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# **Territory, Space, Geography: Where is the Focus of Regional Policy in Europe?**

## **EoRPA Paper 06/5**

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## Preface

The paper has been prepared by the European Policies Research Centre (EPRC) under the aegis of EoRPA (European Regional Policy Research Consortium), which is a grouping of national government authorities from countries across Europe. The Consortium provides sponsorship for the EPRC to undertake regular monitoring and comparative analysis of the regional policies of European countries and the inter-relationships with EU Cohesion and Competition policies. EoRPA members currently comprise the following partners:

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- Näringsdepartementet (Ministry of Industry, Employment and Communications), Stockholm

### **United Kingdom**

- Department of Trade and Industry, London
- Scottish Executive Enterprise, Transport & Lifelong Learning Department, Glasgow

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### **Disclaimer**

It should be noted that the content and conclusions of this paper do not necessarily represent the views of individual members of the EoRPA Consortium.

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## EXECUTIVE SUMMARY

Questions have emerged in recent years over the appropriate geographical focus of regional policy and how spatial issues should be reflected in the design and implementation of regional policy mechanisms. Most European States undertake some form of regional policy but there are considerable differences between States in terms of goals, target-locations and instruments. Many States provide specific public support to enhance prospects for development in structurally weak regions. Some also allocate funding to other locations, with the goal of releasing bottom-up capacities for growth in all regions or at stimulating a less spatially concentrated pattern of economic activities. Regional policy goals are shaped in part by the current socio-economic situation but also by influential theories and discourses, as well as by domestic and EU institutional frameworks.

Most European States have a number of different regional policy goals and focus on more than one type of target-area. In the Cohesion countries, policy-makers are faced with the need to address the dual objectives of national and regional economic development. In wealthier States, the main focus is often on supporting the development of regions with structural socio-economic weaknesses, or at maintaining a critical mass in large regions with very low population density. In some wealthier States, there is a strong emphasis on targeting regional policy on the broader goal of supporting national economic growth, although this goal is sometimes also linked to a desire to achieve more geographically balanced economic development.

As regional policy in most States is implemented through multiple instruments and is targeted on more than one category of region, it is rarely easy to provide a clear overview of the spatial allocation of regional policy funding. The approach taken in individual States is influenced by the EU's Regional Aid Guidelines and Cohesion policy mechanisms but is also shaped by a range of domestic factors. Some States earmark a percentage of regional policy funds for lagging regions, or ring-fence certain instruments for these regions. An alternative approach is to target some categories of spending on areas with growth potential, or to allow actors throughout the country to apply for components of regional policy funding – a practice which tends to favour regions with existing strengths. Finally, some States allocate a percentage of regional policy spending to each region, on the basis of population shares and, sometimes, socio-economic criteria.

The spatial orientation of regional policy does not only vary between States but also between instruments, with some commonalities in the spatial orientation of certain instruments across a number of States. Key regional policy instruments in Europe include direct State aid to businesses; central State block grants to sub-national authorities; large infrastructure projects; a range of projects focused on enhancing the business context; projects in the field of research, development and innovation; support for building sub-national strategies and networks; and special economic zones providing tax incentives to businesses.



This paper focuses primarily on the situation in 2006, yet it is clear that the coming year will see various changes in the shape of regional policies in Europe, which may encompass revisions in spatial orientation. These changes are mainly due to the introduction of new EU Regional Aid Guidelines and the start of a new programming period for Cohesion policy. However, some individual States may also decide to introduce additional reforms to domestic regional policy at this time of externally-driven change. It remains to be seen how forthcoming shifts in EU and domestic frameworks will affect the spatial balance of regional policy goals and instruments in individual Member States.

# Territory, Space, Geography: Where is the Focus of Regional Policy in Europe?

## 1. INTRODUCTION

Regional policy takes a variety of forms, targeting different goals, focusing on diverse kinds of areas, and employing a wide range of instruments. This paper examines the various spatial or geographical dimensions of regional policy in a number of European States, primarily the ten EoRPA-network partners, but also Spain, Ireland and Portugal. The paper explores why differences in approach may be seen between States and also why commonalities sometimes emerge in the geographical approach of specific instruments in different States.

Although regional policy by definition has some form of spatial dimension, questions have emerged in recent years over the appropriate geographical focus of regional policy and how this can and should be put into practice. These debates have often concentrated on the 'territorial' aspects of regional policy, not least in the EU's Community Strategic Guidelines,<sup>1</sup> as well as in the seminar held under the Austrian Presidency of the EU in June 2006.<sup>2</sup> The recent focus on these issues is in part a response to the challenges generated to existing regional policy thinking in the EU by the accession in 2004 of a number of new States facing serious developmental challenges. However, it is also related to the emergence of new forms of regional policy since the 1980s, sometimes focusing on all regions or on growth-potential regions, rather than solely on regions with structural economic weaknesses. This paper thus aims to contribute to ongoing discussions on different forms and spatial orientations of regional policy.

The diversity of European regional policies implies the need to define clearly the instruments to be covered. First, the paper mainly focuses on those instruments funded by domestic regional policy, although account is also taken of EU Cohesion policy and the EU Regional Aid Guidelines which influence the spatial orientation of regional policy in all States. Second, the paper adopts the definitions employed within each individual State i.e. policy instruments are included in this paper if policy-makers in a particular State define them as components of regional policy. For example, regional policy in some countries includes State funding that is devolved to regional authorities but in others this is instead seen as part of the overall federal public finance settlement. Similarly, regional policy in some States incorporates support for R&D and innovation projects in all regions, yet other States see such funding as part of sectoral R&D/innovation policy. A further example concerns urban and rural policies, as aspects of these are perceived in some States as part of a broader regional policy but not in others. The need for such a pragmatic approach is

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<sup>1</sup> European Commission (2006) *Proposal for a Council Decision on Community Strategic Guidelines on Cohesion*, 17.03.2006. Brussels.

<sup>2</sup> W. Huber (2006) *Governance of territorial strategies: going beyond strategy documents*. Seminar of the Austrian EU Presidency, 8/9.6.2006.

underlined by the wide range of policies that influence regional development, and which may come to be seen as part of regional policy in different places and at different times. These include macroeconomic policies, interpersonal and interregional redistribution mechanisms, an array of sectoral policies, and frameworks for regulating labour, product and capital markets.

The remainder of the paper explores these issues in more depth, starting with a theoretical overview of the different typologies of spatial orientation seen in regional policy, as well as the factors that may explain differences between States. The following section explores the spatial orientation of regional policy in different European States in terms of stated policy goals, areas targeted, and the allocation of funding. The paper then examines how the spatial orientation of regional policy varies between instruments within these States. Finally, the conclusions examine expected forthcoming changes in the spatial orientation of regional policy, partly due to shifts in EU Regional Aid Guidelines and Cohesion policy frameworks, and partly due to new approaches in domestic regional policies within some States.

## **2. A VARIETY OF SPATIAL APPROACHES TO REGIONAL POLICY**

### **2.1 Different kinds of spatial orientation in regional policy**

Although most European States employ some instruments that are characterised as 'regional policy', these show considerable variation in terms of goals, target-locations and instruments. Many States provide additional public support for the development of structurally weak regions, usually aimed at improving the context for business development, via funding for public infrastructure, business aid or education, training and RTDI. However, some States also undertake regional policy in other types of locations, either aimed at releasing bottom-up capacities in all regions, at concentrating resources on growth-potential areas, or at providing support for selected areas with diverse characteristics.

Studies<sup>3</sup> note the emergence of new forms of regional policy in recent decades. While some States continue to target additional spending on poorer regions with the goal of reducing regional disparities, many have also introduced instruments aimed at encouraging bottom-up growth in all regions, both rich and poor. New forms of regional policy include support for training and innovation in businesses, as well as initiatives aimed at building bottom-up strategies and networks. Moreover, a wide range of actors and institutional frameworks is now often involved in the field of regional policy, which is now less likely to be designed and implemented by central State authorities alone than would have been the case in the 1970s.

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<sup>3</sup> J. Bachtler and D. Yuill (2001) *Policies and Strategies for Regional Development: A shift in paradigm?* European Policies Research Centre, Regional and Industrial Policy Research Paper No.46. J. Alden and P. Boland (1996) *Regional Development Strategies: A European Perspective*. London: Routledge

Regional policies for structurally weak regions may take various forms<sup>4</sup>, aiming to stimulate demand within weaker regions, to boost their supply of productive factors, to improve access to external markets, or to enhance conditions for exporting businesses. In most cases, the eligibility of regions for public intervention is determined on the basis of socio-economic criteria, such as low GDP per capita, low earnings per capita, low public capital endowments, high unemployment rates or low employment rates. In the Nordic countries, however, area designation also depends on demographic criteria, with well-established regional policies focused on northern, sparsely populated regions, with the aim of improving, not only business conditions, but also quality of life and the provision of public services.

