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Research Report

Scenarios regarding community developments in the field of competitiveness, cohesion and regional policy

Strategy and Policy Studies (SPOS), No. 2007,1

Provided in Cooperation with:

European Institute of Romania, Bucharest

Suggested Citation: Bal, Ana; Luțas, Mariana; Jora, Octavian-Dragomir; Topan, Mihai-Vladimir (2007) : Scenarios regarding community developments in the field of competitiveness, cohesion and regional policy, Strategy and Policy Studies (SPOS), No. 2007,1, European Institute of Romania, Bucharest

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EUROPEAN INSTITUTE OF ROMANIA

Project SPOS 2007 - STRATEGY AND POLICY STUDIES

Study no. 1

Scenarios regarding Community developments in the field of competitiveness, cohesion and regional policy

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December 2007

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Abbreviations List

CAP – Common Agricultural Policy
EC – European Commission
EEC – European Economic Communities
EFTA – European Free Trade Association
EMS – European Monetary System
EMU – European Monetary Union
EMU – European Monetary Union
ERM – Exchange Rate Mechanism
ESCB – European System of Central Banks
EU – European Union
EU 10 – EU member states that acceded in 2004
EU 12 – Euroland
EU 15 – EU before the last enlargement
EU 25 – EU before Romania and Bulgaria accession
EU 27 – EU currently
EUROSTAT – European Statistics Office
FDI – Foreign Direct Investments
GDP – Gross Domestic Product
GNP – Gross Domestic Product
IMF – International Monetary Fund
NGO – Non-governmental organizations
OECD – Organization for Economic Cooperation and Development
PPP – purchasing power parity
R&D – research and development
ROP – Regional Operational Program
SME – Small and Medium Enterprises
USA – United States of America
VAT – Value Added Tax

Chapter 1. Evolutionary trends in some of the Community policies

1.1. Competitiveness by convergence and cohesion. General trends at Union's level

The European Union, considered as unity in diversity represents, in spite of its name of a „union” a complex socio-economic and political entity in which existing disparities between the founding member states increased as a result of the intensity of the two processes of deepening and enlarging its structures.

The founding Treaties of the Communities, as well as the New Constitutional Treaty aimed „to promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, a high degree of competitiveness and convergence of economic performance, the raising of the standard of living and quality of life, and economic and social¹ and territorial² cohesion and solidarity among Member States.”

Apart from the general issues, the bi-dimensional process of European integration developed within the framework of globalization and by this, symbiotic to it generated, in time, a number of constraints and conditionalities which pressed upon the common policies, internal market, rules concerning competition, modifying structures and interdependencies.

Economic development within an integrated space may be the result of the two apparently interdeterminant components of economic convergence. The first one is given by the increase of competitiveness, the second by the economic and social cohesion. Competitiveness basically presumes the most efficient use within the limits of economic rationality of resources and factors and distribution of incomes, while cohesion concerns, along with or even more than the economic component, the social one and is addressing mainly to the catching-up of the more developed areas.

Starting from the above mentioned considerations, social and economic cohesion as basis of competitiveness is one of the most important issues, due to the fact that the entire European construction is based on the concept of creating a new structure on the basis of solidarity in which the major goals of security, stability and economic growth are attained in another type of framework but the national one. We may also admit that security, stability and economic growth cannot be attained as long as important disparities between founding parts of a space hinder the competitiveness of the structure.

¹ Treaty Establishing the European Community, consolidated text, art. 3 and 4, citat în Kuokkanen, Kanerva and Vihinen, Hilkka, *Contribution of the CAP to the general objectives of the EU*, MTT Economic Research, august 2006, p. 3

² Treaty Establishing a Constitution for Europe, citat în Kuokkanen, Kanerva and Vihinen, Hilkka, *Contribution of the CAP to the general objectives of the EU*, MTT Economic Research, august 2006, p3

In spite of the common objectives and results obtained until now, lacking a real political and institutional unity³ states continuously promote their national interests, acting in a specific way towards reducing disparities.

In this context, a number of specific instruments were directed in time towards reducing disparities by increasing cohesion. They are to be found and inter- react both at the level of common policies (mainly for the Trade Policy and the Common Agriculture Policy along with Regional Development Policy) and at national policies' level as well.

Internal Market as basis of competitiveness and convergence

Internal market represents, at economic level, the specific unity in diversity" feature of the EU. A fragmented demand (by tradition, different cultural background, consumption patterns and consumers' tastes) is covered by a fragmented supply, made up of small and medium size enterprises which may answer to the needs of consumers in a more specific way. Under these circumstances, the dichotomy competitiveness-cohesion is viewed under the constraints given by the two parts of the nowadays reality: on one hand, the global context which asks for the increase in competitiveness by efficiency, ignoring, more or less, the social component, while on the other hand, the regional context asks for increase competitiveness by cohesion, which implies, along efficiency, social solidarity and responsibility.

As a remark, fragmentation of the Internal Market may be observed not only for goods but mainly for services and within it, for the sectors with a high added value like financial services or a high degree of technologies, like communication services, energy, transportation, etc.

Differences in the innovation capacity between the EU and its main competitors increased by the entrance in the Community of the new Member States⁴. Relevant for this aspect is the fact that Finland and Sweden, ranked on the first position for the mentioned above indicator and a relative small number of European regions cover more than half of the funds directed towards research and development, but, in the same time, none of these regions belong to the new Member States of Cohesion states⁵.

Recent studies⁶ point out the fact that the Internal Market covers, in comparison to the complete integrated markets, a fragile support for competitiveness. There are several reasons, out of which of most importance are the ones like the fact that, over decades from the beginning of the functioning of the Internal Market, the four fundamental freedoms are still under the constraints given by the unity in diversity which makes the flows of persons, goods, services and capital lower than the similar ones in the national markets.

In the new global context, in which innovation and technological development become determinants of economic growth ask for a re-consideration of the share of economic structures within economies, with the major importance of services within this process. This

³ see also the new Constitutional Treaty and the fact that, after more than 50 years of European integration, the EU institutions are still fragile

⁴ European Innovation Scoreboard, 2005

⁵ David White, *Innovation Policy and Europe's Regions*, 4th Innovating Regions in Europe Plenary Conference, Ljubljana, June 2005, pag.18

⁶ see also Paul Brenton, *What are the limits to economic integration*, CEPS working documents, CEPS website(<http://www.ceps.be>, ISBN 92-9079-359-7), pag.2

aspect is more visible in the new cohesion states, whose share of sectors within their national economies is still far away from the model of developed integrated markets.

Re-modelling the Internal Market for increasing its competitiveness starts from the legal and institutional point of view with the transposition of community directives into the national legislation. A recent survey of the European Commission on the implementation of the Internal Market directives proves that until March 2007 around 1.6% of the total directives which should have been implemented into the national legislation and for which the implementation deadline has passed are not currently written into the national law⁷.

Another important aspect for increasing Internal Market's competitiveness and cohesion is regulating the competition for stimulating the industrial restructuring and re/allocation of economic activities.

In the actual situation, maintaining strong barriers for entering or leaving the Member States' markets due to differentials in the national legislations represents one of the factors reducing the competitiveness of the companies within the Union's space.

Entering or leaving the market determines directly a reallocation of resources towards the most competitive companies while the facile entrance on the market determines an increase in the level of innovation and, by this, of labor productivity. According to some authors⁸ differences in the national financial markets make access to financing sources more difficult and with higher costs than for the similar companies acting on competitive markets.

Another important way of consolidating the Internal Market is the one coupling it to the priorities of development set in several strategies issued by the EU for creating the most dynamic and competitive knowledge-based economy, able to assure the sustainable economic development by growth of employment and respecting environmental conditions.

In this respect, are to be mentioned:

§ The re-launched Lisbon Strategy, which represents the general framework for the renewal of the EU's economic policy (see also the complementary comments below)

§ Community Strategic Guidelines for Cohesion 2007–2013, in which cohesion policy is perceived as the main instrument at EU level in the realization of the Lisbon strategy because of its big share of the Community budget and because of the importance of strategies designed at local and regional levels in the promotion of growth and jobs.⁹

§ New Social Agenda, issued in 2005, in accordance to the new objectives of the Lisbon Strategy, which affected the European Employment Strategy (incorporated afterwards in the Lisbon Strategy).

§ The European Union strategy for sustainable development from 2001

⁷ data sources: Internal Market Scoreboard: Member States need to focus on correctly applying Internal Market rules, <http://europa.eu/rapid/pressReleasesAction.do>

⁸ Bartelsman et al, 2003, quoted by Juan Delgado, *New Challenges of the EU Single Market*, DG Internal Market Workshop, „The economic policy of the Single Market of the Future”, pag.2

⁹ Kuokkanen, Kanerva and Vihinen, Hilikka, *Contribution of the CAP to the general objectives of the EU*, MTT Economic Research, August 2006, p. 3

An important role in the development of the Internal Market from the perspective of attaining economic and social cohesion, and by this increase in the level of competitiveness is played by the monetary and fiscal policies. The constraints generated by the provisions of the Maastricht Treaty and by the Stability and Growth Pact on convergence and catching-up of the cohesion countries represent important elements of re-shaping the structures of the Internal Market.

The EU Member States are in different stages of development and evolution within the Economic and Monetary Union. The ones that adopted the Euro face the constraints given by the common monetary policy and the Stability and Growth Pact, while the new Member States are under the conditionality of adopting the Euro.

Under these circumstances, the two components of the community structures, the Euro and non-Euro members apply, in spite of the common interest different policies and instruments.

Recent studies consider the important role of the fiscal policy for the states preparing to adopt the Euro¹⁰, while belonging to the Euroland imposes the fiscal provisions of the Maastricht Treaty and of the Stability and Growth Pact with a budget deficit less than 3% and a public debt less than 60% of the GDP along with a budget position close to equilibrium in the long run, which means fiscal consolidation, in a period of time when the new Member States are in the process of ending the transition and transposition in the national legislation of the *Acquis Communautaire*, which asks for consistent budgetary efforts.

The re-launched Lisbon Strategy

Lisbon Strategy sets two types of objectives. The first ones, on the short time proposes a number of measures in order to achieve the state of equilibrium between supply and demand at Community level, while the second type of objectives, in the long run, is oriented towards increasing competitiveness and employment by linking its objectives to the ones of the cohesion policy¹¹

The link between Lisbon Strategy and economic and social cohesion is obvious and demonstrated by the fact that more than 60% for Convergence objective and 75% for the objective Regional Competitiveness and Employment from the actual Financial Perspectives (2007-2013) cover the type of expenses sustaining the Lisbon Agenda.

The objectives of Lisbon Strategy are towards:

- a) research and development, information society. For reaching this objective Member States set as reaching an overall target of 3% of GDP on research and development, and, institutionally the creation of the European Institute of Technology and the European Globalization Adjustment Fund for financing these aspects.
- b) Improvement and reducing burdens on businesses. In this respect. The Commission proposed to reduce of the burden of regulation by 25% by 2012,

¹⁰ In accordance to the EUROSTAT, the budget deficit for the EU 15 represented, in 2003, about 2,7% of the GDP and the public debt 64.3% of the GDP, while for the New Member States it was only about 42,1% of the GDP.

¹¹ Iain Begg, Lisbon II, Two Years on: *An Assessment of the Partnership for Growth and Jobs*, Special CEPS Report, July 2007, pag.2

necessarily by deregulating but by simplification¹² and, by this, an increase in the common approach of the UE institutions and member states' responsibilities.

c) Consolidating the position of the SME's on the Internal Market, considering that the fragmentation of demand asks for the fragmentation of supply, which gives an increasing role to the SME's as Union's motor of development.

d) Completing the Internal Market for services, mainly for the financial ones, for logistic support, information, consultancy, marketing, management, innovation

e) Elimination of barriers concerning the physical, academic, occupational movement and development of a common opinion upon migration. All these represent the sensitive matters of the EU, as migration's effects are one of the factors contributing to the resources allocation and incomes distribution leading, by this, to the increase, or, opposite, to the decrease of convergence between member states' economies.

f) Sustaining efforts for countervailing the social effects of economic restructuring

g) Human capital development, of entrepreneurship, labor and employment policies flexibility and development of the labor market.

h) Development of the European dimension of the transportation, energy and telecommunication infrastructure.

i) Sustainable use of resources, energetic efficiency, development of renewable resources, and of sound technologies that do not affect the environment. In this respect, the Commission proposed three directions for the development of the EU's energy policy. The first pillar is the creation of a fully integrated market for energy, which presumes giving-up of the national control over the energy resources and the transfer towards community level, for a more efficient use of resources and lowering prices. This pillar is important as long as the community is strongly dependent of the import of energy resources and by this obliged to increase the efficiency in using its own resources both for sustainable growth and development but also for increasing competitiveness. The proposals include separation of production and distribution, better inter-connection across borders and stronger application of competition rules. Pillar 2 is about a coherent strategy for diminishing the carbon intensity of energy supply. It encompasses targets for use of renewable (20% by 2020), and research to position the EU as a global market leader in low-carbon emission energy production. Pillar 3 concerns proposals for increasing energy efficiency, with a target of reducing demand in 2020 by 20% compared with its projected level. Compared with current energy use, this would represent a reduction of 13% in energy emissions.

New priorities for the EU's budget

The EU's budget is passing in the last decade one of the most important period of restructure, determined by the change in the priorities of the economic policies, asked to sustain the evolution of some both endogenous factors like enlargement or deepening integration, and

¹² *A Strategic Review of Better Regulation in the European Union*, COM(2006) 689 final, citat în Iain Begg, Lisbon II, Two Years on: An Assessment of the Partnership for Growth and Jobs, Special CEPS Report, July 2007, pag.19

exogenous, like increasing dependency for energy resources , international migration of labor, or climate change.

An important change is to be seen in the structure of expenses, as the founding did concentrate on a relatively small number of objectives. At the beginning of the integration process, the specific budgets of the three Communities covered almost exclusively the administrative costs, the last community budget became an operational one, directed towards the financial sustainability of sustainable development, (by the objectives of Cohesion and competitiveness for growth and jobs 44,2%, preservation and management of resources, direct payments and other market expenses, 32,9% and rural development 10%), European citizenship, security, justice and external actions of the Union.

The cohesion policy was granted, by the budget of 1965 only 6% of the total expenses, and this was constant until the Single European Act. Starting from 1988, when the structural actions covered about 17% of the total, the expenses dedicated to this area increased constantly, so that for 2013 to represent 35.7% of the total, out of which 2/3 are dedicated to competitiveness, economic growth and employment.

Financing other policies, most of them linked to competitiveness, external actions and rural development, initially limited, boosted due to the changes in priorities of economic policies and competitiveness, so that these policies will represent, by 2013, more than 26% of the community budget.

The priorities of the budget underline the efforts towards increasing competitiveness by convergence and cohesion. In this respect, are to be mentioned the challenges posed by the permanent increase in diversity and changes of the global context, along with increase in competition for resources and markets.¹³

Opening up of the new large markets creates new opportunities but is also a test for the Union's capacity to adjust to continuously structural changes and to manage their social consequences.

Globalization disseminates scientific and technological progress, determine the Union to become an important actor in stimulating knowledge, mobility, competitiveness and innovation.

The transformation of economy into a knowledge based one is profound, and similar to the period of passing from agriculture towards industry. The information technology and investment in people became priorities, so that the Union should face the challenges posed by the transformation of its structures in the most developed and competitive knowledge based economy, and the budget set up, as a priority, the financial sustain of the Lisbon Strategy.

As a main component of the budget's expenses, the cohesion policy is under its constrains. In this respect, is to be mentioned the fact that for the first time the expenses covering economic growth and employment will represent the biggest share of community budget, surpassing the ones dedicated to agriculture, so that for the financial perspectives 2007-2013, about 44.2% from the total are dedicated to cohesion and compositeness for growth and jobs.

The change in priorities for the new financial perspectives 2007-2013 is for sure determined by the change in the general economic background. By this, the community budget must

¹³ Communication from the Commission. *Reforming the budget, changing Europe. A public consultation paper in view of the 2008-2009 budget review*, Brussels, 12.09.2007, SEC(2007) 1188 final, pag. 7

cover the expectations of tax payers to get the highest added value to their budget contribution. Recent debates underline the importance of the nature of such expenses; from the political perspective, they demonstrate solidarity, increase of visibility and, more than that, the capability of attaining the political goal of the EU. In the same time, there are some expenses which do not confirm the efficient use of the community budget, that is why reconsidering the structure of the budget should address to expenses able to determine:

- a) Development of the social responsibility within and of the community, in the context of increasing competition for resources and markets and the development of the new large markets outside the Union, which may become potential supply sources for goods and competitive labor for the Union.
- b) Increase in the level of scientific and technological progress as sources for developing knowledge, mobility, competitiveness and innovation.
- c) Transformation of the community space into a knowledge based economy, by developing the information technology and improving professional performances.
- d) Change in the structure and balance of demography and the confrontation to the pressures posed by migration.

The role of Common Agriculture Policy in increasing convergence and competitiveness by cohesion

The CAP and the Rural development policy represent an important components of the effort made at Community level for attaining economic and social cohesion. Differences in conditions and the diversity of productive structures in agriculture determined the inclusion of some of the structural elements of the CAP in the Treaty of Rome, and the Single European Act, set up for creating a common European area and which introduces the concepts of economic and social cohesion played an important role in the diminishing disparities by the use of the structural instruments.

The successive enlargement stages affected negatively cohesion in the sense of its structure on sectors, due to the increase in the level of disparities in agriculture. The influence of the CAP on cohesion is important mainly because of the need to maintain the level of incomes in agriculture.

The CAP objectives, as set up in the Treaty of Rome are to be found as well in the new Constitutional Treaty: increase in productivity, a high standard of living for farmers, stable markets and reasonable prices for the agricultural products. The objectives set up by Agenda 2000 were directed towards increasing competitiveness by giving up subsidies, stability of farmers' income while the European Plan for Spatial Development¹⁴ concentrated on economic and social cohesion as a way to increase competitiveness set up a new perspective for the place of agriculture in the sustainable economic development of the Union.

The CAP was and still is the policy of the EU on the sector level which generates the highest redistribution of incomes among citizens, as more than half of the output in the agriculture is

¹⁴ Kuokkanen, Kanerva and Vihinen, Hilkka, *Contribution of the CAP to the general objectives of the EU*, MTT Economic Research, august 2006, p. 9

the result of the money transfers from tax payers and consumers of agricultural products towards farmers.¹⁵

In spite of all these efforts, by analyzing the territorial impact of the CAP and of the Rural Development Policy points out the fact that even if they were created for diminishing disparities, the results were on the contrary.¹⁶

From the cohesion point of view, the first pillar, which sustains the level of market prices and direct subsidies favoured the central areas more than the periphery ones and at local level favoured the more accessible areas on the behalf of the less accessible ones. This may be explained mostly by the dimensions of the farms, their location in the centre of Europe and the type of activities performed.

In the same time, some studies demonstrated the existence of some positive effects in distribution between Member States and, within them among regions.

The price policy determined contradictory effects both in the sense of equity in incomes distribution and efficiency measured by competitiveness and economic development.

From the competitiveness perspective, price sustainability generates distortions in the internal market structures both at inter and intra-sector level, with high social and budgetary costs which lead to the decrease of competitiveness. By this, the negative effects of the Community policy for prices in agriculture on resources allocation and competitiveness have a negative effect on cohesion as well.

The second pillar, the one of rural development did not sustain growth of cohesion, even though it favoured the periphery regions more than the centre¹⁷.

1.2. Other recent orientations of Community policy having an impact on cohesion and competitiveness objectives

A. Proposals for labor market flexibility

The European Commission has proposed, at the end of June 2007¹⁸, the establishment of some common principles of flexicurity in order to promote more and better jobs, by combining flexibility and security for both workers and firms. This strategy, according to the Commission, would modernize European labor market and would better respond to opportunities and challenges of globalization. The Commission proposed to the states the adoption of 8 principles for the elaboration of some national strategies of flexicurity, in accordance with the New Lisbon Strategy principles for growth and jobs. We mention some of them: supporting equal opportunities for all workers, irrespective of sex and job (part-time

¹⁵ Kuokkanen, Kanerva and Vihinen, Hilikka, *Contribution of the CAP to the general objectives of the EU*, MTT Economic Research, august 2006, p. 7

¹⁶ University of Aberdeen, *CAP and the regions. The territorial impact of CAP and Rural Development policy*, pag.3

¹⁷ University of Aberdeen, *CAP and the regions. The territorial impact of CAP and Rural Development policy*, pag.9

¹⁸ Flexicurity: getting more people into good jobs, Press Releases, Brussels, 27 june 2007, <http://www.europa.eu/rapid/pressReleasesAction.do?reference=IP/07/919&format=HTML...9/5/2007>.

or full-time), creation of a trustful climate between social partners, consolidation of national social models. According to the Commission, the structural instruments – particularly the European Social Fund – can significantly contribute to budgetary support of flexicurity by: employees training at company's level, lifelong learning programmes, entrepreneurship promotion.

B. Policy in the field of research and development (R&D) and innovation (I)

The Community policy in the R&D and I fields, crucial for the achievement of the Lisbon Agenda objectives, aims at supporting the competitiveness objectives to be reached in the regional areas and at increasing the participation of Objective1 regions to the Framework Programmes (during 2002 – 2006 this represented only 18% of all the carried out projects)¹⁹.

In the cohesion countries R&D and I activities are focused in the capitals and in the economically developed regions. The diminished impact of cohesion policy is also due to the fact that only a small amount of the public expenditure for R&D in EU (about 5%)²⁰ is financed by structural funds. The Community policy in the R&D field does not replace but supports and completes the national, regional and local actions. The actions at local and regional levels refer to:

- clusters creation;
- creation of informal networks of distributing information (based on trust and proximity);
- supporting SMEs to adapt public services to their needs.

For example, in the 6th Community Framework Programme on R&D, measures were introduced aiming at increasing its impact at the level of less developed regions. Thus, in connection with European Research Area:

- there were taken 2 new initiatives to support creation of links between regions in order to avoid or reduce brain migration from less economically favored regions (Network of Excellence and Integrated Projects);
- funds for human resources development were doubled (among them 15% was meant for SMEs);
- the applicants from Objective1 regions could ask for supplementary funds from the structural funds.

The action plan in the innovation field was revised in 2005 through New Lisbon Agenda perspective. At the recommendation of European Council, in spring 2006, the Commission has elaborated an agenda drawing the attention on the fact that the cohesion policy and the innovation one are complementary. As a result, the 7th Framework Programme for research (2007 – 2013) includes various instruments for the consolidation of regional dimension on 4 levels: cooperation – which finances knowledge dissemination and technological transfers; ideas; people – finances a continuous formation, career development and researchers

¹⁹ Growing Regions, Growing Europe, Fourth report on economic and social cohesion, Brussels, 2007

²⁰ idem

mobility, insuring also the co-finance of regional and national programs in this field; capacities.

