Payment by results and structural reforms in the post-27 Cohesion Policy Framework

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1. **Rethinking the ambition and potential of Cohesion Policy in Europe**

The compelling raison d'être and one of the main goals of the European Union (EU) is to reduce disparities in the levels of development among regions and prevent the least favoured ones from stagnating. Thus, Cohesion Policy (CP) is at the heart of the single market and is the EU's main instrument for promoting economic convergence among regions.

There are clear economic and social justifications for CP. Economic convergence is beneficial for the overall economic stability of the EU, as it creates a more balanced, more integrated internal market. It also promotes a sense of solidarity and fosters deeper integration within the EU. It helps bridge economic and social gaps, strengthens cooperation and contributes to a more cohesive, more united Europe. There are also other justifications, such as upholding the EU's priority of promoting smart, green, sustainable development, which have been progressively incorporated but which are difficult to reconcile, given the differences in the natures of these objectives, in their territorial impacts and in their timeframes.

It should be noted that the EU's response to the crisis caused by the pandemic and subsequently to the Russian invasion of Ukraine has sparked an important and necessary debate on the identity, objectives and mechanisms of the CP. At the same time, the Recovery and Resilience Facility (RRF) has burst onto the budgetary scene of all institutions, establishing an entirely new paradigm for EU funding of Member States and regions.

On top of that, all this is happening in a context where crises have become the norm and the megatrends of decarbonisation and digitalisation seem to have accelerated. In this scenario, regional disparities are likely to widen in the next few years and strengthening the European CP is becoming an even more urgent need than ever. The following reflections on the role of structural reforms and payment by results in the post-27 CP should be seen in this context.

2. **The impact of cohesion policy, development traps and structural reforms**

The current debate on the role of structural reforms and payment by results in the post-27 CP hints at a latent concern about the lack of effectiveness and/or efficiency of CP as currently designed.

Many efforts have been made to measure the impact of CP in reducing regional disparities, but there are major difficulties related to the availability of adequate data and methodologies for such measurements. The wide range of studies that make up the scientific literature which seeks to analyse the impact of CP are not conclusive.

Some articles conclude that positive results can be seen in the long term, others that positive results can only be seen in the short term, and others find either no effects or even negative effects. In many cases the diversity of results seems to be due to issues such as the complexity associated with local circumstances, the diversity of policies and actions implemented at regional level outside CP, the presence (or not) of inter-regional spillover effects, the time scale of impact analyses and so on (Bachtrögler *et al.*, 2020; Crucitti *et al.*, 2022; Darvas *et al.*, 2019).

Some of the studies concerned with the lack of effectiveness of CP in reducing regional disparities seem to suggest that there are «development traps» at regional level[1] that may require specific attention and may explain the concern about the need to «fine-tune» CP to improve its effectiveness.

One contribution of these analyses to CP design is to recognise that such traps can occur at different income levels. Indeed, some European regions with above-average per capita income levels could be at high risk of falling into development traps, as are some of the least developed regions. Breaking out of these traps is also

[1] A regional development trap is defined as the state of a region unable to retain its economic dynamism in terms of income, productivity, and employment, while also underperforming its national and European peers on these same dimensions.

essential for Europe as a whole, as it would not only strengthen GDP growth, productivity and employment in these regions but also help to improve the competitiveness of enterprises and the quality of life of the European population as a whole.

This could also serve as a justification for proposing structural reform conditionalities in CP. The question that arises in this particular case, however, is whether such conditionalities should be established at the appropriate territorial scale, respecting a multi-level governance architecture.

Note that both the RRF and the CP require Member States to address the challenges and priorities set out in the country-specific recommendations under the European Semester. However, the RRF Regulation directly links funding to the national structural reforms set out in these recommendations, while the CP requires Member States to address all or a significant part of the challenges included in the country-specific recommendations in their recovery and resilience plans. Therefore, if structural reform conditionalities were to be established in the CP, they should be regionally relevant and should recognise regional governments as necessary negotiating partners.

The fact that national and regional governments can and do have different orders of priority should not be overlooked. The Committee of the Regions has already warned in its *State of the Regions and Cities of the EU 2022 Report* that centralised management by state governments of European post-pandemic recovery funds risks increasing territorial inequalities between regions in the EU.

This neglect of regional gaps by state governments has led to considerable attention being paid in Europe to the less advanced regions through CP. But it must be remembered that, caught between these two points of view (the centralist vision of Member States and the vision focused on the most disadvantaged regions of the CP) there are many regions which are in «development traps» or at risk of falling into them in the many and varied circumstances in which they occur in Europe. Such development traps can only be addressed through interventions that go beyond the traditional concern for less developed regions.

