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More Funding for Metropolises

The financial crisis has changed EU structural support in the regions

By Moritz Neujeffski

The European Cohesion Policy is intended to mitigate the disparities between European regions and to encourage states to invest financial resources in their weak regions. But what happens in times of crisis when funding is scarce and austerity dominates? Using the examples of Portugal's North Region and Saxony-Anhalt in Germany, this article illustrates whether it has been possible to sustain the policy of strengthening the regions under the dictates of austerity since the financial crisis of 2008.

The European Cohesion Policy is considered to be an active form of solidarity within the European Union. At €392 billion, this budget item is currently also one of the European Community's largest spending areas. Since the introduction of the Cohesion Policy in 1988, financial resources have been distributed through five different funds with the aim of "reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions" (TFEU, 2007, Art. 174). This policy involves the redistribution of financial resources between economically more developed Member States and the less developed regions of the EU. The Cohesion Policy is also emblematic of a Europe of the regions, for regional authorities are actively involved in the implementation of funding measures.

Since 2007, the Cohesion Policy has undergone a major transformation. Under the Lisbon Strategy the subsidies had already become increasingly oriented to the goal of improving regional competitiveness, reducing the importance of the classical avenues for funding social infrastructure projects. Besides establishing new climate protection criteria and an explicit focus on urban spaces, the European Commission in 2013 linked its funding policy to the European Semester as part of the EU budget negotiations so that EU funds can be withheld if Member States violate the EU stability and growth criteria. Through the European Semester, the European Commission reviews member states' budgets. Moreover, the Commission promoted new financial instruments that rely on concessionary loans—instead of traditional grant models.

The consequences of the financial crisis for cohesion policy

Although the impact of the financial and debt crisis on European regions and regional development programs has already been studied, its consequences for the European Cohesion Policy have so far received little attention in research. What has gone unnoticed is how government austerity programs in the regions come into conflict with the implementation of EU-funded structural measures. This collision is due to the fact that state institutions at national or regional level must always provide some co-financing for EU-funded projects. The so-called additionality principle of cohesion policy therefore also prescribes a minimum of national or regional structural funding, regardless of specific co-financing. EU funding is intended to complement national spending, not to replace it.

To trace the consequences of restrictive fiscal policy on the implementation of cohesion policy in the regions, this article presents results of field research in Germany's Land (federal state) of Saxony-Anhalt and in Portugal's North Region. It deals with the thematic and spatial distribution of EU structural funds within the two regions and with concrete funding measures over time. The two regions differ greatly in both their economic development and their regional political competencies. Whereas the state government in Saxony-Anhalt has far-reaching jurisdiction in the implementation of structural funds, in Portugal it is the national authorities that spend and manage EU funds in the regions. What the two regions have in common is that they faced comparable fiscal policy challenges during the crisis, which produced similar strategies for the use of European funds.

Portugal's austerity policy came at the expense of small communities

The financial crisis sometimes took on existential aspects in Portugal and changed the way the North Region used EU funds. In 2011 Portugal was forced to request a €78 billion rescue package from the IMF and the EU after speculation on international financial markets about the country's possible bankruptcy. The austerity measures included a reduction in national structural spending and transfers to municipalities. To avoid possible conflict with the additionality principle of cohesion policy, the EU Commission immediately lowered the national minimum spending. The austerity policy received institutional priority over the financing of regional development policy. However, the Commission's plans to withhold some of the European funds earmarked for Portugal were blocked by the member states in the European Council and by the European Parliament. At the same time, the reduction of national expenditures amplified the importance of the European Structural Funds "immensely! Our regional EU funds were the main support for our infrastructures and for financing small expenses," as one administrative official reported (Interview No. 8). The North Region had thus already been using EU funds to fill short-term financial gaps.

Portugal and the North Region responded to the crisis by, among other things, increasingly committing EU funds to strengthening the country's export-oriented competitiveness. Spending on social infrastructure and public services in weak regions was reduced, and funding for small and medium-sized enterprises and research and development was boosted. Investments shifted in favor of urban centers, with funding for metropolitan Porto rising by 10 percentage points in the 2014–2020 financing period compared to the previous period (2000–2007), whereas funding for rural and much less developed areas such as the Douro region decreased from 8% to 3.8%.

Portugal also set the goal of expanding private participation in EU funding, for this measure would foster the utility of structural funds for the Portuguese economy. The country thereby adopted a proposal made by the Troika in 2014. From then on, the turn to new financial instruments shaped the North Region's structural policy as well. Aside from new programs such as Portugal Inovação Social, which is partly based on what are known as Social Impact Bonds, a loan-based financing program was also launched in the housing sector.