The Framework Programme includes several objectives having regional impact, among which:

- supporting the development of new pan-European infrastructures and optimization of existing infrastructure necessary for the scientific community to keep up its performances (1.8 billions euro);
- assisting the SMEs in financing R&D by extending their network, a better results valorization, development of technical solutions for the SMEs having similar problems, obtaining technological know-how (1.3 billions euro);
- consolidation of R&D potential of the regions by supporting the “research – driven clusters” which should associate universities, research centers, companies and regional and local authorities (126 millions euro).

Another important Community program in supporting the regional development policy is the Framework Programme for Competitiveness and Innovation (CIP) which directs 1/3 of the funds towards sustaining the entrepreneurship and innovation. It includes 3 subprograms:

- support for business initiation (start up);
- support for information technology and communications;
- development of alternative energy sources (by 2010, their share should reach 12% of the total sources) and reduction of energy consumption.

Some of the actions foreseen in this program are complementary to those carried out on the basis of cohesion policy and by the Framework Programme for research: support for SMEs innovation network and for clusters, support for regional programs stimulating innovation, identification of excellence examples.

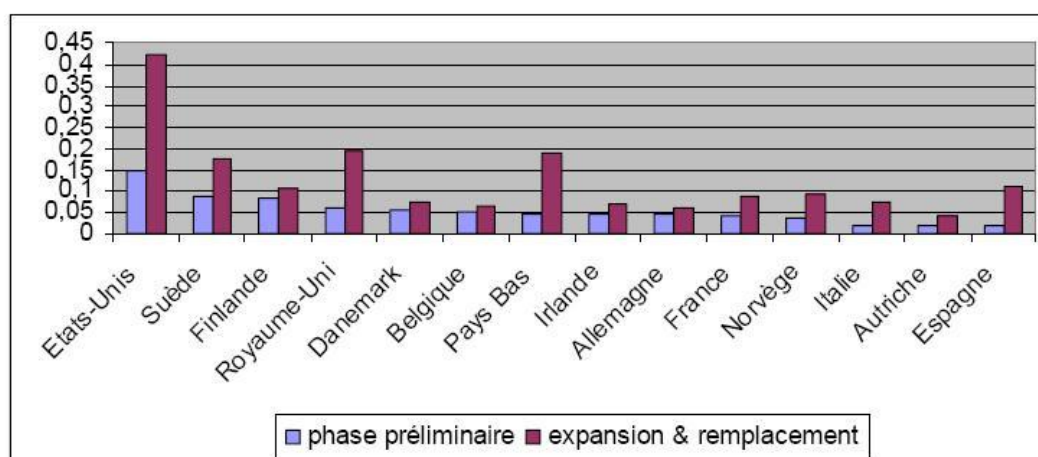
C. Competition policy: connections with the cohesion policy

The Commission recently proposed a new vision on using the state aids²¹, namely:

- redirecting them mainly to the support of New Lisbon Agenda objectives;
- their management modernization by increasing states responsibilities;
- revision of the directives to support the regions;
- sustaining the necessity of public intervention in the field of general interest services;
- orientation of public intervention to sustain the risk-capital, the research and innovation (both for the big companies and SMEs, taking into consideration the gaps between the European countries and USA in this fields (graph 1.1.)).

Graph no. 1.1: Venture capital investments, % GDP

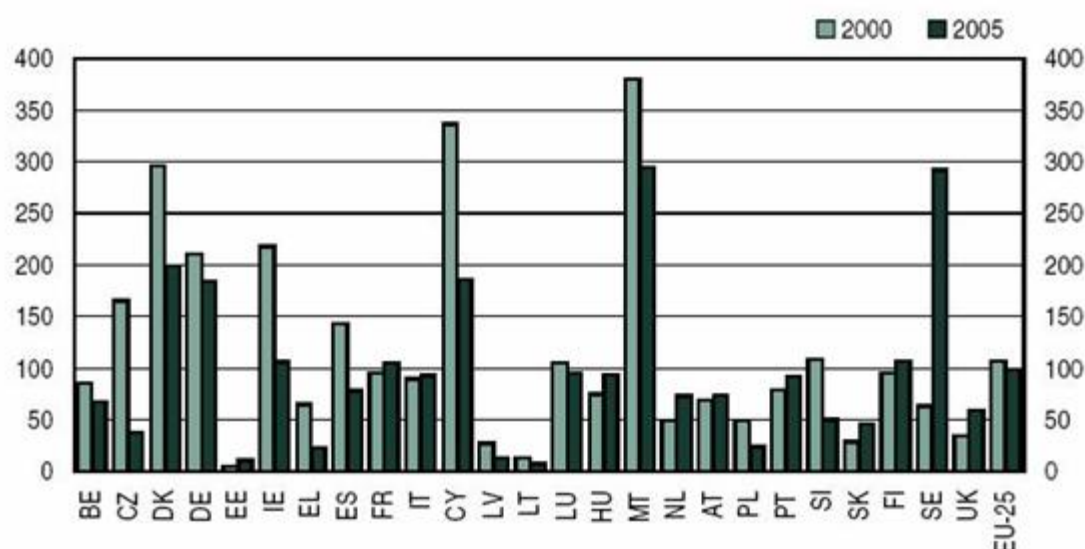
²¹ Growing Regions, Growing Europe, Fourth report on economic and social cohesion, Brussels, 2007



Source: Amable (2006)

In accordance with these orientations, some member countries have already channeled the state aids with priority as per New Lisbon Agenda: Portugal, 75% for financial services. Others maintain their orientation towards industrial sectors (Hungary, 48% for processing industry), even towards the declining ones (Spain and Poland for mining industry: 34% and 24% respectively). In 2005 about 2/3 of state aids were concentrated in the big EU countries: France, Germany, Great Britain and Italy. If the average of state aids per capita, in the states which did not get structural transfers, was in the range 150-300 euro, in the cohesion countries it was much lower, much under the Community average (graph 1.2), which is a very paradoxically situation.

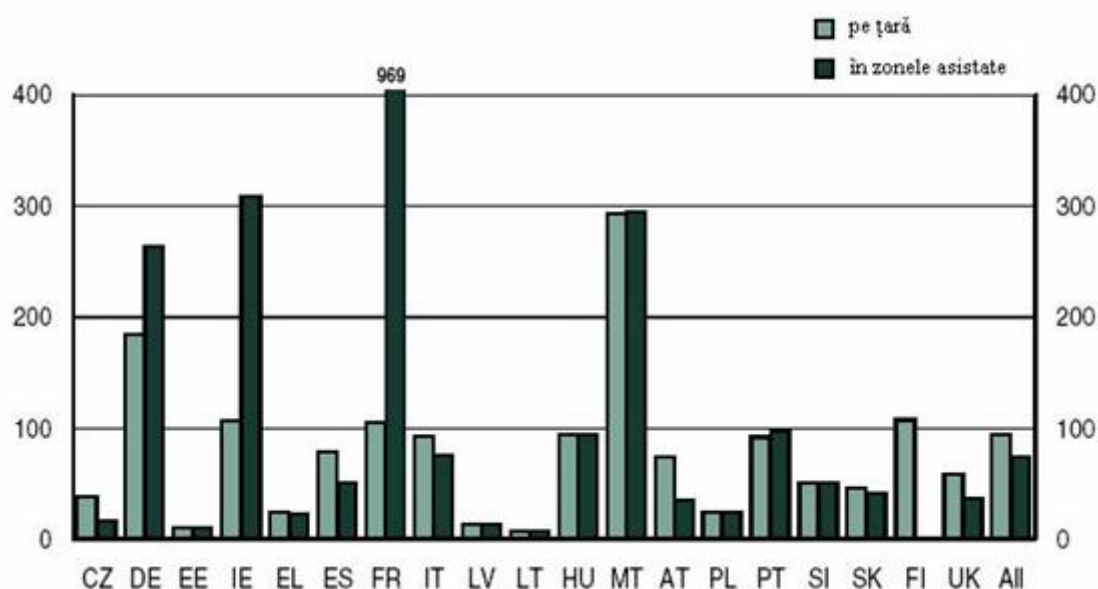
Graph no. 1.2: State aid evolution in EU 25 (euro/capita, 2005 prices)



Source: Fourth Report on Economic and Social Cohesion (2007)

The state aids to less favored regions are eligible according to Art. 87.3 (of the Treaty) and represent one of the 5 general notifying exceptions²². The reform on the regional aids has 3 major objectives to achieve: continuing the reduction of aids for the industry, concentration in less favored regions, providing the competitiveness in all EU regions. Out of the 19 states with eligible regions in 2005, 7 were eligible on the whole (Malta, Poland, Hungary, Slovakia and the 3 Baltic states). In the other 12 states there are big differences between aids intensity for eligible regions and the intensity for the whole country. Thus the aids for eligible regions registered in average, in 2005, the level of 73 euro per inhabitant, compared to 93 euro per assembly of countries totally eligible and 104 euro for partial eligible countries (graph 1.3.).

Graph no. 1.3: State aid intensity 2005 (euro/capita)



Source: Fourth Report on Economic and Social Cohesion (2007)

The above graph illustrates two different views existing at the level of member countries regarding the orientation of aids: 2 great powers (Germany and France) and one cohesion country (Ireland) tend to concentrate the aids towards less favored regions, while most of the others direct them to growing centers. These differences indicate different options on national regional policy and industrial policy at the same time, for the above mentioned countries, the latest aiming at actively supporting by the state the industrial activities in the less favored zones.

²² Besides: support to SMEs; aid for research development meant to SMEs; support to employment; aid for professional training.

D. Industrial policy²³

Neither the European Community Treaties (Roma Treaty) nor the subsequent ones (Maastricht, Amsterdam) use the term of industrial policy. Art 130 of the 13th title of Maastricht Treaty permits the understanding of the outlook of the Community in this field. The role of public authorities would be only to offer the firms an economic environment, having clear and foreseeable rules for their activity²⁴. So that the state will insure an adequate infrastructure and will support the research and development activities and the SMEs. In other words, the provisions in the treaty refer only to the creation of conditions necessary for Community firms' competitiveness increase.

The official documents of the Community lead to the conclusion that the industrial structural adjustments should take place not due to applying a strategic perspective in this field (a strategic commercial and industrial policy), but due to the influence of competition policy, to a commercial policy (which promotes free change) and to the measures stimulating firms competitiveness.

However, the older documents, from the beginning of the 90s, not repudiated by the Commission, take into consideration the possibility of intervention by the national authorities in this field, the same way as in the competition policy and by connection with some of the regional policy objectives, which refer to the less favor regions marked by serious adjustments on the sector level. In spite of all these restrictions imposed at the Community level for national industrial policies, some EU member states seem to revert to active interventions in the economy in this respect. The next case study shows the possibility to achieve such connections. For example, in France the project to create some "competitiveness poles" is considered to be a "return to an industrial active policy"²⁵, major sums being allocated by the French state for the implementation of this project objectives (about 1.5 billions euro for 2006 – 2008, to cover credits given by the respective ministries, income tax and social contributions exonerations for certain firms etc.).

Possible connections between Community policies in Portugal²⁶

For the elaboration of its industrial policy, Portugal has made use, in addition to

²³ Bal A.(2003), Strategia de pregătire a aderării României la Uniunea Europeană; exigențe ale Pieței Unice și răspunsuri posibile la acestea în perioada de preaderare (cap.1), în *Liberalizarea schimburilor economice externe, Avantaje și riscuri pentru România*, Ed. Economică, București, pag.38-39.

²⁴ Shigéyasuk Osabe, Le marché européen et la transformation de la politique industrielle, în *Economies et sociétés*, nr.10/1998

²⁵ Le retour de la politique industrielle en France, în *Dossiers de La documentation Francaise*, mars.2006;

²⁶ M.Francisco, Revue du Maché Commun et de l'Union Europeenne, nr. 447, aprilie 2001

landmarks offered by EU treaties, of some recommendations on competition, made by the Commission in its reports: “the state intervention represents an instrument of structural policy necessary each time when the market will not allow (or time is too short) to have access to certain similarities of lawful development, out of the desire for better qualitative and quantitative increase, or any time when the market will generate intolerable social tensions²⁷”. Consequently the public authorities in Portugal have applied, during 1994 – 1999, several measures of industrial policy, which were simultaneously financed from national and structural funds in order to support the enterprises. Thus, their national industrial policy was connected to the EU regional policy.

Thus, fiscal and financial instruments were used not only to support investments in internationalized industries, but also in enterprises of strategic sectors (like textiles and ready made cloths industry, which insured a high rate of employment) as exceptional state aids. An argument in favor of financial instruments, before EU institutions, was the fact that the banking market in Portugal was oligopolistic, and consequently, the interest rates were established at levels higher than on a competitive market, leading to raising the financing cost by credits for firms in difficulties.

Mateus Plan, providing fiscal incentives, observed the competition conditions imposed in the Community:

- a) aids were not granted directly but downstream;
- b) the supported enterprises did not belong to the same economic sector;
- c) conditions of granting the financial aids were adjusted every year in accordance with the interest rate evolution.

1.3. Scenarios regarding the future of cohesion policy

Examining the most recent positions taken up by high level community and some member countries officials²⁸, a series of scenarios, regarding the future of the reform of the cohesion policy, have been outlined.

These outlined scenarios try to answer some major questions of today, regarding the cohesion policy, as:

1. Is it any more a necessity?
2. Which is the content it should have after 2013, and which are the orientations to be given to the structural and cohesion funds, taking into account the major challenges faced by EU at present?
3. Which is the way of joining the community, national and regional levels?
4. Which is the cohesion policy place in the general EU governance?

Here there are the answers outlined with the occasion of the European Forum on Cohesion, in September 27-28, 2007.

²⁷ M.Francisco, *Revue du Maché Commun et de l'Union Europeenne*, nr. 447, aprilie 2001

²⁸ See the communications from European Cohesion Forum , 27-28 September, Brussels, on: http://ec.europa.eu/regional_policy/conferences/4thcohesionforum/home_en.cfm?nmenu=0

1. It seems, for the time being, that the opinions of the most member countries of EU 27 converge on backing up the necessity of preserving the cohesion policy, as one of the most important community one. Beyond the roots of the European political tradition that explains maintaining this option²⁹, at present, the economic reason in its favor becomes more solid:

a) It is admitted that the cohesion countries, respectively the less favored regions lack chronically capital, so the community transfers can become complementary sources to the local, regional or national ones. Decisive for their efficiency is, nevertheless, their way of utilization (orientation, management, administration).

b) The cohesion policy supports the better functioning of IM through:

§ supporting the development of the European transport and telecommunication networks ;

§ the increase of the demand, through the increase of incomes (inclusively in the less favored regions);

§ expansion of the intra-European trade (for example, in the case of Portugal, it is estimated that about 35% of their growth is due to the structural funds).

c) The regions become distinct territorial entities regarding the competitiveness under globalization conditions. For instance, one of the major axes of competitiveness, the support of R&D and innovation, cannot be approached only through the community programmes (directed, mainly, to the large companies) but it has, also, to be approached at regional level, through projects supported by the regional development policy and directed to the SMEs.

d) For some cohesion countries, the community funds have represented instruments of spreading the economic rationale and decreasing the structural laggings³⁰.

Debates regarding the cohesion policy

Schematizing, two main currents of ideas confront on the theme of cohesion:

I. The standard current, which, in accordance with the classic and neo-classic theory of growth, considers that the free market mechanisms lead automatically to a real convergence between countries and regions³¹ (the generated economic growth, having the tendency to reduce the imbalances). As a consequence, the community and national authorities have only to consider the consolidation of these mechanisms, to achieve cohesion on the account of competitiveness growth, having as priorities, on one hand, the expansion of IM, deregulation, liberalization and internationalization processes, and on the other hand, the preservation of macroeconomic stability, on the account of fiscal consolidation.

This course of opinions ignores the divergence tendencies created at the same time with

²⁹ Recognized as strongly oriented to social solidarity, as opposed to the American (Anglo-Saxon) one.

³⁰ *Quinze pays dans un bateau: La cohesion economique et sociale, pierre angulaire de la construction europeenne*, Groupement d'etudes et de recherches "Notre Europe", 1998, la <http://www.notre-europe.eu/uploads/tx-publications/...>

³¹ As Pelkmans said (2003, pag.299), this would have been the very perspective of the founders of the Community.

those of convergence, as well as the fact, empirically certified, that the negative effects of these processes tend to be of greater extension in less developed regions.

We have to admit the correctness of the major criticism to the cohesion policy, from this perspective, namely that the increase of available capital in countries and regions benefiting of community transfers does not automatically mean, an efficient use of them (see also the arguments at subchapter 2.1).

II. The non-standard approaches, recognize the simultaneity of bringing about convergence and divergence, under the above-mentioned conditions, and argue the need for the cohesion policy, community transfers, deeming them as an instrument of counteracting the "market failures" (through the supply of public goods and diminishing of inequalities). At present, the opinions of this kind see the transfers not only as a political means of compensating the costs of deepening and expanding of EU (having the functions of a „solidarity pact", similar to the „social pact", achieved in certain national, European economies, meant to preserve the social peace), but a means of supporting competitiveness, through the help given to countries and regions, with the aim of turning into account their comparative advantages or, of creating new ones, for their integration in the national markets, now components of IM, itself now a part of the global market.

2. As J. Socrates, Prime Minister of Portugal recently said, at the European Forum for Cohesion, the reform of the cohesion policy implies the alignment of its logic to the great directions of development on the whole of EU, directions that should address the great challenges this is confronted with, in the first place, by assuming the synergies with the other community policies and not by increasing the funds.

The opinions and proposals delivered at this forum of debates outline the following possible scenarios for the evolution of the cohesion policy substance and the orientation of the structural funds:

A. Preserving of the cohesion policy features, of the period till the year 2006, policy mainly directed towards the recovering the development disparities, on the account of the community transfers, added as supplementary sources to the public transfers in the cohesion countries and less favored regions.

B. "Lisbonization" of the cohesion policy³², i.e. its exclusive orientation towards competitiveness, direction that would suppose either to "freeze" the amount of transfers or their maintenance at a low level.

C. Simultaneous orientation of the cohesion policy towards two major objectives, namely the increase of the competitiveness and decrease of the development gaps at regional level, thus keeping the idea of substantial amounts distribution from the community budget to this purpose, but at the same time, the consistent change of the way these are used.

The last two opinions outline the trend to modify the concept regarding the role of the cohesion policy, similar to the modification of the view regarding the role of the state in economy during the 80', from that of a source of massive social transfers to that of counteracting the market failures and not of its replacement. The "new paradigm", expressed by the European Commissioner for regional development, D.Hubner, would be "the creation

³² See Appendix 2 for a critical analysis on this subject.

of opportunities for the future and not compensating the problems of the past”³³, as, in this new perspective, “catching up” of lagging regions is dependent on or connected to an ever more globalized economy. Or, in a more direct manner, the transition from the delivery of direct aids to the supply of “public goods”, for the lagging regions. Under this new perspective, the role of the cohesion policy would be to “assist the economies of the regions to find out a place on the world markets and to encourage their internationalization”.

This new paradigm reflects, in fact, the position of the most member countries of EU - 27, namely that the binomial „competitiveness - cohesion” does no longer represent an antinomy (competitiveness vs. cohesion)³⁴ but a tandem of un-dissociable and interdependent objectives.

However, one has to underline the fact that the new cohesion countries (generally, the former communist countries which entered EU after 2004) have a more shaded position, reflecting their particular situation in comparison with the countries of EU - 15, and the existence of great disparities of development, both between countries and between regions. Thus, Poland representative at the European debates on this subject (but, also the Germany’s representative) declared that the “Lisbonization” of the cohesion policy should not exclude the solidarity with the less favored regions, meaning that the cohesion policy has to create conditions for these regions to use the given particular competitive advantages and even to create new specialized and complex advantages. This means, she underlined, that one has to find out the optimum balance between the convergence (catching up) and competitiveness.

Moreover, the commissioner D.Hubner, underlined the essential economic aspect of the cohesion policy and indicated as future objectives of the cohesion policy the qualitative aspects of its growth and sustainability:

- § long term support for the economic growth;
- § creation and exploitation of the structural factors of competitiveness³⁵;
- § facilitation of anticipating the changes generated by the market forces and the adjustment of the regional economies to them.

3. Opinions regarding the governance of the cohesion policy go towards the preservation of the actual system, of multi-level governance at the community, national and regional level. The actual system is not considered efficient enough, due to many drawbacks at the community level, and, partially, at the national one: excessive bureaucratization, standardized solutions for objectives and instruments. Moreover, it is agreed on the objective incapacity to correctly identify the most efficient ways of planning the funds at the community and national level, due to the information asymmetry that works between the decisions levels against the beneficiaries ones.

Of course, finding out the optimum ratio between centralization-decentralization between EU and states, and states and regions is a sensitive matter which is influenced by more factors:

³³ Idem 27

³⁴ As A. Rousset, the president of the Associations of Regions from France, said “the debate which opposes the competitiveness to cohesion is sterile and obsolete” (European Cohesion Forum)

³⁵ The Global Competitiveness Report for 2007 (elaborated by the World Economic Forum) enumerates 9 categories of decisive factors: institutions, physical infrastructure, macroeconomic stability, primary education, health, higher education and training, market efficiency, technological readiness, business sophistication and innovation.

- a) configuration of community competence in a EU with a higher level of political unification and the vision on the size of the community budget, the “contributions” of the countries to it, and its expenditures destinations;
- b) specificity of the national governments (unitary, confederate, etc.) and the credibility of the national authorities as units of efficient management of the community funds (effective and uncorrupted administration);
- c) competence and credibility of the regional and local administrations from the perspective of drawing up the regional policy, administering and managing the community funds.

We shall discuss to greater details the above aspects.

a) The economic theory of federalism (partially applicable to EU³⁶) recognizes at least two reasons of the community management, in the way it is applied, at present, to the cohesion policy: ensuring a standard of minimum uprightness (horizontally, see the subsequent difference), that would provide at the same time a greater political and social stability and the guarantee of the efficient redistribution among countries.

b) The increase of the importance of the national level would suppose the management of the community budget, based on the principle “impartiality on vertical”³⁷, that would mean a lower contribution to the community budget for the cohesion countries, but, probably, a control of the community’s authorities (maintenance of a certain conditionality, but changed in spirit, in comparison with the one applied at present) regarding the utilization of the rest of the remained funds, at national level, which would be a favorable situation, only if the national authorities would be more responsible.

The commissioner Hubner admitted the necessity of finding out some better governance structures, to ensure, at the same time, the flexibility in decision taking, the integration of objectives at national and community level, through a complex system that combine the efficient co-ordination with the large co-operation of all involved economic, social and political partners (public-private partnership, national or regional employers or trade-union associations, NGO’s).

4. Regarding the role of the cohesion policy in the EU management, the participants at Forum delivered two more important ideas:

a) for creating the effects of synergy with the other community policies, it renders evident the possibility of a better co-ordination between policies, in different fields, as for instance :

§ European transport corridors could include also less favored regions;

§ measures associated with Ob.3 of the cohesion policy, regarding the territorial co-operation, could be connected to those of the European Instrument for Partnership and Neighborhood;

§ Better connections with CAP, in the field of rural development.

b) the cohesion policy should address, on a greater extent, the current challenges confronting EU, as the migration: the pursuit of the objective of employment would reduce its pressure.

