# COHESION IN THE EU

## STRUCTURAL POLICY AND ECONOMIC CONVERGENCE

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The promotion of economic convergence has been a long-standing aim of the European Union that has spawned a wide range of structural policies. Structural policies have also moved to centre stage in economic governance since the appointment of the Barroso Commission in 2005 and the re-launch of the Lisbon strategy. In the latter case structural reforms have been sought to underpin the competitiveness of the EU as a whole, not least in response to challenges from China, India and other emerging economies as well as more established competitors such as the United States. Structural policies – widely defined – consequently have a dual aim of reducing regional disparities and boosting aggregate competitiveness. The policy challenges are further complicated by the use of the term 'cohesion' which intuitively implies more than a purely economic convergence objective.

Following the accession of Bulgaria and Romania to the EU, regional disparities have become wider than ever before in the EU: in fact, the ten regions with the lowest GDP per head in 2005 (the latest year for which full data are available) are in these two countries, and just above them are the four least prosperous Polish regions (Eurostat 2008). Convergence is undoubtedly occurring, within the EU, with the rapid growth of the Member States that acceded to the Union in 2004 raising their GDP per head relative to the EU average. Convergence is advanced both by market integration and by the support from cohesion policy, although experienced observers such as John Fitzgerald (2006) maintain that it is integration (provided it is supported by suitable accompanying policies) that is the more powerful force. The sheer diversity of experience is also salient and even if there is a plausible case that policy intervention has had positive effects, the added value from carrying out the policy at EU level may not be proven. Twenty years ago, Ireland's GDP per head was barely 15 percent above that of Portugal, but Ireland's GDP per head today is double that of Portugal, even though both countries have enjoyed similar support from the Structural Funds since the major policy reforms of the mid-1980s.

The clear implication is that structural policies can be helpful, but only as part of a more comprehensive development strategy and governance framework. Yet cohesion policy is something of an enigma. It is a popular policy: a Eurobarometer survey carried out early in 2008 found that as many as half of EU citizens were aware of cohesion policy support for their region or city, and of that proportion, 70 percent approved of the way the policy was conducted as opposed to 22 percent who believed that it had no positive effects (European Commission 2008). But critics – and there are many, especially among the ranks of orthodox economists – assert that it has little or no impact on regional growth and that the money is ineffectively spent.

This article looks at the role of structural policies in advancing convergence, and at the tensions between Lisbon aims and cohesion aims. The next section elaborates on the policy background and is followed by an appraisal of how effective cohesion policy is.

### Policy background

In the Treaty Establishing the European Community (Art. 158, TEC), economic and social cohesion is defined in terms of reducing regional disparities in the level of development, usually measured by GDP per head (relative to the EU average) in purchasing power parities. Assuming the Lisbon Treaty is ratified, the definition will change somewhat through the addition of the word "territorial" to the objectives of cohesion, implying a focus on spatial balance in economic development.

European Commission (2007) lays great stress on the fact that cohesion policy is confluent with the goals of the Lisbon strategy by promoting growth and employ-

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ment, implying that it improves the use of resources, but many regard it is primarily a distributive, rather than an allocative policy. In cash terms, the outlays are substantial, with projected commitments in the current fiscal year, according to the EU's 2008 budget, of 47 billion – more than the entire GDP at current prices of Luxembourg, Slovenia or Slovakia. But as a proportion of EU GDP they are just 0.35 percent.

While there are well-established broad orientations for cohesion policy, articulated notably in the Community Strategic Guidelines (European Council 2006), in practice it embraces a wide range of public interventions and, in some of the current discourse, several new directions are canvassed. The strategic guidelines (European Council 2006) go some way towards fleshing out what is meant by territorial cohesion, emphasising that it is about different facets of geography. On the one hand, "territorial" is about assuring that economic activity is spatially balanced, thereby avoiding simultaneous over- and under-heating of regional economies that results in less favourable macroeconomic conditions. On the other hand, it is about tailoring policy support to the differing geographies of different sorts of regions, including urban, rural, peripheral, mountainous, maritime and so on. The impact of economic integration on border regions is recognised as a specific challenge for the EU.

