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Abstract

This paper asks whether we can, from an economic point of view, justify the EU Cohesion Policy. To this end, our research – using structural equation modelling, macro-economic modelling and regional input-output analysis – found a) positive dynamic effects of Cohesion Policy on regional growth, b) small static effects on output if parts of the Cohesion Policy funds are reallocated to the strongest EU economies and c) strong demand spillovers from the less-developed to the more-developed regions. For us, the dynamic Cohesion Policy gains in growth outweigh the static allocation inefficiency. Additionally, the spillovers from the less-developed regions mitigate potential losses in the more-developed regions. Therefore, our answer to the question 'Can we justify EU Cohesion Policy from an economic point of view?' is 'Yes, we can.'

Keywords: Cohesion Policy, EU regions, regional development

JEL classification: R11, R58

Can we justify EU Cohesion Policy?

Sometimes it is good to recall that the word 'cohesion' has Latin origins and derives from the verb *cohaerere*, meaning 'to grow together' or 'to be connected to each other'. If you are ever asked to explain in a single sentence what EU Cohesion Policy is all about, it helps to be aware of this.

It could be argued that the Romans were the first to take cohesion (or Cohesion Policy) seriously, when they created the first unified pan-European, North African and Middle Eastern economic area. Of course, the Roman Empire was forged in blood; but, once established, it did bring 450 years of (near) stability and prosperity.[1] This was because not only did the Romans bring '*the sanitation, the medicine, education, wine, public order, irrigation, roads, the fresh water system, and public health*' to their provinces – they also '*brought peace*'.[2]

There are certain similarities to be found in the history of the EU: it was born from the ashes of two world wars; it aims at developing less-favoured regions; and it won the Nobel Peace Prize in 2012, having '*for over six decades contributed to the advancement of peace and reconciliation, democracy and human rights in Europe*'.[3]

Today, it is clear that EU Cohesion Policy has played a definite part in the EU's success. But it was not always so: Cohesion Policy had a rather rocky start. Although the idea was acknowledged in the 1957 EU Treaty of Rome, it was not until the late 1960s – early/mid 1970s that Cohesion Policy was formally established, with the creation of the Directorate-General for Regional Policy in 1968 and the establishing of the European Regional Development Fund (ERDF) a in 1975. But even by then, regional policy was considered a national rather than European affair.

Despite a gradual Europeanisation thereafter it was not until 1988/1989 that, also as a reaction to the accession of the economically weak countries Greece (1981), Portugal and Spain (1986), the reform of Cohesion policy marked a "*significant step towards a more coordinated and more incisive regional policy*"[4]. From then on, Cohesion Policy became more and more important as first ten mostly Central- and Eastern European countries joined the EU in 2004, increasing the EU's population by 20%, but its GDP by only 5%. It was followed by the accession of Bulgaria and Romania in 2007 and finally in Croatia in 2013.

The accession of these economically weak countries was a major shock to Cohesion Policy, and, one might argue, something it was, by design, not fully prepared for at the begin. But over time it evolved, adapted and adjusted to tackle existing and the emergence of new challenges. And still, despite contributing to the development of weaker regions, Cohesion Policy has come under fire and '*remains*

[1] Considering here only the Western Roman Empire from Emperor Augustus (27 BC) to Emperor Romulus Augustus (AD 476). The Eastern Roman Empire lasted until 1453, i.e. the fall of Constantinople.

[2] Borrowed (happily) from Monty Python's *Life of Brian.*

[3] https://www.nobelprize.org/prizes/peace/2012/summary/

[4] Commission of the European Communities (1985), Tenth Annual Report (ERDF), COM (85) 516.

under threat, as a range of academics, analysts, practitioners and European governments continue to question the policy's rationale, organisation and effectiveness'.[5]

In our opinion, some of the criticism serves a useful purpose. After all, Cohesion Policy utilises public (i.e. taxpayer) money to finance its operations, and so there will always be questions of accountability and effectiveness. Those who handle Cohesion Policy money are expected to use it to maximise the utility to Europe and the value added. They are also expected to treat it with the respect it deserves, as it derives from the activities of people all over the EU. In other words, greater transparency and accountability are not only useful, but may even boost acceptance of the EU, as people learn what is being done with 'their' money and come to see that Cohesion Policy funds are being spent in a reasonable way. Also, increased accountability and transparency at the EU level could provide a good example for national policy makers.

