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Less Poverty, More Employment:

Helping the European Union to achieve its 2020 targets

A Study of the organisation of the European Union Cohesion Policy with special reference to anti-poverty policy in the People’s Republic of China

by

Jon Bloomfield, Michael Dunford, Steve Fothergill, Richard Harding, Margareta Griessler, Graham Meadows, Peter Ramsden, Laurent van Depoele, Kadri Uustal, Tony Venables, Thomas Wobben

Edited by Graham Meadows

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The authors and participants in the study

Jon Bloomfield is Head of European Policy at the West Midlands Regional Development Agency in the United Kingdom and Honorary Research Fellow at the Institute of Local Government Studies, University of Birmingham.

Michael Dunford is Professor of Economic Geography at the University of Sussex, in the United Kingdom. He is also visiting professor at the Institute of Geographical Sciences and Natural Resources Research at the Chinese Academy of Science, Beijing.

Steve Fothergill is a Professor in the Centre for Regional Economic and Social Research at Sheffield Hallam University in the UK. He is also National Director of the Industrial Communities Alliance, which represents local authorities in Britain’s older industrial areas.

Richard Harding is a former Desk Officer in the European Directorate General for Regional Policy. He is now a senior adviser to transition countries and new Member States on management of EU Pre-Accession and Structural Funds.

Margareta Griessler-Hermann is senior advisor for International and European affairs to the Mayor and Governor of Vienna and fellow at the Department of Chinese Studies, University of Vienna.

Graham Meadows is a special adviser to Commissioner Lazlo Andor, the member of the European Commission responsible for Social Policy and Employment. He is a former Director General for Regional Policy.

Peter Ramsden manages Freiss ltd a specialist social innovation company specialising in policy learning, exchange and implementation of good practices in economic, urban and social policies. He is the pole manager of URBACT for social inclusion and governance.

Laurent van Depoele is Professor at the Institute for International and European Policy in the Faculty of Social Sciences at the Catholic University of Leuven, Belgium. He is a former Director for Rural Development policy in the directorate-general for agriculture in the European Commission.

Kadri Uustal is a counsellor of EU Resources and Regional Policy in the Estonian Permanent Representation to the EU. She has worked for the Estonian Structural Funds’ Managing Authority since 2001.

Tony Venables is Director of the European Citizen Action Service (ECAS) in Brussels, an organisation which seeks to enable NGOs and individuals to make their voices heard by the EU by providing advice on how to lobby, fundraise, and defend European citizenship rights.

Thomas Wobben is Director of the Representation of the Federal State of Saxony-Anhalt to the European Union.
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General Introduction and Executive Summary

1. A study of the organisation of policy

This study is about the ways in which China and the EU organise their medium-term policies to reduce poverty and to raise and maintain employment. In China, anti-poverty objectives are enshrined in the current Eleventh Five Year Plan and will feature in its soon-to-be published successor, the Twelfth, and in an accompanying ten-year plan dealing specifically with poverty reduction. In the EU, poverty reduction and high employment are also ten-year objectives and are central to its plan for Europe 2020. And, in order to pursue these similar objectives, China and the EU both make use of the fact that poorer people are concentrated in certain geographic areas and use regionally-differentiated development policies to seek to raise incomes in a sustainable way. In China, policy targets villages which are officially classified as poor, which may be concentrated in the centre or the high plateau in the west; the EU targets the citizens of its poorest regions which are predominantly in the east and south. China’s regionally differentiated policies take a number of forms, ranging from the massive policy experiments to co-ordinate urban and rural development in Chongqing and Chengdu to the highlighting of areas of particular poverty in its anti-poverty plan. In the EU, poorer citizens are targeted through EU Cohesion Policy, which combines programmes for physical investments and for social actions.

The organisation of EU Cohesion Policy is the object of this study, which compares it to aspects of similar policy in China to see how EU policy-makers may benefit from the experience of their Chinese counterparts. There are similarities between regional policies in China and the EU which make such a comparison worthwhile. Both aim at sustainable poverty reduction through economic development – a modern term in development policy would be “pro-poor growth” – and both attach importance to continual economic adaptation to safeguard competitiveness, although EU Cohesion Policy is the more active in this field. Both use a territorial approach to better target their anti-poverty policies on poorer communities. A difference between China and the EU is that, where China uses an absolute measure of poverty, the EU uses a relative measure of poverty, comparing its poorer citizens with the average EU income, and aiming to reduce income disparities. One particular aspect of EU Cohesion Policy is its success in working as an instrument of other policies, helping them to achieve their objectives and thus securing a higher value return for its allocated budget and a multiple use of its implementation system.

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1 Mainland China’s 31 regions (made up of provinces and municipalities) might be taken to correspond with the European Union’s 27 Member States. Henan, with a population of 95 million, is 36 times larger than Tibet, population 2.6 million. Germany, with a population of 82.5 million, is 180 times larger than Luxembourg. The extremes of income between China’s regions are twice as wide as between EU Member States: Shanghai’s GDP per head is 11 times higher than Guizhou’s; Luxembourg’s is 5.5 times higher than Latvia’s.

2 The co-ordination of rural and urban development in Chongqing and Chengdu, capital of Sichuan Province, are two of six policy experiments being carried out in China. Policies designed to influence the establishment of industrial clusters are being tried in Wuhan, in Hubei Province, and the three towns of Changsha, Zhuzhou and Xiangtan, in Hunan Province; and policies for the establishment of financial centres are being developed in Pudong, part of Shanghai, and Binhai, in Anhui Province.
China is seeking to reduce poverty and, at the same time, manage in a harmonious way issues which arise from its rapid transformation from a rural into an urban economy. It is a policy “must” that rural and urban development is successfully co-ordinated. To this end, policy-makers pursue a range of objectives which, among other things, seek to

- improve agricultural efficiency so that agricultural incomes rise, and poverty is reduced, as more food is produced from each hectare of land;
- provide better quality public services and social security provision to the rural population as well as to those farmers who choose periodic work in the cities, so that they will be encouraged to “work-away” and thus supplement their farm and village income;
- spread the economic benefits of industry and economic activity from the booming coastal regions into the country’s centre, partly by encouraging “working away” and the location of medium-sized businesses closer to, rural areas;
- reduce – and, if possible, correct – the environmental damage caused by China’s rapid industrial development, paying special attention to global warming and the possibilities of low-carbon growth in rural areas.

These challenges have an echo in the European Union. Some of its newer member states must reduce the number of people dependent on agriculture if their rate of economic growth is to increase. Migrant workers are fewer in number in the EU than in China but their presence – or, even, the possibility of their presence – provokes a political tension which leads the Union at times to compromise the free movement of its workers. Social security provision is mobile, although, in some member states, national social welfare systems are being undermined by the cost of providing for an ageing population. Also, although economic activity is widely spread in the EU, there are poverty black-spots and some regions lag well behind the economic average.

The prime objectives of EU Cohesion Policy are well-matched to the EU’s 2020 objectives of reducing poverty and raising employment. The policy seeks to raise the economic growth rates of the EU’s poorer regions so that poorer citizens gain ground on the EU average. EU Cohesion Policy is, therefore, one of four Union policies for economic growth – the others being the single market, the single currency and the Union’s effort to co-ordinate national policies for improved business competitiveness, initially through the so-called Lisbon agenda and now through special procedures put in place by the new Lisbon Treaty.

With its investment and labour market components, EU Cohesion Policy operates both as a policy in its own right and as an instrument for a family of policies at European, member country and regional level. It increases the added value of its expenditure and the efficiency of its implementation system by providing a financial
instrument which supports other policies in meeting some of the Union’s most pressing challenges.

- It invests in the achievement of higher skill levels among the Union’s economically-active population and, in particular, works for the social and economic integration of migrant workers.
- It provides in a number of ways a financial instrument in support of the Lisbon objectives of improved competitiveness of EU businesses – for example by creating conditions helpful to the birth and development of new enterprise; supporting research directed at improving production processes and products; promoting a faster innovation rate among Union businesses; and, of course, vocational training.
- It works to spread economic activity throughout the Union territory, paying special attention to territorial cohesion and the creation of alternative opportunities in rural areas. In this it co-ordinates with EU agricultural policy which has the task of increasing the efficiency of EU food production. It also pays special attention to the economic performance of urban areas, and especially to the well-being of people in the worst-off quarters of cities and towns.
- It supports the Union’s efforts to reduce carbon emissions by seeking higher levels of energy-saving and by incentivising the use of energy renewables.
- It deploys large-scale financial resources in favour of environmental improvement and investments in basic environmental infrastructure which meet regulatory environmental norms.
- It co-finances major transport infrastructures thus improving connectivity in the EU internal market and, through investment in urban transport systems, further contributing towards reduced pollution.

2. The architecture of EU Cohesion Policy: an executive summary

It is helpful to think of EU Cohesion Policy as consisting of four elements: its objectives, its budget; its method of implementation, or delivery mechanism; and its “content”, by which is meant the range of investments and social actions it co-finances in order to reduce poverty and increase employment. Chapter I of this study – “EU Cohesion Policy from a Chinese standpoint: the importance of organisation” – uses this four-fold breakdown as the framework for a discussion of possible changes to EU Cohesion Policy, many of which are suggested by a consideration of Chinese experience. It is presented in a manner which continues a discussion begun by the European Commission’s Directorate General for Regional Policy on what constitutes the key elements of a generalised regional policy.3

The second chapter of the report provides a series of notes as background for the more in-depth discussions of later chapters. It provides a potted history of the policy and gives a factual account of its role as an instrument of EU Competition Policy and EU Environment Policy, as well as introducing the question of a reform in the policy’s system for the classification of regions (discussed more fully in Chapter IV). It illustrates its discussion of multi-level governance by considering the implementation of policy, first, from the point of view of the centre, and then of a particular region, taking the case of Saxony Anhalt, one of the new regions in the Federal Republic of Germany.

The efficiency of European Cohesion Policy as an instrument for targeting poverty and increasing employment rests critically on its definition of what constitutes a region and what regional data are collected. In the EU, this presents special difficulties because of the administrative diversity of its member states. Chapter III discusses the EU’s system of Nomenclature des unités territoriales pour la statistique (the NUTS classification system), or, in English, the system Nomenclature of Statistical Territorial Units. It looks also at the data collected by the European Statistical Office through its expanding series of Urban audits and some of the types of data which may become useful as EU Cohesion Policy evolves to meet new political problems, for example in the field of carbon reduction.

An important characteristic of EU Cohesion Policy is the objectivity with which it seeks to measure its budget needs and, once its budget is approved, allocate EU finance to member countries and regions. The policy’s budget methodology is discussed in Chapter IV, which also deals with the policy’s range of financial instruments – the European Regional Development Fund, the European Social Fund, and the Cohesion Fund. It discusses the intensity of EU financial support for the people in poor regions, showing the effects of the capping of support for poorer regions.

The spread of privatisation through the EU has transformed much of the public sector into an extensive range of private-sector companies. Financial support from EU Cohesion Policy is, thus, increasingly deployed in favour of private-sector businesses, so that public funds become in effect private sector capital. When EU Cohesion Policy funds are used to promote industrial development, to help capital mobility and to encourage innovation, there is always the risk that they will distort private markets. EU Competition Policy safeguards against this but it is still vital that policy interventions are managed to ensure that they address problems of market breakdown and that the private projects they support will bring public benefit. These problems are discussed in Chapter V, which also introduces a newly developing part of EU Cohesion Policy which seeks to reduce poverty and raise employment through recyclable loan funds alongside the more traditional support system of financial grants.

The rural-urban divide is a feature of economic development in economies like that of China, which are passing through a phase of rapid urbanisation. It also affects policy in the EU, despite the fact that the process of urbanisation is a great deal more advanced. Chapter VI explores issues around the urban-rural dichotomy, comparing experience in China and the EU. It argues that for the EU, policy for poverty reduction and employment might be more effective if it ceased to draw a distinction
between the two sectors and, instead, concentrated on using a single set of measures and a single implementation system for both parts of the economy. One gain would be that the LEADER initiative, which, as a part of rural development policy, was effective in pioneering village-based development, would be available for use in urban areas.

Chapter VII continues the discussion of the urban-rural dichotomy and gives the urban side of the story. It first considers how the EU is chiefly composed of a mosaic of cities and small towns, how these urban centres spread their influence into the countryside which surrounds them and what this means to policy-makers. It then discusses ways in which a regional policy, which aims to increase the rate of economic development of entire regions, also works as an effective urban policy. It also demonstrates the similarity between urban and rural policy instruments.

Any attempt to compare policies for social cohesion in the EU with those in China is immediately in danger of running aground because of their different stages in policy development. In the EU the present challenge for policy is to ensure the financial sustainability of social cohesion measures by transferring more of the cost to the individual and away from the taxpayer (evidenced by stricter conditions governing eligibility for social benefit; increases in pensionable age; privatisation of social services and infrastructure provision; higher levels of financial contribution from individuals and from businesses). In China, on the other hand, the challenge for policy-makers is to maintain growth, reduce poverty and income gaps and increase domestic consumption. China sees the pursuit of social protection as an important element in meeting this challenge. It is actively seeking to develop financially-sustainable “safety nets” for the unemployed, the sick and the elderly, as long as it can be done without restricting the mobility of the working population and adversely affecting business competitiveness. Chapter VIII discusses one aspect of this network of policy issues – that of migration, which is an important feature of economic and social life in both China and the EU, and, although, it takes different forms, poses similar sets of questions for the policy-maker.

Chapter IX discusses civil society. Its main theme is that EU Cohesion Policy should make more use of the contribution which Civil Society can make to help it achieve its 2020 policy objectives, a contribution which is as yet largely untapped. But it has a wider significance in that experience with EU Cohesion Policy illustrates both the benefits which can be gained by involving Civil Society in the implementation of development policy and also the difficulties in ensuring the sector’s close involvement. It considers civil society and Cohesion Policy’s principle of partnership; the contribution and types of activity which civil society contributes to the implementation of the policy; and recommendations for new Cohesion Policy implementation procedures which would enable policy-makers to tap into the full potential of civil society.

Discussion about the reform of EU Cohesion Policy is carried further in Chapter X which is the first of three chapters which considers EU Cohesion Policy as an instrument of other policies, and which argues that the relationship between EU Cohesion Policy and EU Competition Policy needs to change. The rules which govern member countries’ own regional aid are determined on the same periodic cycle as the EU Cohesion Policy and its three Structural Funds and the chapter
explains why EU rules to control national State Aid matter so much. It argues that EU Competition Policy goes too far in constraining member countries’ regional policies, and that, in future, the EU control of national regional aid needs to be based on a different set of principles.

The final two chapters of the report deal with aspects of environment policy. Chapter XI compares the ways in which China and the EU address the challenge of sustainable resource use in their current regional development investments. China’s rapid development and urbanization call, in particular, for urgent measures to safeguard water resources and curb pollution from power generation and heavier industrial operations. The EU is still dealing with a legacy of pollution from its industrial past, whilst striving to accelerate the provision of basic environmental infrastructures in its new Member States. The challenge of sustainable resource use also places demands on other key policy fields including agriculture, fisheries, industry and trade in both China and the EU.

Human activities that contribute to climate change cause emissions of carbon dioxide, the main gas responsible for climate change, as well as of other ‘greenhouse’ gases. To bring climate change to a halt, global greenhouse gas emissions must be reduced significantly. Chapter XII discusses the policy initiatives which seek to bring about these reductions.
Chapter I: EU Cohesion Policy from a Chinese standpoint: the importance of organisation

An Introduction to this report

This report appears at a particular point in the ongoing history of European Union (EU) Cohesion Policy. Discussions are well-advanced in fixing the Union’s overall policy programme to 2020: the EU supreme decision-making body, the European Council, and the European Parliament have agreed on the programme’s objectives 4; its measurable headline targets 5; and that it will be put into effect by a combination of action at EU-level and coordinated action by EU member countries. The Union’s next step will be to agree the detailed breakdown of the necessary policy changes to come into effect from 2014 – including the overall size of the EU budget to 2020 6 and its allocation between the various policies. The discussions leading to this agreement will be critical for EU Cohesion Policy, which must, if it is to maintain its standing in the EU policy-hierarchy, use the opportunity of the discussions to demonstrate how it will help the Union advance towards its measurable objectives. This introduction will consider the present position of EU Cohesion Policy from a Chinese standpoint in the hope that it can contribute to this demonstration of the policy’s value.

China, at first sight, does not seem particularly helpful vantage point from which to increase understanding of how EU Cohesion Policy operates, since it would seem that, on the surface, European and Chinese policy-makers have little in common. Setting aside differences in political organisation, China is one country, the EU twenty-seven; China’s population is more than twice as great, its land area too; the EU economy is developed and is to be compared with those of the United States and

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4 In June 2010 the European Council concluded: “We adopt Europe 2020, our new strategy for jobs and smart, sustainable and inclusive growth. It constitutes a coherent framework for the Union to mobilise all of its instruments and policies and for the Member States to take enhanced coordinated action. It will promote the delivery of structural reforms. The emphasis must now be on implementation, and we will guide and monitor this process.” See Conclusions, European Council, Brussels, 17 June 2010 (EUCO 10), p1.

5 The headline targets are to:

- achieve a 75% employment rate for women and men aged 20-64, including through the greater participation of young people, older workers and low-skilled workers and the better integration of legal migrants;
- improve the conditions for research and development, in particular with the aim of raising combined public and private investment levels in this sector to 3% of GDP;
- reduce greenhouse gas emissions by 20% compared to 1990 levels; increasing the share of renewables in final energy consumption to 20%; and moving towards a 20% increase in energy efficiency;
- improve education levels, in particular by aiming to reduce school drop-out rates to less than 10% and by increasing the share of 30-34 years old having completed tertiary or equivalent education to at least 40%;
- promote social inclusion, in particular through the reduction of poverty, by aiming to lift at least 20 million people out of the risk of poverty and exclusion.

See Conclusions, European Council, Brussels, 17 June 2010 (EUCO 13/10), pp11-12

6 The end-date for the next EU budget framework is not yet decided. It will be 2020 if the EU follows the practice of the last two budget agreements and fixes an agreement for seven years.
Japan; China is developing, still going through the massive shift of population from countryside to cities. A landmark was reached this year when China became the world’s second largest economy, overtaking that of Japan. Even the current recession and recovery are affecting China and the EU differently: while the EU economy is smaller now than when the recession began, China’s continues to expand at only a slightly slower rate than the past twenty years; recovery in Europe, when it comes, risks to be “jobless” while recovery is creating and re-creating jobs in China. Yet there are similarities between the two which offer the opportunity for EU policymakers to see their own policy problems through fresh eyes.

China is large, but so is the EU. China varies widely in climate and topography, so does the Union. China is a new country, but so are some members of the EU. Yes, the political organisation of China differs but, again, there are similarities: China has 31 provinces and the Union 27 member countries and some of the provinces and member countries are of more or less equal size; although China has more counties than the Union has regions, China’s counties and Europe’s regions are of similar size in terms of population; policy in the EU is an amalgam of Union and national initiatives and there is a similar mixture of policy in China between those of national ministries and provinces. More important, perhaps, for a discussion of regional development in China and the EU is that income levels among the counties in China diverge widely, as they do among the regions of the EU (see the Annex to this Introduction). In both places, action to raise the incomes of the poorest territories is founded on the view that economic development is the only route to sustainable poverty reduction and that wide income disparities are not conducive to social harmony.

The differences between the EU and China and between China and the EU make it unlikely that techniques for policy implementation can be easily transplanted from one to the other. But there is sufficient similarity to suggest that it might be possible to gain fresh and useful insights into EU Cohesion Policy by viewing it, as far as possible, from a Chinese standpoint. These insights arise because of factors like the following.

- Their shared characteristics are sufficiently numerous to suggest ways in which the EU may be able learn from several aspects of China’s internal policy for economic development.
- The attractive features of EU Cohesion Policy, and its warts, can perhaps be more easily seen from outside the EU. In order to compare policy in the EU with policy in China, we are obliged to strip away the often obscure jargon which is used to facilitate discussion between policy-makers inside the EU, but which may conceal important truths.
- China is both a developed and a developing country and still has “development-aid-relationships” as both a recipient of aid (though less and less) and an aid donor. This suggests a number of possibilities, one being that there may be advantages for EU Cohesion Policy in considering it in relation to EU Development Policy (Cohesion Policy, internal economic development; Development Policy, external economic development); and another being that China’s recent status as an aid recipient has led
it to concentrate on aspects of policy, notably evaluation, which receive less attention in the EU.

This introduction will, therefore, consider and compare aspects of EU and Chinese experience in economic development, with a view to identifying those parts of EU Cohesion Policy where improvement might be possible. It is structured around most of the ten issues which, in the light of its twenty-year experience with Cohesion Policy, the European Commission’s Directorate General for Regional Policy considers to be “essential”. This structure is chosen to enable comparisons between EU Cohesion Policy, not only with China but with countries like Brazil which have developed close ties with the EU Commission in connection with regional development policies.

European Cohesion Policy – and, indeed, all government policies – can be dismantled into four parts: its objectives (see Section 1 below), its budget (see Section 2), its method of operation (see Sections 3, 4 and 5) and its content (see Section 6). These parts provide the skeleton for this introductory chapter, which begins by discussing improvements related to EU Cohesion Policy’s objective, which the EU Commission’s Directorate General for Regional Policy considers to be a regional policy’s first requirement. The conclusion of this first part of the discussion will be that EU Cohesion Policy would derive a number of benefits if it refined the definition of its objectives.

1. The importance of a clear objective

   a). EU Cohesion Policy’s long-term strategic vision

   The objective of economic development policy in China is to reduce poverty, especially in the rural areas which are away from the coast. The result of its market opening and regional policies is widely recognised: the almost unanimous judgement of academic and political observers is to give its policy credit for lifting 500 million people out of poverty in the last 25 years, in other words raising the income of 500 million Chinese citizens above the World Bank’s poverty income of “one US dollar-and-a-quarter a day”. For the fast-growing regions on China’s south-east coast, this is easy to understand. But the benefits of coastal and industrial growth also reach inland cities and poorer, less developed regions – in the latter case through the migration of villagers to cities and their money transfers back to their homes. China’s policy distinguishes two kinds of migrant worker: those who wish to permanently settle in urban areas and those who wish to remain farmers and see work away from their village as a supplement to their farm income – the earnings and remittances of the latter help villages to invest and stimulate their own economic development. Chinese

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7 The parts of this Introduction which indicate possible improvements in the design and organisation of EU Cohesion Policy are indicated in the text by being indented and marked with the symbol reproduced below.

