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PROBLEMS AND DILEMMAS OF EU REGIONAL POLICY

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Abstract

The aim of the EU regional policy is to increase the level of social and economic cohesion of the Community. The effectiveness of this policy is not unanimously agreed upon. There are regions in Europe which took maximum advantage of the Structural Funds and considerably decreased the gap between them and the average EU level (Lisboa e Vale Do Tejo), or even went beyond it (Ireland). However, there are also regions that, despite huge transfers from the EU budget, are stagnant (southern Italy)

The negative examples are exploited by the opponents of the current policy. According to them, the policy's achievement in its current shape is too expensive for the entire Union (too high opportunity cost). The same transfers used to support innovativeness in the well-developed regions would lead to an increased innovativeness and modernization of the Member States' economies in general.

The article's aim is an attempt to answer the question about the policy's future shape. It will depend on many factors (social and economic situation in the entire Europe, catch-up processes, political situation, etc). A different shape of regional policy could, however, mean a return to the idea of two-speed Europe, which would not be advantageous to the new Member States.

Key words:

Regional Policy, Social and Economic Cohesion, effectiveness of the Regional Policy, catch-up processes, two-speed Europe

The aim of regional policy is to reduce regional disparities. It is worthwhile to stress the particular character of this policy, whose instruments (Structural Funds) are used to finance investment in peripheral regions. Regional transfers contravene the fundamental premise of liberalism, which was a driving force behind the creation of the common market and the elimination of barriers hindering economic integration. Still, there is an important argument justifying regional intervention – namely, market failures. This ineffectiveness manifests itself at several levels. For one thing, there still exit a segmentation of the common market, trade barriers and state intervention-induced competition distortion. Secondly, another market failure is related to allocation and localisation ineffectiveness. Thirdly, there are different living and employment standards as well as different social-policy safety nets[1]. Finally, unequal distribution of wealth amongst countries and regions plays a part, too. Each of these imperfections is corrected by means of different instruments which operate within the framework of competition, trade, industrial, social and regional policies.

Intervening in the market mechanism is controversial *per se*. The fundamental question that arises in this context is whether intervention actually help to eliminate market failure or whether in the long run it entrenches ineffectiveness. This question is particularly relevant to regional policy due to its specific character. This is because regional policy involves money transfers, has a substantial scope (it is second in terms of budget expenditure) and is difficult to unequivocally assess. The aim of the paper is to answer the following questions: what will the possible direction of the evolution of regional policy be?; will the current character of regional policy not be changed in the future?

Modifications of this policy may have a particluarly big impact on the interests of countries from Central and Eastern Europe that joined the Eu in 2004 and 2007. This is not a new problem as it resurfaces whenever EU member fees are set in each new budget perspective. In 2005, controversies over this issue were particularly manifest and hence it was very difficult to reach a compromise.

That is why – and it has to be stressed – debate over the model of regional policy is of critical importance since, on the one hand, it highlights ceratin threats (on the part of the richest memebers) to the principle of cohesion and, on the other, it sends a

[1] This manifest itself in social exclusion and labour market discrimination (mainly against women).

signal to the least properous regions that the regional-policy rationale might change and that opportunities risk being missed.

At first, it is essential to refer to theory that focuses on regional economic growth, regional competition enhancement and regional policy. The literature of the subject is very rich. Contributors include researchers representing classic approach, Keynesianism, neoliberalism, stage development, new growth theories and new trade theories. Insights from urban growth theory, new institutional economics, business strategy economics, new Schumpeter approach or economic geography also taken into account by researchers (Martin R., 2004), (Reid, 2003). The fact that the above theories have different premises and that different factors are seen as critical to growth determines the attitude towards regional policy and to its character (its instruments and areas of influence). It is impossible to refer to all these concepts, so only two of them are discussed.

Stage development theories highlight that core regions – thanks to their advantages – constitute engines of growth of peripheral regions, but regional policy should support economically weak regions, allowing for their actual stage of development. It is also important to reinforce spread effects by, among much else, promoting direct investment and development funds. New growth theories regard technological progress as a source of dynamic growth, which, however, does not constitute *manna from heaven*. There are centres that are predestined to fostering technological progress and differences in regional development are a result of regions' technological potential and human capital. It follows that investment in R&D and improvement in human capital are a driving force behind development. So potential intervention should support such investment. Even in view of these two theories it is possible to present dilemmas about the choice of regional policy. Should it have a disparity-reducing character or a polarisation-inducing one? (Bachtler, 1996).