Here, we are concerned with the question: 'Can we justify EU Cohesion Policy from an economic point of view?' A research project supported by the Austrian National Bank has focused on finding an answer to this. The outcome has been three papers.

The first (by Maucorps, et al.)[6] analyses the effects of the EU Cohesion Policy on the economic growth of 276 European NUTS-2 regions between 2008 and 2016. Using a structural equation model, the authors defined two indices. The first is based on the regions' economic structure, skills supply, accessibility and degree of urbanisation, and provides information on their structural advantages and disadvantages. The second index is based on Cohesion Policy investment from the ERDF, the Cohesion Fund (CF) and the European Social Fund (ESF), as well as other forms of investment. It shows the regions' reliance on (EU) investment for development. Both indices are illustrated in Figure 1.

The structural index (left-hand map) shows that regions with a structural disadvantage (in terms of economic growth) are located not only in the economically weaker countries of the EU's South or East, but also in economically stronger countries, like the UK or Sweden (although there, the weak regions are sparsely populated). Also, not all regions in the economically weak countries are structurally disadvantaged (this is especially true of the capital cities).

In the EU, the difference is that the economically strong countries have enough resources of their own to support their weaker regions, whereas especially in the countries of CEE, EU Cohesion Policy is often the only policy that deals explicitly with regional development, i.e. there is little or no national regional policy – except for in Poland. This reliance on EU investment is illustrated in the right-hand map.

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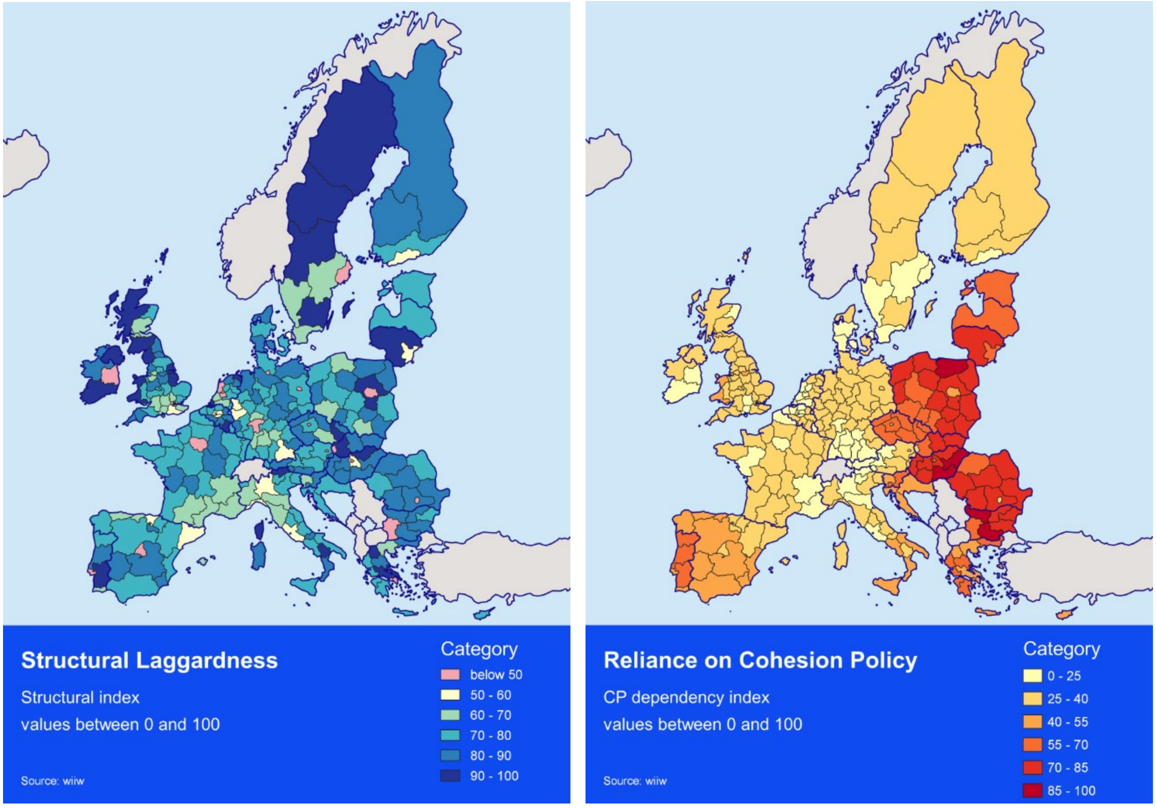
5 G.P. Manzella and C. Mendez (2009). The Turning Points of EU Cohesion Policy, EPRC Working Paper, University of Strathclyde.

