

Regional Policy

European economic integration

Oldřich Dědek

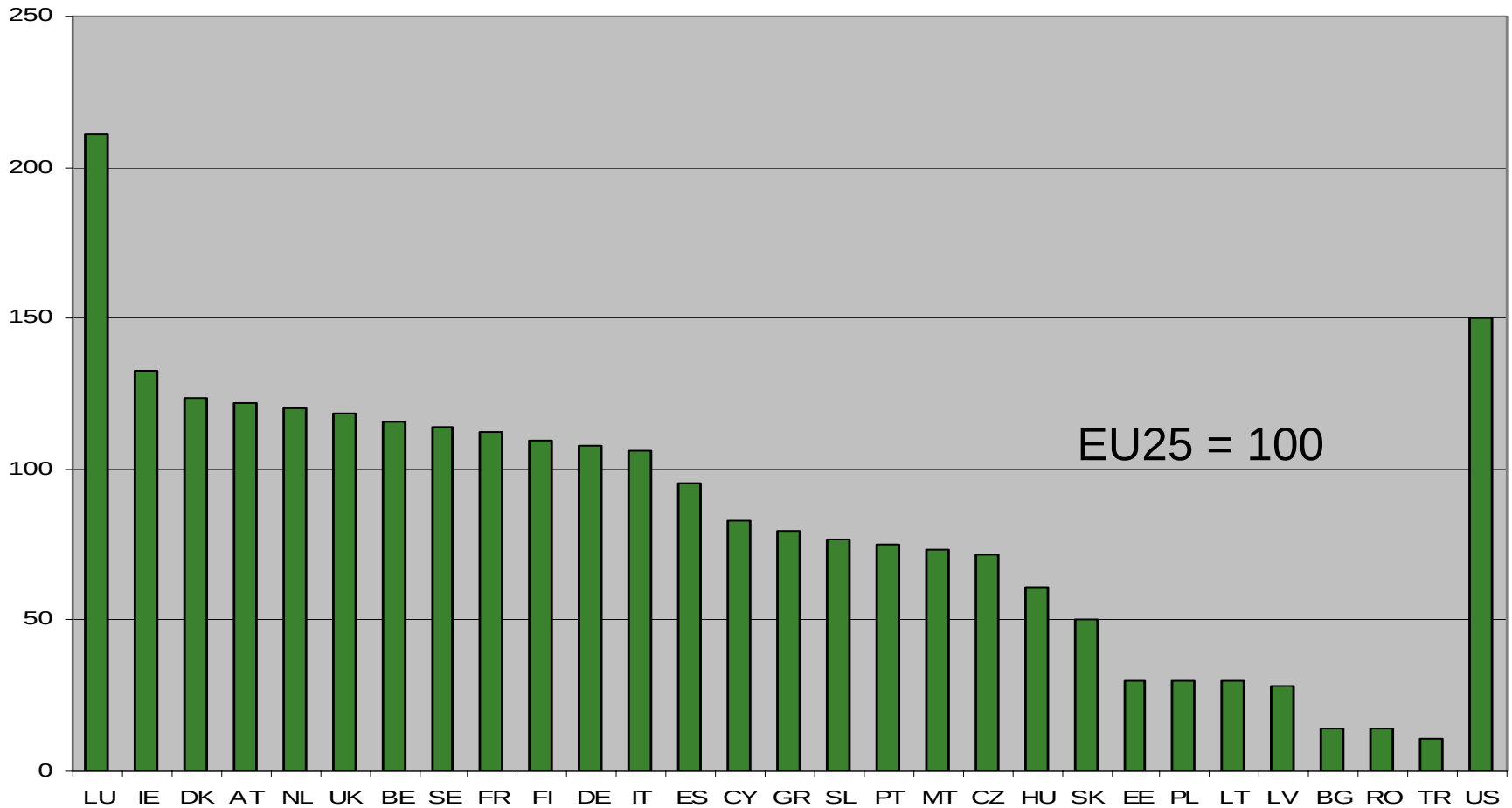
Institute of Economic Studies, Charles University



Summary

- Economic differences among member states and regions
- Typology of converging and diverging forces in internal market
- Organisation of regional policy

GDP per capita (in 2003)