Proponents of the former advocate state intervention, which should be addressed to the poorest regions. The aim of intervention is the restructuring of the economy, which should accelerate growth and trigger the catching-up process. The arguments adduced by advocates of the disparity-reducing theory are typical of neo-Keynesianism. They include: the aforesaid market failures, imperfect information, price and wage deformation.

Proponents of the latter reckon that any intervention affects the market mechanism, which is the most effective, and hence they argue in favour of giving up state intervention in regional developmental processes. They claim that any intervention does not help poor regions and is a cause of their underdevelopment (Levison, 1992). What character should EU regional policy have? If – in line with new growth theories – it is investment in R&D and human capital improvement that condition development, there is no doubt that economically strong regions (and metropolitan areas) are predestined to carry out such investment because they have critical mass (research institutes, universities, skilled human resources able to innovate and communities capable of absorbing it) to start it (Reid, 2003), (Sepic. D.). This approach holds that spread effects initiated by these centres will cause disadvantaged regions to develop and all society will benefit from economic growth. In this context two questions arise. For one thing, is there any guarantee that its current character will be preserved? Secondly, what can cause its modifications?

As mentioned above, the aim of regional policy is to increase EU socio-economic cohesion. With the processes of deepening and expanding integration gathering momentum, this objective has undergone evolution. In the literature of the subject regional policy is presented in stages, delineated from the perspective of its aims, which changed in line with new integration tasks[2]. The most noteworthy event during the first two stages was the establishment in 1972 of European Regional Development Fund (it started functioning in 1975). Regional policy got a boost in 1986-1992 and this was caused by:

1. The establishment of the common market (since 1 January 1993, but the preparations for its introduction had been under way since the Single European Act);
2. The accession of Spain and Portugal in 1986;
3. The UK-led emphasis on such a distribution of transfers from the EU budget that all Member States would participate in them in a more equitable way.

The Single European Act introduced to the EU Treaty the title *Economic and Social Cohesion* and the earlier statements from the Treaty of Rome were replaced by the phrase stating that:

In order to promote its overall harmonious development, the Community shall develop and pursue its actions leading to the strengthening of its economic and social cohesion. In particular, the Community shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions, inlands, including rural areas (The EU Treaty).

The change of regional policy status prompted reform of the Structural Funds[3] in 1988, which were meant to operate in a more co-ordinated fashion on

[2] The following years mark the consecutive stages of regional policy: 1958-1974, 1975-1987, 1986-1992, 1993-1999, 2000-2006, 2007-2013.

[3] European Social Fund, European Regional Development Fund, European Fund for Agriculture Guarantee and Orientation.

the basis of uniform rules (Pietrzyk, 2000). This was supposed to enhance the effectiveness of the use of financial resources (OJ, 1988). A decision was also made that regional policy would be programmed on a six-year basis. The first programming period concerned the years 1988-1993. This means that programming stages coincide with EU financial frameworks[4].

The reason for introducing such deep modifications was the establishment of the common market. This programme caused less developed Member States to raise concern as to whether the existence of four basic freedoms would not affect negatively the EU's economically weakest regions. Richer members – at a cost of accepting the processes of integration deepening – were inclined to devote more financial resources which would contribute to enhancing their competitiveness (El-Agraa, 1990).

The period of 1992-1999 constitutes the next stage of significant changes. The modifications of regional policy were then caused by:

1. The signing of (1992) and the introduction of The Maastricht Treaty (1993), which laid the legal foundations of the monetary union;
2. The lobbying carried out by less prosperous members which feared the effects of the monetary union[5];
3. The accession of Austria, Finland and Sweden[6]

The most important reason for changing regional policy was the decision to establish the monetary union. The implementation of this most advanced stage of integration could have negative implications for less developed regions. The Committee of Regions warned against such a possibility, arguing that the participation in the monetary union could lead to the intensification of competition amongst regions, which would necessitate mitigating the negative consequences for disadvantaged regions. Poorer members had reason to fear that more discipline in public finances and the need to keep down interest rates and inflation would result in slower economic growth and higher unemployment.

To ally these fears, the Maastricht Treaty included a statement (Maastricht Treaty) about setting up the Cohesion Fund[7], within the framework of which financial resources were to be used to co-finance investment in less developed regions particularly vulnerable to the negative effects of the participation in the monetary union[8]. The criterion for receiving aid was a GDP per capita lower than 90% of the EU average. Greece, Ireland, Spain and Portugal became cohesion countries[9].