³⁶ See Pelkmans (2003)

³⁷ Idem

Chapter 2. Contribution of the Cohesion Policy to the EU convergence

2.1. Conceptual framework

Nominal convergence

The nominal convergence implies that certain criteria regarding *nominal variables* reflecting macro-economical stability are met. For example, the European Union has retained an exact set of nominal convergence criteria – aimed at pointing up the preparedness of various EMU accession states – the so-called Maastricht criteria:

§ Price stability: the average inflation rate for the last 12 months (calculated with the consumer price index) should not exceed the inflation rate of the first three states with the lowest inflation rates by more than 1.5%; moreover, the inflation rate from the candidate country must be sustainable.

§ Public finance: the budget of a country must be sustainable; respectively, no excessive budget deficit should exist. In particular: (i) the concerned state's consolidated budget deficit should not exceed the level stipulated by the Treaty, namely 3% of the GDP; if this value is exceeded, the budget deficit must be substantially and continuously reduced to a value close to the reference value or the excess of the reference value should be temporary and exceptional, and (ii) the gross public expenditure should not exceed 60% of the GDP, or if it has a higher value, it should significantly decrease and reach the reference value at a satisfactory pace;

§ Interest rates: The average rate of return of long-term government bonds calculated for the last 12 months should not exceed the rates of return corresponding to the government bonds of the first three states with the lowest inflation rates by more than 2%;

§ Exchange rates: should remain between the fluctuation margins agreed through the exchange rate mechanism within ERM of EMS for at least 2 years, while the concerned state cannot depreciate, at its own initiative, its currency with respect to the other currencies of the member states.³⁸

³⁸ Essence of criteria. Firstly, *low inflation rate*. The obsession for restraining inflation came from Germany, a country with an (better) inflation culture and background different from most of the EUM partners. Without the guarantee of a mechanism to maintain a low inflation rate, Germany would have stayed away from a currency for which it would have to accept average inflation rates below those it had wanted, given the European partners' probably higher inflation preferences.

Secondly, sustainability of budget position. The (German) fear of inflation is found here too, if the expenditure criterion is considered: the higher the expenditure is, the higher the inflation risk claimed by the concerned state will be, in order to decrease its actual burden. Besides the arbitrariness of the maximum expenditure established for 60% of the GDP, the budget deficit limited to 3% of the GDP derives from a conventional estimation of the 5%-growth at which the expenditure becomes constant as percentage from the GDP ($3\% = 5\% \times 60\%$).

Thirdly, the interdiction to depreciate the national currency for two years aimed in fact to eliminate the possibility of a "competitive depreciation" of the currency the day before its conversion into Euro, which would have artificially influenced the exports of a member states adopting such conduct.

Real convergence

The interests into (real) convergence were implicit in the first theories of economic growth (for example Solow; Solow 1956) and more explicit later, when the issue was revived during last century's 8th and 9th decades (Ambramovitz, 1986; Baumol, 1986; Barro and Sala-i-Martin, 1991 and 1992) and they considered the possibility that less economically developed areas, countries or regions catch-up the gap between themselves and the more advanced ones. Thus, on the whole, actual convergence encompasses the equalisation of the welfare and development of a group of countries, regions, areas etc. Or, in other words, the tendency of the areas subject to a comparative study to larger similarity or equality of *real variables* (GDP/capita, unemployment and employment, productivity etc.) describing the performance of national economies.

The underlying treaties of the European construction fail to stipulate clearly and explicitly real convergence criteria. However, some of the most important aspects deemed to indicate this type of convergence are: economic openness (weight of export plus import in the GDP); weight of bilateral trade with EU member countries in the total foreign commerce; economy structure (demonstrated by the structure of large sectors– agriculture, industry, services – in the GDP); and – the most synthetic expression of real convergence – GDP/capital (at the nominal exchange rate or standard purchasing power parity)³⁹.

Specialized literature has retained two types of real convergence: *sigma* and *beta* convergence.

Sigma convergence in a group of economies appears when, during a certain period, the income dispersion per capita corresponding to the concerned economies against their average reduces. The empirical testing of this sort of convergence is most of the times performed through indicators such as variance, standard deviation or coefficient of variation. It is considered that this type of real convergence is not necessarily the most relevant one as far as the income per capital may also converge to lower average levels (than the desired standards or even than previously registered ones – this because of the fact that the most dynamic economies slow down their growth rate or, possibly, undergo major economic crises).

Beta convergence operates by a different rationale, namely that of the regression function: the income per capita during a certain period is estimated depending on its initial level and takes two forms: *absolute beta* and *conditional beta* convergence. The first is defined as “the growth trend of all the values of incomes per capita towards the same equilibrium point, which is possible owing to the fact that less developed regions grow at a higher rate than developed ones and grow until they reach the highest equilibrium point, common to all of

Lastly, long-term convergence of interest rates. States were concerned that disparities among the interest rates of bonds issued into different national currencies would have led to huge trade-offs on the secondary capital market, which would have had disturbing effects for a period of time. However, given the duration of the transition to the final phase of the monetary integration, the respective profits and losses would have been used up, while the perspective of joining the Euro zone, pointed by the other criteria would have levelled interest rates naturally. On the other hand, basically, since the state pressure over the credit market lowered through the limitation of its indebtedness (monitored by the 2nd criteria – public debt) and the reduction of the inflation pressure from interest rates (carried out through the 1st criteria), this criterion became redundant.

³⁹ Mugur Isărescu, *România: Drumul către Euro*, Presentation to the Conference organised by the Academic College of the University „Babeş Bolyai”, 2004 (version updated in March 2007), p. 6.

them”⁴⁰. In other words, absolute beta convergence exists when all countries develop/grow during a certain period; however, poorer countries grow more rapidly than rich ones, going to a development level similar and accessible to all. At the same time, we can talk about the catching up process. Moreover, this type of convergence meets also egalitarian exigencies (in the end every country will reach the same development level).

The second type of beta real convergence is conditional. If certain initial parameters (technology, savings, population growth rate, capital depreciation, etc.) are not identical within the group of countries/regions whose convergence is studied, then each of them will “converge” towards its own limits (its own equilibrium position on the long-run or stationary status)⁴¹. Nevertheless, since these limits/equilibrium points can be different, the so-called “club convergence” phenomenon occurs (as things seem to be within the Euro area). The absolute convergence issue remains open under this type of convergence: to what extent do the equilibrium development points corresponding to the different state “clubs” converge in their turns (maybe how quickly and under the influence of which factors).

Economic and social cohesion (issues)

Nominal versus real convergence

The two large types of convergence – nominal and real – are usually considered at least distinct if not somehow opposite. The distinction itself between the two follows a classical separation – between real economy (aspects related to production, commerce, services) and symbolic economy (aspects related to the financial-monetary part of an economy). However, this distinction is artificial to a certain extent – even if it has a heuristic-operational utility – and rather recalls the vision that in economy, money is a mere “veil,” cash and financial flows being only the necessary consequence of real flow movement. From another perspective, of a paradigm that considers money itself a driving force of the market, the separation between the real and the symbolic (or real and nominal, to use the same words) decisively loses relevance. Why would the unemployment rate be, let us say, a more “real” aspect of the economical situation of a certain area than the inflation rate? In other words, why would the possibility to get a job necessarily be more “real,” more tangible than the reduction in the purchasing power?

In view to extrapolate the above, we might point out that there is no difference of nature between nominal and real convergence issues; on the contrary, the two of them can reinforce each other. The so-called nominal convergence would be an important premise of real convergence to the extent that, on one hand, nominal exigencies “clean up government’s behaviour” and, on the other hand, “the main ingredients of economic growth are: the private property, the free entrepreneurship and ... the accumulation of capital” (which presupposes a healthy currency to allow accurate business calculations). Some of the European economic mainstream believes that nominal convergence criteria might be incompatible with economic

⁴⁰ Pompilia Idu, *Instrumentele structurale și convergența statelor în Uniunea Europeană*, Oeconomica, Year XV, no. 3, 2006, p. 44.

⁴¹ José Villaverde Castro, *Indicators of Real Economic Convergence. A Primer*, UNU-CRIS e-Working Papers, w-2004/2, p. 9.

growth. The key to understanding these issues is to abandon the simplistic “numerical” “⁴², aggregative vision and to adopt in exchange an entrepreneurial approach of economic performance whereby nominal convergence and single currency become brands of the European way of reform. Criteria are not only displays of an anti-inflation obsession, “but also a truly economic performance framework to unleash private businesses and restrain government fiscal-monetary discretionism. Nominal convergence criteria are a key ingredient for real convergence!” (Spiridon 2004, pp. 22-23)

Natural convergence and self-chosen disparities

The simple but fundamental question to which the ordinary treatment of the convergence and cohesion issue fails to answer is: why cohesion or convergence (howsoever they may be expressed) is necessarily beneficial for everybody. And here there is possible that certain communities do not recognise generally accepted standards (GDP/capita, productivity; employment; infrastructure, etc) as elements of welfare. If we think – from the perspective that Romania is an orthodox country – of the orthodox areas populated with monasteries (Mount Athos; certain areas of Moldavia) it might be possible that the similarity with rich areas from the EU’s hard core will not only be a priority but quite an inconvenient. Moreover, in order to reach certain internal consistency, the European model – that treasures non-discrimination ideal - should reflect on the particular communities issue (we could add here a part of the gypsy community) and on how such communities see the desideratum to “converge” with the rest of the European communities.

Therefore, the idea of self-chosen disparity should be firstly accepted during the discussion on convergence and only then, should the convergence issue be raised. This point, however, leads to a fundamental question: how necessary is government or inter-governmental intervention (especially the cohesion policy instruments) to build convergence. Even the underlying neoclassic model of the absolute beta convergence idea recognises the normal, normal convergence of a space/area within which capital and labour force (not to mention goods and services) circulate freely. Thus, economic policy measures for cohesion might concentrate on building this necessary premise: freedom of circulation, because there is the risk that the attempts to go beyond natural convergence might actually undermine it.

Cohesion policy and its possible weak sides

Basically, the European Union economical-social cohesion policy reduces to two large

⁴² The rationale of instruments emphasizing real convergence (sigma, beta versions – absolute or conditional) does not start from realistic intuitive elements, but it is a product of the use of mathematical-statistical tool: dispersion and regression. In other words, no fundamental issues related to convergence are raised (what is it and especially, why is this beneficial), but it is tried to give the answer to an implicit question like “what can we say about convergence by using the statistical-mathematical tool.” The official methodology favours the statistical correlation for the detriment of fundamental causal economical explanations. The impact of a measure of policy (e.g.: cohesion policy) cannot be observed either empirically or by putting the empirical measurements into a model, despite the quantitative precision impression of the model observations or results. See, for example, the non-homogenous assumptions (and the results) between the three models used in the European Commission’s report (HERMIN, EcoMod and QUEST) partly inspired by new-Keynesian theories that can demonstrate how imperfect this way of decrypting economy remains.

instruments: intergovernmental transfers of funds and regulations.

I. The economic theories indicate us 2 major obstacles to its success: *calculational chaos* and *moral hazard*.

§ Moral hazard: a (national or European) public/civil servant is not motivated by profit & loss to behave for the interest of the taxpayer-consumer. If it is possible for him to establish a “priority” or to change the result of a public tender in favour of political clientele, his county or simply to his family, nothing can guarantee he will not do it.

§ Economic calculation: the fundamental instrument that makes possible for the production structure such as that of modern contemporary economies to be maintained through rational allocation of resources is *monetary calculation*. If expected revenues from an investment project do not exceed expenses (both present and anticipated), the concerned project *will not* be carried out at market conditions (under voluntary exchange conditions). In general, the so-called disadvantaged areas have, due to various reasons (remoteness, unqualified and relatively expensive labor, low demand, ill-conceived regulations etc.), few chances to carry out profitable projects. The idea of regional policy based on intergovernmental transfers of funds disregards this very type of market verdict. The market gives the following message through its business elite: in such and such region, currently such and such projects are not feasible (profitable); bureaucracy disputes this very verdict of the market without, however, having the intellectual instruments to actually do/replace it (that very monetary calculations it had given away).

II. On the other hand, the analyses carried out both at the centre (Brussels) and at the destination (member states) (ab)use of the principle that in public expenditure terms “spent money means well-spent money” and consider that *absorption capacity* equals *economic performance* (equaled quite disputably with disparity reduction). The aggregate Keynesian perspective provides the main argument in favour of this interpretation: EU funds lead to GDP growth (economic growth). However, the focus on aggregates raises an issue: not every amount of money pumped into the economy leads to healthy economic growth. It may also lead to inflation, if we were at the “full employment” point. This vision overlooks the crucial importance of resource allocation micro-processes, private property and business activity.

Therewith, the process of making European funds profitable depends on the extent to which the absorption environment is structurally reformed. The “cohesion paradox,” which can be formulated like: *least underdeveloped* regions have relatively higher chances to attract European funds, while disparities compared to relatively *less developed* regions might even intensify, can be broken only through multi-dimensional reform. Correctly interpreted, this issue could be virtuously solved by the fact that it suggests that reform remains the key factor for reducing disparities, not the funds *per se*.

III. Also, the persistence of disparities despite cohesion assistance should be interpreted differently. This may mean that institutional incentives are still weak or adverse natural data cannot be overcome or that self-chosen disparities may exist (see previous comments).

2.2. Results of the EU cohesion policy

Considering the previous discussions and issues regarding *convergence* and evaluation of the impact of *cohesion instruments* upon the achievement of this objective, we further seek to

present a positive (empirical) perspective of the results currently obtained within the European Union.

Our opinions will start from the last report on cohesion published this year by the European Commission⁴³. The considerations in said report of the EC will be commented by alternative analytical opinions from the academic literature.

The EC report presents a comprehensive overview on the cohesion policy's "added value" on the situation and evolution of economic, social and territorial disparities, cohesion reform directions between 2007 and 2013, as well as on the new challenges identified by the EU institutions.

Conclusions of the EC report on the status, trends and impact of the cohesion policy

- *Economic, social and territorial status and trends within member state and EU-27 regions*: the study reflects the reduction of the disparities regarding incomes and employment within the European Union during the last decade. However, it is considered that is also necessary to make a long-term effort in view to reduce the differences between most disadvantaged areas and the rest of the regions.
- *Impact of the cohesion policy*: European cohesion programs have directly supported the promotion of regional convergence and employment. For example, during the period of 2000 to 2006, the convergence policy contributed to the GDP increase by 2.8% in Greece and by 2.0% in Portugal; the preliminary estimations provide that during the period of 2007 and 2013, the cohesion policy will contribute to the GDP increase by approximately 8.5% in Lithuania, Latvia and the Czech Republic, 5.5% in Poland and about 3.5% in Greece. The cohesion policy also contributed to the reduction of social exclusion and poverty by co-financing the professional training courses of 9 million people every year, of which more than half are women. Such training courses concur on obtaining better labour conditions and higher incomes; 450,000 jobs were created between 2000 and 2005 in more than six countries by using 2/3 of the funds provided under Objective 2 for this purpose.

Evolution of economic, social and territorial cohesion – synoptic overview

Economic cohesion

- *Convergence between the member states of the Union*

The large beneficiaries of the cohesion policy during the period of 1994-2006 – Greece, Spain, Ireland and Portugal – registered an impressive economic growth as a group, however, unequally distributed, as the gap from the rest of the EU-27 countries is sensibly decreasing, except for Portugal; to be exact, between 1995 and 2005, GDP/capita against the community average (EU-27) evolved as follows⁴⁴: in Greece (from 74% to 88%), in Spain (from 91% to 102%), in Ireland (from 102% to 145%), while, on the other hand, Portugal succeeded to

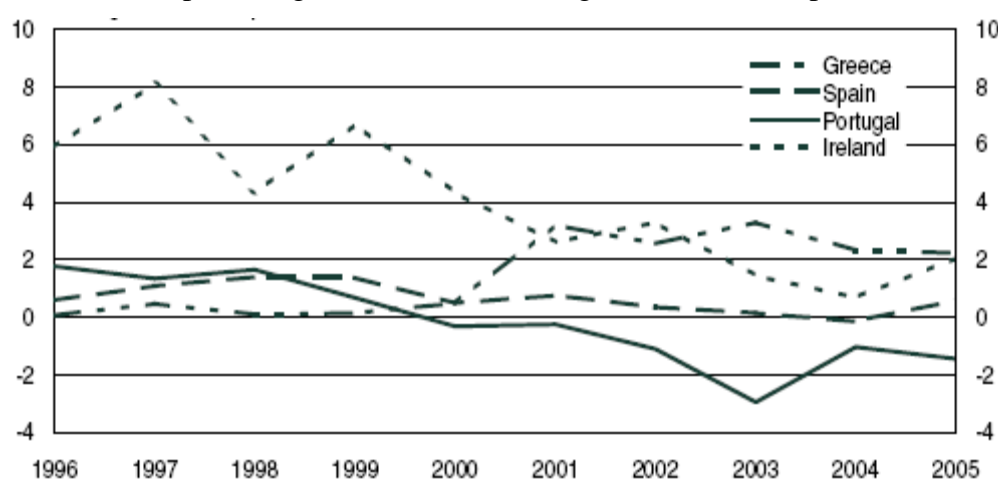
⁴³ *Growing Regions, Growing Europe, Fourth report on economic and social cohesion*, European Commission, 2007.

⁴⁴ *Growing Regions*, pp. 3-7.

distinguish from the rest of the group by a decrease in its GDP/capita from 80% in 1999 of the future UE-25 average to 70% in 2006 (or 74% of the EU-27 in 2005).

Graph no. 2.1.: Differences in real GDP/capita growth in EU 15 cohesion countries, compared to EU 15 average (1996-2005)

(Difference in percentages of the annual changes in the GDP/capita)



Source: Fourth Report on Economic and Social Cohesion

The new EU member states, especially those with a very low GDP/capita, visibly register a stronger growth and a more rapid gap reduction. The GDP of the three Baltic States almost doubled between 1995 and 2005. The growth rates of Poland, Hungary and Slovakia are more than double the EU average. However, a realistic forecast assumed by the European Commission is that since the process started from very low GDP/capita and considering the current growth rates, it is possible that 15 years pass before Poland and, especially Bulgaria and Romania, reach a GDP/capita of 75% of the EU-27 average.

Marelli's study (2007), which is consistent with the EC report introduces an analytical sophistication of the *country convergence* issue in terms of *GDP/capita*. The study divides EU member states into five separate groups (see annex no. 3) whose evolutions are related to the EU-15 average (period of 1980-2005) and EU-25 (1990-2005), as the case may be. The study reveals the same tendency towards convergence, however by groups of countries. The

graphs in the annex show that the countries registered different GDP/capita evolutions compared to the EU-15 average: some made progresses (Ireland, Luxemburg), other regressed (Germany, Italy, Sweden, Austria) while other stagnated (France, Greece, Portugal).

- *Convergence (also) between the Union regions*

Given the sustained economic growth noticed within the regions faced with difficulties (low GDP/capita) that were also the main beneficiaries of the cohesion policy between 2000 and 2006, a visible convergence trend seems to exist between the EU regions. Thus, between 1995 and 2004, the number of regions with GDP/capita below 75% of the EU average dropped from 78 to 70, while the number of those with GDP/capita below 50% of the EU average dropped from 39 to 32⁴⁵.

- *Convergence limits (persistence of disparities)*

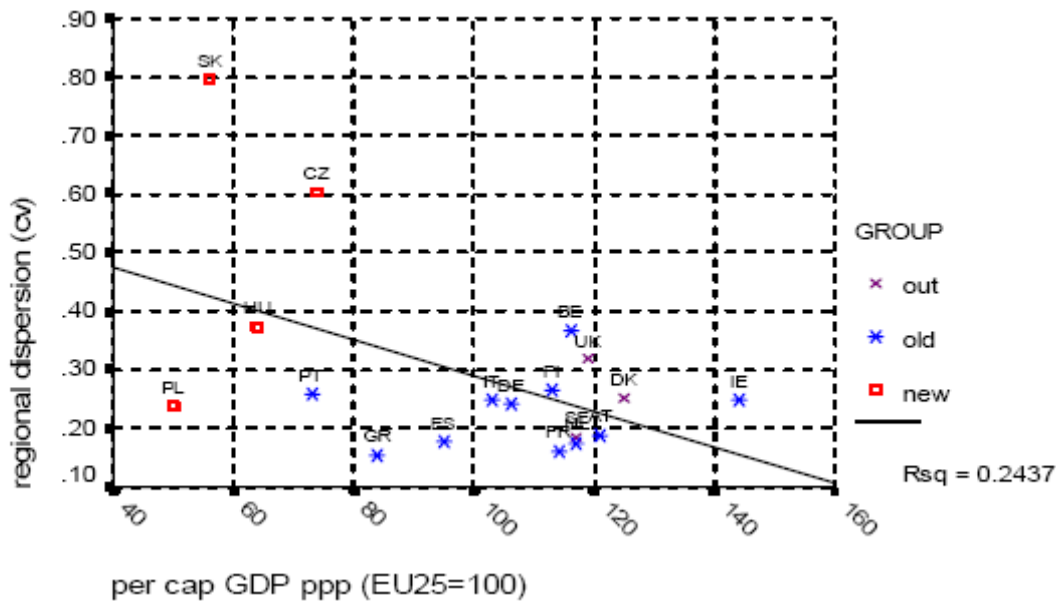
The persistence of the absolute disparities – even if a sharpened general trend towards convergence is noticed – is partially due to the recent enlargement and to the fact that the enlargement process tends to concentrate – in the initial phases of development – into the most dynamic areas of a country. Even some of the most developed countries (with a GDP above 75% of the EU-27 average) have started register very low or even negative economic growth rates. During the period of 2000-2004, the real GDP/capita lowered in 27 regions, while in other 24 it increased by less than 0.5% per year. In five of such regions, the GDP/capita dropped below 75% of the EU average.

Correlations between different convergence indicators

a) The investigation of the general relation between the aggregate income levels within the EU member states on one hand and the internal, regional distribution of such incomes on the other hand might be an interesting exercise. The regional dispersion is measured through the coefficient of variation of the regional incomes per capita. This measurement of dispersion seems to negatively correlate in 2005 with the national income (as GDP/capita index, where EU-25=100). In other words, the poorest countries prove a high dispersion among their regional levels of incomes. The observation is valid for all the new members, as well as for Portugal and for Italy, to a certain extent.

Graph no. 2.2.: GDP/capita level – regional dispersion for UE 25 (coefficient of variation)

⁴⁵ In 1995, 50 regions totalling 71 million inhabitants registered a GDP/capita below 75% of the EU-15 average. In 2004, almost one of four of such regions totalling about 10 million inhabitants registered an increase of the GDP/capita above the 75% threshold. (*Growing Regions*, pp. 3-7).



