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NOTRE EUROPE

President: Jacques Delors

HOW TO ENHANCE ECONOMIC AND SOCIAL COHESION IN EUROPE AFTER 2006 ?

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Report by Marjorie JOUEN

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Notre Europe

Notre Europe is an independent research and policy unit whose objective is the study of Europe – its history and civilisations, integration process and future prospects. The association was founded by Jacques Delors in the autumn of 1996. It has a small team of six in-house researchers from various countries.

Notre Europe participates in public debate in two ways. First, publishing internal research papers and second, collaborating with outside researchers and academics to contribute to the debate on European issues. These documents are made available to a limited number of decision-makers, politicians, socio-economists, academics and diplomats in the various EU Member States.

The association also organises meetings and conferences in association with other institutions and publications. Under the organisation's articles of association, a European Steering Committee comprising leading figures from various European countries and political and professional origins meets at least three times a year.

The European Policy Centre

The European Policy Centre (The EPC) is widely recognised as an influential and innovative think-tank specialising in the analysis and monitoring of European integration. It plays an active role by bringing together government, business, professional associations, regional authorities and civil society organisations to debate and influence the major policy challenges facing the European Union.

The Centre works with a panel of experienced policy advisors and cooperates closely with other bodies on policy themes of common interests. It is progressively developing a network of structured partnerships to enhance the impact of its work.

The EPC web-site (http://www.theepc.be) and its Challenge Europe online journal have provided a platform for a much wider range of comment and exchanges of views throughout Europe, and beyond.

The Advisory Board of The EPC, under the chairmanship of the former European Commissioner Peter Sutherland, has attracted the involvement of eminent European public figures.

The organisers would like to warmly thank the Fondation Roi Baudouin for giving its support and for graciously providing its premises for this seminar.

FOREWORD

Questions concerning the reform of the Structural Funds are divisive. The impact of the forthcoming enlargement, the weight of acquired interests and the incapacity of our current analytical tools to question these have, up until now, led the Commission and the Member States to maintain the status quo through to 2006. However, as with the Common Agricultural Policy, this cautious approach must not lead to a self satisfying opposition to change that outlaws all adaptations to the realities of the present and the foreseeable requirements of the future.

Beyond these political and tactical considerations, beyond even the necessity to prepare ourselves to welcome new members before 2006, there is another way to address European cohesion policy. One can analyse this policy in relation to economic and social transformations and question whether the current tools, which have certainly shown their effectiveness – the attachment of the current beneficiaries is the best proof of this – albeit in a different context, need to be adapted.

It is this second problematic that Notre Europe and the European Policy Centre sought to address by uniting some fifteen experts at this seminar.

The conclusion drawn from this undertaking is unambiguous. Since the mid 1980s, the development model of our economies has changed considerably. The ever increasing importance of non-material factors of production has altered the conditions for the accumulation of wealth and is also the source of new forms of disparities both between the regions and social groups. The current tools of cohesion policy have not sufficiently kept track of these mutations. They run the risk of becoming inappropriate and incapable of obtaining their objective, having failed to address the new causes of inequality that cannot be measured with the help of classic economic criteria, and due to the fact that interventions either take place at an inappropriate geographic level or privilege the development of material infrastructure.

It is necessary, therefore, to reform both the nature of our analysis and interventions. But how? It is here that opinions diverge: for some, we must continue to try and bridge directly the economic and social gaps, while placing the accent on the social and cultural aspects of development and on the endowment of publics goods, the definition of which also has to be revisited. For others, it is necessary to go further through a co-ordination of European interventions and national redistribution policies, with regard to both public goods and individual income, and by providing for a "right to sustainable development for all". The remarkable work of this group of experts brings to a close this dilemma, opening the door for other analyses.

For our part, we shall satisfy ourselves with stressing the principle lesson of this exercise: resistance to change cannot be permitted unless one wishes to let cohesion policy, which is one of the most noble characteristics of European integration, fall obsolete. We do not have to wait until 2006, not to reinvent but, to adapt this policy to the economic and social evolution of Europe's regions. If this study can initiate a movement in this direction, it will have obtained its objective.

Jacques Delors | Hywel Ceri Jones

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EXECUTIVE SUMMARY

Disparities between the EU's Member States have decreased substantially since the mid-1980s, in no small way thanks to the Structural Funds, which have allowed the least advantaged countries to develop their infrastructure and modernise their economies. However, this success, while undeniable at national level, is less clear-cut at lower territorial divisions which seem to have their own development logic. If the aim of cohesion policy is still to close the gaps not only between European States but also between European regions, certain policy changes are therefore required.

Europe, like other developed regions elsewhere in the world, seems to be following a new growth pattern which started at the beginning of the 1990s but whose effects only became clearly apparent after 1995. Driven by the third technological wave, the creation of wealth is determined mainly by intangible factors (education and training, technological innovation and research, communication networks and relations of trust). An overriding concern for efficiency has bred a rapid and cumulative process whereby development occurs mainly in areas where the above-mentioned factors are in plentiful supply, leaving other areas far behind. As a consequence, income distribution is far less even than before, for two main reasons. First of all, the concomitant dematerialisation of the economy is allowing boundless accumulation of wealth and knowledge. Secondly, traditional redistribution mechanisms and policies have lost their effectiveness. The result is a growing tension between economic development and social progress, which can be painfully obvious in geographically close areas (a phenomenon known as "global convergence, local divergence").

In Europe, the phenomenon is reflected in the dichotomy between central and peripheral regions, and in persisting or rising sub-national disparities within certain countries. However, new development hotspots have recently emerged in Europe in certain areas (such as the Baltic Sea and the Portugal-Spain border). These hotspots could be harbingers of new forms of integration, although their scope and significance remain unclear.

Given these trends, we should not be too optimistic about the catching-up prospects of the regions benefiting from the Structural Funds. Not only are these areas hamstrung by poor productivity levels after having repeatedly lost ground in the social and – in some cases – institutional spheres, but they could also shortly have to undertake further restructuring following EU enlargement to eastern Europe (since the applicant countries are competing for the same markets and foreign direct investment).

However, the impact of the Structural Funds should be considered in a broad context, as basing the cohesion policy's legitimacy solely on economic results could lead to difficulties. The results must be treated with caution for three reasons:

- Firstly, any evaluation is bound to be skewed on account of the very nature of the Structural Funds. The amounts awarded are low compared with national transfers, beneficiary areas are influenced by other national and regional policies and provisions, and the evaluation periods are usually not long enough to enable any assessment of structural changes.
- Secondly, the available data do not allow relevant and reliable macro-economic modelling. GFCF – gross fixed capital formation – would be a more reliable indicator than per capita GDP, but the historical series are not continuous.
- Lastly, the microeconomic evaluations do not fully reflect a quantitative and scientific logic. They are biased towards a programme-based rather than region-based approach. It

is therefore very difficult to determine the total amount received by an area and to aggregate the data.

Nevertheless, the Structural Funds have had a major impact on the development of the regions in qualitative and political terms. Besides boosting the participation in the internal market of peripheral regions and areas whose development was lagging behind, the funds have also, by virtue of their programming rules, exerted a useful influence on beneficiary regions with respect to new development factors (innovation, social capital, partnership between economic and social players, cooperation with universities, etc.). Their added value lies in the choice of regional development priorities, the modernisation of public administration and, sometimes, the change in attitudes they have encouraged. They may legitimately be regarded as privileged instruments of European integration.

We might conclude these considerations on the economic context and the impact of the Structural Funds with a few technical and policy recommendations for strengthening European economic and social cohesion in the future. As regards future policy guidelines, two competing approaches can be identified:

- Under the first of these, the aim would remain to promote the catching-up process and reduce disparities in economic and social development. However, the main eligibility criterion would no longer be per capita GDP. This indicator would be replaced or complemented by others (of a social and institutional nature) that provide a better picture of structural backwardness. The approach would encourage a reform of Community priorities in line with the new determining factors of economic development: less heavy infrastructure and more intangible assets; support measures to promote regional innovation, modernise institutions, improve and increase "public goods", encourage education and training, etc. It would also recommend discontinuing assistance for micro-areas and concentrating on strategies at regional level, in addition to giving up trying to address overly specific social or local issues (use of a composite regional index).
- The second approach goes a bit further, since it assumes that disparities between regions are due not only to growth deficits but also to inadequate and obsolescent redistribution policies. Community assistance should therefore focus on promoting the political and social dimension of European integration, as well as economic cohesion between the regions. The main objective would be to ensure that all regional players can enjoy sustainable social development. Community assistance would be subject to stricter conditions and would be part of a greater and more ambitious political framework. In particular, this assistance would provide for a review of the redistribution systems in the Member States, internal institutional adjustment of the regions and support for innovation (not only in the economic, but also in the social and political spheres) in micro-areas.

REPORT

Notre Europe and EPC brought together 16 researchers specialised in economics, political science, geography and sociology, who based their analysis of the regional development situation in Europe on the three main chapters of the introductory paper (attached). They agreed that the cohesion policy would need to be reviewed if it was to remain an effective means of reducing disparities between regions, and put forward a number of reform proposals.

1 – THE SOCIAL AND ECONOMIC SITUATION OF THE EU'S REGIONS

According to **Mick DUNFORD**, the issue facing developed countries today is one of redistribution rather than wealth creation. Disparities are growing, both between individuals and social groups, and not just regions. His arguments draw on the theories of Amartya Sen and Danny Quah. According to the first of these authors, there is development only where everyone has access to healthcare and education services, public transport, leisure facilities, etc. Accordingly, the criterion for comparing our countries should not be their average income levels but rather their ability to achieve fair and widespread redistribution of what is produced – even accumulated – by a small group. The second author holds that we have moved into a new era: the "twin peaks" growth model, characterised by the disappearance of the "middle classes" and a worsening of the social divide (see attached graph). This trend is caused, in the main, by the fact that there are no boundaries to the accumulation of capital made possible by the dematerialisation of the economy (the unlimited copyright on a work reproduced via the Internet is one example). The European redistribution systems seem unable to cope with this change in growth model. In geographical terms, the main phenomenon Europe is having to contend with is the increasing divergence between regions, which has accelerated recently with the spread of communication technology and the reorganisation of business production methods. European structural policy is to a certain extent misguided in its effort to help the least wealthy regions catch up through economic development programmes. The two most important factors behind inequality today – educational levels and the quality of institutions – have been underestimated.

Iva PIRES expressed a similar lack of optimism, pointing out that the most lagging countries and regions are still labouring to catch up with their most advanced counterparts. Up until the mid-1990s, the Structural Funds played a significant role in supporting economic modernisation and infrastructure development in Portugal, Spain, Ireland and Greece. In fact, the funds had more influence than direct inward investment in promoting convergence in these countries. However, it seems that this catching-up model is running out of steam. Furthermore, it would appear that the “knowledge economy strategy” launched in Lisbon is not perfectly adapted to disadvantaged regions either, as these regions have already obtained high employment levels but suffer from low productivity rates. These countries are also competing directly with central European countries for both markets and investment. Portugal, for instance, is experiencing a slowdown in investment from Germany and France and is having to move towards sectors with a higher added value. In itself, this challenge is not negative but it does call for a renewed effort in the areas of training and R&D investment. The burden of this expenditure on public finances should not be underestimated, for the private sector will probably not agree to share it. A new trend is worth highlighting, however. The Portuguese border regions have registered continuous growth for the past three years, thanks to Spanish investment. This development could indicate the emergence of a specific form of regional integration, but the data is still too recent to allow any definitive conclusions to be drawn.

The debate focused on four questions:

- <u>What are the phenomena behind the main trends found in the European regions?</u>

Most participants referred to growth and economic geography theorists, indicating that the main trend in Europe is the polarisation of regional development. A degree of convergence between countries can be noted at European level, but more detailed analysis of what is happening at lower levels indicates that disparities are persisting and even increasing in some cases. In cities, this "global convergence, local divergence" phenomenon can be observed across both districts and social groups. At regional level, the agglomeration effect is further enhanced by the concentration of dynamic businesses seeking to reduce their transaction costs and pool the benefits of their investment and technological advances, while resorting to highly skilled local labour. Improvements in transport infrastructure and the completion of the internal market have facilitated the emergence of a divide between central and peripheral areas, which is steadily widening. The introduction of economic and monetary union has further strengthened the trend, for it is exposing the regions to more direct competition. Unlike what can be observed in the United States, the geographical mobility of Europeans has remained structurally low and cannot therefore contribute to reducing disparities. In contrast to previous decades, the distinguishing factors between regions are probably intangible and qualitative rather than material and quantitative. As a highly flexible source of innovation, information technology has boosted these developments.

- <u>How can we explain the persisting gaps between certain regions and countries?</u>

The main short-term explanation is the fact that disadvantaged regions have been unable to exploit the new wave of technological innovation that appeared in the mid-1990s, or have done so very slowly. However, the most frequent reason why a number of disadvantaged regions are having trouble catching up is that they are suffering from accumulated economic and social backwardness, in some cases caused by cultural attitudes. We cannot establish a hierarchy of causes. However, in no particular order, we might mention the burden of the past and political structures, distance from the main consumer markets and transport costs, the traditional inequality between towns and rural areas, the unfavourable economic environment which means that the effect of direct inward investment varies according to the country or region, the scarcity of human resources and the inability of the area to attract technological innovation, rigid labour markets and, more specifically, unit labour costs. This last factor, however, seems doubtful in the light of the situation in certain Portuguese and British regions, and in the *Mezzogiorno* in Italy. In addition to very low productivity and a low level of labour skills, these regions suffer from under-utilisation of local resources linked to the failings of public institutions. These regions are also handicapped by poor coordination between Community and national policies, in particular sectoral policies. Lastly, Community structural assistance – combined with the suppression of non-tariff barriers – has frequently generated unwanted side-effects by prompting a change in local consumer habits, which have tended to follow those of richer regions. This phenomenon has increased the dependence of peripheral regions on consumer goods and services produced elsewhere.

