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## A critical view of the 2nd Social and Economic Cohesion Report and the future of regional policies after 2006

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## **A critical view to the Second Cohesion Report**

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### **Abstract:**

Thirteen months after the deadline set at Maastricht the European Commission has released its second Report on social and economic cohesion. According to the Report, gaps between countries are shrinking but probably not only with the help of Structural and Cohesion Policies (S&CP), while gaps within countries are widening. The picture of regional development and of the impact of S&CP on convergence is therefore still ambiguous. This lies in part in the kind of indicators used by the Report to map social and economic development in regions which are still based around the criterion of GDP per capita. Indicators used have not changed since the first Report and are still focused on mapping deficiencies and problems while too little attention is given to indicators on the dynamism of territories, of processes related to companies and employment creation, of the new trends such as the new economy, and last but not least on the real impact of EU funded projects. In future, a much more detailed analyses will be needed to give a full picture of cohesion in order for a full discussion on the future of S&CP in an enlarged Europe. Further policy implications should be followed from the ESDP framework as well as a more bottom up approach to regional policies should be promoted.

## **Introduction**

Based on the article 159 of the EU Treaty the European Commission presents every three years a report on the progress achieved in social and economic cohesion and on the contributions of the various instruments to cohesion. The contents of these reports are defined in article 45 of the general regulations on structural funds<sup>1</sup>.

These regulations state that the Report should contain: a ) a balance of progresses achieved with reference to the situation and evolution of social and economic cohesion, to the analysis of investment flows and to the input on employment, b) a balance of the role of the different funds (Structural and Cohesion funds, European Investment Bank) and an indication as to their impact, c) proposals as to how to improve social and economic cohesion.

This paper analyses the second Cohesion Report starting by recalling the context in which they are produced, then analyses the indicators used to map development in Europe by showing that disparities could be exaggerated, that dynamism of enterprises and territories as well as the new processes of the new economy should be better taken into account, and then makes some reflections with regard to policy implications for the next phase of the Structural and Cohesion policies after the current programming period 2000-2006.

### **1. The Cohesion Reports within the context of European Agenda**

The first Cohesion Report (European Commission 1997) received a lot of attention because it was the first time that such a report on European local development was produced and that comparisons between regions were introduced and the topic of efficiency of Structural and Cohesion Policies (S&CP) was addressed.

Moreover, Europe was in the process of debating AGENDA 2000 and important decisions were being taken as to the financial perspectives for the period 2000-2006 at the Cologne Council and on how each Members States would pay to and receive from the EU budget.

Due to these political diversions, the fact that the first Cohesion Report contained a limited number of social and economic indicators passed without notice. Today, the context is quite

different. S&CP is not on the top of political agenda in most Member States and their participation to the second Cohesion Forum of May 2001 was rather scarce. Also, we are not in a year of highly relevant negotiations, and political deadlines even if in 2002 certain features of the regional policy post-2006 should already be decided upon.

In a public Memorandum the Spanish government on enlargement and cohesion complained about the obvious statistical effect that enlargement would have on the current less developed regions of the EU. The Memorandum did not, however, provoke a fierce debate among European governments just weak echo from Italy and quiet disagreement from Germany.

## **2. Sufficiency of indicators used by the second Cohesion Report**

In the first Cohesion Forum that took place in April 1997 the general agreement in retaining the criterion for determining the regions eligible for assistance under Objective 1 (75% or less of average EU GDP per capita). Some suggested during the Forum that other indicators should also be used such as unemployment . There was less agreement about the criterion to be applied to other regions, though a number of possibilities were proposed such as infrastructure endowment or innovative capacity, although measurement difficulties were acknowledged (European Commission 1997).

While the “Hercules columns” of EU regional policy remains GDP per capita, .the second Cohesion Report presents only a limited number of indicators to map social and economic development. The lack of political echo around the second Report highlights more evidently these shortcomings.

The indicators used by the second Cohesion Report are: GDP per capita, sector GDP, stock of capital, funds committed and spent, employment and unemployment per sector, total expenses for R&D, number of employees in R&D, expenses of R&D in companies, number of projects in EU R&D programs.

### **a) Are disparities exaggerated ?**

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<sup>1</sup> CE N. 1260 / 99 of 21.6.1999

The first Cohesion Report showed in a specific chapter that between 20% and 40% of the interregional disparities in GDP per capita are eliminated through taxes, transfers, and other national measures (European Commission 1997). The gap in real living standards may shrink even further if regional price variations and differences in access to goods and services outside the market economy are taken into account.

The second Cohesion Report only mentions the case of Luxembourg and Ireland as to the impact of income transfers. In Ireland the GNP is 13% lower than GDP due to the foreign companies based in Ireland but which do not spend their profits there. In 1999, accordingly the GNP per capita was under the EU average while the GDP per capita was well above.