8 See especially the chapter “How far can this experience be an inspiration outside Europe?” in European Regional Policy, an inspiration for Countries outside the EU? Luxembourg: Office of the Official Publications of the European Union. 2009. Pp13-15. Although, in terms of this Introduction, a more suitable title would be “How far can China’s experience be an inspiration inside Europe?”
policy is experimenting with ways to make away-working more attractive to farmers so as to channel an even greater share of income growth into the countryside.

The effect of China’s economic development policies is usually judged against a yardstick of absolute income – the World Bank’s poverty indicator. Seen from the standpoint of relative incomes, China’s experience is broadly similar to that of the EU. The income gaps between rich and poor people and between poorer and richer regions are becoming wider: in China, better-off regions get richer faster than the lesser-well-off; in the recession-hit EU, the picture is more complicated with poorer regions becoming poorer while richer regions become richer. Reducing income disparities between people and regions is a target for China’s policy-makers, just as it is in the EU and both follow a similar policy approach. They implement measures to help poorer regions and communities to grow more quickly whilst encouraging richer regions to keep growing also. Put differently, policy-makers in China and the EU do not seek to close income gaps by slowing the growth of better-off incomes – they choose the more ambitious route of seeking to stimulate poorer people or poorer areas so that their incomes grow more quickly than the average.

China’s policies for regional development seek to stimulate growth in a number of specified urban centres at the same time as they help rural areas to raise their productivity and, thus, incomes. The policies are working, judging by the growth performance of some of China’s up-and-coming cities. Preliminary figures indicate that, in late 2008, non-coastal Wuhan recorded a 15 per cent growth in GDP; Chongqing 14.3 per cent; Nanjing and Chengdu, 12.1 per cent; while the northern port cities of Tianjin and Dalian both notched 16.5 per cent. These growth rates were well in excess of the national growth performance, which was depressed as China battled with the effect of international recession on its exports.

It is widely understood, then, that the objective of economic and regional development policies in China is to reduce poverty. In the EU, there is less clarity about the objective of EU Cohesion Policy: sometimes it is expressed as creating more and better jobs; sometimes as economic convergence or closing the income gaps between the poorest and average regions; sometimes as seeking economic modernisation and greater competitiveness. The fact that the policy’s different financial instruments or its Convergence and Competitiveness strands might express their objectives in different terms is frequently glossed over in political discussion, which further adds to confusion. Indeed, the recent Barca Report devotes several pages to deciding what is, or should be, the objective of EU Cohesion Policy and opts in favour of two – “realising the full utilisation of the potential of every place or region,” which it calls the efficiency objective and “ensuring equal opportunities for individuals irrespective of where they live,” which it calls the equity objective.9

When expressed in this form, however, neither objective is adapted to the needs of policy-makers

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Judgements of EU policy, when compared with those of policy in China, indicate the damaging effects of this lack of clarity about its objectives. It saps political consensus. It obscures Cohesion Policy’s importance in the Union’s policy framework, successfully disguising that it is one of the Union’s policies for economic growth and the major spending instrument supporting the Union’s drive for greater competitiveness. It undermines evaluations of the policy’s performance by creating confusion over relevant quantitative indicators and their interpretation. This suggests that EU Cohesion Policy would gain if, in the course of the present debate over its future, it sought to clarify, and make operational, its objectives – one for Convergence and one for Competitiveness, and one to promote Co-operation. Its foundation for both should be the European Union’s objectives for 2020. Of course, it is recognised that in pursuit of these objectives, EU policy may achieve other desirable ends, and this should be encouraged. But there should be no confusion as to what are the primary aims.

Its objective for Convergence is clear, and has been since 1989 – poverty reduction, although it is rarely expressed in these simple-to-understand terms. Its quantifiable target is to raise the incomes of the poorest regions above 75 per cent of EU GDP per head. Thus, the policy measures its performance in reducing poverty against a moving target, a relative income indicator which will move upwards as the Union’s average GDP per head rises. The opposite is also true.

However, the normal evolution of the moving target – setting aside the once-for-all-effects of EU enlargement or the effects of recession – is one of increase. This has a disturbing consequence for the reputation of the policy. As fast as policy succeeds in closing the poverty gap between the poorer and average regions, the upward-moving average risks to re-create it. This phenomenon reflects the churning effect of growth, and is observable in China, and elsewhere. Policy cannot avoid this difficulty but it needs to take it into account in assessing its performance, by demonstrating when a widening gap between a given region and the EU average is due to the rising average and not to the decline of the target region or a weakness in policy.

The conclusion from a China standpoint, therefore, would be that EU Cohesion Policy would benefit from clarifying its goals and thus making sure that they were widely understood. Taking into account the EU’s 2020 objectives\(^{10}\) might indicate that EU Cohesion Policy goals would be better expressed in the following way.

- The Convergence objective should be expressed as one of poverty reduction, the quantifiable target being, as now, to raise the incomes of poorer regions to equal 75 per cent of EU GDP. It would be possible, if thought desirable, to calculate, according to the official criteria of the member country concerned (as indicated by the EU 2020 plan), the number of people in these regions who were classified as being poor or at risk of being poor. Thus, Convergence efforts under EU Cohesion Policy would provide a targeted financial instrument to help the EU and its member

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\(^{10}\) See footnote 1.
countries to achieve their 2020 goal of lifting 20 million people out of the risk of poverty and exclusion.11

- The Competitiveness objective could also be quantified so as to take account of the Union’s 2020 objectives. Here, the target for Competitiveness regions might be set at a 75 per cent employment rate for women and men between 20 and 64 years; further, non-binding targets could be set for other groups mentioned in the Union’s 2020 programme – young people, older people, unskilled workers, migrants.

These clarifications in the regulatory framework of EU Cohesion Policy would bring a number of advantages. They would:

- make explicit the role of EU Cohesion Policy in achieving the EU’s 2020 objectives;
- focus the attention of the policy on poverty reduction and increased employment and emphasise the inter-connections between investment and employment;
- be equally applicable for each of the financial instruments which are deployed by the policy, most especially the European Regional Development Fund and the European Social Fund;
- provide a context and criteria for deciding actions to make regions and cities more competitive and sustainable; for example, the desirability of investments in basic, environmental and transport infrastructure; energy production and saving; innovation; rural development; urban improvement; as well as in infrastructure and equipment for education could be evaluated against the quantified poverty and employment objectives;
- make it easier for the European Union and the member countries to design and coordinate the actions they undertake to reduce poverty and increase employment;
- aid the design and evaluation of investments and social and training actions.

b) Target regions

Economic development policy in China has evolved a number of ways of classifying China’s provinces. The most apparent is a policy focus on four geographical regions which agglomerate a number of provinces: Eastern, Central, Western and North-Eastern. Policy in the past has distinguished between these four. For example, there have been actions targeted at the West (financial transfers to Xizang and Xinjiang; development of Chongqing and Chengdu as growth poles); at the “rust-belt” of the North East (plan for the North East Renaissance and the development of Dalian, Harbin, Changchun, Shenyang); at the Centre (the Centre Rising policy, the Chang-

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11 EU Cohesion Policy has suffered from a reluctance to clearly state its objectives in terms of poverty – a reluctance which seems to be due to its wish not to, in effect, classify some whole member countries as being poor, for example, Romania and Bulgaria. Even now (September 2010), when the EU has clearly set poverty reduction as its 2020 objective, EU Cohesion Policy appears reluctant to draw attention to its central role as an instrument for poverty reduction.
Zhu-Tan triple city growth project to develop Changsha, Zhuzhou and Xiangtan; and at the Eastern, or coastal, region (with economic free zones in places like Qindao and Xiamen; growth poles behind the coast like Nanjing and Hangzhou). Chinese policy is currently creating a system which will classify its counties according to their suitability for development, using a range of factors, economic, resource-endowment, and environmental. The final system will enable policy-makers to achieve greater precision in their efforts to reduce poverty, drawing a distinction between those counties which can support high levels of industrialisation and inward migration of workers, and those where, for resource or environmental reasons, intensive industrial development should be carefully regulated or, even, discouraged.

Yushu Autonomous Prefecture in Qinghai Province will almost certainly be classified as an environmentally sensitive region. It lies in West China; on the high plateau so that its average height above sea level is 3,370 metres; it covers 330,00 square kilometres; its basic economic activity is farming and pastoralism; it has a four-month growing season; its population is 330,000, largely of Tibetan ethnicity; and it is the source of three great rivers (the Yangtze, the Yellow River and the Mekong). In the EU, it would be classified as a Convergence region and the object of policy would be exactly the same as it is in China – reduction of poverty with special regard being paid to the protection and preservation of the region’s ecology. China’s economic development policy for Yushu follows the same lines as in the EU: establishment of a development strategy which then guides a range of actions to reduce poverty through economic development and to increase employment.

Recent thinking in Yushu underlines the similarities. The economic development strategy emphasises “six combinations” which, despite the different terminology could all feature in an EU regional development strategy. They include such guidelines as: poverty reduction must be placed in a medium and long-term context; it requires the upgrading of industrial structures; environmental protection is of first importance; urbanisation should be developed in small towns to provide alternative economic possibilities for pastoralists; agriculture should tend to ecologically-friendly husbandry. These “six combinations” are accompanied by “six transformations”. They include: to maintain a focus of policy on low income people in the Prefecture; to aim higher than mere improvements in basic subsistence; to widen policy thinking so that it is based on partnerships from all parts of society; to attract additional resources from outside the various layers of government; to operate the policy through systematic programmes; to place a greater emphasis on the widening of employment as the remedy for poverty. It is clear that in this region, which is unlike any region in the EU, policy for the reduction of poverty and the increase of employment uses similar mechanisms to those used by EU Cohesion Policy.

Cohesion Policy in the EU has modified its classification system during its twenty-year evolution and currently divides its regions into two types – Convergence regions (those at 75 per cent of EU GDP per head or below) and Competitiveness regions (all others). It also has two temporary classifications for former Convergence regions which will, in a phased manner, withdraw support from the regions concerned in 2012 or 2013, as long as they have not fallen back below the 75 per cent income target. The first of these is for those regions where average income had grown at the last classification beyond 75 per cent of EU GDP per head (Phasing Out regions). The second is those regions where average income was pushed above the 75 per cent
threshold not by their growth but by the fall in EU average GDP on the accession to EU membership of the EU10 countries (Phasing In regions). This binary classification, or binary-plus if we take account of the temporary transitional regions, is more crude than EU Cohesion Policy’s previous applications. In the past it classified regions into four, or five, groups – without including temporary transition classifications, which were brought about by the sudden and radical redrawing of the map of prosperity in the Union after enlargement in 2004 and 2007. It distinguished between low-income regions (the present Convergence group but formerly Objective 1), regions with rising-unemployment (formerly Objective 2), a rural development group (formerly Objective 5b), and a sparsely populated group (Objective 6). There was, in effect, a fifth group, which might be described as a “silent Objective 7”, composed of those regions which were not covered by any of the other four classifications. The question which China’s classification initiative prompts for EU Cohesion Policy is whether its present binary system, which causes a sharp reduction in the intensity of EU financial aid at 75 per cent of EU GDP, reflects the realities of economic development.

There are indications that the binary system, even when it is supplemented by temporary arrangements, does not accord with the EU’s long-term strategic vision and does not reflect the economic reality of regional development. First, by inflicting, in association with other aspects of the policy, a considerable fall in aid intensity when regions pass the still-low income level of 75 per cent of average EU GDP, it imposes on them a sharp change in policy. Second, its temporary transitional arrangements, which phase-down financial and other support according to a strict and prearranged timetable, give only limited recognition to the economic fragility of these poorer areas. Third, it thus jeopardises the achievement and sustainability of the Union’s poverty and employment objectives.

EU experience shows that the politico-economic reality of regions in the income range 75 to 100 per cent of average GDP, and of the people who live in them, is characterised by a number of weaknesses – and that the weaknesses are more severe in those regions closer to the lower part of the range. Such regions may be typified by, among other things, numerous pockets of poverty; above-average unemployment and a poorly skilled workforce; low birth and survival rates for businesses; “branch-factory industry” with low research and low capacity for spin-offs; and low levels of labour productivity. Periodically, these factors cause social unrest. In short, a sharp reduction in policy and financial support in such regions risks to cause the double effect of a check, and even decline, in incomes and employment. In those regions with an average income closest to 75 per cent of EU GDP – in other words, the

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12 An unseen variation in this binary classification of regions is provided by the working of one of EU Cohesion Policy’s financial instruments, the Cohesion Fund. This fund, which intervenes nationally not regionally, and which disposes of a significant share of the EU Cohesion Policy budget, operates in member countries which have a GDP which is less than 90 per cent of the EU average. The Cohesion Fund thus creates a financial benefit for the whole territory of the eligible member countries and, thus, for some regions with a GDP per head above the 75 per cent threshold. It does not have the same effect, however, as would a revised regional classification system.

13 Objectives 3 and 4, which are not mentioned here were related to social factors and applied to the whole EU territory.

14 This question is discussed further in Chapters II and IV of this Report.
weakest regions – a sharp scaling-back in EU funding causes a disproportionate decrease in their investment funds which cannot be made up out of local taxation. The present policy seeks to reduce these harmful effects by offering the financial cushion of transitional arrangements – but, because these are temporary and degressive, and thus insist on the bulk of spending taking place in the first years of the programme, the protection they afford is limited.

- EU policy-makers might, therefore, consider the advantages to be gained by introducing, say, two more regional groupings so that the intensity of financial support was reduced in three steps as opposed to one. For example, the intensity of EU financial support may be reduced when the region’s GDP per head rises above 75 per cent of the EU average, 90 per cent of the average and 100 per cent. In this way, EU Cohesion Policy would create what might be termed a “gearbox for growth” which scaled back support as poverty was reduced and income increased.

These modifications to regional classification would bring a number of advantages. They would:

- offer a continuing policy framework to economic policy-makers and planners in their efforts to overcome poverty and raise employment;
- offer a range of aid possibilities geared to the progress of development on the ground, thus avoiding the possibly-damaging effects of an abrupt reduction in aid;
- provide a basis upon which other changes might be introduced into the policy; for example, as a region’s economy becomes stronger it might be expected to use an increasing part of its EU financial allocation in recyclable loan funds rather than for grants and subsidies.

In current conditions there would be one important additional benefit. The operation of EU Cohesion Policy after 2014 may be distorted by variations in the timing of the present economic recession. Under the present policy arrangements, the selection of regions to receive the highest aid intensity (the Convergence regions) will be based on regional GDP figures for 2007, 2008 and 2009. In other words, the three years which cover the end of the long-growth period, the financial crisis and the onset of the world recession will be the basis for support in the second decade of the century. But recession affected the GDP of regions at varying times. GDP of some regions may have bottomed-out by 2009 while it was still falling in others. In these circumstances, it will be difficult for policy-makers to be sure that a three-year-average of 2007, 2008 and 2009 provides the basis for a fair allocation of Cohesion Policy funds up to 2020. The introduction of a three-step reduction of aid intensity would not remove the distortions caused by the different timing of the recession, but it would dampen the effect because the fall in aid intensity at the 75 per cent threshold would be less severe.

2. The budget of EU Cohesion Policy
The European Commission’s Directorate General for Regional Policy has identified a number of budgetary characteristics as important elements in a well-designed policy for regional development. It lays stress on an objective, or “non-political”, method for raising and allocating budgetary resources. This ‘objective method’ should be supported by statistical indicators which are regionally based. The budget arrangements for EU Cohesion Policy meet these criteria. The negotiation which fixes the overall size of its budget and, at a second stage, its allocation between regions are both carried out on the basis of objective data relating to poverty (regional GDP per head) and employment (employment and unemployment rates). There is an on-going discussion about how the data could be enriched by using indicators which reflect the overall well-being of the population, rather than poverty, and others which reflect important information on the state of the regional environment (perhaps carbon output data) but it is generally accepted that the indicators and data employed at present are those which are best adapted to the EU’s 2020 objectives of poverty reduction and the achievement of a high employment rate. Moreover, increasing the number of indicators used simply shifts the political debate onto the weights to be used, a debate which is likely to be resolved by an unedifying trial of relative strength rather than through economics. This is probably the aspect of policy where the European Union has least to learn from practice in other areas – in fact the clarity and objectivity of the EU arrangements for its Cohesion Policy are greater than those in most of its member countries.

The importance of its ‘objective method’ of budget determination and allocation is magnified by two other characteristics of EU Cohesion Policy’s budgetary arrangements. The first is the seven-year length of EU Cohesion Policy’s budget agreements. The second is that member countries and their regions know the amount of resources they will receive at an early stage of their development planning – in fact, before their plans are finalised. In addition, they receive a proportion of their agreed EU finance as an advance payment which is continually topped up as their investment and social programmes advance. These characteristics combine with the objectivity of the budgetary method to assure policy-makers in EU member countries and regions that they can plan and implement their investment and social programmes in a known and stable medium-term financial framework. Together they help provide policy-makers in the EU with a strong foundation for their efforts to alleviate poverty and raise the employment rate.

Twenty years of experience in the EU also suggests, however, that improvements are possible in the budgetary method of Cohesion Policy, especially if policy-makers want to maximise the value of policy expenditure in terms of poverty reduction and employment-generation. The possible improvements which will be discussed here relate to the allocation of EU Cohesion Policy finance between its investment and social funds (the European Regional Development Fund (ERDF) and the European Social Fund (ESF)) and the problem of budget absorption, the ability of member countries and regions to invest and spend within the correct time period the financial resources which EU Cohesion Policy allocates to them. This is a problem which concerns the investment side of Cohesion Policy (the ERDF) rather than social

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15 See European Regional Policy, an inspiration for Countries outside the EU? p13.
16 Questions relating to the budget for EU Cohesion Policy are thoroughly discussed in Chapter IV of this report.
programmes (normally, the ESF). The discussion on absorption will refer to two causes of difficulties for member countries. The first is a lack of administrative ability (a point which is well understood in China, where continuous efforts are undertaken to build the capacity of policy administrators). The second is the time profile of the Cohesion Policy budget which does not allow financial managers to take account of the fact that expenditure builds up slowly when they are beginning programmes of investment and social action. It begins with the allocation of Cohesion Policy finance between its investment and social funds (the ERDF and the ESF).

a) The equal importance of jobs and investment

The sustainable reduction of poverty and increase of employment depend critically on the creation of jobs. And each job is composed of two parts – a vacant workplace and a trained person to fill it. A job – or employment, to use an alternative term – is created when a trained person is hired to fill a vacancy. The creation of work places is a function of investment and the availability of trained people depends on the provision of structured vocational training. The former is, broadly speaking the task of the ERDF, the latter of the ESF. The two activities, investment and training, are of equal importance – only in very particular cases or periods can employment be created by one or the other. Given the EU’s 2020 objectives, it would be “normal” if the EU institutions decided on the allocation of Cohesion Policy funding between the ERDF and ESF, taking account of the EU political priorities. Instead, they remain silent on the allocation, leaving it to be decided by member countries and regions acting in a decentralised way. The result is that the respective sizes of the ERDF and ESF frequently understate the importance of training and social actions.

- Given the EU’s 2020 insistence on the reduction of poverty and increased employment, and the critical importance of education and training in raising the employment rate, the institutions of the EU should consider deciding for themselves on the allocation of Cohesion Policy finance between the two funds, rather than allow it to be decided in a decentralised way. This would present the EU with the chance to establish its political priorities at the overall level.

b) Ensuring that EU Cohesion Policy funds are used

When EU regions discuss the problem of financial absorption, they frequently focus on the policy rule which says that funding which is provided by Cohesion Policy should be spent within two calendar years of the year in which it is allocated or “committed” to the action concerned. This rule – which is known as the “n+2” rule – in effect, gives regions two to three years in which to spend the EU resources allocated to them. It was introduced to counter the tendency among regions to allow expenditure to be delayed by four, five or, even, six years, thus reducing the entire value of the policy. This is of significant importance. It is the act of spending which transforms the intention to reduce poverty and create employment into action. Therefore, the act of financing selected actions is critical to the success of the policy: and delays in spending are in fact delays in delivering the benefits of the policy to EU
citizens. Difficulties in absorption become evident when member countries and regions delay spending beyond the permitted period of two to three years. The solution they advocate for the problem is to weaken the “n+2” rule so that it becomes “n+3” or is even repealed and disappears entirely, giving them as long as they wish to start investments and social actions. This is the very opposite of what is required, which is to try to tackle the factors which cause them to slow down and delay the act of spending.

The capacity of regions and member countries to run investment and social programmes of sufficient size to draw down EU finance according to the EU budget timetable became an issue as the Union prepared itself for the membership of EU10 and EU12 countries\(^\text{17}\). It was immediately apparent that, because of their low levels of GDP per head, the ‘objective method’ of EU Cohesion Policy would allocate to them considerable sums of EU finance. Two questions arose. Since one of the requirements of the policy is that member countries add their own funding in a direct proportion to the EU financial allocation, would they be able to allocate sufficient capital of their own to match their EU resources? The second question, which was treated as being of lesser importance, related to the pace at which the member countries and regions would be able to invest and spend the Policy’s financial allocation: would they be able to spend and invest at the speed demanded by the budget programme? Put differently, the latter question is would they be able to adhere to the n+2 rule?

Studies in connection with the first question concluded that the new, poorer member countries would be able to raise sufficient capital (both public and private) to place alongside the EU resources allocated to them. Therefore, ‘objective method’ was left unchanged, resulting in large financial allocations to the newcomers. But it then became apparent that the bigger barrier to absorption lay in the ability and capacity of the administrations of member countries and regional administrations to manage the large amount of EU funds allocated to them. The spending of large amounts of resources on investment and social programmes requires a national or regional administration which is sufficiently well-staffed with capable administrators. It became apparent that this was not the case in some member countries or regions – and the difficulty is still not overcome everywhere. The European Commission sought to combat this problem in a number of ways. The financial allocations to new member countries were reduced during their first three years of EU membership and their financial allocations under EU Cohesion Policy were capped at 4 per cent of their GDP. (The undesirable side effect of these measures has been to compromise, in a hidden way, EU Cohesion Policy’s principle that it should concentrate its resources on the poorest regions and member countries.\(^\text{18}\)) The European Commission also created a technical support service, known as the ‘JASPERS scheme’, which it operates with the European Investment Bank, to help poorer countries and regions to administer large investment projects. But even though the scheme has considerably expanded beyond what was first thought to be necessary, it is clear that a lack of administrative

\(^{17}\) The EU began to negotiate membership with the EU12 countries at the same time on the assumption that they would all become members together. As the date for decision drew near, it became clear that two of the twelve (Romania and Bulgaria) would need a little longer to prepare and they joined the Union three years after EU10.