Economists are not unduly worried by these disparities, in so far as development is unequal by nature. Traditionally, cities have always been more dynamic than rural areas and some trading regions more prosperous than autarchic areas. Sociologists, political scientists and geographical experts, however, view the current situation with alarm. Disparities are too large and too conspicuous, in particular on account of information technology, resulting in tensions that the public authorities may well be unable to defuse.

- <u>What makes some regions prosper?</u>

The renewed growth in central regions and countries stems from their ability to exploit their reserve of intangible assets. One of the keys to their responsiveness is "social capital", which is as relevant to the public authorities as to the local population and economic players. The value of social capital at regional and local level hinges on proper interaction between the social and economic spheres, i.e. high levels of skills in the workforce, sustained relations between universities, research centres and production units, a climate of cooperation between businesses, a decent quality of life delivered by efficient public services, and active and corruption-free public authorities. Generally speaking, cities and areas with a high population density are usually at an advantage, for they can provide businesses with easy outlets in large consumer markets combined with a diverse and plentiful source of labour. "Industrial districts" or "clusters" are the prime example of this form of rapid development that is so attractive for new and high value-added businesses. While certain regions have a long-standing competitive edge they can exploit, others have managed to gain an advantage in new sectors. The degree of maturity is therefore an important consideration in selecting an activity or sector.

- What might be the nature of disparities in the future, between the 15 Member States and in an enlarged Union?

Disparities in the future could well be of a mainly social and cultural – or possibly institutional – nature, even if they are reflected in economic terms.

Among the current 15 Member States, those which have done well out of the Structural Funds over the last ten years – in particular Ireland and Portugal – will have to redirect part of their production resources towards the services sector and higher value-added goods. This move – albeit desirable – could be painful for areas which have only just achieved a decent level of development, particularly since they may have to compete with the applicant countries for markets and direct inward investment. Other inequalities may worsen as a result of the malfunctioning national redistribution systems. Although they will have less statistical significance and will not be clearly reflected at local level, these disparities will affect groups of people who are unable to adapt to new technology and new market conditions, are not very mobile, and live in the areas hardest hit by restructuring. In this regard, it is significant that the success recorded in Objective 2 areas (areas under industrial conversion) has been very uneven. In the run-up to enlargement, institutional disparities and administrative capacity will probably be the main differentiating factors.

Even if the hypothesis of newly emerging forms of regional integration between Portugal and Spain appears to echo the developing cooperation in the Baltic Sea and the efforts to achieve polycentric regional development, the scope and significance of the phenomenon are still unclear. The divide between central and peripheral areas is therefore likely to remain for the next ten years, at both European and national level. A choice will have to be made between two incompatible cohesion policy objectives: either ensuring the convergence of all Member

States on the Community average, or avoiding at all costs any increase in disparities between regions within the various countries.

2 – AN EVALUATION OF THE IMPACT OF THE COMMUNITY'S STRUCTURAL INTERVENTIONS

John BRADLEY began by expressing doubts about the reliability of macro-economic evaluation exercises, stressing that the Structural Funds assistance is very low compared with national transfers and is sometimes granted to small areas (NUTS III or sub-NUTS III[1]), where other sectoral and national policies may have a higher impact. We must bear in mind that social transfers among individuals are the most significant redistribution flows within European countries. Furthermore, the effects of structural policies appear only after long periods, extending far beyond a five- or six-year programming phase. By way of example, Ireland's success stems from the combination of a tax policy geared to attracting direct inward investment, a social pact that secured wage restraint and the distribution of the benefits of growth among the most disadvantaged groups, and a pro-active education programme designed to establish a pool of highly skilled labour tailored to the country's new economic strategy. This result could not have been achieved if Ireland had been a British region, for in that case it would not have had the necessary tax, budgetary and legislative powers. The impact of the Structural Funds should be assessed by combining a horizontal approach – based on comparison with other Community policies which have a geographical impact such as EMU, competition policy and transport policy – with a vertical approach, based on comparison with policies conducted mainly at national and regional level. It is unfortunate that micro-economic evaluations should focus on the overall efficiency of the programmes, without giving any clues as to the efficiency of each individual measure. Furthermore, up to now analyses have been distorted by the fact that the evaluation and assistance schedules were not properly synchronised.

Philippe MARTIN insisted on the time factor in Community assistance and the geographical scale of the evaluation exercises. Results will differ depending on whether the period under consideration is short (five years) or long (over ten years), and the impact of the Structural Funds cannot therefore be presented in the same way in both cases. For instance, building a motorway may have positive effects in the medium term in a disadvantaged region since demand for labour and goods will increase. In the longer term, however, the impact on supply may be negative, for the lower transport costs may encourage businesses to review their location strategy. Enterprises with high profit margins and salaries will prefer to move nearer to technological innovation centres and similar businesses in more central areas, and export to the peripheral region from there. Alternatively, businesses in competitive sectors will stay because low wage costs are a crucial factor for them. Macro-economic evaluations of structural assistance that take account only of the national level are inconclusive, for they underestimate the significance of the current trends towards global convergence. In the case of Ireland, Portugal and, to a lesser extent, Spain, the impact of the single market has probably been stronger than that of the Structural Funds at the beginning of the 1990s. Furthermore, the regional data required to develop a reliable macro-economic model are not available. The data series relating to capital accumulation are not continuous, despite the fact that they are undoubtedly a more significant indicator than GDP.

The debate focused on three issues:

- The lack of significance of available evaluations

The debate confirmed John Bradley's analysis of the weak economic foundations on which evaluations are based. Some participants even questioned the relevance of GDP per capital as an eligibility criterion and basic indicator for economic evaluation, for the level of regional GDP is almost as much the result of national regulations and policies as of local structural problems. In certain countries and regions, statistics are still unsatisfactory and financial circuits are so complex that it is impossible to tell the precise amount of funds received by a specific area during a given period.

Without a common methodology, it is virtually impossible to draw a summary of micro-economic evaluations and aggregate regional surveys. Furthermore, except for Objective 1 areas (regions lagging behind), the amounts granted by the Structural Funds often seem negligible at this level. In certain cases – such as the large-scale works financed by the Cohesion Fund –, evaluating projects would be more useful than evaluating programmes.

Although substantial efforts made recently have produced some improvements, the debate pinpointed a number of continual shortcomings of the evaluations. Certain participants believed that the modelling cost is an obstacle, in particular since a complex multilevel and multiregion model would be required to cross all the data. Others considered that the delay in creating a reliable database is solely due to a lack of political will. We must not forget that the

[1] The NUTS classification (nomenclature of territorial units for statistics) provides a standard framework for analysing economic and social trends. The NUTS II level is equivalent to the regions, while the NUTS III level corresponds to sub-regional areas and population groups.

principle of evaluation emerged quite late. It was not initially provided for by those who designed the Structural Funds, for their main concern was to achieve fair redistribution of the funds and encourage a large number of areas to take part in European projects.

- <u>The evaluation paradox and the pitfall of economic legitimacy for the Structural Funds</u>

The fact that evaluation results seldom coincide with the topical concerns of political decision-makers is inherent to the Structural Funds. The Funds can nevertheless be said to have fulfilled their purpose by improving cohesion within Europe. The true impact of Community support could be formally established only in the unlikely event that we could determine what the situation would have been without them.

Attempting to base the legitimacy of the cohesion policy solely on economic results could be counter-productive, because economists are quick to point out that, in their view, reducing disparities is justified for reasons of equity, but not efficiency. In addition, the economists do not take account of sub-regional inequalities and the negative externalities of conurbations, despite the fact that they often give cause for concern to political decision-makers (social risks, urban violence, pollution, etc.).

The European institutions are faced with a paradox. On the one hand, evaluating the efficiency of the Structural Funds is useful and delivers positive results but does not arouse much enthusiasm among the general public. Although ordinary citizens are reassured to learn that the public authorities have used the funds wisely and are not corrupt, they are not necessarily convinced of the need for such expenditure in the first place. On the other hand, while an efficiency-based evaluation is more telling for the general public and does demonstrate the results achieved, it can prompt demands for an instant return from the Structural Funds – something these were not designed to deliver.

In the case of the PHARE programme, for instance, the "cost-benefit" evaluation principle proved disastrous, in particular since it took no account of the initial situation of beneficiary countries which were at very different stages of economic transition. The Community institutions should heed this lesson.

- <u>The impact of the Structural Funds as Europeanisation tools</u>

The role of the Structural Funds in carrying European integration forward and promoting institutional convergence is largely recognised. They have contributed to disseminating good practice with respect to public administration and to setting up regional development programmes in the Member States. They have had an influence on how regional development is pursued with responsible partners and according to a more democratic method, by building on a development strategy rather than an accumulation of projects, and by encouraging the choice of projects on the basis of economic and social considerations (*ex ante* surveys of strengths and weaknesses, impact studies, market surveys, etc.) rather than political whims, fashion or mere imitation of what is being done elsewhere.

The results have undoubtedly been very different from one region and country to the next. In some areas, changes have been rapid and lasting, encompassing working methods, institutional organisation and attitudes. As a consequence, the beneficiary areas have been better placed to cope with the new development factors (innovation, social capital, involvement of economic and social partners, cooperation with universities, etc.). In those cases – Ireland and Portugal, for instance –, the performance has been remarkable. In others, however, progress has been slow and the achievements seem fragile.

This impact is not the product of chance. It is the direct consequence of the Structural Funds "discipline" established since 1987. The programming rules require the beneficiary public authorities to observe a number of constraints (creation and appointment of programming and monitoring committees, development of multiannual programmes, programme evaluation, strict financial control, etc.). However, improvements can undoubtedly be made. The formal purpose of the three Structural Funds is not to promote integration, but to achieve more sectoral aims. Furthermore, Community assistance is not based on the right development indicators for the future; no institutional index has yet been created.

3 – RECOMMENDATIONS AND POLICY GUIDELINES

Nicolas JABKO began by looking at the conditions that paved the way for the cohesion policy. It benefited from a favourable context combining political consensus (on making a success of the enlargement to Spain and Portugal) with a promising economic outlook (the completion of the internal market). Today, enlargement to eastern Europe is not being approached in the same way by the Member States and the applicant countries. Trade flows are already substantial and what the Structural Funds have to offer seems inadequate to meet the needs for developing human resources and institutional capacity, as set out in the second report on cohesion. Generally speaking, the current cohesion policy can be criticised for having become a collection of sectoral and geographical priorities with no overall design. Nicolas Jabko could offer no rousing and unifying new concept, but he did identify two preconditions for developing one. First, we must ensure that the proposed measures are tailored more closely to findings on the needs of the regions and the European Union, if the latter is to remain – or become – a cohesive geographical entity. Next, we must resist the temptation to renationalise the policy. This would not necessarily deliver the expected fiscal gains, since implementation at several geographical levels could turn out to be more expensive given the need for additional administration and coordination. And in political terms, the message that the objective of European cohesion was being abandoned would have disastrous effects.

Brian MORGAN outlined a very different approach. He took the aim of regional economic development as a starting point and tried to envisage a reform of instruments and priorities without calling into question the rationale underpinning the Structural Funds. Indicating that the theories on endogenous growth deserve more attention from politicians, and that neo-classical models are of little help because they refer to exogenous shocks, he proposed to draw on the "invention-innovation-dissemination" sequence of the Schumpeterian development cycle. The weakness of the disadvantaged European regions is precisely the dissemination phase. We have known for a number of years that R&D generates positive externalities that businesses tend to internalise in the absence of public intervention. The public authorities must therefore seek to establish an environment that is conducive to the dissemination of innovation, in particular by encouraging the emergence of clusters and districts, direct inward investment, networks and improved efficiency within the internal market. What is required is a long-term knowledge-based development policy, rather than the stop-and-go approach that is likely to result from the constantly changing recommendations issued at European Council meetings (in Lisbon and Stockholm).

The debate highlighted three main strands of analysis and recommendations:

1) <u>A strictly economic – almost cynical – approach</u>, whereby nothing has to be done to strengthen economic and social cohesion in Europe except in the most disadvantaged areas, since inequality is a source of dynamism and is bound to decrease in the long term. Nevertheless, experience has shown that a public policy can be effective if it is properly targeted and if it is implemented at a time of "territorial indetermination" (i.e. during a change in the criteria governing the location of activities) related to an exogenous shock. For instance, certain telecommunication and information infrastructure developments have allowed regions to increase their attractiveness in certain sectors. The approach also involves promoting the mobility of labour by reducing transport costs for individuals and adapting regulations (on support for businesses) to restore conditions of fair competition. Beyond that, the main recommendations aim to:

- follow more closely the basic economic trends relating to development, i.e. supporting innovation rather than heavy infrastructure
- improve the monitoring of events by means of relevant indicators (of a social and institutional nature)
- reconcile micro-economic and macro-economic evaluations

2) <u>A more political approach</u>, preserving the aim of closing the economic gap in order to achieve European cohesion in the future. Under this approach, the assistance boundaries (NUTS) need to be reviewed, given that below NUTS II level the Structural Funds cannot be expected to produce any real effect. The amounts allocated should probably be increased to ensure that the grants have an impact on the regional budgets. In terms of equity, attention should also be given to producing "public goods" and disseminating new technologies to correct market failures, rather than just attracting investments with a high economic return. Universities should be more closely involved in designing and implementing the projects supported by the Structural Funds. In this respect, there does not appear to be any justification for maintaining three funds. Merging them could speed up the transition towards knowledge development policies. Furthermore, assistance for micro-areas is hardly compatible with the spirit of structural policy. Such assistance might possibly be justified in cases of short-term social or economic crisis, and should therefore be dealt with separately.

