Is additional EU funding for economic, social and territorial cohesion through the Recovery and Resilience Facility likely to result in more investments?

Administrative capacity constraints and long-lasting permitting procedures might prove to be bottlenecks for additional investments through the Recovery and Resilience Facility

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1. Strengthening the EU's economic, social and territorial cohesion: a joint mission for cohesion policy and the RRF

Cohesion policy is the main long-term investment policy of the European Union (EU). Originally known as «regional policy», the notion was first introduced by the Treaty of Rome. Starting in 1988, different regional policy funds at the time were integrated into one overarching policy, the objective being to «strengthen economic, social and territorial cohesion by reducing disparities in the level of development between regions»[1].

In July 2020, the European Council agreed on the NextGenerationEU (NGEU). This temporary instrument aims to «tackle the adverse economic consequences of the COVID-19 pandemic or the immediate funding needs» that emerged from the crisis[2]. Around 90 % of NGEU funding is channelled through the Recovery and Resilience Facility (RRF)[3].

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[1] Article 174 of the *Treaty on the Functioning of the European Union* («the TFEU»).

[2] Article 1 of *Council Regulation (EU) 2020/2094* establishing a European Union Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis («the NGEU Regulation»).

[3] *Regulation (EU) 2021/241* establishing the RRF («the RRF Regulation»).

Both cohesion policy and the RRF[4] are implemented under the same title of «Economic, social and territorial cohesion» of the Treaty on the Functioning of the European Union (TFEU), and are disclosed under the same heading «Cohesion, resilience and values» in the EU's multi-annual budget, known as the Multiannual Financial Framework (MFF)[5].

This article draws on a review released in January 2023 by the European Court of Auditors[6]. The review provides a comprehensive comparative analysis of the design of cohesion policy and the RRF[7].

2. Significant, but temporary increase in EU funding for economic, social and territorial cohesion objectives

The 2021-2027 MFF[8] totals €1 211 billion[9]. Almost a third of this amount, €361 billion, is dedicated to the three cohesion policy funds: the European Regional Development Fund (ERDF), the Cohesion Fund (CF) and the European Social Fund (ESF+)[10].

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[4] Recital 2 of the RRF Regulation cites Article 175 of Title XVIII «Economic, social and territorial cohesion» TFEU.

[5] European Commission, *«EU's next long-term budget and NextGenerationEU – Key facts and figures»*, April 2021, p. 16. The MFF allows EU spending to be planned over a given period rather than from year to year, with the aim of making policies more effective. This period is currently seven years, from 2021 to 2027. The MFF also sets out annual ceilings for expenditure that can be spent by policy area.

[6] The *European Court of Auditors* (ECA) was established as the EU's external auditor in October 1977. In 1993, the Treaty of Maastricht elevated it to the rank of an EU institution. The ECA's mission is to improve the way the EU's finances are managed, and to provide independent assurance that the EU has collected and spent its money according to the rules. The ECA carries out both financial and performance audits, and produces products such as annual reports on the implementation of the EU budget, special reports on specific topics, opinions on proposed legal bases, and reviews on any subject of EU interest.

[7] European Court of Auditors, *Review No 1/2023*: «EU financing through cohesion policy and the Recovery and Resilience Facility: A comparative analysis», January 2023.

[8] Annex I to *Council Regulation (EU, Euratom) 2020/2093* laying down the multiannual financial framework for the years 2021 to 2027 («the MFF Regulation»).

[9] All amounts in this article are in current prices.

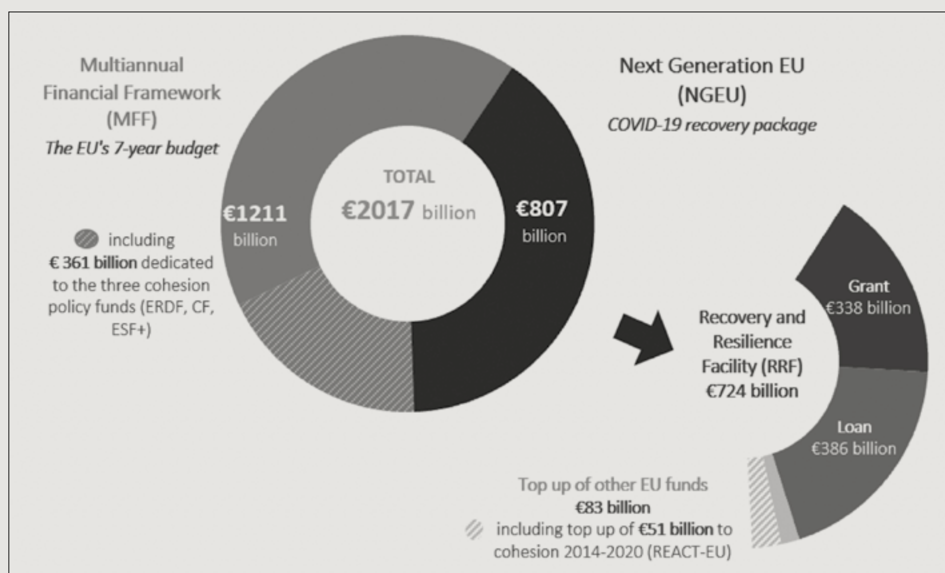
[10] European Court of Auditors, *2021 Annual Reports*, October 2022, paragraph 5.2(a):

