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Chapter 6: Cohesion and the EU's Budget: Is Conditionality Undermining Solidarity?

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6.1. Introduction

Cohesion and solidarity between member states are fundamental values of the European Union (EU), recognised in Article 3 of the Treaty on the Functioning of the EU (TFEU). The goal of cohesion is to reduce regional disparities across the EU, usually measured in terms of GDP per head and unemployment. The main instruments of Cohesion Policy are the European Structural and Investment Funds (ESIF), which comprise the European Regional Development Fund (ERDF), the European Social Fund (ESF) and the Cohesion Fund (CF) - as well as agriculture and fisheries funds. Cohesion Policy accounts for a major share of the EU budget, around €370 billion (or a third of the total budget) over the 2014-20 period and a major share of public investment in many less-developed countries. The policy is the most direct expression of financial solidarity in the EU budget. Funding is highly concentrated on the least developed EU countries and regions in the form of investment strategies and projects in areas such as transport infrastructure, business development, training and education with a view to fostering sustainable growth and improving citizens' daily lives.

Cohesion Policy is governed by a common regulatory framework with wide-ranging obligations and conditions on how to allocate and manage funding. The increasing use of conditionality is justified in terms of changing member state behaviour to conform to agreed EU objectives and policies. However, the effectiveness of conditionality is questionable, and its increasing use raises fundamental questions about the EU commitment to solidarity and the traditional goal of reducing regional disparities at a time of increasing populism and euroscepticism when effective and visible EU policy responses to crisis recovery and inequality are most needed.

This chapter charts the evolving relationship between the EU budget, Cohesion Policy and conditionality and assesses the implications for the effectiveness and legitimacy of Cohesion Policy. It begins with an overview of the history of EU budget and Cohesion Policy reform before describing the institutional decision-making framework. The rise of conditionality in Cohesion Policy is then reviewed. The next section explains why conditionality has gained an important role in Cohesion Policy and assesses the implications for Cohesion Policy effectiveness and legitimacy. A final section draws together the key conclusions and implications.

6.2. The History of the EU budget and Cohesion Policy

6.2.1. Reforms of the EU Budget

In the foundational years of the EU, the relatively small Community budget was financed annually through national contributions. Following the creation of the Common Agricultural Policy (see Chapter 7), the first steps were taken to create 'own financial resources' from the allocation of agricultural levies as well as customs duties to the Community. However, the 1965 proposal from the Commission President Walter Hallstein for independent financial resources precipitated the '**Empty Chair Crisis**'. The immediate crisis was resolved by the 'Luxembourg Compromise' in 1966, but it was not until 1970 that the Community were able to agree on an **own resources system** – based on ‘traditional’ own resources (agricultural levies and customs duties) and a resource based on VAT - to finance the budget. A budgetary procedure to ensure more accountability granted the European Parliament greater decision-making power over annual budgets. The next key milestone was the **Fontainebleau agreement** of 1984, which increased the rate of VAT accruing to the Community and established the **UK’s rebate** to reduce its net contribution, together with a commitment to budgetary discipline as a result of unsustainable increases in spending under the Common Agricultural Policy (CAP) and inequalities in country receipts.

During the 1980s, important steps in European integration – the Single European Act and accession of new member states – created new demands on the Community’s resources in areas such as the internal market, economic and social cohesion, social policy, research and development, environmental policy and foreign policy. This led to a further reform of the own resources in 1988, notably the introduction of a ‘fourth resource’ based on GNP and capping the VAT base. From 1988, EU budgetary planning was also based on so-called multi-annual ‘financial perspectives’, providing more stable guidelines for income and expenditure over five-to-seven-year periods - 1988-92, 1993-99, 2000-06, 2007-13 and 2014-20. In each case, financial planning on the allocation of expenditure was accompanied by adjustments to the ceiling of own resources and the relative importance of the sources of revenue (mainly VAT).

The first two financial perspectives for the periods 1988-92 (Delors I) and 1993-99 (Delors II) increased the EU budget significantly, rising to 1.2 percent of Community GNP by 1992 and 1.27 percent by 1999. These two expansionary budgets provided the financial and political underpinning for the relaunch of European integration through the single market programme and then economic and monetary union (EMU). By contrast, the ‘Agenda 2000’ financial perspective for 2000-2006 maintained the budget ceiling (at 1.27 percent of GNP) even though the budget had to cater for enlargement to mostly poorer EU12 member states, reflecting a resistance among richer countries to increased contributions. The next reform for 2007-13 also maintained the same budget ceiling of 1.27 percent of GNI. However, the 2014-2020 MFF (at a time of economic crisis) reduced the EU budget for the first time by around three percent in real terms; the commitments limit was set at 1.0 percent of EU GNI (€959 billion) compared to 1.12 percent (€994 billion) in 2007-13.