Source: Marelli (2007)

b) The analysis of two variables regarded in terms of their modification in time may be as interesting: it is a significant increase in GDP/capita (related to the European average, the modifications are considered in form of indexes where EU-25=100) associated with an increase or decrease of the regional dispersion of incomes? Marelli (2007) makes three observations regarding this question:

- 1) Regarding the '80s, when only the "old" member states of the EU-15 are considered, the relation seems positive. In other words, the countries that improved their position in terms of GDP/capita at national level (e.g.: Ireland, Finland), reduced the inter-region dispersion, while the Netherlands is on the opposite side.
- 2) Regarding the '90s, no significant correlation whatsoever between the GDP/capita and the modification of the inter-regional disparities was identified.
- 3) The period of 1999-2005 registers a positive correlation between the two variables, especially in the new member states, however, which was not confirmed in the old member states with rapid economic growth (Ireland, Greece or Spain), whose regional disparities remained relatively stable.

c) Due to the fact that *productivity* (added value per employed person in constant prices) is the key variable in many of the neoclassic theories on growth, we deem useful to present the evolution of this indicator in EU member countries during three periods of time: 1989 vs. 1980, 1999 vs. 1990, respectively, 2005 vs. 1999. After analysing the diagrams of Marelli (2007) the followings were noticed (see appendix no. 4):

- 1) The position of EU-15 states remained relatively the same between 1980 and 1989.
- 2) Persistence continued during the '90s, as it may be noticed from the second diagram the follows the EU-25 states. During the last reference year (1999), productivity below average can be found in all (future) new member states, as well as in three of the cohesion states (Spain, Greece, Portugal).

- 3) In 2005, most of the new member states registered a lower productivity than a third of the European average, with the exception of Cyprus, Malta and Slovenia.

Another interesting analytical approach regarding the productivity may result from the comparison of the employment growth with the value added growth. The idea is that if the growth of the added value is higher than that of employment, productivity increases (and vice versa). Three growth models can be noticed in the EU (Marelli 2007):

- 1) An intensive model with high productivity gains resulted from at the expense of employment, as in Ireland and France in the '80s, or several new members in the '90s (Estonia, Slovenia, Cyprus, Slovakia); or, more recently (1999-2005), again in case of many new member states (especially Poland);
- 2) An extensive model with significant improvements in terms of employment, despite moderate (or even negative) growth rates and thus to the detriment of productivity (Greece in the '80s, Italy in the '90s and recently, Italy);
- 3) A virtuous model characterised by the significant growth of employment, however, with even higher gains from added value (and productivity): in the '80 Luxemburg, Spain and Finland; in the '90s in Ireland and Netherlands and, recently, in Ireland, Spain, Greece, as well as many of the new member states (Cyprus, Latvia, Slovakia, etc.)

Social cohesion

- The employment rates convergent at community level and national level

Even if between 2000 and 2005, the regional employment rates were convergent within the EU, in 2005, the employment rates in the poorly developed regions were still by 11 points lower than the others from the other EU countries. During the period, certain countries have experienced a consistent and significant increase of employment, while other countries, such as Romania and Poland, have registered a decrease in the majority of regions, in certain cases by more than 2 points.⁴⁶

- Decreasing discrepancies regarding unemployment rates

Between 2000 and 2005, the unemployment decreased from 13,4% to 12,4% in the poorly developed regions, even if in 17 of them the unemployment rate increased by more than 2 percent. In the more developed regions, the unemployment rate remained stable, between 2000 and 2005, with a rate a bit lower than 8%, even if the regions in Spain, Italy, France and

⁴⁶ In order to fulfill the objectives from Lisbon regarding the employment of labour forces (reaching a rate of 70% in general and of 60% for women, until 2010), EU must generate approximately 23,5 milion additional labour places, of which 7 milion should be destined for women, and 7 milion to perons between 55 and 64 of age.

Under the same chapter – social cohesion, the report indicates that poverty – defined for the EU by incomes under 60% of the national average amount– affected in 2004 almost 20% of population in Lituania, Poland, Ireland, Greece, Spain, Portugal and 10% in Holland, the Czeck Republic and Sweden. 16% of the EU population (75 milion) were menaced by poverty in 2004.

In the same sense, the education levels increase in general even if they remain quite reduced in the economic undeveloped regions. As regards the university studies, the number of persins with a master's degree vary from 35 in Finland to 10 in Romania. Nevertheless, the levels of education of youth are not as they should be, especially in Romania, the Czeck Republic, Italy and Slovakia.

Great Britain have registered in general a decrease of the unemployment rate, and the regions from Germany, Austria, Holland and Belgium a slight increase.

Territorial cohesion

- The GDP in the EU-27 concentrated territorially less in the traditional European core, but the concentrations remain obvious at national level

The areas in the developed regions, namely around London, Paris, Milano, Munich and Hamburg has had in 2004 a substantial lower quota from the GDP of the EU-27 as compared to the year of 1995, even if the proportion of population remained stable. This trend is due to the emergence of new development centers such as Dublin, Madrid, Helsinki and Stockholm, but also Warsaw, Prague, Bratislava and Budapest. But within the member states, the economic activity is concentrated rather in the region of main cities on the entire territory of the EU, exception being Berlin and Dublin.⁴⁷

- The occurrence of suburbanisation trend, combined with depopulation of rural areas and a trend of increase of possibilities of cross border exchanges

The dominant trend in the European cities is the suburbanisation trend. Between 1996 and 2001, in 90% of the urban agglomerations, the increase rate of population from the suburbs was higher than the rate of population in the center of towns. A third of these urban agglomerations have lost inhabitants in the period mentioned; nevertheless, in the majority of cities the suburbs have developed concomitantly with the decline of the central urban area.

The significant migration outside the rural areas represents still the dominant trend in numerous regions of the EU, especially in Southern Italy, northern Finland, Sweden and Scotland, the Eastern part of Germany and Poland. Numerous years of cross border programs have improved the cooperation between the border areas within the EU-15, especially between Benelux, Germany and France. The new internal borders are still not sufficiently permeable and the traffic flows are much lower.

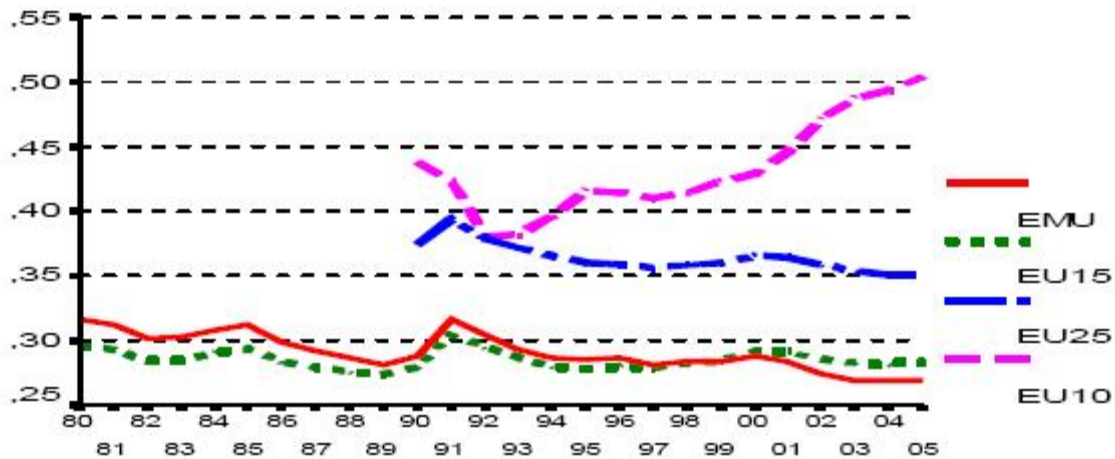
Evidence of some real convergence elements – statistical testing

a). Sigma convergence

Enrico Marelli (2007), using as dispersion index a variation coefficient of regional income for four territorial aggregates (EMU, EU15, EU25 and EU10), reached the following conclusions: the discrepancies seem to have decreased beginning with the year of 1980 (with a small exception at the beginning of the 90s) both in EU15 and in the Euro area, where the evolution for the latest 15 years leads to the conclusion that „Euro does not seem to have accentuated the regional discrepancies”. Also, for the entire range of EU25, the discrepancies computed have decreased, even if, nevertheless, within the group of new member states (EU10), they rather increased.

Graph no. 2.3: GDP/capita level – regional dispersion for country groups (coefficient of variation)

⁴⁷ Between 1995 and 2004, as average, the regional quota of capital cities of the national GDP increased by 9%, while the population increased by 2%. This trend was extremely powerful between 1995 and 2000, especially in Warsaw and Bucharest.

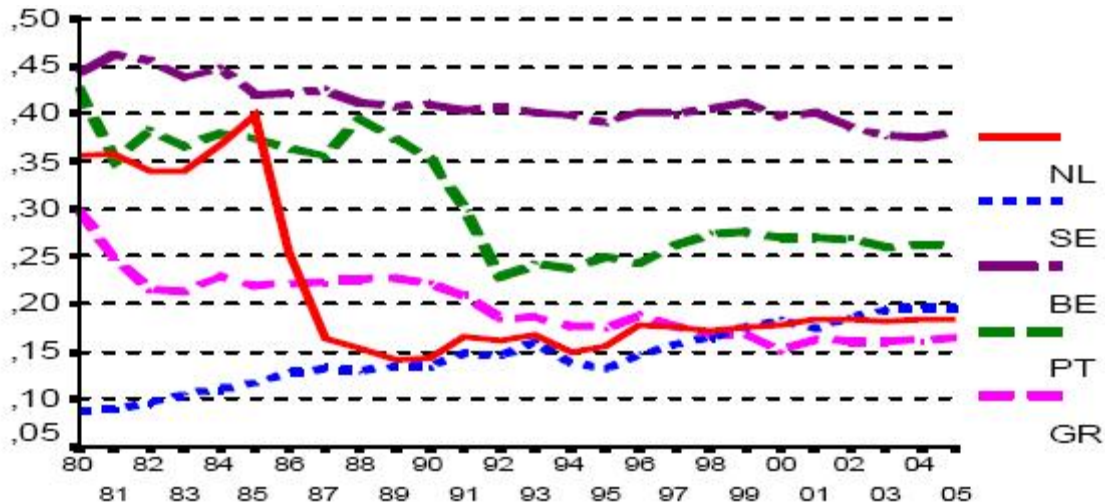


Source: Marelli (2007)

At the level of regions in the European states (the regional convergence *within* the member states) things seem not to have changed significantly. In Germany for example, the discrepancies have increased as a consequence of the reunification process. Similar evolutions have been noticed also in Great Britain (somewhat milder, and only in the 80s) or in France. Spain is the only example where the decrease of territorial discrepancies seem to be related to the accession to the EU family (but is only a correlation; the causality remains to be proved). Other interesting conclusions of the research of the same author mentioned above are: between the average size member states (others than the new member states EU10) only Sweden did not register any large scale decrease of internal discrepancies.⁴⁸ Regarding the new member states, the internal regional discrepancies have increased in all these states.

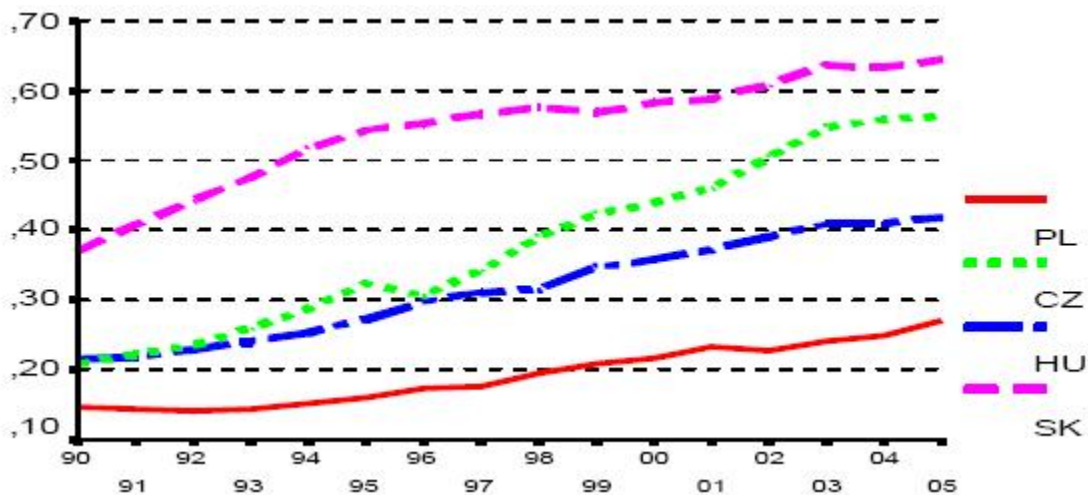
Graph no. 2.4.: GDP/capita level - regional dispersion for countries I (coefficient of variation)

⁴⁸ Cumulated with the information above regarding the UK, it would result that the discrepancies have created problems which are rather in the states outside the EUR area (Sweden, UK).



Source: Marelli (2007)

Graph no. 2.5.: GDP/capita level - regional dispersion for countries II (coefficient of variation)



Source: Marelli (2007)

b). Beta convergence

Hereinafter we shall underline a few conclusions which may arise regarding the beta convergence of European countries. We shall take in consideration the same survey performed by Enrico Marelli mentioned above.

The author mentioned performed a survey on beta convergence on three directions: GDP/capita, employment and productivity.

Regarding the beta convergence of GDP per capita, the same four territorial aggregates above were taken in consideration – EMU, EU15, EU 25 and EU10 – and the four main periods – 1980-2005, 1990-2005, 1990-1999 and 1999-2005. In almost all the cases a significant level of convergence was registered in the EU regions, the only major exception being the states becoming new members during the period 1999-2005. The conclusion underpins the idea that

the recent quite rapid convergence of these states towards European average levels was achieved to the disadvantage of regional redistribution. The convergence was also more intense in the Euro area than in EU15, and even more than in EU10.

Regarding employment, proceeding according to the same method as above, the beta convergence was registered in all the four periods and in three of the four territorial aggregates (exception being again UE10, during the period 1999-2005).

Last, if we take into consideration the productivity, computed as added value per employed person, a significant convergence level was registered, even superior than income per capita or employment. Also, somehow surprising, during the recent period (1999-2005), the group of new member states (UE10) does not seem to be an only exception any longer, but the Euro area as well.

Chapter 3. Complementarities between structural funds and national policies in reaching the objectives related to economic development and cohesion

3.1. National Policies and the competitiveness and cohesion objectives

The analysis on the relationship between national policies and cohesion policy started from the following premises:

- a) The national policies play a different role with respect to achieving different economic and social cohesion objectives. Thus, it is evident that, concerning the growth boost they entail and complete the structural instruments' action, while related to the reduction of regional disparities, they do not always aim at such an objective (only national policies of regional development);
- b) National economic policies of EU member states are more and more influenced by policy tendencies existed at EU level and carried out in the documents – programs, by which the structural reform are coordinated.
- c) Taking into consideration that in the present study the analyses concern the connection between competitiveness and cohesion objectives, this chapter will examine those instruments of economic policy by which reaching of these connected objectives is pursued, in the EU member states. Consequently, this subchapter underlines the tendencies in the EU countries under the following aspects:

§ structural and institutional reforms having as priorities growth and jobs; both of them represent, in fact, cohesion policy objectives (convergence and social cohesion) and Lisbon New Strategy objective (competitiveness):

§ public expenditure policies;

§ national policies of regional development.

I. Structural and institutional reforms

All EU countries have elaborated National Reform Programs by which they pursue to carry out the structural reforms with the scope of achieving the objectives of New Lisbon Agenda focused on growth and jobs⁴⁹.

The policies under the Reform Programs apply to 3 levels: macroeconomic, microeconomic and employment.

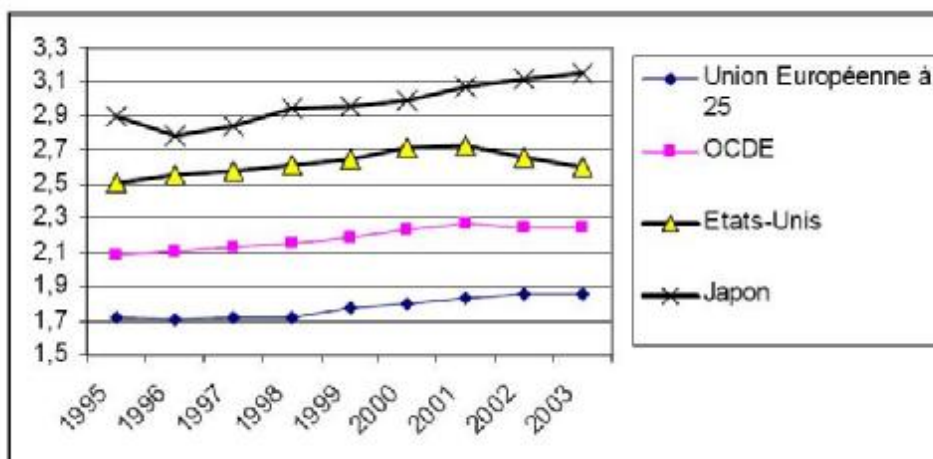
- a) The macroeconomic policies have as main objective the budgetary consolidation and propose a reform of the pension and health systems (both being in potential conflict with some orientations mentioned previously, like the guarantee of high social protection, which

⁴⁹ Their landmarks include the Integrated Guidelines for growth and jobs for 2005-2008, elaborated by the Commission, with such main directions: research-development and innovation, efficient usage of resources and energetic efficiency: SME's potential release, entrepreneurship and education: human capital investment and flexibility of labor market associated with the guarantee of high social protection.

shows the coexistence, in the Guidelines, of some contradictory objectives). However, 9 of the member states, the cohesion states, declare the infrastructure investments as a priority.

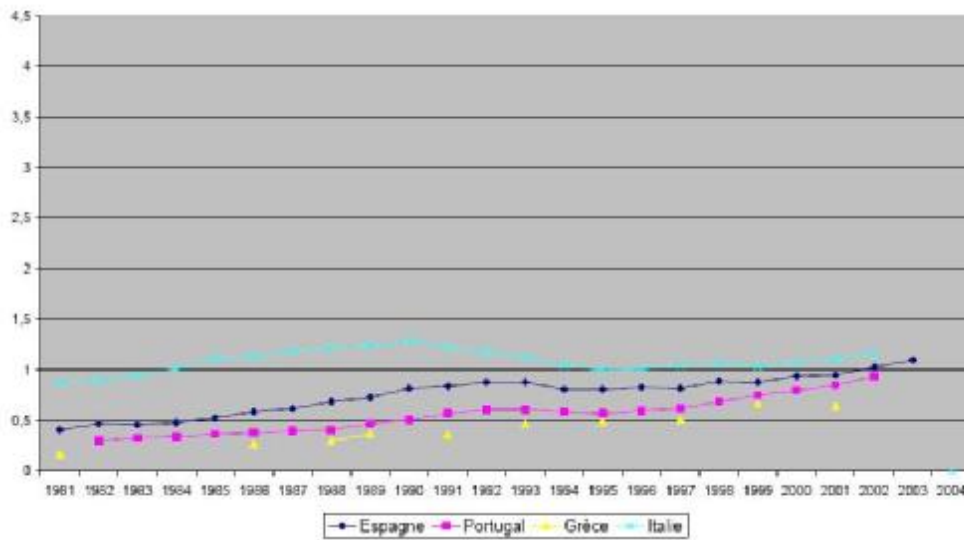
b) As regards the microeconomic level policies, most of the member states have research and development and innovation, creation of new companies and adequate environment for their development, as their main provocation. EU has to regain a relative big gap against to other power poles concerning expenditures for research and development (graph 3.1.), which would justify their choice as a priority. In fact, the member states, and especially the cohesion ones, are very far from the Community objective of 3% of GDP (graph 3.2.).

Graph no. 3.1: R&D expenditures, % GDP



Source: Amable (2006).

Graph no. 3.2: R&D expenditures, in some EU 15 member states, % GDP



Source: Amable (2006)

a) Regarding employment, the most frequent option for the member states is that of supporting, by various means, the improvement of adaptability capacity for workers and companies to change and not of state intervention in favor of creating new jobs. The main purpose of these measures is to attract and keep increasingly more people on the labor market. The first evaluation made by the European Commission, at the end of 2006⁵⁰, on the quality of this national programs and the resulting outcomes, start from the assertion that there is a normal difference within their content at the level of member states and that the programs lack the connections between the three levels of reform: macroeconomic, microeconomic and jobs. Another general remark made by Commission is that, by the present time, the transfers from the structural funds contribute to small extent to achieving the objectives of New Lisbon Agenda. Therefore connection of cohesion objectives to competitiveness ones is relatively reduced. The Commission report on growth and jobs outlines some deficiencies of the national policy, at the level of member states, which continue to exist during 2005 – 2006, like: unconsolidated public finances, a slow labor market reform, reduced competition on services market, especially the network ones. Among the policies and measures applied by member states, which aim at the growth and jobs objectives, we have chosen to present some belonging to three priority fields at European level: research-development (R&D) and innovation, improvement of business environment and market functioning, and employment. The first two play an important role in supporting competitiveness and growth, while the third one in achieving social cohesion.

R&D and innovation

Half the member states have applied fiscal incentives for R&D in private companies. Spain intends to reduce the tax on reinvested profit for companies who invest in R&D, following Holland's example, while Hungary will simplify tax deduction. Spain, Denmark and Estonia

⁵⁰ "A Year of Delivery", The European Commission's 2006 Annual Report on Growth and Jobs, COM (2006) 816 final, part I, 12.12.2006, Mise en oeuvre de la Strategie de Lisbonne renouvelée pour la croissance et l'emploi, "Une année de résultats", COM (2006) 816 final, partie II/2, 23.02.2007

have already made specific programs aiming at increasing the number of researchers within the companies. Spain and Portugal created a common research institute. Germany launched an excellence program to promote excellence in universities and so did Italy. In Slovenia, a relatively recent initiative of clusters (like in France, where there exists a program to create competitiveness poles) gave promising results: in 2004 there were already operating 18 groups of management for these clusters which facilitated the cooperation between 450 companies and 40 education and research institutions. In Lithuania the government created an Institute for technology whose purpose is to assist companies in the research, technological development and innovation fields.

Improvement of business environment and market functioning

Several countries took measures to more closely and more firmly supervise the implementation and application of Community legislation in terms of Internal Market (IM), in accordance with the prevailing trend, according to which IM plays a key role in achieving EU objectives on growth and jobs (creating an ever greater number of working places).