\(^{18}\) See Chapter IV below.
capacity still reduces the capacity of member countries and regions to absorb EU Cohesion Policy funding at the required rate.

The second contributor to difficulties of absorption is the time profile of the EU Cohesion Policy budget. Broadly similar amounts of resources must be committed and spent each year which does not take account of the fact that spending is slow to gather speed in the first part of a programme (this was one reason why the n+2 rule was not n+1). In this initial period, a considerable effort is required to put in place the necessary arrangements to start-up investment and social programmes. Here the Union’s political aims conflict. One aim is that programme managers should constantly search to maximise the value of Cohesion Policy spending in terms of poverty-reduction and employment. Programme-makers and managers are encouraged to innovate in order to find ways to make spending more effective and to improve value but this, at first, slows down the rate of programme spending. A second aim is to commit and spend Cohesion Policy a broadly similar amount of resources each year. These two objectives trap programme managers in a conflict, making it difficult for them to try new ideas. Instead, they are pressured to keep up to timetable and this may lead them to prefer investment options which are quick-spending, but do not necessarily deliver the best performance.

- EU policy-makers might, therefore, consider the advantages to be gained in terms of a greater value for Cohesion Policy spending by helping member countries to overcome the problems associated with the absorption of resources. This might lead to measures which:
  - require those member countries and regions which have a record of slow implementation, to satisfy the Commission that they have deployed a sufficient number of properly trained staff to administer Cohesion Policy; as an incentive to encourage them to give proper attention to this question, a member country’s spending record could be taken into account when the policy is allocating resources;
  - seek ways of ensuring that the budget profile for, at least, Convergence countries and regions reflects the necessarily slow build-up of expenditure at the start of programmes; this would affect the profile of the overall EU budget and be difficult to achieve, but the discussion should be launched so that a solution can be found.

These adjustments in budget arrangements would minimise or remove factors which slow down the progress of EU Cohesion Policy spending and thus increase its efficiency in helping the EU reach its 2020 objectives.

3. Partnership, civil society and the integration of funds

The issues discussed above relate to the first two of the four components of policy – its objective and its budget. This Introduction will now turn, to the third of the four components – the policy’s way of working, which can also be described as its system of delivery.
Multi-level governance in the European Union – the combination of the Union, national governments, regions and cities and towns – is judged to be effective. The Barca Report points out that “EU Cohesion Policy is where multi-level governance has flourished.” In China regional development policy is also delivered through multi-level governance, involving five rather than four levels – central government, provinces, counties, townships and villages. It can be seen in operation in the huge reconstruction effort being undertaken in the zone affected by the Wenchuan earthquake and its aftershocks in May of 2008.

An important part of the reconstruction is being carried out in 4,834 poor villages in the provinces of Sichuan, Gansu and Shaanxi where, once the emergency reconstruction of homes and basic infrastructure has been completed, priority will be given to the rebuilding and development of economic potential. This urgent regional development is being carried out by the State Council’s Leading Group Office for Poverty Alleviation and Development (LGOP). Under LGOP guidance, each of the affected villages has prepared a programme for its development, has been allocated an amount of funding and has been asked to indicate its priority projects. In this way multi-level governance in China is reaching even closer to the citizen than in the EU.\(^\text{19}\) Aid from NGOs – Oxfam will finance projects in about 40 villages – is being co-ordinated with the state’s main effort.

NGOs and Civil Society play a considerable part in the delivery of EU Cohesion Policy, which is made more effective by Civil Society’s close connection with the grassroots of regional economies and with community development. Indeed, this is one area where the system for implementing EU Cohesion Policy is sharply distinguished from policy delivery in China: Civil Society is integral to the delivery of regional development and social policy in the EU. Yet, the question arises as to whether policy implementation in the EU maximises the benefits which Civil Society can bring. There are signs that recent developments in Cohesion Policy’s construction are reducing the effectiveness of Civil Society and, with it, the effectiveness of overall policy delivery.

Setting aside discussion over the exact definition of Civil Society, two points are worth making. First, it is a large sector; a significant source of new jobs, even in recession; and a considerable contributor to GDP. A Johns Hopkins University study of forty countries revealed that the sector’s real economic value was constantly underestimated. In Europe, it is about as large as the construction industry and the pre-crisis financial services sector while, overall, the sector represents about 5% of the combined GDP of the countries studied. Second, its value to the delivery system for EU Cohesion Policy is that 90% of the sector is at local community level, frequently with cross-border links which enhance regional integration and with very diverse organisations which ensure that Civil Society is adaptable to different circumstances. The growing awareness of corporate social responsibility – a trend in China as well as in Europe – is strengthening the link between private business and Civil Society.

\(^\text{19}\) The only aspect of EU internal development policy which has reached down to village level is the LEADER initiative in the area of rural development.
But the ability of Civil Society to contribute to the delivery of EU Cohesion Policy is being reduced. The removal of Community initiatives, or the lessening of their importance – for example, the loss of the EQUAL initiative under the ESF and of the URBAN initiative under the ERDF – has knock-on effects. It removes the possibility of action and support by Civil Society and also deprives them of the chance to learn-by-doing the ways to manage the Policy’s regulatory requirements. This is further compounded by the recent separation of the two funds (ESF and ERDF) which, if it were taken further, would diminish the role of Civil Society in the economic development of poor communities.

The concern that recent policy changes are, unintentionally, threatening to remove the benefits which Civil Society can bring to policy implementation is magnified by suggestions that the decision-making power of regional partnerships should be reduced. The Barca Report has suggested reforms to the present partnership system. It would end the flexibility given to member states and regions in their choice of investment and training and replace it with a contractual system. The present arrangement of loosely-formulated guidelines as the basis for regional decisions would be replaced by a strategic framework and a small number of core-priorities (three or four) to which member states and regions would have to allocate up to two-thirds of their European Union funding. Once member states and regions had decided on the allocation of funding between the core priorities and other activities, their decisions would be tied into contracts between the European Commission and member states, which would contain progress indicators. EU funding would become conditional on achieving the indicators.

Such a reform would appear to ignore the policy’s experience of twenty years: that investment and training programmes must be sufficiently flexible to respond to changes in the general economy and that strict controls, for example in the area of financial management, undermine partnership and the quality of the policy’s investment and effort. A more profitable line of action in the search for improved implementation of EU Cohesion Policy would appear to be closer consultation between the levels of governance, including Civil Society, with a view to a stronger and deeper consensus on actions needed to secure the growth of regional economies. This should be accompanied by a concerted effort by the Union’s institutions to review existing rules of financial management and audit so that – whilst still protecting the Union taxpayer – they impose a lesser burden on the various levels of governance and Civil Society.

The amendments to EU Cohesion Policy for the period after 2014 might therefore consider changes with the express purpose of making the policy’s investment and training programmes more accessible to civil society organisations. Such a move would enhance consensus and partnership-working and strengthen its links with communities. In this respect it would add an important element to the EU’s progress towards its 2020 objectives.

4. Cohesion Policy as an instrument of other policies

The EU Directorate General for Regional Policy considers it important that there should be a clear separation between (a) the legal framework which establishes the
policy and (b) decisions on which projects should be granted funding. This is achieved in both China and the EU – in the latter by EU’s institutional architecture and its insistence on the decentralised management of programmes. This clear separation between a policy’s legal framework and its management of project approval should not blind us, however, to the fact that EU Cohesion Policy is frequently the instrument of other EU and member country policies. The “classic case”, perhaps, is the link between EU policies for Cohesion and Competition – where Cohesion Policy plays an instrumental role in ensuring a proper observance of Competition policy in connection with state aids to businesses. But Cohesion Policy’s role as an instrument is wider and enhances its importance to the EU in connection with its 2020 goals.

The EU’s 2020 goals go further than reducing poverty and raising employment. They speak of improving conditions for research and development; of reducing greenhouse gas emissions by 20% compared to 1990 levels; of increasing the share of renewables in final energy consumption; increasing energy efficiency; improving education levels, in particular by aiming to reduce school drop-out rates and increasing the share of 30-34 year-olds having completed tertiary or equivalent education; and of promoting social inclusion. EU Cohesion Policy contributes as an instrument to the achievement of all of these objectives.

In all of these policy areas, EU Cohesion Policy insists that its expenditure – as well as that leveraged from member countries and regions – is used to achieve the objectives of other EU policies. Thus, it becomes the instrument of the policies for Research, Energy, Climate Change, Environment, Social Affairs, and so on, making their objectives its own. And Cohesion Policy’s implementation procedures ensure adherence to these objectives. Cohesion finance is distributed through a large number of development programmes operated by member countries and their regions. Each programme represents a consensus between a large number of partners to pursue explicit objectives, a consensus reflected in agreed priorities for action to which are allocated almost all of the programme finance. This method of implementation carries the EU’s overall 2020 objectives down to the grassroots. In addition it offers a considerable reduction in administration procedures and red tape, since the one administrative system serves several policies. If EU policy-makers wish, they can insist that Cohesion Policy strengthens its performance as an instrument linking policies which touch on EU concerns. The possibilities for close working between Cohesion Policy and others can be further developed in support of the EU’s 2020 objectives.

- In formulating its proposals for EU Cohesion Policy after 2013, the European Commission might consider how it can further develop the policy’s joint working with other EU policies, especially in relation to EU 2020. The links between the EU 2020 objectives, the range of key policies and Cohesion Policy should be enhanced to gain further advantages from integrated policy implementation.

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20 See European Regional Policy, an inspiration for Countries outside the EU ? p13.
5. Tackling Cohesion Policy’s “counter bureaucracy”

The European Commission’s Directorate General for Regional Policy emphasises administrative capacity and monitoring and evaluation as being important in the implementation of regional development policies. It is difficult to over-state the importance of this observation. Indeed, it is possible to argue that the way in which it organises its economic and development policies and the quality of its administration make up one of the key factors in determining the speed of a country’s economic growth. A country’s economic policy instruments may be founded on truths established through academic research – for example, the importance of research and innovation in the growth process – but if the instruments to promote these truths are not well designed and ably administered, they will not have the desired effect. Yet, all too frequently, questions related to administrative efficiency are boiled down to slogans which, although containing the seeds of truth, may lead to errors in policy organisation.

In this kind of discussion, EU Cohesion Policy organisation is jeopardised from two sides. On one side is the school of thought which might be characterised as “the simpler, the better”. This school often deploys its arguments in terms of “red tape” – arguing that “red tape”, bureaucracy and over-control frustrate initiative and thus reduce employment and perpetuate poverty. The other side is motivated by suspicions of “waste” and “misuse of public money” and calls for more stringent financial management, controls and audits. There is truth in both schools but, when their ideas are adopted too crudely and without sufficient forethought, they create problems as well as solve them. For example, the call for “simplification” has led EU Cohesion Policy to reduce the number of its regional categories as well as to the loss of Community initiatives like Social Policy’s EQUAL and Development Policy’s URBAN which were universally applauded and produced good value for public money. A third such initiative, LEADER, was only preserved by incorporating it into mainline rural development programmes which delivered, perhaps, an administrative gain but also reduced its visibility and its usefulness to village communities. The call for more stringent financial management has led to an emphasis on compliance rather than on securing, often by innovative means, the greater effectiveness of Cohesion Policy. A change is needed.

EU Cohesion Policy is not alone in encountering this problem. Andrew Natsios was the Administrator in charge of the United States Agency for International Development (USAID) from 2001 to 2005. In a recent essay he has detailed how growing requirements of compliance – what he terms the “counter-bureaucracy” – has clashed with the design and implementation of USAID’s development programmes so that the two have become unbalanced. Oversight is essential, he says, but something is wrong when compliance becomes the primary mission of development programmes. He gives as the reason for USAID’s administrative imbalance that the architecture of oversight has been designed incrementally, over a long period, without any thought being given to its cumulative impact. There are ample signs that the same thing is happening, and in the same way, to EU Cohesion Policy.

21 See European Regional Policy, an inspiration for Countries outside the EU ? p14.
In the EU, administrative, financial management and audit requirements attached to Cohesion Policy programmes have also increased incrementally. The growth of financial and audit regulations accelerated after the resignation of the European Commission led by Jacques Santer in January 1999 over allegations of financial mismanagement. The allegations against the Commission did not involve EU Cohesion Policy but the Policy was affected by the aftermath, and the determination to tighten up financial and audit regulations generally. Much of the change in policy administration which ensued was beneficial and increased confidence in Cohesion Policy but its incremental nature has created burdensome regulations and a climate in which the European Commission prefers to avoid risk rather than manage it. A good thing thus becomes disadvantageous and, eventually, weakens the EU’s ability to achieve its 2020 targets.

- It is clear that public resources should be properly managed, that fraud should be prevented and that risks of financial loss through the failure of projects and actions should be managed and minimised. It is equally clear that administrative techniques should be kept as simple as possible and that “red tape” should be kept to the unavoidable minimum. But there is a need to survey compliance requirements as a whole to see how they might be lightened without jeopardising their objectives. One way to achieve this might be the creation of a standing conference composed of the European Institutions, including the EU Court of Auditors, and the member countries which could systematically survey the entirety of compliance requirements and, where possible, seek to rebalance them so that more attention could be given to the quality of EU Cohesion Policy implementation. There are signs of progress in this direction but this does not satisfy the need for a new approach.

The evaluation and monitoring of EU Cohesion Policy investment and social programmes is, as the Commission’s Directorate General for Regional Policy says, of key importance in securing improved efficiency in policy delivery and, thus, the highest value for money. Only by continually reviewing performance, searching for weaknesses in implementation, and then correcting them, can Cohesion Policy maintain a high performance and secure even greater benefit. Monitoring and regular evaluation should help assure EU Leaders that Cohesion Policy is helping them to achieve their 2020 objectives.

China also bases its internal development policies on thorough evaluation – frequently introducing initiatives on a large-scale pilot basis – before applying them more widely. But there is a significant difference between China and the EU. In the EU, evaluation is carried out internally – through the European Commission or member countries evaluating their own programmes. China also carries out evaluations in this way but, as an aid recipient in a development context, has regularly had its performance evaluated by donor organisations and organisations like the World Bank. This attitude has been maintained and, even though it is now moving out of the category of an aid recipient, and could, if it wished, fall-back into self-evaluation, it still remains open to outside assessment. Even when it evaluates for itself its national
policies, it is not uncommon for China’s policy-makers to include international experts in evaluation teams.

Evaluations of the working of EU Cohesion Policy might also benefit by either being carried out by an outside-EU agency or by including experts from outside-EU agencies. Gains might be secured in the organisation and quality of the evaluation itself and in the confidence of policy-makers and politicians in the findings of such evaluation studies. Additionally, evaluations of Cohesion Policy programmes in one member country might be carried out by experts from another member country in what is known as “peer group” evaluation. This is already done in connection with some EU Cohesion Policy programmes but is not yet a general practice.

- EU policy-makers might consider extending systematically the practice of “peer group” evaluation so that Cohesion Policy’s investment and social programmes could be evaluated by experts from other member countries or from organisations not related to the EU, say the World Bank or the OECD. Such evaluations should be technical, not political, and aim to discover weakness in policy implementation and suggest how they might be eradicated. In connection with its political memoranda of understanding with China and other countries, it might be interesting, for example, if some aspects of Cohesion Policy or some of its programmes could be evaluated by teams of Chinese experts.

There are, however, dangers present in the systematic use of evaluation results as a driver for both policy improvement and the improvement of investment and social programmes. Evaluation programmes and individual studies need to avoid such pitfalls by following the sort of rules as those listed below.

- Evaluations should not require evaluators to measure the unmeasurable. This is especially important in systems which are based on the idea of “payment by results”. Some aspects of EU Cohesion Policy lend themselves to a judgement based on results (basic infrastructure provision, for example), some do not (capacity building, technical assistance). Because of this “payment by results” may lead to some investments or social actions crowding out others which may have been more useful in terms of achieving the EU 2020 objectives.

- The intended recipient of the evaluation should be identified at the outset and the recipient’s needs taken into account in the design of the study. Evaluations have different purposes: those for policy-makers need to be based on indicators which can be easily defended and summarised for use in political discussion; those for programme designers and managers need to go deeper into rather arcane aspects of programme management and will require different indicators. An evaluation which uses indicators of the second type will probably be of little use to policy-makers.

- Evaluation should not become over-complicated, since it then risks suffering the same fate as financial management and accounting and its method of organisation and arrangement, which should be subordinate to programme management, will become dominant.
Therefore, approaches to evaluation need to be kept as simple as possible and have a work-a-day nature.

- Evaluation must not encourage programme managers to be risk averse. It is not uncommon to discover that programme managers are deterred from innovations in policy delivery – or even from dealing with particular problems which should be the subject of policy intervention – because they involve risk. Evaluation should encourage risk management and should be ready to be critical of risk avoidance.

- Policy-makers for EU Cohesion Policy might usefully review the evaluation requirements which are written into the policy’s structure with a view to ensuring that they fit the objectives they are supposed to achieve. Evaluations which are not seen to be useful and which are carried out “just because they have to be carried out” risk reducing to a mechanistic nuisance an activity which is of key importance.

6. Coming to grips with conditionality

The notion of conditionality runs strongly through the mechanisms of EU Cohesion Policy. The European Commission’s Directorate General for Regional Policy lists it as an important consideration in the policy’s delivery, or implementation, system. Indeed, it is one of the foundations of Cohesion Policy’s role as an instrument of other EU policies, which has been discussed above. In this connection, DG Regional Policy lists a number of EU policies which are reinforced because Cohesion Policy insists on the observance of the rules of these other policies as a condition of payment under its own development programmes. It mentions as examples open market and competition policy (including public procurement rules), environmental and climate change policies and regulations, and social policies for equality of opportunity. And there are several more, including industry policy and research policy, which are supported in different ways. The policy is so successful as an instrument in advancing the cause of other policies that policy-makers look for it to support other policies also – most notably the achievement of the so-called Lisbon policy’s objective of enhanced competitiveness in the EU economy.

Conditionality is also a fundamental principle of EU Cohesion Policy’s financial mechanisms. It makes its financial contributions to investment and social actions conditional on certain rules of management. For example, the rule governing the speed of spending (the n+2 rule) has already been referred to in this Introduction; and there are other rules concerning proper financial management, which are enforced through audits of sample programmes and projects, which also have to be observed. The question is frequently posed as to whether EU finance itself can also be made conditional on the quality of the programme, or action or project it is used to finance. This is the thought which underlies the idea of “payment by results” which would introduce the notion of a “business contract” into social and investment programmes. Under this form of conditionality, each project or action would specify the outputs it

23 See European Regional Policy, an inspiration for Countries outside the EU ? p14.
would achieve and, in order to secure its EU financial contribution, it would have to achieve these outputs, in addition to observing the financial management rules.

The desire to make payments under EU Cohesion Policy conditional on pre-set results to be achieved by projects and actions raises a list of issues. Chief among them is, ‘Is regional or social development sufficiently similar to business to be able to benefit from this business practice?’ The answer given in Section 4 of this introduction is that some parts (for example, basic infrastructure provision) are – at least for most of the time. But the usefulness of “payment by results” in the implementation of investment and social programmes is greatly reduced by other factors, most especially by movements of the business cycle. The current recession provides a good example. Current EU Cohesion Policy programmes were written in 2006 and 2007 – before the crisis. Their quantified targets for the creation, for example, of particular numbers of jobs, or businesses, or business sites, or the training of particular numbers of people, will all have been overthrown by the recession. Even the provision of basic infrastructure which is easiest to quantify and measure will have been affected by reductions in public budgets so that targets will probably not be achieved. Consideration of the business cycle alone, therefore, shows that great care would need to be taken in introducing into EU Cohesion Policy a conditional payments system based on quality – or “payment by results”.

The recession is a good example of why this may be a bad idea – because its universality means that all member countries and regions are affected at more or less the same time. But even in good years, when national economies are moving ahead, there will be recessions in certain regions, or cities, or localities. The unexpected closure of an important local business, for example, a difficulty in one particular sector of world trade (say motor cars or computer chips), or an oversupply of a basic commodity may all affect one region or city to such an extent that, through no fault of its own, it cannot achieve pre-set targets. In such cases, it would defeat the EU’s 2020 objectives if “payment by results” was enforced, since it would reduce EU support for an area and for the people living and working in it, just when it was needed most. It would mean that Cohesion Policy was being counter-productive in areas of poverty at a time when employment rates were falling. Such considerations need not fully undermine the concept of “payment by results” in regional policy but they do indicate that enormous care would have to be taken in designing and administering such a system. And a full consideration may lead to the conclusion that conditionality in the form of “payment by results” would add to the unhelpful “counter-bureaucracy”, which hinders regional development, rather than promote the quality of EU Cohesion Policy’s delivery.

The latest discussion about conditionality and EU Cohesion Policy concerns monetary policy and the defence of the Euro. The EU Stability and Growth pact obliges the sixteen member countries of the Euro to maintain an annual budget deficit at or below three per cent of their GDP. The question under discussion is whether financial support under EU Cohesion Policy can be used to enforce this provision – the financial support being made conditional on whether the member country has met the three per cent limit. On first inspection, such conditionality appears useful. The threat of having its EU Cohesion Policy support suspended or withdrawn would surely help to focus the attention of Euro member countries and keep them active in fulfilling this requirement.
A brief consideration shows such conditionality to be dangerous. Euro members who exceed the three per cent limit are required to take immediate action to reduce their budget deficit to below three per cent of GDP. Such a move will usually imply a decrease in government spending or increased taxation or a mixture of both. Either option will reduce purchasing power in the economy and will tend to depress economic activity. If EU Cohesion Policy payments are suspended, this will further reduce purchasing power with a further depression in economic performance. Not only will this deliver hardship to the citizens of the Euro member, it will intensify the Euro country’s difficulties in reducing its budget deficit to three per cent or below. Indeed, in the case of Greece in 2009 and 2010, the EU tried the opposite tactic of keeping EU Cohesion Policy payments as high as possible in order to maintain purchasing power. In other words, when confronted by a practical case, the EU’s monetary managers refused this kind of conditionality for EU Cohesion Policy finance.

- In deciding the structure of EU Cohesion Policy for the period after 2013, policy-makers need to be clear-headed in their treatment of conditionality. It has proved to be useful in helping Cohesion Policy to work as an instrument of a number of other policies and to help them achieve their objectives. Beyond that it may prove to be a dangerous concept. If it is introduced into the policy in the form of “payment by results” there is a risk that, frequently, it will not be applicable and will have the principal result of weighing down the policy by adding to the “counter-bureaucracy”. If it is introduced as an element of “punishment” for Euro countries which exceed the three per cent limit on budget deficits, it risks making economic readjustment more difficult. Also, the idea of conditionality in these two areas of implementation – evaluation and deficit reduction – will make it more difficult for the EU to reach its overall 2020 objectives, which are the reduction of poverty and increases in the employment rate.