Budgetary decision-making in the EU has always been politically contentious, particularly because of is its redistributive function. Decisions on how much each country pays and receives are closely associated with the policies on which the money is spent. For the two biggest areas of the EU budget (the CAP and Cohesion Policy), funding is largely pre-allocated, and, since 1999, successive reforms have seen the Commission being pressed by member states to become more transparent about how its funding allocation model operates. member states have therefore been increasingly able to estimate broadly how much they should receive under specific proposals for policy reform, and their negotiating positions are invariably (and understandably) directed to securing the best possible net balance.

This limits the scope for making policy decisions that are in the best interests of the EU as a whole and is a cause of inertia in changing the structure of the budget (Begg, 2009). It has led to debates on the question of whether and how it would be possible to separate the redistributive aspects of the budget (how much member states pay and receive) from the allocative ones (how much funding is spent on different policies), notably through the establishment of genuine own resources and the elimination of rebate mechanisms.

6.2.2. Reforms of EU Cohesion Policy

The **European Regional Development Fund** was established in 1975. The key drivers were the accession of Ireland and the United Kingdom, which supported the establishment of a Community regional policy to address development challenges and increase their receipts from the Community budget, as well as wider EU concerns about the impact of moves towards economic and monetary union on regional disparities. The ERDF was initially a small fund used to support member state projects in accordance with their own regional policy approaches. Reforms in 1979 and 1984, and the creation of a new regional policy instrument (the so-called Integrated Mediterranean Programmes), gradually increased the Fund's budget, enhanced its Community orientation by granting the Commission more control, and provided a blueprint for the landmark reform of 1988.

In the context of treaty reform, enlargement and the adoption of the single market programme, the 1988 reform marked the arrival of Cohesion Policy as a core EU policy. Underpinned by a Treaty commitment to cohesion and a substantial budget, the reform introduced a new governance framework bringing three Structural Funds (ERDF, ESF, European Agricultural Guarantee and Guidance Fund: Guidance Section) together under a common framework. A more coherent approach to Cohesion Policy was based on the principles of: concentration (on less developed regions); programming (through multi-annual strategies in line with the Multiannual Financial Framework); partnership (to involve subnational governments and economic and social stakeholders); and additionality (to ensure EU funding did not substitute for national funding).

The Maastricht Treaty, which provided for the establishment of a single currency by 1999, established economic and social cohesion as a core Treaty objective on a par with the internal market and EMU, and created a new Cohesion Fund to support infrastructure development and macroeconomic convergence in the poorest member states. These commitments were reflected in a substantial financial boost to Cohesion Policy, doubling the 1994-99 budget relative to 1989-93. By contrast, for 2000-06 the Cohesion Policy budget remained stable reflecting the new financial imperatives of fiscal consolidation in the run-up to EMU and to contain the anticipated costs of enlargement to Central and Eastern Europe.

The key regulatory principles of the 1988 reform were retained in the subsequent 1994, 1999, 2006 and 2013 reforms but each time making changes to the objectives, thematic focus, spatial coverage and governance of the policy (Manzella and Mendez 2009, Bachtler et al., 2013). The main trends in the policy are threefold. First, Cohesion Policy has been increasingly aligned with EU policy objectives, initially under the Lisbon Agenda for 'growth and jobs' (in 2006) and subsequently with the Europe 2020 Strategy (in 2013). Second, progressively more emphasis was placed on financial management, control and audit following the resignation of the Santer Commission in 1999, and concerns about the probity of EU expenditure. Third, from the mid-2000s, more attention was placed on the effectiveness of Cohesion Policy, with strengthened monitoring and evaluation requirements, the introduction of incentives and sanctions on performance and spending – and, as discussed, below the controversial introduction of institutional and policy conditionalities.

6.3. The Institutional Decision-Making Framework

The Treaty on the Functioning of the EU provides the legal basis for pursuing cohesion objectives and specifies the main funds along with their aims (Box 1).

Box 1: The Treaty basis for Cohesion policy

TITLE XVIII - ECONOMIC, SOCIAL AND TERRITORIAL COHESION

Article 174: The Union shall develop and pursue its actions leading to the strengthening of its economic, social and territorial cohesion. In particular, the Union shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions.

Article 175: […] The Union shall also support the achievement of these objectives by the action it takes through the Structural Funds (European Agricultural Guidance and Guarantee Fund, Guidance Section; European Social Fund; European Regional Development Fund), the European Investment Bank and the other existing Financial Instruments.

Article 176: The European Regional Development Fund is intended to help to redress the main regional imbalances in the Union through participation in the development and structural adjustment of regions whose development is lagging behind and in the conversion of declining industrial regions.