In contrast to official opinions which underline only the positive effects of IM the academic opinions are slightly different. The standard opinions assumed in the integration practice points out the fact that participation to IM is associated, for companies, to scale economies, which lead to competitiveness growth, to a more efficient allocation of resources, to a national and regional specialization in accordance with real comparative advantages. In addition, further to a tendency of equalization of the incomes of the production factors, a real convergence of per capita income is achieved in the participating countries⁵¹. The nonstandard opinions underline the interaction between specialization dynamics and the agglomeration effects. In an analysis on the effect of Spanish economy participation to IM Barbara Dluhosch⁵² affirms that benefits of this participation were practically eliminated in Spain by the agglomeration tendencies of economic activities in IM around economic power centers. So that the commercial flows and capital investments have a tendency to concentrate in these regions at the expense of less developed regions and countries. In addition, the producers of newly integrated countries in IM face a reduction of their own internal market, due to the competition made by more competitive companies from the developed countries. Consequently, for some of them, unitary costs rise (and do not lower as a consequence of scale economies) and therefore the competitiveness of their products on internal and external markets does too. Admitting these possible effects, of market failure type, the necessity of the cohesion policy would come forth⁵³.

a) But IM can reach its full potential benefits only if its legislation is introduced and effectively applied by all member states. One of the latest evaluations made by European Commission on national legislations to be introduced for the directives on IM⁵⁴ permits the remark to be made with reference to an existing correlation between IM functioning and

⁵¹ See also Pelkmans, *Integrare europeană*, ed. a II-a, IER, 2003.

⁵² *On the fate of newcomers in the European Union: Lessons from the Spanish Experience*, Banco de Espana, Documento de Trabajo, 1996

⁵³ Even Pelkmans recognize the necessity to counteract the agglomeration tendencies by the structural funds, see op. cit. ,pag. 306

⁵⁴ Internal Market Scoreboard: Member States need to focus on correctly applying Internal Market rules, Press Releases, Brussels, 2 July 2007, <http://www.europa.eu/rapid/pressReleasesAction.do?reference=IP/07/991&format=HTML&aged...9/5/200>

general economic performances of the countries. According to it, the more accurately the directives are transposed, the more efficient is the market functioning and the positive results are visible. Compared with the European average of 1,6% transposition deficit (June 2007) most of cohesion countries were close to the average, but some of them had greater deficits (Poland 1,8%, Spain 1,9%, Czech Republic 2,3%, Greece 2,4%, Portugal 4,4%, Bulgaria 2,9%, Romania 7,4%).

b) A second problem related to IM legislation transposition is represented by its infringements. The Commission has drawn the attention, at the beginning of this year, to an alarming tendency of increasing number of such situations registered in the member countries⁵⁵. The fields where such problems arise more frequently are environment, customs union, taxation, energy and transport (half of cases). Among the countries which registered an increasing number of such cases, the Commission named Malta, Poland and Ireland, but the countries which registered most cases of this type are Spain, Germany, Greece, France and Italy.

c) Moreover, in order to avoid changes in legislation, some member states discourage adding new dispositions to the Community ones and, in correlation to this tendency, there exists a tendency towards simplifying the administrative procedures, which apply to companies or to citizen⁵⁶. If some states have already issued real simplifying programs for legislation (Denmark, Ireland, Sweden, Luxembourg) others will launch theirs in the shortest possible time (Estonia, Poland, Slovenia, Spain). Simplifications first of all aim at legislations on taxation, company's administration and control, setting-up of new companies, insolvency procedures, protection of consumers and employees. Consequently, it became possible to launch a company in less than 2 weeks in Denmark, France, Holland, Italy and Finland. The Latvian entrepreneur can now recruit his first employee by one simple procedure.

d) At present, many member states undertake analyses on administrative costs imposed by the legislation (Austria, Belgium, Cyprus, The Czech Republic, Denmark, Estonia, France, Germany, Latvia, Portugal, Slovenia, Great Britain), considering also the suggestions given by the Commission in October 2005⁵⁷, addressed to the Council and to the member states regarding this objective. As a result, 5 states target at reducing by 20-25% the administrative costs by 2010 (the Czech Republic, Denmark, Holland, Sweden and Great Britain).

e) With respect to the markets functioning, EU member states have in view, as a priority, removing the obstacles, and full liberalization of energy and services markets (Slovakia, Ireland).

f) Others interesting directions aiming at increasing the liberalization and internationalization of member states economies are worth mentioning. For instance, Portugal

⁵⁵ idem

⁵⁶ "A Year of Delivery", The European Commission's 2006 Annual Report on Growth and Jobs, COM (2006) 816 final, part I, 12.12.2006, Mise en oeuvre de la Strategie de Lisabonne renouvellee pour la croissance et l'emploi, "Une annee de resultats", COM (2006) 816 final, partie II/2, 23.02.2007

⁵⁷ The European Commission recommended to reduce the administrative cost for the firm by about 25% until 2012.

has intends to develop a program by which the national companies' internationalization should be supported.

Employment

One of the public policies used to influence the evolution of employment is the public expenditure policy. Under the pressure of Community trends, a change in priorities takes place in this field, namely from the social transfer meant to counteract deepening of the income gaps of various categories of people (unemployed, pensioners) towards supporting competitiveness factors (education, health - for most member countries; infrastructure for some cohesion countries).

For instance, in order to increase the labor productivity and labor capacity to meet the labor market requirements, some states have increased the expenditure to education: Great Britain, Ireland and Finland. A new law in Greece is reforming the national system of education and labor formation for life long period. In most of the states, action is taken in order to reform the pension system, so that its validity should be consolidated on a long-term basis. For example, Belgium, Spain, France, Austria, Portugal, Finland have tighten the link between subscriptions and payments as by allowing a greater share in calculating the subscription years against pension age. Several of the new member states (Estonia, Latvia, Lithuania, Poland, Hungary and Slovenia) have diversified the risk of pension systems, transferring part of funds from compulsory pension systems to private ones. Pension system reforms account for the increase of employment rate of elderly people, since 2000, by the increase of the age for retiring.

II. Trends regarding the government expenditure

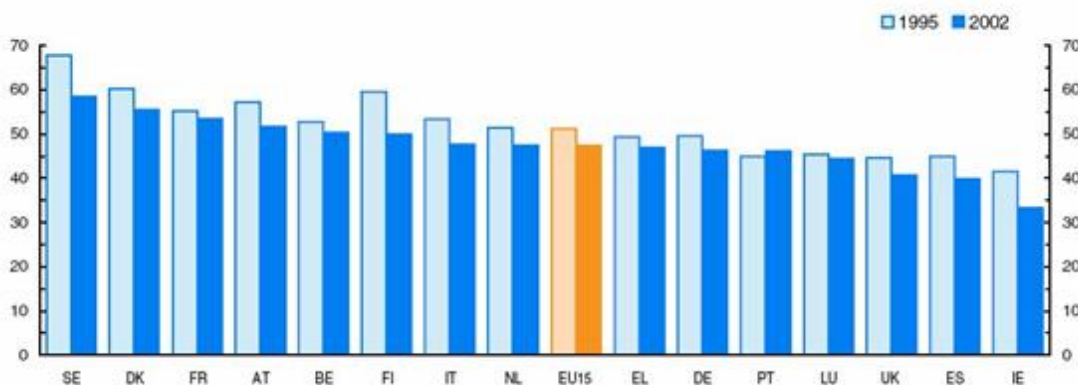
National policies on public expenditure influence the competitiveness objectives and economic and social cohesion objectives both directly and indirectly. We shall analyze their evolution under several aspects: value volume and destination. We shall focus our attention on the evolution of basic public investments, which represents the expenditure chapter that is considered to have, as to the neoclassic theory, a decisive impact on the real convergence evolution.

a) Public overall expenditure amount is, in most of EU member countries, usually greater than the volume of transfers from Community's Funds (structural and of cohesion), hence, their impact on cohesion objectives is greater, although they are not targeted necessarily on the less favored regions but on national territory as a whole. At present, in most EU member countries, there is a tendency to consolidate public finance (the determining factor being euro sustenance for euro area country), that is a pressure to reduce general public expenses level as a GDP share. Therefore, on the whole of 15 EU countries, during 1995 – 2002⁵⁸, the share fell from 51% to 49% (see the graph 3.3.). It is considered that fiscal adjustments does not affect economic growth if they are associated with structural reforms, meant to increase competitiveness of overall economy. However, at European Commission

⁵⁸ European Commission, *A new partnership for cohesion: convergence, competitiveness, cooperation*, Third Report on Economic and Social Cohesion, European Communities, Brussels, 2004

level⁵⁹ there was admitted that this adjustment of public overall expenditure affected mostly the less advanced economic regions.

Graph no. 3.3: Governmental expenditures in EU 15, % GDP



Source: Third cohesion report (2004)

b) Destination of public expenditure differs from each country, according to political and social engagements and agreements, specific to each country. Out of the total of public expenditure the sums allotted to regions by national regional policies are established according to several criteria: population, its structure based on age, need for social support. Here are some changes in the structure of public expenditure, seen from the destination point of view, which occurred in the period 1995 – 2002:

1. expenses for social protection were reduced (representing 16% from GDP) although the evolutions were complex: number of pensioners increased (sums destined for their protection represented about 46% of total social benefits) but the number of unemployed decreased due to the structural reforms initiated on the basis of Lisbon Agenda (countries with different tendencies, as compared to the general trend, were: Greece, Portugal, Ireland, Germany);
2. reductions were registered also, by most countries, in expenditure meant for business support (minus Portugal) and for infrastructure (without Greece and Ireland) and in salary payment for public sector workers;
3. public expenses in education and health fields remained constant.

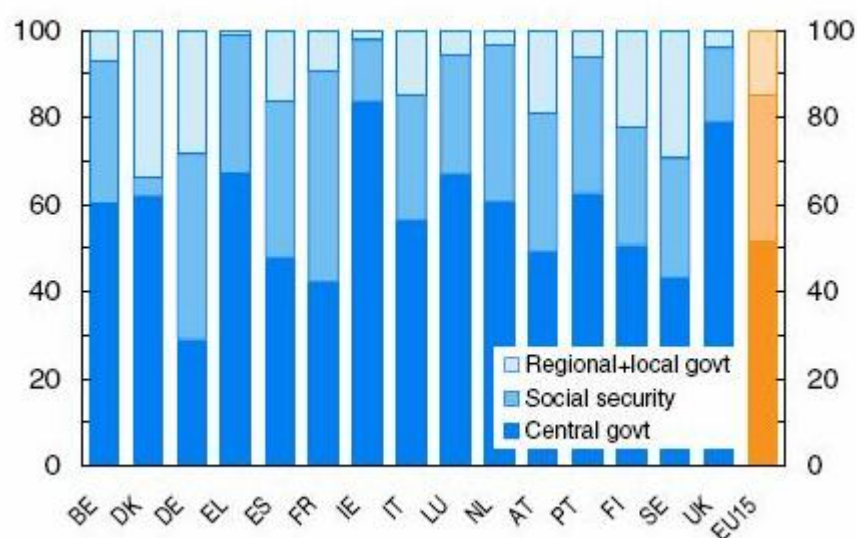
In the cohesion countries, allocation of public expenditure on certain destinations is more closely linked to allocation of Community funds; this tendency is certainly determined by additional principle (in Greece the regions who get big Community transfers also receives substantial funds from the national budget; in Spain the inter-

⁵⁹ European Commission, *A new partnership for cohesion: convergence, competitiveness, cooperation*, Third Report on Economic and Social Cohesion, European Communities, Brussels, 2004

territory compensation funds allocated from the national budget are directed to Objective1 regions).

c) The governing system specific to each EU country determines the decentralization degree of collecting the public incomes (graph 3.4) and allocation of public expenditure, a characteristic feature which influences their impact on economic and social cohesion objectives. This trend manifests itself in different degrees on different types of public expenditure. Mention should be made that once the decentralization of responsibilities to regional and local authorities is applied, there also takes place a consolidation of measures to insure that the less prosperous regions should not be disadvantaged, not having enough funds of their own (income from local taxes being compensated by national schemes aiming at either providing supplementary funds or leveling of fiscal capacity). However the need for expenditure, at local or regional level, is estimated at the central level in such a way as to ensure a standard level of public services per capita.

Graph no. 3.4: Public revenues structure in EU 15 (2001), by source



Source: Third Cohesion Report (2004)

We detail our analysis on public expenditure at one of its destination, namely, public investments in the basic infrastructure.

Public investments and cohesion policy

If the positive influence of public investments on the growth was not always sustained by empirical evidence, more recent studies show that opinions agree on the existence of some positive effects. Public investments, largely understood, refer both to investments in physical capital and to human capital. Because of difficulties in having access to comparative data, a fact recognized even by the Commission⁶⁰, our analysis is focused on public investments, mainly on the accumulation of fixed capital⁶¹. Any further comment on public investments refers actually to this type of investment.

The effects of investments in the infrastructure on the growth are difficult to be evaluated, due to a long time period involved – over 25 years.

The factors which optimize the impact of public investments on economic performances are:

- a) expenditure structure for public investments; those which seem to have direct economic effects are: building of road and railway networks, airports, urban transport systems and energy distribution networks;
- b) the way of financing the investments which can be alternative or a combination of more types: by tax increase, by loans, by reducing other government expenditure;
- c) institutional quality, administrative and management capacity of the authorities;
- d) dimension of existing equipment;
- e) their degree of being complementary to private investments.

Trends on public investments during 1993 – 2005

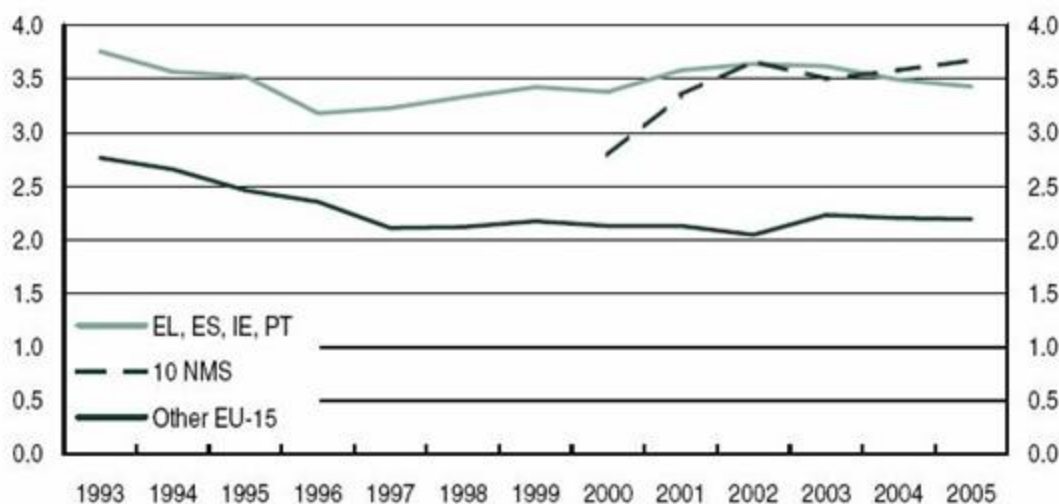
The general tendency of 15 – EU countries was to diminish the share of public investments in GDP (from 2.9% to 2.4% in the whole EU) and in the total amount of budget expenditure, in the period 1993 – 2005, except for some cohesion countries (Greece, Ireland). However, in cohesion countries, as a whole, the share of public investments in GDP is by about 50% higher compared to other 15 EU countries⁶². It is obvious that this evolution is accounted for mainly by the sustenance of this tendency by the cohesion policy (graph 3.5). During 2000 – 2006, transfers from structural Funds represented on average 60% of the overall public investments expenditure in Portugal, 48% in Greece and 24% in Spain.

⁶⁰ See the cohesion reports.

⁶¹ Because they are individualized in the national accounts.

⁶² European Commission, *Growing Regions, growing Europe, Fourth report on economic and social cohesion*, European Communities, may 2007, http://ec.europa.eu/regional_policy/sources/decoffice/official/reports/cohesion4/index_en.htm

Graph no. 3.5: Evolution of public expenditures on investments in old cohesion countries and new member states as well as in the other EU member states, % GDP



Source: Fourth report on economic and social cohesion (2007)

Reduction of public investments in EU member countries is accounted for by the following factors:

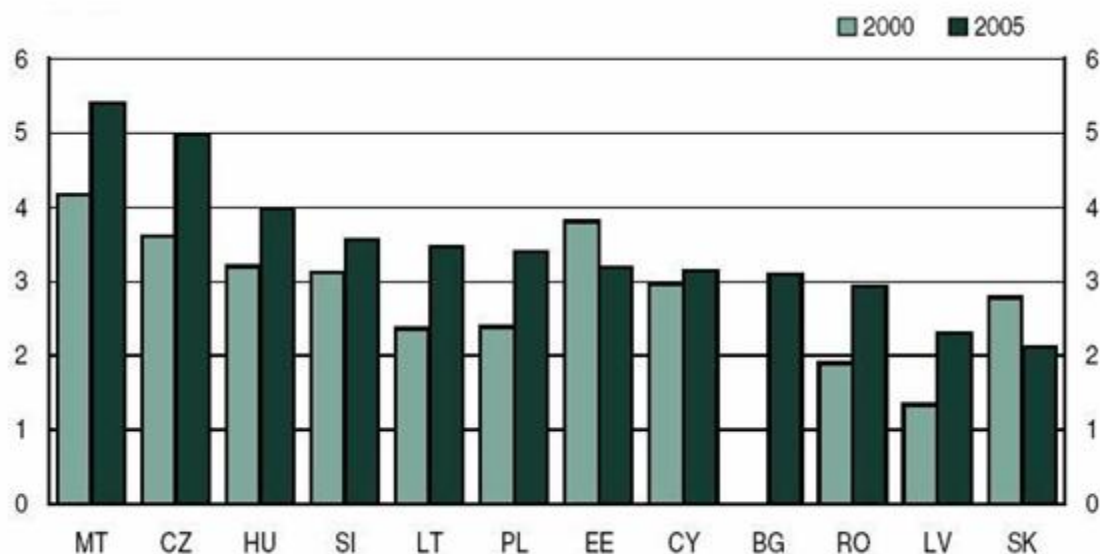
- general tendency to reduce the public sector;
- growing participation of private sector in the public investments projects;
- the pressure applied by the requirements of Growth and Stability Pact to reduce the budgetary deficits.

The states which increased the investments have done it on account of tax increase, under compulsion to reduce budget deficit (Spain).

In the new member countries, the share in GDP of basic public investments had the tendency of getting close to the level reached in the cohesion countries – 3.7% compared to 3.5% (graph 3.5 and 3.6).

The Commission was in favor of maintaining this level in these countries, taking into account the necessity to catch up with the gaps compared to the other member countries, on the condition of maintaining budgetary stability.

Graph no. 3.6: Public investments in new member states 2000 – 2005, % GDP



Source: Fourth report on economic and social cohesion (2007)

The correlation between budget consolidation and reduction of public investments seems to be ambiguous in the new member countries, because in most of them, although the first tendency existed, it did not correlate to the second one. Thus, the tendency of budgetary consolidation coexists with the one of growing the infrastructure public investments in these countries. The funds transferred from the EU can support this tendency, necessary to be maintained, given the large gaps at this chapter between the new states and the old member states, including the 4 cohesion ones.

a) But there exists a possible conflict between real convergence (GDP increase per capita) and nominal convergence (expressed firstly by budgetary consolidation, therefore a share of budget deficit of below 3% from GDP), the later being necessary not only for association to euro area but also for maintaining of long-term economic growth. Cohesion policy can exacerbate this conflict in as much as the obligation of the beneficiary countries to co-finance the community transfers leads to the increase of budget deficit and of inflation pressure.

b) The basic infrastructure (transport and telecommunication, energy, research-development linked to economic affairs) represents the most important type of public investments, which is allocated about 8% of GDP on average for 15 EU countries and about 1.5% of GDP for cohesion countries (for these about 45% of total public investments). A similar situation is encountered in the new cohesion countries, with significant variations between them. But some economists, like Pelkmans (2003), said that the telecommunications and information infrastructure is more important, for these countries, than the transport one.

c) Administration system and the amount of regional and local competence in managing the public investments⁶³ vary from one member state to another. For instance, in

⁶³ It doesn't refer forcedly to their financing from local sources.

the case of 15 EU cohesion countries, like Spain and Ireland, decentralization is high (70% respectively 80%, especially for roads and education), while in Greece it is rather reduced (20%). In the new member states, the trend is to maintain centralization (more due to low funds level), except for Poland, Czech Republic and Latvia.

The general decentralization trend is to be explained by the perception that local and regional authorities have a better knowledge of the needs in the respective areas. But they point out the fact that decentralization is efficient only if it is associated with the: existence of a local and regional efficient administration and central control systems for the efficient management done at the local and regional level.

According to the Commission evaluations⁶⁴, assignment of responsibilities concerning public investments at regional level seems to facilitate absorption of structural funds.

III. National policies of territorial⁶⁵ (regional) development

The approach on territorial development differs from one country to another and it reflects:

- a) institutional characteristics of that country (which determines the finance centralization or decentralization degree and its application);
- b) opinion changes on development decisive factors.

In addition, mention should be made that there exists a trend of changing the view regarding the regional development policy. In the past, it was based on a large re-distribution of budget funds, oriented especially towards infrastructure projects and on drawing direct foreign investments in the less favored regions. At present there is a tendency to focus on the valorization of local and regional assets (and in a less degree on the internal or external transfers) and, at the same time, on the growth of competitiveness at the regional and national level. The emphasis goes therefore towards supporting local companies to become more competitive and not only on developing the physical regional infrastructure, but on turning into account other factors, less tangible.

The national policies of regional development⁶⁶ of EU member countries have a variety of objectives and means. Regarding the objectives, some focus on drawing great infrastructure projects in the less favored areas (Ireland) or on creating more jobs (Ireland), others on creating clusters, this being the latest trend and in compliance with the new outlook on regional development previously mentioned⁶⁷. Regarding the means, they are of different types: support for SMEs, aids for industrial restructuring (in case of production and jobs cut-down), assistance for research-development and innovation. Since some of them are classified as state aid they belong to restrictions derived from regulations on competition

⁶⁴ *Growing Regions, Growing Europe...*

⁶⁵ There doesn't exist a perfect agreement on the meaning of the word „territory” in EU and in the member countries. For instance, it does exist in Germany and in the cohesion countries, but in France it doesn't.

⁶⁶ The national policy targeting to decreasing the disparities, by supporting the economic activities in less favored regions.

⁶⁷ *Competitive Regional Clusters: National Policy Approaches*, OECD, may 2007, <http://www.oecd.org/document/2...>

policy and can be used only if they do not contradict these regulations. Nevertheless some of these instruments of regional development policy, which do not address to certain companies, cannot be classified as such, and therefore can be used: subsidies granted to private companies which supply services of general interest, assistance given by a private company to another one.

One of the trends of regional national policy is that of attracting the FDI both at general level and in the economically lagging regions (see appendix 5).

The specific dilemma of cohesion countries under this aspect is that FDI tend to focus on the most developed regions (usually around capitals) while the government would like them to be oriented, at a higher degree, towards less developed regions. For example in Spain, 70% of the inflow gathered around Madrid and only 1.5% went to Objective1 areas, while in Greece only 1% went to Objective1 areas.