The focus of structural policy in the Lisbon agenda is, though, rather different. The twenty-four integrated guidelines for the Lisbon strategy comprise six with macroeconomic objectives, ten aimed at structural policies and eight covering employment. The expression "cohesion" does appear in the text of the guidelines, but not in a systematic way, nor is it visible in the focusing of the Lisbon strategy, re-affirmed by the European Council in March 2008, on four overarching priorities of investing in people and modernising labour markets; unlocking business potential; investing in knowledge and innovation; and developing energy policy and countering climate change.

### Is cohesion policy working?

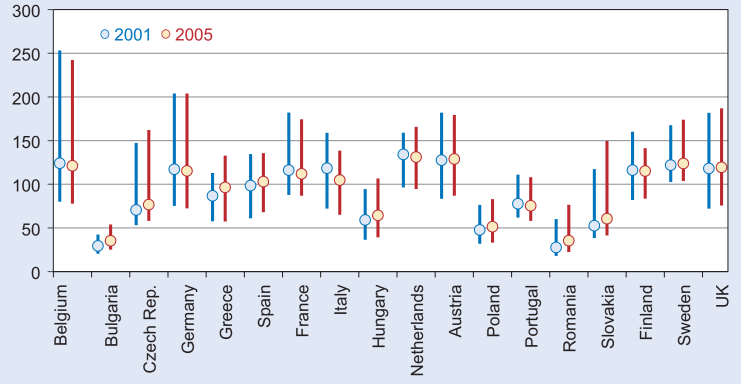
As the Commission's 4th *Cohesion Report* notes, convergence can be observed at both the national and regional levels (European Commission 2007). In addition to the overall story of catch-up by the least prosperous Member States, it notes that average growth in the regions below 50 percent of the EU average for GDP per head grew 2.4 percentage points faster than the EU27 as a whole over the period 2000 to 2004. The report also draws attention to declining GDP per head in a number of higher-income regions and the relatively slower growth of geographically core regions relative to the EU's periphery. The upshot is that standard measures of regional income inequality show that the EU is becoming less unequal and, moreover, that territorial cohesion is improving insofar as growth is more widely spread.

*Possible concerns*

However, the 4th Cohesion Report also identifies regional divergence within many Member States as a continuing difficulty. As Figure 1 shows, in many Member States the disparities between the most and least prosperous regions have been widening. In Slovakia, for example, the GDP per head of the capital region jumped from 116 percent of the EU27 average in 2001 to 148 percent in 2005, whereas the least prosperous region rose only from 40 percent to 43 percent. Even allowing for data anomalies such as the "commuting" effect (European Commission 2007) that over-states the GDP per head of geographically compact urban regions, the aggravation of such imbalances is worrying with regard to territorial cohesion. In addition, as Landesmann and Römisch (2007) show, most of the gains posted by the recently acceded Member States stem from rapid productivity increases, whereas employment has not

**Figure 1**

DISPARITIES IN REGIONAL GDP PER HEAD: HIGHEST AND LOWEST REGION
EU27 = 100




Source: Eurostat.

grown much. Although the growth is impressive, this conjunction poses problems of social cohesion.

There is more disturbing evidence about future prospects from indicators of regional R&D and the *Regional Innovation Scorecard*. These data testify to how spatially concentrated these activities are. Favoured regions in the three Nordic countries and southern Germany dominate the top of the innovation scorecard list along with the capital regions of the UK, France, the Czech Republic and Austria, while the bottom end comprises less-favoured regions in the southern and eastern periphery of the EU (Innometrics 2006). R&D expenditure is even more spatially skewed (European Commission 2007) with high R&D effort in much the same favoured regions, nearly all of them high income ones, yet with more than 100 regions recording R&D investment rates below 1 percent of GDP – less than a third of the "Barcelona" target adopted for the Lisbon strategy.