Article 177: A Cohesion Fund set up in accordance with the same procedure shall provide a financial contribution to projects in the fields of environment and transEuropean networks in the area of transport infrastructure

TITLE XI – EUROPEAN SOCIAL FUND

Article 162 : …a European Social Fund is hereby established in accordance with the provisions set out below; it shall aim to render the employment of workers easier and to increase their geographical and occupational mobility within the Union, and to facilitate their adaptation to industrial changes and to changes in production systems, in particular through vocational training and retraining

The European Commission's power of initiative grants it sole responsibility for drafting legislative proposals for Cohesion Policy. The Commission begins the process by setting out proposals for reform as part of the negotiations on the EU budget (the MFF) for the period ahead (currently seven years) covering all EU budgetary headings, and accompanied by legislative proposals for the implementation of Cohesion Policy instruments, in the form of draft regulations.

The negotiation and adoption of the budget and regulations is the responsibility of the Council of the European Union and European Parliament (EP). The Council comprises government ministers from each member state with responsibility to negotiate laws and coordinate policies. Rotating presidencies of the Council have played a crucial role in the negotiation of the MFF and the reform of Cohesion Policy, partly during the debate stages – when they can put issues onto the agenda, and seek conclusions – and in the negotiation stages when progress depends (for both budgetary and legislative aspects) on the ability to craft compromises (Bachtler and Mendez, 2016).

Much of the legislative work on Cohesion Policy reform is undertaken in the Council. The General Affairs Council of member state ministers is responsible for the adoption of the MFF and Cohesion Policy regulations. The preparatory work is done by the **Committee of Permanent Representatives** (COREPER) of Brussels-based missions of the member states and in Council working groups such as the Friends of the Presidency for financing issues and, for Cohesion Policy regulations, the Working Party on Structural Measures and the Coordination Committee for the European Structural and Investment Funds (COESIF).

The European Parliament is the co-legislator for Cohesion Policy regulations under the ordinary legislative procedure, which enables it to make amendments to the Regulations and on contested issues to enter into **trilogue** negotiations with the Commission and Council. By contrast, the Parliament's role in MFF negotiations is governed by the consent procedure allowing it to approve or reject proposals without amendments, and it can threaten to withhold consent unless its concerns are addressed.

The European Council defines the EU's overall political priorities. It plays a crucial role in the final stages of MFF negotiation when it is invariably left to heads of state and government to find agreement on the most intractable issues: the size of the budget and its allocation to budget headings; the acceptable net balances for individual member states and Cohesion Policy allocations to individual countries. Decisions require unanimity. The negotiations for the 2014–2020 MFF were the first in which the President of European Council was involved, and were notable for the important role played in facilitating agreement and in determining key Cohesion Policy reform, notably in the area of macroeconomic conditionality – and, in doing so, side-lining the Presidency of the Council at the time.

Box 2: Key actors

Decision-making Actors	**Consultative Actors**
- European Commission	- Committee of the Regions
- Council of Ministers	- Economic and Social Committee
- European Parliament	
- Council of the European Union	

6.4. The Rise of Conditionality

Conditionalities are a long-standing tool in multi-level governance systems where performance and accountability are difficult to manage. When authority is diffused vertically between levels of government and horizontally between state and non-state actors, the challenges is how to ensure that actors at different levels (who may have different priorities and values, as well as varied capacity and resources) deliver policy outcomes that are in line with policy objectives (Bauer, 2006; Bovens, 2007; Bachtler and Ferry, 2013; Vita, 2017). Conditionalities have been used to set pre-conditions, manage administrative processes, or stipulate outcomes as part of the provision of funding, often involving sanctions or rewards to encourage compliance.

The increased use of conditionality in Cohesion Policy (see Table 6.1) is partly a political spill-over from the effects of the eurozone crisis, which saw opportunistic moves by the Council (particularly Germany, 'supported' by France) and parts of the Commission to promote greater fiscal and budgetary discipline in member state economic and monetary policies, using the leverage of funding allocated under Cohesion Policy (Tokarski and Verhelst, 2012, Coman, 2018). While the Parliament was unable to prevent the introduction of macro-economic conditionality, it was able to moderate its influence in the implementation regulations. Similar institutional contestation is emerging over the conditionalities proposed by the Commission for the 2021-27 period relating to structural reforms (again flowing from the economic governance agenda) and, more controversially, a new conditionality linked to the rule of law - related to post-accession 'backsliding' in compliance with core EU values in countries such as Poland and Hungary (Halmai, 2018).

Other conditionalities promote the effectiveness and efficiency of the implementation of Cohesion Policy. Institutional and performance conditionalities have been introduced in response to evidence that EU spending under ESIF has been undermined by a lack of appropriate legal, institutional, administrative and policy pre-conditions being in place at national or regional levels (Bachtler and Ferry, 2013).