7. The “contents” of EU Cohesion Policy

The fourth element in EU Cohesion Policy – after its objective, its budget, and its way of working or delivery mechanism – is its “content”, by which is meant the tens of thousands of investment and social actions to which it contributes financially. It is this element of the policy which determines its effectiveness in helping the EU to achieve its 2020 objectives of poverty reduction and high employment, and which ensures that Cohesion Policy works as an instrument and ally of other EU policies. Decisions on investment and social projects are taken in a decentralised way, by programme partnerships throughout the EU, and are influenced by guidelines adopted by the central EU institutions. In this way, the EU seeks to empower regions and cities to decide and implement their own “development policies” – more usually called programmes – whilst ensuring that decentralised decision-making takes place within the overall EU framework determined by its 2020 goals.
Experience in the EU and China is similar in this respect. Both see action against poverty to be central; both set poverty alleviation as a ten-year goal – the EU fixing a ten-year objective for 2020, China a ten-year objective in its Poverty Alleviation Plan (the next ten-year-plan being due for publication in 2011); both superimpose the ten-year goal on a five-year political cycle – the EU’s five-year programmes for each session of the European Parliament, China’s Five Year Plans; and both seek a decentralised implementation of anti-poverty policy. Yet, currently, it is China which seeks the greater decentralisation. In the 1980s, its poverty-alleviation policy connected the centre to the provinces (the provinces being roughly equal to the EU’s member countries), while the EU was more ambitious and connected the centre to its regions, cities, parts of cities and, even, villages through rural development policy’s LEADER initiative. Since then, China has sought to extend the delivery of its anti-poverty policy to its villages, which may have a population of three or four thousand people or less, charging villages with the task of targeting support on the poorest families. At the same time, EU Cohesion Policy, in the name of “simplification”, has retreated from trying to connect the EU centre to its citizens, seeking only to connect the EU centre to member countries or regions.

This “simplification” has costs. One is the lost “visibility” of the policy, or the lost “solidarity” between the EU and its citizens, both in metaphorical and actual terms. EU citizens become unaware that the policy is supporting their efforts to improve the quality of their lives – for example, in many member countries, citizens are unaware that their training courses are part-financed by the EU through the ESF, or that improvements in their locality are part paid by the EU through the ERDF. Another is the erosion of one of the founding principles of EU Cohesion Policy, which remains valid, the principle that the “integration” of EU, national and regional policies increases their mutual effectiveness and value for money. An important element of the 1989 vision for the policy was that it would knit together a range of policies to boost the incomes and employment of citizens in those parts of the EU economy which were in economic difficulty, either because they consistently lagged behind the rest of their member country or the EU as a whole, or because they were facing industrial or rural restructuring.

In an effort to partially restore a degree of policy integration, the EU has introduced mechanisms – first, the Lisbon agenda (the conclusions adopted by the European Council in Lisbon in 2000) and then the Lisbon Treaty – which seek to integrate EU, national policies, and, to a lesser extent, regional policies. But these efforts are less successful at integrating policies “on the ground”.

- It would be comparatively easy for the EU to regain this connection to its citizens, to promote the EU’s visibility and to emphatically state its determination to reduce poverty and increase employment, if it were to restore EU Cohesion Policy initiatives like URBAN (for urban development), EQUAL (for social actions), LEADER (for rural development) alongside initiatives like Regions for Economic Change (which promotes new approaches to old economic problems) and INTERREG (which promotes cross-border programmes). Such a decision would not require the EU to abandon its quest for policy simplicity. It should seek simpler administrative arrangements for these initiatives and
so lighten the burden on national, regional and local administrations.

Such a restoration should take place within an approach which explicitly seeks to connect EU Cohesion Policy to EU citizens, and their needs and wishes, and which seeks to restore to the policy its ability to experiment and innovate in its methods of implementation. The loss of this ability – unwittingly eroded by the incremental increase of administrative and financial controls – is reducing both the policy’s value-for-money and its ability to respond to changing political priorities and emerging problems. There is a balance to be struck between the two “offers” of EU Cohesion Policy: the offer to member countries and regions of a longer-term framework in which to plan and programme economic and social development; and the offer to EU and member country political leaders that EU Cohesion Policy can help them bring attention to bear on emerging difficulties and changes in economic and social circumstance. “Events” provide constant reminders that this balance has been lost with the effect that EU Cohesion Policy appears unresponsive to new expressions of the needs of citizens and that, although it plays a key role in the EU’s armoury of economic instruments, it is losing its relevance in the EU’s political armoury.

Annex

**Ratio between top and bottom regions in terms of GDP per head, covering 25% of population in each case**

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<tr>
<th></th>
<th>EU</th>
<th>Brazil</th>
<th>NAFTA</th>
<th>Russia</th>
<th>USA</th>
<th>India</th>
<th>Mexico</th>
<th>China</th>
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<tr>
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<td>3.6</td>
<td>4.5</td>
<td>4.9</td>
<td>1.5</td>
<td>3.4</td>
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Chapter II. Some Notes on EU Cohesion Policy

By Thomas Wobben

This chapter brings together a series of notes in order to provide background information for later chapters in this report. It begins with a brief history of European Union (EU) Cohesion Policy. Its second part provides a preview of Chapters X, XI and XII of this report by outlining the relationship between Cohesion Policy and two other EU policies – competition policy, which works in tandem with Cohesion Policy and regulates the size and scope of subsidies which can be given for regional development (Chapter X), and policies for environmental protection and against global warming, which use Cohesion Policy as a financial instrument in achieving their own policy goals (Chapters XI and XII). The third section raises an issue of a different nature and asks whether Cohesion Policy’s binary classification of regions – into the poorer Convergence regions and the rest, which are all considered as Competitiveness and Employment regions – is the classification best suited to the policy’s purposes. It suggests a new approach. (This section might be read in conjunction with Chapter IV, Section 6). The fourth, fifth, and sixth sections of this chapter discuss governance aspects of EU Cohesion Policy. After a brief discussion of its multi-level governance structure (Section 4), the chapter offers notes on Cohesion Policy’s implementation, or delivery, mechanism, first from the viewpoint of the centre (Section 5), then from the viewpoint of an individual region, taking the German Land of Saxony-Anhalt as an example (Section 6).

1. The emergence of Cohesion Policy in the European Union: a brief history

EU Cohesion Policy has two histories – a short history and a long history. The short version begins in 1989 when the policy and its method of working benefited from a root-and-branch reform, so great that it can be classified as revolutionary. The changes which came into effect on 1 January 1989 integrated two components (regional policy and labour market policy) and operated in a decentralised way. The regional component aimed to support investments in basic and productive infrastructure and, for the first time, could use public resources to subsidise private investment. The labour market component aimed to improve skill levels and raise the rate of employment. Both were to be implemented through partnerships of national, regional and local economic and social actors. In one step, the EU had acquired a policy for its economic development in place of two distinct funds which did not operate in an integrated way, and, since that time, the policy has continued to change in response to changes in the EU economy. The longer history of the policy, however, covers fifty years, rather than twenty-one, and allows a more considered view of how Cohesion Policy has developed to become one of the key pillars of the EU integration process; one of the Union’s three policies for economic growth; and one that has often constituted a central tenet of the relations between member countries and the other EU institutions.

The long history of EU Cohesion Policy can be simplified into five phases.

a) 1957-73: the beginnings of regional policy
The founding in 1957 of the European integration process, which was eventually to lead to the European Union, gave little priority to the question of Europe’s economic and social cohesion. The main mission of the Treaty of Rome, which established the European Economic Community (EC), was the setting up of the Common Market by eliminating customs laws and by setting up common customs tariffs. It foresaw the creation of a common agricultural policy and the abolition of obstacles to the free circulation of people, services and capital between the Member States.

Even though the Treaty of 1957 included in its preamble the overall aim of the founding members “to strengthen the unity of their economies and to ensure their harmonious development by reducing the differences existing between the various regions and the backwardness of the less favoured regions”, it provided little by way of instruments and resources for achieving this goal. Cohesion was rather seen as a by-product of the successful completion of the Common Market.

But the Treaty already included three important elements for the future design of cohesion policy:

- competition policy
- the establishment of the European Social Fund (ESF); and
- the creation of the European Investment Bank (EIB).

In Article 92 of the Treaty, the founding members agreed upon a widespread limitation of state aids to avoid distortions of competition in the Common Market. Exceptions were made – among others – only for “aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious unemployment” (Article 92(3)(a)). This restriction on state aid in the EC was designed to allow a concentration of such aid in low-income regions and member countries and was intended to avoid – in attempts to attract inward investment – state aid “bidding wars” between poorer and richer regions or, even, between richer regions themselves.

In addition the Treaty foresaw in Article 123 the creation of the ESF as a tool “to improve the employment opportunities for workers in the Common Market.” From 1960 onwards the focus of the ESF was on increasing labour mobility by supporting “vocational retraining and resettlement allowances” as well as employment support. This instrument was designed to improve the mobility and adaptability of labour in the Common Market, thus contributing to higher employment rates and the higher rates of labour productivity which were essential for faster economic growth.

In Article 130 the EIB was set up with the aim of contributing to the “balanced and steady development of the common market” by financing “projects for developing less-developed regions” and modernising and converting undertakings of common interest for several Member States. The EIB role was to provide the necessary capital for financing projects in the less developed parts of the EC.

b) 1974-88: setting up the European Regional Development Fund

The enlargement of the EC in 1973 to include the United Kingdom (UK), Denmark and Ireland opened a new chapter of Cohesion Policy. Of the three new members, the UK saw little national advantage from the common agricultural policy – its
agricultural sector was structured differently from those of the other member countries; it was far from self-sufficient in food production; its consumers were accustomed to pay low, world-market prices for their food; and the policy needed a high-level of EC funding. The UK argued in its accession negotiation that it would be paying into the common agricultural policy more than it would receive – giving it a considerable disadvantage. The UK faced a bigger burden than other member countries in restructuring old industries such as coal and steel, and was interested in the creation of a European Regional Development Fund which would focus on using EC budget resources to help regions lagging behind and to restructure the economies of industrial regions in decline. The member countries reached a political agreement in Paris in December 1973 – on the eve of the EC’s first enlargement – to create a fund for the economic development of less well-off regions and the European Regional Development Fund (ERDF) was formally set up in December 1974, becoming operational in 1975 for a first funding period which would last until the end of 1977. The EC now had the two Funds which would later constitute two of the funding instruments for its Cohesion Policy in 1989, the ERDF and the ESF.

But the initial idea that the ERDF would be the financial instrument for a policy of industrial restructuring was only partly achieved. The agreement establishing the Fund did make clear that it would operate in those regions in which state aid was possible, according to Art. 92(a) of the European Treaty’s Competition Policy. There would, therefore, be coherence between the Fund and EC Competition Policy. But agreement to establish the ERDF was only possible on the basis that it would operate through a system of national financial quotas and this proved to be a major handicap in the Fund’s ability to support industrial restructuring. It also undermined the ability of the Fund to be a financial counterweight to the common agricultural policy, which had been one of the original intentions. The consequence was that the EC continued to evolve in a lopsided way, reflected by the common agricultural policy’s domination of the budget.

The evolution of the Fund into a policy – and into a budget counterweight to agricultural policy – was to be long and the role of the European Commission in its implementation grew only slowly between 1975 and 1987. Gradually, however, the dominant practice – to rubber-stamp investment projects which had already been approved by the member country government concerned, which had the effect of depriving the ERDF of any additional value – began to weaken. The European Commission increased the share of the ERDF which it administered outside the national quota system and began to experiment with the decentralised operation of regional economic development programmes, in place of single projects decided by member country governments. It was taking its first steps towards the programme planning approach which would characterise EU Cohesion Policy.

c) 1988-93: the birth of European Cohesion Policy

One of the first achievements of the EC had been the elimination of internal tariffs and the harmonisation of external tariffs on trade. But the common market was still fractured by non-tariff barriers. From the mid-1980s the EC set as priority task the completion of its internal market – in effect, it embarked on its own “internal globalisation” – and in the period 1988-93 Cohesion Policy became a key aspect of this “internal globalisation”. Several member countries feared that a genuine internal
market would threaten their economic well-being by exposing their businesses to irresistible competition and they pressed for a policy which would help them to restructure their economies and thus fight off any economic ill effects of the internal market. Cohesion Policy, as a policy with a range of its own financial instruments, was born.

The Single European Act (SEA) of 1986 gave for the first time in its Article 130(a–e) comprehensive definitions of the aims and objectives of a EC-level Cohesion Policy. Furthermore, it spread the objective of cohesion to all other EC policies by declaring that “the implementation of the common policies and of the internal market shall take into account [the cohesion objectives] and shall contribute to their achievement.” At EC level, the ERDF, the ESF and the European Agricultural Guarantee and Guidance Fund (EAGGF) Guidance Section, as well as the EIB, were identified as the key financial instruments for the implementation the policy.

The SEA also gave the European Commission a mandate for the comprehensive reform of existing policies for economic restructuring and, from January 1989, the new Cohesion Policy would be administered according to a new set of five principles. (These are also discussed in Section 5b below as part of a review of the delivery mechanism for EU Cohesion Policy.)

- **Concentration.** The aim is to increase the critical mass of available funding by focussing regional development efforts on a limited number of regions (while concentrating most resources on those regions lagging behind the Community’s average performance, measured by GDP); and a limited number of investment and training priorities. At its beginning, Cohesion Policy was built on three geographical objectives (targeting less-favoured regions; those industrial regions which were structurally weak and undergoing change; and rural regions) and two objectives geared to helping people to perform better in labour markets. In addition, it had fourteen Community initiatives, covering special problems.

- **Partnership.** The central plank of decentralised management is to involve national, regional and local level authorities and special interest groupings in the planning and implementation of regional policy programmes, with the decentralised partnerships taking funding decisions for individual investments and training actions. Decentralised management, in effect, offers these national, regional and local level partnerships the opportunity to formulate and implement their own economic development policies for their areas.

- **Addinality.** A key element in Cohesion Policy’s effectiveness is that its finance should be extra to that provided by the member country or regional government and not simply a replacement of national or regional finance – in other words, Cohesion Policy co-finance should be additional. This is an important support for the principle of concentration in increasing the mass of financial
resources available for the economic development of needy regions.

- **Programming.** Cohesion Policy works through fixed-term, multiannual regional, or national, development programmes which integrate actions for investment with those for training and allow for synergy effects between various instruments at national and European level. The fixed-term of programmes uses time as another element of concentration. Also each programme concentrates its financial resources on development priorities – investment and training actions which are considered to be essential for the economic development of the region in question. This becomes another element in the effort of concentration.

- **Co-finance.** From the very beginning of the European Social Fund and the European Regional Development Fund, the EU rarely provides all of the finance necessary for an investment or training action. Instead it provides a proportion – which may sometimes be 100 per cent for some actions in Convergence regions but is more often no higher than 80 per cent, whilst in Regional Competitiveness and Employment regions it will be less than 50 per cent. This rule was not changed in 1989 but the new regulation made it possible for the other share of funding to come from either national public or national private sources. This practice has a number of advantages for EU Cohesion Policy: it increases the mass of finance available for economic development in needy areas and so supports the effort of concentration; it ensures that the EU and member countries work together and in harmony to tackle economic difficulties; it ensures that the EU and member countries work together to achieve the best value, in terms of economic impact, for the resources they invest.

Following the adoption of the SEA, funding for Cohesion policy was doubled from €7.2 billion 1987 to €14.5 billion in 1993.

d) 1994-99: preparing for the single currency

The next phase in the development of Cohesion Policy at European level took place between 1994 and 1999 and is linked to preparations for the introduction of the €, as the EU’s single currency.

Just as in the mid-1980s when the EU accelerated towards the achievement of its single market, the push towards the EU single currency again aroused fears for the economic development of the less well-off parts of the Union. A number of member countries with weaker economies argued that adoption of the single currency would rob them of one of their principal economic policy instruments, the possibility to vary their exchange rates, and that, consequently, it risked slowing down their development. An extra financial instrument for Cohesion Policy was therefore created by the Maastricht Treaty with the intention of helping member countries, whose GDP
was below 90 per cent of the EU average, to keep their economic development on track. This was the Cohesion Fund. This Fund is applied at the level of member countries rather than at the level of regions and is designed to subsidise national investments in transport infrastructure and environmental projects. In this way the Fund helps beneficiary countries to offset the effect of the restrictions on their public deficits imposed by the single currency’s fiscal convergence criteria.\textsuperscript{24}

Furthermore, the European Commission was given the task to “submit a report … every three years on the progress made towards achieving economic and social cohesion and on the manner in which the various means provided for in this Article have contributed to it.” The Cohesion Report has become a major element in planning the future development of Cohesion Policy, frequently being used to sketch out policy options for the next phase of the policy’s evolution.

During this period, the accession negotiations with Austria, Sweden, Norway and Finland resulted in the addition of a new objective for the sparsely populated regions in Northern Europe. At first, this new objective was managed as a distinct entity within Cohesion Policy but it is now merged into the Convergence Objective. Although accession negotiations were carried out with Norway, the country withdrew its application for membership and is still not a member of the EU.

Financial resources allocated to the Cohesion Policy continued to increase, reaching €141.4 billion for the period 1994-99.

e) 2000-08: enlarging the Union with twelve new member countries

This latest phase of EU Cohesion Policy was marked by the preparation and implementation of the biggest-ever enlargement of the European Union. It was dominated by two fundamental debates: how to overcome, on the one hand, the political divide in Europe; and how to deal, on the other, with the apparent lack of willingness of richer Member States to finance this enlargement in a similar way to earlier enlargement rounds.\textsuperscript{25}

\textsuperscript{24} Payment of cohesion fund is however conditional and can be withheld on the basis that excessive government deficit exists in a beneficiary Member State, and that the Member State concerned has not taken effective action.

\textsuperscript{25} The legal framework of the current EU Cohesion Policy is currently defined in the Union’s primary and secondary legislation. The primary legislation at European level contains the following references:

\textbf{Article 3 of the Treaty on the European Union:}

The Union “shall promote economic, social and territorial cohesion, and solidarity among Member States.”

\textbf{Article 174 of the Treaty on the Functioning of the European Union:}

“In order to promote its overall harmonious development, the Union shall develop and pursue its actions leading to the strengthening of its economic, social and territorial cohesion.

In particular, the Union shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions. Among the regions concerned, particular attention shall be paid to rural areas, areas affected by industrial transition, and regions which suffer from severe and permanent
The debate for some member countries became focussed on the purely financial aspects of Cohesion Policy reform. The compromise which was eventually found fixed the 2000-06 budget for Cohesion Policy at a total of € 213 billion with a further € 47 billion designated for the new member countries after their accession in 2004.

The biggest policy change was to begin to make more explicit the link between EU Cohesion Policy and the objective of making the EU economy one of the most competitive locations in the world – an objective which the member countries had set themselves at a summit in Lisbon in 2000. To ensure that the this objective was by all parts of EU Cohesion Policy’s decentralised management system, each programme was asked to “earmark” a certain part of its finance which would be used to co-finance investments in priorities like innovation, human resource development and education. This marked the recognition of Cohesion Policy as a growth-oriented policy for EU regions.

Finance for Cohesion Policy for the period 2007-13 was set at € 304 billion at 2004 prices. Taking account of the changes in the value of the Euro which have taken place since 2004, the 2007-13 financial envelope for Cohesion Policy is now above € 350 billion.

The signing of the Lisbon Treaty in October 2007 opened a new chapter of Cohesion Policy with its coverage being extended to include territorial cohesion. It still remains unclear as to how this addition will affect the future design of cohesion policy.

f) 1988-2007: simplifying the policy’s implementation mechanism

natural or demographic handicaps such as the northernmost regions with very low population density and island, cross-border and mountain regions.”

This aims and objectives of EU Cohesion Policy are then further elaborated in secondary legislation:

- Inter-Institutional Agreement between Commission, European Parliament and the European Council (OJ C 139, 14.06.2006) providing the framework for a multi-annual programming in general and of cohesion policy in particular;
- Regulation on the General Provisions (Regulation 1083/2006 (OJ L 210 31.07.2006)) defining the overall conditions of the implementation of Cohesion Policy regarding the ERDF, ESF and Cohesion Fund;
- Regulation on the ERDF (Regulation 1210/2006 (OJ L 210, 31.07.2006)); and
- Regulation on the ESF (Regulation 1081/2006 (OJ L 210, 31.07.2006)); and
- Commission Regulation on the Implementation Provision elaborating the detailed rules and regulations for implementing development programmes.
- Based on the decision on the Regulation for the General Provisions of Regional Policy further decisions were taken regarding eligibility for the Convergence Objective, Phasing In and Cohesion Funds (OJ L 243, 6.09.2006) and the financial allocation for the Convergence, Competitiveness and Co-operation Objectives (OJ L 243, 6.09.2006 as well as OJ L 247, 9.9.2006).

Furthermore the European Commission is called upon, by an obligation of the Treaty on the functioning of the European Union (Art. 175), to provide a comprehensive report on economic, social and territorial cohesion – what has become known as the Cohesion Report – every three years. Over the past years the European Commission also introduced so-called progress reports to cover years between the three-yearly Cohesion Reports to focus on current aspects of cohesion policy.
This brief sketch of the history of EU Cohesion Policy reveals the efforts which have been made to adapt the policy to meet changing economic conditions. But it does not show clearly enough the parallel effort – which began in the mid 1990s and which continues – to simplify its management. This has led policy-makers to reduce the number of Cohesion Policy programmes by merging and reducing its separate objectives and its special Community initiatives which it used to tackle particular problems (for example, the economic reconstruction of former coal, steel, shipbuilding and textile areas; the encouragement of R&D as a development tool; the redevelopment of former military bases after the reunification in Europe; encouragement of social innovation; rural development). The four programming periods since the reform of the policy in 1989 have resulted in the following evolution of programme mechanisms.

- **1988 – 1993:** 5 objectives and 14 community initiatives, with 3 Funds;
- **1994 – 1999:** 6 objectives and 6 community initiatives with 4 Funds, adding the Cohesion Fund
- **2000 – 2006:** 3 objectives and 4 community initiatives with 4 Funds, plus the Solidarity Fund to assist regions in their recovery from natural or man-made disasters;
- **2007 – 2013:** 3 objectives with 3 Funds (since the Fund for rural development was re-integrated into the Common Agricultural Policy) plus the Solidarity Fund and, in addition, a new Globalisation Adjustment Fund to help regions to carry out industrial restructuring made necessary by the effects of globalisation.