Next changes to regional policy (2000-2006) were the effect of the accession of 8 ex-communist countries from central and eastern Europe together with Malta and Cyprus. The proposed set of reforms was a compromise allowing for the interests of candidate countries and constituted an effort to depart from regarding regional policy in terms of expenditure. It is worth noting that a heated debate preceded the Berlin Summit (at which the Agenda 2000 was approved). This debate revealed diverging interests of members: some of them highlighted that in the long run they were bound to bear the brunt of financing Cohesion Policy, being so-called net payers (Germany, the Netherlands, Sweden and Austria); France refused to accept cuts in aid for framers, while Greece and Portugal accentuated the need to restructure their economies. In 2000-2006 regional policy objectives were reconstructed and their number was reduced to there.

The main premises of the 2007-2013 stage were finally approved at the Brussels Summit in December 2006. The compromise was reached after the fiasco of the June Summit, during which some members blocked an agreement on the budget for the next budgetary perspective. The bone of contention was related to the question of whether – if outlays were to be reduced – this reduction would include in equal proportion all the expenditure items or some categories would be maintained at the same level. It has to be said that at this stage the parties reached the consensus on one thing: there would be no cuts in spending on the increase of the EU economy's competitiveness.

This accent on competitiveness is connected with the abortive attempts to catch up with America within the framework of the Lisbon strategy. Its main aim was to transform the EU into the most competitive economy in the world. As we know, this task has proved too ambitious. One of the reasons for this was the failure to set into motion a knowledge-based economy and to capitalise on information and

[4] Since 1988 the Commission and the Parliament, while working out yearly budgets, use financial plans for several years. The first financial prognosis concerned the period of 1988-1992 (so-called first Delors packet), the second one concerned the period of 1993-1999 (second Delors packet), the third one is envisaged for the period of 2000-2006 (concluded in the Agenda 2000).

[5] Spain's lobbying is seen as particularly effective; Spain agreed to support the monetary union in exchange for doubling aid for the poorest regions. This compromise was included in the Cohesion Protocol, which was added to the Maastricht Treaty.

[6] The accession of Finland and Sweden prompted the establishment of a new objective of regional policy: aid was earmarked for regions with population density of less than 8 people per square kilometre.

[7] This is despite the fact that the Cohesion Fund did not finance initiatives strictly related to regional problems.

[8] Financial resources from this Fund were used to finance investment in railway and road infrastructure, environment protection and development of trans-European communications networks.

[9] Likewise, proportions of quotas for cohesion countries were set as follows: 16-20% for Greece, 16-20% for Portugal, 7-10% for Ireland and 52-58% for Spain.

communications technology (ICT). This does not mean, however, renunciation of the strategy. In 2005 the European Council decided to modify certain aspects and to revive the reformist efforts. It was agreed that "the EU must mobilise all its existing national and European resources, including those with Cohesion Policy(COM (2005(24). A communiqué on joint efforts to promote growth and employment highlights the necessity of more active involvement in the Lisbon Strategy on the part of regions, in particular local and regional entities, and social partners. This is especially important in such domains as innovation, a knowledge-based economy, employment, human capital, support fro small and medium-sized enterprises and access to venture capital. At the same time, it was decided that Cohesion Policy should focus on three priority areas:

1. Improvement in the attractiveness of Member States, regions and cities by means of enhanced access, better-quality services and environment protection;
2. Support for innovation, entrepreneurship, a knowledge-based economy through increasing the potential of R&D and ICT;
3. Creation of more better-quality jobs.

It follows that in the priorities of Cohesion Policy for the period of 2007-2013 accent is placed on encouraging innovation. This confirms an assumption that the improvement of the EU's position in the area of R&D and the creation of a knowledge-based economy has become an integral part of Cohesion Policy. This is also borne out by the earlier initiatives of the European Commission aiming to stimulate endogenous growth of regions through increasing innovation levels (the co-financing from the ERDF of Regional Innovation Strategies within the framework of Innovative Actions). Special attention needs to be paid to two EU programmes currently carried out with a view to promoting innovation activity: the Seventh Framework Programme in the area of R&D and technological progress and the Framework Programme for supporting competitiveness and innovation. Their implementation should ensure "the synergy effects between Cohesion Policy and those instruments; national and regional development strategy must show how this can be attained" (COM(2005)02/99).

