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DISCUSSION PAPER

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The Fiscal Architecture of the EU Cohesion Policy

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Abstract

In its current setup, the European Union is often characterised as slow, decision-impeding, inefficient and therefore not really ready for enlargement. The pandemic, the war in Ukraine, the energy crisis and the increasingly uncertain role in the global economy have further increased the high pressure on the EU to undergo modernisation. In this context, structural and Cohesion Policy is of double interest. With 30 per cent of the regular EU budget, it is one of its most important fields of action – one that has historically grown into a complex and opaque maze of objectives and instruments – and is therefore "part of the problem". At the same time, regional policy is traditionally a "part of the solution" whenever the need arises to pave the way for the enlargement and/or deepening of the EU through financial compensation. The paper sheds light on this dual function of Cohesion Policy by examining its fiscal architecture, which forms the underlying framework for convergence and cohesion policies.

In several steps, Cohesion Policy is examined in its function as a European financial equalisation system. The history of regional policy is reconstructed as a development in which the equalisation motive always came first, before Cohesion Policy justifications were applied to instrumental or financial expansions of this policy field. The "Mezzogiorno test" shows that the function of financial equalisation – albeit hidden – continues to dominate; alongside the promotional Cohesion Policy, the equalising Cohesion Policy plays de facto a very important role. This is also illustrated quantitatively and with an in-depth look at the little-analysed mechanism that ensures the allocation of EU funds across the Member States and their regions. Not least with regard to this fiscal equalisation formula, known as the Berlin method, the paper formulates several recommendations for the modernisation of structural policy, which are based on the premise that the purpose of Cohesion Policy to act as a financial equalisation is openly recognised and used productively for the further development of this policy area. The character of vertical fiscal equalisation with a horizontal effect and a strong investment focus should be retained, but further developed in accordance with the principle of subsidiarity. In the course of this, the "luxury fiscal equalisation" can also be reduced, which is currently carried out by allocating cohesion funds even to the richest regions of the EU and which costs 27 billion euros per year. A stronger focus on subsidiarity in cohesion policy would also support Member States in implementing modern, place-based policies, which will also make it easier and more efficient to achieve climate change and broader transformation goals.

Keywords: cohesion policy, European structural and investment funds, EU fiscal equalisation
JEL codes: H70, H77, R11

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1 The mounting pressure to modernise the EU and Cohesion Policy

The central cycle for all regular financial measures of the European Union is seven years. However, the EU's current Multiannual Financial Framework (MFF) for the years 2021 to 2027 clearly shows that many of Europe's political, economic and social challenges cannot be squeezed into this slow rhythm. The most important decisions for the current MFF were made in 2018 and 2019 – years in which the global Covid-19 pandemic that followed shortly afterwards was not yet foreseeable. The current Cohesion Policy, which is essentially implemented via the European Regional Development Fund (ERDF), the Cohesion Fund and the European Social Fund (ESF), therefore still reflects a pre-Covid world in many respects. Also, the fundamental changes in the general environment brought about by the Russian war of aggression against Ukraine for energy supply, international trade links and Europe's geopolitical conditions for action cannot, of course, be reflected in the previously fixed medium-term financial framework.

However, this is not necessarily a problem for the EU. The economic and social disparities between Member States and regions, which Cohesion Policy aims to reduce, remain key objectives of European integration, even in the face of the pandemic, war and energy crisis. With the large Next Generation EU fund (NGEU), Europe has shown that it can make swift and innovative decisions beyond the seven-year cycle. In particular, the Recovery and Resilience Facility (RRF) has established a second dimension of regionally oriented investment support.

However, this paper does not examine the coexistence of the two regional policy systems in the EU in detail[1] and only touches on the seven-year cycle of the multiannual financial framework in passing. Nevertheless, it takes its impetus from the observation of this prominent clash of two European policy modes – the slow-moving standard mode and rapid crisis response – and of the related strengths and limitations for a Europe that is fit for action and fit for the future. The acute crises and challenges that the Member States and their common European institutions have had to face since the beginning of the 2020s have given the EU an unforeseen development boost (Pestel and Süß, 2022). Rather than through calmly balanced reform programmes, the EU changes in response to immediate crises. In the EU's notorious constellation of significant structural obstacles to reform, this tactic of seizing the emerging opportunity to reform by overriding oneself – Jones/Kelemen/Meunier (2016) speak of "failing forward" from crisis to crisis – is very well understandable from a political economy perspective. In fact, something like the NGEU would hardly have been conceivable politically in less dramatic times than the pandemic.

At the same time, this unique European mobility in face of crisis does not ensure that the EU as a whole will move towards strengthening its functionality. This is because the ability to act in the crisis has arisen from two concessions: Firstly, the responses to the crisis establish an *additional* mechanism, while the traditional, financially and politically carefully balanced system remains untouched. Moreover, this additional mechanism is very expensive in financial

[1] See Corti et al. (2024).

terms. NGEU and ARF clearly illustrate these two characteristics. As a result, the flexibility gained in the short term also has an adverse effect on the ability to act in the medium and long term. As a result, the need for modernisation in the EU's established policy areas and for their governance mechanisms is increasing further. And this pressure was certainly not low beforehand.

The most recent proposal in a long string of reform initiatives was presented in autumn 2023 by a twelve-member Franco-German group of experts with proposals for reforming the EU based on two initial propositions that are difficult to dispute: For geopolitical reasons, EU enlargement is "is high on the political agenda, but the EU is not ready yet to welcome new members, neither institutionally nor policy wise“ (Group of Twelve, 2023, 5). The Group makes a series of far-reaching proposals for the further institutional and constitutional development of the EU, which could also serve the German government's reform goals for a "more democratically consolidated, more capable and strategically sovereign European Union" (...) "in accordance with the principles of subsidiarity and proportionality" (Coalition Agreement, 2021, 131). The reform perspectives of the governments of many other Member States– not least France– also aim to strengthen the EU by modernising its institutions with a focus on policy areas with clear European added value, thus rendering it more capable of acting independently.

This paper builds on this motivation for modernisation. With a view to a possible enlargement, but also for the EU-27, it is worth examining all areas of activity and all institutions of the European Union, which is, in President Macron's words, "too weak, too slow and too inefficient" in its current state. The aim is to see how a perspective based on European added value and the principle of subsidiarity can contribute to achieving the common European goals more efficiently in structural and also in financial terms. Cohesion Policy currently receives around one third of the EU's regular budget and, not only for this reason, lends itself to such an examination from many different angles – as shown by the various papers produced by the BMF Expert Network, within which this paper was also written.

2 Cohesion Policy from a fiscal-federal perspective

The paper analyses the *fiscal architecture* of EU Cohesion Policy. The subsequent sections characterise this fiscal element as the load-bearing construction on which the diverse regional, social and transformative features of past and present Cohesion Policy constitute the interior fittings of the building. From a fiscal federal perspective, Cohesion Policy is analysed in its function as a unique and hidden European fiscal equalisation. The idea is not to *pretend* that structural policy is a financial equalisation or to construct a different "narrative". The fiscal architecture of Cohesion Policy describes facts that are obvious – although they may not always be talked about.

With this, the author uses a decidedly fiscal perspective for the third time to analyse the structures of the European Union. The application of the concept of public goods to the tasks of

the European Union leads to a classic application of the theory of fiscal federalism with conclusions on the "Europeanisation" of the EU, i.e. a stronger focus on *European public goods* (Thöne/Kreuter, 2020).[2] A closer look at the European multi-level system from a public finance perspective shows that, contrary to an obvious and widespread analogy, this proto-federal structure is in no way comparable to the dual federalism of the United States of America. Rather, the EU functions as a vertical co-operative administrative federalism similar to the German or Austrian model. This includes, above all, the so-called connectivity problems of synchronising the decentralised implementation of European tasks and their adequate 'federal' financing (Thöne/Kreuter, 2021).