3) <u>A more radical change of tack</u>, based on the principle that "enlargement is a political shock which calls for a new political contract" and which goes beyond the strict scope of regional economics. The participants in favour of this option indicated that cosmetic changes to the cohesion policy would not be enough, for that would give a poor image of European solidarity. Banking on a gradual change in regional priorities is a recipe for failure. The temptation to finance heavy infrastructure remains strong, for such projects have a high profile and can be easily evaluated and controlled. This view is unfortunately borne out by the drop in the share of support for businesses and human resources in the 2000-2006 programmes, in spite of the Commission's recommendations. On the other hand, basing the cohesion policy solely on intangible infrastructure could prolong disparities, for the most disadvantaged regions would find themselves locked in a vicious circle: as they are unable to attract private-sector investment, they cannot secure much "leverage" of Community funds. An instrument such as the Cohesion Fund will therefore probably have to be preserved for these areas.

Given the prospect of a Europe of over 25 members after 2006, if we want to avoid the emergence of a multispeed economic area, we must try to establish arrangements that are as coherent as those agreed in 1986 with Spain and Portugal, and develop new redistribution mechanisms at European level. New watchwords have been put forward with this in mind, such as "welfare for everybody" and "sustainable development for all". This ambitious political project would include, *inter alia*, a comprehensive review of the redistribution systems in the Member States, internal institutional adjustment in the regions and support for economic, social and political innovation in micro-areas. The first steps in this direction would include the reform of the current funds, and the ESF in particular, in terms of purpose and working procedures, and stricter rules for the management of European public funds on the part of the regions.

While no participant supported the first approach, which was deemed to be politically unrealistic and too distant from the European social and economic model, they were split almost down the middle between the two other options, which were considered to be competing approaches. The main objection to the third option was that it required strong political will and was liable to run up against a number of obstacles: administrative and accounting hassle, competition between the sectoral and local organisations managing the funds and policies, and lack of Community enthusiasm and common commitment on the part of the Member States. However, the response was that only through this type of ambitious proposal can we hope to cope with the major cohesion problems looming on the horizon, in particular in connection with the forthcoming enlargement.

ANNEXES

INTRODUCTORY NOTE:
WHAT THE SECOND COHESION REPORT TELLS US

Marjorie Jouen

In February 2001 the European Commission published its second report on Economic and Social Cohesion, entitled " Unity, solidarity, diversity for Europe, its people and its territory". Beginning with an analysis of the current situation and trends in development within the Community and an assessment of the likely future impact of enlargement to Central and Eastern Europe, it also seeks to evaluate the contribution of the Community's policies and structural interventions.

The report draws several conclusions and makes a number of recommendations on:
- the future priorities of economic and social cohesion;
- the organisation and management of future interventions (zoning, budgetary allocations);
- the co-ordination of other policies at territorial level.

This documents, which aims to launch a debate, concludes with a series of ten open questions. To which the Commission has invited all interested parties to respond (see http://wwwinforegio.cec.eu.int/wbdoc/docoffic/ official/report2/contentpdf_en.htm).

The diagnosis

According to the report, the main trends observed with regard to gaps in development and income in the EU are the following:
- the reduction in national disparities has been substantial. However, at the regional level, certain gaps have increased, either because some lesser developed regions have found it difficult to catch up to the community average or because more developed regions have also experienced strong growth. This situation exist as much amongst the rich member states as it does in the four so called cohesion countries. In these countries the national results are remarkable since between 1988 and 1999 the GDP per capita ratio of Greece has evolved from 58 to 67, while that of Spain has moved from 72 to 82. During the same period Portugal has, one might say, propelled itself from 59 to 67 and the Republic of Ireland from 64 to 114. But, between 1988 and 1999, the deviation between the richest and poorest 10% hardly diminished at all, passing from 2.8 to 2.6. However, while regional disparities measured in terms of *"standard deviation"* have remained more or less stable over the same period (passing from 26.7 to 28.3 in EU15, not including the new Länder), certain countries have registered a decline in internal economic cohesion. This is the case for example of Spain, where the *"standard deviation"* has grown from 13.9 to 19.1, and for Greece (6.1 to 10.2), the Republic of Ireland (13.9 to 17.3), and Italy (25.7 to 27.6).
- inter-regional gaps are accumulating. This is not only with regard to the lowest GDP per capita but also with regard to productivity rates, levels of education, percentage of investments in R & D, as well as in terms of technological capacities. The same is true for the social sphere, a low level of regional employment often coincides, in the least developed and wealthy regions, with a high level of unemployment, stark inequalities between men and women in the labour market, as well as a greater number of people within the region falling under the poverty line.
- even if some areas show particular characteristics which call for specific responses (towns, rural areas, border regions, and regions with natural handicaps) the analysis of territorial disparities highlights a clear and dominant cleavage between core and

periphery. The accessibility index identifies three large groups of regions in terms of economic and social performance (level of GDP per capita, sectoral repartition of employment).

- nevertheless, one is witnessing a favourable evolution in terms of funding for infrastructure, which has allowed one to be confident that the general conditions of development are improving for lagging regions of the current Member States.
- enlargement is a both major quantitative and qualitative challenge for the cohesion of 500 million citizens. The principal problem for the candidate countries can be expressed in terms of their weak GDP per capita, and enlargement will about a doubling of the gap between the wealthiest and poorest 10% of the Community (from 2.4 to 5.3). Those needs judged as most important are production investments, transportation infrastructure, the improvement of the environment, et the reinforcement of their administrative capacity.

The impact of the EU's Structural Interventions

The contribution of the Union's policies to cohesion is analysed successively according to the different sectors – EMU, Internal Market, Competition, Agriculture, Employment, Environment, Research, Transport, Energy, Enterprise, Fishing – and structural policy. Even though sectoral policies clearly have and essential impact on the structuring of territories, at the moment it appears difficult to draw and clear and positive report on the effects of European integration. Not only is it difficult to assess the reciprocal weight to be accorded to certain policies, some even appear to be having contradictory effects. For example, EMU favours on the one hand economic convergence, while on the other it places the least competitive regions under increased pressure through the introduction of the euro.

With regards to structural interventions, their quantitative contribution to the development of Objective 1 regions is evidently essential. For Portugal, Greece, the Republic of Ireland (all of whom were entirely eligible between 1994-99), the Structural Funds constituted 3.3, 3.5 and 2.4 percent, respectively, of their national GDP. In terms of investment, structural interventions also played an important role, equivalent to 15% of total investment in Greece, 14% in Portugal, 10% in the Republic of Ireland, and 6% in Spain.

For the period 2000-2006, and despite the modifications announced with regard to sustainable development; infrastructure accounts for 40% of the sum total for Objective 1 regions, including structural cohesion funds. The percentage dedicated to human resources will reduce slightly to 24% while the amount destined to production sector falls in a sensible manner from 41 to 35 percent. The environment also receives 10%. National financial efforts with regard to Objective 1 regions vary greatly from one country to another. Even if the baton was taken up by the budget of the Republic of Ireland where the Community structural interventions have been considerably reduced since 2000, and if Portugal, Greece and Italy consent to undertaking substantial efforts, the general tendency is for stagnation, or even for decline as is the case with Germany and the new Länder.

The analysis of the impact thus appears a lot more difficult, and given its date of elaboration, the report couldn't take advantage of the results of recent evaluations, such as the ex-post evaluations of the 1994-99 programmes.

Globally, the GDP per capita of the regions lagging in development and eligible for Objective 1 funding has passed from 63% of the Community average in 1988 to 70% in 1998. Meanwhile, taken individually the results are at times deceptive for Objective 1 as certain regions registered, between 1988 and 1997, a deterioration. In Greece, for example (Central Macedonia, from 63% to 60% of the Community average, Epirus static at 43%, and Sterea Ellada declining from 72 to 64% of the average), the United Kingdom (Merseyside, from 80 to 75%, the Highlands and Islands from 83 to 76%) and the Mezzogiorno region of Italy (from 69 to 68%). Certain qualitative facts appear to be more encouraging, such as the fact that in the absence of EU support 70 percent of investment projects would not have taken place and that the half a million enterprises that received assistance have contributed to the creation of 300 000 jobs.

For the other Objectives – 2, 3, 4, 5a and 5b, and 6 – the results forwarded appear to provide even less clear evidence, without being referable to any evident quantitative facts. Moreover, it is recognised by certain studies undertaken in Britain that 30% of the sums invested for employment creation in the UK under Objective 2 served nothing. It is always possible that the nature of the problems to which the structural funds are to be addressed under these objectives are incapable of being evaluated quantitatively. Accordingly, the impact of these interventions deserved to be appreciated according to certain qualitative criteria borrowed from political scientists, namely, the "value added by the Community". Only the 13 Community initiatives are evaluated according to this criterium according to a table of four points: co-operation, bottom-up approach, innovation, and sectoral diversification. For those who watch the implementation of the funds, the 1999 reform is presented as a response to the preceding gaps.

Future Priorities

If one takes from this initial analysis a prescription for future developments, one can say that economic and social cohesion policies should take greater account of the new factors of convergence and should follow more closely the modernisation of the re-equipping of physical infrastructures, investment in knowledge en new communication technologies, the environment and sustainable development. This recommendation seems worthwhile for both the EU 15 and the potential new Member States. Under exploited in the report, the "value added by the community" is not presented as a possible solution to the needs of the Central and Eastern European Countries.

A number of priorities for future cohesion policies are listed, some having a more or less territorial character (the less developed regions, the urban question, the diversification or rural regions, zones of industrial restructuring, zones suffering from severe geographical and natural handicaps), while others are rather of a general or regional nature (creation of better quality jobs, support for the new economy and the information society, promotion of social inclusion, equality of opportunities). With regards to the other sectoral policies, the only recommendation made is to reinforce the synergy between these polices and the complementary elements of the cohesion policy.

THE NEW PHASE OF DEVELOPMENT AND THE ASSOCIATED INEQUALITIES

Mick Dunford
University of Sussex

To be able to make judgements about the impact on cohesion of economic change in market societies, it is important to bear in mind the fact that the new phase of development associated with the rise of what one might call the information age may lead to greater inequalities than did the development models of earlier phases of development. An argument of this kind has been advanced by Danny T. Quah[2] who has suggested that the rise of a weightless economy in which value is embodied in immaterial things may give rise to superstar economies and to societies in which the income distribution corresponds to a twin peak model rather than a model in which there are a lot of people with middle incomes and few rich and few poor people or regions (see graph attached).

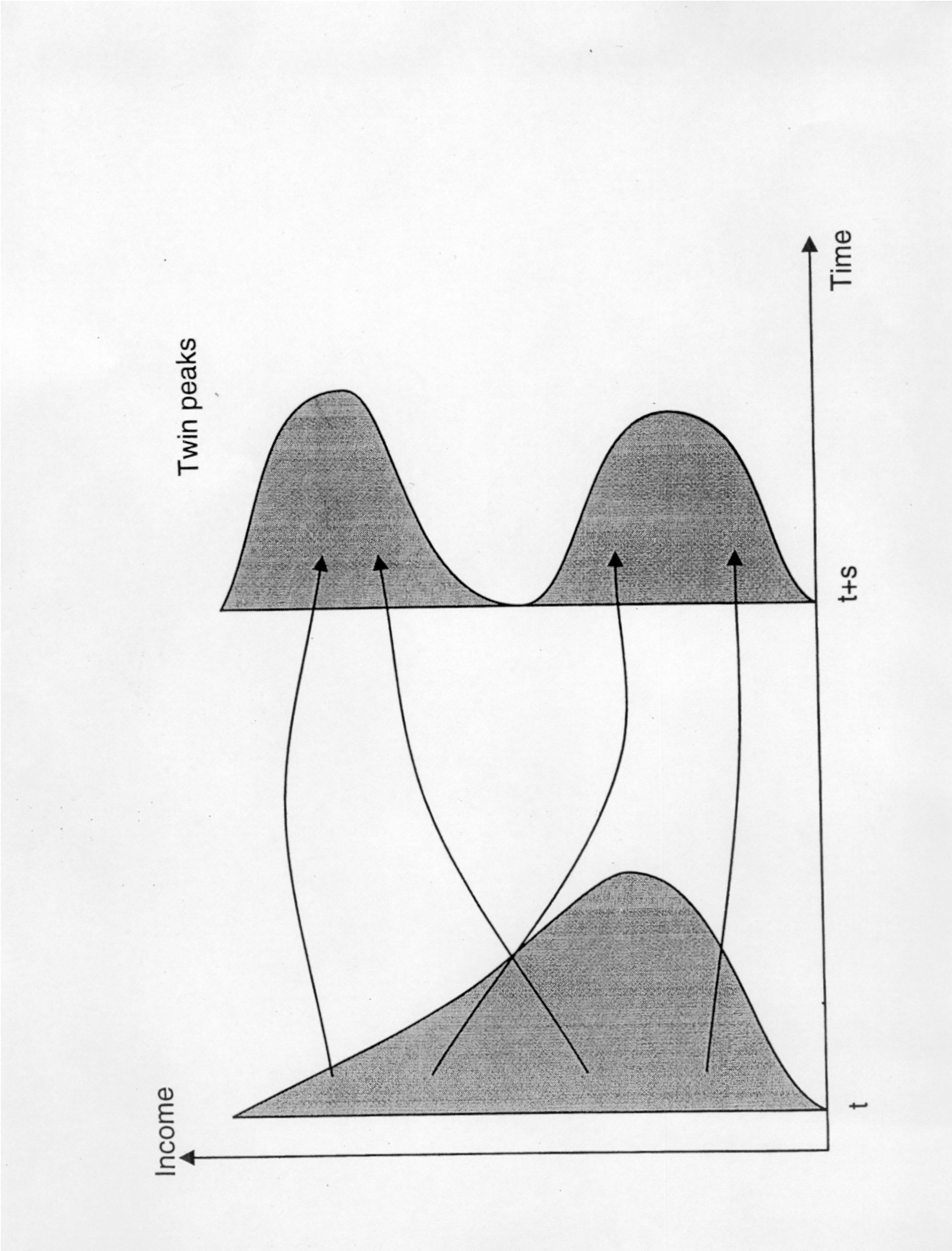
For Quah at the centre of the new age is the valorisation of ideas and concepts. Ideas are exclusive only for as long as those who develop them keep them to themselves. Once ideas are divulged anyone can use them. Citing Jefferson, Quah argues that ideas are not in their nature a subject of property, though in practice the originators of ideas seek to establish intellectual property rights over them. Of course ideas have always underpinned human progress. What is distinct about the new age is the extent to which ideas do not simply underlie technical progress but are themselves commodities. An example is a computer operating system.