In contrast, regional policy for all regions focuses less on large-scale public investment and business support programmes than on enhancing 'softer' capacities that are sometimes argued to underpin development. There is often an emphasis on bringing local actors together to develop a strategy and new ways of working, as it is argued<sup>5</sup> that socio-economic development cannot be imposed from above but has to grow out of social capital in the form of cooperation and knowledge-sharing between individuals and organisations within the region. Similarly, spatial strategies are sometimes seen as a more holistic approach to development, cutting across existing boundaries between sectoral policies and/or existing administrations. An outstanding issue is whether and how locations should be selected for such forms of regional policy support. Sometimes, central public authorities at national or regional level may select areas, for example those seen to have strong potential for enterprise or innovation. In other cases, funding is allocated via calls for tender or in response to applications from local actors, so that regions are seen to be self-selecting. A further possibility is to issue calls for tender for projects in different typologies of region, defined on the basis of a combination of physical and socio-economic criteria, such as urban, rural, coastal, or industrial restructuring.

Although these new forms of regional policy developed in response to the perceived limitations of more traditional approaches, a number of criticisms have also been made of the instruments that have emerged in recent decades. Some argue<sup>6</sup> that there is an ongoing need in structurally weak areas for traditional regional policies that go beyond a focus on bottom-up capacities. Others note the difficulties inherent in developing and implementing holistic regional strategies, particularly in locations with entrenched interest groups, or where policy decisions are complex and depend on specialist sectoral expertise. A final set of challenges is seen to relate to area selection, as many question the capacities of public authorities to pre-select areas<sup>7</sup>, and yet also note that open calls for tender generally

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<sup>4</sup> H. Armstrong and J. Taylor (2000) *Regional Economics and Policy*. Oxford: Blackwell.

<sup>5</sup> R. Putnam (1993) *Making Democracy Work: Civic Traditions in Modern Italy*. Princeton: Princeton University Press. J. Jacobs (1961) *The Death and Life of Great American Cities*. New York: Random.

<sup>6</sup> J. Lovering (2001) The Coming Regional Crisis (and how to avoid it) *Regional Studies* 35: 349-354.

<sup>7</sup> B. Alecke and G. Untiedt (2006) Möglichkeiten und Grenzen der Förderung von Clustern - einige kritische Überlegungen am Beispiel der Investitionsförderung. *Informationen zur Raumentwicklung* Vol.6.

favour structurally stronger locations where local actors are typically more liable to generate new ideas, to construct credible applications, and to cooperate with one another.

## **2.2 Reasons for different spatial approaches to regional policy**

### **2.2.1 *The views of decision-makers***

Given the complexity and variety of regional policy goals, target-areas and instruments, no single set of factors can explain the reasons why different States take particular approaches to regional policy. This section explores the diverse sets of factors that may influence regional policy, focusing on the range of issues that may influence the views of decision-makers, notably in relation to the scale and type of developmental challenges facing the State, as well as the capacities and appropriate roles of regional policy. These factors include information on the actual socio-economic situation, theoretical and political discourses, as well as domestic and EU institutional frameworks.

Regional policy goals and instruments depend on decision-makers' views of regional socio-economic disparities and of national economic challenges. The emphasis on regional development will depend in part on perceptions of the need for policies to support national growth, as well as on broader fiscal pressures. There may also be diverse views on the ways in which national and regional socio-economic processes interact. In particular, views may differ on whether economic and demographic concentration is entirely negative (for example, if it leads to a dual economy which may generate socio-economic tensions) or may also bring benefits in terms of higher national economic growth. Finally, policy-makers at regional and local levels usually focus primarily on the developmental situation in their individual areas, so that their views of developmental challenges and constraints often differ markedly from those of national decision-makers.

Opinions also differ strongly in relation to the capacities and roles of regional policy. A first issue concerns the ability of regional policy instruments to reduce regional disparities. For example, the emphasis on building up regions' supply-side capacities in some States is related to the view that demand-oriented funding to a lagging region tends to leak out, and also to the perception that regional aid is subject to deadweight effects. Perceptions also vary of the effect of regional policy spending on the wider economy, which may be seen to contribute to national economic development, or to distort economic incentives and reduce the economic capacity of richer regions. Views may also differ of the relative importance of active regional policy compared to other policy goals and instruments, not only those relating to national growth and fiscal sustainability, but also other spatial goals and instruments, such as equalisation mechanisms or urban and rural policies. Finally, opinions may vary in relation to factors that enhance regional policy effectiveness, such as the concentration of funding, or a bottom up approach to strategy-building.

Clearly, the views of decision-makers do not develop in isolation but are influenced, both by individuals' own experiences of policy-making and by a range of external institutional, discursive, political and economic factors. These factors are explored in the following sections.

### **2.2.2 The current socio-economic situation**

Clearly, decision-makers' views on regional policy are shaped in part by the scale and type of socio-economic challenges facing the State, at both national and regional levels, and reflected in indicators such as GDP per capita, personal disposable income per capita, employment rates and unemployment rates. Perceptions of disparities are also influenced by the degree of concentration in terms of economic activities and population, even if this is not translated into strong disparities in socio-economic indicators.

Most States with strong disparities have some form of regional policy for weaker regions, but it is not clear that there is any direct correlation between the level of disparities and the level of regional policy spending for lagging regions. States vary in terms of the extent to which regional disparities are perceived as acceptable by the general public, politicians and policy-makers. A stronger and more consistent emphasis on limiting regional disparities is generally seen in those States with a constitutional commitment to equal living conditions throughout the national territory. Other institutional factors and the influence of diverse political discourses can also affect the extent to which policy-makers emphasise the need for active regional policies. Thus, although regional policy is influenced by the regional and national socio-economic situation, its importance within a State at any time is also shaped by a range of other factors.

### **2.2.3 Influential theories and political discourses**

Regional policy goals and instruments are also influenced by theories derived from economics and other academic disciplines, as well as by broader political discourses. In some cases, policy-makers may draw directly on academic studies and theories in formulating policy, but they may also be influenced by the communication of theoretical ideas via the formal education system and via a range of other media. Table 1 illustrates some of the economic theories which are often drawn on by policy-makers in the field of regional policy.

Few policy-makers in European States draw solely on theories that suggest that regional policy can stimulate development by expanding demand in lagging regions, either through business aid, public investment or redistribution, although some recent studies<sup>8</sup> advocate a stronger demand-side focus. Instead, policy-makers in the Cohesion countries and some States with lagging macro regions often draw on supply-oriented economic growth theories. First, mainstream economic growth theory<sup>9</sup> suggests that investment in an expanded definition of capital (to include human and knowledge capital, as well as physical capital) per worker is a key means of raising productivity and thus of enhancing economic growth. However, mainstream economic growth models suggest that such productivity gains are

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<sup>8</sup> J. Adams, P. Robinson and A. Vigor (2003) *A New Regional Policy for the UK*. London: Institute for Public Policy Research. A. Amin, D. Massey and N. Thrift (2003) *Decentering the Nation: A radical approach to regional inequality*. London: Catalyst.

<sup>9</sup> R. Solow (1956) A contribution to the theory of economic growth. *Quarterly Journal of Economics* 70:65-94.

only temporary, falling as the level of capital per worker rises. Second, therefore, some policy-makers draw on theoretical models<sup>10</sup> which indicate that investment in public, human and knowledge capital can generate non-diminishing returns and thus drive self-reinforcing productivity gains on a permanent basis. Policies which contribute to such goals are thus perceived as a potential means of stimulating the economic catching-up of poorer States and regions with the prosperity levels of wealthier locations.

**Table 1: Economic theories underlying active regional policy**

Theoretical approach	Countries
Catching up depends on investment in public, human and knowledge capital	Cohesion countries
Improving market access raises business competitiveness	Cohesion countries
Regions' growth depends on export-oriented firms	Germany
Eliminating market failures allows all regions to raise productivity and grow	UK
Sustained growth in a small open economy depends on innovation, human capital etc	Finland, Sweden, Norway, Austria, Ireland, Netherlands

Source: EPRC

Two other theoretical strands are also drawn on in States with significant regional disparities. On the one hand, some emphasise the need to improve access to Europe's core markets, in order to enhance the competitiveness of businesses located in lagging regions. Although this approach remains important (contributing not least to the emphasis on developing Trans-European Networks), studies in new economic geography<sup>11</sup> suggest that a reduction in trade costs can combine with a range of other factors, notably agglomeration economies and market size, to pose developmental challenges to low population areas. On the other hand, regional policy in Germany draws explicitly on regional export base theory<sup>12</sup> and aims to develop a regional production structure that can attract a range of private resources. Its goal is therefore to provide favourable conditions for the activities

<sup>10</sup> R. Lucas (1988) On the mechanics of economic development. *Journal of Monetary Economics* 22:3-42. P. Romer (1986) Increasing returns and long-run growth. *Journal of Political Economy* 94:1002-1037.

<sup>11</sup> M. Fujita, P. Krugman and A.J. Venables (1999) *The Spatial Economy: Cities, Regions and International Trade*. Cambridge (MA): MIT Press.

<sup>12</sup> N. Kaldor (1970) The case for regional policies. *Scottish Journal of Political Economy* 18:337-348. R. Dixon and A. Thirlwall (1975) A model of regional growth rate differentials along Kaldorian lines. *Oxford Economic Papers* 27: 201-214.

and investments of businesses that are capable of exporting beyond the region's boundaries.

In wealthier European States, the main focus is on supply-oriented growth theories, as regional policy usually aims mainly to raise levels of education, R&D and technological innovation in all regions in order to contribute to national economic growth. In these countries, the emphasis is not on catching-up but, instead, on the challenges facing relatively small open economies, and the desirability of specialising in activities that are R&D intensive, in order to maintain and raise productivity rates and standards of living. Some States take a distinctive approach to the broader goal of raising productivity through higher level skills and technologies. The UK, for example, combines this approach with a strong emphasis on the need for intervention to contribute to reducing or eliminating market failure.