3.2. Experience of the “old” cohesion countries

I. A comparative analysis of cohesion for the EU15 cohesion countries

Cohesion countries⁶⁸, called like that due to the low level of the income/capita, in comparison to the other Member States, represent a distinct group of members of the EU. At the beginning, in this category were included only Greece, Spain, Portugal and Ireland as member states without any geographical proximity or strong cultural similarities, were included into a separate systemic category, opposed to the core of the Union, made up of rich countries. The last two stages of enlargement brought in the Union economies which, by their low economic performances, in comparison to the Community average fit into cohesion countries' category as well.⁶⁹

Similar to all the other member states and the EU as a separate entity, these cohesion countries developed in the last decades different stages of increase or decrease cohesion. Between 1960-1973, in the period of consolidation for the integrative structures, economies converged on the basis of the general process of political stability and of economic growth and development. Between 1974-1986, covering the period in which the cohesion states became members of the EU (except Ireland which entered in 1973), on the general trend of economic decrease generated at world level by the two oil shocks, a general tendency of divergence has occurred. The actual period is one of re-launch of convergence in relation with deepening integration and enlargement.

By analyzing these stages, one can identify a number of factors of influence for convergence. According to the results of the studies on convergence in cohesion countries, developed by Frank Barry⁷⁰, similarities may be identified between the determining factors of the economic

⁶⁸ Cohesion countries are also called „peripheric countries” referring to their geographical position but, more than that, to their economic development.

⁶⁹ Nowadays, cohesion countries are Bulgaria, Czech Republic, Estonia, Greece, Cyprus, Latvia, Lithuania, Malta, Poland, Portugal, Romania, Slovenia, Slovak Republic and Hungary. There is a second type of Member States which act under Convergence Objective (NUTS II), which are: Bulgaria, Estonia, Latvia, Lithuania, Malta, Poland, Romania, Slovenia and regions from Czech Republic, Germany, Greece, Spain, France, Hungary, Italy, Portugal, Slovakia and Great Britain. For regions beneficiaries of structural funds until now, there is a phasing-out payment system in the financial perspectives 2007-2013.

⁷⁰ Frank Barry, *Economic Integration and Convergence Processes in the EU Cohesion Countries*, JCMS 2003, volume 41, number 5, Blackwell Publishing LTD 2003, pag 900,

behavior before adhesion, both for the old and the new cohesion countries, among which we mention:

a) gradual decrease in the level of trade protectionism along with an increase in the state control over given sectors which developed in a different way for each of the cohesion countries. In a first stage, called “the golden age of European construction” between 1960-1973, 3 out of the 4 cohesion countries registered a decrease in real convergence, along with decreasing trade protection. In Spain, after a period of relative autarchy, the removal of barriers on the imports of raw materials and capital goods determined the modernization of consumption goods, the ratio of this sector in the total exports doubled in the period of time mentioned above. At the same time, the state involvement in the sectors producing capital goods, chemistry or energy remained high.⁷¹

On the position of a founding member of E.F.T.A., Portugal partially liberalized its trade, mainly to Great Britain, for products like textiles, shoes and wood, keeping a high control on the basic industrial sectors, such as metallurgy, cement and petrochemicals. As for Greece, the removal of tariff barriers was a slow process and the involvement of the state was not present in some of the important sectors of the economy, like banking, electricity and communications. Ireland reduced, starting from 1950, the level of custom tariffs (with Great Britain concluded a free trade agreement in 1966) and after 1973 adopted the common external tariff. For Ireland, the opening of trade overlapped with the removal of profit taxation, for the exporting manufactured products, for textiles, shoes, breweries and cigarettes, up to high technology products, along with a severe reduction of food exports. The public property was limited to transport and telecommunications, sectors which were maintained under public control in most of the member states, in the given period.

This trend could be identified in the new cohesion states as well, which applied restrictive trade policies until the moment of signing the Association Agreements, which was followed by a gradual opening of their markets towards imports.

b) Labor market management connected to employment, salaries and migration. In the ‘60s, each of the cohesion countries had to face high rates of emigration. At the same time, in Spain, Portugal and Greece, salaries increased at a moderate pace and by this attracted foreign investments more than Ireland, where salaries increased between 1960 and 1973 with over 19%. Between 1973 and the end of the ‘80s, following the general process of economic decrease generated by the oil shocks, decrease in the level of productivity of almost all European states was registered, except for Spain, Portugal and Ireland, where the average labor productivity was over the Community average. From the political perspective, democracy in Greece, Spain and Portugal following the first oil shock determined a rise of salaries and a reconsideration of limits and fields of intervention of the state in the economic mechanism. In this respect, we mention Spain, where along with the pressure put on salaries, a strong pressure on subsidies and social protection could be observed leading to an increase in the tax pressure and the slowing of economic growth. The same situation was common in other Member States of the Community, in the same period of time. In Portugal, following the revolution of 1974, the increase in the budget expenses more over incomes asked for the strong intervention of IMF through macroeconomic stabilization programs⁷². In Greece, democracy was accompanied at the beginning of the ‘80s by rising taxes on corporate profits along with a massive process of nationalization. In this context, an increase in the level of

⁷¹ Frank Barry, op.cit, pag. 900

⁷² Frank Barry, op.cit, pag.905

salaries with over 30%, not followed by an increase in the level of labor productivity and the role played by the government as “employer of last resort” determined the covering of the rise of salaries by rising the amount of money on the market and lead to a low rate of unemployment and a high rate of inflation.

In Ireland, the oil shocks determined a substantial change in approaching the budget deficit, meaning that the interdiction of the budget deficit was no longer applied, leading to the rise of salaries. At the same time, the recession in Great Britain discouraged immigration and in this way unemployment rose, social expenses rose as well asking for an increase of taxes thus asking for further rises of salaries along with a high rate of unemployment. The adherence of Greece, Spain and Portugal in the Community brought about a new approach towards macroeconomic policies. The consolidation of democracy in the country enabled national governments to focus on macroeconomic problems, due to the fact that the political structures were rather stable ⁷³.

Greece, after 1981, Spain and Portugal, after 1986 continued to open their markets for goods and services and started opening markets for capital as well. At the same time, their entrance into the Exchange Rate Mechanism by the end of the period, obliged to a reconsideration of the fiscal and monetary policies and after adopting the euro, they transferred their power of decision in monetary issues from national to community level. Reforms on the labor market in Spain and Portugal between 1994 and 1997 determined a decline of unemployment due to less rigidities provided by the employment policy, reduction in the cost of firings and changes in the work practices. In Greece, labour market rigidity, distortions generated by the tax system, insufficient development of employment services represent some of the factors hindering the catching up process ⁷⁴.

Ireland is, starting from 1987, the success story of cohesion states due to the substantial changes in the rate of unemployment (from 17% in 1987 to 4% at the beginning of 2000), spectacular rise of investments, real income and standard of living. At the same time, there are some influences of the Economic and Monetary Union on cohesion, both by macroeconomic policies, and changes in the labor market. Entering the E.M.U. leads to an increase in industrial specialization and in this way a closer interdependence between the component economies and structures. At the same time, increasing specialization leads to higher vulnerability, to asymmetric shocks, emphasized by the lack of flexibility on the labor market, which is stronger in the cohesion states than in the others.

The lack of labor market flexibility is often incriminated when explaining the slowing of convergence, especially for Ireland and Spain. The asymmetrical shocks have had different impacts in the case of Ireland which due to its strong commercial links to Great Britain and dependency to foreign direct investments coming from the US benefited from the fact that the lack of labor market flexibility was replaced by the rise of demand for labour, generated by investments and exports. From budgetary perspectives, trade unions accepted a relatively constant level of salaries, under the condition of reducing taxes. However, this brought about a deterioration of public services, following the decline of financing sources.

The comparative analysis of economic performances of the cohesion states points out the fact that the main determining factors of cohesion and convergence were negatively the unfavourable conditions on the labor market, non-performing macroeconomic policies and

⁷³ Frank Barry, op.cit, pag.907

⁷⁴ Frank Barry, op.cit, pag. 908

the system of public administration. As positive factors of cohesion, we mention the structure of funds and the policies attracting foreign direct investments, open towards innovation.⁷⁵

II. Case studies: Ireland, Portugal, Greece ⁷⁶

Ireland: reduction of public expenditure, superior to the incoming European funds

For the occurrence of „the Celtic Tiger” phenomenon multicausal explanations are often, such as *European transfers* (agricultural subsidies, plus structural funds and cohesion funds), *“knowledge-based economy”*, or the *deregulation and fiscal –budgetary exemption*. Nevertheless, which is the true story of Irish success?

In the last two hundred years, Ireland has been the poorest region in the British archipelago. After the accession of Ireland to the EEC, in 1973, “the catching up” has become the main objective, but the initial instruments have been typical for the governmental Keynesian activism: high public expenses in order to absorb unemployment, high taxes, high credits for the public sector. The public debt level also became very high, but taxes, extremely high, could not be safely increased anymore.

Belonging to the ECC has deprived Ireland of monetary “expedients”: monetary inflationary expansion in order to finance the public debt was incompatible with membership of the European Monetary System (EMS). The Irish government had to discover other principles of action, which would be regarded as “attacks” to economic democracy: in 1988, the government from Dublin applied the most drastic reduction of public expenses in the last decades⁷⁷, solving the fiscal crisis. The economic freedom extended vigorously, and the role of the government in economy diminished adequately.

The Irish recipe of development would be the classical recipe (ante- and anti- keynesian): the decrease of weight of the public sector in the economy, small and balanced budgets, monetary stability, free foreign trade. Another Irish “secret” of early stage reform: *absence of populism and trans-party compromise*. The power and the opposition were hand in hand in 1987, year ,0’ of reforms, with social partners getting involved in a „social contract” both responsible and responsibility fostering: the government committed itself to low taxes and low inflation rates in exchange for payment requests moderation on the part of trade unions.

The virtuous and disciplinary effects of EU membership materialized between 1990 and 1995 in form of a very responsible monetary and fiscal behaviour – the Maastricht criteria have disciplined the public finances (the budget deficit and the public debt), and the perspective of adopting the Euro has disciplined monetary management. At the same time, the tax burden was to be relaxed both at the income tax and corporate profit tax level. Subsequently, the government from Dublin shocked once again. Accused by the states from the same „social Europe”, whose capitals migrated towards the island, for „distorting competition” due to the existence of some “special areas”⁷⁸, where corporate taxes amounted

⁷⁵ Frank Barry, op.cit. pag.910

⁷⁶ We have chosen Ireland as a succesfull « model », for Portugal, as example of missing the convergence and for Greece, as an example for recovery after a period of failure.

⁷⁷ For example the costs for health have been reduced by 6%, those for education by 7%, agriculture had a lower budget by 18%, the military expenses have decreased by 7%, and the roads and dwellings received 11% less!

⁷⁸ The area Shannon and the Center for Financial Services from the Internacional Airport Dublin.

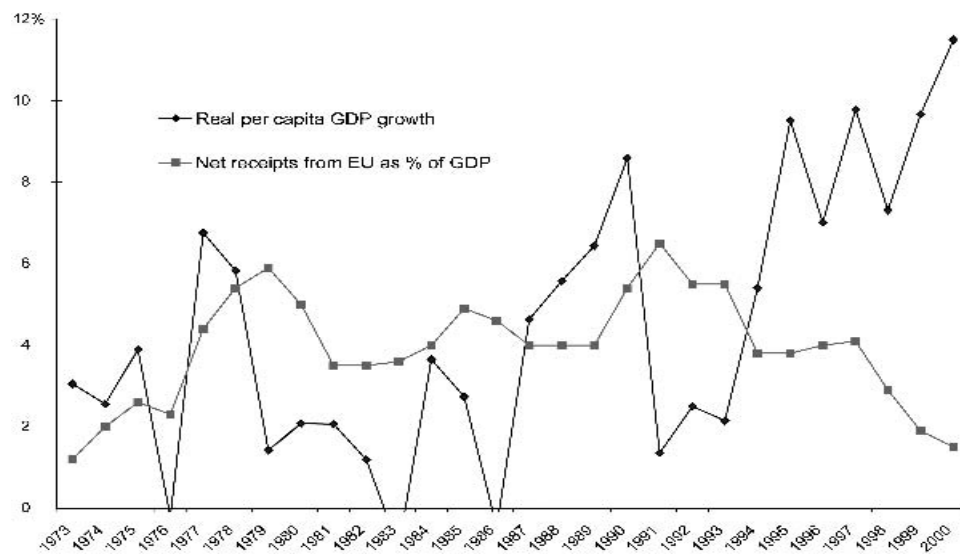
to 10% (while the general level amounted to 24%), Ireland had to comply and leveled taxes to only 12,5%.

After a sustained *forcing* with growth rates of over 5% between 1990-1995 and over 9% between 1996-2000 – and somewhat lower afterwards (we will see why) –, with important capital inflows (especially American), flourishing exports, a good demographic growth (as compared to the continent's „hardcore”), and with the acceptance of the idea of immigration, productively inserted in society and not on the pay roll of social security, as elsewhere, Ireland⁷⁹ has accomplished „more than catching-up”, having at present, after Luxemburg, the highest „positive” difference as compared to EU average: 145% the EU GDP/capita average.⁸⁰

As for the European funds and the possibility for them to be the main explanation of the Irish economic success, we shall just notice that: i). public expenses cuts were higher than the European funds entries, ii). there is a negative correlation between the economic growth rates and the amount of financial assistance⁸¹ and iii). there is no other major recipient country of such transfers from the European Union (and nowhere else either) which had similar satisfactory performances.

So, the Irish example is, most probably, a living proof of the force of private free enterprise.

Fig. 3.7. Net european transfers and growth rates in Ireland



Source: Department of Finance, Ireland (2002).

⁷⁹ The pre- community Estonia has also a story of the economic reform, similar in its essence: tariff and non-tariff unilateral “desarming”, early privatization, current and capital account liberalization, taxation unique quota, eliminated subventions, budget balance imposed by the law. (Magnus Feldman and Razeen Sally, From the Soviet Union to the European Union: the political economy of Estonian trade policy reforms, 1991-2000)

⁸⁰ And the second most reduced fiscal burden in EU – 31%, as compared to the average level of 46%. See also Dorgan (2006).

⁸¹ Empirically, if the European funds had represented a major cause of the economic growth, it would have been expected that the respective growth had been the highest during the period when the fund transfers would have been the biggest.

The slowing down of the Irish economic growth, after the beginning of the 2000's, must be interpreted with nuance: either by the conjunctural changes in the world economy – after 2001, USA, Ireland's main trade and investment partner, entered into a period of recession because of the volatility of the previous growth, which resulted in the fall of the prices of listed securities, coming from the technology intensive sectors („tech bubble burst”)–, or because of the occurrence of certain contagions with ideologies such as the „Welfare State”⁸².

None of these invalidates or fully accounts for the recipe and the significance of growth spurred by economic freedom.

Portugal: the EU funds have not compensated the structural reform deficit

Two decades have passed since Portugal joined EEC and it continues to be one of the ambiguous stories of the “(financially assisted) development by European integration”. Providential after the right-wing dictatorship of Salazar (which was economically rather open towards the exterior), and after the left-wing democracy which succeeded it (along with the “Carnations Revolution” in 1974), its entry into the European Community marked the destiny of probably the most “Balkan”-like economy of Western Europe.

Portugal's accession in 1986 produced, until the beginning of the '90's, only a percentage point movement, as compared to the revolution in '74, of the real convergence with, at that time, EU-12. The structural-type discipline – and less the fund-irrigated “catching-up” –, imposed by the EU accession, has begun to be treated responsibly only recently, the latest Portuguese governments choosing to “sacrifice” the sanitary, nominal convergence, for a misunderstood real convergence.

The economic growth, recorded in Portugal, has stayed below the EU average, starting 1999. The convergence increased by 21 points from 1974 until 2002, reaching about 74% from the EU-12 average. But from a different perspective, the GDP/capita decreased from 80% the average of the future EU-25 (1999), to 70%, last year, (or 74% from the average of the future EU-27), given the fact that fund entries were higher, as cohesion country, than for any other performers in catching-up! After 2000, the Czech Republic, Malta and Slovenia (from the group of the new EU member states), as well as Greece (from the old cohesion countries in EU-15) outran Portugal in GDP/capita growth rate. Today, Portugal's economy is marked by chronic backwardness in the classifications of almost all the European economic performance indicators. (The increase of GDP in 2006 was the lowest not only in the European Union, but even in the entire European continent). The history of economic slippages in the last years shows that Portugal was the first member state to receive warnings of penalties for failure to comply with the Stability and Growth Pact terms – the out of control governmental expenses pushed the budgetary deficit in 2005 to 6,9%, the highest level in Euroland at that moment.

At present, the Portuguese government, run by José Sócrates proposes the continuation of the „lisbonization” of the pan-European economic reform, but the Portuguese vision seems to more clearly emphasize today a discipline of means.

At home, Sócrates has already started to clean up the public finances. In his last two years as Prime-Minister, the budgetary deficit has been lowered from 6,9% to 3,8% “and lowering”⁸³,

⁸² “Over the last 5 years, the country has been sliding into the abyss of rising government spending, indirect taxation increases and more regulation and state involvement in the economy.” De Vliedhere, M. et al. (2006)

⁸³ The Economist, 2007.

and by rising the minimum legal retirement age from 60 to 65, Sócrates intends to continue the structural depressurization of his country's budgetary deficit in order to bring it, in 2008, below the 3% limit imposed in the EU.

If the Portuguese talk about Ireland as about a “small and atypical” economy, to which the comparison would not be relevant, the comparison to Spain is not at all unreasonable. Portugal shares the peninsula with Spain, which is a country perceived as the locomotive of Iberia, and where the annual rate of economic growth has been of around 3% in the last decade (except for one year). The explanation of the unequal performances between the two states varies among analysts, but the essential cannot be avoided: Spain has reformed the public sector and disciplined the public finances before EMU accession and not afterwards, as in Portugal.

When the interest rates converged downwards at the end of the ninth decade, with EMU joining, Portugal did not capitalize on the premises of economic growth by making budgetary “provisions” to cover future deficits, but forced an amplification of the growth rate by an expansionist budgetary-fiscal policy. The failure to seize this opportunity indicates why the European funds, as generous or well-oriented as they could be, could not find but a shaky ground for fructification.

The funds represented on average 2,3% from the Spanish GDP between 1990 and 2000 and 3,8% respectively from the Portuguese GDP, while the nominal economic growth was of 2,5% in Spain and 2,6% in Portugal. Moreover, the contribution of the cohesion funds in the public investments was, between 2000 and 2006 of 60%⁸⁴, the highest share in EU-15. But the result was the one already mentioned: growth rates which persist in remaining under the EU average.

Greece: two decades lost and the last just to be gained

In the first period after the accession (1981), despite some substantial financial transfers from structural funds (equivalent of 45% of GDP), Greece was the only EU member country which underwent a draw-back in GDP per capita, as relative level, in the period 1981 – 1997 (see graph in chapter 2).

The explanations are complex, they stem from two big categories of reasons which influenced these evolutions: external and internal causes.

The external causes refer firstly the economic adjustments occurred as a result of EU accession both in the 80s and in the 90s. During the latter period they were determined by the implementation of the unique internal market UIM and by the preparation of the economy to accede to euro area. As to the UIM impact, one of the explanations is given by the so called “clustering / concentration effect”, which would manifest itself as a concentration of positive effects in the regions which have already gained advantages (economies much more advanced in EU old members).

⁸⁴ Fourth Cohesion Report

Regarding euro adoption, the process obliged Greece to apply restrictive monetary and tax policies to attain convergence criteria. Most analysts admitted that these policies are associated with high costs⁸⁵ like: reduction of real income, unemployment growth, etc.

The major internal causes were considered to be the following:

- A) An incoherent development strategy, without clearly defined strategic objectives:
- The incapacity to stimulate internal private investments which led to slowing down the fix capital formation. The specialists point out that the positive results in the economy are noticed only from a certain “critical” level of investments, mainly the private ones;
 - The appearance of a strong deindustrialization phenomena without creating services which could produce great added value;
 - The maintaining employment with two significant costs: a relatively high level of inflation (compared to other EU countries) and of budget deficit;
 - The small expenditure for the human resources qualification, education expenditure maintained at about 4% of GDP compared to a Community average of 5%.

B) Defeatist public powers

The foreign specialists were speaking at the end of the 90s about the Greek state as about a “state of privileges, a corporatist and cliental state”⁸⁶.

The close relationship between the Greek politicians, the administration of public sector, banks and great enterprises managers hindered the economy to adjust to the market exigencies.

The state was not able to diminish the tax fraud, so that the underground sector represents about 20 – 30% of GDP, which, according the specialists, equal institutionalized corruption.

At the end of the 90s they considered that the main remedy for these aspects was to support an economic growth with strongly endogenous character, because the effect of propagation from EU towards Greece was weaker, as a result of the great geographic distance from the EU growing centers.

C) Uninspired strategies to use the structural transfers

During 1984 – 1993 strategy to use structural funds was characterized by its orientation towards small projects, this being looked upon critically at present by government authorities in Greece. Thus, according to their recent evaluations⁸⁷, this strategy lacked, in order to be efficient, the focus on great infrastructure projects (essential provision to attract FDI) and focus on the support of growth and productivity (therefore of competitiveness).

⁸⁵ Among them, in the 90's years, the winner of Nobel Prize, Maurice Allais (*Combats pour l' Europe*, Ed. Clement Juglar, 1994).

⁸⁶ *Revue du Marche Commun et de l'Union Europeenne* nr.424, ianuarie 1999

⁸⁷ *Structural Interventions in Greece:policies, results, perspectives*, Information Report 2005, prepared by Greek Ministry of Economy and Finance, General Secretariat of Investement and Development, Managing Authority of the Community Support Framework, oct.2005: http://www.hellaskps.gr/documents/INFO_REPORT_OCT05.pdf

Funds obtained by Greece from structural funds during 1984 – 1993 were directed towards 6 priorities:

- § consolidation of basic infrastructure (transport, telecommunication, energy);
- § development of primary sector and of rural economic activities;
- § improving the industrial competitiveness;
- § a balanced economical development of tourism;
- § development of human resources and of employment (to improve the formation and make the labor market mechanism more flexible);
- § reduction of inequalities between regions (a better usage of development potential).

During 1994 – 1999 3 new axes are added to the old ones in order to speed up the economic convergence (necessary for Greece to enter euro area); the most important one was the improvement of all economic sectors competitiveness (19% of total financing).

The evolutions after 2000 showed the political will to change the economical performances of the country.

According to OECD evaluations⁸⁸, between 2000 - 2006 Greece real GDP increased by 25%, compared to the previous period, being one of the highest in the OECD member countries; unlike the years 80 and 90, a real convergence progress was registered in comparison to the other EU countries.

The specialists estimate that this favorable evolution in the 2000's is due to several factors:

- § a more efficient public policy, especially as the result of accession to euro zone: a substantial improvement of public finances, increase in labor market flexibility, education system reform;
- § an adequate orientation of structural funds;
- § consolidation of spill-over effects in euro zone (mainly under 2 aspects: increase of investments and exports, which were the main supporting vectors for overall economic growth in this period).

During 2000-2006, the priorities channeling the structural funds were⁸⁹: human resources, transport, competitiveness, rural development, life quality, IT sector, regional development.

