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« Macro-economic Conditionality in Cohesion Policy: Added Value or Unnecessary Burden? »

Roundtable Report

Markella Dimitrakopoulou

On 14 November 2012, Egmont – Royal Institute for International Relations organised a roundtable on the controversial issue of macroeconomic conditionality in cohesion policy. The event was held against the backdrop of the Commission's proposal for the EU cohesion policy 2014-2020 and on the occasion of the publication of the Egmont European Policy Brief No. 13 on that matter. This report presents the main positive and negative aspects of macroeconomic conditionality in cohesion policy and the concerns expressed against the expansion of macroeconomic conditionality in the upcoming programming period.

Introduction

Macroeconomic conditionality in cohesion policy is a controversial element of the ongoing negotiations between the parties involved in respect of the proposal for the Multiannual Financial Framework 2014-2020. As part of its proposal, the Commission seeks to expand macroeconomic conditionality by introducing it in all cohesion policy funds and by increasing its scope. Such conditionality would make the cohesion funding dependent on the respect of the European economic governance rules.

The EU Institutions approach the above issue from a rather different perspective. The European Parliament stands up firmly against the Commission's proposal. Nevertheless, some progress is recognised in the Council's position towards a compromise in favour of the proposed macroeconomic conditionality. However, given these opposite views, negotiations to reach a consensus on the future of cohesion policy are on a difficult path.

Macroeconomic conditionality has both positive and negative aspects, as analysed during the roundtable by Stijn Verhelst and Paweł Tokarski respectively, who are the co-authors of the Egmont European Policy Brief on that matter. Several elements of the proposed conditionality were debated, together with some question marks surrounding this topical subject. The roundtable was held just before the European Council of 22-23 November, thus several points in respect of the proposed conditionality and the lengthy MFF negotiations have among others been at the centre of attention.

Presentation by Stijn Verhelst[1] and Paweł Tokarski[2]

Mr Verhelst started his presentation by outlining that the crisis has affected countries' public finances, has revealed the insufficiency of the economic pillar of the Economic and Monetary Union and has impacted the cohesion policy. Against that background, the Commission proposes expanding conditionality in cohesion policy. The speaker also explained the link macroeconomic conditionality would introduce between cohesion funding and economic governance rules. In principle, such conditionality could result in cutting cohesion funding, thus having a rather corrective character. Exceptionally, it could result in easing access to funds for countries under financial assistance programmes.

[1] Stijn Verhelst is a Senior Research Fellow at Egmont - Royal Institute for International Relations.

[2] Paweł Tokarski is a Senior Analyst at the Polish Institute of International Affairs.

The speaker then underscored the positive aspects of the proposed conditionality with respect to economic governance rules, particularly in terms of credibility, comprehensiveness, automaticity, as well as positive incentives and national ownership provision. Among others, he analysed the positive impact on cohesion policy funding and the MFF negotiations. The ultimate dilemma, as concluded, is member states' choice between a smaller cohesion budget with less strings attached or a larger cohesion budget that would allow for wider EU-level control on national policies.

Mr Tokarski subsequently examined the negative side of macroeconomic conditionality. He expressed his concerns about the inconsistency in the level of responsibility between local authorities and central governments. Given that the former are the recipients of the cohesion funds, whereas the central governments have the main responsibility for macroeconomic policies, the speaker argued that macroeconomic conditionality as a sanction could turn into a form of collective punishment for local and regional authorities. He also questioned the balance between sanction and incentive, stressing that "*the stick is longer than the carrot*" in the proposed conditionality. Another aspect discussed was that the Commission, according to its proposal, would possess a high degree of discretionary power. Its large role in macro-economic conditionality is particularly evident when compared to the Commission's power in the context of the economic governance procedures. Comparing the level of sanctions between macroeconomic conditionality in cohesion policy and the EU economic governance framework, the speaker went on to note that net beneficiaries would be affected more severely than net contributors. Yet, the former are mostly outside the euro area. Consequently, non-euro area countries are to some extent more targeted than euro area countries. As this seems inconsistent with the goal of strengthening economic governance in the euro area, the speaker remarked that it can make sense to differentiate sanctions between those inside and those outside of the currency union. Lastly, the negative impact macroeconomic conditionality could have on cohesion policy itself was emphasised.

At the end of his presentation, Mr Tokarski stressed that macroeconomic conditionality is a rather interesting concept in terms of strengthening the economic pillar of the EMU. However, one should not overlook the potential disadvantages. He therefore suggested possible changes to the proposed macroeconomic conditionality in order *"the costs not to outweigh the potential benefits"* of such a mechanism.

Presentation by Sidonia Jędrzejewska, Member of the European Parliament

In her presentation, Ms Jędrzejewska firstly highlighted that the European Parliament stands clearly against the Commission's proposal. She furthermore underscored the weaknesses of the proposal and then provided comments on the issues discussed by the co-authors of the policy brief.