In some countries, policy-makers also draw on theories or discourses of a political or political economy character. In particular, a more 'poly-centric' or geographically balanced distribution of economic activities and population is sometimes perceived as superior to a more concentrated pattern, even if the latter need not imply strong regional disparities in GDP per capita or living standards. Similarly, there is a strong emphasis in the Nordic countries on the need to ensure a critical mass of population and economic activities in northern areas in order to maintain viable communities and public service provision.

#### **2.2.4 Domestic institutional frameworks**

A further diverse set of factors that influences regional policy choices is located in the domestic institutional context. A number of these factors relate directly to regional policy, while others concern broader political or regulatory frameworks.

In terms of regional policy itself, future policy choices are partly shaped by the *status quo*, as many new instruments and goals develop from (or are blocked by) the existing approach. Policy change may be slower and more open to compromise when many diverse partners are involved in strategy design and implementation, than when one actor at central State or regional level is able to push through a new approach. Other issues relate to the human, physical and financial resources available to policy-makers, as these affect their capacity to design and implement different instruments, particularly those that involve a greater or more complex administrative burden.

At the level of the broader political context, the role of regional policy is generally reinforced if there is a political or constitutional emphasis on the benefits of equal living conditions throughout the State or the desirability of a geographically balanced distribution of economic activities. The degree to which various governmental tasks are decentralised to regional or local authorities can also influence the shape of regional policy, not least by creating actors which prioritise regional or local strategies and projects. Moreover, some new forms of regional policy – particularly those aimed at building regional or local strategies or networks – develop on the basis of the perception that there is a need for stronger cooperation between local authorities either below the central State or below the regional level.



Finally, broader national policy and regulatory frameworks also influence regional policy goals by shaping the context for regional economic development. Of particular importance are the institutions that regulate labour, product/ service, capital and housing markets, and the ways in which these shape the incentives facing individual workers and businesses. Although the same frameworks are generally in place throughout individual States, they may have different effects in regions with structurally weaker economies, or they may hinder or facilitate recovery following region-specific shocks.

### **2.2.5 The influence of EU frameworks**

Regional policy decisions in all States in this study are also influenced by EU policy frameworks, not only in terms of broad goals, but also in the selection of instruments to be used and areas to be targeted. The two EU frameworks that most directly influence regional policy are the EU's Regional Aid Guidelines which set the framework for selecting areas eligible for regional State aid, and Cohesion policy funding which co-finances multi-annual public spending programmes in the fields of infrastructure, human resources and business support. However, regional policy may also be influenced by aspects of the Common Agricultural Policy, particularly its rural development dimension; the earmarking of such funds for rural areas, for example, may shift the focus of regional policy to more urban or industrial areas.

In recent years, States' domestic regional policies have also been shaped by the EU's core economic strategies. The Lisbon agenda has been particularly influential, particularly in reinforcing the focus of regional policy on R&D and technological innovation (even though the Lisbon agenda itself addresses a much wider range of issues). This influence has been channelled primarily through EU Cohesion policy which, however, co-finances many regional policy instruments in all Member States.

Nevertheless, EU frameworks are the results of negotiations between Member States, so the extent of 'top-down' influence should not be exaggerated. In the case of the regional policy focus on RTDI, for example, this approach pre-dates the Lisbon agenda in many States. Indeed, support for efforts to use the Lisbon agenda as a framing device for Cohesion policy interventions in 2007-13 is partly due to the existing orientation of States' domestic regional policy towards RTDI.

## **3. THE SPATIAL GOALS AND TARGET-AREAS OF REGIONAL POLICY**

This section provides an overview of the geographical goals of regional policy in the different European States covered by this study, as well as of the types of areas which are targeted. It shows how these States typically adopt multiple goals and address more than one kind of location in the context of their regional policies.

### **3.1 The stated goals of regional policy**

Most European States have a variety of strategic regional policy goals. The following assessment draws on official political and policy statements in strategic and constitutional

documents, and illustrates the multiple and complex character of regional policy goals in these States. It also notes some broad differences in emphasis which can be discerned between spatial goals in different European States.

Table 2 shows the diversity and multiplicity of regional policy goals in different countries. A number of States (Germany, Spain, Italy) see the goal of regional policy primarily in terms of assisting certain regions to overcome their structural socio-economic weaknesses (reflected in indicators such as GDP per capita, personal disposable income per capita, unemployment rates and employment rates). All other States in this study set multiple goals for regional policy. In some Cohesion countries (Poland, Portugal) and also in some wealthier Member States (Netherlands, Austria, UK), regional policy has the dual goals of raising national economic growth and supporting economic development in all regions. In France and Ireland, the national growth goal is combined with the aim of achieving a more geographically balanced distribution of economic activities. Both of these goals are shared by other States (Norway, Finland, Sweden) but a third objective is added, namely to ensure equal living conditions in regions facing specific challenges.

**Table 2: The goals of regional policy in selected European States**

	National growth	Equal living conditions	Spatially balanced economic development	Regional economic development
All regions	Sweden, Norway, Finland, France, Austria, Netherlands, Ireland, UK, Portugal, Poland	Norway, Finland, Sweden	France, Ireland, Sweden, Norway, Finland,	Austria, Portugal, Poland, France, UK
Structurally weak regions		Norway, Sweden, Finland	Germany, Spain, Italy	Germany, Spain, Italy

Source: EPRC

### 3.2 Translating goals into types of regions

A range of different kinds of locations are targeted by the regional policies of States in this study. Because many States have a number of different regional policy goals and target-areas, they fall into more than one of the following categories.

The first three approaches can be seen to focus on 'problem' locations, whether the entire Member State, large regions or relatively small areas. First, the entire State may be covered by regional policy, where the level of economic development is low relative to the EU average. Second, a number of Member States concentrate on supporting the development of lagging regions, which are selected on the basis of economic indicators.

Although this category mainly concerns large lagging regions, the emphasis on micro-zoning under the EU's Regional Aid Guidelines means that other States also designate some regions on the basis of socio-economic indicators, even though this approach may not be the main focus of their domestic regional policies. A third type of focus on 'problem' regions is seen in the three Nordic countries in this study, all of which have instruments that aim to mitigate the specific problems of large regions with very low levels of population density.

The remaining approaches do not focus exclusively on locations with structural socio-economic weaknesses and have usually emerged in wealthier countries where policy-makers have seen a need to adapt regional policy goals and instruments. A first focus is on all regions, with the dual goals of contributing to national growth and stimulating a more geographically balanced distribution of economic activities. A second approach includes a wide range of interventions, aimed at addressing the particular needs of diverse areas, selected on the basis of social, economic and physical indicators. Finally, some States provide funding to all regions but generally focus funding on those locations with potential to attract business investment or to contribute strongly to productivity-based national economic growth.

### ***3.2.1 The dual goals of national and regional development in the Cohesion countries***

Regional policy in the Cohesion countries generally focuses on the dual goals of national and regional economic development, largely due to the scale of challenges facing these States. The process of economic catching-up generates significant challenges for poorer States because it involves wide-ranging sectoral restructuring, which also has a spatial dimension. Catching up tends to involve job losses as well as job creation, and the closure or scaling-down of existing firms as well as the establishment of new ones. New firms and jobs initially tend to be concentrated in a limited number of areas, often the main cities, while areas that depend on agriculture and restructuring industries typically experience significant loss of jobs, but only limited employment creation and growth.

The difficult choices faced by policy-makers in such countries have been the subject of increased attention in the context of the 2004 EU enlargement, which saw the accession of a number of States with very low national GDP per capita as well as internal regional disparities. These challenges have, however, been evident for some time in the 'old' Cohesion countries, and are well-known in development economics. Such States often endeavour to raise national growth rates and, simultaneously, to reduce regional disparities. In practice, however, it is often difficult to achieve both goals simultaneously, at least in the short-to-medium term. This is because national growth in States that are undergoing radical structural change tends to be driven by those locations which are home to the majority of the population and businesses, while the benefits of structural change do not quickly reach poorer regions with production structures based on agriculture or

declining industries.<sup>13</sup> Some Cohesion countries are responding to these challenges by focusing regional policy funds on a limited number of potential growth poles in different regions, with the aim of enhancing both national growth and regional development.

The scale of problems means that it is often difficult to reach agreement on the appropriate balance between the two goals of national and regional development. A key issue is whether the potential trade-off between national and regional economic development is temporary or permanent. Williamson<sup>14</sup> argues that regional disparities in catching-up countries decline over time, as higher national income levels allow for the construction of diffusion mechanisms, notably transport and communications, as well as public investment and consumption flows to lagging regions. Others argue that leading regions may gain a permanent advantage in new sectors and technologies<sup>15</sup> although effective redistribution systems can limit regional income disparities.

Particularly in smaller Cohesion countries, such as Portugal (and Ireland until recently), EU Cohesion policy funding tends to focus mainly on the goal of national development in early programming periods. In later programming periods, however, the Commission has required Structural Funds resources to be used in part to co-finance regional programmes – and these are often synonymous with regional policy in many smaller Cohesion countries which lacked indigenous regional policies before EU membership.