Table 6.1: Conditionality in Cohesion Policy

Category	Instrument	Programme period of introduction	Purpose
Macro-economic	Macroeconomic conditionality	1994-1999	Compliance with conditions of the Stability and Growth Pact. Initially applied to the Cohesion Fund in 1994, it was strengthened and extended to all shared managed funds in 2014-20 with more automatic enforcement and sanctions.
Structural	Structural reform conditionality	2014-2020	Implementation of structural and administrative reforms in policy areas subject to country-specific recommendations under the European semester.
Institutional	Ex ante conditionality	2014-2020	Fulfilment of ex-ante preconditions: (i) regulatory, mainly the transposition of EU legislation; (ii) strategic, linked to overarching strategic frameworks for investments (iii) *institutional,* the effectiveness of institutional and administrative structures and systems.
Performance	Performance reserve	2000-2006	Better progress in achieving objectives of the programmes or progress in attaining EU targets and objectives through a reward mechanism i.e. a performance reserve (obligatory in 2000-06 and 2014-20, voluntary in 2007-13).
Values	Rule of Law Conditionality	2021-2027	Protect the EU budget from deficiencies in the rule of law in a member state

6.4.1. Ex ante conditionality

A structured system of ex-ante conditionality was introduced for the 2014-20 period to ensure that the strategic, institutional and administrative conditions for effective Cohesion Policy investments are put into place before funding is paid out to member states. The Regulations distinguished two types. *Thematic conditionalities* are specific to each thematic objective and relate mainly to the pre-existence of domestic strategies (e.g. on smart specialisation), the transposition and implementation of EU Directives (e.g. on water or waste), addressing EU guidelines (e.g. employment and social policy) and capacity-building activities (e.g. sufficient project pipelines in the transport sector). *General conditionalities* relate to compliance with EU law (e.g. strategic environmental assessment, public procurement, state aid) and capacity-building to support compliance, as well as a conditionality to strengthen the statistical systems and data for monitoring and evaluation.

For the 2021-27 period, the Commission has proposed streamlining the ex-ante conditionalities (now labelled 'enabling conditions') by halving the number to 20 with more precise conditions specified.

Action plans will no longer be required in cases of non-fulfilment, but member states will not be able to send payment claims related to unfulfilled conditions and they will be monitored more rigorously.

6.4.2. Macroeconomic conditionality

The origins of macro-economic conditionality (see Table 6.1) in Cohesion Policy date back to the establishment of the Cohesion Fund in 1992 linked to the agreement on economic and monetary union under the Maastricht Treaty. This included a commitment to establish a Cohesion Fund to co-fund infrastructure projects in member states with a per capita GNP of less than 90 percent of the Community average (i.e. Greece, Ireland, Portugal and Spain) and which had a programme leading to the fulfilment of the EU's economic convergence conditions relating to government deficits. The conditionality mechanism entailed a potential suspension of payments if macro-economic conditions were not fulfilled i.e. the deficit ceiling of three percent of national GDP (set under the EMU convergence criteria) was exceeded. Suspensions would be cancelled if the excessive deficit procedure was lifted within one year or any other period specified by the Council.

The 2013 reform of Cohesion Policy for the 2014-20 period widened the application of macro-economic conditionality to all shared management funds, made the procedure more automatic and extended its scope beyond the Excessive Deficit Procedure to cover the Macroeconomic Imbalance Procedure as well as countries under an economic adjustment programme. Although opposed by the European Parliament, the mechanism requires the Commission to propose the suspension of funding commitments or payments (in serious cases) when a Council Decision is taken on non-effective action by a member state to address an excessive deficit (or other Council decisions or recommendations set out in the Regulation). The Commission was also empowered to request reprogramming of national strategies and programmes to support the implementation of Commission recommendations under the Macroeconomic Imbalances Procedure where relevant to the ESIF, and to maximise growth and competitiveness in countries with assistance programmes. In the event of non-compliance by the member state, the Commission could propose financial suspensions to the Council.

6.4.3. Structural reform conditionality

The EU promotes structural reforms primarily through its annual economic and fiscal policy coordination cycle known as the **European semester**, which issues Country-Specific Recommendations (CSRs) in areas such as labour and product markets, the business environment, innovation, taxation and welfare systems.

To support the EU's evolving economic governance framework, structural reform conditionality (see Table 6.1) in Cohesion Policy was first mooted in the EU budget review debates during 2010 and formally proposed in the Fifth Cohesion Report (European Commission 2010a). The report referred to the aim of providing incentives for reforms in areas directly linked to Cohesion Policy, such as flexicurity policies, education or research and innovation. More detailed discussion on structural reform conditionality were held in the EU's conditionality task force in 2011 on the basis of a Commission discussion paper. The paper proposed making CSRs on structural reform mandatory with enforcement through ESIF suspensions for non-compliance. Positive incentives were also proposed in the form of rewards for fulfilling recommendations such as higher EU co-financing rates and advance payments, and flexibility in the application of spending rules.