Whereas large parts of the already small state housing budget had to be used for debt repayment, the intrumento financeriro reabilitacao e revitalizacao urbanas, or Financial Instruments for Urban Development in Portugal (IFRRU) created a new subsidy program for housing rehabilitation. The €102 million from the Portuguese Structural Fund were used to minimize risk to secure private investment. Because this program structure depends heavily on private demand, the ability of the government to channel investment is limited. Such restriction was then reflected in the spatial distribution of investments and the recipient structure. Despite significant efforts to promote the program nationwide and cover all Portuguese territory, recipient data show that only 28% of Portugal's municipalities received IFRRU funds (as of December 2022). The vast majority of investments were made in the Lisbon and Porto metropolitan regions. In the North Region more than 84% of IFRRU funds were allocated to the Porto metropolitan area, although it is home to only 48% of the North Region's population.

https://datawrapper.dwcdn.net/CE8sI/2/

Moreover, demand for secured IFRRU loans appears to have been driven in part by the tourism boom in Lisbon and Porto. Hence, a large share of the loans benefited the hotel industry or firms in the short-term rental sector. The change in practice is likely to have accelerated rather than counteracted the current housing shortage, rapidly rising rents, and displacement processes that Porto and Lisbon have been struggling with since about 2014.

Smaller changes in Saxony-Anhalt

In Germany's region of Saxony-Anhalt, too, the crisis led to a worsening of the situation with the deficit-ridden budget and to some changes in the allocation of EU funds. The situation was less severe than in Portugal, however. Saxony-Anhalt nevertheless, also heeded the Commission's guidelines and used the funds more than before to promote regional competitiveness. Similar to the North Region in Portugal, this change was also accompanied by a geographical shift in EU funds. Resources from the EU's Regional Development Fund (ERDF) grew by 7.4 percentage points in the next funding period, with more than half of that support going to the urban centers of Halle, Magdeburg, and Dessau-Roßlau. The vast majority of the population living in rural areas and small towns in Saxony-Anhalt (85.7%) therefore received less than half of the ERDF funding (44.8%), as shown by a comparison of recipient data between the funding periods 2007 to 2013 and 2014 to 2020.

Besides austerity measures in the state administration, the response to the crisis was a funding cut in Saxony-Anhalt, especially in the education system and the cultural sector. There measures resulted in the largest demonstrations in Saxony-Anhalt since German reunification, involving students, cultural workers, and trade unions.

In the 2014 to 2020 funding period, Saxony-Anhalt's regional "Operational Program" intended to assign more EU funding to research institutions than before. However, this prioritization of EU investments contrasted sharply with the university policy that the state actually adopted. Whereas Saxony-Anhalt planned to increase EU investments for universities by about €22.3 million compared to the previous funding period (2007–2013), state funding was to be reduced by €75 million between 2013 and 2024. Substantively, too, there was a strong overlap between the specific items cut or funded. Similar, albeit unsuccessful, attempts to replace state funds with EU funds were also made in cultural funding. As with the North Region in Portugal, the harshest effects of the crisis were apparently to be cushioned in Saxony-Anhalt with the help of the European structural funds.

In conjunction with the euro crisis, the intensified orientation of European cohesion policy to the goal of regional competitiveness has led to changes in the disadvantaged regions. Spatially, a stronger emphasis on promoting competitiveness is leading to a shift of funds to the more productive urban centers of the regions. This development holds both for the North Region in Portugal and for Saxony-Anhalt in Germany. It raises the question of whether intraregional inequalities are being reinforced by the new funding practices. Proponents of the new strategy argue that the new focus on promoting strong centers benefits the economically weaker parts of the regions as well. Most research available to date does not support this thesis.

These results show that the implementation of cohesion policy in the sovereign debt crisis basically reflects the contradictory European demands faced by regions and their member states alike. As the example of the Portuguese North Region demonstrates, the pressure from EU institutions to save money and restructure public budgets has led to an unavoidable violation of the additionality principle, which stipulated a minimum level of national or regional structural support. This balance could be struck only when the Commission lowered previously fixed national support rates. In many places the principle of additionality was fundamentally called into question. What is clear is that, when in doubt, the policy of budget consolidation enjoys priority—with adverse consequences for the disadvantaged regions.

For the current funding period (2021–2027), the additionality principle has been officially set aside. At the same time, the need for wide-ranging European investment programs is more evident than ever in view of the advancing climate crisis and calls for both European and national efforts. If a fundamental conversion to a lower-carbon economy is to be achieved, the socioecological transformation must not be permitted to further exacerbate already existing economic inequalities. Closer consideration of environmental objectives in the allocation of cohesion funds is certainly to be welcomed. But the already obvious trade-offs of cohesion policy and the now often substitutive use of European funds keep raising the question of whether and how regional inequalities can be reduced against a background of restrictive fiscal policy.

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The photo shows vineyards and countryside on the Douro River in northern Portugal.