This kind of analysis adopts an outsider's perspective that deliberately does not fit in every respect. Precisely fitting studies of the European Union view it as the singular institutional and political entity that it is. Such an idiosyncratic view naturally does the EU the most justice. But this insider's view inhibits associations, analogies and comparisons with similar phenomena: the view of the EU as a unique entity hinders thinking in alternatives.

The alternative view of Cohesion Policy as a kind of financial equalisation is not new. It is a well-established term in the European policy discourse. This dual view also underlies the research project of the Federal Ministry of Finance, in the context of which this paper was written: "Regional policy is implemented in cooperation with the Member States (MS). It leads to a horizontal fiscal equalisation between economically strong and weak MS" (BMF, 2022). This does not refer to horizontal fiscal equalisation in the narrower sense, but to vertical fiscal equalisation with a horizontal distribution effect. Theoretically, horizontal fiscal equalisation with direct payments between the Member States– or a structural policy financed horizontally in this way– is also conceivable. However, it could be argued that Article 174 TFEU (ex-Art.158

[2] Just as the EU financial framework follows a seven-year cycle, the systematic discussions on the federal allocation of tasks to the European level follow a similar cycle. With regard to European public goods, Heinemann (1999, 293), for example, stated early on that "(...) much of the traditional financial literature on the EU financial constitution [is] based on false assumptions" if it believes that the EU concentrates its activities on normatively well-justified tasks of a central federal level. A quarter of a century ago, this statement was perhaps more pertinent than today. However, it should also be noted that the *first-generation theory of fiscal federalism*, i.e. the normative theory of fiscal federalism based on welfare theory, was not wrong as such. If responsibility for European public goods were actually concentrated at the EU-level, this would constitute an efficient allocation of tasks. However, it would be wrong (and naïve) to assume that the actual distribution of tasks in a federal entity such as the EU would in reality fulfil the requirements of the normative allocation theory. The *second-generation theory of fiscal federalism* (Weingast, 1999; Oates, 2005; Weingast, 2009), with its focus on political economy and empirical research, has cleared up this potential misconception by explaining how actual federal fiscal constitutions are formed. These empirical findings are important not least in order to better understand the significant political economy hurdles on the way to an efficient allocation of tasks. Since Europe– regardless of the cyclical nature of systemic discussions– is continuing to evolve, it should be added that from today's perspective, the discussion on European public goods has gained in importance. In the immediate aftermath of the biggest pandemic in a century, in the face of rapidly advancing climate change and in a geopolitical constellation in which Europe must bear much more responsibility for its own security, there are good reasons to take European public goods seriously not just as a theoretical, appealing concept, but as an existential, urgent, realpolitik postulate for Europe. On the discussion on European public goods see also Heinemann (2016), Fuest/Pisany-Ferry (2019), Calliess (2021), Wyplosz (2024) and Claeys/Steinbach (2024).

TEC) explicitly assigns the cohesion objective and the policy geared towards it to the Union, which would rule out horizontal financial equalisation (Emmerling, 2002).

Whether this EU competency actually prohibits a conceivable horizontal transfer technique– e.g. as netting with own resources– can be left open. What seems more important here is that other fiscal equalisation schemes are also typically organised on a vertical basis for good reason and thus only indirectly generate their horizontally redistributive effect. For example, all 13 municipal fiscal equalisation schemes of the German Länder are structured on a primarily vertical basis.[3] The horizontal financial equalisation *among* the Länder in Germany, which had been in place for decades, was also converted into a vertical fiscal equalisation between the federal government and the Länder with effect from 2020 – at the insistence of the financially strong contributor Länder (Bullerjahn/Thöne, 2018).

The preference for vertical systems can be explained in political or political-economic terms. From a rational point of view, the direction of payment – whether horizontal or vertical – should make no difference in a transfer system. In a horizontal system, there is a clear distinction between payers and recipients, i.e. between "rich" and "poor" countries or local authorities. The resulting transparency is to be welcomed in principle. At the same time, however, it is also argued that such a "brotherly approach" must be based on very strong solidarity (Zimmermann and Döring, 2019, 257). Furthermore, in political practice it can be observed that the absence of horizontal equalisation elements has the effect that the political representatives of legally and democratically equal regional authorities also treat each other as equals. In this sense, it helps if the parties involved do not have a precise picture of who is subsidising whom or who is being subsidised to what extent. In contrast, the decades-long dominance of the horizontal element in the German federal-state fiscal equalisation system has fuelled the polarisation between contributor and recipient states. As a result, federal reform debates always concentrate on either financial issues or on more substantive issues such as the federal allocation of government tasks. These two dimensions of federal reform, which actually belong together, could never be negotiated at the same time because the complexity involved was too high for the political powers to find agreements. Even within the European Union, the so-called *juste retour* thinking, i.e. the fixation of the Member States on their own net contributor or net recipient position, is seen as a central obstacle to overcoming the common chal-

[3] The distinction as to whether a fiscal equalisation system is horizontal or vertical with a horizontal redistribution effect cannot be made with regard to legislative powers, as horizontal systems must generally also be enacted vertically by the higher federal level. Horizontal financial equalisation systems have explicit recipients and payers; the central level primarily assumes the function of a clearing house to simplify payments. In vertical systems, on the other hand, there are only lower-level authorities that receive allocations of different sizes from the central level according to their financial or economic strength. This bigger central budget can, but does not necessarily have to, go hand in hand with greater power of disposal. Naturally, a central level in such systems must have higher initial funding in order to be able to finance the system. However, constitutions can make very clear stipulations as to the equal treatment or possibly even prioritisation of lower-level local authorities in such vertical systems. In Germany, for example, the constitutions in the Länder Brandenburg, Saxony-Anhalt and Schleswig-Holstein give the municipalities equal or even better financial protection than the respective Land level.

lenges that Europe must face. In other areas of European integration, too, less obvious transfer relationships often prove to be the politico-economically acceptable solutions because they are easier to adopt, especially for the (indirect) payers, as shown by Heinemann (2021) using the example of the lack of a transparent sovereign debt restructuring mechanism (SDRM).

Knowing the reasons for non-transparent transfer mechanisms does not mean approving of them. However, to the extent that vertical financial equalisation is also a means of dealing with limited decision-making capacities and irrational loss aversion, the theoretical merits of transparent horizontal equalisation systems become questionable. In the following, this paper will place particular emphasis on increasing the transparency of European Cohesion Policy insofar as its character as a fiscal equalisation mechanism is discussed explicitly and is the subject of recommendations for further development. However, it will not go so far as to recommend a transformation of Cohesion Policy into a genuine horizontal fiscal equalisation between the Member States. Given the vulnerability of the European decision-making system to blockades due to high consensus requirements and diverging interests of the Member States, which has now been analysed in detail in political science research (Holz, 2022, with further references), opening up an additional sphere for intergovernmental dissent would be too great a step. This would thwart the potential benefits of a fiscal federal perspective on Cohesion Policy.

3 Highlights from the evolution of structural policy as an equalisation mechanism

When we speak of the development of structural and Cohesion Policy as a policy of financial equalisation, we are not referring– from a historical perspective– directly to fiscal equalisation between economically different Member States. The focus is on the development of structural policy itself as compensation for impending financial losses or as *side payments* in the event of major changes, in particular the enlargements of the European Community(ies) and later of the European Union.

Throughout its history, in almost every major change, European structural and Cohesion Policy has served as a bargaining chip for the realisation of other objectives. New structural funds were used to buy the agreement of individual Member States to important Community decisions. Without the enlargements, structural policy would not exist in its scope and organisation (Emmerling, 2002; Freise and Garbert, 2013; Holz 2022):

- When the European Economic Community was founded in 1957, the European Social Fund (ESF) was created in order to win Italy's approval and enable the poorer regions of southern Italy to catch up economically.
- The European Regional Fund was set up in 1975 to prevent the last-minute failure of the accession of the United Kingdom, Ireland and Denmark to the EC. Originally, the British government itself had called for such a fund during the accession negotiations in order to receive more payments from the EC and to counter domestic political resistance. At first,

the six founding members were rather critical. When the demand for a regional fund was dropped after a change of government in London, Italy and Ireland took the initiative and threatened to block the crucial summit meeting at the end of 1974. To avoid this, the ERDF was set up in 1975. Its original limitation to three years would not last long.