Programming documents clearly state that the strategy to improve innovativeness of European economies should allow for the specificity of the R&D sector, which necessitates interactions between all the agents involved in creating poles of growth. It is indispensable to create critical mass enabling the generation and implementation of innovation. This sort of concentration guarantees improvements in competitiveness; that is why "R&D in Member States and less favoured regions should be developed around the existing poles of excellence. By contrast, excessive dispersion of resources should be avoided". The sum – 2.1 billion euro – earmarked for enhancing innovation and competitiveness within the framework of the Lisbon Strategy confirms the weight the European Commission attaches to this issue[10]. It is called *more money for progress*[11].

This drive for improving EU competitiveness found its reflection also in new objectives of regional policy for the period of 2007-2013[12].

1. Convergence;
2. Regional Competitiveness and employment;
3. European Territorial Community[13] .

It is worth underscoring that within Objective 1 financial resources are used to carry out investment in human capital and equipment, development of innovation, information society. All this is connected with enhancing competitiveness. Objective Convergence has been maintained (which is guaranteed by the Treaty), but the emphasis on improving competitiveness is more conspicuous.

Is such a strategy bound to be continued during the next budgetary perspective? It seams that much depends on the pace of growth of regions falling under Objective Convergence and the acceleration of catching-up processes. Now doubts are being cast over the effectiveness of Structural Funds transfers[14]. Some highlight that, despite allocating substantial resources for Greece and southern Italy, the pace of growth has not been increased. Bradley questions the effectiveness of Structural Funds transfers[15]. He points out that this sort of aid is not sufficient to stimulate growth in less developed regions and its impact on development can vary from region to region (de Vet et al, 2004), Sepic, 2005).

To summarise, the debate on regional policy leads one to ask the following question: is it really reasonable to carry out its disparities-reducing variant? Is its opportunity cost not too great? Would regions not develop faster if money transfers were directed to economically strong regions and earmarked for increasing innovation?

The current direction of regional policy is guaranteed by the Treaty's provisions. However, dilemmas related to regional policy come to the fore

[10] Available at: http://europa.eu.int/comm/regional_policy

[11] The biggest part of financial resources will be devoted to distance learning. Additionally 700m euro was earmarked for increasing competitiveness, innovativeness and R&D.

[12] Beside the modification of objectives, regional-policy financial instruments were changed.

[13] The Regulation of the European Council no 1083/2006, establishing general regulations on the ERDF, ESF and the Cohesion Fund and annulling the decree 1260/1999.

[14] Models Beutel, Hermin and Quest are used to make assessment.

[15] Bradley J., The Impact of Community Support Frameworks on Objective 1 Countries: Greece Ireland, Portugal and Spain 1989-2006, Dublin, 2000.

whenever a new budgetary perspective is worked out. The intensification of the debate is likely to be accompanied by the next rounds of accession of poorer countries. The accession of Bulgaria, Romania, and later Croatia and Turkey (?) may dramatically increase budgetary tensions. This is even more so, given that there are not many net payers and they are increasingly less willing to finance cohesion policy[16].

That is why the concern is that Cohesion Policy might be radically modified. Different variants are being considered: from variable geometry, two-speed Europe and concentrated approach that would allow Community intervention only when the action by a Member State would be insufficient[17] to the horizontal option that would engage national authorities to pursue the aims of Cohesion Policy [18].

The option of two-speed Europe (variable geometry) has certain merits (an increase in competitiveness?). This means division of the current regional policy into two variants: the structural option applied to the EU-15 and the disparities-reducing one applied to countries from central and eastern Europe. It seems that setting different priorities for "New" and "Old" Europe would result in new divisions and would be detrimental to "New" Europe.

Hence new Member States should demand that the „Convergence" Objective – which will ensure Structural Funds transfers to the poorest regions – be maintained. One has to remember that the most convincing argument in favour of the levelling-up option of regional policy is the occurrence of catch-up processes and the reduction of distance between the least affluent regions and the EU average. That is why it is imperative to make best possible use of the current programming period as the effective utilization of financial resources might determine whether the premises of the current financial perspective will be kept up in the following prorgamming period or whether they will turn out to be a "not-to-be-missed" opportunity.

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[16] This is confirmed by the last debate on the budgetary perspective for 2007-2013.

[17] Community intervention would be directed only at those countries with GDP per capita of less 90% of the EU average.

[18] Bachtler J., Wishlade F., Yuill D., *Regional Policy In Europe after Enlargement*, EPRC, Glasgow, p. 23-26.