6 A. Maucorps, S. Jestl and R. Römisch (2020). The Effects of the EU Cohesion Policy on Regional Economic Growth: Using Structural Equation Modelling for Impact Assessment, wiiw Working Paper No. 185, August 2020.

Figure 1 / Structural and investment index



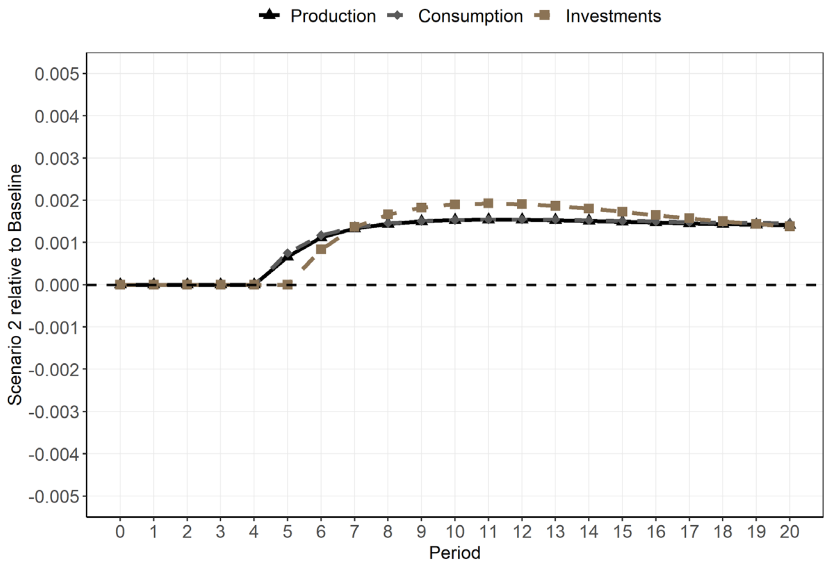
Source: Maucorps et al. (2020).

Turning to the results, Maucorps et al. find that Cohesion Policy support has positive effects on GDP growth. On the other hand, a disadvantageous economic structure dampens regional growth, reflecting the difficulty that regions with deficient structural capacity have in fully exploiting Cohesion Policy funding. Besides, quality of governance, GDP growth in neighbouring regions and population show a positive effect on regional growth. This indicates that, in line with the literature, institutional capacity, spatial spillovers and demographic size are additional drivers of economic growth. Finally, Maucorps et al. also find that income levels across the EU regions tend to converge over time.

The second paper (by Jestl and Römisch)[7] constructs a demand-driven macroeconomic model that spans the country models of 21 EU economies. Using that model, the authors analyse the economic effects of a reallocation of Cohesion Policy expenditure across EU countries. To illustrate the point, in one scenario they assume that 50% of the total ERDF and CF support for CEE countries in the period 2000-2015 is redistributed to the four largest European economies of Germany, France, Italy and the UK. This corresponds to a shift of around EUR 73.7 billion (in 2015 prices). On this assumption, Jestl and Römisch estimate the effects on EU aggregate output, consumption and investment. The results are shown in Figure 2.

[7] S. Jestl and R. Römisch (2020). On the Economic Effects of a Reallocation of EU Cohesion Policy Expenditures, wiiw Working Paper, No. 183, August 2020.

Figure 2 / Total production, consumption and private investments in EU economies – scenario estimations



Note: To obtain the percentage change in the variables, the scale should be multiplied by 100.
Source: Jestl and Römisch (2020).

The results suggest that a reallocation from the weaker economies to the strongest would have positive effects on aggregate production, investment and consumption. The size of the effects would vary between 0.15% and 0.2%. This means that a one-off reallocation of 50% of the total ERDF and CF support to CEE countries in 2000-2015 would have a one-off effect on EU output of 0.15%. Irrespective of the size of the effect, its direction is not really surprising: the strongest EU economies are, on average, technologically more advanced than the countries of CEE, and so shifting investment to them would be likely to produce a higher return over the short term. Put differently, technology and agglomeration effects seem to be stronger than the law of diminishing returns.