- After the death of the dictator Franco in 1975, Spain's first post-war democratic government applied for membership of the European Community. Like Portugal, Spain became a full member at the beginning of 1986. This was accompanied by a doubling of structural funds as of 1988.
- The reform of fund governance, also implemented in 1988, is regarded as the birth of structural policy as an independent Community policy area. In a long, cumulative policy process, it was separated from European budgetary policy (Heinelt et al. 2005). Since taking office in 1985, the Delors Commission in particular had endeavoured to counter the financial issues dominated by the Member States in structural policy with the Commission's own claim to shape them: "The Commission aims to reverse the trend towards treating these funds as mere redistributive mechanisms" (COM, 1985, cited in Holz, 2022, 60). The instrument used to overcome the character of structural policy as primarily financial equalisation was the introduction of the four procedural principles of Cohesion Policy in 1988: (1) concentration, (2) programming, (3) additionality and (4) partnership. The partnership principle in particular– even if its importance is often overlooked in economic analyses– proved to be a very effective instrument for consolidating Europe's claim to control. As the Commission now cooperated directly with public and non-governmental actors at regional level, the previously bilateral relationship with the individual Member States was transformed into a multi-stakeholder constellation in which the Member States now faced the need to negotiate with "above and below". As a result of the 1988 reform of structural policy, the Member States continued to dominate the financial dimension, while the Commission extended its strategic competencies over the management of the Structural Funds (Sutcliffe 2000).
- The character of structural policy as a channel for *side payments* and compensation for far-reaching changes in the Community remained unaffected by this reform. At best, it now became strategically more interesting for the Commission to expand structural policy in this way. As early as 1992, there was a further significant increase in structural funds, which was linked to the completion of the European single market. The perception in the Community – on all sides – was that the central regions would initially benefit most from deeper economic integration, while the increased competition would be disadvantageous or at least risky for the peripheral regions in the short and medium term.
- The agreement of the economically weaker Member States to the Maastricht Treaty for the realisation of monetary union was bought with the establishment of the Cohesion Fund in 1994. At the end of 1991, Spain, Portugal, Greece and Ireland had rejected the Maastricht Treaty unless they were promised additional structural funds and the objective of economic and social cohesion was included in the Treaty. The Cohesion Fund, which

was subsequently set up at the turn of the year 1993/1994, was given the new task of promoting environmental issues and the trans-European transport networks. In contrast to the other structural funds, the resources of the Cohesion Fund were distributed on a national basis. This ensured that the new subsidies from the Cohesion Fund only benefited Spain, Greece, Portugal and Ireland. (Holz, 2022, 52).

- The same period saw the accession of Austria, Sweden and Finland to the EU on 1 January 1995. The doubling of Structural Fund resources with the Delors II package for the 1994 to 1999 funding period can also be seen as a response to Spain's threat to block the accession of the three countries and Norway.[4]
- In summary, it can be said that the decision on monetary union and the EU enlargement in 1995 meant a qualitative leap for structural policy: "Even if Cohesion Policy already knew donor and recipient states beforehand, it was only with the Maastricht Treaty that the financial framework of Cohesion Policy was expanded to such an extent that it is fair to speak of a transfer union" (Freise/Garbert, 2013, 36; original in German).
- Between 2004 and 2007, the European Union was enlarged in two stages to include ten Central and Eastern European states as well as Cyprus and Malta. In two respects, the eastward enlargement represents an exception to the historical development of structural policy as compensation and as a price for agreeing to enlargement. Among the Member States of the EU-15, the eastward enlargement was seen as a strategic and historical opportunity, which – also with regard to the European security – was unanimously supported by and large. None of the old members regarded itself as a serious veto player. At the same time, the net contributors in particular were for the first time very reluctant to take on the financial burden of a potentially massively expanded structural policy, as eastward enlargement was already very expensive as it was. Indeed, without the means for universal compensation on all sides, eastward enlargement has led to a significant deterioration in the net position of a number of Member States. This was most clearly the case for Italy, which went from being a net recipient to one of the largest net contributors (in absolute terms). At the same time, average gross domestic product fell with the eastward enlargement. As a result, 16 regions in southern Europe and eastern Germany lost their Objective 1 status as maximum recipient regions – while their economic situation remained unchanged (Braun and Marek, 2014). As there was no room for major changes or increases in structural policy over and above the endogenous effects of enlargement, the compromise that was eventually reached was primarily aimed at limiting the financial damage to the affected old members. As far as the EU-15 was concerned, the funding objective for the transition regions was central, and the losses of the former Objective 1 regions were mitigated by transitional funding. More developed regions were also able to qualify for

[4] In a referendum in 1994, the voters of the Kingdom of Norway rejected their country's accession to the EU by a narrow majority – as they had once before in 1972.

new funding objectives, meaning that all EU regions were eligible for structural policy funding for the first time in the 2007-2013 period.

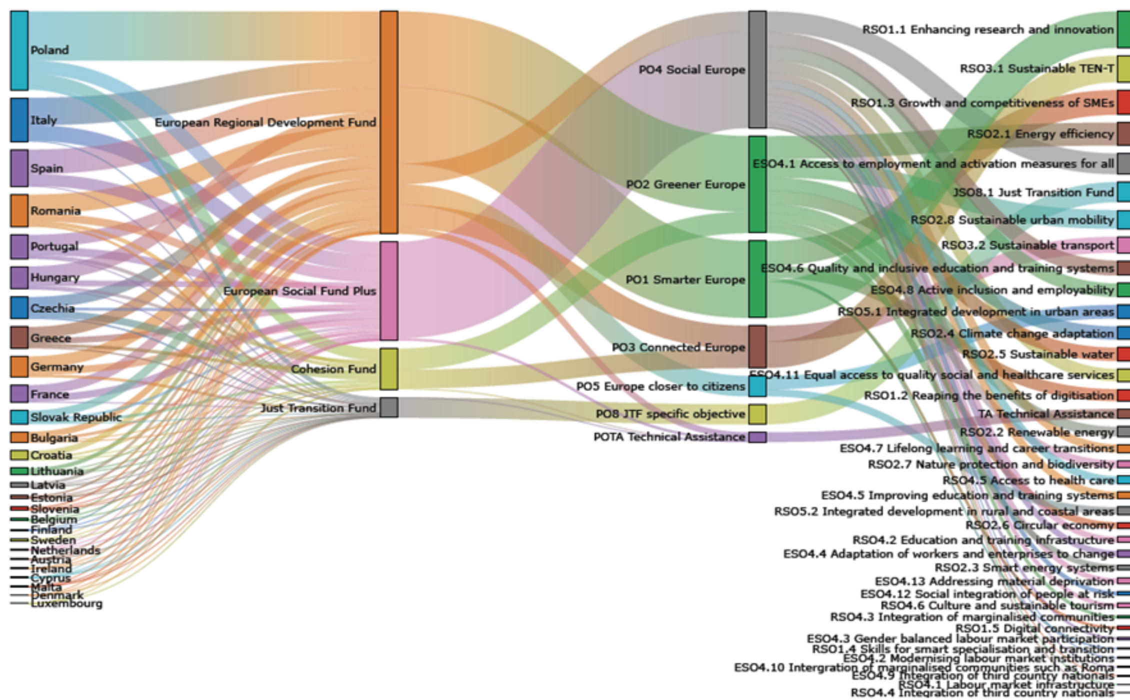
During the reform stagnation of the 2000s and 2010s, comparatively little progress was made due to intensified distribution conflicts following the eastward expansion, increasing criticism of the effectiveness of these programmes and the financial crisis from 2008 onwards (Holz, 2002, 32). In the 2014-2020 funding period, a stronger focus was placed on growth and employment in order to meet the challenges of the economic and financial crisis. In addition to promoting innovation, competitiveness and employment, a stronger thematic focus was adopted in order to emphasise key areas such as research and innovation, environmental protection and education alongside employment. The changes resulting from the parallel operation of Cohesion Policy and the Recovery and Resilience Facility (ARF) cannot yet be validly assessed at the time of completion of this paper.