Source: Third Progress Report on Cohesion (European Commission 2005)

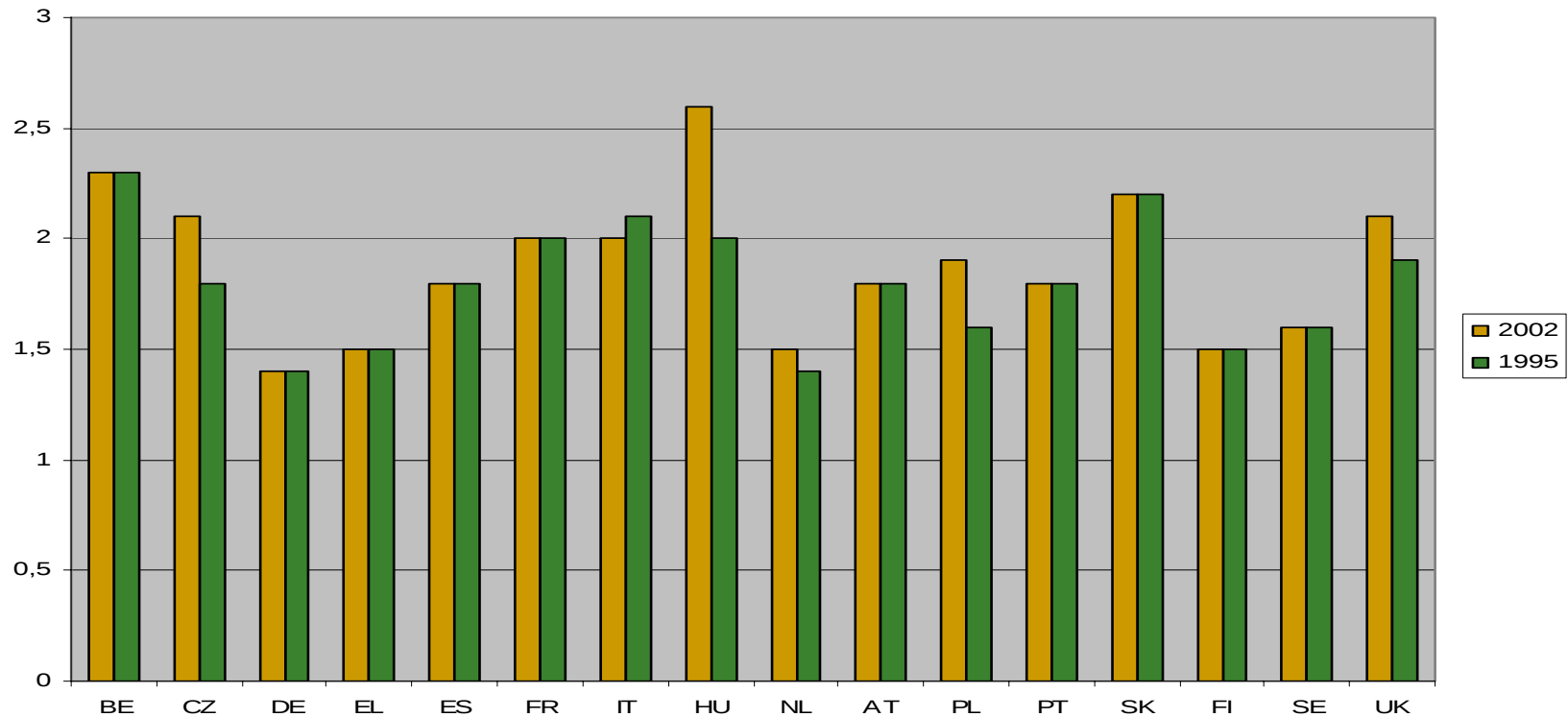
Regional differences (in 2002)

- Economic level of marginal regions (GDP per capita)
 - 10 most prosperous = 189% of EU average
 - 10 least prosperous = 36% of EU average
- Part of EU under “cohesion level” of 75% (GDP per capita)
 - 25% of EU population
 - 13% of population in old EU members
 - 90% of population in new EU members
- Employment
 - 75% of population in regions with lower than 70% employment
 - 15% of population in regions with lower than 55% employment

