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Policy Brief

Fixing Cohesion
How to Refocus Regional Policies in the EU

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#EUBudget
#CohesionPolicy
#Inequality

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The EU's cohesion policy is one of the biggest items in the EU budget and a central sticking point in the upcoming negotiations over the next seven-year funding cycle. Based on data from more than 2.4 million households, we study the distributional impact of the program and show that it often fails to reduce regional and social inequalities. The funds frequently target places that are not particularly needy and mainly benefit people at the upper end of the income distribution. Cohesion policy thus requires root-and-branch reform. This includes a sharper focus on truly disadvantaged areas, a more precise definition of local economic challenges, improved funding access for small municipalities and companies, and redirection of resources now allocated to wealthy member states towards an EU-level investment instrument.

The European Union's (EU) cohesion policy is one of the biggest and politically most important items in the European budget. Over the years, it has served a swath of different goals—from supporting economic catch-up in poor regions, to strengthening EU competitiveness to fighting climate change and, most recently, as a war chest to respond to various short-term crises. At its treaty-enshrined core, however, the policy is supposed to strengthen economic, social, and territorial cohesion by reducing economic disparities between regions at different levels of development (Art. 174 TFEU).

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Via a new study, we show that cohesion policy as it stands fails to support this fundamental goal. We collect income data from more than 2.4 million households, use newly available data on where and when cohesion money has been dispensed over the last 30 years, and study who exactly benefits from the program. Our analysis shows that cohesion policy has a positive impact on regional output and growth but suffers from two fundamental problems.

Put simply, it often targets the wrong places and reaches the wrong people. First, cohesion policy aims to reduce economic disparities between large European regions. However, our data shows that the specific regional inequalities addressed by the policy contribute little overall inequality in Europe and have decreased over time. A lot of money, therefore, simply goes to the wrong places. Second, it reaches the wrong people. While cohesion policy spending raises average incomes in the targeted regions, these gains go almost exclusively to relatively wealthy households. Instead of aiding the needy, the policy often ends up enriching affluent households in areas that are not particularly poor.

Against this background, cohesion policy requires root-and-branch reform. The upcoming EU budget negotiations offer a rare opportunity to achieve this. An ideal reform should effectuate a clearer differentiation between spending that genuinely addresses the pressing political need to reduce regional and social inequalities and investments aimed at other and broader EU policy objectives. This includes four elements: a sharper focus on truly disadvantaged areas; a more precise definition of local economic challenges; improved funding access for small municipalities and companies; and, finally, a redirection of resources now allocated to wealthy member states towards EU-level instrument that is more geared towards supporting common priorities, such as investments in shared infrastructure and industrial policy.

1) Why getting Cohesion Policy right is important

Getting cohesion policy right is important. First, the EU allocates substantial funds to its regional policy. For the 2021-2027 funding period, structural and investment funds in the European budget amount to €392 billion, averaging €56 billion annually. Consequently, in this funding period, close to a third of every euro disbursed under the regular Multiannual Financial Framework (MFF) falls under the cohesion umbrella.

This is not a recent development. A true EU-level regional policy was introduced in the late 1980s and has since expanded in economic scope. In the 1990s, the largest recipient regions saw funds accounting for 2-3 percent of their local GDP. By the 2010s, many regions were receiving EU funds exceeding 5 percent. By way of comparison, this exceeds the allocations that states like Berlin and Saxony-Anhalt receive from the German interstate fiscal equalization scheme.

Box 1 – How Cohesion Policy currently works

In the 2021-27 funding period, cohesion policy comprises five funds. The *European Regional Development Fund* (ERDF) and the *European Social Fund Plus* (ESF+) continue to be by far the largest instruments (see Figure 1). The ERDF aims at reducing economic disparities between regions and, at the same time, funnels spending in five thematic concentrations such as innovation and competitiveness, climate neutrality and social inclusion. The ESF+ is also a regional fund but aims more specifically at reducing unemployment, promoting social inclusion and supporting worker training. Allocations under both funds follow broadly the same rules. Most resources go to less developed regions with GDP per capita below 75% of the EU average. However, transition regions (GDP p.c. between 75-100% of the EU average) and more developed regions (GDP p.c. above the EU average) also receive funding (see Figure 2). On top of regional GDP, other factors such as regional unemployment, youth unemployment and greenhouse gas emissions have a minor impact.

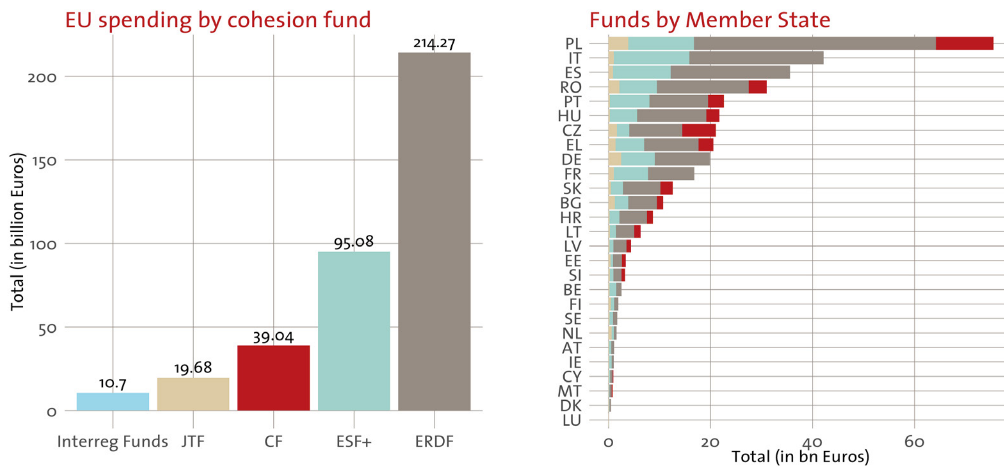

Figure 1 – Distribution of Cohesion policy resources across funds and member states. Source: European Commission (2024)