- The European Regional Development Fund (ERDF) aims to redress the main regional imbalances through financial support for innovation and research, the digital agenda, small and medium-sized enterprises and the low carbon economy;
- The Cohesion Fund (CF), in the interest of promoting sustainable development, finances environment and transport projects in member states with a per capita GNI of less than 90 % of the EU average;
- The European Social Fund plus (ESF+) aims to achieve high employment levels, fair social protections and a skilled and resilient workforce, as well as inclusive and cohesive societies as a cen-

At the same time, from 2020 to 2026, NGEU makes available to member states an additional €807 billion, €724 billion of which is channelled through the RRF. Of the remaining €83 billion, €51 billion top up the 2014-2020 cohesion policy programmes through REACT-EU[11]. The RRF will provide grants (€338 billion) but also loans (€386 billion) that the member states may request[12] in order to finance both investments and reforms, unlike cohesion policy which can co-finance only investments.

In the years to come, the EU will make available to member states a total of € 2017 billion (see Figure 1). If the RRF's loan component is used in full, the proportion of public spending which the EU finances in member states will increase from around 1 % to as much as 3 % of EU GDP[13].

Figure 1. **THE MFF AND NGEU**



Source: European Court of Auditors, based on Commission data published in April 2021.

tral factor in eradicating poverty; for the 2021-2027 programming period ESF+ includes the Youth Employment Initiative (YEI), the Fund for European Aid to the Most Deprived (FEAD), and the EU Programme for Employment and Social Innovation, all of which were previously separate.

[11] *Regulation (EU) 2020/2221* amending Regulation (EU) No 1303/2013 as regards additional resources and implementing arrangements to provide assistance for fostering crisis repair in the context of the COVID-19 pandemic and its social consequences and for preparing a green, digital and resilient recovery of the economy («the REACT-EU Regulation»).

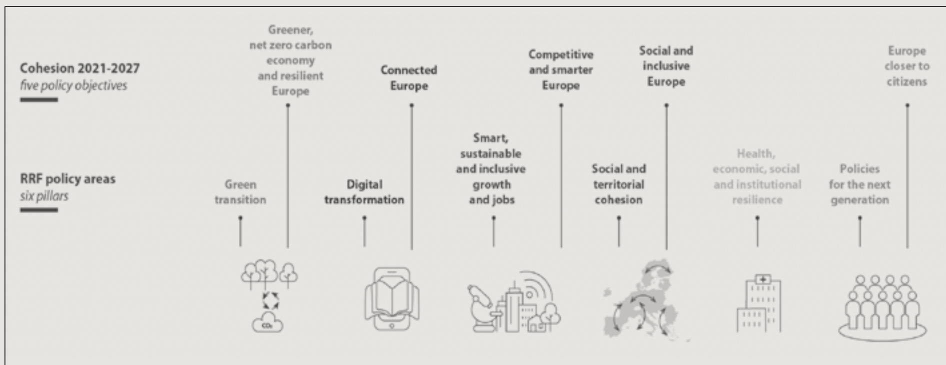
[12] Article 15(2) of the RRF Regulation.

[13] European Court of Auditors, Review No 1/2023, paragraph 20.

3. Member states are likely to prioritise investments financed through the RRF because of time pressures and more favourable funding arrangements

In terms of their spending priorities, the two instruments are very similar, albeit presented differently: the 2021-2027 cohesion policy establishes five policy objectives[14], whereas the RRF has six policy areas[15]. Much importance is given to climate objectives/areas by both instruments[16]. Their similarities are illustrated in Figure 2.