Source: Third Progress Report on Cohesion (European Commission 2003)

Regional differences within member states

Ratio between GDP created in 20% richest regions and 20% poorest regions



Source: Third Progress Report on Cohesion (European Commission 2003)

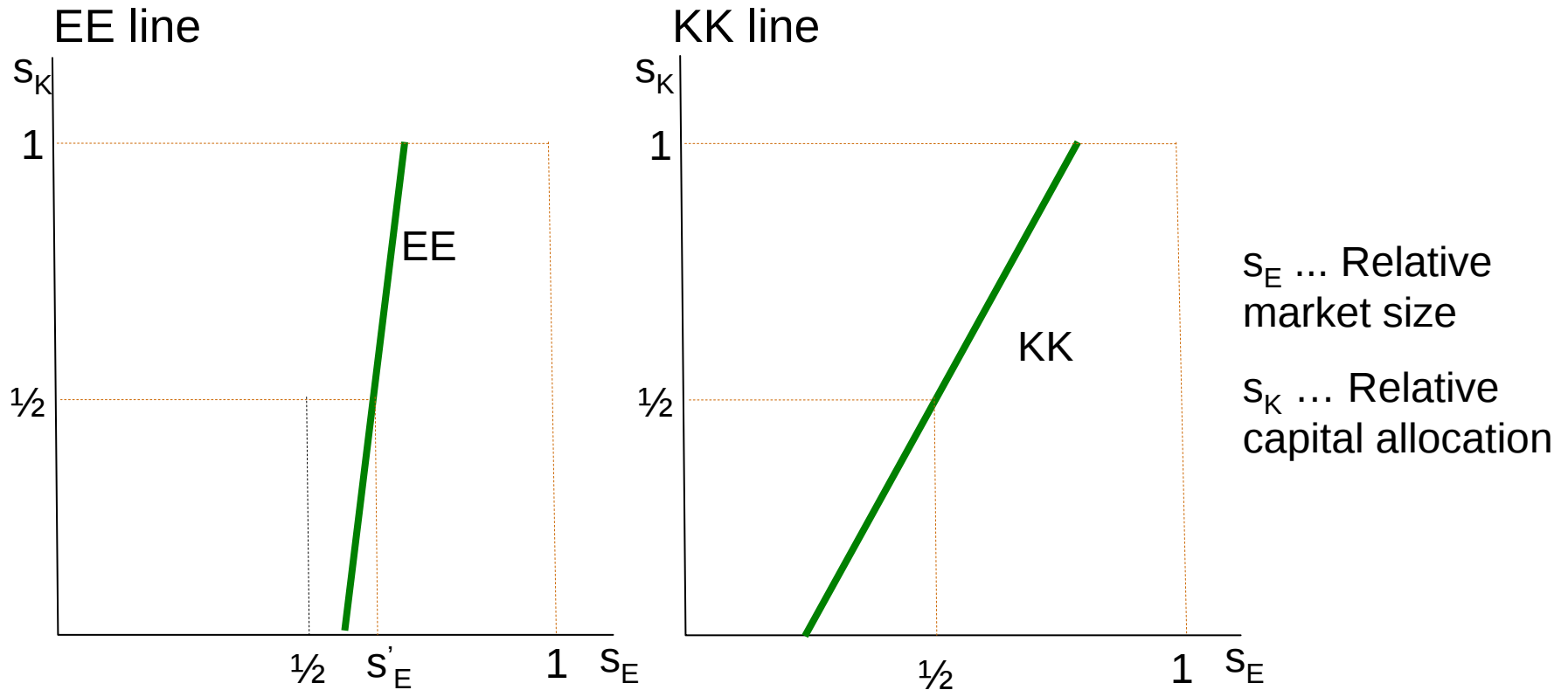
Centripetal effects of market forces

- Mobility of production factors (particularly capital)
 - “Law” of diminishing marginal productivity ensures slower growth in wealthier regions and faster growth in poorer regions as well as equalisation of wages and returns of capital (neoclassical growth theory)
 - But: Rising marginal productivity generates divergence (endogenous growth, vintages of capital, agglomeration effects)
- Free trade
 - Specialisation in products in which country displays comparative advantage (Ricardo, Heckscher-Ohlin)
 - But: Structural problem “*computer chips versus potato chips*”
- Integration leads to less regional disparity
- Internal market project (stress on free trade and capital mobility) believes in dominance of converging effects of market forces