A first weakness that was discussed is the issue of fairness among regions and national governments. It would be unfair to regions to be punished for the shortcomings of the economic governance performed at national level, as noted. Also, in her eyes, equality of treatment between EU member states is at stake, because financially weaker countries risk being sanctioned more heavily than the more prosperous ones. The speaker questioned, *inter alia*, the alleged positive results of the proposed conditionality on cohesion funding, given its multiple negative outcomes, including the damaged predictability related to projects. Another point illustrated is the possible duplication with the already existing economic governance sanctions. She also pointed to an insufficient consideration for the subsidiarity principle in the proposal. As explained, despite the limited influential powers regions can have, EU's intervention would still be there having the power to disturb and cancel ongoing projects' financing.

Next to these, Ms Jędrzejewska responded to some other issues raised by Mr Verhelst and Mr Tokarski, during their presentations. Among others, she added that macroeconomic conditionality is *"a nuclear weapon"*. It would not be used, because of the negative outcomes it could bring, including a considerable *"damage to the credibility of the EU"* due to its unfairness in terms of punishing only certain countries.

At the last part of her speech, she described the situation in respect of the MFF negotiations. Referring to the lack of payments for 2012, she stressed the *"snowball effect"* happening the last three years, because cohesion funds are better implemented but cannot be served by the EU budget.

Debate

Macroeconomic conditionality and EU economic governance

Multi-sides advantages

During the debate that followed the presentation, it was argued that the most important gains of macroeconomic conditionality would be its impact on the respect of the European economic governance rules. The advantages were summarized into the following key concepts: credibility, comprehensiveness, automaticity, possibility of positive incentives and more national ownership.

A first advantage indicated is that macroeconomic conditionality could be more credible as a sanction than the existing EU economic governance sanctions. Comparing the former with the latter, it was highlighted that the fines and deposits contained in the economic governance procedures require a financial transfer to the EU from member states that already suffer huge deficits. Yet, this lacks credibility, because by applying these sanctions, their already difficult position would deteriorate, leading to even bigger deficits. Conversely, instead of requiring a financial transfer, macroeconomic conditionality as a sanction would cut EU funding, thus not directly increasing deficits.

Comprehensiveness was considered as another positive element of the proposed conditionality. Particularly, it could bring comprehensiveness in a geographical way, as the funding cuts would apply to all member states, while the economic governance sanctions only apply to euro area countries. As a consequence, macroeconomic conditionality could result in a wider focus for European economic governance. At the same time, it could lead to comprehensiveness in a procedural way, strengthening the preventive arm of the EU economic governance procedure as applied from its very first stages.

A further advantage stated during the discussion is automaticity in respect of the decision on applying macroeconomic conditionality in cohesion policy. In that respect, it was stressed that this rather automatic decision-making would make EU economic governance less subject to political bargaining, especially given the Council's unwillingness to impose sanctions in the past.

In addition to its corrective role, it was commented that the proposed conditionality could offer positive incentives for countries in fiscal difficulties that are willing to adopt the necessary measures. In particular, the Commission proposes an easier access to cohesion funding for countries under financial assistance programmes. In respect of that, further suggestions were made during the roundtable with a view to enhancing the incentive side of macroeconomic conditionality (see *infra*).

A last advantage underscored was that the proposed conditionality could provide for more national ownership of the EU economic governance. Experience has by now shown that economic governance had become a bureaucratic procedure managed by parts of the central government. As macroeconomic conditionality could make cohesion funding depended on the respect of the European economic governance rules, regions would be under the threat of losing some part of their EU funding.

Consequently, regions would be more interested in central governments' administration within the EU economic governance framework. This could include twofold benefits: (a) more pressure to central governments to abide by the European rules exerted by regions and (b) more prudent regional policies pursued by the regions themselves in order to avoid large fiscal deficits.

Multiple negative effects

The counter arguments in respect of the EU economic governance rules were centered around the following issues: macroeconomic conditionality's effect as *"a nuclear weapon"*; the level of responsibility between local and central governments, as well as regional authorities' power to influence national policies; the balance between sanction and incentive; the Commission's discretionary power and the issue of democratic participation; the inequality in the level of sanctions among EU member states and, lastly, the matter of duplication between the economic governance sanctions and the proposed macroeconomic conditionality that has not been assessed in the Commission's proposal.

A first negative impact concerns the inconsistency in the level of responsibility between local authorities and the central governments. While central governments are responsible for macroeconomic policies, the recipients of the cohesion funds are the local and regional authorities. It was therefore questioned whether *"the local and regional governments regard to be punish for the sins of the central government"*. This way, there would be some kind of collective punishment for local governments. In the same vein, it was wondered whether local politicians would eventually have enough power to influence central government's macroeconomic policies.