The current period, in effect, uses just two objectives to tackle the mainstream problems of economic development – the Convergence objective which channels 80 per cent of Cohesion Policy finance to the poorest regions, those with an income per head of population lower than 75 per cent of EU average GDP – and the Regional Competitiveness and Employment objective, which covers all other regions. Discussions are still going on about the full effects of some of these changes, with critics saying they have reduced Cohesion’s Policy to experiment and, therefore, innovate and that they have made it less accessible to EU citizens, and especially civil society.

### 2. Interaction with other EU policies

EU Cohesion Policy has to take into account the rules and regulations of other EU policies laid down in the so-called “acquis communautaire” – the name given to the body of Union legislation which all member countries agree to apply. At the same time these other policies should contribute to the overall cohesion objectives of the European Union.

The link between EU Cohesion Policy and other EU policies can be illustrated by looking at the link between
- EU Competition Policy and Cohesion Policy; and
- EU Environmental Policy and Cohesion Policy.
a) Cohesion and Competition Policy

EU state aid policy is based on Article 107(1) of the Treaty on the Functioning of the European Union. This article declares that state aid is, in principle, incompatible with the common market. Article 108 of the Treaty gives the task to the Commission to control state aid. This article also requires member countries to inform the Commission in advance of any plan to grant State aid (“notification requirement”).

Articles 107(2) and 87(3) of the Treaty specify a number of cases in which state aid could be considered acceptable (the so-called “exemptions”).

Article 107(3)(a) covers “aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment”;

Article 107(3)(c) refers to “aid to facilitate the development of certain economic activities or certain economic areas, where such aid does not adversely affect trading conditions contrary to the common interest”.

Depending on the size of the firm, the industry concerned, its location and other matters, the Commission has developed specific approaches. In order to ensure transparency, predictability and legal certainty the Commission has made public the criteria it uses when deciding whether aid measures which are notified to it by member countries qualify for exemption. These publications have taken the form of regulations, “communications”, “notices”, “frameworks”, “guidelines”, and letters to member countries.

Three main aid categories under Articles 107(3)(a) and 107(3)(c) of the Treaty can be distinguished:

Regional aid: Articles 107(3)(a) and 107(3)(c) of the Treaty both provide a basis for the acceptance of State aid measures aimed at tackling regional problems. Article 107(3)(a) of the Treaty applies to State aid to promote the development of “areas where the standard of living is abnormally low or where there is serious underemployment”.

Compatibility between EU Competition Policy and EU Cohesion Policy is assured by using the same criteria to determine eligibility for special treatment. Thus, eligibility status under Article 107(3)(a) and eligibility for Cohesion Policy’s Convergence objective is currently granted to those NUTS II regions27 which have a GDP per head (PPS) lower than 75 per cent of the EU25 average (excluding Romania and Bulgaria from EU27 since they only acceded to the Union on the first day of the current 2007-13 programming period. For the period 2007-10, regions with less than 75 per cent of the EU15 average GDP per capita (PPS) are also eligible under Article 107(3)(a).

Article 107(3)(c) of the Treaty covers aid to other types of (national) problem regions – “aid to facilitate the development of … certain economic areas”. This article gives

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26 The interaction between EU Cohesion Policy and EU Competition Policy os fully discussed below in Chapter X of this report.
27 The classification system for EU regions is more fully discussed below in Chapter III.
member countries the possibility to assist regions which are disadvantaged compared to the national, rather than the EU, average. The list of regions qualifying for this exemption is also decided by the Commission, but on a proposal by member countries. Member countries may use national criteria to justify their proposal.

The criteria used for the assessment of regional aid are brought together in the “Guidelines on national regional aid for 2007-2013”.

Other horizontal rules: Cross-industry or “horizontal” rules set out the European Commission’s position on particular categories of aid that are aimed at tackling problems which may arise in an industry and region. The Commission has adopted “frameworks”, “guidelines” or “block exemption regulations” setting out the criteria that are to be applied to the following categories of aid:

- aid for small and medium-sized enterprises;
- aid for research and development and innovation;
- aid for environmental protection;
- aid for risk capital;
- aid for services of general economic interest;
- aid for the rescue and restructuring of firms in difficulty;
- aid for employment; and
- training aid.

Sectoral rules: The Commission has also adopted industry-specific or “sectoral” rules defining its approach to State aid in particular industries. The most relevant in this context are:

- general sectors;
- agriculture, forestry, fisheries and aquaculture; and
- transport.

For the use of specific aid instruments such as guarantees, fiscal aid, capital injections, or for the calculation of the aid content of a measure, guidance has been provided through the publication of a number of notices which the European Commission has made publicly available.

Procedural questions: Community supervision of state aid is based on a system of ex-ante authorisation. Under this system, member countries are required to inform (“ex ante notification”) the Commission of any plan to grant or alter state aid and they are not allowed to put such aid into effect before it has been authorised by the Commission (“Standstill-principle”). Under the Treaty, the Commission is given the competence to determine whether or not the notified aid constitutes State aid in the sense of Article 107(1) of the Treaty, and if it does, whether or not it qualifies for exemption under Article 107(2) or Article 107(3) of the Treaty.

Member countries cannot grant any state aid unless it is notified to, and authorised by, the Commission. Any aid, which is granted in the absence of Commission approval, is automatically classified as “unlawful aid”. Under the present procedural rules, the Commission is under the obligation to order the recovery from the beneficiaries of any unlawful aid that is found to be incompatible with the common market. Moreover, the European Courts have recognised that national judges are competent to decide
whether the notification procedures have been complied with and if not, to order recovery of the aid.

The operational programmes under the structural funds for 2007-13 contain a standard form clause indicating “any public support under this programme must comply with the procedural and material state aid rules applicable at the point of time when the public support is granted”. It is the responsibility of the authorities who manage EU Cohesion Policy development programmes – called the “managing authorities” in the Cohesion Policy regulations – to ensure that this condition is fulfilled.

**Aid intensities:** Depending on the wealth of the affected regions, maximum aid intensities for initial investment vary across the EU.

<table>
<thead>
<tr>
<th>Regional GDP as % of EU-25 GDP</th>
<th>Maximum aid rates for large companies</th>
<th>Aid rates in the EU outermost regions*</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt; 75%</td>
<td>15%-10%</td>
<td>40%</td>
</tr>
<tr>
<td>&lt;75%</td>
<td>30%</td>
<td>50%</td>
</tr>
<tr>
<td>&lt;60%</td>
<td>40%</td>
<td>60%</td>
</tr>
<tr>
<td>&lt;45%</td>
<td>50%</td>
<td>n/a</td>
</tr>
</tbody>
</table>

*The EU’s outermost regions are the Canary Islands, the Azores, Martinique, Guadeloupe, La Guyane, La Réunion

So-called ‘statistical effect regions’ – which have less than 75 per cent of EU15 GDP but more than 75 per cent of EU25 GDP (3.6 per cent of EU25 population) – will benefit from transitional status and qualify for the lowest rates of aid under Article 107(3)(a) of the Treaty, with a 30 per cent aid rate for large companies until 31 December 2010. The situation of these regions will be reviewed in 2010. If their situation has declined, they will continue to benefit from Article 107(3)(a) of the Treaty. Otherwise, they will be eligible under Article 107(3)(c) of the Treaty with an aid rate of 20 per cent, as from 1 January 2011. The eligible areas are identified in the regional aid maps for each member country published by the European Commission.

Transitional arrangements are foreseen until 2010 for regions suffering the biggest reductions in aid intensities and, until 2008, for regions losing eligibility under the new aid guidelines.

For large investments the regional aid intensity ceiling is reduced as follows:

- For the part of the eligible cost between € 50 million-€ 100 million, the intensity is reduced to 50 per cent of the regional aid ceiling.
- For the part of the eligible cost exceeding € 100 million, the intensity is reduced to 34 per cent of the regional aid ceiling. With the exception of large investment projects, aid intensities can be increased in all assisted areas by 20 per cent where aid is given to small enterprises and 10 per cent where it is given to medium sized enterprises. No SME bonus is permitted for large investment projects with eligible expenses over € 50 million.
EU Competition Policy and social and economic cohesion in the EU: The strict application of EU Competition Policy and the strong role of the Commission in this field is often a matter of concern and conflict with the various levels and parties involved. EU Competition Policy is often seen by local, regional or national governments as a stumbling block for awarding “essential” subsidies for attracting investment to the region.

This picture may, however, be misleading and is certainly not what policy-makers seek to achieve through Competition and Cohesion policies. The function of EU Competition Policy is to restrict the ability of stronger member countries and regions to hand out subsidies to companies so that those regions and member countries which are lagging behind may have a chance to attract, with their limited resources, the essential investments which they need for growth and employment in their territories.

It is also relevant that the role of direct grants, or subsidies, in attracting investment projects (especially Foreign Direct Investment) to a region or member country is overestimated. Often it ranks low down in the priority list of an investor. Other factors such as human capital provision, production conditions, and, above all, access to markets, are more important than subsidies. This means that there are still plenty of factors other than subsidies which determine the competitiveness and attractiveness of an investment location and which allow richer regions or Member States to stay successful in the race for inward investment, even if their ability to give direct subsidies is curtailed.

EU Competition policy seeks, therefore, to protect the poor from the rich and, by doing so, seeks to play an essential part in achieving balanced economic development. The compatibility between the two policies, however, is more fully discussed below (see Chapter X) and one of the conclusions will be that there is scope for improvement in the way the two policies work together.

b) Environmental Policy: Strategic Environmental Impact Assessment

Another policy which has a major impact on EU Cohesion Policy is the EU Policy for the Environment. The two policies are linked in a number of ways. The first is that all projects which are co-financed by the Cohesion Fund or Cohesion Policy’s development programmes must conform to environmental legislation and meet EU environmental standards. Most often this is a matter of routine, but occasionally the needs of economic development and environmental protection conflict when a sophisticated system of environmental compensation comes into play before the projects in question can be implemented. A second linkage is that a half of Cohesion Fund finance is used to co-finance investments in environmental infrastructures, while the Cohesion Policy development programmes do the same for a wide range and a large number of projects linked to all aspects of the environment.28

The Strategic Environmental Impact Assessment (SEIA) plays an important role in assuring compatibility between legislative standards and the programming and 28 The interactions between EU Cohesion Policy, EU Environment Policy and policy to reduce the effects of global warming are more fully discussed in Chapters XI and XII below.
implementation of EU Cohesion Policy. It will, therefore, be dealt with in some detail here.

The SEIA Directive applies to any plan or programme which comes within its scope of application as defined in its Articles 2 and 3. The exemption for plans and programmes co-financed by EU Cohesion Policy and the Cohesion Fund does not apply in the 2007-13 programming period, and both regulations 1083/2006 and 1698/2005 refer explicitly to the need to take environmental impact assessment (EIA) and SEIA legislation into account in the evaluations which are to be carried out for projects to be financed under the policy.

It follows that any of the current EU Cohesion Policy or Cohesion Fund plan or programme, which comes within the scope of the SEIA, requires assessment as provided for in the Directive. Therefore all Operational Programmes submitted to the European Commission for the current programming period contain a specific chapter on this matter.

Environmental assessment in accordance with the SEIA Directive contains the following elements:

- **The scope of the environmental report**: Environmental authorities designated by the Member State must be consulted when deciding on the scope and level of detail of the information which must be included in the environmental report (scoping) (Article 5(4)).

- **The preparation of the environmental report**: The report (which must be of sufficient quality) must contain the information that may reasonably be required (Article 5(2)) and its detailed contents are prescribed in Annex I of the Directive.

- **Carrying out consultations**: Once the draft plan or programme and the environmental report have been drawn up, the public and the environmental authorities must be given the opportunity to comment on the draft plan or programme and the environmental report (Article 6). The report and the results of consultations will be taken into account in the decision-making process.

- **Notification of decision**: The designated environmental authorities and the public (and any Member State consulted) must be informed of the adoption of the plan or programme and certain additional information (including how environmental considerations and the results of consultation have been taken into account) must be made available to them (Article 9).

- **Monitoring**: Monitoring is not included in the definition of environmental assessment in Article 2 but in its Article 10 the Directive requires the significant environmental effects of the implementation of the plan or programme to be monitored in

order, inter alia, to identify unforeseen adverse effects, and to be able to undertake appropriate remedial actions.

c) Experience in operating the SEIA

Even though the SEIA requires substantial actions at regional or national level, environmental NGOs are still critical of its implementation and integration. They claim that integration should not stay at a rhetorical level but should be part of the delivery mechanism of environment policy in the regions. Furthermore, they say that closer integration could promote synergies between the environment and regional economic development. They also argue that the SEIA contributes to finding a balance between the priorities for environmental protection and enhancement in a region and other development priorities.

An opposite view is presented by regional administrations and the managers of economic development programmes in EU member countries and regions. They say it is a matter of concern that the SEIA imposes an additional bureaucratic burden on the implementation of development programmes.

3. Does EU Cohesion Policy need a new category of regions?30

a) Transitional Regions

The current EU Cohesion Policy works on the basis of a binary classification of regions. There are the Convergence regions, which have an average income below 75 per cent of EU GDP per head, and the rest, which are brought together into the group called Regional Competitiveness and Employment. The Convergence regions receive 80 per cent of Cohesion Policy funding and the transition of a region from one group to the other can, quite suddenly, remove most of its support from EU Cohesion Policy and, also, the possibility of nationally financed support which would be acceptable under EU Competition Policy. This state of affairs is being questioned in connection with next-stage reforms of EU Cohesion Policy. Is it “safe” to abruptly reduce both EU and national support to poorer regions as they pass from 75 per cent to 75.1 per cent, for example, of EU average income without the danger that their economies will sink back? The present policy, in effect, answers this question in the negative because it contains ad hoc transitional arrangements to soften the blow. But would it not be better to transform these, at present, ad hoc – and therefore temporary – arrangements into a permanent framework which would allow public support in growing regions to be stepped-down in line with their development?

In the Fifth Interim Report on Social and Economic Cohesion published in June 200831, the European Commission grouped EU regions for the first time into three categories: Convergence; Transition; and Regional Competitiveness and Employment (RCE) regions, highlighting that each group has a distinct socio-economic profile. While the Convergence and the RCE regions largely represent the current binary classification, the classification of “Transitional Regions” is new and allows an

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30 This question is also discussed below in Section 6 of Chapter IV.
31 http://ec.europa.eu/regional_policy/sources/docoffic/official/reports/interim5_en.htm
analysis of the advantages and disadvantages of a more gradual approach to the phasing out of EU and national public support.

The European Commission listed under this “Transitional” classification all those regions currently part of the “Phasing In” or “Phasing Out” regime of the current EU Cohesion Policy (see below for definitions of “Phasing In” and “Phasing Out” regions).

**EU regions which may be included in the Transition category (European Commission definition).**

<table>
<thead>
<tr>
<th>Region</th>
<th>Population</th>
<th>GDP/Capita</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hainaut</td>
<td>1.284</td>
<td>79.50</td>
<td>Phasing-Out</td>
</tr>
<tr>
<td>Brandenburg-Südwest</td>
<td>1.405</td>
<td>83.80</td>
<td>Phasing-Out</td>
</tr>
<tr>
<td>Leipzig</td>
<td>1.077</td>
<td>86.20</td>
<td>Phasing-Out</td>
</tr>
<tr>
<td>Lüneburg</td>
<td>1.700</td>
<td>82.00</td>
<td>Phasing-Out</td>
</tr>
<tr>
<td>Kentriki Makedonia</td>
<td>1.911</td>
<td>77.90</td>
<td>Phasing-Out</td>
</tr>
<tr>
<td>Dytiki Makedonia</td>
<td>295</td>
<td>77.20</td>
<td>Phasing-Out</td>
</tr>
<tr>
<td>Attiki</td>
<td>3.958</td>
<td>131.10</td>
<td>Phasing-Out</td>
</tr>
<tr>
<td>Asturias</td>
<td>1.050</td>
<td>90.20</td>
<td>Phasing-Out</td>
</tr>
<tr>
<td>Melilla</td>
<td>67</td>
<td>91.30</td>
<td>Phasing-Out</td>
</tr>
<tr>
<td>Ceuta</td>
<td>71</td>
<td>93.50</td>
<td>Phasing-Out</td>
</tr>
<tr>
<td>Murcia</td>
<td>1.263</td>
<td>87.70</td>
<td>Phasing-Out</td>
</tr>
<tr>
<td>Basificata</td>
<td>597</td>
<td>74.30</td>
<td>Phasing-Out</td>
</tr>
<tr>
<td>Burgenland</td>
<td>277</td>
<td>88.70</td>
<td>Phasing-Out</td>
</tr>
<tr>
<td>Algarve</td>
<td>408</td>
<td>79.60</td>
<td>Phasing-Out</td>
</tr>
<tr>
<td>Highlands and Islands</td>
<td>372</td>
<td>N/A</td>
<td>Phasing-Out</td>
</tr>
<tr>
<td>Sardegna</td>
<td>1.647</td>
<td>80.10</td>
<td>Phasing-In</td>
</tr>
<tr>
<td>Merseyside</td>
<td>1.365</td>
<td>84.80</td>
<td>Phasing-In</td>
</tr>
<tr>
<td>Itä-Suomi</td>
<td>688</td>
<td>85.30</td>
<td>Phasing-In</td>
</tr>
<tr>
<td>CYPRUS</td>
<td>740</td>
<td>92.60</td>
<td>Phasing-In</td>
</tr>
<tr>
<td>South Yorkshire</td>
<td>1.278</td>
<td>92.70</td>
<td>Phasing-In</td>
</tr>
<tr>
<td>Canarias</td>
<td>1.887</td>
<td>93.70</td>
<td>Phasing-In</td>
</tr>
<tr>
<td>Notio Aigaio</td>
<td>303</td>
<td>94.40</td>
<td>Phasing-In</td>
</tr>
<tr>
<td>Valenciana</td>
<td>4.459</td>
<td>94.80</td>
<td>Phasing-In</td>
</tr>
<tr>
<td>Madeira</td>
<td>244</td>
<td>94.90</td>
<td>Phasing-In</td>
</tr>
<tr>
<td>Castilla y León</td>
<td>2.466</td>
<td>97.00</td>
<td>Phasing-In</td>
</tr>
<tr>
<td>Sterea Ellada</td>
<td>559</td>
<td>102.40</td>
<td>Phasing-In</td>
</tr>
<tr>
<td>Border, Midland and Western</td>
<td>1.084</td>
<td>104.30</td>
<td>Phasing-In</td>
</tr>
<tr>
<td>Közép Magyarország</td>
<td>2.835</td>
<td>104.90</td>
<td>Phasing-In</td>
</tr>
<tr>
<td><strong>Total(Mio.)</strong></td>
<td><strong>35.290</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

According to the European Commission analysis, Transitional regions have the same share of employment and GVA in the growth sectors of Construction and Trade, Transport and Communications as do RCE regions, but their share of financial and business services is much smaller. The difference between financial and business services in Transitional and RCE regions remains large.
The sectors of Construction and Trade, Transport and Communications grew at above average rates in the Transition Regions. In Transition Regions, the share of the Construction sector is much higher than in the other regional categories. This can be partly explained, before the current crisis, by their strong economic growth, rising incomes and the continuing need to upgrade some of their physical infrastructure. In some regions, the growth of Construction is also partially due to demand for second homes and tourist accommodation. The highly cyclical nature of this sector, however, leaves these economies vulnerable to a reversal in the direction of economic development as a result of a Construction recession.

The share of Industry is less important in Transition regions than in the other two categories.

Transition regions are catching up with RCE regions thanks to their strong performance in Construction and Trade, Transport and Communications, together with high and medium-high tech manufacturing. As a result, the economic structure of Transition regions is coming to resemble that of RCE regions. However, the question remains valid as to whether they have reached a stage of development which would allow financial support from the EU to be phased out sharply. Important differences in the economic structure of the three groups of regions remain – for example, the share of highly educated people aged 25-64 is considerably lower in Transition regions than in RCE regions, at 17 per cent and 25 per cent respectively. This has several implications from a policy point of view.

b) Need for further discussion on Transitional Regions in Europe

The initial analysis of the European Commission shows that:

- there are many reasons to investigate the specific challenges and needs of these Transitional regions in the future;
- on the basis of economic data reflecting their position before the financial crisis and the ensuing economic recession, the end of the current funding period will see almost all Convergence Regions in the EU15 Member States lose their Convergence status, raising the question of the future relevance of EU Cohesion Policy in EU15 countries;
- due to the dramatic changes in social and economic conditions, it can be observed that GDP growth in a number of current RCE regions has fallen below the EU rate so that these RCE regions are in danger of losing ground again and slipping back towards Convergence status.

Furthermore it has to be assessed and discussed whether the current definition of the European Commission for defining the “Transitional Regions” falls short of real needs.

Commissioner Hahn, the member of the EU Commission responsible for EU Cohesion Policy, recently suggested that Transitional regions might be defined as those regions which have a GDP per head between 75 and 90 per cent of EU GDP per head and that such regions should be entitled to specific support. But further details
of such support must remain unclear until the European Commission decides how to modify EU Cohesion Policy for post 2013. Another school of thought would define Transitional regions as having a GDP per head between 75 per cent and 100 per cent of the EU average. But, based on Commissioner Hahn’s definition and on the most recent EUROSTAT survey, the following regions would currently fall in the Transitional category.