*Post hoc ergo propter hoc?*

What is much more difficult to show is causality. Plainly, expenditure from the Structural and Cohesion Funds will, by adding to demand, increase GDP in recipient regions and Member States and, vice versa, reduce it in the areas that are net contributors to the EU budget. This is a *level* effect and given that the resulting transfers may reach as high as 4 percent of GDP in the most intensively assisted regions, should have a corresponding effect on their measured prosperity. Consequently, for regions in the new Member States, the build-up of cohesion spending before and after 2004 can, itself, explain a proportion of their convergence. Given the budgetary arithmetic, a small, negative level effect of around a third of a percentage point should be expected in regions that pay for the policy.

The more interesting question is whether cohesion transfers have an impact on underlying growth rates. Answers vary, depending on the methodology employed to assess the policy, and none in isolation offers a wholly convincing answer. On the whole (for an overview, see Begg 2008; see also Bachtler and Gorzelak 2007), econometric studies find little evidence that cohesion policy increases growth rates (see, for example, Boldrin and Canova 2001; Ederveen et al. 2006). Other studies are more supportive of the role of the Structural Funds (see Cappellen et al. 2003), but still have difficulty making a convincing case for the effectiveness of cohesion policy.

By contrast, macroeconomic modelling exercises are more sanguine, partly because they attempt to look beyond the immediate effects. In modelling work, Bradley et al. (2007) distinguish two distinct phases. They refer, first, to the level effect as an "implementational time phase" in which the main effects on recipient area economies is through the demand-side. Demand is boosted by, notably, increased spending on construction or similar public investment. After this initial phase, it is the supply-side effects resulting from the investment that make the difference. These can arise from enhancement of infrastructure or human capital, effects on technological capacity and so on. According to Bradley et al. (2007), though generally positive, structural effects are typically much smaller than the demand-side effects, albeit of different magnitudes from one Member State to another.

Qualitative evaluation studies are generally much more positive, highlighting the influence of governance aspects (Leonardi 2005). There is thus a paradox that it is hard to draw firm conclusions about the effectiveness of policies subject to so much evaluation effort. One contributory factor is that Member State governments have used the cohesion budget as a fund for evening-out net balances in the EU budget, with political leaders judged more by what they concede or obtain in the negotiations than whether or not there is a sound purpose for the expenditure, let alone whether the money is well-used. Moreover, a frequently over-looked consideration is that regional development can be a painfully slow process, with success only being achieved over decades rather than months or years. Yet as Fitzgerald (2006) observes, there are often unrealistic short-term expectations of what cohesion policy can deliver and there is a tendency – whether in econometric specifications or critiques of policy – to under-estimate the lags involved in either turning-round a declining region or building up an under-developed one.

**How should cohesion money be spent?**

In the past, support from the Structural Funds was concentrated on infrastructure and, to a lesser extent, on human capital development. However, the Lisbon strategy's emphasis on the knowledge economy potentially raises new policy orientations for cohesion policy, especially around approaches to innovation and research, prompting questions of compatibility of aims. Cohesion policy has the potential to augment innovative capacity and performance in qualitative as well as quantitative ways, but convergence cannot be taken for granted.

The Community Strategic Guidelines (European Council 2006) explicitly stress the link with the Lisbon strategy (in the first clause) and list three over-arching priorities:

- improving the attractiveness of regions, in terms of accessibility, environment and services,
- encouraging innovation, entrepreneurship and growth, and
- fostering more and better jobs and the development of human capital.

While the guidelines repeatedly stress that expenditure has to be adapted to the needs of individual regions, noting for example that infrastructure investment exhibits diminishing returns and makes most sense in lower-income Member States, the language of the Lisbon strategy appears frequently in the elaboration of all three priorities. Indeed, it is presented as though cohesion and Lisbon aims largely coincide. If the purpose of cohesion policy is seen as being purely allocative, this conjunction can largely be defended, so long as the policy is activating or enhancing factors of production that would otherwise be less productive, although it has to be recognised that cohesion spending implies an increased tax burden on the most productive regions. However, to the extent that cohesion also has distributive aims, it cannot so easily be assumed that the transfers are welfare enhancing for the EU as a whole. The equity/efficiency trade-off is a familiar one in any debate on regional policy, and it would be cavalier to assume that it does not apply to cohesion policy.