The balance between sanction and incentive is another negative effect in question. As argued, *"the stick is longer that the carrot"* in the proposed conditionality. The logic behind this counter argument is that its positive incentive would only be used in exceptional cases when member states receive external financial aid. And the question is whether an easier access to cohesion funds would actually assist the difficult macroeconomic situation these countries are facing.

Among other issues, the Commission's role was discussed. According to its proposal, the Commission has large discretionary power and, in some cases, it can even impose modification to the partnership contracts. It was also observed, responding to the advantage of *"less room for political bargain"* due to the proposed automatic decision-making (see *supra*), that the issue of democratic participation in the proposed conditionality framework should not be neglected. As regards the role of the Commission, a reference to the draft European Council conclusions of 22-23 November 2012 was also made. At the end, as noted, the automaticity proposed by the Commission would probably be refined, whereas, especially regarding the suspension of payments, political limitations might be introduced as being a severe decision.

Additionally, a comparison of the level of sanctions between macroeconomic conditionality in cohesion policy and the Excessive Deficit Procedure and the Excessive Imbalance Procedure was made.

The latter procedures could apply sanctions to countries of up to 0.5% of their GDP. But in terms of macroeconomic conditionality as a sanction, there are some member states that receive cohesion funding of more than 3% of their GDP. To that extent, it was highlighted that net beneficiaries -which are mostly countries outside the euro area- would be disciplined more severely than net contributors, leading to an uneven level of sanctions between EU member states.

Macroeconomic conditionality and cohesion policy funding

More efficient cohesion funds

Next to these question marks, the impact of macroeconomic conditionality on cohesion policy was debated. The central argument in its favour was defined in terms of efficient cohesion funds' spending.

Analytically, it was noted that conditionality could better guarantee that cohesion funds are used in an efficient manner. By limiting funding that goes to countries facing fiscal imbalances, it could be ensured the money is not wasted, but used in a productive way. Macroeconomic conditionality would also allow for a wider EU-level control on national cohesion policies.

Negative influence

The above value of macroeconomic conditionality on cohesion policy funding was questioned by other participants. The main counter argument is the potential damage that projects would suffer from applying conditionality. Another issue of concern is a lack of the principle of subsidiarity.

Underscoring that cohesion funds are a rather secure source for financing projects, it was stressed that conditionality would mean artificially interfering in the project management cycle, especially in case payments are suspended. This could damage the predictability of long-term projects and further lead to cancelling the projects' financing, thus putting additional pressure on local and regional budgets.

Macroeconomic conditionality and EU budget negotiations: Offering a compromise?

Another aspect of macroeconomic conditionality discussed is its possible impact on the negotiations on EU budget 2014-2020. According to the optimistic viewpoint, macroeconomic conditionality *"can offer a compromise"* among net contributors and net beneficiaries, as being positive for both groups of countries. The former would be guaranteed that their contributions are spent effectively by allowing wider EU control on national expenses, whereas, concerning net beneficiaries, there would be larger regional policy budgets available.

Contrarily, for others expanding macroeconomic conditionality would not ease negotiations. Under this point of view, current negotiations are about figures instead of policies. Net beneficiary countries would have to accept more conditionality, independently of the final amount in the EU budget that is reserved for cohesion policy.

Suggested modifications in terms of macroeconomic conditionality

During the debate, some changes in terms of macroeconomic conditionality in cohesion policy and the EU economic governance framework were suggested.

As mentioned above, there is a particular negative effect of the proposed conditionality on countries that are net beneficiaries. These countries are mainly outside the euro area. Therefore, non-euro area member states would be most affected by macroeconomic conditionality. Yet, economic governance is more important inside the euro area. In order to overcome this asymmetry, it was proposed during the roundtable that macroeconomic conditionality rules should be differentiated between non-eurozone and eurozone member states.

Furthermore, it was pointed out that one of the advantages of the proposed conditionality in respect of the EU economic governance is the provision for positive incentives for member states in financial distress (see *supra*). However, according to the Commission's proposal, these incentives are limited to countries under financial assistance programmes. It was therefore suggested strengthening the incentive side of macroeconomic conditionality by expanding it to other phases within the economic governance procedure.

Conclusions

Macroeconomic conditionality in cohesion policy is a controversial issue as it entails both positive and negative elements. It is not "*a panacea*", as observed even by its advocates. Surely, the several negative sides it contains cannot be neglected. But, at a certain point, a comparison should be made between macroeconomic conditionality as a sanction and the existing EU economic governance sanctions. Both have their own positive and negative effects. Subsequently, the following question should be answered: is the equilibrium between the advantages and disadvantages of the proposed macroeconomic conditionality more efficient than the existing European economic governance sanctions?

The roundtable debate took place under the Chatham House Rule.

Markella Dimitrakopoulou is Research Assistant at Egmont - Royal Institute for International Relations.

EGMONT
Royal Institute for International Relations
Naamsestraat 69
1000 Brussels
BELGIUM

> www.egmontinstitute.be