Member state representatives in the task force rejected the introduction of this form of structural reform conditionality because of concerns over breaching the principle of subsidiarity with respect to member state competences over structural reform, the lack of alignment between the scope and timing of the European semester and Cohesion Policy processes and other negative consequences such as administrative burdens.

This opposition led to the 2013 reform of Cohesion Policy introducing structural reform conditionality through alternative mechanisms. The first is a requirement for member states to address relevant CSRs in the programming of Partnership Agreements (PAs) and programmes. The second stricter route empowers the Commission to request revisions of PAs and programmes to support the implementation of new CSRs and also to propose suspensions of payments to the Council if the member state fails to take effective action in response.

The creation of the Structural Reform Service Programme (SRSP) provides another conditionality mechanism for supporting structural reforms through positive financial incentives funded by ESIF. The SRSP was proposed in November 2015 and agreed in May 2017 with a budget of €142.8 million for the 2017- 2020 period. The objective is to provide, upon request of a member state, support for the implementation of structural reforms through technical assistance.

This has been developed further under the 2021-2027 Commission proposal to create a Reform Support Programme and a European Investment Stabilisation Function, as part of the broader agenda to deepen EMU. The Reform Support Programme would support priority reforms in all EU member states with a much larger budget of €25 billion and comprising three elements: a Reform Delivery Tool to provide financial support for reforms; a Technical Support Instrument to offer and share technical expertise; and a Convergence Facility to help member states on their way to joining the euro.

6.4.4. Values conditionality (rule of law)

The latest addition to the Cohesion Policy conditionality toolbox is a rule of law conditionality linked to breaches of fundamental EU values. In response to EU criticism of the independence of judiciaries in Hungary and Poland, the Commission's 2021-27 MFF proposals introduced rule of law conditionality in relation to EU budgetary procedures and policies (Bachtler et al., 2018) (see also Chapter 18). In the case of shared management funds, financial sanctions are envisaged to protect the EU budget where there is a risk of a generalised deficiency in the rule of law in a member state. These would take the form of a suspension, reduction or restriction of EU funding and would be applied where the rule of law deficiency risks affecting the principles of sound financial management or the protection of EU financial interests. The decision-making procedure would involve the Commission proposing measures to the Council, which would make a decision based on a reversed qualified majority vote.

6.5. Causes and Consequences of Conditionality in Cohesion Policy

The institutionalisation of conditionality can be explained by a combination of two factors. The first is internal to the policy and related to efforts to improve policy performance, drawing on lessons from implementation experiences, evaluations as well as international practices. A second factor relates to external spill-over effects relating to EU economic governance and negotiations on the EU budget.

The case for stronger ex-ante conditionality to improve Cohesion policy performance was forcefully made in an influential independent review of Cohesion Policy known as the Barca Report (Barca, 2009). It concluded that the conditionality system is not sufficiently results-oriented or effective and proposed a more contractually-binding governance framework including the introduction of contracts and conditionalities on strategic and institutional pre-conditions (Barca, 2009). The report had a significant influence on the reform debate and proposals on conditionality (Mendez, 2013; Berkowitz et al., 2017). This was evident in the EU budget review and Fifth Cohesion Report, which proposed setting up Cohesion Policy contracts underpinned by conditionalities, and in the setting up of a specific task force to develop proposals on conditionality. The Commission was also influenced by successive audits by the Court of Auditors and evaluations highlighting systemic weaknesses in some member states' administrative capacity to implement Cohesion Policy rules (Berkowitz et al., 2017; Mendez and Bachtler, 2017).

External lessons were drawn from international organisations such as the World Bank and the International Monetary Fund (IMF) with consolidated experiences in applying conditionalities in development policies (Berkowitz et al., 2017). DG REGIO commissioned a study to identify lessons from conditionality in World Bank lending, EBRD operations and country regional policies (Ferry and Bachtler, 2013). Dialogue between DG REGIO and the OECD and World Bank on these and other issues was facilitated through knowledge exchange activities (joint seminars and studies) as well as staff movement across the institutions. For instance, the Deputy Director General of DG DEGIO Katarína Mathernová during the agenda setting phase of Cohesion Policy reform in 2007-10 had a long career at the World Bank previously, and continued to play a liaison role between the Commission and World Bank on structural reforms in the member states.

There is, however, a contested relationship between conditionality and performance (Bachtler and Ferry, 2013; Berkowtiz et al., 2017). While it is argued that conditionality is a key element of the relationship between funder and recipient, effectiveness is difficult to establish – changes in performance are rarely related to conditionality. Conditionalities are problematic to implement, due to conflicts over objectives and ownership, and they can have negative consequences in terms of perceived legitimacy and fairness. Much depends on whether they are designed in collaboration with actors affected and whether their operation is predictable and transparent. The fact that the effectiveness of conditionality is highly contested indicates that there are other factors at play in explaining the adoption of conditionality in Cohesion Policy.