This overview of the evolution of structural and Cohesion Policy is incomplete in many respects. Neither was Cohesion Policy appraised in terms of its actual performance in creating economic convergence and social cohesion, nor were the macroeconomic and ex-ante conditionalities enforced since the Lisbon Strategy considered, with which structural policy is also increasingly used to enforce the common economic policy coordination procedures and as a sanction instrument for the Stability and Growth Pact.

There have been successes and setbacks in all of these dimensions. This is true regardless of the fact that most of these policy areas were not primarily established at European level because there was a compelling technical need to do so. This observation can be distilled from the short history of Cohesion Policy: Cohesion Policy has always emerged "the other way round". The normal case would be that political actors form around an emerging or long-standing problem and formulate political objectives and instruments to solve it. This sequence was easy to observe with the COVID pandemic and the "NextGenerationEU" (NGEU) recovery plan adopted in its response. Not so with the many stages of Cohesion Policy: "The sequence is always the same: First, a compensation demand is put on the table. If this is generally accepted, then a normative disguise for the payments is sought (...)" (Heinemann, 1999, 294; original in German). Or, as Hooghe (1996, 7) put it early on, but still aptly: "The budget came first, then came the policy".

The number of such *policies that* have been added to structural policy over the years is clearly illustrated by a current chart in which the European Commission attempts to bring together all the objectives, funds and recipients of structural funds in one picture (Figure 1).

Figure 1 **Cohesion Policy Planned EU financing by themes (2021-2027)**



Source: COM (2024); Cohesion Open Data Platform. https://cohesiondata.ec.europa.eu/cohesion_overview/21-27 (2024)

In view of this closely intertwined – and, from an evaluation perspective, dauntingly complex – web of many objectives, numerous sub-objectives and the associated financing plans, it seems far-fetched to associate the multi-layered Cohesion Policy with something as (supposedly) simple as financial equalisation.

However, there is no contradiction with the image of fiscal architecture: anchored in the load-bearing framework of fiscal equalisation, the interior fittings of Cohesion Policy have become increasingly complex, colourful and complicated over the decades. So at the end of our historical review of structural policy, it becomes clear that the question is not whether Cohesion Policy can be compared with financial equalisation. The question is rather how well this policy, primarily founded for equalisation and compensation, still functions as this financial equalisation system that it was created to be, despite – or in spite of – the many different forms it has taken. The question is rather how well this policy, which was primarily founded as an equalisation and compensation, still functions as the financial equalisation system as which it was created, considering– or in spite of– the many different policy purposes it has been assigned to.

4 On the relationship between regional structural policy and fiscal equalisation: empirical similarities and differences

Regional policy and financial equalisation are not the same. When considering the question posed in this paper, one repeatedly comes across contributions in the literature in which the fundamental differences between the two concepts are worked out on the basis of their ideal-typical characteristics. Moisio and Vidal-Bover (2023) currently offer a good overview; the older literature on European financial equalisation also uses such classifications (Walthes, 1996, Thomas, 1997; Mackenstein, 1997; Püttler, 2014). Working out the differences and similarities of regional aid policies and fiscal equalisation on a conceptual and instrumental level has great merit if one is interested in ideal types. Moisio and Vidal Bover (2023) characterise the ideal financial equalisation, compare it with an ideal and also *successful* (!) regional aid policy, work out the differences between the two models and identify potential synergies between the two fields. We will return to any synergies in our conclusions. However, we are not starting from the ideal, but from the reality of European Cohesion Policy– equipped with the empirical knowledge that in reality, financial equalisation also sometimes strays far from the ideal.

4.1 Promotional policy or fiscal equalisation? The Mezzogiorno test

How much financial equalisation is there in the European Union's regional structural policy? The answer to a simple question can help: *Would the EU stop supporting poorer regions via structural policy measures if or where this support ultimately fails?*

This paper is based on the assumption that the answer to this question is *"no".* Figure 2 outlines what this consideration, here called the "Mezzogiorno test" in reference to the founding of the ESF in 1957, means for the distinction between regional aid policy – characterised as "promotional policy" – and financial equalisation.

Figure 2: The "Mezzogiorno test" on the continuation of unsuccessful regional promotional policy

Premise: Convergence remains the focus of EU regional policy (= "strengthening economic, social and territorial cohesion" = "correcting imbalances between countries and regions" = "**catching up**").		
What if, catching up...	**Promotional policy**	**Fiscal equalisation**
...is achieved?	Allocations are discontinued.	Allocations are discontinued.
... is not yet successful, but there is reasonable hope?	Allocations are continued.	Allocations are continued.
... has not been achieved and there is no prospect of it?	Allocations are discontinued.	Allocations are continued.
Mezzogiorno test: If the allocations continue, Cohesion Policy is...	**…failed promotional policy.**	**…regular fiscal equalisation.**

Source: Own illustration.

As is clear, promotional policy for economic development and fiscal equalisation run in parallel in the majority of cases when regional economic strength and fiscal strength correlate (which is the rule). The observation of the Mezzogiorno test that a regional promotional policy aimed at economic development that has not led to success after several decades but is nevertheless continued is pointedly characterised as a failed promotional policy in Figure 2. From an evaluator's point of view, this is certainly true: Subsidies that consistently do not achieve their objectives have failed and should be abolished. But in the political reality, subsidy policy often reacts to findings of this kind by formulating new objectives and continuing the grants. The continued redefinition of the objectives of the Structural Funds through the European programming process also sometimes has to face this criticism (see Feld/Hassib 2024). However, reprogramming that turns out to be purely opportunistic will do little to change the evaluators' judgement if the original objectives are not met.[5]

From the point of view of fiscal federalism, this polarisation is exaggerated anyway. In the absence of economic progress, allocations continue as normal. This is a perfectly conventional constellation that fiscal equalisations are designed to address as a standard. Fiscal equalisations are regularly designed to take appropriate account of different levels of prosperity as well as their changes– convergences and divergences. Leaving aside the fact that the fiscal distributive function of Cohesion Policy is historically the older one anyway, the financial dimension of structural policy can certainly be described as complementary to the cohesion objective: Convergence-oriented structural policy is intended to deepen economic and social cohesion by steering support measures to help weaker regions catch up. It is still the case that cohesion through greater convergence of prosperity and economic performance – i.e. cohesion through convergence – is the ideal path for structural policy. However, decades of experience have shown that a *promotional* Cohesion Policy does not succeed everywhere. The economic and social convergence of all European regions remains an unattainable goal.

The legislative development of EU Cohesion Policy already echoes this understanding. The political objectives of the ERDF, the ESF+ and the Cohesion Fund have been formulated in such a multifaceted way, for the current funding period at the latest, that the convergence perspective is only one of several dimensions (see Figure 1 above). This systematically legitimises what has long been a reality of European policy: *stabilising* Cohesion Policy. This side of Cohesion Policy concerns the economic, social and territorial cohesion of an EU where the regions do not (or cannot) converge as desired. It reflects the fact that regions that do not catch up in the long term (must) remain a target of Cohesion Policy. The coexistence of *promoting* and *stabilising* Cohesion Policy is a central feature of what is described here as the actual fiscal architecture of Cohesion Policy.

To further clarify the effect of structural policy as a de facto fiscal equalisation, two aspects will now be examined in more detail: the fiscal equalisation formula and the actual redistributive effect between economically stronger and weaker Member States.

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[5] Reprogramming as learning from past failures is naturally evaluated differently.

