COMMENT TO "ASSESSING POLICY OPTIONS FOR THE EU COHESION POLICY 2014-2020" BY ANDRIES BRANDSMA, FRANCESCO DI COMITE, OLGA DIUKANOVA, D'ARTIS KANCS, JESUS LÓPEZ RODRÍGUEZ, DAMIAAN PERSYN AND LESLEY POTTERS

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I appreciate the opportunity to comment on this interesting paper on assessing policy options for the EU Cohesion policy 2014-2020. This policy is an important part of the EU's institutional architecture, accounting for about one third of the EU's budget. It has acquired increased importance in recent years, as many EU countries have been forced by the crisis to cut back public investments. The policy has evolved over time, reflecting the expansion of EU membership, and its changing development needs, in particular gaps in infrastructure and human capital.

Not surprisingly, there has been a spate of cross-country, cross-region, and national studies that have attempted to assess the effectiveness of the policy.[1] The evidence from the studies is mixed, but on balance it suggests that the policy has been more effective in promoting convergence in national growth rates within the EU than in reducing within-countries regional disparities.

Recent spatial economics literature highlights the advantages of agglomeration and the consequent policy challenges in promoting economic convergence of relatively isolated and backwards regions with faster-growing metropolitan areas. A number of studies have emphasized the obstacles to convergence posed by weaknesses in institutions (e.g., corruption, legal uncertainties, and poor administrative capacities).

The reformulated Cohesion Policy for 2014-20 aims to address some of these issues. Specifically, it aims to combine the regional convergence objective with those of the Europe 2020 strategy, namely: innovation; increased competitiveness; employment growth; environmental sustainability; and social inclusion. This new approach is reflected in an increased focus on: investments in R&D; SMEs; the environment; access to high speed internet; and labor market programs.

The main instruments of the Cohesion Policy for 2014-2020 are: five structural funds (ESIFs), with common streamlined rules; and partnerships with national governments, with levels of support and co-financing varying depending on the level of the country's development. A key feature is an increased focus on strengthening governance, including at the sub-national levels of government. National strategies supported by the Cohesion Policy must be broadly consistent with structural reform priorities identified in the European Semester.

The paper by the EC's Regional Economic Modelling Team represents a useful attempt to evaluate ex-ante the expected impact of the Cohesion Policy for 2014-20. It presents the methodology and results of a simulation of the growth impact of the budgeted expenditures under 4 main lines of the policy (Human capital, R&D, Aid to Private Sector, and Infrastructure) on 267 EU regions. The simulation uses a spatial CGE model (RHOMOLO), supplemented by other analytical tools as needed (SAMs, and the TRANSTOOL model to analyze the impact of the policy on transport costs). The paper does not attempt to model the effects of Cohesion spending on capacity-building.

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[1] See Shankar and Shaw, 2009 for a comprehensive literature review.

The paper's key assumptions can be briefly summarized as follows:

- Cohesion expenditures on human capital (21 per cent of the total) are assumed to reduce labor supply and increase workers' productivity in a ratio of 0.3 to 1;
- The expenditures on R&D (12 per cent of total) are modeled as increasing (with a distributed lag) total factor productivity (TFP). The impact is assumed to be greater the farther away is the region from the technology frontier;
- Subsidies to non-RD&D private innovation activities (12 per cent of total) are also assumed to boost TFP with an elasticity of 0.15-0.18;
- The impact of infrastructure investments (49 per cent of total) on bilateral trade costs is modeled with a three-step procedure.

The different policy interventions are simulated first separately and then jointly. The distribution of the effects of the different components of the policy varies across regions, partly reflecting differences in initial conditions (skills and infrastructure gaps). The combined impact of the policy is estimated to boost the average EU GDP by 0.4 per cent, that of the newer members (EU13) by 2.6 per cent, and that of the EU15 by 0.2 per cent. Much of the difference in the effects reflects differences in the allocation of the funding. However, differences in initial gaps and in production structures also play a role.

In my view, the paper provides a valuable and carefully constructed analysis of a very relevant policy question, using state- of-the-art analytical tools. As for any analysis based on a CGE model, its results depend heavily on the assumptions underlying its specification and main parameters. The relevant literature shows significant variance in the available empirical estimates of the parameters.

For this reason, it would be desirable to test the robustness of these assumptions through a range of sensitivity analyses, in particular regarding the elasticities of labor and total factor productivity to positive spending shocks. It may also be desirable to analyze to what extent differences in labor productivity among the six sectors included in the model affect the estimated impact of industry-specific interventions.

I think that a significant limitation of the analysis is the fact that the quality of institutions does not influence in the model the effectiveness of the Cohesion Policy funds. This limitation largely explains why the impact of the funds is found to mostly mirror their projected geographic distribution. Yet, as found by some of the studies mentioned above, capacity constraints can affect the rate of absorption of the funds, and leakages due to inefficiencies and corruption can and do impact adversely their growth and employment stimulation potential.

A formal incorporation of this important dimension in the model may be prevented by a lack of comparable regional indices of the quality of institutions in the EU. However, it may be possible to supplement the model-based analysis with more detailed qualitative case studies of a few regions projected to be especially successful (or unsuccessful) in utilizing the Cohesion Policy funds (as measured by the projected ratio of impact to funds allocation). Such case studies should attempt to identify potential institutional obstacles to the effectiveness of the funds, and suggest possible remedial actions.