Table 6.2: Application of conditionalities in public policy

Category	Aim	Application	Strengths	Weaknesses
Macro-economic	macro-economic stability as a basis for sustainable growth	Funding linked to indicators such as inflation rates, levels of government debt, ability to finance deficit etc	Clear and measurable conditions	Top down – controls are outside the control of funding recipients. No link to performance
Structural	Supportive policy framework for interventions	Funding requires specified policy or institutional framework conditions (e.g. business environment)	Provides relevant framework to facilitate implementation	Controls may be outside control of funding recipients. Frameworks may not be achievable in the short to medium terms
Performance	Linkage of intervention to policy objectives	Funding is linked to achievement of specified outcomes	Focuses attention of implementers on progress and outcomes. Promotes accountability among recipients	Difficulty of identifying measurable and relevant indicators and targets. Requires effective monitoring. Outcomes may be influenced by external factors. Outcomes difficult to verify.
Institutional	Appropriate governance and institutions for	Funding requires provision of specified level of governance	Addresses deficits in administrative capacity. Relates	Conditions complex to assess – require qualitative judgements.

	implementing interventions	systems, capacity, regulatory compliance	directly to implementation of funding. Potential for spillovers.	Institutional and system changes take time.

The second factor explaining the rise of conditionality is the economic and financial crisis and resulting changes to European economic governance to strengthen the resilience of EMU, which had major spill-over effects on Cohesion policy-making (Mendez, 2013; Berkowitz et al., 2017; Coman, 2018). Bailout loans to Greece, Ireland and Portugal involved strict conditionality on the implementation of austerity and structural reforms, followed by Commission proposals to reinforce EU macro-fiscal governance (European Commission, 2010b). These proposals – which included a European semester for coordination of structural reforms and macro-economic conditionality for all Cohesion policy funds (and the CAP) - were part of reform of the 2014-20 MFF (European Commission 2011).

Net payers member states have been strongly supportive of efforts to use EU funding to support economic governance objectives and thereby reduce the risk of contagion effects from macroeconomic and fiscal imbalances. A financially-motivated subtext was also to reduce EU budget and Cohesion policy allocations in order to increase their net budget balances.

During the 2015-18 period, the migration crisis also spilled over into Cohesion Policy conditionality debates. To encourage fair burden sharing of refugee placements across member states, some member states proposed introducing a migration conditionality in Cohesion Policy by making the disbursement of EU funding conditional on the acceptance of migration quotas (e.g. Austria, Finland, Germany, Italy, Sweden). However, the controversial proposal did not gain traction owing to strong opposition from Central and Eastern European countries and the Commission.

Assessing the institutionalisation of conditionality from the perspective of European integration theories raises two key insights. First, EU budgetary and Cohesion policy-making has taken an intergovernmental turn as a consequence of the increased politicisation of the EU budget in the post-crisis era and the alignment between Cohesion Policy and economic governance (Bachtler and Mendez, 2017). Theories of integration stressing the role of supranational actors in decision-making remain relevant but incomplete. On the one hand, the Commission continues to be a powerful actor by virtue of its power of initiative and agenda-setting role, and the EP has acquired greater formal co-legislative power because of Lisbon Treaty, but remains the junior partner over budgetary matters.

On the other hand, intergovernmental dynamics and negotiations surrounding the EU budget and wider EU objectives - led by the most powerful member states - are increasingly determining the policy content and implementation of Cohesion Policy, and the role of the European Council has acquired greater significance. The European Council had a stronger impact on the 2014-20 regulatory framework than previously by issuing conclusions on the MFF that impinged directly on the competence of the co-legislators (Council and Parliament) over the substance of the Cohesion Policy regulatory package, notably in the areas of macroeconomic conditionality, definitions and eligibility, the Connecting Europe Facility, the performance reserve and co-financing rates, amongst others.

Second, Cohesion Policy decision-making has become more politicised, and public opinion is playing a more important role in line with post-functional theories of European integration. While the negotiations of EU Cohesion allocations and net budgetary balances are always politicised, the level of division among member states and across EU institutions has been compounded by linking EU funding to wider macroeconomic and political goals. Analysis of media stories on Cohesion Policy over time shows that news coverage of conditionality has increased and is largely negative in tone (Triga, 2017, 2018; Carracosa *et al.*, 2017). Further, there is evidence that public opinion is impacting on decision-making. The Commission's protracted decision to not suspend funding to Spain and Portugal in 2016 was partly motivated by concerns about negative political backlashes in a context of deteriorating trust in the EU (European Commission, 2016a).

6.6. Is Cohesion Policy Conditionality Effective and Legitimate?

Macroeconomic conditionality is a paradigmatic case of the application of conditionalities in Cohesion Policy, with some of the experiences also reflected in the implementation of ex ante, structural reform and values conditionalities.