Agglomeration and congestion effects

- Agglomeration effects operate towards spatial concentration of production
 - Technologically rising returns to scale derived from production allocated in one place
 - Larger market is more profitable outlet (economies in transportation costs, higher number of customers, developed infrastructure, vicinity of suppliers, rich supply of financial services, etc.)
- Self-enforcing character of agglomeration effects (large agglomeration tends to get even larger)
- Integration leads to greater regional disparity
- Congestion effects operate toward spatial dispersion of production
 - Rising price of land, higher wage costs
 - Higher number of competing firms

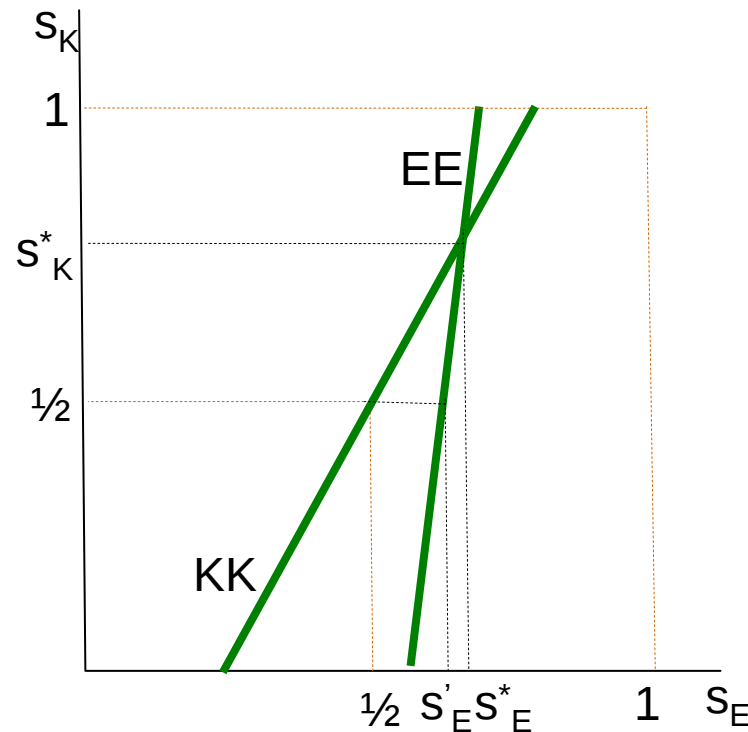
EE-KK model – basic blocks



EE line shows relationship between number of firms and resulting size of market in given agglomeration (demand effect of agglomeration)

KK line shows relationship between size of market and resulting number of firms in given agglomeration (supply effect of agglomeration)

EE-KK model – spatial equilibrium



- Features of spatial equilibrium
 - More than proportional concentration of firms and capital in larger agglomeration ($s_E' < s_E^*$)
 - Tendency towards further enlargement of larger agglomeration due to removal of trade barriers (KK line becomes steeper)

Evolution of regional policy (1)

■ Beginnings of EEC

- ❑ Rome Treaty speaks generally about harmonious and balanced growth, but foundation of common regional policy is not envisaged
- ❑ Founding members represented relatively homogeneous group (exception Mezzogiorno)
- ❑ Regional measures implemented widely at national level
- ❑ European Investment Bank established
- ❑ Important regional dimension of CAP (support for rural areas)

■ First enlargement

- ❑ ERDP set up for correcting imbalance of UK as large net contributor
- ❑ Criticism: poor coordination, insufficient flexibility, replacement of national funding

■ Mediterranean enlargement

- ❑ Accession of less developed countries
- ❑ Greater increase in available funds
- ❑ More involvement of local and regional authorities

Evolution of regional policy (2)

■ Single European Act

- Concept of economic and social cohesion as important complement of market forces (justification for redistributive policies on equity grounds)
- Structural funds as instrument for achieving economic cohesion (doubling of available financing)
- Formulation of principles of operation