The third paper (by Römisch)[8] develops a method to consistently break world input-output tables down into regional input-output tables. The resulting regional input-output tables are used to estimate Cohesion Policy-induced demand spillovers in the EU over the years 2007-2018. In this period, total ERDF, CF and ESF support was around EUR 460 billion (in constant 2016 prices). Of this, the less-developed regions of the EU received around EUR 274 billion (i.e. around 60% of the total), the transition regions around EUR 70 billion (i.e. 15%) and the more-developed regions around EUR 117 billion (i.e. around 25%).

This money was used for EU co-financed public and private investment, upgrading of skills, construction of infrastructure, etc. In short, it created investment and consumption demand. The point about Cohesion Policy spillovers is that part of the demand that is created through EU support in one country is satisfied by importing goods and services from other countries. That is, less-developed regions spend part of their EU support on imports from more-developed and transition regions, while more-developed

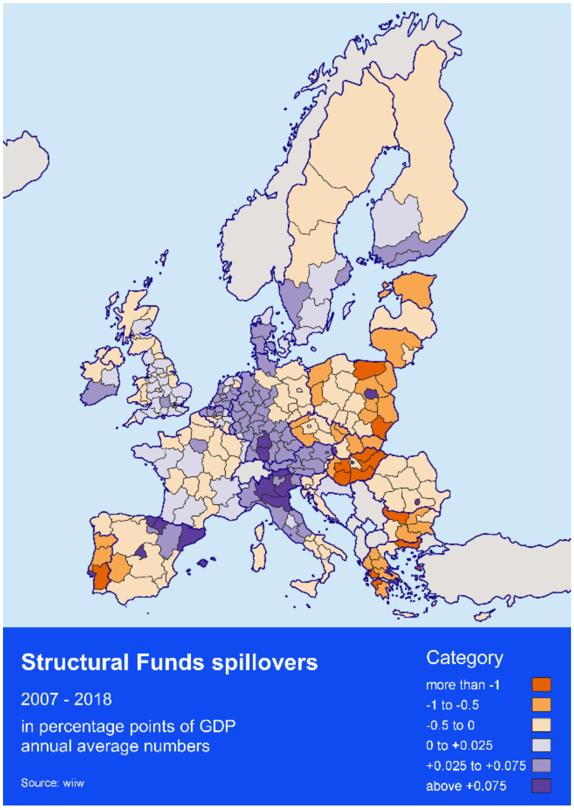
[8] R. Römisch (2020). Estimating Demand Spillovers of EU Cohesion Policy Using European Regional Input-Output Tables, wiiw Working Paper, No. 184, August 2020.

regions buy intermediate inputs and final goods or services from the less-developed and the transition regions (and the same goes for the transition regions).

On a net basis, i.e. considering all flows across all types of region, Römisch’s findings suggest that the spillovers from the less-developed regions were around EUR 85 billion. That is, in these regions outflows of Cohesion Policy spillovers were much higher than inflows. Net negative spillovers of around EUR 20 billion were also found for the transition regions, while the more-developed regions received net positive spillovers of around EUR 54 billion. Around EUR 52 billion leaked to countries outside the EU.

At the more detailed regional level, net negative spillovers in terms of GDP were largest for those regions where initial funding was also large in terms of GDP (e.g. the Hungarian and eastern Polish regions). There, negative spillovers to other regions were up to 2% of GDP per year. The regions that benefited from these spillovers were the more-developed regions, including some of the capital cities of Central and Eastern Europe. The regions that gained most were the industrially strong regions, mainly located along the ‘blue banana’ in the EU, but also including the strong centres in the Scandinavian countries (see Figure 3).

Figure 3 / Structural Fund spillovers, 2007-2018, NUTS-2 regions



Source: Römisch (2020).

To summarise, our results show:

› positive dynamic effects of Cohesion Policy on regional growth;

› small static effects on output if Structural Funds are reallocated to the strongest EU economies; and

› strong demand spillovers from the less-developed to the more-developed regions.

In conclusion, we are convinced that the dynamic Cohesion Policy gains outweigh the static allocation inefficiency. Additionally, the spillovers from the less-developed regions mitigate potential losses in demand in the more-developed regions. Therefore, our answer to the question ‘Can we justify EU Cohesion Policy from an economic point of view?’ is ‘Yes, we can.’

IMPRESSUM

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