### **3.2.2 Supporting the development of economically lagging regions**

In many countries, regional policy focuses on regions or areas with specific socio-economic weaknesses, selected on the basis of socio-economic indicators. This is particularly the case of countries with very large lagging regions (Germany, Spain, Italy) but also those where certain small areas face specific problems (France, Austria, Finland, Sweden).

A key reason for this approach, particularly in States with structurally weak macro regions, is the extent of genuine socio-economic disparities. Although these States are wealthy, levels of prosperity, employment or economic activity vary considerably between regions, so that policy-makers and politicians perceive a need for specific instruments and funding channels that support the development of lagging regions. An associated reason in many countries is that there is a long history of regional policy, focused on locations with particular socio-economic weaknesses (Germany, Italy). This policy approach is often institutionalised in a broad-based political consensus or constitutional commitment on the obligation on government to ensure equal living conditions or balanced economic development throughout the national territory.

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<sup>13</sup> J. Williamson (1965) Regional inequality and the process of national development: A description of the patterns. *Economic and Cultural Change* 13: 1-84. S. Barrios and E. Strobl (2005) The dynamics of regional inequalities. European Commission's Economic Papers No. 229.

<sup>14</sup> J. Williamson (1965) Op. Cit.

<sup>15</sup> M. Fujita et al. (1999) Op. Cit.

In some countries, however, this approach may also be influenced by EU frameworks on regional aid or the Structural Funds, which at least until the end of 2000-06 take an approach of micro-zoning. In some countries (Austria, Finland, Sweden), small areas are designated on the basis of socio-economic indicators, particularly under the EU's Regional Aid Guidelines. However, the primary logic of domestic regional policy in these States does not fit with the logic of focusing on economically lagging regions but instead into categories that are outlined below.

### ***3.2.3 Maintaining a critical mass in large regions with very low population density***

In the Nordic countries (Norway, Finland, Sweden), regional policy has traditionally focused on the large northern regions which face specific challenges. The weaknesses of these regions tend not to be adequately captured in economic indicators such as income per capita or employment but are clearly shown by extremely low population density levels. These mean that local markets are very small and can support only few private firms, which face higher market access costs and times in supplying external markets. Low population densities also present challenges to the provision of public services, raising questions over the appropriate level of services, and over responsibilities for paying for these services.

All three Nordic countries in this study are characterised by an ongoing political or constitutional commitment to the provision of equal living conditions throughout the territory, and to the right of individuals to live in any region and to access adequate public services in all regions.

### ***3.2.4 The dual goals of national growth and spatially balanced economic development in richer countries***

In a number of countries (France, Ireland, Norway, Austria, Finland, Sweden), a key strand of regional policy focuses on the dual aims of supporting national economic growth and facilitating a more spatially balanced distribution of economic activities and population. These are generally wealthier countries with limited regional economic disparities. They share political concerns over their capacities to sustain productivity-based economic growth and thus living standards, and aim to ensure that all regions contribute to national growth. However, they also share a political or constitutional emphasis on the desirability of balanced socio-economic development and equal living conditions throughout the country.

In some cases, this approach has developed in response to criticisms of more traditional forms of regional policy, or out of attempts to reinvent regional policy. This dual rationale for regional policy in wealthier countries is clearly consonant with –but generally pre-dates – the EU's Lisbon agenda.

In most of these countries, regional policy either focuses on all regions or funding is available to project applicants from all regions. However, the approach of France is distinctive, as policy instruments are targeted on a diverse range of pre-defined types of areas, which are selected on the basis of physical, social and economic indicators.

### **3.2.5 Using regional policy to support national economic growth**

In a final set of States (Netherlands, UK), the primary goal of regional policy is to ensure that all regions contribute to national economic growth. There is thus a strong emphasis on the need to exploit indigenous resources and capacities, and on the goal of enhancing national productivity gains. Although the extent of regional disparities varies (being relatively strong in the UK and weak in the Netherlands), there is general political acceptance in both States of the degree of existing disparities. In neither is there an explicit political or constitutional goal of ensuring spatially balanced economic development.

This approach has developed in response to criticisms of more traditional forms of regional policy that focused primarily on lagging regions, not least due to questions over the capacity of traditional instruments to reduce disparities. For example, regional State aid is often seen to have strong deadweight effects, while regional redistribution is often argued to be ineffective as resources leak out to wealthier regions, generating excess demand. The new approach instead aims to develop the supply of productive factors in all region and to ensure that regional policy interventions clearly contribute to national growth.

Although the institutional structures of these States differ, both have some form of decentralised frameworks which are incorporated into the systems of regional policy. The role of regional institutions in participating in the implementation of regional policy is a key feature that differentiates these policies from broader national policies focused on economic growth.

### **3.3 The balance between spatial goals in terms of funding allocations**

As regional policy in most States is implemented through multiple instruments and is targeted on more than one category of region, it is rarely easy to provide a clear overview of the spatial allocation of regional policy funding. This section examines different approaches to the allocation of regional policy funding between different kinds of locations or geographical goals. It draws on case studies of a number of States, providing estimated figures on the distribution of regional policy spending in Germany, Spain, Italy, the Netherlands and Poland. Some States choose to earmark a percentage of funds for lagging regions, or devote certain instruments only to lagging regions. In contrast, some States ring-fence some categories of spending for areas with growth potential, or allow actors throughout the country to apply for components of regional policy funding – a practice which tends to favour regions with existing strengths. Finally, some States allocate a percentage of regional policy spending to each region, on the basis of population shares and, sometimes, socio-economic criteria.

In all cases, the influence of EU frameworks is evident but so too is the role of domestic goals and institutions in shaping regional policy allocations. The EU's Regional Aid Guidelines and Cohesion policy funding mechanisms currently ensure that a significant percentage of regional policy funding in all States is allocated to designated areas, and these are generally locations with structural socio-economic weaknesses. Thus, even when States place a strong domestic emphasis on promoting bottom-up or innovation-based

growth in all regions (as in Austria, Finland or Sweden), a relatively large percentage of funding is still allocated to designated areas. However, while criteria for selecting Objective 1 or Article 87(3)a regions are clearly defined, States have some limited flexibility in selecting Objective 2 or Article 87(3)c areas, although the Commission also requires selection largely to be based on socio-economic indicators. Moreover, some categories of Cohesion policy spending are allocated outside structurally weak areas. In 2000-06, these primarily include Objective 3, Fisheries outside Objective 1, and some funding for Community Initiatives. There is likely to be even greater scope for Cohesion policy intervention outside weaker areas in 2007-13 (see Section 5.)

A first approach to the allocation of funding is taken in Italy, which sets explicit goals on the percentage of different categories of public funding to be allocated to the southern regions. Table 3.1 in Annex 2 shows the four main strands of public spending in Italy which the authorities see as key to the development of the structurally weaker regions or 'under-utilised areas'. These include EU and domestic co-financing for Structural Funds programmes, as well as domestic regional policy resources for 'under-utilised areas' and, finally, mainstream public capital spending ('ordinary resources'). While the spatial distribution of Structural Funds co-financing is agreed with the European Commission, domestic goals have been set for the other two funding strands,<sup>16</sup> so that 85 percent of domestic regional policy resources is reserved for the southern regions, as well as 30 percent of 'ordinary' capital account resources. In total, the goal is to allocate 45 percent of public capital account resources (covering both regional policy and 'ordinary' capital spending) to the southern regions, although it has proved difficult to attain this goal in recent years. In comparison, 36 percent of the Italian population lives in the southern regions (including Abruzzo and Molise), which produce 25 percent of national GDP.<sup>17</sup>

An alternative approach is taken in Spain, where funding under certain domestic instruments is earmarked for the lagging regions (Objective 1 regions) alone, as shown in Table 3.2. In particular, the domestic Inter-Territorial Compensation Fund (which is not co-financed by Cohesion policy) provides funding for public infrastructure in Objective 1 regions. Similarly, the Regional Investment Grant allocates aid to businesses (and is co-financed by the Structural Funds under a Sectoral Operational Programme in the Objective 1 regions). The other main regional policy mechanisms are co-financed by EU Cohesion policy, with Structural Funds resources currently earmarked for different categories of regions, and Cohesion Fund money allocated to major projects throughout Spain.

Both Poland and Norway have established geographically-delimited special zones which benefit from tax incentives. In Poland, this is the main regional policy instrument which is not co-financed by EU Cohesion policy, as shown in Table 3.3. While funding for these zones, selected on the basis of high unemployment rates, is substantial, it was relatively low in 2004-05 compared to total regional policy funding in Poland.

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<sup>16</sup> Ministero dell'Economia e delle Finanze (2006) *Rapporto Annuale 2005 del Dipartimento per le Politiche di Sviluppo sugli Interventi nelle Aree Sottoutilizzate*. Roma.

<sup>17</sup> Ministero dell'Economia e delle Finanze (2006) Op. Cit. page 167.