4.2 The equalisation formula of Cohesion Policy

Any regular active fiscal equalisation[6] between regional authorities is essentially based on a formula that determines which regional authorities receive what level of funding and under what conditions. In the case of purely vertical fiscal equalisation with a horizontal effect, the formula is limited to the recipient side– if necessary, the formula also determines the conditions under which certain local authorities no longer have insufficient financial needs and therefore do not receive any transfers.[7]

If we want to identify the implicit formula in European Cohesion Policy that determines the distribution of funds to the beneficiary regions and their structural policy projects, we need to look at a multi-stage system at the end of which the decisive, but somewhat hidden, formula emerges. For the sake of simplicity, we will only look at the financially most important area of structural and Cohesion Policy, the allocations under the "Investment for jobs and growth" objective. According to Art. 110 para. 1 of the Common Provisions Regulation (CPR) for the MFF 2021-2027, this accounts for 97.6%– i.e. EUR 329.7 billion– of the total structural policy funds. The focus is on the well-known tripartite breakdown of NUTS 2 regions into:

- *Less developed regions* with a GDP per capita below 75% of the EU average (61.3% = 202.2 billion euros).
- *Transition regions* with a GDP per capita of between 75% and 100% of the EU average (14.5% = EUR 47.8 billion). In the previous funding period 2014-2020, the upper limit for transition regions was still 90% of the EU average GDP per capita. The increase to 100% in the period 2021-2027 has led to a significant relative increase in the applicable funding rates.
- *More developed regions* with a GDP per capita that is above 100% of the EU average (8.3% = EUR 27.2 billion).[8] In the previous funding period 2014-2020, regions with a GDP per capita of 90% of the average were already considered “more developed”.

All three types of region are eligible for funding under EU regional policy, including the last and richest. This was not always the case; funding for operations in the more developed regions only became eligible from the 2007-2013 period. The three types of regions differ in two

[6] Active fiscal equalisation is preceded by so-called *passive* fiscal equalisation, which uses, among other criteria, the principle of subsidiarity to clarify which regional authority is responsible for which government tasks. The debate on European public goods mentioned above takes place in this area. The subsequent *primary active fiscal equalisation allocates* certain taxes or tax shares to the local authorities for their tasks. Finally, in *secondary active* fiscal equalisation, the primary distribution is corrected (where necessary) by reconciling the burden of tasks, the resulting financial requirements and the tax capacity through allocations. This final stage – fiscal equalisation in the narrower sense – ultimately determines how well the local authorities can perform their tasks.

[7] In the case of horizontal fiscal equalisation, the part of the formula geared towards the financially strong local authorities also determines how much these local authorities have to pay (cf. section 2 above).

[8] The 100% missing shares in this rendition from the Common Provisions Regulation of 2021 are largely concentrated in the Member States supported by the Cohesion Fund (12.9%) and in small parts for other purposes (JTF, interregional innovation investments, and outermost locations).

respects. First, for each type of region there is a separate constraint on the minimum or maximum share of total regional funding that can be allocated to which sub-objectives. Secondly– and this is the better known part– different national or regional contributions are required in the different types of regions. According to Art. 112 (3) of the Common Provisions Regulation, the EU co-financing rate for the "Investment in jobs and growth" objective is a maximum of:

a) 85% for less developed regions and outermost regions;
b) 70% for transition regions defined as less developed regions for the 2014-2020 period;
c) 60% for transition regions;
d) 50% for more developed regions that were defined as transition regions for the 2014-2020 period or whose GDP per capita was below 100%;
e) 40% for more developed regions.

At first sight, the regional co-financing rates guarantee that more funds are invested in regional structural policy projects than foreseen in the MFF and the CPR. Whether these funds from Member States are also additional in an economic sense is another, ultimately empirical question (see Asatryan/Birkholz 2024).

So far, these preliminary stages of the formula largely resemble the specifications of a simple, regionally differentiated support programme with co-financing rates designed to ensure local commitment. However, this does not yet answer the question of how much European regional funding will flow to each region. It should be emphasised that this question would not even need to be answered if this were a normal subsidy programme. The above-mentioned (and many other, not mentioned) framework conditions are intended to ensure that investments which are equivalent in terms of their regional economic justification and the specific objectives they pursue can also be subsidised in the same way, provided that they are carried out in the same of the three types of region. Provided that these conditions are met, an EU aid policy that makes efficient use of scarce financial resources should ensure that its funds are used where they have the highest added value in terms of the objective of "investing in jobs and growth". Any additional restriction on the use of funds, in the sense that, for example, EU funds are reserved for less developed regions in Member State A, even though less developed regions in Member State B could implement more effective employment measures in the same way if they could draw on the unused funds from regional programmes, is a potential source of inefficiency, hinders EU-wide comparability and evaluability and, above all, contradicts the principle of a rational and fair promotional policy.

As explained in section 3, such a rational and fair funding policy has not historically been the primary purpose of EU structural policy. It was never designed to support the best projects in the least economically developed regions, regardless of the Member State in which these regions are located. The primary aim of structural policy was and is to provide Member States with specific funds for regional development, which they can then use as efficiently as possible according to different local conditions. It is a system of equalisation which was originally directed at the Member States and in which the regional focus was not the only motivation, but also served as a pretext for differently motivated equalisation transfers and side payments.

Today, this is no longer so obvious. Since 2000, the so-called Berlin method has been used to distribute funds to the regions. The European Court of Auditors (2019) found the procedures for determining the funds available to Member States to be "relatively complicated", prompting it to review these distribution methods in a 55-page Rapid Case Review in preparation for the current funding period 2021-2027. As the final step in the distribution of funds continues to take place outside the Berlin method as a political negotiation between the EU and the Member States, the final quantitative parameters for the allocations still have significantly different values compared to the Rapid Case Review. However, the basic structure of the Berlin Method has remained unchanged in the current funding period. At least, after more than twenty years of application, the method has now been included in the Common Provisions Regulation for the first time (ECA, 2019, 13), where it can be found as the last of 26 annexes. An end to this lack of transparency was long overdue.

The observation that the EU's structural and Cohesion Policy is probably the most evaluated European policy area (Darvas/Mazza/Midoes, 2019) applies to the Member States and the policies they and their regions implement. This is by no means the case for the EU itself. Only now can more analytical light be shed on the central financial equalisation component of structural policy.

In this respect, the European fiscal equalisation established in Cohesion Policy differs significantly from the equalisation systems that are common in Europe's federal and proto-federal states. The fiscal equalisation systems in Austria, Switzerland, Spain and Germany are the subject of intensive economic and, in some cases, legal research. In contrast, the financial equalisation character of Cohesion Policy has not been studied and has never been evaluated.

Beyond this external feature, however, the technical similarities between the distribution of funds according to the Berlin procedure and conventional financial equalisation are striking. To ensure that it does not go beyond the confines of this article, only the first of the three parts, the allocation formula for the less developed regions, is presented in Figure 3.

Figure 3: Equalisation formula for less developed regions according to the Berlin method

Methodology on the allocation of global resources per Member State – Article 109(2)
ANNEX XXVI of the CPR – Common Provisions Regulation (L 231/692)

Allocation method for the less developed regions eligible under the Investment for jobs and growth goal – point (a) of Article 108(2)

1. each Member State's allocation shall be the sum of the allocations for its individual eligible regions, calculated in accordance with the following steps:

a) determination of an absolute amount per year (in EUR) obtained by multiplying the population of the region concerned by the difference between that region's GDP per capita, measured in PPS, and the EU-27 average GDP per capita (in PPS);

b) application of a percentage to the above absolute amount in order to determine that region's financial envelope; this percentage shall be graduated to reflect the relative prosperity, measured in PPS, as compared to the EU-27 average, of the Member State in which the eligible region is situated, i.e.:

   i) for regions in Member States whose level of GNI per capita is below 82 % of the EU-27 average: 2.85 %;

   ii) for regions in Member States whose level of GNI per capita is between 82 % and 99 % of the EU-27 average: 1.25 %;