■ Maastricht package

- Creation of Cohesion Fund to compensate less developed countries for competitive pressures from EMU
- Cohesion countries are obliged to adopt economic policies conducive to convergence

Principles of operation

■ Concentration

- ❑ Concentration of Community outlays on the most needy regions according to pan-European allocation criteria
- ❑ Politically balanced compromise between European solidarity and national egoism (repatriation of funds into contributing MS)

■ Programming

- ❑ Allocation of funds to programmes rather than to individual projects
- ❑ Instrument against uncoordinated funding of nationally selected projects
- ❑ Aspects of programming: planning, operational and financial management, evaluation, accountability

■ Partnership

- ❑ Close involvement of Community, national, regional and local bodies in all aspects of programming
- ❑ Objectives: improving efficiency, tailor-made projects to national conditions

■ Additionality

- ❑ Community sources should complement not substitute financial sources of member states
- ❑ Difficult to verify due to financial practices of MS

Solidarity in regional policy

- Relative notion of poverty
 - Poorer regions in rich states may be richer than rich regions in poorer states
- Politically sensitive issue of unilateral transfers from wealthy to poor countries
 - Political sensitivity of financial redistributions even within national states
 - Advantages of transfers for wealthy states: growing demand for imports from rich MS, investment opportunities for savings accumulated in rich MS
- History of ERDF
 - Initially fixed national quotas for allocation of available funds
 - Then growing share of non-quota allocation distributed according to pan-European criteria

Structural funds

- **European Agricultural Guidance and Guarantee Fund (EAGGF)**
 - Since beginning of CAP
 - Adaptation of farm structures, marketing of agricultural products, development of rural areas (Guidance part)
- **European Social Fund (ESF)**
 - Created in 1969
 - Employment policies, education and professional training, social inclusion of disadvantaged groups, equal opportunities of men and women, improving living standards, etc.
- **European Regional Development Fund (ERDF)**
 - Created in 1975
 - Infrastructure project, assistance to distressed regions, environment protection, research and development, etc.
- **Financial Instrument for Fisheries Guidance (FIFG)**
 - Created in 1993
 - Modernisation of EU fleet, safeguarding marine areas, improving procession and marketing of fish

Comparison of financing channels

■ SF versus CF

- SF: targeted at EU regions or at cross-sectional policies (GDP per capita less than 75% of EU average)
- CF: targeted at selected “cohesion” countries (GDP per capita less than 90% of EU average)

Since 1 Jan 2000 included Ireland, Portugal, Greece, Spain

Since 1 Jan 2003 excluded Ireland

Since 1 May 2004 included all new EU member states

- Drawing from CF is conditional on compliance with convergence programmes (particularly SGP)

■ SF and CF versus EIB

- SF, CF: grants (non-repayable financial assistance)
- EIB: commercial loans charging slightly lower interest rates due to lower borrowing cost (rating AAA) and government guarantees granted

Objectives – Financial Perspective 2000–2006

■ Objective 1

- ❑ Formulation: Supporting development and structural adaptation of less developed regions, development of human resources, support for investment, etc.)
- ❑ Criterion: Regions with GDP per capita less than 75% of average EU economic level
- ❑ Scale: approx. 70% of structural outlays

■ Objective 2

- ❑ Formulation: Revitalisation of regions suffering from structural problems (coal-mining, steel production, fisheries, depressed urban and rural areas)
- ❑ Criterion: Regions with prevailing declining industries
- ❑ Scale: approx. 10% of structural outlays

■ Objective 3

- ❑ Formulation: Development of human resources (active employment policies, social inclusion, life-long education, equal opportunities for men and women, etc.)
- ❑ Criterion: All EU members excluding areas covered by Objective 1
- ❑ Scale: approx. 10% of structural outlays

Objectives – Financial Perspective 2007–2013

■ Convergence

- ❑ Accelerating economic convergence of less developed regions (less than 75% of EU average)
- ❑ Increasing employment via investment in physical and human resources
- ❑ Support for knowledge economy
- ❑ Enhancing capacity to adjust to economic and social changes
- ❑ Protection of environment