What the second Report fails to do is to analyse the effects of redistribution at regional level. Per capita income and per capita GDP has been studied in France between 1982 and 1996 and shows that disparities in terms of per capita income have decreased more than in terms of per capita GDP (Le Monde 2001). The gap in GDP per capita between Ile de France and other regions has not changed in more than 10 years or is even increasing (Table 1). The closing of the gaps has been achieved by transfers in particular through pensions with regard to “old” regions.

Per capita regional GDP decreased from 1982 to 1996 respectively from 0,73 to 0,66 in Haute Normandie, from 0,68 to 0,65 in Alsace, from 0,54 to 0,51 in Corsica, and from 0,53 to 0,50 in Limousin. On the other hand, regional per capita income increased between 1982 and 1996 from 0,74 to 0,81 in Haute Normandie, from 0,83 to 0,87 in Alsace, from 0,76 to 0,79 in Corsica, and from 0,74 to 0,81 in Limousin.

**Table 1: Hierarchy of wealth and income in France**

	per capita regional GDP		per capita regional income	
	<i>1996</i>	<i>1982</i>	<i>1996</i>	<i>1982</i>
Ile-de-France	1	1	1	1
Haute Normandie	0,66	0,73	0,81	0,74

Alsace	0,65	0,68	0,87	0,83
Corse	0,51	0,54	0,79	0,76
Limousin	0,50	0,53	0,81	0,74

Source: INSEE

Taking the case of Haute Normandie where the high regional GDP is due to directly to the presence of petroleum industries, chemical sectors and car manufacturing but 56% of industrial employment depend of decisional centers outside of the regions<sup>2</sup>. The high level of regional GDP has deformed since many years the relations between Haute Normandie and the central government and this has lead to gaps in endogenous development, of capacity in education and R&D, etc.

All what this tends to prove could be that economic gaps are smaller than what is contended in the Cohesion Reports, that they shrink slowly in the long run through the integration process and that they are only modestly affected by S&CP (European Voice, 2001).

## **b) Mapping of dynamism of enterprises and territories**

What are missing from the second Cohesion Report are proper indicators of the dynamism and continuous change that enterprises, economic sectors and territories are experiencing and which must be part of an integrated approach to regional development. Regional policies in particular those after 2006 should be more in line and responding to the ongoing needs of the territories (Economic and Social Committee 2001). Part of this need can be overcome by strengthening at European Commission level the cross analysis between the Cohesion Reports and other relevant works done by other departments of the European Commission such as the Competitiveness Report, the IPTS Reports, etc.

With regard to SME, the most important indicators are those of the business climate, the number of SME, the natality and mortality rate of companies, the number of employment

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<sup>2</sup> Some of these companies are Renault, Exxon, Glaxo, Pasteur, Aventis, Snecma

created, etc. The sixth Periodic Report (European Commission 1999) underlines that SME tend to be concentrated in more developed regions of Southern Member States, particularly capital cities, while in the poorest regions there are comparatively few. Regional policies should not only focus on the stock or concentration of SME but more so on enterprise creation and on the regions which show better targets of enterprise creation.

In Italy, a recent report (Istituto Tagliacarne 2001) shows that the South is proving more dynamic than northern regions of Italy in terms of exports, innovation, creation of enterprises : 54% of net creation of companies is in the South, the growth of export in the South has been in 2000 at 27,3% compared to 16,4% of the national average, the share of SME which will invest in new products is 31,7% in the South compared to 26 % in the North. The same report recalls that the gap in infrastructure remains important: it is 25% lower than national average. Services to SME (banks, etc) are also even 40% lower than national average.

### **c) New mapping of human resources and demand of labour**

As to human resources, the second Cohesion Report looks at employment rates, unemployment rates, and at the earnings by level of educational attainment while the Sixth Periodic Report looked at the educational attainment level of persons aged 25 to 34 years. With regard to unemployment figures what can be said is that they should be handled with care. A region with low unemployment rate is not per se a region that performs well. Dynamic and growing regions “attract” unemployed people and may show a higher unemployment rate than regions that are losing population.

Concerning the educational level, the problem in many EU countries lies in the labour supply which is inadequate and not in line with the needs of territories. While labour mobility in Europe is low, there is great scarcity of personnel and an enormous number of vacancies. What would need to be mapped is rather the demand of professional profiles requested by companies at regional level. In Italy, this is currently being done by the Italian Chambers of Commerce through the Excelsior system ([www.unioncamere.it](http://www.unioncamere.it)) that has been extended at European level ([www.lapin.org](http://www.lapin.org)).

### **d) The new field of R&D and ICT in regional development**

Regions are seeing the emergence of new economy and the role of R&D, innovation and ICT is now recognized. With regard to R&D, few conclusions can be drawn from the second Cohesion Report. Likewise the sixth Periodic Report (European Commission 1999) measured the technology gap only through the number of patent applications and spending on research.

Indicators are missing as to how small and medium enterprises are behaving, where centers are being created, what their dynamic links are to territories, etc. It is not only important to know how much companies invest in R&D but also what is the nature of the R&D expenditures and what kind of professional requirements SME will need in the future.