Methodology on the allocation of global resources per Member State – Article 109(2) ANNEX XXVI of the CPR – Common Provisions Regulation (L 231/692)
iii) for regions in Member States whose level of GNI per capita is over 99 % of the EU-27 average: 0.75 %; c) to the amount obtained in accordance with point (b) is added, if applicable, an amount resulting from the allocation of a premium of EUR 570 per unemployed person per year, applied to the number of persons unemployed in that region exceeding the number that would be unemployed if the average unemployment rate of all the less developed regions applied; d) to the amount obtained in accordance with point (c) is added, if applicable, an amount resulting from the allocation of a premium of EUR 570 per young unemployed person (age group 15-24) per year, applied to the number of young persons unemployed in that region exceeding the number that would be unemployed if the average youth unemployment rate of all less developed regions applied; e) to the amount obtained in accordance with point (d) is added, if applicable, an amount resulting from the allocation of a premium of EUR 270 per person (age group 25-64) per year, applied to the number of persons in that region that would need to be subtracted in order to reach the average level of low education rate (less than primary, primary and lower secondary education) of all less developed regions;; f) to the amount obtained in accordance with point (e) is added, if applicable, an amount of EUR 1 per tonne of CO2 equivalent per year applied to the population share of the region of the number of tonnes of CO2 equivalent by which the Member State exceeds the target of greenhouse gas emissions outside the emissions trading scheme set for 2030 as proposed by the Commission in 2016; g) to the amount obtained in accordance with point (f) is added, an amount resulting from the allocation of a premium of EUR 405 per person per year, applied to the population share of the regions of net migration from outside the Union to the Member State since 1 January 2014. **Allocation method for transition regions eligible under the Investment for jobs and growth goal – point (b) of Article 108(2)** **(....)** **Allocation method for the more developed regions eligible under the Investment for jobs and growth goal – point (c) of Article 108(2)** **(...)**

As this is a regional policy, whose funds are allocated to the Member States, the funding of a country is composed of the separate funds calculated for the three types of region. Separate rates apply for each type of region. The formula for the less developed regions, which is by far the most important in fiscal terms, is particularly interesting in view of its fiscal equalisation function:

- At the centre stands the relative economic power of the region per capita, i.e. the difference between the GDP per capita of the region and the average GDP per capita of the EU. This calculation of a gap to an overall average corresponds to the main approach of traditional fiscal equalisation, in which a region's own standardised fiscal strength is compared to an average fiscal strength. This gap is the primary basis for the allocation amount. By (always only) partially closing the gap, interregional differences in fiscal and economic strength are reduced without leading to levelling or overcompensation.
- Finally, five different factors can give rise to additional allocations: relative backlogs or additional burdens in terms of regional unemployment, youth unemployment, education levels, greenhouse gas emissions and immigration from outside the EU. Comparable, but

usually independent ancillary approaches are also used in conventional financial equalisation schemes to take into account additional needs for intervention and the associated financial requirements on a generalised basis.[9]

- A distinction is made between the main approach and the five ancillary approaches with the three-stage scale (i) to (iii) of point (b), which is applied to the main approach. Poor regions in rich Member States receive significantly less funding than economically comparable regions in poorer Member States. The percentages used here show considerable discontinuities at the transitions from (i) to (ii) and (iii) – which would be a design flaw in any well-constructed fiscal equalisation system. The percentages applied in the three steps do not show a differentiation that can be understood on the basis of objective criteria. They are obviously used for political fine-tuning to ensure that the different Member States ultimately receive the regional funding intended for them. However, the three-tier system is also interesting for another reason: it conceals a "financial equalisation within the financial equalisation", since the relative fiscal strength of the Member States concerned is again taken into account in this formula, i.e. the principle of subsidiarity is applied in an unexpected place. It is also worth noting that the usual reference to GDP has been abandoned in favour of gross national income (GNI). GNI is the more appropriate reference when it comes to fiscal capacity and fair fiscal equalisation, as in the case of the EU's own resources.

Of the two other allocation formulas for transition regions and more developed regions, which are not specifically shown here, the first still roughly corresponds to the model of the formula for less developed regions. For the transition regions, too, a main approach based on the gap in economic strength is combined, albeit not identically, with the five ancillary rates mentioned above. The ancillary rates formulated are partly identical to the rates for the less developed regions and partly deviate from them. Once again, there is no discernible justification for such discretionary arrangements. Obviously, they are used as political levers.

The allocation formula for the more developed regions differs markedly from the previous two. Since a main approach based on economic disadvantage is clearly unsuitable in the above-average regions, these regions instead are all assigned a per capita amount for the regional population, without any recognisable justification linked to the cohesion objective. For every region in the EU, no matter how rich and free of all economic, social or other worries,

[9] However, as these additional factors are taken into account *within* a region type defined on the basis of GDP, they do not create an independent regional framework, e.g. geared towards climate protection, for this specific target. The premium for higher GHG emissions in the less developed regions and in the transition regions is formulated identically in Annex XXVI. However, due to the different funding quotas, also different marginal transfers per tonne of CO2 equivalent are provided in the different regional types. The ancillary objectives are subordinated to the regional categories related to economic strength. This is consistent in terms of traditional regional policy, but inefficient with regard to the other transformation goals. For example, Südekum and Rademacher (2024) use the German example to show that a spatial framework related to climate protection would deviate significantly from the conventional spatial framework of regional policy. This reveals tensions and trade-offs that can hardly be avoided if modern, multidimensional place-based policies are to be implemented in a one-dimensional spatial framework. In a fiscal equalisation logic, such problems could be mitigated with independent, overarching ancillary approaches.

its Member State is entitled to a certain amount of regional funding from the Union. However, this basic entitlement is small and is only weighted at 20%. Most of the allocations (70%) are determined using indicators that take into account any relative backwardness of the more developed region concerned compared to the average of all these rich regions. This financial equalisation between the rich regions alone relates to indicators such as unemployment, youth unemployment, higher education and early school leavers. Greenhouse gas emissions do not play a role here, but sparsely populated regions are taken into account (2.5%).

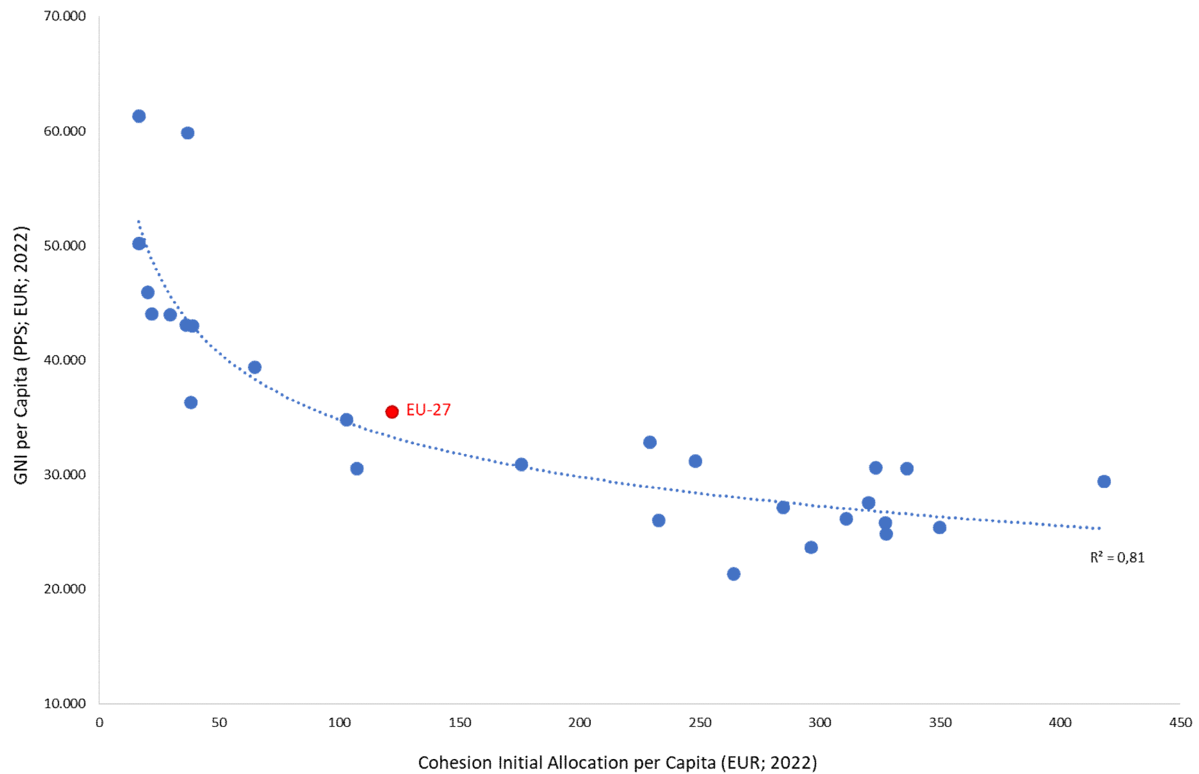
Finally, with a weighting of 7.5%, a small equalisation element based on relative economic strength is included in this formula: An economically strong region receives more allocations the further it is below the per capita GDP of the *richest* NUTS 2 region in the EU. This means that structural policy not only includes many fiscal equalisation elements, but also a small "luxury equalisation". Not only this particularly absurd element reveals the fundamental problem of promoting rich regions for activities for which they do not need financial support and, according to the principle of subsidiarity, should not receive it.