**EU regions which may be included in the Transition category (Commissioner Hahn definition)**

<table>
<thead>
<tr>
<th>NUTS II Level Regions</th>
<th>Inhabitants 2006</th>
<th>GDP/Capita 2005</th>
<th>GDP/Capita 2006</th>
<th>GDP/Capita 2007</th>
<th>3 year average</th>
</tr>
</thead>
<tbody>
<tr>
<td>AT11 Burgenland (A)</td>
<td>279.317</td>
<td>84,0</td>
<td>82,1</td>
<td>81,4</td>
<td>82,5</td>
</tr>
<tr>
<td>BE32 Prov. Hainaut</td>
<td>1.290.079</td>
<td>78,6</td>
<td>77,1</td>
<td>75,3</td>
<td>77,0</td>
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<tr>
<td>BE33 Liège</td>
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<td>86,7</td>
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<td>BE34 Luxemburg (B)</td>
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<td>81,6</td>
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<td>80,4</td>
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<td>BE35 Namur</td>
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<td>81,5</td>
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<tr>
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<td>75,7</td>
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<tr>
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<tr>
<td>DE93 Lüneburg</td>
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<tr>
<td>DED1 Chemnitz</td>
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<td>81,1</td>
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<td>81,6</td>
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<tr>
<td>DED2 Dresden</td>
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<td>87,4</td>
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</tr>
<tr>
<td>DED3 Leipzig</td>
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<td>88,6</td>
<td>87,9</td>
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<tr>
<td>DEEO Sachsen-Anhalt</td>
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</tr>
<tr>
<td>DEG0 Thüringen</td>
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<tr>
<td>ES11 Galicia</td>
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<td>ES42 Castilla-la Mancha</td>
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<td>ES61 Andalucia</td>
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<tr>
<td>ES62 Región de Murcia</td>
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</tr>
<tr>
<td>Region</td>
<td>Population</td>
<td>Grade 2005</td>
<td>Grade 2006</td>
<td>Grade 2007</td>
<td>Grade 2008</td>
</tr>
<tr>
<td>--------------------------------</td>
<td>------------</td>
<td>------------</td>
<td>------------</td>
<td>------------</td>
<td>------------</td>
</tr>
<tr>
<td>FR22 Picardie</td>
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<td>FR25 Basse-Normandie</td>
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<td>88,3</td>
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<tr>
<td>FR30 Nord-Pas-de-Calais</td>
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<td>FR81 Languedoc-Roussillon</td>
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<td>FR83 Corse</td>
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<tr>
<td>FR92 Martinique (FR)</td>
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<tr>
<td>GR13 Dytiki Makedonia</td>
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<tr>
<td>GR25 Peloponnisos</td>
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<tr>
<td>GR43 Kriti</td>
<td>602,658</td>
<td>82,4</td>
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<td>83,7</td>
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<tr>
<td>ITF1 Abruzzo</td>
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<tr>
<td>ITF2 Molise</td>
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<tr>
<td>ITG2 Sardegna</td>
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<tr>
<td>PL12 Mazowieckie</td>
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<td>84,0</td>
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<tr>
<td>PT15 Algarve</td>
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<td>81,2</td>
<td>79,6</td>
<td>80,7</td>
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<tr>
<td>RO32 Bucuresti - Ilfov</td>
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<td>76,9</td>
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<td>84,3</td>
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<tr>
<td>FI13 Itä-Suomi</td>
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<td>85,3</td>
<td>88,8</td>
<td>86,3</td>
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<tr>
<td>UKC1 Tees Valley and Durham</td>
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<td>84,6</td>
<td>81,5</td>
<td>83,7</td>
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<tr>
<td>UKD1 Cumbria</td>
<td>496,200</td>
<td></td>
<td></td>
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<tr>
<td>UKD4 Lancashire</td>
<td>1,449,300</td>
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<tr>
<td>UKD5 Merseyside</td>
<td>1,365,022</td>
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<td>86,4</td>
<td>83,2</td>
<td>85,5</td>
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<tr>
<td>UKF3 Lincolnshire</td>
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<td>82,7</td>
<td>83,2</td>
<td>83,4</td>
</tr>
<tr>
<td>UKG2 Shropshire &amp; Staffordshire</td>
<td>1,513,600</td>
<td></td>
<td></td>
<td>89,0</td>
<td>89,0</td>
</tr>
<tr>
<td>UKK3 Cornwall and Isles of</td>
<td>515,493</td>
<td>76,3</td>
<td>77,6</td>
<td>75,2</td>
<td>76,4</td>
</tr>
</tbody>
</table>
It is immediately clear that more regions would be eligible for Transitional support under Commissioner Hahn’s definition than are eligible under the present ad hoc arrangements and that the eligible population would almost double (44 regions instead of 28; 66.6 million people against 35.3 million).

Any new Transitional regime, particularly for those regions which will lose their Convergence status at the end of the current funding period will be assessed in light of the existing transitional arrangements:

- the so-called transitional support for “Phasing In” regions, which crossed the 75 per cent GDP per head threshold before the current funding period as a result of their own economic performance, lasts for 3 years. Then, the intensity of EU Cohesion Policy financial support is gradually reduced from the level of 80 per cent of the previous allocation in 2006 to the level of the Regional Competitiveness (RCE) Objective in 2010. This amounts to a reduction of approximately 66 per cent of the previous allocation over the funding period.

- the so-called transitional support for “Phasing Out” regions, which only crossed the 75 per cent GDP per head threshold due to the “statistical effect” of EU enlargement, which suddenly lowered EU average GDP per head, lasts for seven years. Their support runs from 80 per cent of the previous allocation in 2006 to the aid intensity of the Regional Competitiveness (RCE) Objective at the end of the funding period in 2013, resulting in a reduction of approximately 50 per cent of the previous allocation.

- the so-called transitional support for “Phasing Out plus” regions in Germany and Greece which had their support cut from 80 per cent of the previous allocation in 2006 to 50 per cent in 2013, which represents a reduction of about 35 per cent.

4. Multi-level governance

a) Definitions of multilevel governance

As a first step in a discussion of the models and experiences of regional administration, or governance in the EU, it may be useful to consider some of the ways in which governance has been defined. “Governance” denotes the concept of “steering” in Greek and Latin 32, while “government” describes the power over something in a hierarchical sense. Governance, therefore, is mainly seen as the

32 More on the etymology of this word can be found at:http://ec.europa.eu/governance/docs/doc5_fr.pdf
decision-making process and the range of mechanisms through which policy decisions are implemented.

Governance occurs in four broad ways, through:

- top-down methods that primarily involve government and the state’s bureaucracy;
- multi-layer governance in political systems with several levels of government – for example, EU, national, regional, local; or, in China, national, provincial, municipality, township, village;
- the use of market mechanisms whereby market principles of competition serve to allocate resources while operating under government regulation; and
- networks involving public-private partnerships (PPP) or with the collaboration of community organisations.

The last three aspects in the most above are all features of EU Cohesion Policy.

Governance has been given slightly different meanings by the United Nations (UN), the OECD and the EU. According to the UN, governance has a number of meanings. When it is applied to the rules of the political system, it refers to issues of ‘legality’. When it is applied to the “proper functioning of institutions and their acceptance by the public”, it refers to ‘legitimacy’. And when it used to evoke the efficacy of government and the achievement of consensus by democratic means, it refers to ‘participation’. The OECD defines public governance as “the formal and informal arrangements that determine how public decisions are made and how public actions are carried out, from the perspective of maintaining a country’s constitutional values as problems, actors and times change”.

The UN Economic and Social Commission for Asia and the Pacific has gone one stage further and defined ‘good governance’, which it understands as a set of eight major characteristics:

- participation;
- rule of law;
- transparency;
- responsiveness;
- consensus orientation;
- equity and inclusiveness;
- effectiveness and efficiency; and
- accountability.

The presence of these characteristics would ensure that the views of all stakeholders were taken into account in implementing policy; that the voices of the most vulnerable in society were heard in decision-making; and also that corruption was minimised.

The EU White Paper on Governance of 2001 presented five principles of good governance: openness, participation, accountability, effectiveness and coherence and said they applied to all levels of government – global, European, national, regional and local. Based on the specific construction of the EU this includes “governance
across all levels of government” – or “multilevel governance” – which is of considerable importance in territorial policy-making. The EU’s Committee of the Regions (COR) recently published its own White Paper on multi-level governance\textsuperscript{36} in which it considers multilevel governance to mean coordinated action by the European Union, the Member States and local and regional authorities, based on partnership and aimed at drawing up and implementing EU policies.

b) Governance of regional policy and regional administration

With regard to the more specific focus on the governance of regional policy and regional administration, multi-level governance means:

- the system and legal framework for the planning, development, implementation and evaluation of regional policy;
- the arrangements between all levels of government and their involvement in policy implementation;
- the inclusion of all relevant stakeholders in order to achieve an efficient and effective implementation of regional policy targets.

5. The delivery mechanism for EU Cohesion Policy – the centre

a) The principles which underlie EU Cohesion Policy

The EU governance model for its Cohesion Policy, which aims to reduce income disparities between regions and to create sustainable employment, is an example of multilevel governance and is based on the shared responsibility of the local, regional, national and European levels of government. Since each of these levels of government carries out policies which have a direct effect on regions in Europe, one key aspect of this governance model is to provide a framework of dividing responsibilities, to enable solidarity between the richer and poorer members of the European Union and to ensure the efficient delivery of the policy.

EU Cohesion Policy seeks to achieve these objectives through a system of implementation, or a delivery mechanism, based on a number of principles (which were first referred to in Section 1c of this chapter, see above).

- Multi-annual programming imposes a policy cycle beginning with general guidelines laid down by the EU Council of Ministers; includes the elaboration of regional development programmes; and goes down to the grassroots where projects are assessed, decided and, if successful in applying for EU funding, monitored. The length of the multi-annual period has varied since the inception of the EU’s modernised Cohesion Policy in 1989 – covering five, six and seven years. But, whatever the length of the period chosen, the multi-annual period has brought the advantage of medium-term budget certainty, permitting regions to thoroughly plan and programme their economic development. An important reason for developing permanent transitional arrangements is to create this

\textsuperscript{36} CdR 89/2009 fin
programming environment of “certainty” for regions which are still in a delicate stage of growth.

- **Concentration of financial resources** achieves maximum impact for the financial resources available to EU Cohesion Policy. The concentration is achieved in four ways:
  - by allocating more intensive aid to the worst off regions of the EU, so that about 80 per cent of the policy’s funding is used to co-finance investment and training in the worst-off, or Convergence, regions;
  - by maintaining the practice of co-financing so that EU financial resources for physical investments and training are “matched” by a contribution from national public or private sources; in the regions eligible under the Regional Competitiveness and Employment objective, this practice of “matching” EU resources may double the amount of finance available for EU Cohesion Policy programmes; this “leverage” effect is lower in the poorer Convergence regions since the EU finances a larger proportion of project costs in such places; when the “matching” finance is provided from private sources, the “leverage” is larger since the EU contribution is limited to a low level (see Section 2a above which discusses subsidies for private investment and Chapter X below);
  - by concentrating on particular types of investment – development priorities – and excluding others; the clearest demonstration of the value of this type of concentration in the current round of Cohesion Policy programming is the “earmarking” of specific quantities programme resources for physical investments and training on support of the EU’s overall drive for increased competitiveness;
  - by fixing the rule that, broadly speaking, EU Cohesion Policy funds must be used with two or three years of them being granted; this aspect of concentration frequently causes difficulties for programme managers who feel they need more time to prepare and launch investment and training projects, but it is essential if the programmes are to achieve maximum additional impact “on the ground”.

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• **Co-partnership**\(^{37}\) and shared responsibility between the European Commission, EU Member States, regions and other partners guarantees the relevance of regional programmes to local conditions. EU Cohesion Policy has been successful in stimulating and creating innovative ways in which the various levels of governance and social and civil society partners can cooperate to achieve targets set by either the EU or member country governments at the centre. The biggest challenge of co-partnership is proving to be the creation of administrative, financial management and audit arrangements which do not become too great a burden. This has been an area where EU and member country officials have not demonstrated the same ability to innovate.

• **Additionality** aims to ensure that EU finance is additional to national public and private finance and is not used merely to replace national public resources. Although the principle can be easily understood, it has proved difficult in practice to devise regulatory provisions which ensure that it is followed at all times by all member countries and regions.

These principles intend to develop a governance system for regional development which is, on the one hand, geared towards common European objectives of economic, social and territorial cohesion and, on the other hand, provides enough flexibility to adapt to the specific regional and national needs towards reaching these objectives.

**b) The organisation of policy delivery**

An important part of any policy – but one which is frequently underestimated in policy design – is the organisation of the policy’s delivery. This is an area in which EU Cohesion Policy has been innovative and it has evolved a delivery, or governance, system with the following stages.

• **The programming stage** begins as soon as the regulatory framework has been decided for the next cycle of the policy. It achieves its first objective when the development programme begins to come into effect but, in effect, continues almost to the end of the programme since it is frequently necessary to adapt

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\(^{37}\) The European Commission has identified in its report “Partnership in the 2000-2006 programming period” the potential added value of a well-organised partnership and the following four points:

- through the involvement of a broad group of participants, a wider range of expertise is available for use during the programming cycle of Structural Funds programmes;
- the participation of regional and local authorities and that of civil society helps to legitimise the decision-making process by counterbalancing any specific political or other influence;
- in many cases the involvement of partners contributes to the development of institutional capacity at sector and territorial levels;
- the analysis also broadly confirms the positive impact that partnership has had on the improvement of the planning and implementation procedures of public administrations responsible for the Structural Funds.

programmes to changed circumstances. The first stages are critical since they ensure that the decentralised programme is inscribed in an integrated policy effort emanating from the centre. Programming, therefore, begins with Community guidelines for investment and training which set out the overall objectives of EU Cohesion Policy, making clear, for example, in the current phase the importance of EU competitiveness, or of energy saving, or carbon reduction. On the basis of the EU guidelines, each member country is asked to develop its National Strategic Reference Framework (NSRF) outlining the key challenges and framework conditions for regional development at member country level. On the basis of the NSRF the individual Operational Programmes of the regions and member countries are drawn up based on ex-ante evaluations and regional development strategies. At the end of the programming stage, the Operational Programme will be approved after taking into account a series of discussions between the regional partnerships, member country governments and the European Commission.

- **Implementation stage begins** once the Operational Programme is adopted. At this point in the process, the European Commission checks the conformity of the programme with other EU regulations and evaluates the efficiency of the programme’s management, administration and financial control systems. A financial advance is transferred from the Commission to the programme’s Managing Authorities to allow the programmes to begin co-financing investment and training projects. This advance remains open until the final stages of the programme and, on the basis of regular expenditure reports, is regularly replenished by the European Commission as it reimburses eligible expenditure incurred in the construction of projects approved by the regional partnership or the carrying out of approved training actions. Furthermore provisions are made, at this point in the programming cycle, to ensure an ongoing monitoring of the programme, which will result in regular progress reports to the European Commission. These include checks and balances to ensure that the resources are spent on time and that the economic impact of co-financed projects and training actions is measured.

- **Mid-term evaluation and adjustment stage:** After three years of programme implementation a regular mid-term evaluation is carried out and provides an opportunity to adjust the Operational Programmes to take account of their initial performance and any changes which may have occurred in the socio-economic conditions of the region. Furthermore, the Commission presents a
strategic report on the implementation of EU Cohesion Policy which is based on national reports from member countries.

- **Final evaluation and closure stage:** The final stage of the Operational Programme includes the carrying out of an ex-post evaluation and the closing of the programme’s financial facility. This part of the process can often take much longer than initially foreseen. It is not uncommon to close programmes several years after the date set by regulation.

c) **Experience of the current EU governance system of cohesion policy**

A closer look at the implementation of these principles in the current EU Cohesion Policy programmes 2007-13 provides a better understanding of the challenges encountered in their application by policy-makers and programme managers. The experience discussed below relates to the first two of the four stages outlined above – the programming and implementation stages.

At the beginning of the programming cycle for 2007-13, in July 2005, the European Commission launched a consultation on the future Guidelines for Cohesion Policy, aimed at ensuring that each decentralised programme plays its part in contributing to the Union’s economic development. The Guidelines cover physical investments and training actions. The Commission suggested in the document that, in line with the Union’s renewed commitment to improve its competitiveness – the renewed Lisbon strategy – structural funds intervention in 2007-13 should be concentrated in the following areas:

- improving the attractiveness of member countries, regions and cities to investors by improving accessibility, ensuring adequate quality and level of services, and preserving environmental potential;
- encouraging innovation, entrepreneurship and the growth of the knowledge economy by increasing capacity for research and innovation, including in the areas of new information and communication technologies; and
- creating more and better jobs by attracting more people into employment and entrepreneurial activity, improving the adaptability of workers and enterprises to change and increasing investment in human capital.

In reply to this public consultation, the Commission received 197 valid contributions from policy stakeholders throughout the Union. The contributions and the Commission’s comments were published in a report by the European Commission.

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The main results of the consultation can be summarised as follows.

- EU Cohesion Policy is intrinsically linked to the overall competitiveness of the European Union and supports its overall policy for growth and jobs as set out in the Lisbon conclusions of 2000.
- By developing synergies and complementarities with other EU policies, Cohesion Policy can further contribute to the Union’s target of greater competitiveness.
- The double emphasis on innovation and the knowledge economy was widely supported. Stakeholders also confirmed the need to strengthen action in support of research, education and training.
- Concentration in regional development programmes on a limited number of priorities would help to further maximize the impact and added value of Cohesion Policy expenditure.
- The inclusion of more novel elements – such as the emphasis on access to finance and financial engineering, public-private partnerships, investment in health to foster competitiveness and productivity, and administrative capacity-building – was widely welcomed and encouraged.
- EU Cohesion Policy investment guidelines should allow each region and member country the flexibility it needs to select – whilst still working within the framework of the Union’s overall development strategy – an appropriate mix of priority investments and actions to respond to its own development requirements.

The EU Cohesion Policy regulations themselves were adopted by the Council in July 200641 which left member countries and the regions only a little more than six months to prepare their development strategies and operational programmes before the new funding period began on January 1 2007. The difficulties created by this short time were aggravated by the fact that the EU investment and training Guidelines – which are designed to be a key part of the framework for programming – were not adopted by the European Union until October 6 2006 – three months before the beginning of the new period.42 This, they did not have the desired impact on the programming of EU Cohesion Policy at national or regional level.

In order to save time, in many cases the preparation of operational programmes took place in parallel to the preparation of National Strategic Reference Frameworks (NSRFs) and without waiting for the formal adoption of the EU investment and training guidelines. In effect, the NSRFs were frequently derived from the operational programmes, instead of the other way round. This was a serious shortcoming since the NSRFs – the national response to the EU investment and training Guidelines – were intended to provide the full development context for the operational programmes. In those member countries where the initial sequence of actions was kept – first, finalising the NSRF and, then, submitting the Operational

Programmes – there was a significant delay in the implementation of operational programmes.

The key discussion between the European Commission and member countries in approving operational programmes related to finance – what proportion of the finance allocated to the operational programme would be devoted to those measures and training actions with direct effect on competitiveness and job creation. In Article 9(3) of the General Regulation43 it was laid down that “the Commission and the Member States shall ensure that 60 per cent of expenditure for the Convergence objective and 75 per cent of expenditure for the Regional Competitiveness and Employment objective for all the Member States of the European Union as constituted before 1 May 2004 is set for [promoting competitiveness and creating jobs].” These targets were based on expenditure-categories which were annexed to the General Regulation.

The following lessons can be drawn from this experience.

- **The link between EU investment and training Guidelines and the actual operation of development programmes** is important in ensuring that EU Cohesion Policy serves the goals set by the EU. This, in turn, makes it important to achieve the correct sequencing of operations – so that the Guidelines, inform the National Strategic Reference Frameworks and these, in turn, provide the framework for operational programmes at member country and regional level.

- **A successful implementation of EU investment and training Guidelines in development programmes depends also on the degree of ownership of these Guidelines by economic and social actors in member countries and regions.** The greater the degree of ownership felt by stakeholders and programme managers, the greater the impact of the Guidelines in shaping development programmes. This implies thorough communication, consultation and cooperation between the layers of multilevel governance in preparing the Guidelines. The sense of ownership is higher if enough flexibility for adjusting to local needs is provided and enough effort is invested in defining the priorities of the policy.

- **Effective administration is necessary of development programmes are to succeed (effectiveness and efficiency).** Various studies on the leverage effect of cohesion policy have outlined the importance of the capacity of regional and national administrations in developing and steering the regional policy process. But the role of these administrations frequently goes beyond the mere organisation and bureaucratic management of operational programmes. They also serve as the programme’s “imagination”, catalysing the development process.

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• **The time factor** is linked to the capacity building in ensuring efficient and effective regional policy programmes. The case in Eastern Germany – see the description for Saxony-Anhalt below – demonstrated clearly that the Land administration needed several years to create the proper statistical base, to amass the overall knowledge and build up the experience in assessing risk and managing the funds. Central policy-makers need to understand that their success in reaching their goals requires them to create a constancy in policy which allows administrations to build their experience and develop required skills.

• **Evaluation is central to policy improvement (effectiveness and efficiency).** The ongoing evaluation of regional policy programmes based on a clear set of policy objectives and performance indicators is a precondition for successfully steering regional development programmes, adjusting them so that they better achieve their objectives and adapting them to changing socio-economic conditions in the areas they cover. Linked to the success of evaluation is the willingness of the regional or even national leadership to take on board evaluation results and make the necessary adjustments in the implementation of operational programmes. Regional and national administrations must not view evaluation as a potential criticism of their actions but merely as a tool to help them identify the parts of a programme which are working less well so that they can be improved.

• **Regional governance and co-ordination (responsiveness) must bridge the gap between the public sector and civil society.** (See Chapter IX of this report for a fuller description of the important role of Civil Society in achieving regional economic development.) It is therefore essential that regional governance allows civil society to play an active part in planning, implementing and evaluating regional policy programmes. Many regions in Europe have responded to this challenge by setting up co-operation and co-ordination mechanisms which involve a wide range of socio-economic stakeholders in the ongoing co-ordination of development strategies at regional and sub-regional level.

• **The respective functions and responsibilities of the various implementing authorities of development programmes must be clearly defined (rule of law).** Efficiency is directly linked to the existence of a clear division of responsibilities between economic and social actors at a horizontal level within a region and between the different levels of government. This is proving to be difficult to achieve in the fields of financial management and audit where the requirements of the EU institutions – the European Commission and the EU Court of Auditors – frequently overlap with those of member country governments resulting in an overlap of responsibilities, the complication of procedures and resulting
confusion and inefficiency in the administration of EU Cohesion Policy programmes.

- **Consensus building** (consensus orientation) is important for a smooth governance process. A key factor for the successful planning and implementation of regional development programmes is the establishment and maintenance of a strong consensus around the projects and training actions which are necessary for the development of a region or country. This requires constant communication and cooperation between the different layers of governance and socio-economic actors in the region so that all members of the partnership are familiar with and understand the overall objectives of the development strategy and its implementation (see below).

- **Transparent financial management** (transparency) is the foundation for confidence in the operation of a regional development programme. There is inevitably a competition for financial resources between stakeholders in a regional or national programme. When this competition is between government departments it may not be of overwhelming importance. But when it is between government departments and other stakeholders, or when it is between stakeholders themselves, it can breed mistrust and a lack of confidence which can destroy the regional consensus. EU Cohesion Policy programmes, therefore, require transparent financial management structures in order to allow democratic control and ensure the efficiency and effectiveness of programme interventions.