Moreover, the second Cohesion Report also measures the number of R&D projects of the cohesion countries financed through the EU R&D Framework programme. Participation to EU programmes is certainly not only due to excellence and competitiveness but also to familiarity in EU programmes by those happy few.

The link between R&D, innovation and territory should be examined further. A study (ING Economics Department 2001) has benchmarked the business climate in North Rhine Westphalia, Flanders and the Netherlands which show how SME will, through the introduction of the Euro, take increasingly advantage of the opportunities presented by the internal market, particularly close to home. The Netherlands seems to have the best business climate.

The public sector in the Netherlands takes a much more direct role in ICT market compared to the other two regions where the government operates creating the right framework. The Netherlands also leads the way as to the utilisation of its labour force and entrepreneurs are less negative about the mismatch of supply and demand on the labour market.

**Table 2: Assessment by entrepreneurs of innovation climate**

<b>Aspect</b>	<b>Netherlands</b>	<b>Flanders</b>	<b>North Rhein Westphalia</b>
ICT infrastructure	7.3	7.4	7.7



Accessibility of knowledge	6.4	6.2	5.7
Interaction	6.2	6.0	5.4
Collaboration	6.3	5.9	5.1
Knowledge matching	6.3	6.0	5.5
Innovation policy	5.9	5.3	4.7
Innovation climate	6.3	6.0	5.7

Source: ING

The financial sector is also more competitive in the Netherlands. In terms of size and composition of the knowledge infrastructure, North Rhein Westphalia stands out from the other regions: it has the densest geographic concentration of higher education institutes and acts as a magnet for the region, Flanders has a narrow knowledge infrastructure base, and the Netherlands' knowledge network relies on multinationals (Table 2).

### 3. Policy implications

#### a) Rather a bottom up than a topdown approach

The persistence of GDP per capita and per sector inside regional policies reflects the “topdown” approach of equalisation paradigma which promotes equal measures for territories only statistically similar. To counteract this tendency it is crucial that in future regional policies introduce a proper system of governance to involve local and regional actors and functional bodies such as Chambers of Commerce. Involvement of regional actors will contribute to with their knowledge of the territories to a more “bottom-up “ approach to regional policy.

One case study of botttom-up initiative concerns Luxembourg, the little big brother at the heart of Europe (Financial Times 2001), which grows by 5,6% since 1995 with the transformation into a modern service sector economy. Luxembourg with 2,4% unemployment is attracting 100,000 workers every day from neighbouring regions which are affected by unemployment where is at reached 8,5% in Saarland, 13,3% in Wallonia, 6,4% in Rheinland-Pfatz, 8,4% in Eastern France.

These relationships have strengthened since 1993 when the EU introduced free movement of capital and labour. The regions of this greater Luxembourg are building a more common identity and it is likely that Luxembourg will deepen in the future its economic, social, educational, and cultural ties with the *grande région* and that borders will become even more fuzzy between the Member States at the heart of Europe.

#### **b) Better inclusion of ESDP in new regional policy**

Strategic thinking about the new forms of territorial action was developed within the ESDP (European Spatial Development Programme). The second Cohesion Report includes a chapter on territorial cohesion which examines spatial dimension such as concentration effects and balance of development. However, the lack and poverty of indicators does not show links to the contents of ESDP and the action lines which it has identified such as the TEN, cities, etc. It does therefore not seem to take up fully the implications of spatial development for creating a federative development project for Europe (Conférence des Régions Périphériques Maritimes d'Europe 2001).

The risk in the second Cohesion Report is that without a common strategic framework such as proposed by the ESDP, a multiplicity of exceptions and new fragmented objectives and measures would turn up (mountains, rurality, etc) without a strong reference to this framework. A new regional policy cannot be only the summary of all these objectives. Just take the case of mountainous regions where for instance the linkages to both financial and communication networks are as important than the traditional forces of development such as tourism (Sole 24 Ore , 2001). The future of mountains cannot be discussed without a common strategy at European level towards the role of networks in the new economy.

#### **c) Case studies for impact of S&CP**

The continuation of S&CP in face of enlargement will depend also on the conviction that these funds are indeed efficient and that a track record of proof of impact on development can be seen.

This is made more difficult by the fact that the impact of structural funds on assisted regions cannot be detached from the impact of other EU policies. Regions are developing because of a number of factors and not only because of EU support. Even the success of growth model in Ireland is only partly due to S&CP (Andreosso-O'Callaghan 2001). Some institutions even contest that EU policies contribute to cohesion and suggest that some Community policies actually are contrary to the objectives of cohesion (Committee of the Regions 2001). To the extent that the EU has had a positive effect, the most powerful engine has probably been the internal market.

What is needed therefore are much more detailed analysis, through case studies and local/regional studies, to determine the real impact of projects financed by the EU on the framework of cohesion.

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