or not. This has led to the situation that a suspension of the Cohesion Fund has never been proposed by the Commission (which has been criticised in the spring Communication)⁵.

While the discussion on relation with the SGP concerns the EU budget as a whole, the application of sanctions in the context of cohesion policy needs to meet two pre-conditions:

- (1) the sanctions are necessary to ensure the effectiveness of the policy; and
- (2) the legal provisions need to ensure equal and fair treatment to all Member States.

Accordingly, the main changes related to cohesion policy compared to the current period could be the following:

- Sanctions would apply to all Funds (ERDF/ESF) and not just to the Cohesion Fund. They would thus apply to all Member States and not just to those eligible to the Cohesion Fund (equal treatment).
- The application of sanctions (i.e. suspension of commitments for year n+1)⁶ could be made more automatic. In the present framework the Commission and the Council enjoy a high room of discretion to decide whether a sanction should be applied or not. In the future, commitments could be automatically suspended in case that a Member States does not take effective action following the Council Recommendation. To provide some degree of political discretion, it could be useful to foresee the possibility for the Commission to provide a recommendation to the Council not to use the suspension due to specific economic circumstances of the country in question.
- The access to a possible performance reserve at mid-term could be denied to a Member State under Excessive Deficit Procedure which has been identified as not having taken action in response to a Council recommendation.

⁴ Article 4 of the Cohesion Fund Regulation (EC) 1084/2006

⁵ The Communication states that “the suspension of the Cohesion Fund is only considered at a late stage of the Excessive Deficit Procedure” and that “a more rigorous and rules-based application of the existing suspension clause for Cohesion fund commitments should be pursued in case of recurrent breaches of the Pact”.

⁶ This means that payments could be continued on the basis of the commitments of previous years.

- In the case that a Member State has been subject to a sanction, the Commission could be given the right of initiative to modify the Development Contract and the Operational Programmes to the extent it considers this necessary to address the problems of the country concerned.

Q4: How could a modified sanction mechanism be best integrated within the strategic programming process for cohesion policy?

Annex

Example of conditionality principles

These examples are not a proposal, but simply a way to test whether the principles indicated above are actually enforceable and non-prescriptive; to collect alternative proposals; and to open a debate on this crucial aspect of the reform of cohesion policy as proposed by the Commission.

Cross-cutting conditionality principles

- **Link between projects and objectives.** For each thematic priority, Operational Programmes set the objectives in terms of outcome indicators and targets, describe the typology of projects that they plan to implement, and explain how and with what time-lag they are expected to achieve those objectives.
- **Outcome indicators and targets.** For outcome indicators and targets the Operational Programmes provide information and commitment on a list of minimal requisites such as clarity and accepted normative interpretation; responsiveness to policy intervention; source, robustness and statistical validation; timely collection, publication and availability.
- **Evaluation.** Operational Programmes include the plan for on-going evaluation. The impact evaluation and assessment of projects is designed ex-ante, ensuring the appropriate collection and diffusion of data and results. For a sample of projects, evaluation panels are created, including both “local” and “external” assessors.

Thematic conditionality principles

I. Promoting innovation and smart specialisation

- Launching of the programme follows a preliminary search aimed at: identifying the territory of intervention; its comparative advantages in terms of unused knowledge base and innovation potential; synergies with other territories. Competition with other territories and mobility of researchers is maintained and promoted.
- In the selection criteria for projects and in their implementation, incentives are used to reduce the risks of attracting the wrong actors (adverse selection) and of them not making the effort that the public intervention calls for (moral hazard). Examples are:
 - a) Conditioning the transfer of funds to verifiable outcomes in those phases of the innovation process which can be sufficiently standardised.
 - b) Separating the innovation process in phases and granting funds sequentially, according to the performance in the previous phase.
 - c) Designing, when possible and useful, incomplete contracts with open-ended requisites which a third party is then asked to interpret and monitor ex-post.

II. Removing bottlenecks to key network infrastructures

- At least X % of funding is allocated to priority projects of EU interest, listed in the Operational Programmes, which are expected to bring about the highest outcome in terms of elimination of bottlenecks in the flows of people and goods [*list of 2-3 effects that represent the main outcomes on the basis of which the updated TEN strategy is being built*].
- Complementary investments in secondary connectivity, aimed at ensuring that all regions benefit from the opportunities created by the major networks, are selected on the basis of their expected contribution to [*list of 2-3 effects that represent the main outcomes to be expected*]
- [*A conditionality principles aimed at guaranteeing conditions of access in rail infrastructure for independent operators and incentive mechanisms both for the respect of deadlines in the construction and for quality and quality maintenance*]

III. Correcting and preventing the unsustainable use of resources

- The water framework directive foresees the putting in place of water pricing arrangements by 2010. Within the broader context of the monitoring requirements of the directive, it may be possible to introduce relevant trigger points.

IV. Removing obstacles to the growth of SMEs

- Implementation of those provisions of the Single Market Act that tackle bottlenecks particularly relevant for the MS.