*Innovation and research in convergence processes*

Research on productivity growth at the national level by Fagerberg and Srholec (2007) – adopting a capabilities approach to economic development – finds that the quality of systems of innovation and of governance play an important part in promoting catch-up. At the regional level, the literature on knowledge spillovers shows that spatial proximity plays an important part in fostering knowledge creation, an implication of which is spatial imbalance that is to be expected. Empirical work undertaken by participants in the DIME network fleshes out the extent of the disparities and their determinants (see, for example, the evidence on technology clusters adduced by Verspagen 2007).

The volume of patenting in a region is greatly stimulated not only by the indigenous science base and, implicitly, the funding of research, but also by the region's proximity to other regions with strong scientific performance (Frenken et al. 2007; see also, Maurseth and Verspagen 2002). They find that researchers collaborate most with each other in research-intensive regions, but that cross-border links tend to be between researchers located in capital regions. As a result, less-advanced regions struggle to connect to the research leaders and find it harder to access the potential benefits of research networks. Networks, such as those funded by the Framework programmes can help, but there is a danger that the philosophy behind the European Research Area will reinforce the links between the best researchers in capital regions, leaving others on the outside. A possible conflict with cohesion cannot be excluded.

In the integrated guidelines for the Lisbon strategy, innovation poles or clusters are mentioned in Guideline 8, which refers to "helping to bridge the technology gap between regions" and Guideline 10, which focuses on networking between clusters. However, elsewhere in the guidelines cohesion is only mentioned in connection with social and territorial aims, not economic. Instead, the message from these Guidelines is much more that regional and structural policies should serve "Lisbon aims". Thus, in introducing Section B.1 on *Knowledge and innovation: engines of sustainable growth*, the Commission document places policies to invest in knowledge and to strengthen innovative capacity at the heart of the strategy, and states that "national and regional programmes will be increasingly targeted on investments in these fields in accordance with the Lisbon objectives" (European Commission 2005, 16). However, few "Lisbon" National Reform Programmes (NRPs) have a strong regional dimension and, instead, focus on improving national economic performance.

*Policy development challenges*

It can be difficult to design an approach to structural interventions that combines common principles and customised content. For some parts of the EU, deficiencies in basic infrastructure are still striking and are likely to prevent other policies having much effect. In other areas, entirely different obstacles to increased competitiveness may be most damaging[1]. While cohe-

[1] A possible approach would be to focus on what inhibits investment in a region and to concentrate policy effort on overcoming such obstacles – what Begg (2002) has called an "investability" approach.

sion policy has progressively become more subtle, there is a danger that too great a "Lisbonisation" of cohesion policy will result in inappropriate policy choices, and may also undermine equity considerations. For example, De Propris (2007) finds that approaches to clustering appear to lack coherence and to be overly prone to capture by narrow interests.

One strand of thinking, strongly advocated in the Sapir Report (2004) and reinforced in other work (for example, de la Fuente 2004; Santos 2008), is that the regional focus of cohesion policy is inappropriate. Instead, it should be at the level of the Member State that the distributive element of cohesion policy operates, leaving Member States to determine their own priorities. For the recently acceded Member States, there is an open question about whether it makes more sense to promote national growth, irrespective of territorial balance. Certainly, there is strong evidence that inward investment is attracted primarily to growth areas and that in the competition between countries to lure inward investors, infrastructure and services play an important role. According to Santos, it is the confusion between growth and convergence aims that needs to be resolved, and she argues that the former requires a concentration on where the resources are most productive, whereas the public good of convergence has to be reconciled with subsidiarity concerns.

The Sapir Report also emphasised the importance of boosting institutional capacity. New cohesion policy instruments with the colourful acronyms *JASPERS, JEREMIE* and *JESSICA* have been introduced, partly in response to a perception that administrative weaknesses can greatly diminish the effectiveness and efficiency of structural policies. In this regard, the measures can be seen as offering a response to the empirical finding that cohesion policy works best where there is a robust institutional capacity (Ederveen et al. 2006). The Catch-22 is that the regions lagging furthest behind are, very often, those that exhibit the greatest institutional shortcomings.