6.6.1. Macroeconomic conditionality: a politicised and blunt tool?

The provisions for macroeconomic conditionality have proven difficult to apply in practice and arguably have been a blunt tool. Greece, Portugal and Spain did not comply with the three percent deficit target in the first few years of the Fund's implementation but were not subject to suspensions. Greece and Portugal were also subject to excessive deficit procedures for a number of years in the 2000s as were several of the member states that joined the EU in 2004. Again, no member state was subject to a formal decision by the Commission or the Council to recommend Cohesion Fund suspensions (Begg *et al.* 2013).

The lack of enforcement can be explained by the discretion available to the Council and the weakened credibility and legitimacy of the Stability and Growth Pact. SGP sanctions had been waived against Germany and France by the Council against recommendations by the Commission. The SGP was eventually watered down in 2005 by defining several situations that could justify a violation of the three percent reference value for excessive deficits.

The implementation of macro-economic conditionality in 2007-13 took place in a turbulent environment of economic and political crisis with intense pressure on public finances and the Eurozone system, requiring bailouts of several troubled economies, and growing public mistrust in EU institutions. In this context, the first country to have been subject to a financial suspension decision under the Cohesion Fund, in 2012, was Hungary (Council 2012) - the only member state to have been permanently under the excessive deficit procedure since its accession in 2004. However, the suspension decision was lifted three months later (in June 2012) based on a Commission assessment that Hungary had taken effective action to reduce its deficit to 2.5 percent in 2012 and to remain below the three percent SGP reference value in 2013. As a result, no suspensions were made to Hungary's Cohesion Fund commitments in 2013 and the Council terminated the excessive deficit procedure for Hungary in mid-2013.

The strengthened macro-conditionality provisions in 2014-20 were highly controversial from the outset. A number of member states, the European Parliament and Committee of the Regions strongly opposed the introduction of macro-conditionality. Support was mainly from the Commission (notably the ECFIN council), the ECB and Germany (later supported by France). Several member states explicitly rejected macroeconomic conditionality (Belgium, Greece, Italy, United Kingdom), while others drew attention to problematic aspects such as a disproportionate impact on poorer countries/regions (Bulgaria, Hungary, Poland), the unfair penalisation of regions for non-compliance by national governments and negative fiscal consequences for troubled economies (Hungary) (Begg et al., 2013). In practice, the first application of the new rules was problematic. Although the Commission initiated suspension procedures for Spain and Portugal due to excessive deficits in June 2016, less than six months later it decided against proposing funding suspensions given new fiscal commitments by the two countries but also due to concern about negative political reactions, including strong opposition of the European Parliament (European Commission, 2016a; Coman, 2018; Vita, 2018).

Similar tensions are evident on proposals for macro-economic conditionality in 2021-27. Net payers such as Austria, Finland and Germany are in favour of strengthened macroeconomic conditionality, but others are opposed (Greece) or have called for it to be abolished (France), reconsidered given the potential to endanger investments in areas with structural difficulties (Italy) or replaced with more positive incentives (Poland, Portugal, Romania) (Bachtler et al, 2018).

6.6.2. Ex-ante conditionality: a sound rationale with mixed success

Turning briefly to the new ex-ante conditionalities applied to Cohesion Policy in 2014-20, the Commission's assessment of their implementation, supported by independent evaluations, is largely positive (European Commission 2018). They have contributed to improving the framework within which the EU budget operates, ensuring a direct link between the investments and EU level policies, contributing to the transposition and implementation of EU legislation, helping to tackle investment barriers, and supporting climate change. Moreover, strategic, regulatory, institutional and administrative changes in the member states were triggered that should lead to more effective and efficient spending. However, the ECA has been less positive (ECA 2017), finding that some of the conditionalities are vague, open to misinterpretation and have a weak basis for enforcement. Other policy analysts have also noted that the rules lack the necessary cogency to ensure effective implementation (Heinen, 2013).

6.6.3. Structural Reform Conditionality: From Weak Conditionality to Positive Incentives

A first analysis by the Commission of the integration of CSRs into Cohesion Policy programming in 2014-20 found that recommendations were generally well reflected in the strategies but that few linked expected Cohesion Policy results to the CSRs or provided detail on how the CSRs would be implemented through programmes (European Commission, 2016b). Comparative analysis of a selection of national Partnership Agreements found significant variation in the level of detail provided on CSRs across member states and that in some countries very few if any CSRs were relevant to Cohesion Policy (Kah et al, 2016). Evaluation evidence across the entire EU27 showed that the CSRs were not only defined vaguely, but that they generally did not specify targets and milestones for their implementation nor was there any systematic monitoring (ISMERI Europa & WIIW, 2018). Further, the Commission has not requested the reprogramming of PAs or OPs to support the implementation of CSRs (European Commission, 2017).