Figure 2. **COHESION POLICY OBJECTIVES AND RRF PILLARS**



Source: European Court of Auditors, based on the 2021-2027 CPR and the RRF Regulation.

The RRF will significantly increase the proportion of EU-financed public investments with a cohesion policy profile in the member states. This variety of funding instruments allows member states a great deal of discretion in choosing which instrument will finance a given investment[17].

Against this backdrop, member states are likely to prioritise investments financed through the RRF because of time pressures and more favourable funding arrangements. In particular, although the two instruments are implemented in paral-

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[14] Article 5(1) of *Regulation (EU) 2021/1060* laying down common provisions (Common Provisions Regulation – «the 2021-2027 CPR»).

[15] Article 3 of the RRF Regulation.

[16] According to Article 4 of *Regulation (EU) 2021/1058* on the ERDF and the CF («the ERDF/CF Regulation»), under the thematic concentration requirement for the 2021-2027 cohesion policy a minimum 30 % of ERDF and CF funding must be allocated to a «greener, net zero carbon economy and resilient Europe». In line with Article 18 of the RRF Regulation, the RRF sets budget allocation targets of at least 37 % for the «green transition».

[17] European Court of Auditors, Review No 1/2023, paragraph 11.

lel, the RRF's eligibility period[18] ends in August 2026[19], whereas the 2021-2027 MFF finishes in December 2029[20]. In addition, RRF measures or reforms are 100 % financed from the EU budget, whereas, in the case of cohesion policy, national or regional co-financing applies[21].

4. For the first time, the EU has issued jointly guaranteed loans to finance the RRF

The multi-annual financial budget is primarily financed from member state contributions, and is allocated to the EU-27 on the basis of the long-established «Berlin formula» that was adopted by the European Council in 1999[22]. Bearing in mind the national allocated amounts and the cohesion policy objectives for the MFF period in question, national authorities prepare their partnership agreements[23] and programmes[24] (previously known as «operational programmes»). A further step entails funding by programme and priority being disbursed to projects, following calls from the relevant national authorities for proposals that define the eligibility criteria for financing.

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[18] We define the eligibility period as the period when expenditure can be declared for co-financing in the case of cohesion policy funds, or when milestones and targets can be achieved for 100 % financing in the case of the RRF. After the end of this period, the member states forgo any unused funds.

[19] Articles 17(2), 18(4)(i) and 24(1) of the RRF Regulation.

[20] Article 63(2) of the 2021-2027 CPR. Under cohesion policy, expenditure can be declared for reimbursement after the MFF period ends. This creates an overlap between periods: the eligibility period extends into the beginning of the following programming period and may prevent the subsequent period from starting on schedule.

[21] The co-financing rate indicates the proportion of costs covered by EU funding. For cohesion policy funds, it ranges from 40 % to 85 %, depending on the fund and the level of development of the supported region. In the past, there have been some instances of member states receiving 100 % EU financing from cohesion policy funds, but only in exceptional circumstances.

[22] European Court of Auditors, *Rapid case review 2019*: «Allocation of cohesion policy funding to member states for 2021-2027», March 2019, paragraph 4. According to Article 108(2) and Annex XXVI of the 2021-2027 CPR, the main allocation criterion for cohesion policy funds is regional GDP and gross national income (GNI) per capita, i.e. relative prosperity compared to the EU average, adjusted for purchasing power.

[23] A partnership agreement sets out the national authorities' plans on how to use funding from the cohesion policy funds, and outlines each country's strategic goals and investment priorities during a given period (currently seven years), linking them to the EU's overall aims for smart, sustainable and inclusive growth. It is prepared by the member states in cooperation with the Commission, and must be adopted by the Commission before the national programmes are adopted.

[24] The programmes provide details of a member state's priorities and specific objectives beyond the partnership agreement, and describe how funding (EU, national public and/or private co-financing) will be used to finance projects. The programmes are prepared by the member states and must be approved by the Commission before any payments can be made from the EU budget. They can be modified during the programme period, but require the Commission's agreement.

By contrast, the method for allocating RRF funds to member states mainly considered development disparities at national (rather than regional) level prior to the pandemic. This means that structural and pre-pandemic disparities were a bigger factor in determining the allocation of RRF grants than the economic impact of the COVID-19 pandemic, even though mitigating the impact of the pandemic was one of the RRF's primary objectives[25]. With the total allocated amount in hand, member states had to prepare their national Recovery and Resilience Plans (RRPs), by means of which they agreed with the Commission the set of measures and reforms they would aim to implement. Measures and reforms were linked to milestones and targets for measuring the implementation of the RRP[26].