A variety of domestic approaches are employed in Germany to ensure that most regional policy funding is allocated to the new *Länder* which, in interregional comparisons on core socio-economic criteria, continue to show evidence of structural economic weaknesses. On the one hand, certain instruments are ring-fenced for the new *Länder* and Berlin, notably the Solidarity Pact II and federal programmes of support for enterprise and innovation (see Table 3.4). On the other hand, all *Länder* have agreed that six-sevenths of funding under the Germany-wide regional policy instrument (Joint Task for the Improvement of the Regional Economic Structure) is to be allocated to the new *Länder* and Berlin. Similarly, the majority of Structural Funds allocations are earmarked for the new *Länder* in 2000-06. In comparison the new *Länder* and Berlin account for 20 percent of the German population and generate 15 percent of national GDP.<sup>18</sup>

In the Netherlands, significant changes are currently being introduced to domestic regional policy. Until the end of 2006, some instruments are focused on the traditional weaker northern region, while others allocate funds to all regions (see Table 3.5). The main instruments for the North are the Structural Funds co-financed Kompas programme and the regional aid instrument (Investment Premium) for Article 87(3)c regions. This focus on the North is due both to the influence of EU frameworks and to the traditional approach of domestic regional policy in the Netherlands. However, changes are to be introduced in 2007, with the Kompas programme and Investment Premium likely to be replaced by the Peaks in the Delta programme. Under the new approach, a lower percentage (27 percent) of funding is earmarked for the North on a transitional basis until 2010 but a significant share of funding is to be allocated to other regions. Moreover, all Peaks in Delta funding should be focused on projects with significant growth potential. There is to be continued funding under other instruments for all regions, so that there will be an overall shift in regional policy towards a focus on encouraging growth in all regions.

## **4. THE SPATIAL ORIENTATION OF DIFFERENT INSTRUMENTS**

### **4.1 The geographical focus of regional policy instruments**

The spatial orientation of regional policy does not only vary between States but also between instruments. Indeed, there are commonalities in the spatial orientation of certain instruments across a number of States. Annex 1 sets out the full list of the regional policy instruments included in this study by category of intervention, while Table 4 illustrates the differing spatial orientations of instruments across States. The entries in Table 4 refer to the specific domestic regional policy instruments listed in Annex 1. Any interventions that are wholly co-financed through Cohesion policy and do not have a separate domestic identity are included in the final column 'Cohesion policy'.

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<sup>18</sup> Statistische Ämter des Bundes und der Länder (2006) Volkswirtschaftliche Gesamtrechnungen der Länder. Berlin.



**Table 4: Regional policy instruments and areas targeted**

	Regional aid	State block grants	Large infrastructure projects	Business context projects	RTDI projects	Strategy/network building	Special economic zones	Cohesion policy
Throughout the country	Ireland		Ireland, Italy		France, Norway, Austria, Sweden	France		Spain, Ireland, Poland, Portugal
Each and every region		France, UK						Austria, Poland, Portugal
Macro-regions with relative structural weaknesses	Germany, Spain, France, Italy	Germany	Spain, Italy	Germany, Italy	Germany	Germany, Italy		Germany, Spain, Italy
Small areas with relative structural economic weaknesses	Germany, France, Italy, Austria, Finland, Sweden	France	Italy	Germany, Italy		Germany, Italy	Poland	Germany, Spain, Italy, UK, France, Austria, Finland, Sweden
Large regions with sparse population	Norway, Finland, Sweden						Norway	Finland, Sweden
Small rural areas	France			France				
Growth areas in every region				Netherlands	Netherlands			
Growth areas in weak regions	Netherlands, UK			Ireland				Netherlands
Rural growth areas				France				
Urban areas in any region					Finland	France		
Industrial restructuring areas						France		
Mountain/coastal areas				France				

Source: EPRC.

There are a number of reasons why certain types of interventions tend to be focused on specific kinds of locations or on particular spatial goals across a number of different States. First, demand for certain types of interventions may be voiced more strongly in certain types of locations, either by businesses or by public and quasi-public actors; in contrast, demand may not be strongly voiced in structurally weak regions, not least due to the limited number of businesses. Second, decision-makers may believe that certain instruments are more needed or more likely to be more effective in certain kinds of areas. For example, support for R&D activities may be seen as more in demand and more effective in urban areas, where knowledge spillovers may emerge, rather than in poorer rural areas with few businesses. A third set of factors concerns political and institutional frameworks. On the one hand, EU regional aid guidelines and Cohesion policy frameworks influence area designation, particularly in relation to regional aid instruments, although also in a range of other policy areas. On the other hand, domestic institutional mechanisms may affect the spatial orientation of certain instruments. For example, the allocation of responsibility for different components of regional policy between regional authorities and central State Ministries often affects the spatial orientation of different instruments.

#### **4.1.1 Regional aid**

Regional direct aid to business is the only type of regional policy instrument which is implemented in all States in this study.<sup>19</sup> This is partly because business aid is the main traditional instrument of regional policy in some States, and partly due to States' fears over competition for mobile investment. Moreover, EU Regional Aid Guidelines strongly shape the spatial coverage of direct aid instruments in different States, as each State has to agree multi-annual regional aid maps with the European Commission. In 2000-06, Article 87(3)a areas were selected on the basis of EU-wide criteria, applied at NUTS II level. In the case of Article 87(3)c areas, however, States had a limited degree of flexibility, as they were responsible for selecting the domestic socio-economic criteria to be used in designating areas, although a consistent set of spatial units had to be used throughout the State and national population ceilings were set at EU level.

Although all States in this study implement regional aid, policy-makers' views of the impact of regional aid to business vary, largely because some economic theories and empirical studies suggest that State aid may have strong deadweight effects. Such questions over impact may influence the approach taken in different States. For example, the Netherlands and the UK aim to raise the effectiveness of regional aid in 2000-06 by selecting Article 87(3)c areas not only on the basis of socio-economic weakness but also in terms of their potential to attract private investment. However, authorities in many States (such as Germany, Austria and Italy) perceive regional aid as a highly effective means of stimulating economic development in weaker regions, particularly to the extent that it enhances the level of private investment by businesses that export outside the region and thus contributes to the emergence of new productive factors in the region.

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<sup>19</sup> However, Denmark has not implemented regional aid since 1991.

#### **4.1.2 Central State block grants to regional authorities**

In some countries, central State block grants to sub-national authorities are seen as a component of regional policy but in other countries such instruments are instead perceived as part of the broader public finance settlement. Such funding can be divided into categories: first, finance that is allocated to each and every region and second, finance that is awarded only to selected regions, generally those with particular structural weaknesses.

France and the UK allocate some categories of central State spending to elected or non-elected authorities in each and every region, and see these financial allocations as part of regional policy. In these traditionally centralised States, the emergence of new forms of regional policy in recent decades has occurred in the context of broader discussions over political decentralisation. In both States, the allocation of public resources to regional authorities is also seen as a means of enhancing the development of all regions, by facilitating the emergence of bottom-up strategies and the use of indigenous resources and capacities. In the UK, funding is allocated not only on the basis of population shares but is modulated on the basis of socio-economic criteria, to the benefit of weaker regions.

France also allocates additional block funding to the overseas departments (*départements d'outre-mer*) and to Corsica, due to the specific socio-economic weaknesses of these locations, as well as their particular political circumstances. Similarly, Germany provides central State funding to the new *Länder* under the Solidarity Pact, which operates in addition to the country's extensive financial equalisation mechanisms. The latter are not seen as components of active regional policy even though they contribute strongly to the reduction of disparities in public service provision and income levels. However, Solidarity Pact funding can be seen as a form of active regional policy because resources are supposed to be used to develop core public infrastructure and provide business support, thus contributing directly to the economic development of these lagging regions. The Solidarity Pact was set up in 1995 to help the new *Länder* address their longer-term developmental challenges, after the end of the five-year post-reunification Fund for German Unity. It is seen as a special instrument, limited in time (with the first phase lasting 1995-2004 and the second phase 2005-19) and aimed at overcoming the low fiscal base of the new *Länder* and addressing their investment needs, in line with the constitutional goal of spatially balanced development.

#### **4.1.3 Improving the business context via infrastructure support**

The allocation of regional policy resources for infrastructure projects is a well-established means of endeavouring to improve the context for economic development in lagging regions. In the Cohesion countries and macro lagging regions, funding is often focused on upgrading or extending core infrastructure, such as transport hubs and networks, business parks and environmental facilities. Outside these States and regions, there has been some debate about the appropriateness of using regional policy funding for infrastructure, so that such support is generally relatively limited. Many States also endeavour to attract private co-financing for infrastructure projects, or to make better use of private sector expertise in designing these interventions.

A key reason for the emphasis on infrastructure support in the Cohesion countries and macro lagging regions is that these locations usually lack the high quality public capital that is seen as a necessary condition for increased business investment and activity. The aim is to ensure sufficient funding for capital investment, in a context of fiscal pressures to maintain or increase current spending and to limit public indebtedness. This approach is supported by mainstream economic growth theory,<sup>20</sup> which sees potential for investment to increase the amount of capital per worker until diminishing returns set in. Moreover, endogenous growth theories<sup>21</sup> argue that investment in certain forms of capital can generate ongoing positive returns and thus permanently higher productivity rates.

In principle, such funding in the Cohesion countries and macro lagging regions may be allocated throughout the eligible territory. In practice, many different locations benefit from funding, with some resources often allocated for relatively small-scale infrastructure in all regions, although the majority of funds tends to be focused on infrastructure projects in the main agglomerations and along the main communications routes. Much domestic funding for public infrastructure in the Cohesion countries and macro lagging regions is channelled through projects and programmes that are co-financed by EU Cohesion policy. The balance between funding for large national infrastructure projects and smaller infrastructure projects in all regions is often influenced by the allocation of EU resources between the Cohesion Fund, Structural Funds national infrastructure programmes and Structural Funds regional programmes.