A case in point can be found in the infrastructure policies of the Member States, which can ignore the circumstances and determining factors for the economic take-off of the regions. In this sense, the unease and concern of the regions of the Spanish-French Atlantic arc, including the Basque Country, is clear, given the delay recently announced by the French state in the proposed connection of these regions via a high-speed rail network. This delay could condition progress, reduce productivity and force them into stagnation.

Recognising, therefore, that CP should broaden its focus to cover not only less developed regions but also the development traps that threaten regions at different income levels, let us return to the question of what role structural reforms could play in CP.

Most structural policies are «place-blind». This means that in most cases they are applied uniformly throughout the territory of a state and do not change from one region to another. This place-blind nature of structural policies is often unavoidable and is actually desirable in most cases. However, the place-blind nature of structural policies limits their potential for addressing serious differences in economic performance across regions. Moreover, it means that some structural policies set at national level are not optimal for specific regional contexts. The fact that most structural policies do not take place into account does not mean that they are place-neutral, so it is difficult to use them to address problems that exist only in some parts of a state. Given the considerable differences in economic structure and economic performance across regions, structural policies that are appropriate for one part of a state may not be appropriate for another. This means that responding to the large, persistent inequalities between regions calls for policies «with a distributed development approach», as defined by Iammarino *et al.* (2019).

3. The results-based approach

Results-based funding has now become a dominant form of EU funding, as it is the default option for the RRF and began to be introduced on an optional basis under the CP framework from 2014-2020. Performance-based thinking is here to stay in public management, with spending efficiency as the best tool for sustaining the budgetary demands of the European welfare economy. But orientation towards performance must be more than a concept.

So far, result conditionality in cohesion funds has the experience of an explicit 'performance framework' for Member States' operational programmes provided by the 2014-2020 common provisions regulation, including milestones and targets to be attained with European Structural and Investment Fund investments. The European Court of Auditors (ECA) has published a special report on the use of new instruments for performance-based financing in EU CP in the 2014-2020 period that refers to «worthy ambitions, but obstacles» in its title (ECA, 2021) and has concluded that (1) the introduction of the performance framework in the 2014-2020 period has contributed to a cultural change in the financial management of CP; (2) performance-based financing is not yet a reality in CP; and (3) the two new instruments («joint action plans» and «financing not linked to costs») have led to new approaches to implementation have not made any noticeable difference to the way in which EU funding is allocated and disbursed.

As mentioned, performance orientation has to be more than a concept. It requires careful preparation and operational models, including sound methods for estimating costs and meaningful criteria for financing and for partial payments. It should not be forgotten that this innovative form of financing may not be suitable for all areas and investments. This is especially the case where there is a time lag between investment and the achievement of results, or where the achievement of results may be significantly influenced by external factors.

It must also be borne in mind that moving to a system of payment by results requires a radical cultural change, starting with the officials who for decades have been managing a system that is focused on spending funds on the terms stipulated by the operational programmes.

Note also that for these instruments to be attractive, they need to offer a lighter administrative burden and easier implementation. However, establishing performance-based instruments calls for an initial investment in terms of administrative resources, and that investment should not be underestimated.

Progress should therefore be made towards a payment-by-results model, but without forgetting that such a model is by no means a panacea and could even bring more drawbacks than benefits in some areas.

4. Concluding remarks

Over almost half a century CP has evolved from a minor fund to one of the most important spending priorities of the EU. However, in this new millennium, and especially since the 2008 crisis, very important fronts and challenges have opened up that will condition the future development of CP. The success of CP in reducing regional disparities is questionable and there is a widening gap between stagnating and leading regions. Ways must be found to address these development traps, and to do so at a time when the EU is aiming to achieve very ambitious targets for the remainder of the decade. Right now, the EU needs to channel investment from the RRF quickly and effectively to projects that can spur economic recovery from the recent health crisis and increase resilience to future shocks. Beyond the recovery, the EU seeks to accelerate the climate transition and digital transformation, both of which will probably have differential social and territorial impacts. Further, the EU is pursuing major structural reforms and improvements in the governance structure to better exploit the long-term growth potential of the European economy. Thus, looking forward to 2027 and beyond there are important questions for CP.

The EU funding landscape has become more multi-faceted and this requires major efforts in coordination, clear demarcation and development of complementarities between EU Funds and instruments. The experience with the RRF highlights the advantages and difficulties associated with the design of this new instrument, in which features such as results-based payments and conditionality associated with structural reforms are of great importance.

The introduction of performance indicators is supported to ensure effectiveness and enhance the legitimacy of CP. If structural reforms are to play any role in CP they should be place-sensitive.

Lastly, with respect to implementation, it must be borne in mind that for performance-oriented instruments to be attractive they need to offer a lighter administrative burden and easier implementation. In the unresolved EU dilemma between ensuring the best management standards and the ability to comply with regulatory requirements, the future design of CP in Europe should be tilted towards simplicity.

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