In this new world it is the nature of goods that has changed. Immaterial goods are distinct in that they do not have to be transferred from one person to another but are simply replicated. Trade therefore involves the replication or copying of goods. In some cases equipment is required to use these goods but the upfront costs are small. There are strong network externalities. And the marginal cost is often close to zero. The cost of broadcasting to 20,000 is the same as the cost of a broadcast to a handful of people.

It is this fact that the marginal costs of supplying immaterial goods is close to zero that is one part of the explanation of the rise of superstar economies. Alongside this supply side factor there is a second demand-side factor. On the one hand the market for many immaterial goods is extremely large and often global in character (lifting the constraints on the division of labour posed by the extent of the market). On the other consumers often prefer the famous to those who are less famous but whose talents, skills and abilities may differ only marginally from the most famous. In this situation there is a very high level of demand for the goods and services superstars offer, creating very high incomes, a world of winners and losers and wide inequalities. What is more, adds Quah, in many cases winners are made and not born, hence permitting the trajectories identified in the chart.

These mechanisms clearly have an impact on territorial development as immaterial goods and services are produced somewhere just as the people whose incomes are derived from them must live and work somewhere.

[2] Danny T. Quah « The invisible hand and the weightless economy » Centre for Economic Performance Occasional Paper n.12, London School of Economics (1996)


Income
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THE NEXT EU ENLARGEMENT : IMPLICATIONS FOR PORTUGAL

Iva Miranda Pires
Dipartamento de sociologia - Universidade Nova de Lisboa– Centro de Estudos Geograficos

Portugal, Spain and Greece have been EU full member states for a decade and a half. During that period they have benefited from EU structural funds which helped them to build up infrastructures and to modernise their economy. In some aspects the step forward was significant and the gap which separated them from the more developed partners was drastically reduced. Still, if we take other data (GDP per head, R&D expenses, employment structure and qualification, under-representation of high tech branches) the picture is less favourable showing that we still have "a lot of work to do" to converge with the most developed countries.

The adhesion of Portugal didn't pose any problems to EC members, unlike Spain that was an important agricultural producer. On the reverse, for Portugal, it represented an important step. Their integration in a vast and protected market had an enormous impact on the Portuguese economy and society. The community funds supported the economic modernization and the reduction of the regional inequalities, especially in the case of accessibilities. Until the end of the eighties economic growth was very high with the help of EC structural and cohesion funds, and massive FDI were attracted by good business perspectives, for an emergent market, for the privatizations of State owned companies and for the low labour cost. Without them the modernization of the Portuguese economy would have been slower and probably in some cases impossible. Considering the macroeconomic impact of EU transfers in the overall period of the two CSF (1988-1999) an estimated convergence of 17 per cent occurred, being the structural funds responsible for 40 per cent of that development, and an increasing of 0.7 per cent per year in the GDP (CES, 1997, p:33). After the accession, per capita GDP grew very fast until the middle of the nineties afterwhich a slow down occurred. In spite of the observed growth in 1999, the Portuguese GDP per capita was only 73 per cent of the EU average.

In the next few years the adhesion of some Central and Eastern European Countries is foreseen and was reinforced in the Agenda 2000.

Thus, the EU is about to enlarge which is not a new circumstance since it began by being a common market with 6 members and has 15 members today. However, in comparison to the past, this enlargement shows substantial differences. Firstly, the number of candidates is much larger than in any previous enlargements - 10 CEEC plus Cyprus, Turkey and Malta - although the adhesion will be phased. Secondly, it coincides with the implementation of the EMU and with a period of slower economic growth and high unemployment rates, which are leading to a limitation of the Community budget expansion. For the first time, a significant budget increase to support both the applicants' transition and integration and the possible negative impact of the enlargement on the current members' economy is not foreseen. Current costs of this enlargement are to be supported with the same budget, that is to say, with "savings" and budget readjustments, although heterogeneity among EU regions and countries will sharply increase. The EU commitment to lessen disparities between members, which is helped by the Structural Funds since 1993, will be a hard task in the future[3].

[3] The impact of the enlargement on the population and on the economy is far from being balanced. While population will grow 28 per cent, from 374 million to 479 million, their contribution to GDP will be less significant. EU GDP per capita will decrease as globally their GDP per capita is only 40 per cent of the European average.

Even if the adhesion process is to be phased and the impacts diluted along a longer period of time, pressures on the community financial resources will increase. While the applicants hope to count on the EU solidarity to overcome their economic handicaps, the current less-developed members are still involved in a convergence process towards their more developed partners. In spite of the convergence of the Portuguese, the Greek, the Spaniard or the Irish economies and the huge effort they have been making (although with distinct results) inequalities still persist justifying the continuity of the community funds (especially in the case of the structural funds) to surpass them.

To Portugal this enlargement represents significant challenges. On one hand it implies increasing competition inside EU market, especially in the case where the export profile is similar. Portugal might be seized by enlargement in a phase of transition from a manufacturing structure still based on low labour cost to another where high tech branches are better represented as well as modern and qualifying services. Even if the need to move to a different pattern of specialization was identified long ago, this transition has been slower than expected and uneven among economic sectors. This means that the increase in manufacturing productivity and the quality upgrade achieved until now might not be sufficient to avoid trade competition, at least with some of the Eastern countries.

Another problem for Portuguese external trade with EU is that the country might have a very close export structure to the candidate countries and would be therefore competing in the same range of products - the textile and more recently automobile industries. The Portuguese position in a EU 27 and the evaluation to what extent these countries can become important competitors will also depend on the way they will explore present competitive advantages and those to be exploited in the future to win EU market shares. If low wages and geographical proximity are to be exploited, present competitive advantages point to labour intensive industries, like clothing and car components and assembly, both very important industries in our export structure. But once the process of economic restructuring and modernization of the business services and infrastructures will be accomplished[4] the possibility that they will diversify their competitive advantages cannot be excluded.

On the other hand, Portugal, which is already in an outlying position in Europe, sees its periphericity increasing each time the EU "core" moves towards North and East.

Since our integration in the EU our trade exchanges developed, almost exclusively, inside the community territory. We are one of the EU countries most dependent on this market either to export or to import both consumer and equipment goods. This highly geographical concentration of Portuguese external trade is dangerous if we are not able to maintain our export shares or to look for other markets.

An EU report on enlargement suggests that some manufacturing sectors will be affected above average. We point out textile, footwear and clothing industries as those that, at short term, will cause more apprehension to Portuguese exporters. But at medium term, the inclusion of others like motor vehicles and other means of transport, timber/furniture and paper/paper products in the group of the more "sensitive branches" is foreseen (EC, 1996, p: 84 and 142). All of them play a crucial role in our manufacturing and export structures. Our

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[4] EU is already committed to help candidates to reduce existing economic and infrastructure disparities by providing financial assistance. If we compare with the portuguese adhesion process, which is quite recent, positive impacts on the economy are expected to begun before full membership.

Apart from the PHARE programme which has been in place for several years, new pre-accession instruments were created in 2000 : ISPA is a pre-accession structural instrument with a budget of 1040 million euro to support infrastructure investments in environment and transport sectors. SAPARD is a pre-accession agricultural aid to prepare agricultural modernization and rural development.

main concern is the possible negative consequences for Portuguese exports due to the industrial integration of the CEECs. Our exports will come under additional pressure due to enlargement, and once obstacles like insufficient quality, lack of design, inadequate communication and transport infrastructures are overcome, raising exports are expected. If we take the OECD data on employment and production to analyse the recent evolution in Portugal and in some CEECs we can observe a rather concerning future for our country. Since 1995 the CEECs production has increased at higher rates than has the Portuguese and for some products these countries already show a higher potential production volume.

Evidence of the need for Portugal to deepen and accelerate the move towards a more qualified manufacturing structure comes from studies showing that some of CEECs might be better positioned in the overall European economy. An undergoing internationalisation process and the specialization in capital-intensive industries (automobile, machinery and chemicals) (ZYSMAN; SCHWARTZ, 1998) put the CEECs in an intermediate position between the more industrialized northern countries and the less developed in the south (LOPRIORE, 2000). Furthermore, the recent East-West trade is much more complex and integrated than before. Besides increasing intensity, the marked evolution in vertical intra-industry trade is displacing the importance of OPT in the early nineties (ZYSMAN; SCHWARTZ, 1998). The same authors affirm that "for Hungary, the Czech Rep., and Slovenia with Poland close behind, intra-industry trade indexes are already higher that in some EU countries such as Portugal and Greece (p. 417)".

One of the recognized advantages of enlargement is the potential of these emerging markets to absorb consumer and equipment goods produced in EU. The CEECs technological backwardness obliges them to invest in the modernization of their production processes to fulfill the objective of winning market shares in a market demanding quality and design. This modernization effort, whether important to CEECs or not, will also benefit EU equipment exporters.

Trade growth with EU can be observed in all the CEEC especially in those where the process of economic restructuring is more advanced. Only six CEEC are in the group of the 50 main trade partners concerning imports, but in all of them the position is improving with regard to Poland. In 1996, the imports from this group represented almost 7% of the total of EU imports, compared with 2.8% in the beginning of the nineties. In 1998 they amounted to 10%, becoming the second EU main partner after USA with a share of 20% (Eurostat).

But, as expected in this phase, the share of EU exports to these countries is higher than the one of the EU imports. As stated in a European Commission report on the progress accomplished by candidates in the perspective of the accession " the trade surplus of the EU with the candidate countries rose at 33 thousand million of euros in 1998, being 35% resulting from the trade with Poland and 25% with Turkey. The trade deficit of the EU with the rest of the World (13 thousand million euros) was more than compensated by the resulting surplus of the trade with the candidates" (EUROPEAN COMMISSION, 2000, p:17). Within CEECs trade deficit jumped from 7,2 thousand million euros in 1993 to 22,3 in 1998, mainly due to imports of manufacturing equipment and vehicles.

This trade surplus with CEECs is not equally distributed among EU countries. Just four of them get the largest slice: Germany, France, Italy and Austria. Even in this group Germany is far way from the other countries representing 43 per cent of EU exports to CEECs and almost 48 per cent of total imports from this countries. All four retain 67 per cent of the 22,3 thousand million euros surplus of the EU trade balances with the CEECs. Portugal and Greece are the sole EU countries with negative trade balances.

But aside from the disadvantages that we have to face when making comparisons with CEECs we also have some advantages: more developed economic "environment", diversified and qualified business, financial services and amenities, higher family income and tight ties with other emergent markets (as with Brazil).

One must not see competition as a negative aspect but as a stimulus to improve the performance of our economy, representing a healthier and pro-active perspective. In that sense Portuguese firms should be prepared to take advantage of the expected positive effects of the enlargement. The market dimension and the dynamics of goods, capitals and people's flows will create a growth potential inside the UE, improving at the same time its position and competitiveness in the world economy. Portuguese companies have to be more creative in order to increase productivity, investing in product design and quality, developing skills to compensate the disadvantage due to their geographical periphericity.

During the nineties the Portuguese economy reached an important internationalization level due to investments made by some national groups that, after a consolidation process, were able to implement internationalization strategies as in investing abroad in telecommunications, banking, distribution and manufacturing. But CEECs aren't key players for Portuguese companies in the definition of these strategies, at least until present. With some exceptions (manufacturing investments in Romania and in distribution and banking in Poland) few investments were made by Portuguese economic groups in the CEEC's. Even if trade flows are unsignificant (meaning less than 1% of the total trade exchanges with third countries) and they probably will not develop[5] because of very similar production profiles, one cannot exclude that Portuguese companies would reflect upon possible production relocalization in some of these countries. Such a strategy might be implemented if they want to reduce their production costs, but moreover to get closer to their main markets in the centre of Europe and at the same time to set a position in these emergent markets.

If a foreseen shortening of EU transfers and of private FDI and increasing competition in some manufacturing products might be the most evident implications of enlargement for Portugal, it will depend upon the Portuguese entrepreneurs' ability to reverse the potential negative impacts on national economy and to find and exploit their advantages. The increased pressure on some low-tech branches probably will push entrepreneurs to finally adopt different perspectives to approach EU markets. Some positive effects may occur if Portuguese firms develop adjustment capacities and use the increasing competition as a lever to move towards more high tech branches.