In other States, funding for infrastructure is often a less important component of regional policy. This is partly because public capital is seen as broadly adequate (or as the concern of national public investment policy) and partly because regional disparities are perceived to be rooted instead in less tangible factors such as human capital and innovation. Limits on regional policy funding may also be a factor, given the typically high cost of infrastructure projects. As a result, regional policy support for infrastructure in States such as Germany and the Netherlands is now provided only to projects which directly improve the context for business activity. In the Netherlands, regional policy is being integrated into the broader national growth strategy (via the Peaks in the Delta programme), with funding allocated to a limited number of projects which are seen to improve the business context and enhance overall potential for economic growth. This approach is still seen as regional policy because it funds projects in each region, and involves regional programming authorities in designing, selecting and implementing projects.

A slightly different approach is taken in France, where limited funding is provided for infrastructure projects in rural, mountain and coastal areas. The aim is partly to improve the context for business development (notably by funding broadband networks) but also to enhance public service provision in sparsely populated or less accessible areas. This approach is seen to be justified on the grounds that private sector providers do not address existing needs, and that there is a need for action to ensure quality of life and balanced development.

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<sup>20</sup> R. Solow (1956) Op. Cit.

<sup>21</sup> R. Lucas (1988) Op. Cit. P. Romer (1986) Op. Cit.

#### 4.1.4 RTDI projects

There are two main approaches to regional policy support for RTDI in this study, depending in part on the existing distribution of R&D or innovation-oriented activities within individual States, and perceptions of the potential of different areas to develop such activities. The first concerns the Cohesion countries and structurally weak macro regions, while the second covers the other regions and States.

In the Cohesion countries and macro lagging regions, funding for R&D is generally allocated through broad national and/ or regional programmes, co-financed by the Structural Funds, although, in addition, the German federal government provides R&D aid to businesses in the new *Länder*. Funding is generally available to any firm or R&D-oriented organisation in large regions or throughout the country, but in practice is often focused on the main towns or cities because R&D activities are often subject to strong agglomeration economies in the form of knowledge spillovers. The need to concentrate R&D resources on a limited number of locations in poorer States and macro regions is due to the weaknesses of these locations in R&D, with relatively few businesses and institutes engaged in these activities. Some studies have questioned the appropriateness of funding R&D in lagging regions, given their general lack of comparative advantage in R&D<sup>22</sup>. However, there are clearly differences between structurally weak regions, with some eastern German regions, for example, showing relatively good potential in some R&D sectors. In many lagging regions, however, the main emphasis is on knowledge transfer and the diffusion of existing technologies, aimed at building up a base for future R&D and innovative activities<sup>23</sup>.

In wealthier States (France, Austria, Norway, Finland, Sweden), RTDI support has come to play an important role in regional policy, with resources typically being made available to applications from any location. The broad goals are usually to promote the geographical diffusion of R&D and innovation-oriented activities, and to enhance national comparative advantage in R&D. Similarly, the new Peaks in the Delta programme in the Netherlands can to include funding for RTDI projects, where there are seen to contribute significantly to aggregate economic growth.

One reason for the strong focus on RTDI in new forms of regional policy in wealthier States is that R&D indicators (relating spending, patents and employment) generally show relatively strong geographical disparities due to the importance of spatially-delimited knowledge spillovers in fuelling R&D. A further reason is that economic theory suggests that public funding for R&D may be less distorting to economic incentives than other forms of business aid, due to its potential to generate dynamic efficiency gains which outweigh the costs of support. Finally, the spatial distribution of this type of policy intervention is less strictly regulated by the European Commission than that of mainstream regional State aid, so that States have greater scope to design and implement RTDI interventions in all regions.

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<sup>22</sup> K. Midelfart-Knarvik and H. Overman (2002) Delocation and European integration: is structural spending justified? *Economic Policy* 35: 322-359.

<sup>23</sup> G. Grossman and E. Helpman (1991) *Innovation and Growth in the Global Economy*. Cambridge (MA): MIT Press.

#### **4.1.5 Strategy/network building**

Regional policy support for building bottom-up strategies or networks is generally allocated only to selected regions, often via a process of competitive bidding or applications. In Germany and Italy, this type of intervention focuses mainly on the macro lagging regions, but also on the structurally weak areas in western Germany and central-northern Italy. In France, funds are available to different kinds of regions, some of which are self-selecting. Although States adopt a variety of approaches, the aim in all cases is to encourage the emergence of strategies and projects that make better use of existing resources and capacities and that are better tailored to the differentiated needs of diverse locations.

Funding is often allocated via a process of bidding or applications because this is seen as a key part of broader preparations for developing the strategy or network, as it implies that the various actors need to cooperate with one another to produce a successful application. In Germany, local actors in structurally weak regions can apply for funding both to build integrated development strategies and, in the case of the weakest regions, to undertake initial projects, mainly related to mobilising potential. These projects generally focus on networking, communication and marketing activities that are seen as key to building support for the broader strategy.

In Italy, the 'integrated territorial projects' approach is administered by the regional authorities, which define the broad goals and selection criteria for projects. Local public and private actors must then cooperate to develop strategies which conform with the regional approach. Although funds are not available for building for the strategy, successful applications are guaranteed access to significant funding from existing regional policy instruments, for example for business aid and infrastructure. The Italian authorities see this approach as a means of enhancing both economic impact and financial absorption.

France also provides support for strategy- and network building but focuses interventions on a range of different types of areas, including towns, local productive systems, pays and agglomerations, as well as industrial restructuring locations. The French authorities see this approach as a means of bringing sub-national actors together to cooperate across local administrative boundaries, providing for a more strategic approach than can be undertaken by individual municipal authorities.

#### **4.1.6 Special economic zones**

Finally, two States in this study (Norway and Poland) designate specific zones which receive special treatment in terms of a range of tax incentives. This approach is, however, broadly discouraged and strictly regulated by the European Commission, which argues that it has particularly distorting effects on economic incentives. Indeed, Poland has agreed to phase out its special economic zones by 2017.

In Norway, in addition to higher aid ceilings under broader regional policy instruments, the northern Action Zone benefits from reduced personal taxes, exemption from the tax on the household use of electricity, a reduction on student loans, and higher family and child allowances. Poland currently has 14 special economic zones in areas with high structural unemployment, where firms benefit from tax relief as long as they undertake a certain

level of investment and create a certain number of new jobs. In both cases, the eligible areas were selected on the basis of objective criteria: unemployment rates in Poland, and low population density in Norway.

National authorities in both States see this form of intervention as an effective means of attracting business activity and investment, while the Norwegian authorities also perceive the special economic zone as facilitating the retention of population numbers in the far North. In contrast to the view of the European Commission, Norway argues that the blanket implementation of subsidies in the northern region is preferable to a selective approach because the former aims to compensate for the structural disadvantage affecting all businesses in this region, and does not therefore introduce distortions within the region. In addition, the Polish authorities argue that the special economic zones reduce the burden on the public administration because subsidies are provided in the forms of tax rebates, which are allocated automatically. In contrast, grant application schemes are seen as more complex and difficult to administer, as they require effective selection criteria and procedures, publicity mechanisms, financial monitoring and evaluation.

## 5. CONCLUSIONS: LOOKING TO THE FUTURE

This overview of the different spatial approaches to regional policy demonstrates both the diversity of goals, target-areas and instruments in European States and certain commonalities between States. Most States in the study have their own domestic rationales and traditions in the field of regional policy, and this broader domestic policy stance shapes the availability of funding for regional policy, the hierarchy of objectives and the design of interventions. However, EU Regional Aid Guidelines and Cohesion policy mechanisms tend to promote common approaches across States, either by imposing the same requirements on all States or by providing channels for information exchange.

Although this paper has focused on the current situation in 2006, it is clear that the shape of regional policies in Europe will undergo various changes over the coming year, which in many cases may include reforms in spatial orientation. Although these shifts are mainly driven by the revision of EU frameworks, some States may decide to introduce additional changes to domestic regional policy at the same time, particularly as the time-frames of domestic policies have often come to be aligned with those of EU regional policies. Section 3.3 noted the forthcoming reformulation of the Netherlands' domestic regional policy goals and instruments, to concentrate more strongly on those locations with the capacity to contribute significantly to national economic growth.

In terms of changes in spatial orientation, the EU's revised Regional Aid Guidelines for 2007-13 imply a reduction in overall area coverage in wealthier Member States, under both Article 87(3)a and Article 87(3)c.<sup>24</sup> This will further limit the role of aid-based forms of regional policy for structurally weaker regions in the wealthier Member States. As to the

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<sup>24</sup> For a fuller discussion, see F. Wislade (2006) *Recent Developments in EU Competition Policy and Regional Aid Control*. European Policies Research Centre, EoRPA Paper 06/ 4.

mechanisms to be used for selecting the two categories of eligible areas, the broad approach remains similar. In 2007-13, Article 87(3)a regions are being designated on the basis of EU-wide objective criteria (NUTS II regions with GDP per capita below 75 percent of the EU average in purchasing power parities). In the case of Article 87(3)c areas, however, States now have greater flexibility, subject to rules on minimum area size (generally NUTS III) and overall population ceiling. Member States can use their own criteria and mechanisms for designating areas, as long as these generally meet EU-wide criteria (i.e. an unemployment rate above 115 percent of the national average or a level of GDP per capita below the EU25 average in purchasing power parities).