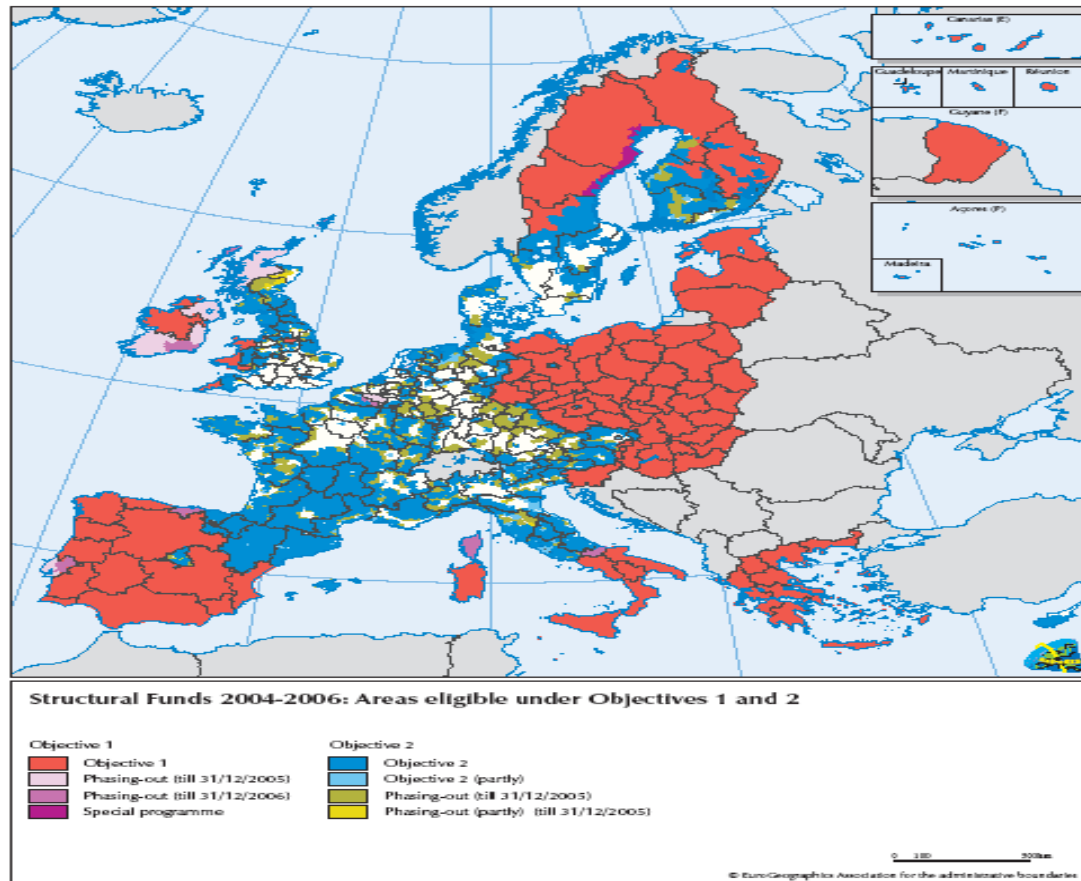
■ Regional competitiveness and employment

- ❑ Increasing employment in regions with highest unemployment rate and less efficient labour markets