According to the Greek authorities⁹⁰, the impact and efficiency of structural funds strategy are strongly influenced by the progress in the following fields:

- the structural reforms on labor and services market;
- durable development of rural environment and of agriculture;

⁸⁸ *Economic survey of Greece 2007*, OECD, may 2007, la adresa: http://www.oecd.org/document/8/0,3343,en_33873108_33873421_38489288_1_1_1_1,00.html

⁸⁹ *Economic survey of Greece 2007*, OECD, may 2007, http://www.oecd.org/document/8/0,3343,en_33873108_33873421_38489288_1_1_1_1,00.html

⁹⁰ *Structural Interventions in Greece: policies, results, perspectives*, Information Report 2005, prepared by Greek Ministry of Economy and Finance, General Secretariat of Investment and Development, Managing Authority of the Community Support Framework, oct.2005: http://www.hellaskps.gr/documents/INFO_REPORT_OCT05.pdf

- private sector activation in all regions;
- significant improvement of management capacity at all levels: national, regional and local.

For the subsequent period, 2007 - 2013, firm action have to be undertaken by public authorities in several areas of economic policy aiming at enhancing the positive effects of structural funds, like:

- extension of deregulation⁹¹ (having priority on energy market);
- continuing the privatization processes of native firms and encouraging their internationalization aiming at strong companies formation⁹²;
- public intervention to ensure financial support for SMEs (to regain the internal market), creation of competitiveness poles at regional level, encouraging some excellence areas in industry and tourism.

⁹¹ As to the recent OECD evaluations, Greece still has to introduce many directives regarding IM and it is often accused of unfair application of community laws.

⁹² Named in the economic literature „national champions“.

Conclusions and Recommendations

I. Conclusions

1. The present trends of different Community policies aim essentially at the growth of competitiveness and, implicitly, on this grounds, at the economic and social cohesion. These trends on Community level affect, on their turn, the member countries performances in these two priority scopes.

One of the most important trends is the consolidation of the Internal Market functioning, seen as the support of the competitiveness growth of the European companies. At the same time, the New Lisbon Agenda directs, by its objectives, the member states to structural reforms, focused on growth and employment.

The criteria of nominal convergence and the Stability and Growth Pact provisions represent strict obligations for the new member countries (NMCs), especially from the expectation of achieving the cohesion objectives, taking into account the budgetary consolidation they require. Constraints are also brought about by the competition policy. This has as a result the possibility that conflictive conditions may occur between the different objectives of the Community policies, themselves, or between the Community policies and the national ones. At the same time, synergies emerge between these policies, in support of the achievement of the cohesion and competitiveness objectives.

2. The IM extension, the introduction of Euro, and the enlargement of EU from EU-15 to EU-27 have led, at present, to a resuscitation of the debates regarding the competitiveness-cohesion tandem, aiming at supporting the need to reform the cohesion policy.

The opinions and proposals, delivered in the framework of the European debates⁹³, outline, as the most probable, the simultaneous orientation of the cohesion policy in the future, towards two major objectives, namely the competitiveness increase and the reduction of the development disparities at the regional level, therefore the preservation of the idea of distributing large amounts from the Community budget, to this purpose, but at the same time, the substantial modification of their orientation. Under this new vision, the role of the cohesion policy would be to „support the economies of the regions to find out a place on the world markets and to stimulate their internationalization”⁹⁴.

This new paradigm reflects, in fact, the position of the most member countries of EU - 27, namely that the binomial „competitiveness - cohesion” does no longer represent an antinomy (competitiveness vs. cohesion)⁹⁵ but a tandem of un-dissociable and interdependent objectives. This approach is confirmed by empirical analyses, that pinpoint as the main sources of the regional disparities: structural deficiencies at the level of the factors that bring up competitiveness (foremost, the insufficient supply of financial capital and human capital) and the lack of innovation capabilities and of business support.

⁹³ European Cohesion Forum, 27-28 September 2007, Brussels.

⁹⁴ European Cohesion Forum, 27-28 September 2007, Brussels.

⁹⁵ As A. Rousset, the president of the Associations of Regions from France, said “the debate which opposes the competitiveness to cohesion is sterile and obsolete” (European Cohesion Forum).

3. In close connection with the debates regarding the future of the cohesion policy, there are, also, the debates regarding the Community budget. This is, nowadays, in a stage of fundamental restructuring, determined by the change in the priorities of the economic policies, asked to sustain the evolution of some both endogenous factors like enlargement or deepening integration, and exogenous, like increasing dependency of energy resources, international migration of labor, or climate changes.

The amounts assigned to the cohesion policy have registered a steady increase, going to represent, in 2003, about 35.7% of the whole budgetary allocations, out of which two thirds are dedicated to competitiveness, economic growth and employment. The funding of other policies, in principle those connected to competitiveness, external activities and rural development, limited at the beginning, have gained importance with the changing of the economic development and competitiveness priorities, so that these policies will represent, in 2013, over 26% of the whole Community budget.

4. Regarding the results of the cohesion policy, the analysis of the European Commission⁹⁶ shows the reduction, during the last decade, of the disparities regarding incomes and employment within the European Union territory.

The great beneficiaries of the cohesion policy during the period of 1994-2006 – Greece, Spain, Ireland and Portugal – registered, as a group, an impressive economic growth, but one unequally distributed between them, the discrepancies against the rest of EU - 27 registering, with the exception of Portugal, a real reduction. More precisely, between 1995 and 2005, the GDP per capita against the Community average (EU-27) have developed as follows⁹⁷: in Greece (from 74 to 88%), in Spain (from 91 to 102%), in Ireland (from 102 to 145%), while, on the one hand, Portugal succeeded to distinguish itself from the rest of the group, registering a reduction of the GDP / capita from 80%, in 1999, of the average of future EU-25, to 70%, in 2006 (or 74% of EU -27 average, in 2005).

The European cohesion programmes have supported, directly, the promotion of regional convergence, as well as the employment. For instance, during 2000-2006, the cohesion policy contributed to a GDP increase with 2.8% in Greece and respectively, 2% in Portugal; the preliminary valuations of the Commission foresee that during the period 2007-2013, the cohesion policy will contribute to a GDP growth of about 8.5% in Lithuania, Latvia and the Czech Republic, about 5.5% in Poland and about 3.5% in Greece. The cohesion policy has brought some contributions also to the reduction of the social exclusion and of poverty.

However, long term efforts are needed, to reduce the existing differences between the most lagging zones and the rest of the regions. In the other words, the poorest states have, still, a high dispersion between the regional levels of incomes. This observation is valid for all the new members, but also for Portugal and, to a certain extent, for Italy. But, on the other hand, the persistence of disparities in spite of the assistance for cohesion would be interpreted with nuance. It can mean, either that the institutional tools are still weak, or that the natural hostile conditions cannot be surmounted, no matter how high the Community transfers are, or that there are assumed disparities.

5. There is a series of similitudes between the old states cohesion experiences and the situations that the new Union member countries have also to cope with, but there also are some differences. The core difference between the two situations is given by the geo-political

⁹⁶ *Growing Regions*, pp. 3-7

⁹⁷ *Growing Regions*, pp. 3-7

present context, where the globalization challenges require a quick pace of response, and the European Union is, at the same time, under the pressure of extensive inner structural changes. It has been proved, from the old cohesion states experience, that the different start situations, from the point of view of socio-economic development, traditions, customs, structures and sectorial division of economic activities, have determined, even under the conditions of putting in action the same type of policies, tools and strategies, getting different effects, from the economic convergence and cohesion perspective.

The cohesion countries experiences, either of the old member countries or of the new ones, show that the national policies are decisive from the point of view of these countries' performances (the competitiveness and convergence, reduction of disparities). At present, the structural reforms have the strongest impact on the performances of this type, aiming at extending the deregulation and the flexible functioning of markets, at supporting the development of entrepreneurship, the R&D activities and the lifelong learning of human resources. However, particularly important remain, also, the fiscal policies, both from the point of view of income and profit taxation, and of the amount, the structure and the destination of public expenditure. The current trend to reduce the public expenditure does not influence the economic growth, if structural reforms are performed with the aim of increasing private investment in economy.

The successful European models, with high economic performances, have as main features, the following: the high quality of the education system, friendly business environment, mechanisms of income redistribution that maintain the social peace⁹⁸. The analysis of the development of the cohesion countries shows that they used different kind of policies to this purpose. The characteristic combinations are determined by **the institutional peculiarities** of the different cohesion countries economies. They exemplify, in fact, two types of European models (B. Amable, 2005), the Anglo-Saxon one (Ireland) and the Mediterranean one (Spain, Portugal and Greece).

In this way, **the Irish model** is characterized by the support of the market mechanisms, as the main instruments of economic regulation, and a high flexibility of the labor market (socially tolerable as a consequence of low income taxation). **The Irish successful „formula”**, how it was named by an Irish minister⁹⁹, includes: balanced public finance, pro-business environment (flexibility, low market regulation, external openness and low taxation), coherent social policies (the existence of a social pact) and „education, education, education.,!

The **Mediterranean** model was characterized by more regulation, both on the goods and services markets, and also, on the labor market. Now, the countries that represent this model are also obliged to major structural changes, aiming at the deregulation of all markets and more flexible labor market. Some authors (B. Amable, 2005) are pointing out though, that this changes have altered certain institutional complementarities, as the loss of some working and regulating mechanisms was not accompanied by the creation of new ones, in order to replace the functions of the lost ones. For instance, the public expenditure reduction was not accompanied by an adequate increase of the private companies' investment, or the renunciation to an active industrial policy by the building up of a very stimulating business environment.

⁹⁸ Conference on European Models, Athens, 25-26 april, 2007.

⁹⁹ Donal McNally, *Ireland's Formula*, Athens, 2007, speech at Conference on European Models, Athens, 25-26 April 2007.

Beyond schematic sentences, as those above-mentioned, there are some characteristics inside these institutional „models” that force us to pay more attention to details. Thus, for example, in the case of Ireland, praised for the strong shrinkage of budgetary expenditure, we must stress that this evolution was accompanied by the maintenance of a high share of public investment in the total of public expenditure (3.3% of GDP, in 2005) and one of the highest level of public aid per capita directed to the least favored regions, amounted to 300 Euro in 2005, in comparison with an average at the EU level of about 100 Euro, according to the Commission estimates¹⁰⁰.

II. Recommendations (lessons for Romania)

A. Romania’s position, as a cohesion country, concerning the reform of the cohesion policy has to take into account the opinions, recently expressed by the representatives of the Community institutions and of other EU member countries¹⁰¹, as answers to a series of questions. The outlined answers are as follows:

1. The most EU-27 members countries support **the necessity of maintaining the cohesion policy**, as one of the important Community policies. Keeping this option is now **sustained not only by the tradition of social solidarity specific to Europe („the social model”) but even more as an economic need**. One of the economic reasons would be the fact that the **private funds are hard to mobilize in the Objective1 regions**, in comparison with those of Objective2 (18% of the total, comparing with 40%, till 2003, in accordance with the Commission estimations¹⁰²), fact that enforces the idea of the need of structural interventions and public investment in these regions. This feature is also connected to the fact that the priorities are different in the two types of regions: in the Objective1 regions they are infrastructure and human resources (objectives that designate the supply of „public goods”, associated with the matter of the „free rider” for the private companies) and in the Objective2 ones the development of business.

2. The opinions and proposals, delivered at this Forum, pinpoint as more likely **two scenarios of development regarding the substance of the cohesion policy and the Community funds orientation**:

a. **”lisbonization” the cohesion policy, thus its focus on competitiveness**, orientation that would suppose either „freezing” the transfers amount, or maintaining them at a low level.

b. **simultaneous orientation of the cohesion policy towards two major objectives, namely the increase of competitiveness and the reduction of development disparities at regional level**, keeping the distribution of important amounts from the Community budget for this purpose, but at the same time, the significant change of the direction of their use.

The last two opinions outline the trend to modify the concept regarding the role of the cohesion policy, similar to the modification of the view regarding the role of the state in economy during the 80’, from that of a source of massive social transfers to that of counteracting the market failures and not of its replacement. . The „new paradigm”,

¹⁰⁰ *Growing regions....*, pg. 140 and 163.

¹⁰¹ At the European Cohesion Forum, 27-28 September 2007, Brussels.

¹⁰² *Third Report on Economic and Social Cohesion, European Commission, 2004.*

expressed by the European Commissioner for regional development, D.Hubner, would be “the creation of opportunities for the future and not compensating the problems of the past”¹⁰³, as, in this new perspective, “catching up” of lagging regions is dependent on or connected to an ever more globalized economy. Or, in a more direct manner, the transition from the delivery of direct aids to the supply of “public goods” for the lagging regions. Under this new perspective, the role of the cohesion policy would be to “assist the economies of the regions to find out a place on the world markets and to encourage their internationalization”.

This new paradigm reflects, in fact, the position of the most member countries of EU - 27, namely that the binomial „competitiveness - cohesion” does no longer represent an antinomy (competitiveness vs. cohesion)¹⁰⁴ but a tandem of un-dissociable and interdependent objectives.

However, one has to underline the fact that the new cohesion countries (generally, the former communist countries which entered EU after 2004) have a more shaded position, reflecting their particular situation in comparison with the countries of EU - 15, and the existence of great disparities of development, both between countries and between regions. Thus, Poland representative at the European debates on this subject (but, also the Germany’s representative) declared that the “Lisbonization” of the cohesion policy should not exclude the solidarity with the less favored regions, meaning that the cohesion policy has to create conditions for these regions to use the given particular competitive advantages and even to create new specialized and complex advantages. This means, she underlined, that one has to find out the optimum balance between the convergence (catching up) and competitiveness.

3. Opinions regarding the governance of the cohesion policy go towards the preservation of the actual system, of multi-level governance at the community, national and regional level. The actual system is not considered efficient enough, due to many drawbacks at the community level, and, partially, at the national one: excessive bureaucratization, standardized solutions for objectives and instruments. Moreover, it is agreed on the objective incapacity to correctly identify the most efficient ways of planning the funds at the community and national level, due to the information asymmetry that works between the decisions levels against the beneficiaries’ ones.

Of course, finding out the optimum ratio between centralization-decentralization between EU and states, and states and regions is a sensitive matter which is influenced by more factors:

- configuration of community competence in a EU with a higher level of political unification and the vision on the size of the community budget, the “contributions” of the countries to it, and its expenditures destinations;
- specificity of the national governments (unitary, confederate, etc.) and the credibility of the national authorities as units of efficient management of the community funds (effective and uncorrupted administration);
- competence and credibility of the regional and local administrations from the perspective of drawing up the regional policy, administering and managing the community funds.

¹⁰³ Idem 27

¹⁰⁴ As A. Rousset, the president of the Associations of Regions from France, said “the debate which opposes the competitiveness to cohesion is sterile and obsolete” (European Cohesion Forum).

4. Regarding the role of the cohesion policy in the EU governance, the participants at Forum delivered two more important ideas:

a) for creating the effects of synergy with the other community policies, it renders evident the possibility of a better co-ordination between policies, in different fields, as for instance :

§ European transport corridors could include also less favored regions;

§ measures associated with Ob.3 of the cohesion policy, regarding the territorial co-operation, could be connected to those of the European Instrument for Partnership and Neighborhood;

§ Better connections with CAP, in the field of rural development.

b) the cohesion policy should address, on a greater extent, the current challenges confronting EU, as the migration: the pursuit of the objective of employment would reduce its pressure.

B. Some lessons for Romania, arisen from the evaluation of the old cohesion countries experiences:

1. Economic policy directions:

a) the structural reforms should be carried out and improved.

In accordance with different international¹⁰⁵ and national¹⁰⁶ estimations, Romania has a moderate free market, the most critical distortions being: the registering of the property rights, distortions of certain markets, many corruption areas (the judiciary and administrative system, underground economy of great extent), high taxation on employee, the number of taxes etc.

At the same time, the extent of turning into account the European funds depends on how much the environment is structurally reformed. Only by means of a multi-dimensional reform the „cohesion paradox” can be broken. This can be formulated as follows: *least underdeveloped* regions have relatively higher chances to attract European funds, while disparities compared to relatively *less developed* regions might even grow.

b) the steady growth of capital supply is a necessary premise for the competitiveness and convergence increase; it can be done on the account of either the public sector (the public investment in Romania, as a share of GDP (3%), is less than in other new member countries), or the private one. The last way implies, firstly, attracting many FDI¹⁰⁷, which is the main explanation of Ireland’s success!

c) high investment in human resources.

¹⁰⁵ Or World Bank (2007 Doing Business project), or The Heritage Foundation and The Wall Street Journal (2007 Index of Economic Freedom).

¹⁰⁶ For example those of CEROPE, included in *The Agenda of an European Romania*, based on Post-accession Strategy of Romania, <http://www.cerope.ro>

¹⁰⁷ Their role in increasing the convergence, at the country level, is undeniable, but their role in reducing the disparities is arguable, taking into account their tendency to focus on the growing centers (“the agglomeration effect”).

In the National Development Plan, the human resources are on the 4th position among the most important factors of development¹⁰⁸. But, the direction toward the increase of the competitiveness (foremost, of the productivity) implies the creation of assets and services, which include high qualified labor¹⁰⁹. For comparison, on the first place among the decisive factors of the economic growth, in the National Development Strategy of the Great Britain for 2003, there were skills - created by education and the training of the human resource - and the other factors follows. In the success formula of Ireland entered, before all, according to its officials, „education, education, education”!

2. Directions regarding the use and management of Community funds

The cohesion countries have different types of strategies regarding the structural and cohesion funds, depending on their level of development and the political options of the respective governments. Some difficult strategic choices stand out for the EU's NMCs, including Romania, which are also cohesion countries, having „basic strategies of development”¹¹⁰ (in terms of competitiveness strategies, these countries have strategies based on production factors or on investment), as:

- a) convergence at the national level vs. the reduction of disparities between regions;
- b) long term investment vs. the short term ones;
- c) territorial concentration of the funds (for example, their orientation to the urban centers, considered as poles of national growth) vs. a better balanced allocation over the national territory;
- d) centralization vs. decentralization.

We shall detail some of them.

a) The cohesion countries have had different choices regarding the two cohesion objectives: some have chosen a more accelerated national growth (that means achieving real convergence by the increase of GDP/capita, as in the case of Ireland), some have acted simultaneously for the reduction of regional disparities, as in the case of Spain. The two examples suggest too, the fact that the decisions were strongly influenced both by the general economic policy options (in the first case, with a strong neo-liberal orientation), and by the political ones (avoiding the escalation of regional tensions – in the case of Spain -, confronted with regional separatist tendencies).

b) The general objective of the Regional Operational Programme (ROP) of Romania¹¹¹ is that of supporting the less favored regions by turning into account the specific resources, insufficiently exploited, in order to accelerate the economic growth. We consider that the **principle stating that the funds are allocated differentiated inversely proportional to the development level of the regions is not the most suitable one**. Taking into account the objective proposed through ROP, as the economic potential of less favored regions is

¹⁰⁸ http://www.inforegio.ro/user/File/PND-2007_2013.pdf

¹⁰⁹ As the Germany's representative recently said at the European Cohesion Forum (27-28 September 2007)

¹¹⁰ J. Bachtler, *A strategic Approach to Cohesion: The Development Planning of UE Member States*, Second National Development Conference, Athens, 9 dec. 2005, la adresa <http://www.hellaskps.gr/programper4/files....>

¹¹¹ <http://www.mie.ro/index.php?p=205>

differentiated, the **funds should be allocated taking into account the real capacity of growing of these regions.**

c) The experience of the cohesion countries shows that the efficient management of the Community funds requires a high collaboration between institutions and organizations, public, private and civic ones, at all levels involved: central, regional and local, or, as the European Commissioner said, a „co-ordination of co-operation”¹¹² and large partnerships.

The current Finland Strategy for the structural funds¹¹³ contains the provision to systematically organize „round tables” with the main players of the regional development policy at the national level, in order to create an organized framework for permanent and open communication between them, aiming at the optimization of the Community funds utilization.

Although it is emphasized the idea that the local authorities have a better perception regarding the way of efficient utilization of the funds, we underline the fact that **decentralization is efficient** only if it is associated with: **the existence of a local and regional efficient administrations** and of a **central performing control system of** the local and regional administrations, that being not yet, unfortunately, the case of Romania.

¹¹² European Cohesion Forum, 27-28 September, 2007, Brussels.