4.3 The redistributive effects

The preceding discussion has identified many characteristics and elements of fiscal equalisation in European structural policy. This is not to say that structural policy is "in truth" exclusively a fiscal equalisation. And certainly it does not mean that it is a *good* fiscal equalisation. Before we draw some conclusions from these observations in section 5, we will take a brief look at the actual redistributive effect of Cohesion Policy. In doing so, we depart from the regional focus of structural policy and look at the redistributive effect between the Member States. This is in line with the approach taken in the previous section 4.2, where Annex XXVI of the CPR also deals with the composition of the allocations to the Member States. Moreover, in a subsidiary fiscal constitution, it would be the Member States that would have to be in a financial position to address the objectives of Cohesion Policy– which generally coincide with their own development and regional objectives– themselves.

Redistribution via EU finances takes place– if at all– via the expenditure side of the EU budget. On the revenue side, the GNI-based own resources dominate with around 60 to 70% of revenue. With gross national income, own resources are linked to the best internationally comparable indicator of the Member States' tax collection potential. The great weight of the GNI-based own resource ensures that the revenue is automatically collected according to an implicitly proportional rate. This means that there is no explicit redistribution between richer and poorer Member States; but the Union is also immune to an unintentionally regressive tariff (Thöne, 2017).

Figure 4 **The implicit equalisation formula of Cohesion Policy in the EU-27**



Own illustration.

Figure 4 shows the cohesion funds allocated to the Member States for the year 2022 compared with the gross national income of the Member States in per capita terms. The power function shown is the best simple substitute for what would be a three-part, section-by-section function if the implicit fiscal equalisation formula from the previous section 4.2 were directly reflected in the large fiscal aggregates. This cannot be observed in its pure form – nor is it to be expected.

A simple regression such as that shown in Figure 4 can only be used to illustrate and formulate hypotheses for further discussion and research. For several reasons, this regression is in fact imprecise from the outset: The "mix" of the three types of region in each Member State has a noticeable influence on its share of cohesion funds. This cannot be captured here. In addition, not all cohesion funds are distributed according to economic strength or region. The formula outlined above with five "ancillary approaches" would also require a multiple regression calculation. If these and other valid reservations[10] were taken into account in a detailed and in-depth study on the fiscal equalisation character of European structural policy, presumably better regression qualities would emerge. Still, this would not reflect the impact of discretionary political fine-tuning.

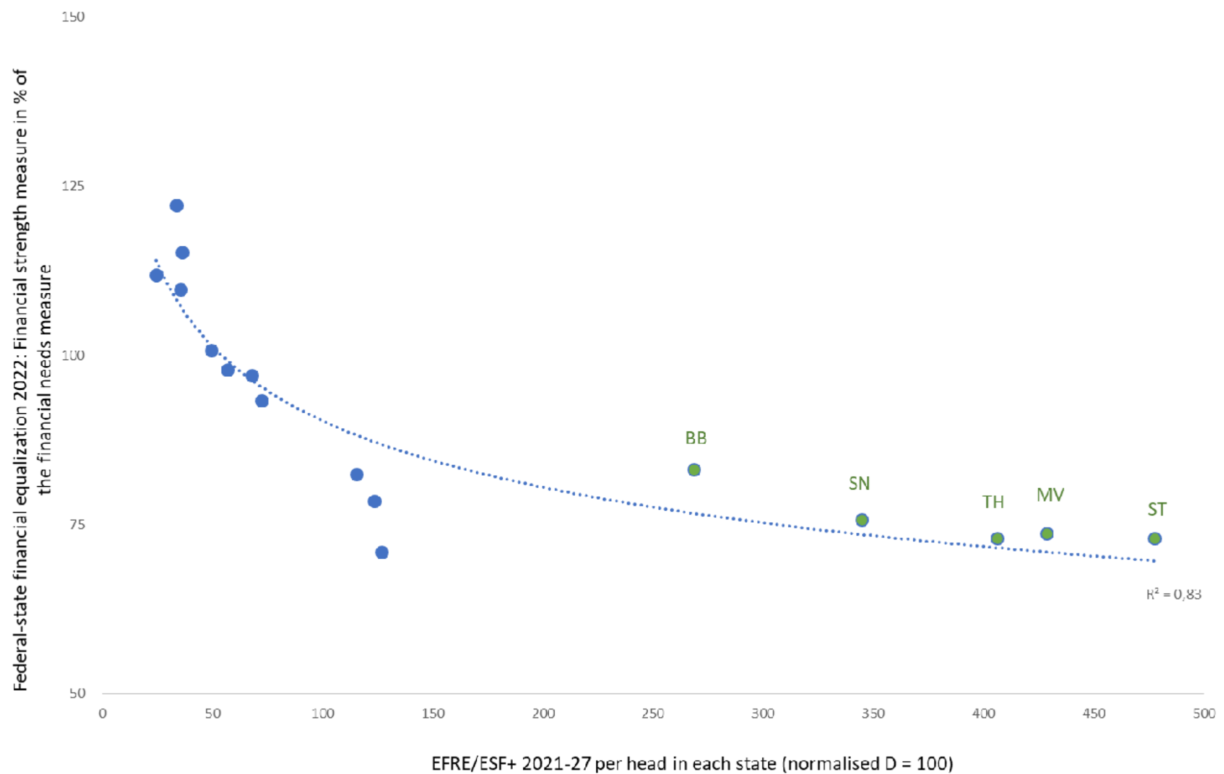
[10] A further caveat: the funding allocations are determined in advance for an entire MFF; in this respect, the GNI for 2018/19 would have been more appropriate than that for 2022. This caveat was taken into account; the regression quality of the again best power function is almost identical with $R^2 = 0.80$.

Against the backdrop of all these reservations about the simple regression presented, it nevertheless exhibits a remarkably high quality with an $R^2 = 0.81$. In other words, the methodologically very elaborate econometric studies on the empirical parameters for German municipal fiscal equalisation– probably the most studied fiscal equalisation systems in the world– only achieve similar regression qualities with the best and most innovative methods; in most cases, one has to settle noticeably lower qualities.[11] Thus, the comparison in Figure 4 actually provides a surprisingly good illustration of the fiscal equalisation effect of European structural policy.

The financial equalisation effect of the Structural Funds could also be traced further downwards. Naturally, the best representation would look directly at the regional level; here, however, the regression would primarily show that the rates defined in the CPR actually work as intended. Instead, Figure 5 briefly illustrates how the regional funds establish a second, hidden financial equalisation between the German Länder in addition to the official federal-state financial equalisation. Similar restrictions apply to this calculation as to the previous one. Here too, the simple regression already shows a similarly high explanatory power. Also, a section-by-section regression would come closer to the actual state of affairs. Figure 5 shows clearly how great the difference is between the western Länder and Berlin (all on the left in the diagram) and the eastern Länder (on the right in the diagram). The aim of compensating for the loss of Objective 1 status in the 2007-2013 funding period with transitional solutions for the eastern Länder has clearly been achieved.