■ European regional cooperation

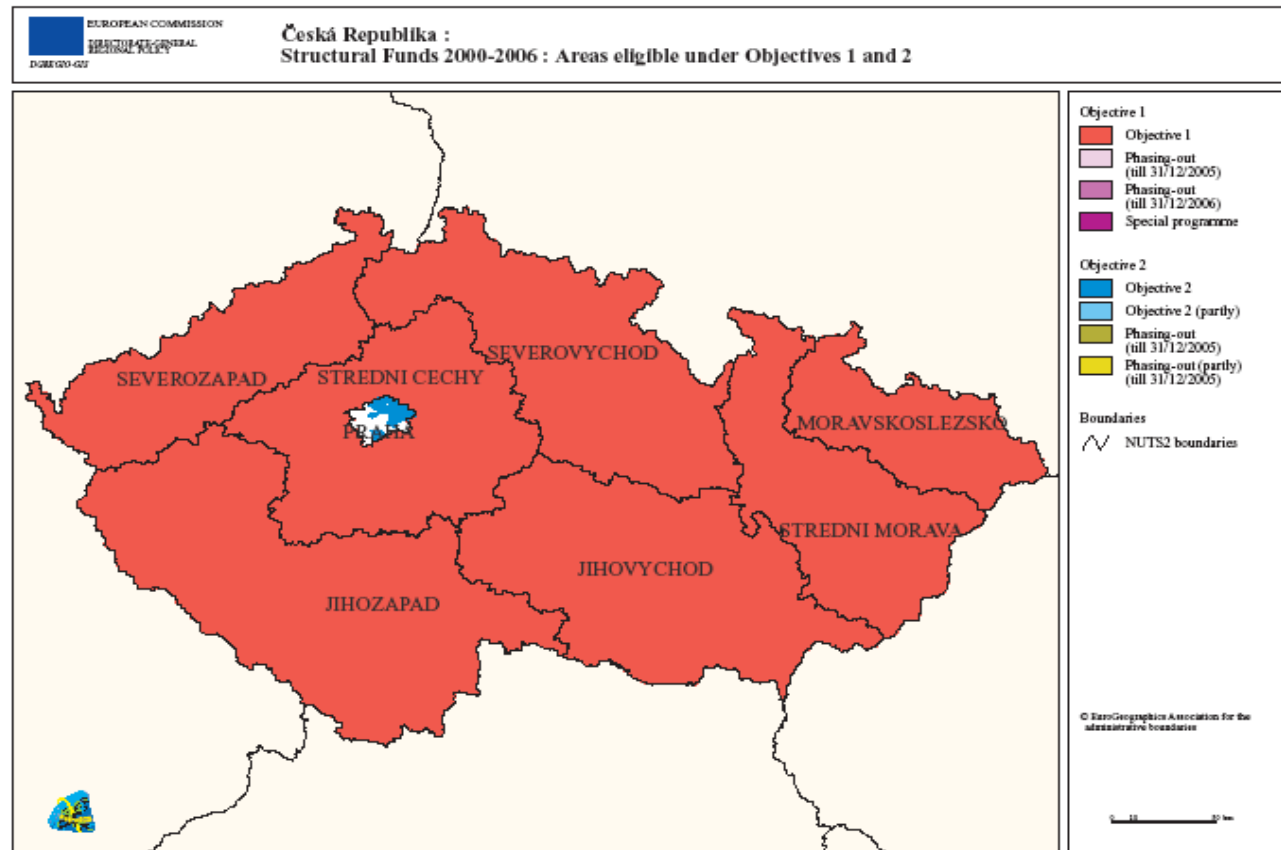
- ❑ Supporting joint programmes of cross-border cooperation

Organisation of regional policy – NUTS



NUTS (Nomenclature of Territorial Units for Statistics)

Organisation of regional policy – NUTS 2 in CZ



Achievements of EU regional policy

- Disparities narrowed among EU countries
 - More favourable indicators for cohesion MS: investment activity, faster GDP growth and productivity, higher employment, etc.)
 - Success story of Ireland (Celtic tiger)
- Negligible convergence among regions within countries
 - Neue Länder in Germany, Mezzogiorno in Italy, etc.
 - Larger volumes of investment did not manifest in higher growth
 - High concentration of FDI, R&D expenditure and manufacturing in most developed regions
- Difficult assessment of regional measures
 - Impact of programmes can only be assessed in the long run
 - Difficult isolation of effects of RP from other factors
 - Difficult separation of impacts of national and EU policies
- Best practices of regional policy
 - Ensuring stable macroeconomic framework
 - Development of effective administrative capacity
 - Overall strategy to avoid uncoordinated measures

Future of cohesion policy

■ Scale of regional policy

- ❑ Net contributors: calls for re-nationalisation of regional policy (cutting contributions to EU budget and financing many existing objectives from national sources)
- ❑ Old cohesion countries: interested in preserving current level of assistance (unfavourable “statistical effect” of enlargement)
- ❑ New cohesion countries: demand equal treatment principle (barriers to effective absorption capacity)

■ Implementation efficiency

- ❑ Reforms of cohesion policy aimed at cutting bureaucracy in management of regional policy
- ❑ Measures: smaller number of funds, financing from only one fund, less detailed national and regional programmes, more flexible financial control, etc.