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[5] In general CEECs are better classified than Portugal in the ranking of world trade (1998) with regard to exports destinations (ranging from 29th in the case of Poland to 84th of Latvia) as well as origin of the imports (the better classified is Czech Rep. in 38th and the worst is Lithuania in the 132nd) although Portugal's trade balance with the CEECs is negative, which is a unique situation among EU countries.

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HOW MAY WE EVALUATE THE IMPACT OF THE EU's STRUCTURAL INTERVENTIONS SINCE 1994 ?

John Bradley
ESRI, Dublin

I have been asked to introduce the discussion of the topic: "How may we evaluate the impact of the EU's structural interventions since 1994?". Two sub-issues have been tabled for particular attention:
- Is it possible to agree on a typology of the tools that have been used and the issues to be addressed?
- To what extent do political institutions and regional specificities matter when explaining the different results?

Although I have been deeply involved with the technical evaluation of the impacts of structural interventions since the major reforms of 1989 – mainly in Objective 1 countries and regions – I welcome the opportunity offered us today to widen the discussion beyond narrow technical questions. The whole issue of evaluation of structural interventions urgently needs to be placed in a wider context.

Disparities between regions and between countries

Let me start with the interesting finding presented at the beginning of the recently published *Second Report on Economic and Social Cohesion*. "Disparities between regions have narrowed less (than between member states), partly because the gaps have widened between regions within certain member states". (page 11 of Summary)

This is an interesting finding and one that perhaps would not have been expected *a priori*. So, why do the regional economies of member states display more diversity of performance on a range of standard convergence measures than the national economies within the present EU? This question lies at the heart of the challenge of European cohesion. The process of addressing it illustrates just how difficult it is to investigate the impact of EU structural interventions in a truly scientific fashion. Let me illustrate what I mean by drawing on a series of examples.

East Germany, the Italian *Mezzogiorno* and Northern Ireland are examples of regions of member states that were designated as Objective 1 during the period 1994-99. Greece, Ireland and Portugal were examples of member states that were designated in their entirety as Objective 1. However, in the above three sub-regions, almost all the key "conditioning" fiscal, monetary, industrial, labour, educational and other policies are set at the national level, and tend to ignore the problems of the lagging region. Thus, a nation-wide approach to wage policy in Germany served to destroy cost competitiveness in East Germany. An over-valued non-euro exchange rate (sterling) in the UK had a similar effect on the struggling industry of Northern Ireland.

Regional policy within member states tends to be what one might call "palliative", in the sense that it makes the regional problems easier to endure that makes any serious attempt to cure them. The main policy instrument used is income transfers from richer to poorer regions. It seems to almost politically impossible to design regional policies that introduce fundamental differences between regions of a nation state other than in terms of the level of income redistribution.

The situation in the Objective 1 states is very different. In particular, anyone who has studied the Irish case will know that a wide range of policies have served to secure for it major

competitive advantages that underlie its dramatic convergence. Examples include the following:
- A regime of low corporate taxation that was first put in place in 1956 and that facilitated a massive inflow of foreign direct investment.
- A social consensus was created at that time that accepted enduring high rates of personal income tax and indirect taxes to offset the low yield from corporation tax and permitted budgets to be balanced.
- A series of major educational reforms, started in the mid-1960s and greatly expanded during the 1980s and 1990s, that would have been impossible if, say, Ireland had remained a region of the UK.
- When it most mattered (in the mid-1980s, a time of high unemployment and fiscal imbalances), a formal Social Partnership process permitted a shift of income away from wages to profits, that would have been inconceivable if Ireland were a sub-region of another nation state.

Clearly, EU structural interventions are just one of a wide range of policy issues that determine the nature and extent of convergence. The recent EU Cohesion Report draws attention to this issue, but this merely serves to highlight just how little we actually know about processes of growth and spatial aspects of growth.

The two dimensions of the evaluation

The evaluation of EU structural interventions may be thought of as having horizontal and vertical dimensions. The horizontal dimension should link the narrow consideration of the impact of structural interventions to such wider issues as:
- The Single Market, since the reforms of EU regional aid of the late 1980s, associated with the name of President Delors, were conceived as a type of "consolation prize" for the poorer, peripheral member states.
- Economic and Monetary Union, where once again the poorer peripheral states were thought to be potential losers.
- Competition policy, with its built-in tendency to encourage concentration in the core.

The separate impact of such policies, together with their interaction, needs far more attention than in the past. DG REGIO perhaps has had a tendency to focus too narrowly on the separate roles of the Structural Funds, taken out of the wider encompassing policy environment of the increasingly integrated Union.

The vertical dimension is needed to integrate the micro, mezzo and macro levels of evaluation of structural interventions. This is at the very frontier of economic research and poses difficult conceptual scientific challenges. For example, in the results reported in the Second Cohesion Report on the impacts of the Community Support Frameworks on the four so-called "cohesion" countries – Greece, Ireland, Portugal and Spain – the following issues arose:
- In Table A.43 (page 60 of the Annex), why should one believe the higher impacts derived using the HERMIN model rather than the much lower impacts identified using the Commission's own QUEST model? The differing modelling methodologies as between HERMIN and QUEST might not matter too much if their results were similar. But where two different policy analysis tools give radically different answers, the readers of the Cohesion Report are owed an explanation!
- In the HERMIN analysis, a crucial assumption needed to be made about the degree to which the underlying micro interventions were designed and implemented efficiently, i.e., so as to generate the highest possible beneficial "externalities" that boost the supply-side output and productivity impacts. But the necessary micro research to permit the credible calibration of these externality impacts is lacking and a common set of assumptions were used for all four

countries. The same problem arises for the Objective 1 sub-regions. So, the Irish and Portuguese impacts are probably understated, and the Greek impacts are probably overstated.

Typology of tools of analysis

In the case of the Single Market, the Cecchini/Emerson project of 1988 and the Monti project of 1996/97 gave a massive impetus to trans-European research through allocation of adequate research resources and concentration of effort. The Emerson project of 1990 (*One Market, One Money*) played a similar role in the advance preparations for EMU.

No such concentrated effort was ever made to address the research challenges of the design and analysis of cohesion policies. National efforts, however admirable, have tended to be fragmented. Within DG REGIO itself, the cohesion fund impacts are often evaluated in a separate exercise from the Community Support Frameworks.

The research that led to the HERMIN model – a macroeconomic model specifically designed to evaluate CSF impacts – was funded by DG XII as an almost accidental offshoot of energy and environmental research within the JOULE research programme. In many countries, macroeconomic and macro-structural analysis of structural interventions has been weak at best and almost invisible at worst. And the situation continues to deteriorate! The recent call for tenders from DG REGIO for the ex-post evaluation of the impact of the 1994-99 CSFs appears to assume that little or no evaluation at the project and Operational Programme levels will be carried out by the national authorities. The sum allocated in the tender (one million euro) is inadequate to cover an in-depth evaluation of eleven countries/regions.

The manner in which the ex-ante evaluation of the National Development Plans (i.e., the national documents that form the major input to the subsequent CSFs) was carried out suggests that the situation is deteriorating rather than improving. For example, DG REGIO still insists that each national or regional CSF be evaluated in isolation from previous ones (i.e., CSF 2000-06 ignores the fact that it is simply a continuation of CSF 1989-93 and CSF 1994-99). This makes little or no economic sense. More widely, within the Commission there appears to be little awareness of the urgent need for cross-disciplinary approaches to the evaluation of structural interventions.

Political institutions and regional specificities

Turning to the political institutions and regional specificities, regional and national perspectives need to be discussed and shared more widely. In regions – as distinct from states - interesting and relevant issues of regional policy impact are often ignored simply because policy is set at the national level. However, wide policy consequences need to be examined if we are to understand the “shadow cost” of national policy-making for their constituent regions.

Perhaps we need to admit that an initial deterioration in intra-state cohesion may be required if inter-state cohesion is to improve?

This may be even more necessary in the applicant states from the CEE area, where it may be difficult to “kick-start” a nation-wide virtuous circle of growth and convergence in the absence of initial regional focus. But any such deterioration has political limits which – if exceeded – risk instability. Spatial focus in the short-term should hold out the prospects of diffusion of the benefits of growth in the longer term. However, in the applicant countries there is a real risk that the longer-term role of government as a “strategic organiser” will be dominated by the shorter-term necessity to slim down government and balance budgets. If the roles of the public versus private sectors, as well as the national versus EU roles, evolves in an antagonistic way, then cohesion is likely to deterioriate rather than improve.

PUBLIC POLICIES AND REGIONAL INEQUALITIES

Philippe Martin
Université de Lille 1, CERAS-ENPC (Paris), CEPR (London)
Lecturer, *École polytechnique*

The spatial concentration of economic activities is one of the prominent features of economic development, and both economic historians and growth and economic geography theorists have underlined the strong correlation between growth and agglomeration. Yet although the growth of economic activities goes hand in hand with their spatial concentration, the latter is seen as negative by the public authorities. The objective of public policies has therefore been to try to curb this trend. Within the European Union framework, spatial concentration has been interpreted as a direct consequence of the integration process. In a situation of decreasing transaction costs between regions and countries, it is more profitable for businesses whose rate of return is growing (i.e. whose profits and salaries are high) to concentrate production in a limited number of regions. They can exploit economies of scale by focussing production in the regions which offer large markets (the richer regions), while being able to export easily towards the other regions of the European Union. Empirical studies have confirmed a process of spatial concentration at European level, even if this process has occurred mainly within countries. In other words, inequalities between European countries have tended to decrease, but the same cannot be said of inequalities between regions within individual States. This has been referred to as a process of "global convergence and local divergence" (see *inter alia* De la Fuente, A and X. Vives, 1995 and Martin, 1999).
Public intervention can be justified on grounds of either efficiency or equity. In terms of economic geography, justifying such assistance on grounds of efficiency entails pinpointing market failings that are specific to the spatial dimension of the economy, that is to say identifying the reasons why the economic geography produced by unfettered market forces is not optimal. Secondly, consideration must be given to the effects of public intervention and the extent to which they can do better, in terms of social welfare, than market forces. This type of two-stage analysis is usual for many forms of public intervention in the fields of education, technology or the environment. However, it is virtually never used in regional policy analyses, either in France or at theEuropean level.

Mobility of agents and regional inequalities

A traditional justification for regional and spatial planning policies is equity. Some economic agents (workers or consumers) lack mobility and are therefore condemned to remain in poor or declining regions whose more mobile factors (capital and skilled workers) have left. Given the low demand for labour in these areas, real salaries will drop or, where labour market rigidities prevent them from doing so, unemployment will increase. In both cases, the worker's quality of life will decrease. Consumers' will also suffer since certain goods and services will no longer be produced locally once businesses have relocated to wealthier areas. In the case of some goods, and particularly some services, transaction costs will rise so much that these agents will no longer be able to afford them. The diversity of goods and services available in the poor region will therefore decrease. Furthermore, the most mobile agents are usually those whose human capital (education, skill, etc.) is the greatest. These agents, through what the economists call positive externalities in the form of localised social interaction, have a favourable impact on productivity and therefore on the real salary of the other workers. Accordingly, the departure of the most productive workers reduces the productivity of the workers left behind (i.e. the most disadvantaged individuals). Market forces are therefore flawed in so far as certain agents make decisions on where they want to work without taking into account the impact of their choice on other workers. From this point of view, there is a market failure which causes an increase in inequalities, is specific to the spatial dimension of the economy and can therefore serve as justification for public intervention.

The impact of agglomeration on the least mobile agents can be analysed in several ways. A first method is to view it as a specific form of market failure rather than as an equity problem. This market failure would be entirely caused by the lack of mobility of the most disadvantaged agents. The phenomenon is a well-known characteristic of European countries compared with the United States. The mobility between US States is much greater than between European countries, of course. However, it is also much greater than between regions of a same European country. Only 1.5% of Europeans live outside the country they were born in. The wage elasticity of interregional migration (i.e. the responsiveness of migration between two regions of a same country to a 1% increase in the salary difference between them) is 25 times higher in the United States than in the United Kingdom. The difference between the United States and France and Italy is even greater.

This high level of mobility within the United States explains why the phenomenon of spatial mobility of economic activity in that country did not lead to divergence in per capita income between its States. In Europe, 25% of the population live in what is known, in the European Union's terminology, as "Objective 1 regions", i.e. regions whose per capita income is under 75% of the Union average. In the United States, only two States, accounting for only 2% of the overall population, meet this criterion. The fact that workers follow the movement of capital (either physical or human) from declining to growing regions makes the problem of spatial equity much less acute. Even if some regions lose their economic activities to others, there is no divergence of per capita income between them. This is because the migration of workers from declining to growing regions reduces labour competition in the former and, on the other hand, increases it in the latter. Migration phenomena are therefore the main adjustment factor of regional inequalities in the United States. Apart from the fact that public intervention is not part of the American ideological tradition, migration phenomena certainly help to explain why regional policy and spatial planning have never been as much of an issue there as in Europe. Conversely, it is because workers (and particularly disadvantaged workers) are less mobile in Europe that economic geography has acquired political significance only on this side of the Atlantic.

In France and, more generally, in Europe, encouraging the spatial mobility of workers is not considered to be an adequate answer to regional inequality problems. To a certain extent, this is understandable. Owing to cultural and sociological barriers, there will always be a significant group of workers who will lack mobility and will therefore be affected by geographical inequalities. The vision of entire regions deserted by inhabitants and economic activities (such as Dakota in the United States) is thus unacceptable in Europe. Nevertheless, public policies could focus on removing some obstacles to mobility (such as the difficulty for people living in council housing to move from one region to another). More generally, training policy should also encourage mobility between economic activities (and therefore also between regions when these are partly specialised) for workers made redundant.