- **Audit process and dealing with irregularities** (accountability) is proving to be a problem in implementing the shared management system of EU Cohesion Policy. Financial corruption in the implementation of programmes is rare and, when discovered, is acted upon in a way which protects the interests of the EU taxpayer. But EU Auditors maintain that they discover a high level of “errors” or faults in the programmes which implement EU Cohesion Policy, even though most of them have their origin in mistakes in the application of other EU regulations, such as public procurement or environmental legislation, and have no financial impact. But the European Commission takes the view that the level of error is unacceptably high and that programme administration needs to improve. The remedy should be three-fold: better and on-going training for programme managers; improved administrative systems; and efforts to make rules and regulations simpler and clearer. There is also a responsibility on policy-makers in the field of audit and financial control to search for more efficient and lighter ways of ensuring sound financial management.
• Civil society and the social economy as well as of non-governmental organisations should be involved (participation) in the design and delivery of operational programmes. An effective and successful partnership with non-government actors can only be achieved when government and the public sector are willing to accord them an active role. This may require a commitment on the part of the public sector to deploy financial resources to train and build the capacity of socio-economic and to make meaningful attempts to involve civil society in programme management (for example, by providing adequate documentation and time for consultation). But it is also important that civil society commits itself to actively participate in the governance of EU Cohesion Policy or in regional policy in general. Only if these factors come together can a meaningful partnership occur.

6. The delivery mechanism of EU Cohesion Policy – the region

This concluding section will relate the principles and overall experience in the implementation of EU Cohesion Policy (see the preceding section) to the experience of Saxony-Anhalt. To do this it will seek to place a regional view of the delivery of EU Cohesion Policy alongside the view from the centre.

a) Making regional strategies and plans – the case study of Saxony-Anhalt

As one of the new German Federal states, Saxony-Anhalt is situated in the centre of the former East Germany between Berlin and Hanover. A region with a population of 2.5 million inhabitants, its main cities are Halle, Magdeburg and Dessau. As the home of most of the former East Germany’s heavy industry (energy, chemicals, tool making), Saxony-Anhalt was hit hardest by the drastic socio-economic changes after German unification. This led to the state having the highest unemployment rate of all of the former East German Länder.

Being a federal state with its own constitution, tax-raising powers, government and regional parliament, Saxony-Anhalt had a wide-ranging competence in defining its own development and regional policy.

With German unification, Saxony-Anhalt became part of the European Union and it has received support from the EU Cohesion Policy since 1991. Until the end of 2006 this support amounted to nearly € 7 billion. The current funding period, 2007-13, adds a further € 2.79 billion of EU support so that the Land has been allocated almost € 10 billion for its economic development over the past twenty tears. The amounts allocated by the EU have evolved as follows.

Saxony-Anhalt’s financial allocations under EU Cohesion Policy (ERDF and ESF) combined, 1991-2013

1991-93: 505,4 mio ECU (Special Structural Programme for the new German Länder)
1994-99: 2.645 mio ECU (Objective 1 Programme for Saxony-Anhalt)
2000-06: € 3.800 mio (Objective 1 Programme for Saxony-Anhalt)
2007-13: € 2,790 mio (Convergence Programme for Saxony-Anhalt) of which € 1,930 mio is foreseen for the ERDF

b) EU Cohesion Policy in Saxony-Anhalt: four steps towards better policy organisation

Becoming a de facto part of the European Union overnight, Saxony-Anhalt was also confronted, without prior preparation, with the task of participating in EU Cohesion Policy, taking into account all its necessary obligations and requirements. The regional administration and the whole socio-economic system in the Land had not had time to prepare for this new way of organising the Land’s economic development, so the uncertainties of coping with the changes induced by Cohesion policy were immense. Over time, the region and its socio-economic actors gained maturity in organising and managing the policy by articulating their interests and by developing and implementing an overall concept. This development has so far taken place in four phases.

Phase 1: 1991-93, the special EU-programme for the East German Länder

The European Council in Dublin decided in 1990 to provide a special programme for the three years 1991-93 for the East German Länder of around 3 billion ECU. Saxony-Anhalt received a total of 505,4 ECU – the ECU was, at this time, the “currency” in which the EU established its budget and, under its Cohesion Policy, allocated finance to investment and training activities.

In this phase, funding priorities and strategies were largely defined by the German government rather than by the newly-created Länder. The German government decided that the special programme for Saxony-Anhalt – as for the other New Länder – should be administered, and the “matching” funding supplied, through a national measure for improving business structures, the Common Task. Underlying this position was the belief that businesses would be able to stimulate the development of economies that had, for forty years, been governed by central planning.

Thus, there was no comprehensive participation of local or regional actors because of the lack of time available for producing the planning document. This time pressure had other consequences: the Operational Programme for the Land was submitted to the national authorities without a prior decision by the regional government as a whole. Not only did time pressure affect the creation, consultation and approval of the Operational Programme, it also affected its implementation. And the effects were magnified by a widespread insecurity at all levels of the Land administration about the methods and procedures for implementing EU Cohesion Policy. The region therefore felt compelled to outsource large
parts of the programming effort and programme management to external service providers. At European level the negotiations about the programmes of the East German Länder were led and directed by central government.

**Phase 2: 1994-99, Saxony-Anhalt’s first operational programme**

After 1994, the earliest time at which it could take place, the East German Länder were integrated into the full working of EU Cohesion Policy, becoming regions eligible for intensive financial support under the then Objective 1. For the funding period 1994-99 the European Union provided for Eastern Germany in total around 13,64 billion ECU of which 2,5 billion ECU were foreseen for Saxony-Anhalt.

As a region which was benefitting from EU Cohesion Policy support, Saxony-Anhalt was obliged to carry out all programming steps foreseen in Cohesion Policy regulations and had to develop for itself a comprehensive economic development strategy. Again, in this phase of its regional policy the Land’s degree of autonomy in relation to EU Cohesion Policy was low since most of the EU financial resources were, as before, directly matched by the national funding instrument of the Common Task. This restricted the uses to which a large part of the EU finance could be put, since the Common Task continued to be focused only on investment support for businesses and the development of business-related infrastructure. Discussions with the European Union about the contents of the Saxony-Anhalt programme were still led and directed by the German government.

However, for the first time the economic and social partners as well as local and regional actors – even though very late in the day – were involved in the programming exercise and first attempts were made to decentralise EU Cohesion Policy and to increase the role of the Land in planning and organising its own economic development.

Despite this, EU Cohesion Policy was still seen in the region mainly as a tool for the support of business promotion. Again, the possibility created by EU Cohesion Policy for the region to develop multi-annual budgeting for its development policy, was lost since most of the EU finance was used to support the cash flow of the annually-budgeted Common Task. This led to a significant under-spending of EU Cohesion Policy finance in the Land and a loss of the potential gains made possible by the EU policy. This was to have far reaching consequences into the next funding period. Only in 1997 was it possible to organise for the first time a horizontal co-ordination of the Land’s development programme across all participating ministries in the regional government, when an inter-ministerial working group on regional policy was set up to reflect the horizontal approach of EU Cohesion Policy.

At this stage the region also started to define its interest in the future design of EU Cohesion Policy beyond the year 2000. This process took place at various levels by:
• defining at a rather early stage (3 years before the end of the funding period) the key investment and training interests of the region for the next round of operational programmes;

• co-ordinating a joint positioning of all East German Länder with regard to the Union’s economic development priorities of the time – set out in a document called AGENDA 2000;

• starting work at European level – and at an early stage in the discussions on the future shape of EU Cohesion Policy – on a negotiation strategy which had as one of its objectives to make EU institutions (the European Commission, the European Parliament and the recently-established Committee of the Regions) aware of the investment and training needs in the Land.

It was in this period that the Land began to assert itself.

Phase 3: the 2000-06 a distinctive development programme for Saxony Anhalt

For its third programming period, Saxony-Anhalt received from EU Cohesion Policy a total of €3,35 billion. For the first time it was possible to carry out a comprehensive programme-building exercise based on existing development strategies and to provide the necessary institutional arrangements in the region to steer the programme efficiently. The development priorities were largely based on those identified during previous years by Regional Innovation Strategies for the sub-regions of Halle and Magdeburg, which had been supported by EU Cohesion Policy and which provided ideas for a policy framework for innovation support in the region.

A horizontal clearing unit comprised of the Secretaries of State of the various ministries was set up to improve the regular exchange of information and views about the implementation of the development programme. At the same time an IT-programme called EFREporter – “ERDF reporter” – was developed to allow the programme managers to obtain information in real time about the state of the programme implementation. This instrument is now in use in a number of the EU’s newer Member States.

During the Mid-Term Evaluation of the programme, in 2002, it was decided to assess all regional funding programmes – even those outside EU Cohesion Policy – to check their efficiency and effectiveness. The same evaluation methodology was used throughout. Due to the change in the financial management rules of EU Cohesion Policy (notably the introduction of the n+2 rule to ensure that EU financial resources are used by programmes within two years of the year in which they are made available to the programme), management of the development programme became more time-consuming. The Land’s increased capacity to manage its EU funds reflects the region’s higher degree of autonomy in deciding
when, where and how to spend EU financial resources. In this way, EU Cohesion Policy in the Land has become disconnected from the Common Task and other national programmes.

Phase 4: 2007-13: the current programme, the best-organised

Shortly after the Union adopted its plan for economic development in 2000, Saxony-Anhalt started the preparation for the next funding period. It quickly became clear that, because EU enlargement in 2004 would lower the Union’s average GDP per head, the statistical base for defining eligibility for the next generation of structural funds programmes would change dramatically. The eligibility threshold for high-intensity EU funding under the Convergence objective would continue to be set at 75 per cent of the EU average GDP per head but the accession of new, poorer member countries would cause this to fall abruptly – literally from one day to the next – in absolute terms. The effect would be that Saxony-Anhalt, like most of the former East German Länder, would lose its eligibility for high-intensity financial support because its average income would be no longer below the threshold.

Saxony-Anhalt campaigned to draw attention to this unusual state of affairs. Its average income was now above the Convergence threshold but its people were just as badly off in absolute terms as they had been before. It was only their relative position which had changed, since the average had fallen. Therefore Saxony-Anhalt prompted the organisation of a network of regions affected by this “statistical effect”. The network campaigned to have their problem recognised and addressed by the EU.

This initiative was at first criticised by the German government which had fixed its main focus on reducing the future financial contribution of Germany to the EU budget as a whole. But it was eventually supported by the German government and the EU created a number of ad hoc transitional arrangements. These are discussed in Section 3 of this Chapter, with Saxony-Anhalt being recognised as one of the “Phasing Out” regions.

c) Planning and programming the current operational programmes

For the first time in the history of Saxony-Anhalt, the process of developing an operational programme for EU Cohesion Policy co-finance for the period 2007-13 was started by a declaration of the Prime Minister in the regional parliament in April 2005. This declaration had the intention to link the work on the new 2007-13 Cohesion Policy programme with overall debate about the future of the region and to encourage all stakeholders in the region to participate in this exercise from the earliest stages.

The programming process included elements of Strategy Building; Analysis; and Partnership. More attention than ever before was placed on the strategy-building element, both in terms of organising the consultation and deciding the content of the strategy. Co-ordination for the planning exercise was transferred from Saxony-
Anhalt’s Ministry of Finance to the Prime Minister’s Office to ensure a cross-ministerial approach for future programme management.

The strategic focus for the future programme was fixed on economic growth and employment. All measures that wished to be included in the programme had to provide convincing evidence of their impact on growth and employment in the region.

A second part of the programming exercise concerned a substantial analysis of the strengths, weaknesses, opportunities and threats (SWOT analysis) which Saxony-Anhalt will face in the coming decade. This included a scoring analysis of the current funding policies of the government and a macro-economic modelling of future impact of the EU Cohesion Policy programme.

d) Analysis of strength and weaknesses

During this SWOT analysis it became clear that there are some socio-economic trends in the Land which constitute weaknesses terms of the Land’s future economic development. For example, the analysis drew attention to the high drop-out rate of young people from the education system; to the Land’s low R&D intensity measured in patent recognition; and to the fact that the region’s local companies have a low export rate. But the analysis also pointed to a number of strengths: for example, the Land’s population is well educated and trained and the Land’s cultural infrastructure is of high quality and easily accessible.

A key challenge for the region is the demographic change foreseen to take place in the first decades of this century: the years 2000-04 were characterised by a significant loss in overall population of almost 5 per cent and it is expected that by 2020 the population of the region will have decreased by 19 per cent compared to 1995. One of the significant impacts of this loss of population will be on revenue for the public budget which will decrease from € 10 billion in 2005 to an expected € 8.5 billion in 2015.

Based on this analysis it became clear that Saxony-Anhalt’s development programme under EU Cohesion Policy would have to address these challenges and would become even more important to the region since, as the Land’s budget revenue decreases, the operational programme will assume a larger part of the Land’s economic development expenditure.

e) Scoring analysis of the current funding programmes of the region

In addition to this classic SWOT analysis the region undertook an overall assessment of all regional funding programmes outside the structural funds. Across all ministerial departments the funding units had to address the following questions:

- How important and adequate is the funding programme with regard to the intended political objective?
- How do the funding programmes contribute to achieving the objective?
- Is the funding programme carried out in a cost-efficient way?
- Does the funding programme imply free rider effect?
• Will the funding programme have any side effects, in particular for environmental and social factors?
• Is it really a public good which needs to be supported or could it be also be provided by private institutions?

Based on the responses of the governmental departments an assessment model was used to compare the scores for individual funding programmes with the overall policy objectives. Finally conclusions were drawn on which funding programmes should be continued and which needed to be adjusted.

f) ERMIN Model to assess macro-economic effects

A third element of the programming process was the macro-economic modelling of the potential impact of the EU Cohesion Policy programme in Saxony-Anhalt. During this exercise it became clear that the impact of the programme largely depended on the degree of focus of its spending on growth-related sectors and infrastructures. The most lasting effects in terms of growth and employment beyond the life-cycle of the programmes were identified as being in the manufacturing industries.

All these elements led to a strong focus of the current programme on growth and employment. It also led to a change in the funding philosophy in the region by introducing several revolving funds as an alternative to the classic model of handing out subsidies. The loan-based approach of revolving funds has a number of advantages: when the loan is repaid, it can be used again for the same purposes — something which cannot be done with a subsidy; also, the introduction of a loan fund helps to prevent the development of “a subsidy-mentality” and can therefore increase the efficiency of the projects which are co-financed.

g) Involving the stakeholders in the regions

A stronger involvement of local and regional stakeholders accompanied the more sophisticated analysis of the likely impact of the EU Cohesion Policy programme. This was a direct consequence of the invitation given by the Prime Minister in his declaration at the very beginning of the programming process. The closer relationship between the programme and its stakeholders was reflected in the organisation of five regional workshops in the planning regions of Saxony-Anhalt and in a presentation of workshop results to the region’s programme monitoring committee. Furthermore various possibilities were given to the socio-economic partners to discuss and contribute to the drafting of the programme and, finally, the philosophy and details of the programme were presented at a session of the regional parliament. Most of the contributions received, together with all the planning documents produced in the preparation exercise, were published on the web-portal of the region and citizens were encouraged to comment on them.

h) Lessons learned and challenges for the future

The planning process in Saxony-Anhalt for the current programmes (2007-13) has shown that programming for economic development is a complex process.
• It needs active leadership in the region.
Programming has evolved from being a planning process behind closed doors to an open strategy-building process for the whole region. A continuing effort will be required to maintain the present degree of transparency and openness.

- Co-operation and co-ordination between the layers of government and the programmes stakeholder partners are essential for success.
- It is necessary to break with traditional practice in order to adapt to new challenges.
- It is of key importance to have the right people in appropriate positions at the right time.
- Any region would benefit by making the creation and implementation of its economic development programme a team exercise for the whole region.
- Focussing on key challenges and developing a permanent monitoring system are crucial.
- And, finally, it is necessary to raise awareness that decisions taken in the context of development programming will have a lasting impact on the economic, social and territorial development of the region.

Since the beginning of the 1990’s then, when, with the reunification of Germany, Saxony-Anhalt was given the task of organising and implementing its own economic development programmes within the framework of EU Cohesion Policy, it has gradually perfected its policy-making techniques. At the beginning the development policy implemented in Saxony-Anhalt was decided outside the Land and organised so that policy-makers in the Land had little to say about its design. Now it is fully-designed and implemented by the Land itself, by the people who best understand the development needs of the area and its people, and who also understand the objectives of EU Cohesion Policy and of Germany’s national policies for economic development. A home-grown policy for economic development does not mean a go-it-alone policy – rather it is a constant demonstration that economic development policy can operate in a fully decentralised way and yet work in perfect harmony with the development objectives of central government and the European Union.
Chapter III: Area definition and classification: the case of the European Union

by Michael Dunford

Introduction

The main aims of this chapter are three-fold. The first is to outline the ways in which regions are defined in the European Union (EU) and deals with the criteria used to define areas, the role of population size and the role of administrative entities. The second is to outline the nature and evolution of the hierarchical Nomenclature of Statistical Territorial Units (NUTS) including a consideration of the hierarchical levels of the system, the way it has evolved, the impact of successive enlargements of the EU and the ways in which changes are implemented. The third is to examine the ways in which NUTS areas have been classified mainly for the purposes of EU Cohesion Policy. In addition, the chapter will pay attention to two other issues. The first is a set of general questions concerning the ways in which regions can be defined. The second is the nature of the information systems put in place to support the design, monitoring and evaluation of public policies including a consideration of the relative merits of traditional regional and urban statistics and the use of Geographical Information Systems.

Part I. Defining regions and collecting regional data

1. What is a region?

A region is essentially a part of the land surface of the earth: a tract of land and its resources along with the people who live in/on it. Usually, its identification rests on the existence of boundaries and characteristics that distinguish it from other regions.

In the geographical literature, regions are defined in three ways, or in accordance with three principles, as, respectively, uniform, functional and administrative areas.

Uniform, or homogeneous, regions are areas with certain significant characteristics in common. These common characteristics may relate to the natural environment: relief, climate, soil types and vegetation. Areas that are mountainous, or have a Mediterranean climate, or comprise steppe grassland are all regions of this kind. The common characteristics may also relate to the economic, political and cultural characteristics of the people who inhabit the area: dominant agricultural or industrial practices, density and linguistic or ethnic characteristics of the population are all cases in point. Of course, identifying similarities involves abstracting from other characteristics that make these areas differ from one another, while any similarities involve differences of degree: Areas
identified as uniform regions are therefore characterized by internal variation even in relation to those characteristics which make them similar and by the existence of fuzzy boundaries.

Functional regions form the second type of region, in which functional roles are the criteria used to establish the classification. Functional areas are not however groups of places characterized by the performance of a particular function. A group, for example, comprising all areas in which plant and animal species are protected is really a uniform region, and perhaps also an administrative area, if the area is designated as a nature reserve. In the geographical literature a functional region is one which combines places which are characterized by strong degrees of interdependence and strong complementarities. Examples include market areas that combine market centres where the function is performed and the places in which the people who use those market centres reside. A classic case is afforded by Christaller’s (1933) theoretical account of the size, number and spacing of market centres and market areas in Southern Germany (Figure 1). Another example is a travel-to-work area which combines places of employment and the places where the people who work in those places of employment live.

As this definition implies, functional areas are essentially city regions: urban centres in which services and jobs are concentrated and the surrounding territory served from these urban
centres and in which some of those people who work in the urban centres live. Kunzmann and Wegener (1991) argued that the spatial organization of Europe should in fact be conceived in city region terms, while Kunzmann (1996) subsequently published an idealized version of the internal structure of individual city regions (Figure 2).

Figure 2. An idealized European city region. Source: Kunzmann (1996)

The third way in which regions are defined is for administrative purposes. In this case the world is divided politically into hierarchical sets of mutually exclusive areas where the number of sets depends on the number of administrative tiers. In some cases the boundaries of administrative areas are established to coincide with natural boundaries such as coasts, the course of rivers, lakes and mountains. Once a regional division is put in place, it can acquire a historical justification, especially if its development is associated with the creation of relatively strong regional identities and with the development of social movements that press for the preservation of the resulting regional entities. The opposite is also possible, however: the creation of new political and administrative arrangements and of new regional divisions designed specifically to make a break with the past. A step of this
type may occur as part of a project of economic and political transformation (Dulong 1975; Dulong 1978). An example is provided by the initial creation of a regional tier of administration in Gaullist France in the 1960s, which involved the creation of Commissions de développement économique régionales (CODER). These institutions were a part of a programme of state-directed economic and social modernization in which regional planning was a vital instrument. An important aim was to recompose regional elites in established regions where powerful traditional elites were considered to be obstacles to economic and political modernization. In the case of Brittany a new region was defined so as not to coincide with earlier definitions. A Breton nationalist movement in which traditional local elites played a leading role sought to resist these developments but was finally unsuccessful (Dulong, 1974). A long view of European development would include many striking instances of these two types of change, as political integration progressed and created, first, a European nation state system out of an earlier patchwork of political entities, and, then, as the state system was itself modified by the interaction of further projects of integration, attempts to preserve the territorial integrity of existing states and attempts to preserve historical identities.

2. Administrative and functional regions: some theoretical considerations

Administrative regions can coincide with uniform regions, functional regions or neither. There are, however, factors which suggest that an administrative region should make functional sense. The first is that administrative areas should be established so as to ensure that services are delivered in an efficient, effective and adequate manner. As Christaller showed, a hierarchical central-place system provides an efficient way of providing goods and services (for example, primary, middle and secondary schools) to the population of the surrounding area: for each service there is a minimum market size (threshold) for its provision; a maximum range or distance that users of a service wish to travel; while competition among centres leads to the creation of service areas whose size lies between the minimum threshold and maximum range for that service. The second factor is that administrative systems should be defined to enable planning and management problems to be handled in an effective way, containing the types of interdependence with which planning and management systems must grapple. Alternatively, co-operation arrangements can be put in place. In situations where neither solution is adopted a series of problems can arise where, for example, a narrowly defined employment centre expands jobs paying no attention to the costs imposed on adjacent residential areas that have to house and provide services for the people who work in the employment centre. A third factor is that an administrative system should afford a degree of accountability and a sense of community, implying that it should correspond to a hierarchical set of zones that themselves correspond to the functional interdependencies of everyday life.