A further change in approach is signalled in the EU's draft document<sup>25</sup> on the future framework for RTDI State aid. Unlike the guidelines for 2000-06, the draft approach does not include the possibility for Member States to introduce higher aid ceilings in Article 87(3) regions. In contrast, the Commission's draft framework does provide for specific aid for innovation clusters in particular sectors and regions, with an emphasis on allocating funding to locations with existing R&D and technological strengths, as well as potential to develop further. This approach thus seems designed to support existing innovative clusters, rather than to establish new ones, and is likely to benefit those regions with existing sectoral strengths in RTDI.

The revised frameworks for Cohesion policy are also likely to contribute to changes in the spatial orientation of Member States' domestic regional policies. The implications of the December 2005 European Council agreement for individual States and regions are complex, shaped in part by the agreement's additional provisions for specific locations.<sup>26</sup> Clearly, the majority of funding is allocated to the Convergence regions (81.5 percent), although a significant share remains for other Objectives, with 15.9 percent of funding for the Regional Competitiveness and Employment Objective, and a further 2.5 percent for the Territorial Competitiveness Objective.

While funding under the Convergence Objective (as well as for Phasing-out and Phasing-in regions) is clearly allocated to specific locations, in 2007-13 States will not be obliged to focus EU funding for Regional Competitiveness and Employment on structurally weak regions. States are likely to take different approaches but in many cases a significant percentage of Regional Competitiveness and Employment funding may be allocated to wealthier areas, leading to a clear shift in the spatial orientation of Structural Funds programmes.

The Community Strategic Guidelines on Cohesion<sup>27</sup> emphasise the 'territorial' dimension of Cohesion policy, although it remains to be seen how this approach will be translated into

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<sup>25</sup> European Commission (2006) Op. Cit.

<sup>26</sup> For a fuller discussion, see J. Bachtler, F. Wislade and C. Méndez (2006) *New Budget, New Regulations, New Strategies: The Reform of EU Cohesion Policy*. European Policies Research Centre, EoRPA Paper 06/3.

<sup>27</sup> European Commission (2006) *Proposal for a Council Decision on Community Strategic Guidelines on Cohesion*, COM(2006) 386 / 13.07.2006. Brussels.



practice in the Member States. The Guidelines suggest that Cohesion policy should address the needs of diverse kinds of regions, including urban and rural areas. One possibility, however, is that the Structural Funds programmes may focus more strongly in future on urban areas, particularly as separate rural development programmes will in future be co-financed by the Common Agricultural Policy, and thus outside the Structural Funds framework. A key challenge in many Member States and regions, particularly those with serious structural economic weaknesses, will be to ensure effective coordination between Structural Funds programmes and CAP rural development programmes.

It is not yet clear how shifts in EU frameworks will affect the spatial balance of regional policy goals and instruments in individual Member States. At present, most States continue to concentrate a significant percentage of funding on those regions which perform relatively weakly on socio-economic indicators (including population density in the Nordic countries). Some States, however, also endeavour to support development in all regions, with the aim of contributing to national economic growth and sometimes with the goal of stimulating a more geographically balanced pattern of economic activities. The respective weighting accorded to each of these two broad approaches in the coming years is likely to be strongly shaped by decisions taken by European States in 2006-07.

## **6. ISSUES FOR DISCUSSION**

How is the spatial focus of regional policy likely to change from 2007 onwards? Will shifts in the EU's Regional Aid Guidelines and in EU Cohesion policy mechanisms lead to additional changes in domestic instruments and approaches?

Is there an appropriate balance at present between different spatial approaches in regional policy? Is there a need for a stronger focus on structurally weak regions? Should policy instead concentrate more on regions with clear growth potential?

What level of spatial units should be used in regional policy? Do different kinds of instruments need to focus on different scales or sizes of region?

## **ANNEX 1: THE SPATIAL GOALS OF REGIONAL POLICY INSTRUMENTS**

### **6.1 Germany**

#### 1. Macro-regions with relative structural economic weaknesses

- a) Regional aid: Joint Task for the Improvement of Regional Economic Structures (Joint Task IRES); Investment Allowance
- b) State block grants: Solidarity Pact II
- c) Business context projects: Joint Task IRES
- d) RTDI projects: Federal programmes: INNO-WATT and Enterprise Regions
- e) Strategy / network building: Joint Task IRES (Regional managements)
- f) Structural Funds programmes

#### 2. Small areas with relative structural economic weaknesses

- a) Regional aid: Joint Task IRES
- b) Business context projects: Joint Task IRES
- c) Strategy / network building: Joint Task IRES (Regional managements)
- d) Structural Funds programmes

### **6.2 Spain**

#### 1. Throughout the country

- a) Cohesion Fund projects

#### 2. Macro-regions with relative structural economic weaknesses

- a) Regional aid: Regional Investment Grant
- b) Public infrastructure projects: Inter-Territorial Compensation Fund
- b) Structural Funds programmes

#### 3. Small areas with relative structural economic weaknesses

- a) Structural Funds programmes

### 6.3 France

1. Throughout the country
  - a) RTDI projects: Funding and tax relief for 66 Competitiveness Poles that include R&D zones
  - b) Strategy / network building: Pays, Agglomerations, Local Productive Systems
2. Each and every region
  - a) State block grants: State-Region Planning Contracts
3. Macro regions with relative structural economic weaknesses
  - a) Regional aid: Aid for Territorial Planning in the Service Sector for all areas except Île de France and Lyons
4. Small areas with relative structural economic weaknesses
  - a) Regional aid: Aid for Territorial Planning in the Industrial Sector; additional numerous aid schemes for the overseas departments
  - b) State block grants: Additional grants to Corsica and the overseas departments
  - c) Structural Funds programmes
5. Small areas with low population and high agricultural employment
  - a) Regional aid: Tax incentives for businesses in Zones of Rural Revitalisation
  - b) Business context projects: funding for public service provision and broadband infrastructure in selected areas
6. Rural growth areas
  - a) Business context projects: in Rural Poles of Excellence
7. Urban areas
  - a) Strategy / network building: in selected large and small towns
8. Small industrial restructuring areas
  - a) Strategy / network building: Ste Contracts
9. Mountain / coastal areas
  - a) Business context projects: in selected coastal and mountain areas

## 6.4 Ireland

1. Throughout the country
  - a) Regional aid
  - b) Public investment projects
  - c) Structural Funds programmes and Cohesion Fund projects
2. Small growth areas in regions with relative structural economic weaknesses
  - a) Business context projects e.g. 'flagship parks' in 'gateway locations'

## 6.5 Italy

1. Throughout the country
  - a) Public investment projects: Target Law no. 443/ 2001
2. Macro-regions with relative structural economic weaknesses
  - a) Regional aid: e.g. Law no. 488/ 1992; Tax credit under Law no. 388/ 2000 (art. 8); IRAP tax relief; Localisation Contracts
  - b) Public investment projects: Favourable treatment under Law no. 443/ 2001
  - c) Business context projects: Framework Programme Agreements
  - c) Strategy / network building: Integrated Territorial Projects
  - d) Structural Funds programmes
3. Small areas with relative structural economic weaknesses
  - a) Regional aid: e.g. Law no. 488/ 1992; Tax credit under Law no. 388/ 2000 (art. 8)
  - b) Business context projects: Framework Programme Agreements
  - c) Strategy / network building: Integrated Projects for Territorial Development
  - d) Structural Funds programmes

## **6.6 The Netherlands**

1. Growth potential areas in every region
  - a) Business context projects: Peaks in the Delta
  - b) RTDI projects: Peaks in the Delta
2. Small growth areas in regions with relative structural economic weaknesses
  - a) Regional aid: Investment Premium
  - b) Structural Funds programme: Kompas programme

## **6.7 Norway**

1. Throughout the country
  - a) RTDI projects: Centre of Enterprise programmes, Knowledge parks, Business gardens etc
2. Large regions with very low population density
  - a) Regional aid: Tax relief on employers' social security contributions; Grant aid
  - b) Special economic zones: Action Zone for North Troms and Finnmark with various forms of business aid and personal tax relief

## **6.8 Austria**

1. Throughout the country
  - a) RTDI projects: RIF 2000 and other knowledge transfer schemes
2. Each and every region
  - a) Structural Funds programmes
3. Small areas with relative structural economic weaknesses
  - a) Regional aid e.g. ERP Fund loans
  - b) Structural Funds programmes

## **6.9 Poland**

1. Throughout the country
  - a) Cohesion Fund projects and Structural Funds programmes
2. Each and every region
  - a) Structural Funds programmes
3. Small areas with relative structural economic weaknesses
  - a) Special Economic Zones providing tax relief to firms

## **6.10 Portugal**

1. Throughout the country
  - a) Cohesion Fund projects and Structural Funds programmes
2. Each and every region
  - a) Structural Funds programmes