¹¹³ *Finland's Structural Funds Strategy 2007-2013*

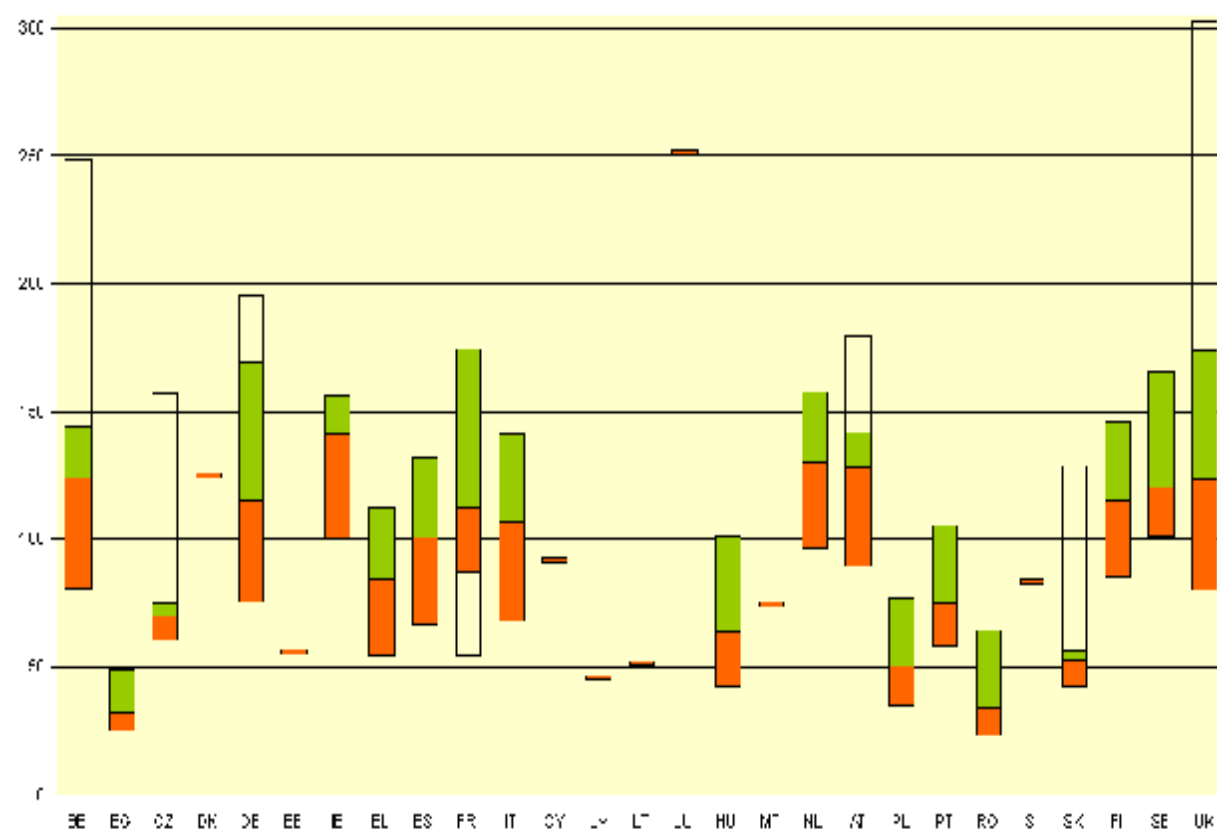
Annexes

Annex no.1

GDP/head (PPS) by Member State and regional extremes, 2004

GDP/head (PPS) by Member State and regional extremes, 2004

Unit: PPS/1000



Source: European Communities

Annex no.2

‘Lisbonising’ the cohesion policy – a critique

The ‘Lisbonisation’ of the cohesion policy, proposal made in 2004 within the framework of the Third Report on Cohesion published by the European Commission and transformed into a piece of legislation by a joint EU Council and the European Parliament rule, remains an attempt to find the rationale of a policy whose objectives were relatively ambiguous, congested and sometimes mutually contradictory. Yet, even a focus of the structural and cohesion funds on (revised) *Lisbon objectives* – “jobs and growth”, since 2005 – and *Gothenburg targets* (“sustainable development”) – towards which more than 60% of the cohesion policy total 308 bln. euro budget (2007-2013) is allocated – retains former main features such as:

- Firstly, from an *economic* standpoint, the competitiveness and growth objective is acknowledged. We must say that on an economic theory level, for all the many attempts, the way to the “route to prosperity/competitiveness/healthy economic growth” is *free market* profitability. Insofar as present-day economy is complex and uses money as means of exchange – ruling out some entrepreneurs’ non-monetary attachment for some industries – we are talking about *profitability in monetary terms*.
- Secondly, from a technological perspective, the Lisbon Strategy is aiming at economic growth geared by high-tech industries, catapulting the EU into an information knowledge-based economy revolving around R&D (alongside the corresponding educational pursuits). The technological criterion can yield different results as compared to the economic one when both are applied to an investment project. Economically optimal projects (meaning the *profitable* ones) can be precisely those that do not use the most sophisticated cutting-edge technologies available. In so far as technological research presupposes some costs, the following question becomes relevant: are new technologies *necessarily* more profitable? In other words, if they are more expensive, is the extra cost made up for in terms of an income surplus? We believe the answer is not necessarily yes. This is a case-by-case issue, and further it is not strictly determined theoretically. So, the Lisbon Agenda option for new technologies can easily conflict with the implicit option for economic efficiency.
- Thirdly, the systematic option inherent in the Agenda contains a social goal. The problem of charity is raised, although not explicitly and not under these terms. On a theoretical level, two main answers arise on the issue of underprivileged categories: either private charity or the welfare state. Private charity consists in a *voluntary* change in resource distribution – a distribution which is the natural outcome of the market (all allocated resources are at the same time expenses for some, and income for others) – under institutional contexts such as families, churches, charities, foundations, sponsorships etc. The welfare state implies *forced* resource *redistribution* from net payers to net beneficiaries. While the private charity solution is perfectly compatible (at incentives and monetary profit/loss calculation levels) with economic growth and efficiency, the welfare state alternative is strikingly at odds with it. To the extent that an overbearing welfare state entails high taxes and/or strangling regulations (such as non-discrimination, excessive employees benefits etc.), entrepreneurship is deterred. Therefore, a *trade-off* occurs between the welfare state solution to social issues and competitiveness goals. Moreover, insofar as new cutting-edge technologies incorporating

a great deal of knowledge and R&D, are more expensive (in the first stages, at least), social objectives can clash with technological ones as set forth in the Agenda.

- Fourthly, for things to be even more complicated, the Lisbon Agenda (or rather the Gothenburg 2001 addenda) proposes *environmental* objectives. As before, courses of action ecologically optimal can (and often do) differ from those acceptable from an economic viewpoint. More forests mean (counterfactually, at least) less lumber, paper or furniture; cleaner air, fewer vehicles or traffic hours etc. Likewise, if technological advance presupposes things like non-biodegradable waste accumulation (such as plastics), environmental objectives can clash with the technological ones too. And, after all, if new nonpolluting technologies are expensive, they are available on a smaller scale, in stark contrast with social goals.

That is why the prospective European model suffers from what Daniel Tarschys calls *goal congestion*. And the problem is not so much the number of objectives, but rather their self-contradictory nature.

Annex no.3

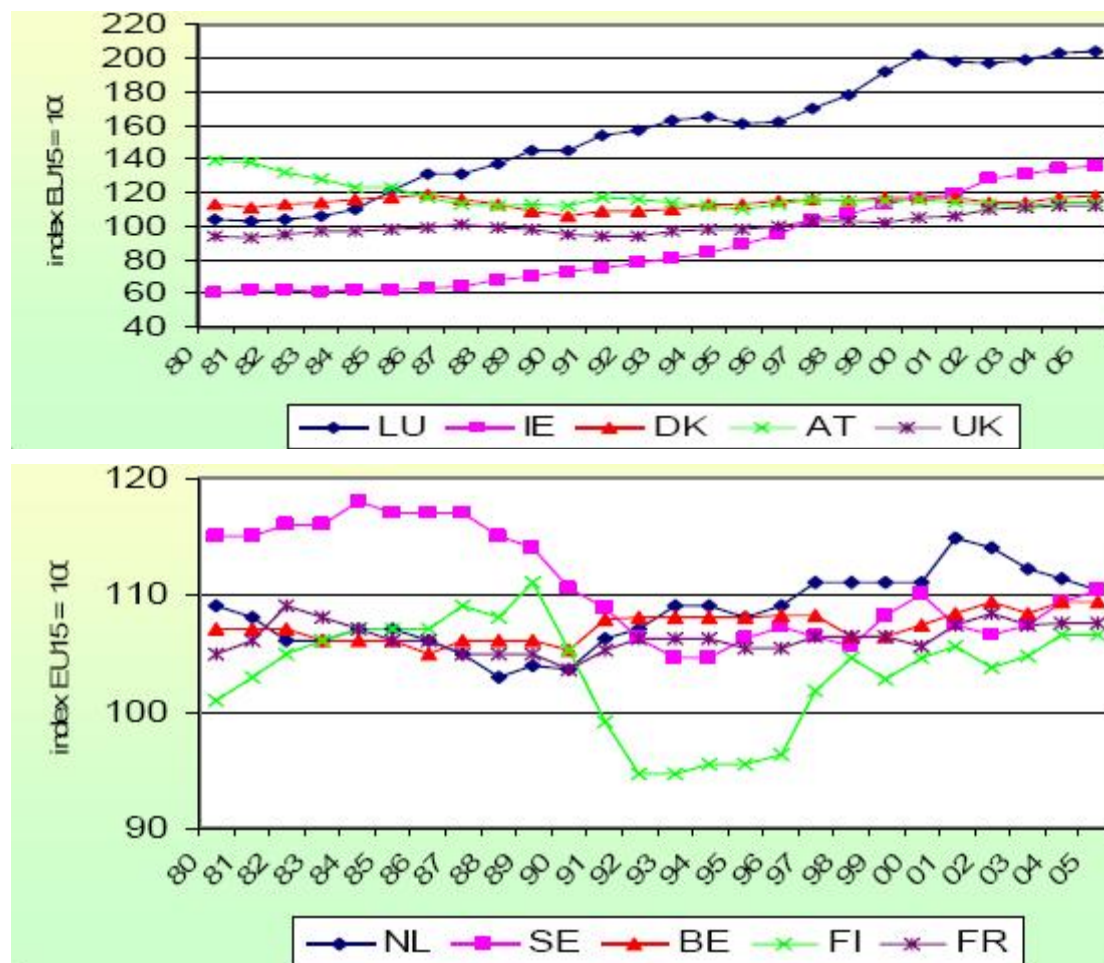
Evolution of GDP/capita, relevant country groups

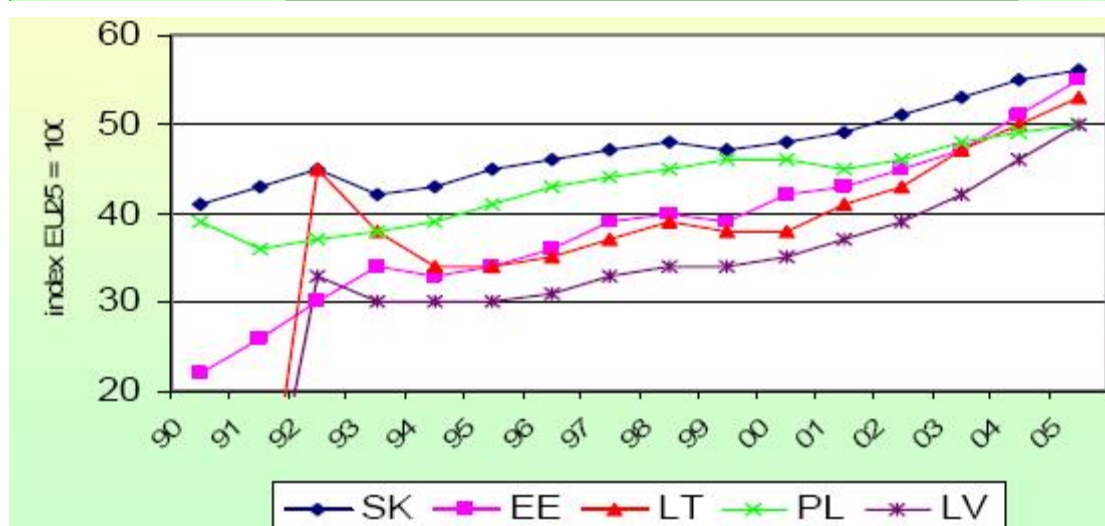
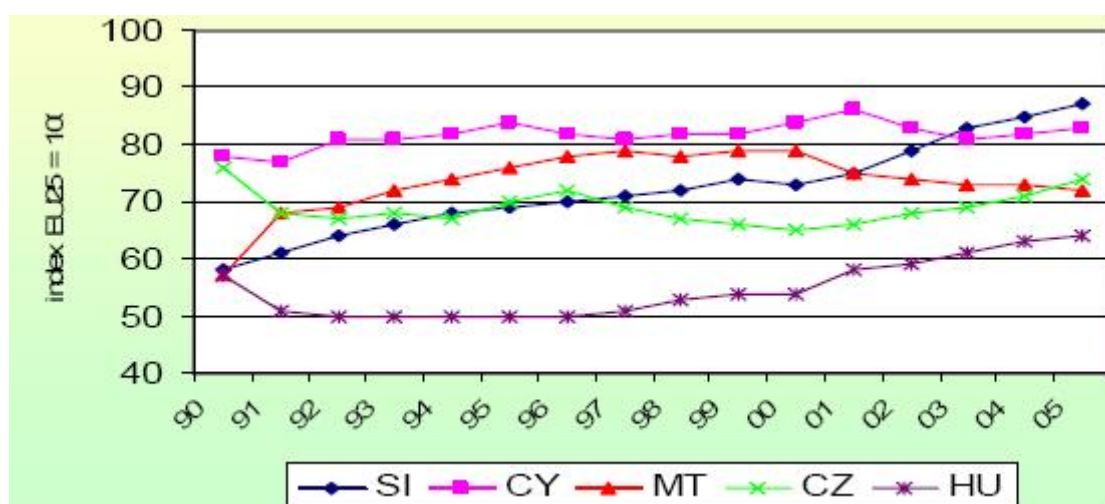
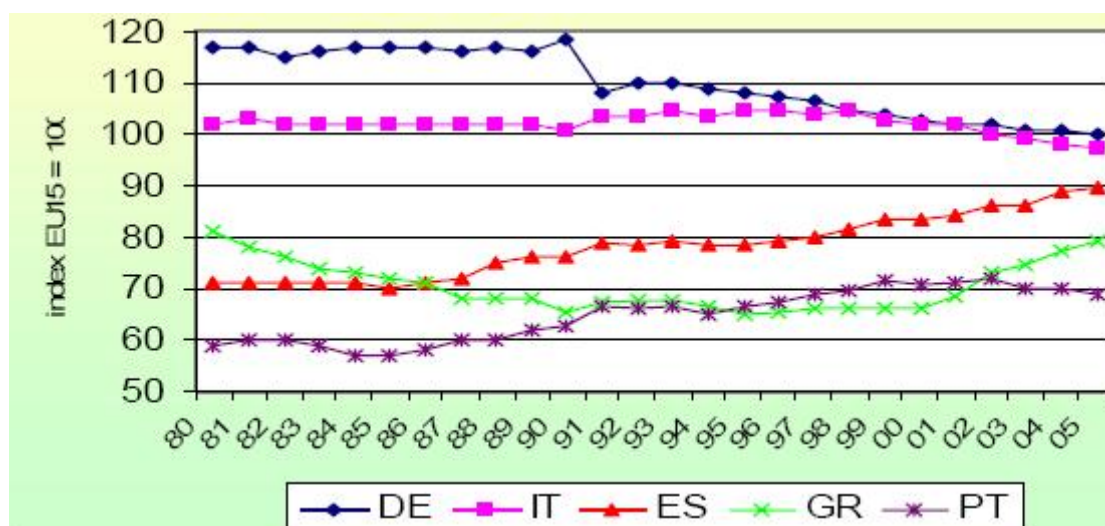
- Index numbers analysis, where, according to the relevance of the benchmark, UE 15=100, respectively, UE 25=100

The groups investigated by Marelli (2007) are as follows:

- (1) the *richest* (with reference to the final year's distribution) countries of EU15: Luxembourg, Ireland, Denmark, Austria, the United Kingdom;
- (2) the *middle* income EU15 countries: the Netherlands, Sweden, Belgium, Finland, France;
- (3) the *poorest* EU15 countries: Germany, Italy, Spain, Greece, Portugal;
- (4) the *richest* EU10 new member countries: Slovenia, Cyprus, Malta, Czech, Republic, Hungary;
- (5) the *poorest* EU10 new member countries: Slovak Republic, Estonia, Lithuania, Poland, Latvia.

(1)

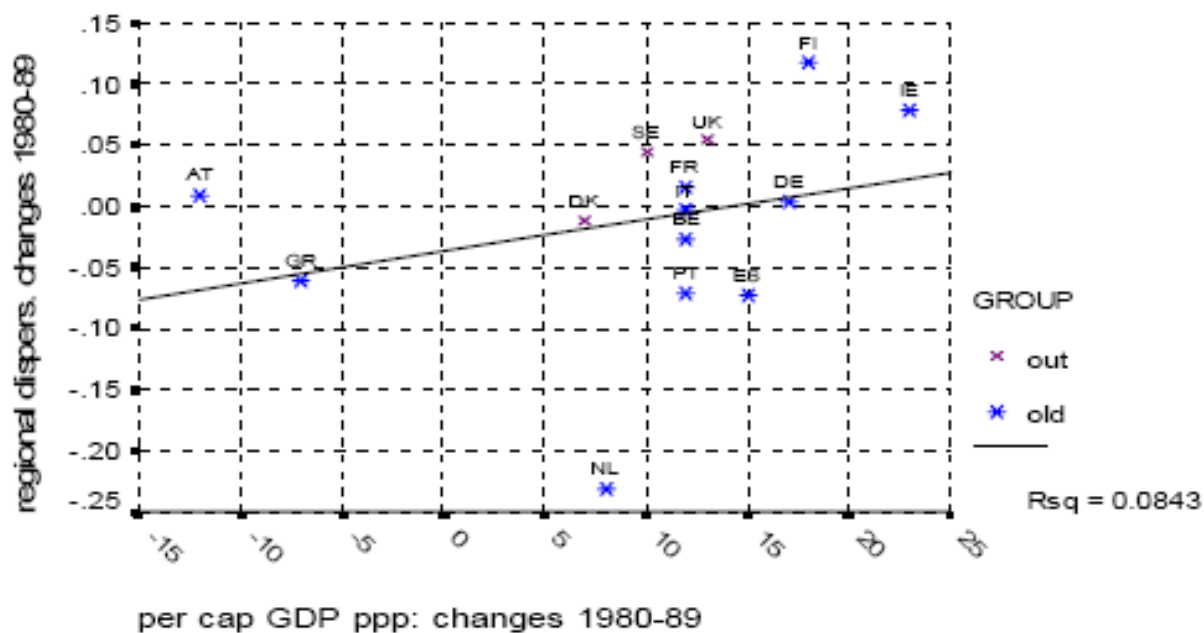




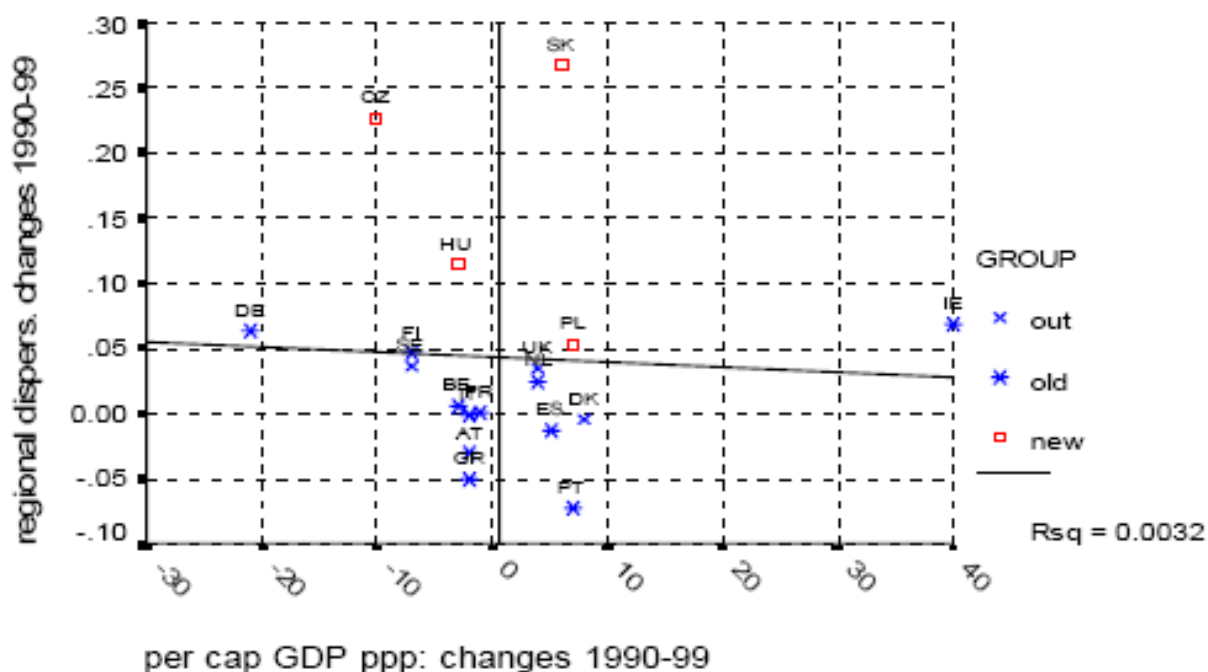
Annex no.4

GDP/capita and regional dispersion in EU 15 in different relevant time periods

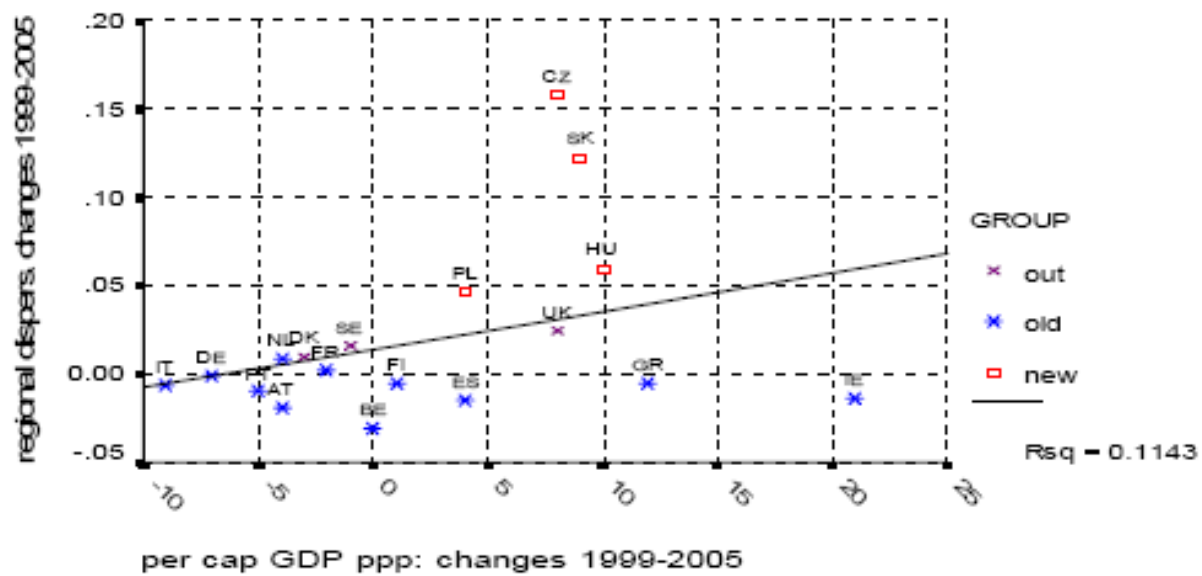
- 1980-1989



- 1990-1999



- 2000-2005



Annex no.5

FDI inflows in cohesion countries and new member states between 2000 and 2005 (% GDP)

	2000	2001	2002	2003	2004	2005	2000–2005
Bulgaria	5.4	5.1	3.9	10.5	13.9	10.8	8.3
Czech Republic	8.9	9.1	11.3	2.3	4.6	8.9	7.5
Estonia	7.0	8.7	4.0	9.7	8.3	21.2	9.8
Spain	6.8	4.7	5.7	2.9	2.4	2.0	4.1
Cyprus	9.2	9.8	10.1	6.7	6.9	7.2	8.3
Latvia	5.3	1.6	2.7	2.7	4.6	4.5	3.6
Lithuania	3.4	3.7	5.1	1.0	3.4	4.0	3.4
Hungary	7.1	7.4	4.5	2.5	4.5	6.3	5.4
Malta	3.7	:	-0.5	:	2.1	11.0	4.1
Poland	5.5	3.0	2.1	2.2	4.9	3.1	3.5
Portugal	5.9	5.4	1.4	5.5	1.3	1.7	3.5
Romania	2.8	2.9	2.5	3.7	8.5	6.6	4.5
Slovenia	0.7	1.4	4.0	3.8	2.1	1.7	2.3
Slovakia	9.5	7.6	15.5	2.2	2.0	4.4	6.9

Note: No data for Greece

Source: Eurostat plus UNCTAD for Romania for 2000–2002, Slovenia for 2000 and Slovakia for 2000 and 2001.

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