Ignoring the adverse effects of regional imbalance would be risky. In Germany and Italy, the problem of coping with uncompetitive regions has been a severe one. Although the lack of success in transforming several of the Mezzogiorno regions casts doubt on the wisdom of policies implemented over many decades, well-conceived structural policies have clearly made a difference in other settings, and it is hard to believe that the continuing problems of the Mezzogiorno would be solved by directing cohesion support to Italy as a whole.

## Conclusions

Cohesion is a Treaty commitment and is something that EU citizens seem to favour, so that the EU needs effective structural policies. Unrealistic promises and aspirations are, however, a perennial problem, whether in regional economic development or in Lisbon NRPs. How then can the cohesion and Lisbon aims be better reconciled? A first element would be to add an explicit convergence/cohesion guideline to the Lisbon framework.

Second, the plausibility of targets and policy orientations should be revisited. All NRPs contain ambitious policies to promote R&D and innovation, and the 4th *Cohesion Report* reveals that the amount spent on innovation and R&D in the 2007–13 programming period of the Structural Funds (European Commission 2007) will double. Questions should, however, be posed about whether a crude R&D target (3 percent of GDP) makes much sense. For several Member States, the economic structure is one for which such a target is potentially misleading and at the regional level, it may be even more so. This suggests a much more subtle approach to innovation and knowledge, rather than allowing it to be hijacked by the crude target (Musyck and Reid 2007). Yet it is here that the policy prescriptions become more tricky, as it is easy to fall into the trap of calling for broader support for regional innovation systems without a sufficiently clear idea of what these entail. Indeed, a number of commentators have expressed dismay about the lack of precision on what such innovation systems imply for policy making. For example, de Bruin and Lagendijk (2005) note that while the concept has taken hold as a normative ambition, it lacks sufficient analytic content.

Structural policies have long time horizons and even when a country achieves substantial progress (as Ireland has), this and the fact that the tap is not immediately turned off are important features of the EU system. Yet cohesion policy faces a dilemma about its spatial concentration and scope. Regional policy, tautologically, is about assisting specific classes of regions, implying that it cannot be comprehensive. For the least prosperous Member States of the EU, convergence is principally about raising GDP per head for the country as a whole, with the regional distribution of growth as a second-order question. As the Sapir Report advocated, the greatest returns are likely to be from investment in the growth poles, most of which are capital regions, such as Warsaw or Bratislava. But from the perspective of future territorial balance, the evidence of widening disparities in several Member States is a cause for concern. In part, the challenge for the least prosperous regions is to build up the institutional capacity to be competitive in future.

An especially contentious issue is how to interpret the Treaty commitment to cohesion for richer Member States; or to put the question starkly: should the EU try to deal with regional problems in eastern Germany, northern England or the Mezzogiorno, or should they be left to the Member States? To the extent that flows from the Structural Funds are one means of attenuating the net contributions of richer Member States to the EU budget, this is a political economy question, and the economic logic is easily lost in the process. Political economy also rears its head insofar as recipient regions in these countries see money from "Brussels" as a means of acquiring additional resources, whereas central governments are more inclined to see the money as a substitute (notwithstanding the principle of additionality that states that EU money should add to what the Member State offers).

Renationalisation as a direction for cohesion policy is an alluring, yet possibly risky option, albeit one that cannot easily be disentangled from wider differences of opinion about the future of the EU budget. A glib answer in some national capitals is to argue that by reducing the EU role, the EU budget can simply be cut, whereas others advocate greater concentration of EU outlays on regions most in need of structural policy support with an unchanged budget. An alternative approach may be the co-ordination of national policies aimed at cohesion objectives (Begg 2003). The policy methodology of the Lisbon strategy puts the onus on Member States to develop national reform programmes that address common strategic goals, and in the areas of social protection and social inclusion, a new co-ordination process has been in place since 2006, also operating through the open method of co-ordination.

Cohesion policy is awkwardly positioned within two over-lapping sets of tensions. The first is between distributive and allocative objectives, while the second is between the imperatives of the Lisbon strategy and the demands of convergence in economic activity. For the period 2007-13, policy has been orientated towards achieving all four aims, although arguably at the cost of not having as sharp a focus on any of them as might be wished. There is an obvious tension here for structural policy.

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