[11] In fact, today only data-intensive, task-specific multiple regression analyses achieve values $R^2 \geq 0.80$ (Gerhards/Schrogl/Thöne, 2020).

Figure 5 **Implicit equalisation formula for ERDF/ESF+ funds between the German Länder**



Abbreviations: BB: Brandenburg; SN: Saxony; TH: Thuringia; MV: Mecklenburg Western Pomerania; ST: Saxony-Anhalt.

Own illustration

5 European structural policy seen as financial equalisation: Prospects and opportunities in a modernising Union

This paper retraces the financial equalisation character of European structural policy. This often amounted to stating the obvious, since Cohesion Policy as not only has the character of an aid policy, but can also be understood as fiscal equalisation system. It has also become clear time and again that promotion and fiscal equalisation are not opposites, but rather two sides of the same European coin. We use the terms *promotional* Cohesion Policy and *stabilising* Cohesion Policy. This pair of terms also makes it easier to reconcile the features of structural policy that are decidedly atypical of standard financial equalisation systems:

- Structural policy is investment-oriented, while conventional fiscal equalisation usually focuses on current tasks and expenditure.
- Structural policy is fixed for seven years in the medium-term financial framework, while conventional fiscal equalisation offers protection against short-term (asymmetric) shocks because it reacts to annual changes.

Both objections are important, but they are not sufficient to refute the argument. Obviously, structural policy involves a unique and impure form of fiscal equalisation. Heinemann (1999) already established a long time ago that this is a tied investment-orientated equalisation system. The interesting question is not actually whether or not a fiscal equalisation limited to

state investments and investment aid deserves its name. Rather, the interesting question is whether such an investment-based fiscal equalisation can also be an attractive option. Many conventional untied fiscal equalisation systems in the Member States and elsewhere exhibit particular shortcomings when it comes to public investment. They are unable to counteract the widespread political economy incentives to favour short-term current expenditure at the expense of future investment. When a regular fiscal equalisation system aims to strengthen investment, this is also implemented by earmarking funds.[12] Against this backdrop, a European fiscal equalisation system limited to investments, which is in any case partial and never meant to cover the full fiscal needs of the local / regional authorities, might even offer a better complement than normal fiscal equalisation system. The orientation towards seven-year periods would also not be unsuitable for investment-based fiscal equalisation in view of the longer planning horizons to be covered.

However, this is only one of the possible conclusions from the above observations. It has also become clear that structural policy would also benefit if it had an *honest* answer for those regions which, for various reasons, are not developing in the direction of cohesion and convergence and where more subsidies cannot be expected to bring about any significant improvement. Such regions have been and will continue to be part of the European reality. Good and adequate fiscal equalisation between the Member States and– where necessary– with the support of European regional policy are suitable instruments for long-term assistance. In many cases, this equalisation-oriented support can be more targeted and use fewer resources if the regions concerned were no longer forced to acquire the funds via the costly and often lengthy structural policy support programmes. The low absorption rates of regional funding, particularly by structurally weak regions, show above all their problems in finding suitable projects (Ciffolilli/Pompili, 2023; Kafsack, 2024). The "competition" from the Reconstruction Fund further exacerbates this problem (ECA 2023).

Structural policy would also benefit if it made a more honest distinction between redistributive transfers in the sense of general cohesion goals on the one hand and political transfers to compensate for reform-related losses and to achieve European policy compromises on the other. Both types of transfer are part of European structural policy; there can be little controversy about this fact. However, by hiding the second transfer type for political fine-tuning in the completely different first transfer type, both tasks become inefficient and potentially more expensive. This has become clear through the example of the numerous systematically inexplicable nuts and bolts in the Berlin method.

Undoubtedly, specific and transparent "transfers for compromise" are politically more difficult to maintain. This should be a good guarantee that transitional solutions actually remain limited in time. In this context, consideration should also be given to lowering the upper limit for transitional regions back to well below 100% of the GDP average. The increase from 90% to

[12] And the problems of preventing substitution with other financial resources and ensuring additionality for earmarked transfers are the same here as they are there.

100% was made as a compromise and as a *temporary* transitory arrangement. A more transparent system would deal with necessary (and certainly legitimate) transitional solutions separately.

Structural policy would benefit from greater respect for the principle of subsidiarity. The European added value of structural policy can be better and more efficiently realised if unrelated and unnecessarily complicated elements are removed. The analysis from the perspective of fiscal equalisation provides important clues in this regard. In particular, regional policy support for more developed regions through European cohesion funds should be reconsidered very critically. From a subsidiarity point of view, it is questionable anyway. The mechanisms outlined for allocating funds solely within the group of more developed regions, including the "luxury fiscal equalisation", highlight this conclusion. The exclusion of these regions from structural policy would have led to savings amounting to 27 billion euros in the current funding period.

In line with the principle of subsidiarity and the fiscal equalisation perspective adopted here, it also seems advisable to thoroughly review the structural policy processes to determine whether the programmatic responsibility for achieving the cohesion goals should be devolved more significantly to the Member States. The Commission already relies heavily on regional and local stakeholders for the operational implementation of structural policy measures. The ubiquitous complaint of the regions that support programmes are often no longer utilised due to their complexity and programmatic overload could be countered if the European level limited itself to those areas of structural policy in which it can generate European added value. In addition to fiscal equalisation support, this primarily involves monitoring, steering and evaluation based on statistics and common general objectives. The investment focus of regional policy fiscal equalisation can also be easily tracked using suitable performance and impact indicators without having to review and approve all regional programmes.

In this context, it should also be considered how many of the European targets for the regions can actually generate added value for the recipients and how many are made more for the benefit of the payers. In the economic literature, the phenomenon of imposing conditions on the recipient of a transfer because it brings additional benefits for the payer has long been known as specific altruism (Tobin, 1970). However, what is an accepted behavioural peculiarity in individuals must, in case of doubt, be regarded as irrational and a source of avoidable inefficiencies when it comes to public actors (Calsamiglia/Garcia-Milà/McGuire, 2013). In other words, the implicit basic attitude, which often resonates in the very specific requirements of regional policy, that local actors alone "cannot handle the money" may be true in individual cases, but in the majority of cases it is inappropriate, elitist and in turn a source of money wasted through bureaucracy and central impediment of local innovation potentials.

A stronger consideration of the principle of subsidiarity in Cohesion Policy also makes it easier for Member States to implement modern *place-based policies*, which can also be used to implement climate protection and transformation goals more smoothly and effectively. The high degree of differentiation of such policies and their demanding *governance* (Südekum 2023;

Green 2023) almost automatically reduce the role of meaningful uniform EU Cohesion Policy to a financially equalising function.

For the specific implementation of the proposed modernisation impulses, countless variations and specific designs are conceivable. This also applies to all approaches to smooth the fiscal equalisation-like rates of structural policy in order to make them appear less non-transparent and less arbitrary. As with all fiscal equalisation reforms, a basic agreement should be reached between the parties concerned before the first tentative calculations are made. The famous Rawlsian "veil of ignorance" proves its worth time and again in practical fiscal equalisation reforms. Because as soon as those affected know whether or not they will financially benefit from a reform that they have agreed to in principle, their previous opinion in favour of reform idea proposals can suddenly change again. This experience is shared by all practitioners of fiscal equalisation reforms.

In conclusion, therefore, only one proposal for procedural reform: The further changes proposed here in the direction of a modernised structural policy, which (also) openly acknowledges its fiscal equalisation character, will meet with approval and rejection. In order to avoid having to work towards a single (and all too rarely achievable) consensus, choice models should also be considered. For example, instead of "classical cohesion"– the full, traditional model of promotional structural policy– Member States could also opt for a leaner "stable cohesion" model, more focussed on fiscal equalisation and European added value. This model would involve fewer procedural requirements, clearer result targets and, for example, only 75 per cent of the standard cohesion allocation, which would, however, be paid promptly and regularly. Such a choice model would endogenously determine which features of structural policy are more important to its addressees and it would provide a fully independent answer to the question "Promotional policy or fiscal equalisation?"

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