## **6.11 Finland**

1. Small areas with relative structural economic weaknesses
  - a) Regional aid
  - b) Structural Funds programmes
2. Large regions with very low population density
  - a) Regional aid
  - b) Structural Funds programmes
3. Urban areas throughout the country
  - a) RTDI projects: Centre of Expertise programme; Regional Centre Development programmes

## **6.12 Sweden**

1. Throughout the country
  - a) RTDI projects: e.g. VINNVÄXT programme
2. Small areas with relative structural economic weaknesses
  - a) Regional aid
  - b) Structural Funds programmes
3. Large regions with very low population density
  - a) Regional aid
  - b) Structural Funds programmes

## **6.13 United Kingdom**

1. Each and every region
  - a) State block grants: to Northern Ireland, Scotland, Wales, and to English Regional Development Agencies
2. Small areas with relative structural economic weaknesses
  - a) Structural Funds programmes
3. Small growth areas in regions with relative structural economic weaknesses
  - a) Regional aid schemes

## ANNEX 2: BACKGROUND TABLES

**Table 3.1: Estimated regional policy resources in Italy (billion current euro)**

	2000	2001	2002	2003	2004
<b>Total for Italy</b>	<b>43.4</b>	<b>49.2</b>	<b>52.6</b>	<b>53.9</b>	<b>55.4</b>
Ordinary resources	31.5	33.8	41.9	44.2	44.5
EU Structural Funds	3.3	4.7	1.7	2.4	2.8
Domestic public co-financing for the Structural Funds	3.1	4.2	1.7	2.3	2.7
Resources for 'underutilised areas'	5.6	6.5	7.3	4.9	5.4
<b>Total for Southern Italy</b>	<b>17.2</b>	<b>20.3</b>	<b>20.8</b>	<b>20.3</b>	<b>20.4</b>
Ordinary resources	8.2	7.6	11.4	12.3	11.6
EU Structural Funds	2.4	4.0	1.7	2.0	2.2
Domestic co-financing for the Structural Funds	1.9	3.4	1.5	1.8	2.0
Resources for 'underutilised areas'	4.7	5.5	6.2	4.2	4.6
<b>% of Total for Southern Italy</b>	<b>39.6</b>	<b>41.3</b>	<b>39.5</b>	<b>37.7</b>	<b>36.8</b>

Note: Southern Italy includes Abruzzo, Basilicata, Calabria, Campania, Molise, Puglia Sardegna and Sicilia.

Source: ERPC calculations based on Table III.4 (page 198) in: Ministero dell'Economia e delle Finanze, Dipartimento per le Politiche di Sviluppo e Coesione (2006) Rapporto Annuale 2005. Roma.



**Table 3.2: Estimated regional policy resources in Spain (in million current euro)**

	2000	2001	2002	2003	2004
<b>Objective 1 regions total</b>	<b>7297</b>	<b>7590.4</b>	<b>7358.3</b>	<b>7708.9</b>	<b>7350.2</b>
Inter-Territorial Compensation Fund	850.3	880.9	894.7	955.8	1011.2
Regional Investment Grant	306.4	569.2	323.3	612.8	198.7
Structural Funds (EU co-financing)	6140.3	6140.3	6140.3	6140.3	6140.3
<b>Other regions total</b>	<b>803.6</b>	<b>803.6</b>	<b>803.6</b>	<b>803.6</b>	<b>803.6</b>
Structural Funds	803.6	803.6	803.6	803.6	803.6
<b>Any region</b>	<b>1971.6</b>	<b>1971.6</b>	<b>1971.6</b>	<b>1971.6</b>	<b>1971.6</b>
Cohesion Fund & Community Initiatives	1971.6	1971.6	1971.6	1971.6	1971.6
<b>Total</b>	<b>10072.2</b>	<b>10365.6</b>	<b>10133.5</b>	<b>10484.1</b>	<b>10125.4</b>
Objective 1 regions as % of total	72.4	73.2	72.6	73.5	72.6
Other regions as % of total	8.0	7.8	7.9	7.7	7.9
Any region as % of total	19.6	19.0	19.5	18.8	19.5

Note: For Cohesion policy funding, multi-annual financial allocations have been broken down to provide pro rata annual data.

Source: EPRC calculations based on national data on the Inter-Territorial Compensation Fund and Regional Investment Grant; plus DG Regional Policy data on Cohesion policy allocations.

**Table 3.3: Estimated regional policy resources in Poland (in million current euro)**

	2000	2001	2002	2003	2004	2005
<b>Special economic zones</b>	<b>73.1</b>	<b>95.6</b>	<b>65.7</b>	<b>101.6</b>	<b>160.7</b>	<b>103.6</b>
Objective 1, of which					2758.6	2758.6
Sectoral Operational Programmes					1771.0	1771.0
Integrated Regional Operational Programme					987.6	987.6
Cohesion Fund and Community Initiatives					1511.3	1511.3
<b>Total Cohesion policy</b>					<b>4269.9</b>	<b>4269.9</b>
<b>Pre-accession aid - ISPA</b>	<b>280.0</b>	<b>280.0</b>	<b>280.0</b>	<b>280.0</b>	<b>280.0</b>	<b>0.0</b>
<b>Total</b>	<b>353.1</b>	<b>375.6</b>	<b>345.7</b>	<b>381.6</b>	<b>4710.6</b>	<b>4373.5</b>
All-country development %of total	79.3	74.5	81.0	73.4	75.6	75.0
All-region development % of total	0.0	0.0	0.0	0.0	21.0	22.6
Special economic zones % of total	20.7	25.5	19.0	26.6	3.4	2.4

Note: For Cohesion policy and ISPA funding, multi-annual financial allocations have been broken down to provide pro rata annual data.

Source: EPRC calculations based on Ministry of Economics "Specjalne strefy ekonomiczne na koniec 2005 r."; plus data on ISPA from the Commission Representation in Poland; plus DG Regional Policy data on Cohesion policy financial allocations.

**Table 3.4: Estimated regional policy resources in Germany (in million euro)**

	2000	2001	2002	2003	2004	2005
<b>Total for new Länder, of which</b>	15087.1	14911.2	14746.3	14659.4	14652	14549.8
Joint Task	1163.7	987.8	822.9	736.0	723.2	588.0
Solidarity Pact	10500	10500	10500	10500	10500	10533
Federal RTDI						
a) INNO-WATT	84.6	84.6	84.6	84.6	90	90
b) Enterprise Regions	62.5	62.5	62.5	62.5	62.5	62.5
Structural Funds (EU co-financing)	3276.3	3276.3	3276.3	3276.3	3276.3	3276.3
<b>Total for old Länder, of which</b>	1454.9	1476.1	1467.1	1447.9	1428.8	1431
Joint Task	123.3	144.5	135.5	116.3	97.2	99.4
Structural Funds (EU co-financing)	1331.6	1331.6	1331.6	1331.6	1331.6	1331.6
<b>Total for any region</b>	253.1	253.1	253.1	253.1	253.1	253.1
Community Initiatives	253.1	253.1	253.1	253.1	253.1	253.1
<b>Total for all Länder</b>	16795.1	16640.4	16466.5	16360.4	16333.9	16233.9
New Länder as % of total	89.8	89.6	89.6	89.6	89.7	89.6
Old Länder as % of total	8.7	8.9	8.9	8.9	8.7	8.8
Any region as % of total	1.5	1.5	1.5	1.5	1.5	1.6

Note: Structural Funds figures are in 2004 prices, while other figures are in current prices. For the Joint Task, data represent final spending. For all other all instruments, multi-annual financial allocations have been broken down to provide pro rata annual data. The table does not include information on the Investment Allowance.

Source: EPRC calculations based on national data sources; plus DG Regional Policy data on Structural Funds allocations.

**Table 3.5: Estimated regional policy resources in the Netherlands (in million euro)**

	2004	2005	2006	2007	2008
<b>Total for structurally weak regions</b>	<b>74.1</b>	<b>74.1</b>	<b>75.3</b>	<b>26.7</b>	<b>26.7</b>
Kompas programme	61.1	61.1	61.1		
Centralised Investment Premium	13.0	13.0	13.0		
ERDF co-finance			1.2	11.0	11.0
Peaks in the Delta approach				15.7	15.7
<b>Total for other regions</b>				<b>42.4</b>	<b>42.4</b>
Peaks in the Delta approach				42.4	42.4
<b>Total for all regions</b>	<b>52.1</b>	<b>81.6</b>	<b>82.4</b>	<b>84.5</b>	<b>82.9</b>
Industrial estates	22.9	22.9	23.1	22.9	22.9
Tourism	21.9	20.7	19.5	21.9	21.9
Regional development companies	7.3	7.2	7.0	6.9	7.3
Urban economy	0	30.8	32.8	32.8	30.8
<b>Total</b>	<b>126.2</b>	<b>155.7</b>	<b>157.7</b>	<b>153.6</b>	<b>152</b>
Structurally weak regions %	58.7	47.6	47.7	17.4	17.6
Other regions %	0.0	0.0	0.0	27.6	27.9
All regions %	41.3	52.4	52.3	55.0	54.5

Note: For the Urban economy, multi-annual financial allocations have been broken down to provide pro rata annual data.

Source: EPRC calculations based on Ministry of Economic Affairs (2004) *Peaks in the Delta: Regional Economic Perspective*. The Hague. Table 9.