Regional policy: between equity and efficiency

In Europe, the option chosen has been to attract businesses to poor or declining regions rather than encourage workers to move to growing regions. I have analysed the consequences of this choice in the light of the balance between equity and efficiency in a previous study (Martin, 1999a and b). Where economies of scale can be achieved, spatial agglomeration generates benefits in terms of efficiency. These economies of scale can be achieved either at business level (deriving simply from fixed costs), or regional level (deriving for instance from localised interaction between businesses which allows them to reduce transport costs or benefit more rapidly from the technological innovations of their neighbours). We may therefore conclude that an economic geography which is too scattered (at European, national or regional level) is not optimal. From this point of view, the American economic geography, which is a lot more specialised than its European counterpart, seems more efficient. However, we have seen that given the low level of mobility of workers in Europe, this type of geography would be very costly in terms of equity. Furthermore, this low worker mobility makes it unlikely that the American scenario could be replicated in Europe. In conditions of monetary union, i.e. where negative shocks cannot be offset by changes in exchange rates, lack of mobility coupled with a high degree of specialisation would also be very dangerous, since it would transform a negative shock affecting one economic activity into a wider regional shock.

The recent literature, under the heading of "new economic geography" (see Krugman, 1991, for a non-technical presentation and Ottaviano and Puga, 1997, for a summary of recent contributions), has also reviewed some issues relating to regional policy. It insists on the cumulative mechanisms found in economic geography, mechanisms which can generate non-linear geographical phenomena. These cumulative mechanisms that can lead to agglomeration can involve either worker migration (the "American model") or business relocation (the "European model"). Let us take the example of the second form of agglomeration. A business locating in a region where there are few other companies will have to import most of its inputs from other regions and sell most of its production elsewhere as well. In this respect, it will be at a disadvantage compared with businesses in regions with a high concentration of economic activities. The effect will be even greater in economic activities which feature substantial economies of scale, i.e. those sectors for which the size of the market has a crucial impact on profits. These are usually economic activities in sectors that are not highly competitive and where fixed costs (such as the research and development costs required before production can start) are high. On the other hand, businesses locating in regions with a low concentration of economic activities will benefit from lower competition for labour (and therefore lower wage costs). The same applies to the cost of land. It would therefore seem that businesses which can benefit from substantial economies of scale and are operating in sectors with high profit margins will be attracted to regions where other businesses (both clients and suppliers) are already established. That is how cumulative processes can form, since the more a region attracts this type of business, the easier it will be for it to attract others. Conversely, regions which these businesses have fled will find it increasingly difficult to reverse the trend. However, such regions will be able to attract businesses for which wage costs account for a large part of fixed costs, in sectors which are highly competitive and therefore generate low profit margins. This cumulative process will thus lead to specialisation: some regions will have a high concentration of businesses with high profits and salaries while others will be able to attract only businesses with low profits and salaries. The former regions will specialise in high technology goods that face little competition from increased trade with low-income countries. On the contrary, the others will be directly hit by trade globalisation. In addition, the former will be in a better position to finance infrastructure and thus attract more businesses because their tax base will be higher (since businesses there typically generate high profits). The opposite will be true of regions specialised in highly competitive sectors with low profit margins.

Theoretical models show us that this cumulative process can start only once transaction costs (related to transport, tariff and non-tariff barriers between two countries, currency differences, etc.) have fallen below a certain point. When transaction costs are high, businesses try to reduce them by locating near their customers, and some of these may be in outlying regions. In such cases, even economic activities that benefit from economies of scale may be scattered throughout a given area. Where transaction costs are sufficiently low, however, it is preferable to concentrate production in a single point of the wealthiest region and export towards the poor region. This spatial concentration process is non-linear, in so far as the reduction in transaction costs may have no effect at first. It is only once these costs have reached a critical threshold that the cumulative process is triggered. Once this process has started (i.e. once the previous spatial equilibrium is upset), it becomes self-sustaining and self-fuelling.

The empirical studies of Fontanié, Brülhart (1998), Brülhart and Torstensson (1996) and Amiti (1998) strongly suggest that such a process is under way in Europe today, in particular since the advances in trade integration within the EU. The introduction of the euro is expected to further strengthen this trend, since a recent study has demonstrated that trade among countries that are part of a monetary union is three times higher than among countries which do not share the same currency. By strengthening trade links, monetary integration should also encourage the process of specialisation and spatial concentration. When a firm sells its products in two countries which do not have the same currency, it may want to have a plant in each country in order to be able to pay its salaries in the respective currencies and thus avoid exchange rate risks. Once a single currency has removed this risk, however, the company may prefer to take full advantage of economies of scale and concentrate its production in a single plant, since having two sites as an insurance against exchange rate fluctuations no longer serves any purpose.

The difficulty of evaluating regional policy

What lessons can we draw from these recent theoretical and empirical studies? One of their main conclusions is that given the cumulative and non-linear processes influencing economic geography, it is very difficult to evaluate and forecast the effect of public policies designed to counter concentration trends. Regional policy measures to finance transport infrastructure, for instance, have both supply-side and demand-side effects. The demand-side effects are mainly short-term and of a typically Keynesian nature, i.e. they are based on a multiplier phenomenon. Building a motorway will increase local demand for goods and labour, and therefore the disposable income of the region. In turn, this will generate expenditure on local goods (in particular non-exchangeable services), etc. If the region benefiting from this infrastructure is experiencing a deficit in demand brought on by recession, the effect can be significant.

Macroeconomic studies such as the one carried out by the European Commission (1999) show that these regional policy measures have a beneficial effect on regional growth in the short term, i.e. within about five to six years. The Commission's econometric study was based on a model that featured mainly demand-side effects. It demonstrated that during the 1989-1999 period, EU transfers increased average growth in recipient countries by between 0.3 percentage points (Spain between 1989 and 1993) and 1 percentage point (Greece and Portugal between 1994 and 1999). This demand-side effect is generally accepted, even if the optimistic results of the Commission's study are difficult to interpret. This because these results indicate the maximum effect of the regional policy, since they assume that the growth differential in recipient countries is entirely due to this policy. We know, however, that during the same period, considerable progress was achieved in the integration process and that substantial amounts of private-sector capital flowed into certain countries (Ireland, Portugal and, to a lesser extent, Spain). In addition, this study merely considers the macroeconomic effects at country level, and does not look at the regional level. This is a shortcoming, for we also know (see Neven and Gouyette, 1994, De la Fuente and Vives, 1995, and Martin, 1998) that there has been convergence between European countries but not between regions of a same country. There is no indication that regional policy has benefited – even in the short term – the poorest regions of countries which as a whole achieved convergence; indeed, we know that the poor and rich regions within these countries did not converge over the same period. The relevant survey level is therefore the region, not the country.

Empirical economists wanting to undertake an econometric survey of the impact of regional policy in Europe are also handicapped by the fact that the Commission does not know how much has been spent in each region. The Commission has declined to reveal the amounts of expenditure (whether committed or paid) of structural policies at regional level. This is somewhat surprising, since this public expenditure accounts for slightly less than half the European budget. Without this data, we cannot answer the key question of whether or not the regional policy has contributed to regional convergence in Europe. The fact that such a policy has contributed to convergence between European countries by no means implies that it has contributed to convergence between regions within a same country. The case studies shed no light on this question. The Commission is therefore in a situation where it must either refuse to reveal information it has, in which case it is preventing an objective evaluation of its policies, or admit that it does not know what has been spent.

More fundamentally, it is essential to study the long-term effects of these policies, i.e. the supply-side effects. However, these effects – in particular those which affect the relocation of businesses – are more complex. They can even be diametrically opposed to the short-term demand-side effects. Take, for example, the case of transport infrastructure, which has been a priority of both European regional policy and national regional development measures, particularly in France. If we consider the economic activities with high economies of scale, an opening-up policy can have paradoxical effects. By decreasing the transaction costs of interregional trade, such a policy can encourage businesses to seek economies of scale by concentrating their production in a single plant. Businesses whose salary costs are relatively low will tend to concentrate in the rich regions, even if this means exporting part of their products to poor regions, since the new infrastructure will have made this cheaper. The recent study by Combes and Lafourcade (2000), which suggests that the drop in transport costs in France over the last 20 years has generated a growing concentration of economic activities with high economies of scale, shows that this consequence is not merely hypothetical. But nor is it a general rule, of course. The public infrastructure which allowed the *Nord* region to move closer (in terms of transport costs) to the wealthiest European regions certainly played a part in the renewed growth that region has experienced. In this case, the transport infrastructure did not just open up a peripheral region, but actually allowed it to acquire a central position. This has enabled businesses to concentrate their plants in an area which is near large markets but also offers relatively cheap labour, or at least a labour market that is very favourable to businesses. The example shows that the same public infrastructure can have very different effects from one region to another.

Regional policy has therefore concentrated on transport infrastructure between poor and rich regions, thus facilitating trade in goods. We have just noted that, while this policy is supposed to decrease inequalities between regions, it can have exactly the opposite effect. Certain empirical studies (Martin, Combes and Lafourcade) – albeit still preliminary – seem to bear out this hypothesis, at least in part. If part of the phenomenon of regional concentration and inequality is due to localised technological spillover processes – i.e. to the fact that businesses in a given region achieve, through social interaction, higher technological performance by learning from one another (as in Silicon Valley, for example) –, recommendations for public policies should be very different. The aim should no longer be to diminish transaction costs on the trade of goods between regions but to diminish transaction costs on the exchange of ideas. This implies a change in priority: rather than financing motorways (and producing Keynesian positive effects), the goal must be to promote technological convergence between regions. Such a goal implies establishing public programmes in the fields of telecommunications, the Internet and human resource development, and facilitating the movement of people rather than goods.

Given the existence of cumulative processes, public policies may also have non-linear effects, depending on the circumstances. Once a spatial configuration or equilibrium is established, it becomes very stable: a grant or public infrastructure policy designed to attract businesses or workers will have no impact. If a region has lost all its businesses, the effect of any subsidies may be nil or very short-lived, for businesses (again because of economies of scale) are more attracted by the presence of other businesses. On the other hand, where a new geography is emerging further to a significant exogenous change or the establishment of new economic activities, the rules of "new geographical economics" indicate that this geography will be fundamentally indeterminate. If what determines the attractiveness of a region is the presence of other companies from the same sector (for instance because this provides ready access to a pool of skilled workers), it follows that the region which attracts businesses first will then be able to build on this advantage to attract others, in a cumulative process.

Fundamentally, the economic geography of this new activity is initially indeterminate – for no region necessarily has any obvious natural advantage that might help it become the agglomeration centre. In this case, a small subsidy or well-targeted public infrastructure project may have a very significant effect by acting as an exogenous trigger of the process leading to the formation of an agglomeration centre. In other words, public assistance can be the determining factor allowing a specific spatial equilibrium to be chosen among the wide range of possible equilibria.

The current stage of European integration, and the introduction of the euro in particular, may provide this favourable context in which spatial equilibria are being upset and new equilibria are emerging. The experience of call centres in France has shown how the establishment of new activities can redefine economic geography. This particular activity does not require the companies to be near a specific region or a large existing agglomeration. In this respect, no region has a decisive initial advantage. However, the presence of several call centres in a given region is attractive, allowing the firm to benefit from a pool of trained workers, who are themselves attracted by the high level of activity in this sector. The city of Troyes has managed to attract many of these businesses through a specific training policy and an industrial estates policy tailored to the sector. To a certain extent, Brittany offers a similar example in the telecommunications sector. Here again, training policy played a crucial role. In very specific cases, a targeted public policy can play a decisive role by exploiting the very cumulative effects which may make such a policy completely ineffective in other situations. Ignoring these cumulative mechanisms of economic geography can result in severe mistakes, showing that the effect of public assistance is difficult to forecast.

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ECONOMIC INTEGRATION AND REGIONAL GROWTH

Brian Morgan
Cardiff University

Introduction

Economic integration within the EU has been significantly influenced by the enlargement process but its impact has been varied; e.g. by encouraging an expansion in trade and investment, the enlargement route was expected to have a significant and positive impact on prosperity. To some extent this happened during the initial enlargement process during the 1970s and early 1980s but since 1988 the growth in total GDP of the EU15 has averaged only 2% per annum – not particularly high by historical standards. In addition, in terms of GDP per head, the EU's prosperity has fallen with each successive round of enlargement from a level of 100 prior to 1973 to the current level of 89 in 1995 (see the table below); during the next enlargement it is forecast to fall even more sharply.

Enlargement	% Increase in GDP	% Increase in Population	GDP per head (EU6 = 100)
EU9 1973	29	32	97
EU12 1986	15	22	92
EU15 1995	8	11	89
EU26 2004?	9	29	75

However, in the period since 1973 there has been some convergence in income levels between Member States. The gap between rich and poor has narrowed. Currently the disparities in incomes have been reduced to a factor of less than 2 - ranging from 66 for Greece to 118 for Denmark (assuming GDP per head of EU15 = 100). The path to convergence at the Member State level has been supported by large increases in regional expenditures: Structural and Cohesion Funds now account for 0.46% of EU GDP or over Euro 30bn.

Over the same period, and despite these significant expenditures, there has been a lack of convergence at the regional level where the gap between rich and 'less favoured' regions has widened to a factor of at least 10 (from 30 for the poorest regions to almost 400 for the richest regions - again assuming EU15 = 100). Furthermore, regional disparities within Member States has also increased on average with countries like the UK, Finland, Sweden, Spain and Greece showing the greatest increase in disparities in GDP at the regional level.