A striking development for NGEU, and thus of the RRF, is that it is entirely financed by borrowing on capital markets. This debt is guaranteed by the EU budget, i.e. jointly by all member states. This is a major novelty for the EU's finances. The debt will need to be paid back by 2058[27]. However, at this stage it is still unclear how these repayments will be funded. Unless new EU-level revenue sources are agreed by all member states, the repayments will be made from future EU budgets.

5. Disbursement based on satisfactory achievement of milestones and targets for the RRF versus reimbursement based on actual costs incurred

For cohesion policy programmes, disbursements are based on «costs actually incurred»[28]. These costs must be substantiated and declared by the national and regional authorities to the Commission. This also means that controls and audits focus on the eligibility of measures and of declared costs.

For the RRF, a fundamentally different financing system has been designed. Disbursements are based on the «financing not linked to costs» model[29]: they are made for the satisfactory achievement of the milestones and targets set out in the national RRPs, and so are disassociated from actual costs. Cost estimates were con-

[25] European Court of Auditors, Review No 1/2023, paragraph 17.

[26] Article 2(4) of the RRF Regulation. Milestones measure qualitative progress and targets quantitative progress towards achieving reforms and investments.

[27] Article 6 of *Council Decision (EU, Euratom) No 2020/2053* on the system of own resources of the European Union and repealing Decision 2014/335/EU, Euratom.

[28] Article 125(1) of the Financial Regulation defines the «reimbursement of costs actually incurred» as one of the three forms of financial support. It involves EU funding being reimbursed, based on the actual costs incurred by beneficiaries. These costs must be substantiated by supporting documents.

[29] Article 125(1) of the Financial Regulation defines the «financing not linked to costs» model as one more form of financial support. According to this model, an operation receives EU funding when it achieves results or meets conditions previously established by legislation. This model was first introduced in 2018 when the Financial Regulation was revised.

sidered only once: when drafting the national RRP. This also means that the control and audit framework focuses on whether or not these milestones and targets were met. In this respect, the design of the RRF comes close to the OECD definition of a performance-based budgeting system[30].

However, the drawback of such a system is its rigidity: when NGEU and the RRF mechanisms were adopted, few anticipated the high inflation rates that we are currently experiencing. As disbursements are made for achieving milestones and targets, member states will have to compensate for price increases of the RRF measures and reforms with their own national funding. By comparison, under the cost-based cohesion policy programmes, the increase in costs can be absorbed by making fewer investments.

Similarly, under the RRF, delays in achieving milestones and targets also mean delays in disbursements, as all milestones and targets for a specific instalment have to be achieved in order for payment to be made. Again, under cohesion policy such delays matter less for the cashflow situation of the national budget, as the costs incurred are declared and reimbursed as the project is implemented.

Moreover, there is the possibility of splitting in phases an investment over the forthcoming MFF period, subject to certain conditions[31].

6. With the 2014-2020 MFF ending soon, the absorption issue will again become a key concern from a budgetary perspective

Member states' capacity to absorb available EU funding for economic, social and territorial cohesion towards the end of a programme period has been a perennial issue in cohesion policy. In previous MFF periods, several member states experienced difficulties in this regard, and EU funds were not entirely used.

The urgent need to absorb available funding entirely may also create difficulties in meeting the value-for-money requirement for EU-funded investments stipulated

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[30] Organisation for Economic Co-operation and Development (OECD), *Budgeting and performance in the European Union*: A review by the OECD in the context of EU budget focused on results, OECD Journal on Budgeting, Volume 2017/1, section 1.2.1. The OECD defines three broad categories of performance budgeting:

- presentational performance budgeting, whereby performance information is produced and shown alongside funding allocations, but not necessarily used to take spending decisions;
- performance-informed budgeting, where such information explicitly influences the allocation of resources; and
- performance-based budgeting, in which funding is linked to outputs and outcomes.

[31] Article 118 of 2021-2027 CPR.

in the Financial Regulation[32]. For example, it increases the likelihood of selecting deadweight projects[33] and of projects being financed retrospectively[34]. Lastly, the risk of double funding of costs[35] may increase in such a situation.