The other three funds are substantially smaller and more sharply targeted. The *Cohesion Fund* (CF) aims at supporting investments in transport and environment infrastructure in member states with a Gross National Income below 90% of the EU average and has no subnational allocation key. The *Just Transition Fund* is the latest addition to the cohesion toolbox and is supposed to support territories most affected by the transition towards climate neutrality. Again, funds are allocated to all member states based on factors such as industrial emissions, employment in industry and overall level of development. In a second step, member states identify smaller NUTS-3 level regions most in need within their jurisdiction. Finally, a subset of funds from the ERDF is reserved for projects that cut across regions and member states (Interreg). Cohesion policy, thus, embraces a variety of funds and aims. However, in practice these funds are negotiated jointly and cuts in one financial instrument are often compensated for by increases in others.

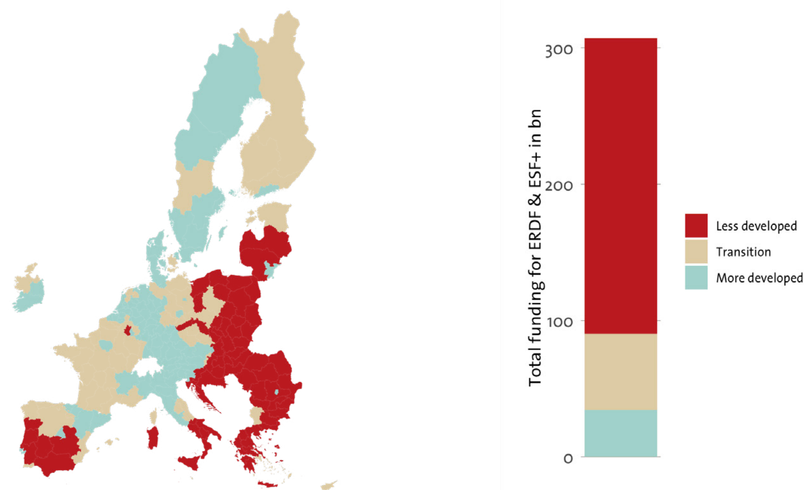

Figure 2 – Distribution of spending under the ERDF and ESF+ across different categories of NUTS2 regions.

king firm support to social conditions, such as wage minimums or job creation, is another option. Solutions are likely to differ from place to place. The key point is therefore that reducing the high-income bias in the current program needs to be a priority in the next cycle.

Improving investments on other policy goals

Second, the EU should stop spending cohesion money in places where funding clearly does not serve territorial or social cohesion. Our findings show that a significant portion of ERDF and ESF investment is currently funneled back to affluent regions in rich member states, benefiting households among the EU's top income earners. If the goal is to reduce regional and social inequalities, this approach is clearly misguided. If the aim, on the other hand, is to invest in EU-wide priorities, resources should be spent where they generate the biggest bang for the buck. Channeling them through regional quotas and shared management systems that leave the interpretation of these priorities and investment decisions largely to member states and regional bodies is unlikely to achieve that.

To better address the broader investment goals currently baked into cohesion policy, ERDF and ESF resources allocated to wealthy member states should, therefore, be redirected. These funds should flow into an EU-level vehicle focused on common priorities like infrastructure, climate initiatives, and competitiveness. This reallocation means that some rich countries will lose out from the revamped cohesion pot. However, given the concentration of economic activity in wealthy member states, central EU funding will likely disproportionally benefit projects in these areas anyway. Importantly, such transfers from cohesion funds alone will not suffice to meet all EU-level investment needs; they should, thus, be viewed as just one financing component of a robust fiscal instrument for tackling joint priorities.

In our view, the outlined reform agenda is the most logical way forward. It may not be the politically most viable one. Within the Commission there are ideas on modelling the next version of cohesion policy more closely on proven RRF lines. However, following this approach comes with its own set of governance issues and would not necessarily solve the distributional issues described above. One important question going forward, then is if and how these ideal reforms could be integrated into a broader RRF-style governance reboot of cohesion policy (see Lindner & Redeker, forthcoming).

Conclusion

The EU faces big economic and social challenges. It needs a bigger – and a better – budget; this includes a cohesion policy that genuinely fosters cohesion and investment strategies that deliver the greatest value for money. The most pressing risk, therefore, is that the EU will squander the upcoming opportunity for reforms and fall back into its usual cohesion rut. The next Commission has only a couple of months before it must present its proposal for the next seven-year budget. It should use this time to push for a meaningful makeover.

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