This Note analyses the main drivers of regional economic growth and looks at some of the explanations of convergence at the national level that are consistent with divergence at the regional level. It concludes by highlighting the type of regional policies that will be needed to reduce disparities in GDP per head at the regional level over the next decade as the enlargement process continues to be driven forward.

Drivers of Regional Economic Growth

To develop policies that might influence convergence we must first understand the drivers of regional growth. The rate of economic growth can be influenced both by greater investment in productive resources (labour and capital) and by increases in the productivity of these resources. Although investment in productive capital assets and in infrastructure has traditionally been identified as a significant determinant of growth, recent studies have shown that the impact of technical innovation on productivity is becoming the main driver of the growth process.

Technical innovation refers to a multiplicity of factors, such as the skills and adaptability of the workforce, the efficiency with which resources are used, the level of 'first time' innovation and the rapid adaptation of new techniques. This means that investment in education and training to improve labour's efficiency in the productive process is an important determinant of regional growth. In this context, investment in skills development can be an important regional policy initiative. Similarly, technical innovation that improves productivity by raising the efficiency with which labour and capital are combined can be viewed as a driver of regional development.

Foreign direct investment (FDI) also plays an important role in the regional growth process by combining increased resources with technology transfer. FDI is an important stimulus to innovation; e.g. a substantial proportion of technology transfer now occurs either <u>within</u> multinationals via intra-firm transactions or <u>between</u> multinationals through joint venture agreements.

However, to stimulate regional growth, FDI must generate 'external economies'; i.e. it must produce improvements in the local supply chain, skills upgrades and networking activity. Large and small firms are increasingly restricting themselves to core activities – sub contracting where possible to specialist firms to reduce costs and raise quality and this plays an important role in reinforcing the competitive position of the final producer. Hence networking has become an important link in the supply chain and developing networks an important regional policy. Only to the extent that a region can successfully develop a strong complementarity between FDI and the innovation process will such investment have a significant impact on regional growth.

The Economics of Growth

Modern growth theory began by distinguishing between factor inputs, such as labour and capital, and total factor productivity (TFP). Initially TFP was assumed to be driven by <u>exogenous</u> technological change. For consistency these 'exogenous' models typically assumed that technology shocks were quickly absorbed by all firms. However, in reality, increases in productivity occur only gradually through a learning process - new knowledge spreads slowly.

To account for these stylised facts of the growth process we need to revisit Schumpeter's original trilogy of invention, innovation and diffusion:

- Invention refers to increases in technical knowledge.
- Innovation is a cumulative process that converts this knowledge into marketable products and processes.
- Diffusion is a sequential process that encourages the adoption of these new products and processes along the supply chain.

This approach to the innovation process emphasises not just the generation of knowledge but also its development, application and distribution. Exogenous growth models, with their emphasis on a speedy adjustment to technological shocks, were simply not convincing in their explanation of the role of technological change in the growth process.

To overcome these problems, the 'new growth' theorists have attempted to make technological progress <u>endogenous</u> by linking it more closely to investment decisions about human capital and skills development. The new growth models emphasise spillover effects from R&D and technical knowledge. In this model the stock of knowledge is interpreted as a non-rival factor – a free good - that generates increasing returns to scale.

This model differs from the earlier approach by identifying a 'third factor' that is not subject to diminishing returns. It achieves this by focusing on R&D expenditures that result in 'innovations'. This was a useful starting point but in reality the innovation process is much wider than this and almost every new production process – even those using existing technologies and not directly related to R&D expenditures – will invariably contain important innovations in terms of the organisation of production. Widening the innovation concept moves the argument closer to reality by linking it to the incentives available to utilise knowledge more effectively.

In the first place the 'endogenous' model is more consistent with the evidence on the innovation process – particularly the time profile of the diffusion patterns identified for new techniques, which indicate that new products are only gradually absorbed by other firms. The conclusion of the new growth theory is that knowledge accumulation and the innovation processes that result from investment in R&D can permanently raise the economic growth rate.

Regional policies can either aim to increase the stock of knowledge via subsidies to R&D or improve its effectiveness and dissemination through encouraging technology transfer and speeding up diffusion. Although R&D expenditure is important it is only a small part of the innovation process and the most effective policy intervention at the regional level is to encourage innovation by improving diffusion rates and technology transfer.

The Regional Innovation Process

Policies to encourage faster diffusion rates can be particularly effective when regional networks are important in forging supply chain links, and where FDI is a major stimulus to growth in the regional economy. Economic theory suggests that the two main factors affecting the firm's decision to become involved in economic networks are the need to reduce transactions costs and the need to manage the risks associated with product development.

Multinationals operating in different markets find it important to internalise market imperfections, especially along the supply chain, and reduce transaction costs; i.e. the costs of searching and contracting, along with the costs of negotiating, monitoring and enforcing agreements. Regional networks are successful to the extent that they can reduce these costs.

FDI is undertaken to capture the full benefits from new products by replicating production processes, product design and managerial systems in other markets. Also, multinationals seek to cover the often significant costs of product development by entering into licencing agreements and joint ventures in order fully to exploit commercially valuable spinoffs. They also work directly with suppliers to ensure that the original innovation is incorporated into component sourcing.

Market structures often develop in ways that enhance the ability of firms to fully exploit R&D spinoffs. European regional policies should acknowledge this and aim to encourage the development of these institutions so as to provide a supportive infrastructure that will help reduce market failure. If the market provides insufficient incentives to undertake innovation, then regional policies should aim to improve its effectiveness by speeding up diffusion along the supply chain.

What sort of market structures are capable of enhancing the regional innovation process? Economic clusters, regional networks and supplier associations are examples of regional activity, that help internalise (i.e. reduce) transactions costs. Interestingly, these are exactly the sorts of strategic measures that business support agencies are now being encouraged to develop at the regional level. For example, the 'learning region' and 'intelligent region' initiatives have highlighted the importance of introducing SME-specific measures to promote networking, develop supply chains and promote clusters as an aid to regional innovation and growth.

Networks

The main contribution of networks is to help harness external economies and other positive externalities by encouraging vertical and horizontal links between independent firms. These reciprocal and cooperative links facilitate risk sharing and encourage joint product and process development. The involvement of firms in networks has grown in line with increases in the complexity of production systems.

Regional networks bring some rigidity or stability into inter-firm relations and allow relationship specific investments to be undertaken in independent firms that would not otherwise occur – largely because in the absence of the network link these highly specialised investments would be deemed too risky.

The introduction of networking activity makes a big difference to the analysis of the innovation process. It is no longer sensible to view innovations as taking place in isolated firms with large R&D departments, but rather as a complex process of knowledge flows that are heavily influenced by the dynamics of regional networks. The success of networking is based firmly on the view that firms learn most from other firms, and that this interactive inter-firm learning is a key ingredient of the innovation and diffusion processes.

Clusters

Developing Clusters is another important strand of a successful regional strategy. Geographic concentrations of firms, specialist suppliers and service providers in related industries offer opportunities for firms to develop their competitive edge but also harness the benefits of co-operation. By grouping together they are able to take advantage of either demand factors in the location or the supply of qualified manpower. Within such a setting it is quite possible for a networked firm to start quite small but to grow rapidly within the network by taking advantage of sub-contracting opportunities.

Supply chain development can improve the interactions between firms by driving up the performance of SMEs in the network in order to better satisfy customer needs. There is a significant body of evidence that suggests that supply chain development is an important engine of economic growth and that working with local clusters of firms forms a good basis for improving the relationships that underpin the network. Business support services should aim to encourage interaction and collaboration within supply chains, and, most importantly, ensure that innovation support programmes are in place to build on existing strengths.

An important focus of supplier networks will be to improve customer service by speeding up delivery times and making greater use of electronic commerce. Other objectives could be to develop joint marketing programmes, minimise waste or to lower stock levels through JIT delivery. In fact supplier networks should focus on all activities that offer increased flexibility to meet customer needs.

<u>Specialist</u> suppliers are able to diversify their activities into the supply chains of several multinationals (or OEMs - original equipment manufacturers) and are less vulnerable to changes in demand or technology. Specialists are more likely to benefit from the long-term nature of supplier development programmes. On the other hand, <u>non-specialist</u> suppliers, whose main role is to provide production capacity and materials throughout the supply chain, are vulnerable from a number of directions. They can be in a strong position when demand is growing rapidly but are dropped at cyclical downturns. They are also in a weak position when

contractual commitments are being sought on new methods of working – such as e-commerce – and therefore lose out when supply chains are rationalised.

Business Support Services

A key skill in developing successful clusters and supply chains will be the ability of local institutions to provide strategic support services to firms that encourage them to develop their core competencies and become 'specialists'. There is considerable evidence that effective business support services can improve the competitiveness of SMEs, enabling them to survive and grow successfully. Yet many firms never make use of such services, largely because they are not aware of them or do not rate the services on offer very highly. It is important to focus support services on groups or networks of firms and also to ensure that the right services are delivered efficiently by professionals, who themselves have the right knowledge and skills.

Responding effectively to the needs of SMEs requires a co-ordinated programme of support that addresses the differing kinds of assistance required by different types of enterprise. The business support services across Europe have a long history and have not evolved systematically. There are a plethora of services, often delivered by different agencies that offer a confusing array of support to potential users. Stimulating regional growth in the less favoured regions will require a coherent package of services that are effectively targeted at the needs of specific types of SME.

Improving business support services is a key aim of the Multi-annual Programme for Enterprise and Entrepreneurship, and is being developed as one of the 'Best Procedure' projects. This is in line with the aims of the European Charter for Small Enterprises which calls for the promotion of 'top-class' small business support. In addition to targeting it will require the development of diagnostic tools for conducting differentiated needs analysis of SMEs, re-packaging services to meet these needs and providing access to specialists.

A particularly important specialist activity is encouraging access to global markets: the internationalisation of SMEs is a key regional development strategy. Few local sub-contractors are likely to be exporters - their path to the global economy is often through the OEM at the head of the supply chain. However, this means that they have little control over their own growth path.

There is no single formula for developing successful supplier networks and a number of factors need to be taken into account. The process is about building on strengths and removing barriers to supply chain development. It will require action and co-ordination between the business support agencies, indigenous SMEs and multinationals.

An important factor will be the creation of a supportive policy environment across the EU that addresses issues such as the availability of finance, the availability of suitable premises and infrastructure and the ability to attract key staff. Other issues will include rationalising business support services to help foster effective networks and to encourage the development of an entrepreneurial culture. This will require on-going research to identify potential growth companies and to develop the skilled workforce needed by high growth sectors.

The creation of supplier networks in the less favoured regions should be a key priority and should be business driven. Conditions need to be created to foster network formation and growth by ensuring that other regional policies do not inadvertently restrict the growth of clusters.

Other Factors

It is important to re-emphasise that R&D activity is only one input into the innovation process and, in any case, differences in R&D expenditure (expressed as a percentage of regional

GDP) are too small to explain differences in growth rates. The ultimate source of technology is knowledge and it is important to understand the many ways in which knowledge diffuses through the international economy. The globalisation of production requires the efficient transfer of knowledge, financial assets and managerial and labour skills across boundaries. The rise of the successful global firm has been accompanied by huge increases in trans-national and trans-regional flows of information and financial transactions.

In this context an additional ingredient in the innovation process is the provision of producer services at the regional level. These are services that add value to the manufacturing sector in the form of finance, retailing, advertising, design and so on. Efficient producer services enable stronger regional links to be forged between multinationals and local firms, enhancing networking activity and promoting clustering. There tends to be a low concentration of producer services in the less favoured regions and this mitigates against the development of cooperative networks. An important producer service is the provision of risk capital and therefore policies that encourage the development of venture capital firms and business angel networks at the regional level will do much to enable the achievement of regional growth objectives.

If trans-regional information flows are growing in importance then investment which lower the cost of conveying information will have the added advantage of fostering interregional spillovers. This will increase the capacity of less favoured regions to raise their innovation rate and absorb new technologies. In this context the well worn arguments about whether it is best to invest in ‘soft’ or ‘hard’ infrastructure could be revisited - especially where ‘soft’ infrastructure investment spurs the development of producer services. It could then have a much more direct impact on convergence than similar levels of investment in roads. In fact there is some evidence to suggest that hard infrastructure can support agglomeration effects and lead to more investment in the core regions at the expense of less favoured regions – e.g. the impact of the autostradas on Southern Italy.

To maximise the utilisation of soft infrastructure projects and broadband communication systems, SMEs also need greater encouragment to use ICT and e-commerce to overcome physical and conceptual boundaries between sectors and between countries, not just within Europe but world-wide. Much recent research has identified a lack of ‘online’ awareness and usage in less favoured regions. Using regional development funds to enhance internet and online activities is a valid policy option – especially for those SMEs outside of the global net-based marketplace that is emerging as result of rapid ICT development.

Finally, less favoured regions are often ‘peripheral regions’; i.e. peripheral to the core of economic activity. Peripherality is an important issue because of the immobility of factors of production and therefore education and training policies that increase the mobility of labour - both at the sectoral level and the regional level - will enhance competitiveness and be an important driver of growth.

Conclusions

Although the standard neo-classical theory of economic growth, which relies on exogenous technology shocks, predicts convergence in income levels between rich and poor regions, its description of the process by which firms absorb new technologies is flawed. New theories of endogenous growth are better at explaining the stylised facts of the growth process but do not predict convergence. These theories highlight the slow rate of diffusion of new ideas and they also emphasise the impact of spillover effects and agglomeration economies on regional growth. The policy implications for the forthcoming enlargement process are that regional investment policies should focus on growth poles rather than the needs of poor areas and they should recognise that there is likely to be a trade off between maximising regional growth rates and achieving convergence.