With the 2014-2020 MFF ending soon, the absorption issue will again become a key concern for cohesion policy from a budgetary perspective. By the end of December 2022, the Commission had made payments to cohesion policy programmes equivalent to 76 % of 2014-2020 MFF funding, i.e. the remaining 24 % has to be absorbed in the 12 months before the end of the period in December 2023. Spain and Italy had absorbed less than 60 % of their allocations, and Denmark, Ireland and Slovakia less than 70 %. Lithuania, Portugal and Slovenia were the only member states whose absorption rate was above a reassuring 90 %[36].

In addition, the absorption issue may now have become even bigger because of NGEU: when REACT-EU and non-absorbed funds for the 2014-2020 MFF are included, six countries have at least twice as much funding to spend as they did in the 2014-2020 period; seven countries at least three times as much; and two countries, seven times more[37]. On top of that, the Commission offered member states the op-

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[32] Article 33 of *Regulation (EU, Euratom) 2018/1046* on the financial rules applicable to the general budget of the Union («the Financial Regulation»). According to this article, appropriations must be used in accordance with the principle of sound financial management, and thus be implemented in compliance with:

(a) the principle of economy, which requires that the resources used by the EU institution concerned in the pursuit of its activities shall be made available in due time, in appropriate quantity and quality, and at the best price;

(b) the principle of efficiency, which concerns the best relationship between the resources employed, the activities undertaken and the achievement of objectives; and

(c) the principle of effectiveness, which concerns the extent to which the objectives pursued are achieved through the activities undertaken.

[33] The deadweight effect occurs when funding is provided to support a beneficiary that would have made the same choice without it. In such cases, the outcome cannot be attributed to the policy, and the aid paid to the beneficiary has had no impact. Thus, the share of expenditure which generates the deadweight effect is ineffective, as it does not contribute to the achievement of objectives.

[34] Retrospective projects are those which have incurred expenditure from national sources, or are completed before EU co-financing has been formally applied for or awarded, i.e. they are financed retrospectively. Retrospective projects are not eligible for EU funding.

[35] Avoiding any form of double funding is a fundamental principle of the eligibility rules for all public expenditure in the EU. According to this principle, costs for the same activity cannot be funded twice from the EU budget. Funding of a project from two different sources is allowed, but the same cost of a project cannot be covered twice.

[36] *https://cohesiondata.ec.europa.eu/cohesion_overview/14-20#sankey*. By absorption rate, we mean the percentage of the total amount allocated to a member state that the Commission has disbursed in response to the national authorities' declaration of incurred expenditure.

[37] European Court of Auditors, Review No 1/2023, paragraph 52.

portunity to transfer part (up to 15 %) of the Social Climate Fund[38] financial allocation to cohesion policy funds.

Given these circumstances, absorbing significantly more EU funds in the 2021-2027 MFF period poses a particular challenge for cohesion countries[39].

7. Reallocating cohesion policy funds can help to shift funding around, but will this provide an adequate response?

In view of the likely absorption problems towards the end of the 2021-2027 MFF eligibility period for the cohesion policy funds (i.e. the years 2028 and 2029), the scope for reallocating or transferring cohesion fund resources to other instruments/funds has been increased. Specifically, the 2021-2027 CPR allows member states to reallocate[40] up to 5 % of their initial national budgets for each cohesion policy fund to any other instrument at partnership-agreement level or via programme amendments. This includes not only the RRF, but also other EU programmes. Of course, providing the option for such reallocations is the result of the long timeframe from programming to implementation of each MMF: this makes it difficult to define detailed investment needs for about a decade in advance and requires some room for manoeuvre.

In May 2022, the Commission proposed increasing this 5 % to 12.5 % as one of the REPowerEU measures, provided that the member state concerned has already used the available 5 % transfer option[41]. The Commission's reasoning for this pro-

[38] Article 11 of *Regulation (EU) 2023/955* establishing a Social Climate Fund and amending Regulation (EU) 2021/1060 and European Court of Auditors *Opinion No 08/2022* concerning the proposal for a Regulation establishing a Social Climate Fund. This fund addresses any social impacts that arise from extending emissions trading to the building and road transport sectors. The fund will finance temporary direct income support for vulnerable households, and will support measures and investments that reduce emissions in the road transport and buildings sectors to reduce costs for vulnerable households, micro-enterprises and transport users. The emissions trading system is a market-based approach to controlling pollution. It is based on the creation of emissions rights (allowances) that can be traded between operators covered by the system.