The creation of the EU's Structural Reform Service Programme (SRSP) provides a positive incentive for supporting structural reform with Cohesion Policy funding, financed through ESIF technical assistance. However, there are potential risks in the division of competences between the EU and member states, as the implementation of the reforms is the responsibility of the member states although the Commission would follow-up the reform progress.

There are also questions about the relevance, accountability and political implications of the reform support programme. First, it aims to link Cohesion Policy to all/any structural reforms, instead of CSRs that are relevant to ESIF programming. Second, it is based on bilateral relationships between an individual member state and the Commission implying less transparency – unlike the European Semester approach, where there is a clear and transparent system. Third, the structural reform programme only funds technical assistance at present i.e. funding to design not implement reforms. Lastly, and fundamentally, it conflicts with Cohesion Policy's aim of reducing regional disparities across the EU (Huguenot-Noel et al*.,* 2018) and could incentivise member states to transfer funds away from

Cohesion Policy to the new instrument owing to its more favourable funding conditions which do not require a national contribution.

6.6.4. Values conditionality: A political time-bomb?

Lastly, the Commission's rule of law conditionality proposals for the 2021-27 period are controversial and have elicited mixed reactions from member states and EU institutions. Poland and Hungary remain in highly politicised disputes with the EU about breaches in the rule of law with respect to judicial independence and are strongly opposed on the ground that it would be implemented subjectively, lacks transparency, politicises the EU budget and does not support the objectives of cohesion. Net payers are supportive in principle, notably Germany, France and the Netherlands. The European Parliament has also provided support for rule of law conditionality as long as final beneficiaries of funds are not penalised for breaches of rules for which they are not responsible.

Procedural issues have been raised by the European Court of Auditors (2018), which considers that the proposals grant the Commission too much discretionary power and do not provide clear criteria and guidance for determining breaches in the rule of law. In line with the ECA's views, a study for the European Parliament argues that significant revisions are needed for the instrument to be effective and workable including greater legal coherence/consistency, a focus on a limited number of key rule of law breaches linked to EU spending, credible guarantees that final beneficiaries would not be affected, and involvement of the Council and Parliament in enforcement decisions to ensure legitimacy (Vita, 2018).

6.7. Conclusion

EU Cohesion Policy is the most tangible expression of solidarity between member states in the EU trough a redistributive programme of public investment to reduce reducing economic, social and territorial disparities across member states and regions. In the post-crisis era, reforms to Cohesion Policy have introduced conditionality as a mechanism to ensure compliance with wider EU objectives linked to economic governance, structural reform and other institutional and policy pre-conditions. As a consequence, the underlying principles of solidarity and cohesion upon which Cohesion Policy is founded are being undermined. As argued by Vita (2017), this new conception of 'conditional solidarity' departs from the foundational principles and ethical convictions underpinning a unified Europe based on solidarity.

The rise of conditionality can be explained by a functional imperative to improve Cohesion Policy performance, and external spill-over effects relating to economic governance and negotiations on the EU budget. The latter raises important implications for theoretical perspectives on EU decision-making and integration theory in the post-crisis context. First, EU budgetary and Cohesion policy-making has taken an intergovernmental turn as consequence of the increased politicisation of the EU budget and alignment between Cohesion Policy and economic governance. This is manifested in a stronger role for the European Council in determining the regulatory framework than previously by issuing conclusions on the MFF that impinged directly on the competence of the co-legislators (Council and Parliament) in negotiating Cohesion Policy regulations, notably in the areas of macroeconomic conditionality. Second, the institutionalisation of conditionality provides support for post-functional theories of European integration stressing the increasing importance of public opinion and politicisation for the direction of EU institutional and policy outcomes. Cohesion Policy decision-making and debate has become more politicised, especially in relation to macro-economic, rule of law and migration conditionality debates, and public opinion is playing a more important role in policy-making deliberations.

Looking forward to the 2021-27 period, the Commission has proposed expanding conditionality in two main areas. The most controversial is a conditionality on the rule of law. While this has a justifiable rationale, it risks politicising EU Cohesion Policy and could generate resentment and mistrust in member states in breach of the rule. By contrast, structural reform conditionality is being strengthened through positive financial incentives and technical assistance support. The question is whether the experience with this new tool will lead to creeping pressures for the introduction of negative financial incentives for structural reform through Cohesion Policy or the transfer of Cohesion Policy funds to the new instrument in the future, thereby reducing the EU's commitment to economic, social and territorial cohesion.

LEARNING TOOLS

Group questions

Q1. What was the impact of the crisis on EU Cohesion policy implementation and reform?
Q2. To what extent has the cohesion rationale of the European Structural and Investment Funds been weakened over time?

Further topics for individual research

1. Multi-level Governance. The influence of different actors at EU, national and subnational levels on the design and implementation of Cohesion policy
2. Impact. The effectiveness of EU Cohesion policy in reducing economic, social and territorial disparities

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