Traditional regional policies that rely on infrastructure investment are unlikely to effectively address this trade off. On the other hand policies aimed at reducing barriers to innovation and increasing diffusion rates are likely to boost both the competitiveness of less favoured regions within the Accession Countries and help them attract investment. Policies to deepen European integration should encourage the formation of networks in less favoured regions and be focused on improving the innovation process at the regional level: examples would include education and training initiatives to the enhance the quality of human capital along with housing policies and certification policies that encourage labour mobility; soft infrastructure investment to improve access to ICT and customised skills development programmes that raise on-line awareness and usage amongst SMEs; promotion of regional producer services – particularly financial services and the creation of corporate venture capital / business angels networks – that can enhance the competitiveness of the manufacturing sector. The emphasis of regional policies should be on providing opportunities for firms to work together and learn from each other.

Typically the delivery of these policies will require better and more focused business support services to be developed for SMEs and more precisely targeted at the needs of specific types of firm. This will mean developing diagnostic tools that identify the characteristics of successful companies but also allow the support services to differentiate between firms that want to grow and those with the capacity for growth. This in turn will require on-going research to identify potential clusters of growth companies and sectors in the less favoured regions of both existing Member States and the Accession Countries. Deepening European integration at the regional level and also stimulating greater convergence in income levels will prove an unattainable policy combination until the innovation process is better understood and policies are better targeted at the regional drivers of growth.

BRIEF REFLECTIONS ON THE FUTURE OF COHESION POLICY

Nicolas JABKO
CERI - Sciences Politiques, Paris

I accepted to talk about the future of cohesion policy not because I have a crystal ball but because there are certain conjectures we can make about the future on the basis of past development and the history of the 1980s.

If we look at that history, we can derive some of the conditions for successful development and assess whether or not similar conditions are present. To anticipate, I think there are reasons to doubt this, judging from the 2nd cohesion report.

1 – If we look at the recent history of structural policy, we can see that it successfully developed under very special conditions.

The rationale for structural funds was embedded in the “Single European Market” project of 1992: the market must be an integrated space for economic development, not only a barrier – free space. Structural policy was conceived as an “accompanying” policy. This was a cogent argument that latched on to two very powerful political circumstances:

First, it guaranteed the support of peripheral states (and regions) eager to develop in the Single European Market and to obtain something in exchange for opening up to big firms in core EU States. Spain has been very tough in negotiation on this.

Secondly, it corresponded to a desire on the part of EU officials to develop the “social dimension” of the Single European Market at a time when they were often criticised on the left for supporting “big business”.

So the big increases of the budget allowed up to 1999 were achieved under completely exceptional circumstances.

2 – Now, we may look at the 2nd cohesion report and think of what we know from the current context. If we ask ourselves - do we find similar conditions? – we may find two different answers.

The optimistic view says “yes”: the policy exists and has entrenched supporters. Previous budgetary negotiations, contrary to expectations, did not fundamentally revise the prospects for an active structural policy, even though there was no more progress on a linear trajectory. Optimists say that enlargement will not change this because there is already some economic convergence of East European economies with the rest of the EU.

I agree with some elements of this diagnosis and it may be that structural policy is promised a bright future.

The idea of structural policy as focused primarily on development rather than redistribution is still there and probably helpful in political terms at a time of leaner budgets and fears over enlargement.

At the same time, there are reasons for concern if we read the 2nd cohesion report and look at the political situation. The overt rationale for “doing” structural policy is much less compelling and convincing both in theoretical terms and in political terms.

The report is very sketchy on what deserves to be done and the methods to assess it.

- Concerning what needs to be done: the Report amounts to a sectoral laundry list that nobody can disagree with (e.g. new technologies, sustainable development, innovation …) but with no overarching concept. This disaggregate approach runs contrary to the flanking policy idea and efforts to co-ordinate various structural actions in the past.

- Concerning the methods for assessing needs and action: the Report cites economic analysis and "institutional value added". This apparently refer to the notion that international cooperation is a good in itself – which is an acceptable tenet in the EU context – and also to recent trends in the economic development literature that stress the importance of institutions as a context for growth.

All this is nice but underdeveloped and not packaged as a set of coherent actions. This means that it is difficult to sell it politically and there are risks of piecemeal implementation.

3 -How could the framework be improved? This is always a challenging question for outside critics.

There are at least two leads however:

- It would be a good idea to increase the coherence of recommendations, starting with a better assessment of what needs to be done. The conceptual coherence of the report needs work. It makes very little use of the latest advances of the research on how to promote development through better / more responsive institutions at local level. That is what the World Bank is doing, that is what all the development agencies are doing, but the Commission is only alluding to it and mostly sticking to sectoral, loosely co-ordinated goals.

- If we agree that structural policy fulfils an important developmental function, it is important to resist pressures to renationalise the policy. There is the subsidiarity principle of course, but behind this you have very transparent intentions to dismantle the policy on the part of some Member States that are net contributors. It may be necessary to amend the policy and to make it more responsive to local needs and actors but this cannot be done if you reduce budget allocations. Any implementation reform is always going to be costly so it is necessary to secure the required resources.

FROM QUALITATIVE EVALUATION TO POLICY RECOMMENDATIONS

Francesc Morata
Dept. of Political Sciences - Universitat Autònoma de Barcelona

Evaluating the impact of the Community's structural Funds and the Europeanisation of the regions' administration

Despite the ceilings on the budget resources allocated, available research shows that the EU cohesion policies have been an essential factor in the Europeanisation of the Member States' administrative procedures and practices. The segmentation of the political process has put the Commission at the heart of a vast multilevel network involving interaction between the Member States' central, regional and local authorities and, to a lesser extent, the socio-economic agents operating on their territory. Furthermore, the Structural Funds' management system seems to have helped the least-developed European regions to adjust and modernise by encouraging them to introduce innovative programming and evaluation techniques, a process which has no doubt contributed to the gradual improvement in implementing procedures. And partnerships – especially in the context of Community Initiatives – have stimulated intergovernmental cooperation and the formation of networks of local players on the basis of objectives shared by all the countries. Although the increase in available social capital is a crucial factor in developing regional competitiveness, this social capital cannot deliver its full potential without an efficient public administration, both internally (new internal management and training methods) and externally (ability to establish new forms of participation and cooperation with social agents).

That said, the impact of the structural Funds depends on a number of variables that influence the evaluation of results, among which:

1) the level of regional economic development.
2) the degree of regional devolution (regional powers vary greatly from one Member State to another; some countries simply have no institutions at the regional level).
3) the complexity of the public networks involved in implementing the Community programmes. These networks can differ considerably from one region to another, depending on administrative bodies, groups of stakeholders and the dominant administrative and political culture.
4) the degree of area-based policy at sub-regional level (i.e. the fairly well-established tradition of implementing development projects within areas identified at sub-regional level).
5) Alignment (or degree of Europeanisation), i.e. the way each regional entity positions itself in relation to the Community programmes. Research has shown that each group of regional players takes its own approach to Community programmes. In some cases, the guidelines and standards set in Brussels are accepted and followed quite closely in the identification or reshaping of regional policy. In other cases, they are interpreted by the regional players, who exploit them to suit their own development strategies.

Partnership is of particular importance, as it is supposed to generate new forms of governance with respect to the definition and implementation of structural Funds. A survey of nine European regions[6] has shown that abiding by the principle of partnerships between public

[6] REGE project (1994-1997), coordinated by the MZES (Mannheim) and involving the Universitat Autònoma de Barcelona (DCPDP), Montpellier (CEPEL), Lyon (ENTPE) and Cardiff (CES).

authorities at various levels and the socio-economic agents is far more common in areas which have taken part in an Operational Programme or Community Initiative. The Community's action is therefore clearly having a significant influence on the relationship between the public and the private sectors.

The principle of partnership has undoubtedly obliged the public authorities to engage in greater consultation than had been the case for purely national and regional policies. Furthermore, in a number of countries, including Spain in particular, the negotiation often involves confrontation with the central government. Partnerships are conducive to the establishment of formal consultation and decision-making processes. "They explain the new institutional arrangements concluded among the various parties involved during the implementation, monitoring and evaluation of Community policies"[7] (2000).

However, observations on the ground have also shown that there is little uniformity in the way partnerships are fulfilling the efficient relay role sought by the Commission. The practices set up to implement the Structural Funds indicate that diverse modes of governance are emerging not only within the Union, but even within the Member States themselves. The local political culture, party politics, traditions and administrative practices all exert an influence on the Europeanisation of collective action in the various areas. For instance, the characteristics of partner involvement and reconciliation of interests differ from one region to another and produce varying results. The heterogeneous nature of the partnerships, if we look beyond standard institutional clichés (federal State, regionalised State, etc.), raises the issue of the political capacity of the regions in question. Therein probably lies the key to achieving the cooperative governance in the field of regional development sought by the Commission. Further to the Amsterdam treaty, the integration of Community policies – and of the programmes relating to cohesion in particular – is the task of the Commission as much as of the Member States. At the same time, the very concept of governance presupposes participation on the part of the social agents involved. Yet the debate on governance all too often tends to neglect the issue of institutional capacities (in organisational, managerial, political and social terms), i.e. the fact that certain preconditions need to be created to ensure sustainable development.

What policy guidelines could be put forward to promote the European integration process?

Policy guidelines should be discussed in the context of the debate started further to the European Council meeting in Nice, in December 2000. This is particularly true as regards federalism and a possible review of power distribution. Some Member States, Germany in particular, are calling for a "renationalisation" of cohesion policies in the name of subsidiarity, while others (France and Spain) would prefer the current situation to be maintained. Yet the essence of the problem is of a budgetary nature. If the European Union opts for federalism, institutional reforms will not be enough. As we saw it in Berlin in March 1999, the caps on spending are undermining cohesion. In addition, as a negative side-effect of the intergovernmental negotiation process, the redistribution logic is becoming a distribution logic (no-one wants to pay more, but everyone wants to receive Community Funds). To put an end to this situation, which has already sparked the beginnings of a conflict between Germany and Spain and could lead to further friction, the system of resources must be entirely reviewed. One option could be to establish a European tax which would be proportional to the

[7] Genieys, Guglielmi, Le Pape (2000), "*Les traductions régionales du partenariat*", D. Perraud (ed.), *L'Europe verte*, Paris, INRA.

wealth of each Member State, with the aim of multiplying the current budget by two at least (see the proposal submitted by Romano Prodi).

In any case, European federalism must rest at the very least on two legitimating principles: economic and social cohesion, and subsidiarity (or proximity). These principles are consistent with the objective of democratic European governance, which stresses multilevel involvement. From this point of view, the regional authorities and representatives of civil society have a fundamental role to play in strengthening European democracy. As a fundamental concept for the federal development of the Union in future, subsidiarity must be extended to the lower levels of government.

AGENDA

WHICH POLICY RECOMMENDATIONS TO ENHANCE THE EUROPEAN ECONOMIC AND SOCIAL COHESION AFTER 2006 ?

Wednesday 23rd May 2001

9.30 a.m.	welcome and presentation of the aims of the seminar
10.00 a.m.	**1st session** What diagnosis may be drawn from the current socio-economic situation of the regions of the EU ? What are the most foreseeable trends (macro and micro-economic, social, societal, political) in the EU and in the candidate countries ? What will the main challenges be for an EU-27 in 2007, 2008 and 2009 ? *Short introduction to the debate by Mick Dunford and Iva Pires*
11.30 a.m.	**2nd session** How may we evaluate the impact of the Community's structural interventions since 1994 ? Is it possible to agree on a typology of the tools that have been used and the issues to be addressed ? To what extent do political institutions and regional specificities matter when explaining the different results ? *Short introduction to the debate by John Bradley and Philippe Martin*
1.00 p.m.	Lunch-break
2.30 p.m.	**3rd session** What policy recommendations may be suggested to deepen European integration ? What reforms could then be necessary, and at which level (European, national, regional) ? *Short introduction to the debate by Nicolas Jabko and Brian Morgan*
4.30 p.m.	Conclusion

PARTICIPATION LIST

<u>Experts</u>

John BRADLEY	Economic and Social Research Institute, Dublin
Mick DUNFORD	School of European Studies, University of Sussex, Brighton
Jacky FAYOLLE	Office Français des Conjonctures Economiques, Paris
Paolo GRAZIANO	Centro Poleis, Universita Bocconi, Milano
Ines HARTWIG	European Institute of Public Administration, Maastricht
Robert HASSINK	Geographisches Institut, Universität Bonn
Nicolas JABKO	CERI – Sciences Politiques, Paris
Charlie JEFFERY	University of Birmingham
Philippe MARTIN	CERAS-ENPC et Université de Lille
Francesc MORATA	Universitat Autonoma de Barcelona (apologized)
Brian MORGAN	Cardiff University
Iva PIRES	Universidade Nova de Lisboa

<u>Observers</u>

Matthew BROWNE	Notre Europe, Paris
Martin HALLET	DG ECFIN, Commission européenne, Bruxelles
Marie RODRIGUEZ	BIPE - Bureau d'Informations et de Prévisions Economiques, Boulogne-Paris
Elena SARACENO	Groupe des conseillers politiques, SG, Commission européenne, Bruxelles

<u>Organisers</u>

Marjorie JOUEN	Notre Europe, Paris
John PALMER	The European Policy Centre, Bruxelles
Marie-Laure TORTEL	The European Policy Centre, Bruxelles