[39] Commission, *8th cohesion report*, p. 242. Cohesion countries are member states that are considered eligible to receive support from the Cohesion Fund (CF). The CF provides support for those member states whose gross national income (GNI) per capita is below 90 % of the EU-27 average. For the 2014-2020 MFF, these member states were 15 in total: Bulgaria, Czechia, Estonia, Greece, Croatia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Portugal, Romania, Slovenia and Slovakia.

[40] Article 26 of 2021-2027 CPR.

[41] Commission Communication REPowerEU Plan, *COM(2022) 230*, paragraph 4.3. European Court of Auditors *Opinion No 04/2022* concerning the proposal for a Regulation amending Regulation (EU) 2021/241 as regards REPowerEU chapters in recovery and resilience plans and amending Regulation (EU) 2021/1060, Regulation (EU) 2021/2115, Directive 2003/87/EC and Decision (EU) 2015/1814 [2022/0164 (COD)]. Following the Commission's proposal, the REPowerEU is about

posal is to allow member states' national RRPs to include new investments and reforms that would contribute to a rapid reduction of fossil fuel imports from Russia. Given the current absorption levels for the 2014-2020 MFF, the 12.5 % of cohesion policy funding is a good estimate of expected non-absorbed funds for the 2021-2027 MFF. However, transferring resources from one fund/instrument to another does not necessarily solve the inadequacies and/or weaknesses in member states' public administrations.

8. Administrative capacity constraints and long-lasting permitting procedures in the member states are potential bottlenecks for making additional investments through the RRF

In the 2014-2020 MFF period, cohesion policy provided funding equivalent to 14 % of government capital investment, from both national and EU sources, in the EU-27. Restricting the comparison to the 2014-2020 ERDF and CF, whose funding primarily goes to financing investment, the two funds accounted for 10 % of the total public investment made across the EU. The ERDF and CF jointly allocated a level of financing equivalent to about 3.6 % of total public investment in non-cohesion countries and 40.6 % in cohesion countries. These figures show that a significant proportion of administration at national, regional and local level entails dealing with the implementation of EU-funded programmes, particularly in cohesion countries.

As the RRF and cohesion policy programmes are implemented in parallel, there is also the issue of a potential «cannibalisation» effect between investments funded via the RRF or cohesion policy funds. This occurs because, at national level, there is what is known as a «single project pipeline», i.e. a specific number of projects that a member state intends to implement in the years to come, and which are in the process of «maturing» with the studies and permits required to implement them. National public administrations have a limited capacity to prepare, authorise and implement projects. Moreover, in many countries the same authorities are charged with implementing cohesion policy funds and the RRF at the same time, thus increasing pressure on their administrative capacity.

Aiming to increase the number of mature projects in a relatively short period of time is unrealistic unless their administrative capacity is better resourced, or the permitting rules are (at least temporarily) relaxed. Under these circumstances, it can be expected that a number of member states will not be able to absorb the available EU funding in full, simply because they are short of mature projects or because they have not managed to pass the necessary reforms to speed up the permitting procedures.

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rapidly reducing the member states' dependence on Russian fossil fuels by fast forwarding the clean transition and joining forces to achieve a more resilient energy system and a true Energy Union.

9. Final remarks

In the years to come, member states will have access to significant additional funding opportunities for investments to strengthen the EU's economic, social and territorial cohesion, thanks to the joint deployment of the RRF (until 2026) and the 2021-2027 cohesion policy funds (up to 2029). Both instruments will provide funding for largely similar priorities.

How much of this funding will actually be used will, however, depend on the national, regional and local authorities' administrative capacity to implement additional public investments or projects in a relatively short period of time. It remains to be seen how the Commission and the member states will respond to this situation, and what kind of solutions they will propose to ensure that more EU-funded investments are implemented while providing value for money.

In any case, the experiences made with the RRF funding model will influence the debates on the EU budget for the next MFF and the post-2027 cohesion policy. In actual fact, the Commission has already replicated the main principle of the RRF financing in the new Social Climate Fund[42] and the EU's common agricultural policy[43]. Against this backdrop, close monitoring and timely evaluation of RRF implementation, and the strengths and weaknesses of a funding model which is based on the satisfactory achievement of milestones and targets, will be of the utmost importance.

The ECA contributes to this endeavour through its selected audits and its annual audit opinions on RRF disbursements and cohesion policy spending[44].

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[42] European Court of Auditors, Review No 1/2023, paragraph 59.

[43] European Court of Auditors, Opinion No 7/2018 concerning Commission proposals for regulations relating to the common agricultural policy for the post-2020 period, February 2019, paragraph 8.

[44] See *here* for our published reports.