In a recent study Parr (2006) identified a set of more specific criteria for the definition of administrative areas:
• administrative inclusion of the whole of lower-order administrative areas inside higher-order areas;
• administrative centrality (geometric centre) relative to the population;
• administrative concentricity so that the centre of county is also the centre of a lower order district;
• centre coincidence of administrative and functional centre structure due to the existence of complementarities; and
• area coincidence of administrative and functional areas for community of interest and planning reasons.

The last two criteria suggest that functional and administrative structures should coincide.

Parr points out that some of the criteria may be modified by particular circumstances. For example, centrality may be abandoned to offset the relative disadvantage of a particular sub-area; concentricity may be abandoned to prevent secondary administrative structures from securing additional locational advantages, as occurs when state capitals and commercial capitals of countries are chosen so as to differ. He shows that establishing a correspondence between an administrative and a functional system of central-places while, at the same time, satisfying all five criteria can prove particularly problematic. Some of the difficulties can be identified by considering central-place systems. Central-place systems only deal, of course, with services for which centrality is important: it is relevant, in other words, for points of distribution and for points of assembly/collection.
Christaller showed that central-place systems can assume a variety of hierarchical forms defined by the number (K) of lower-order centres and market areas contained in each higher-order market area. A K=3 system (Figure 3A) which accords with the marketing principle is one which serves the maximum number of users from the minimum number of centres. A K=4 system reflects a transport principle where the aim is to minimize the length of the transport network connecting all centres and to maximize connectivity: in this case the hexagonal market areas are rotated so that sub-centres lie half way along their sides rather than at their corners. A K=7 system satisfies an administrative principle where lower order centres are completely contained within higher-order market areas.

A large number of central-place systems correspond to the K=3 and K=4 principles, although there are exceptions where administrative principles shaped the development of the
settlement system. K=3 and K=4 systems do not however satisfy the administrative principle of inclusion unless there are fewer hierarchical levels in the administrative system (1:16) in the case of a K=4 system than in a functional system (1: 4:16: 64). If on the other inclusion is imposed on a K=3 or K=4 system, the system does not satisfy the criteria of administrative centrality and area coincidence. Where a K=3 or K=4 system exists, it is therefore, difficult to satisfy the criteria administrative systems should perhaps satisfy.

Similar problems arise in a quest for correspondence of administrative and functional regionalization in systems of city regions (Parr, 2003). For reasons related to service provision, management and planning and community interest, a hierarchically nested pattern of city regions is a convenient foundation for an administrative structure. In the EU such a correspondence exists in the case of France and Spain. In many cases, however, second order city regions are not fully contained in first order city regions as secondary centres/areas cross borders in a way that is very similar to the K=4 case (left-hand side of Figure 4). Cases of this kind can be found in the United Kingdom (UK) and Italy. In UK, a problem of non-inclusion does not arise, due to the absence of an (off-centre) secondary level of administrative city regions, and the division of secondary functional city regions into a number of secondary administrative areas (middle of Figure 4). The consequence is, however, that cities in the secondary administrative areas may be separated from their hinterlands. In Italy conversely the regional limits of administrative areas are extended into adjacent functional areas to retain correspondence at the second tier of the hierarchy: the region of Piemonte for example includes the province of Novara which is much closer to Milan, centre of the region of Lombardia (right-hand side of Figure 4).
It is clear from this rather abstract discussion that in practice it may be difficult to make administrative and functional regionalizations coincide. Non-coincidence may have important consequences for the rationality of administrative systems. We shall see that it also leads to the existence of functionally over- and under-bounded administrative areas with significant repercussions for the meaningfulness of widely used statistical indicators.

3. The definition of regions and the collection of regional statistics and geographical information

No matter how and why regions are defined, the establishment of regional divisions is associated with the emergence of information needs. The definition of a set of regions for scientific reasons is associated with the collection of scientific data. There is also a strong interest in the identification of regional entities that do not change greatly over time so that data collected at one point in time is comparable with data collected at others. Often it is argued that, in these circumstances, functional areas are particularly problematic, as functional zones can change relatively quickly due to the speed of change of the geographies of journeys to work and journeys to service centres. On the other hand, it is also important to recognize that a stable administrative system itself generates a certain degree of functional stability through its impact on the geography of economic activities and the geographical distribution of population.

In the case of administrative areas there is a parallel interest in the timely collection and analysis of accurate and up-to-date spatial/geographical information. In the case of administrative activities, for example, harmonized geographical information – and the infrastructures through which this information is assembled, organized and made available –
play a vital role in ensuring that decision-making, policy implementation and policy evaluation at local, regional, national and global levels are well-founded and supported by relevant evidence. Economic development, environmental management, community land-use assessments and disaster recovery are just a few examples of the areas in which geographical information plays a vital role in decision-making.

In the EU the collection and maintenance of data to support political decisions is one of the tasks of Eurostat, the Statistical Office of the European Communities, established in 1959 as a successor to a statistical service established with the creation of the European Community (De Michelis and Chantraine, 2003).

Today Eurostat performs three important tasks.

- It collects data from national statistical offices and other competent organizations, assesses the quality of the data (in terms of its relevance, accuracy, timeliness, clarity, comparability, coherence with international standards and conventions, and completeness), harmonizes it in accordance with a single methodology, estimates, where it can, missing values and makes the data available to EU services and, as a public service, to other interested parties. More specifically, data from various national sources are collated in each country’s National Statistical Office and then sent to the thematic units of Eurostat, which validate the data (option 1 in Figure 5). The thematic unit in question then loads the data into Eurostat’s statistical database system. The Regional Statistics Section copies this information from the thematic domain into the Regions domain. In some cases data is sent directly to the Eurostat regional team (option 2 in Figure 5) which, after validation, loads it into the Regions domain of Eurostat’s statistical databases (Eurostat, 2007).
- Eurostat co-operates with national statistical offices to develop a European statistical system.
- It is active at an international scale where it also works in conjunction with international organizations such as the United Nations and with non-EU countries.
At the end of the 1960s Eurostat began to collect harmonized regional statistics. This step coincided with moves towards the establishment of an EU regional policy: the first proposal was put by the European Commission to the European Council in 1969; the setting-up of a regional policy was agreed in 1970; and the European Regional Development Fund was established in 1975. A number of other existing funds were harnessed to EU Cohesion Policy in the late 1980s as its financial instruments and their size was increased. The need for objective information to underpin the design of EU regional policy, the allocation of its financial Fund resources and the monitoring and evaluation of its results conferred a vital role on comparable regional statistics. In the 1980s the development of regional statistics was supplemented by the development of European geographical information systems of which a system of regional statistics may ultimately be seen as a part. The last ten years have seen the addition of urban statistics and the associated definition of urban regions.
4. European regional and urban statistics

At present most Eurostat data is stored in the public New Cronos database system. This system is itself organized around nine statistical themes. EUROSTAT’s regional statistics are stored in the REGIO domain of Theme 1 of the New Cronos system entitled General Statistics. They are organized into a number of collections (see Figure 6 and Appendix 1 for a list of the tables in collections that are at present available online). Most of the individual tables have at least four dimensions of which one corresponds to the NUTS regions, one to time, and the others to categories that depend on individual data sets.

Figure 6. Outline content of the REGIO database system

<table>
<thead>
<tr>
<th>Agriculture</th>
<th>Health</th>
<th>Structural business statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Demography</td>
<td>Labour costs</td>
<td>Tourism</td>
</tr>
<tr>
<td>Economic accounts</td>
<td>Labour force survey</td>
<td>Transport and energy</td>
</tr>
<tr>
<td>Environment</td>
<td>Migration</td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td>Science and technology</td>
<td>Unemployment</td>
</tr>
</tbody>
</table>

In the mid 1990s the Commission decided it also required reliable and comparable quantitative data on the quality of life in European cities, given their role as drivers of the economic, social and territorial disparities that Cohesion policy seeks to reduce and the development of EU urban policies. In 1999, accordingly, Eurostat conducted a pilot Urban Audit. The first full-scale urban audit took place in 2003-04; in 2004 the Urban Audit was defined as one of Eurostat’s core activities; and in 2004 and 2006 Eurostat surveyed perceptions of the quality of life in 31 (2004) and 75 (2006) EU and non-EU cities. The first full-scale audit resulted in the construction of a database with 333 indicators (covering demography, social and economic life, civic involvement, training and education, environment, travel and transport, information society and culture and recreation) for 2001 (with data also collected for 1991 and 1996) for 258 cities (as well as a reduced data set for 570 cities). For these cities the data related to city regions, city cores and districts inside the cities. At present data is collected every three years. The second full-scale audit of 367 cities (and in less detail all cities with 100,000 inhabitants) was carried out in 2006-07. At present annual data collection is under consideration for a smaller number of cities.
In 2005 Eurostat started a parallel project to collect quality of life data for rural areas. In the course of time this increase in the demand for small area data may be satisfied with grid data derived from geographical information systems.

5. **Which indicators?**

At present a great deal of weight is attached to Gross Domestic Product (GDP) or Gross Value Added (GVA) and to unemployment rates as drivers of regional development policy.

- GDP and GVA are important indicators of the performance of regional economies. They are, however, subject to important limitations, as are reflected of course in the appointment by French President Sarkhozy of a Commission on the Measurement of Economic performance and Social Progress (see Stiglitz, Sen and Fitoussi (2009)). One is that they cannot easily capture some important differences within regions as the two indicators are not particularly reliable when used on a small scale.
- Another is that GDP and GVA measure output and not income to households. Generally, transfers reduce differences in income and consumption. Admittedly EU regional policy seeks to act on differences in productive capabilities. The question that arises, however, is whether increases in wealth are sought for their own sake or as a way of increasing human welfare. In the latter case attention should also be paid to impacts on income and its distribution and, indeed, to impacts on human happiness which depends on income, employment, health and a range of other factors.
- A third difficulty is that neither GDP nor GVA take account of negative externalities (congestion and other diseconomies associated with over-development) nor of the condition of the natural environment, the depletion of natural resources, environmental damage and non-market environmental goods and services (the value of water-soil protection by forests, biodiversity protection and carbon storage). Addressing these issues requires the creation of new measures of development, of which green GDP estimates which involve subtracting from GDP estimates of environmental damage are an example.

GDP and GVA are, of course, measures of annual flows of income. When policy-makers turn their attention to economic development and human and welfare, other factors are important. Development and welfare depend on a society's capital or national wealth made up of human capital (HC), which is a function of the educational attainment and know-how of a society's population, its health and the social conditions in which it lives; real capital (RC) in the form of machinery, buildings and infrastructure; financial resources (FC); social capital or governance (SC); and natural capital (NC). At present policy concentrates on income accounts but a society's wealth is equal to the sum of these listed elements measured with the help of wealth accounts or a society's balance sheet. A wealth perspective also offers a definition of sustainable development as a situation in which
national or social wealth increased and no critical component of national wealth is irreversibly reduced.

A further difficulty with estimates of wealth and income is that, where such estimates are used to identify variations in standards of living, they must be adjusted for differences in the purchasing power of money. In the EU GDP estimates are, therefore, for some purposes, adjusted to allow for different purchasing power parities (PPPs). At present, PPPs are national implying that there are no significant purchasing power disparities between the regions within individual countries. This assumption is unrealistic but, unfortunately, considerations of data availability make it unavoidable. As the resulting distortions are large, it is important that this gap in current regional statistics be filled.

These considerations increase the importance of developing indicators of sustainable development as a foundation for regional development strategies. These indicators should embrace:

- environmental and climatic change (impacts on renewable and non-renewable natural resources, the quality of environmental resources including air, water and land, the state of ecosystems dealing with acidification, eutrophication, biodiversity, the impact of natural disasters, the incidence of man-made disasters, climate change, greenhouse gas emissions, and ozone layer depletion);
- economic change including emissions, natural resource use, production and consumption patterns, the creation of sustainable products, the development of sustainable technologies, and energy efficiency; the employment rate, growth, skills and innovation;
- social dimensions including population growth, migration and the scale of refugee movements, the satisfaction of human needs for health, food, housing, education, equity and security, the creation of sustainable communities with good living conditions via physical planning, land use policies, regional development, infrastructure projects, housing and transport, and social cohesion reflected in reduced poverty and dependency rates;
- global development co-operation.

6. Geographical information and geographical information systems

The development of geographical information systems (GIS) has seen significant changes in the ways in which geographical information is handled. In a GIS context geographical or more precisely georeferenced data is data/information about the real world that is connected to specific locations on the surface of the earth. This geographical information can be visualized as a set of thematic layers where each layer and the information it provides is linked to a common georeferencing system. A GIS will contain a number of core data layers plus layers that reflect particular applications (Figure 7). Every GIS will include geodetic control which provides the
fundamental reference to a co-ordinate system (latitude, longitude and elevation) representing positions on the surface of the earth. In addition a GIS will involve the use of map projections used to transfer positions on the surface of the globe to the flat surfaces of maps, and a superimposed system of grid squares. Alongside these elements are frequently found layers dealing with:

- topographic and other types of geographical information (hydrological) along with the names of geographical features;
- orthoimagery comprising digitally scanned aerial photographs or satellite images from which displacements caused by terrain relief and sensor tilt have been removed, which permits the image characteristics of photographs to be combined with the geometrical qualities of maps;
- land cover and land use (including vegetation, crops and urban areas), cadastral information identifying the ownership and control of land;
- energy, water and communications networks; and
- political and administrative divisions.

Figure 7. GIS layers. Source: Canada Centre for Remote Sensing, http://www.ccrs.nrcan.gc.ca/

Each data layer contains either an explicit geographical reference, such as latitude and longitude coordinates, or an implicit reference of which examples are addresses, postal codes, census tract names and road names. In a GIS, implicit references are converted to
explicit references by an automated process called geocoding, which ties implicit references, such as an address, to a specific point on the earth’s surface.

The data itself are usually classified into one of three types.

- Map data made up of points, lines and polygons to represent the location and shape of geographical features: points represent anything that can be described as an $x,y$ location on the surface of the earth; lines represent any linear objects having a length; and polygons represent anything having boundaries, whether natural, political or administrative.
- Attribute data describe the characteristics of different map features such as regions, census tracts, and cities; and identify what a feature is and describe or represent some of its characteristics. Attribute data can be categorical (categories of land use for example), ordinal (to represent for example the scenic value of different landscapes), interval or ratio (of which counts and densities are examples).
- Image data comprise digital satellite images and aerial photographs.

All geographical data fall into the two basic categories of vector data and raster data. Vector data represent discrete features whose position, length and shape can be represented as one or more sets of $x,y$ co-ordinates. Examples include the locations of individuals and data summarized by geographical area such as regions or post code zones. In this case data analysis involves summarizing and relating the attributes of features represented by layers in a geographical data base system. Raster data are used to represent continuous numerical values such as elevation, and continuous categories such as soil type, vegetation types and land use. The raster model represents features as a matrix of cells of differing possible sizes in continuous space. Each layer represents one attribute. Analyses of this data often involve the combination of layers to create new layers and new cell values.

A GIS will also include metadata. Metadata is data about data. It provides additional information about the origins of data and changes in data that is not contained in the data itself yet that is required to make the data useful. It can include inventories of data, definitions of names and data items, information about data structures, the way the data was collected, aggregated analyzed and made available for use, and information about data structures. Metadata is also important for its role in the establishment of standards in naming, defining, cataloguing, storing and transmitting data, permitting data integration and comparison.

The EU has established a reference GIS, called GISCO, for use by the European Commission and other European agencies including the European Environment Agency. The EU GIS is also a permanent service of Eurostat which has the role to:
• promote and stimulate the use of GIS within the European Statistical System and the Commission;
• manage and disseminate the Geographical reference database of the Commission;
• act as a reference centre concerning GIS;
• promote geo-referencing of statistics and collaboration between national statistical institutes and mapping agencies;
• pursue and ensure standardization and harmonization in the exchange of Geographical Information; and
• co-lead the INSPIRE initiative on the introduction of a European Spatial Data Infrastructure (Eurostat, 2007) with the intention of improving the integration of European spatial data.

GISCO includes a large number of data layers. These include:

• administrative and statistical reporting areas including Member States, the NUTS administrative areas and the areas identified for the Urban Audit;
• area management zones including areas eligible for Structural Fund support;
• the Corine (Coordination of Information on the Environment) land cover database, originally established in 1985. This database distinguishes 44 classes of agricultural land, forests and semi natural areas, wetlands, water surfaces database and urban settlements, and is used to monitor and assess pressures on natural habitats from urban growth, transport and agricultural development;
• databases covering communications infrastructures, energy production and population distribution; and
• topographical (digital elevation models) and climatic data.

Figure 8. Corine land cover classes. Source: EEA, Copenhagen (http://www.eea.europa.eu)
A number of complementary European Commission databases not included in the GISCO reference database system have also been established. IMAGE 2000 is a satellite imaging programme undertaken by the European Commission’s Joint Research Centre. NATURA 2000 is a GIS established to support the NATURA 2000 network of sites designated under the Birds Directive (Special Protection Areas, SPAs) and the Habitats Directive (Sites of Community Importance, SCIs, and Special Areas of Conservation, SACs).

7. The NUTS classification

This chapter has shown that regions are defined both for scientific or analytical reasons and for administrative reasons. In each case the identification or establishment of regions gives rise to demands for the compilation of statistical and other information to inform scientific enquiry or to underpin administrative and management activities. At present geographical information can be collected either directly for regions defined for one of these groups of purposes or, especially as a result of recent developments in GIS and remote sensing technologies, for grid squares. In the latter case data can be aggregated to coincide with scientifically or administratively defined areas of different types and sizes.

44 Information about the NUTS system including details of the classification and maps of NUTS regions is available on the Eurostat website at http://ec.europa.eu/eurostat/ramon/nuts/splash_regions.html.
European Regional Policy was first put in place at the start of the 1970s. At that time a geographical division of the territory of the EU was required for the analysis of regional problems, for the design and implementation of this new policy and for the compilation of regional statistics to inform analysis and policy decisions.

At that stage Eurostat, in collaboration with European Commission directorates and member states, decided to achieve this objective through the establishment of the Nomenclature des Unités Territoriales pour la Statistique (NUTS) or, in English, Nomenclature of Statistical Territorial Units. This system, as the name implies, exists principally to collect, develop and harmonize EU regional statistics. In the 1970s the NUTS classification gradually replaced the specific territorial divisions used in various statistical domains (such as agricultural regions and transport regions), and it was subsequently used for the development of regional economic accounts and the regional sections of EU surveys.

NUTS has come to serve three functions. First, it provides the framework for the development of harmonized regional statistics. Second, it serves as the foundation for the socio-economic analyses of the EU regions. In the 1960s what came to be called NUTS-Level II (hereafter NUTS II) areas were identified as the framework used for Member State regional policies, whereas NUTS LEVEL I (hereafter NUTS I) areas were identified as the principal entities for the analysis of Community regional issues such as the sub-national impact of customs union and economic integration, and NUTS LEVEL III (hereafter NUTS III) areas were considered as useful in the diagnosis of regional problems and in identifying where regional policy measures were required. Today the periodic report on the social and economic situation and development of the regions of the EU, which the Commission is required to prepare every three years, draws mainly on NUTS II data. Third it provides a framework for EU Regional Policy and in particular is used in deciding on eligibility for regional aid: from the reform of the policy in 1989, the classification of areas eligible for support under Objective 1 or the Convergence objective was carried out for NUTS II regions, while the classification of areas eligible under other priority objectives has involved the use of NUTS III data.

The NUTS is intended to provide a single uniform breakdown of the territory of the EU into a hierarchical set of statistical regions. The main building blocks of the NUTS system are general-purpose administrative divisions of each member state. The use of special-purpose (for example, travel-to-work areas which have nonetheless a strong functional rationale) as opposed to general-purpose administrative areas is resisted, yet they are sometimes used in some member states. The reasons given for this resistance are twofold. The first is that special-purpose regional divisions are too specific: while serving as particularly appropriate divisions for narrow subsets of indicators they are particularly inappropriate as divisions for many of the other sets of indicators Eurostat must develop. The second is that special-
purpose areas give member states too much discretion and can significantly reduce the comparability of regions from one member state to another.

The current NUTS system is a three-level hierarchical classification of regions in which each member state is subdivided into a whole number of NUTS I regions, each of which is in turn subdivided into a whole number of NUTS II regions and each NUTS II region is subdivided into a whole number of NUTS III regions.

As EU policy increased its interest in areas not derivable from these three levels, and especially in smaller territories (mountainous areas, disadvantaged agricultural areas, coastal zones, deprived urban areas), smaller NUTS LEVEL IV (hereafter NUTS IV) and NUTS LEVEL V (hereafter NUTS V) areas were also identified. At present however NUTS IV and V areas are classed as Local Administrative Units 1 and 2 (hereafter LAU1 and LAU2). Each member state has to supply Eurostat with lists of LAUs by NUTS III region.
A number of factors made it difficult to combine national territorial communities into an EU-wide system: administrative systems and the division of responsibilities between different administrative tiers in different member states differ quite significantly; the estimations of population size required to meet administrative responsibilities efficiently and effectively varies; the histories of sub-national governance are also distinct. It was, however, the path that was chosen since data availability and regional policy implementation required the
NUTS nomenclature to be based primarily on the institutional divisions currently in force in the member states.

One consequence of these differences is that, in many member states, construction of the first three intra-member state tiers permitted the use of only two levels of the administrative system and therefore required construction of a non-administrative NUTS Level. For example, in Germany, Länder and Kreise; in France, régions and departments; in Spain, Comunidades autónomas and provincias; and in Italy, regioni and province could be used. To create three tiers of comparable units however a further tier corresponding to a less important or even non-existent administrative structure had to be identified – for Italy, Greece, Spain and France at NUTS I (the Zones d’Etudes et d’Aménagement du Territoire in France); for Germany at NUTS II; and for Belgium at NUTS III.

Establishing a NUTS classification for each member state involved several steps (Eurostat, 2003). The first was an examination of the member state’s administrative structure and the calculation of the average size, mainly in terms of population, of each tier. Also, it was necessary to check whether regional statistics were compiled and disseminated for each tier. If information was available, and if the average size of a tier more or less corresponded to that of one of the NUTS Levels (average size in all other member states), the next step was the selection of that tier of the administrative structure in its entirety as the NUTS breakdown at that level. The size of individual entities could, however, differ widely from the EU average. In the case of Italy, for example, the average population of Italy’s 20 regioni (some 2.9 million inhabitants) was close to the NUTS II average (some 1.8 million). The regioni therefore comprise Italy’s NUTS II regions. And yet some of the regions are very small and others very large: Valle d’Aosta has 120,000 inhabitants while Lombardia has almost 9 million. If, however, no administrative tier for which suitable statistics existed was similar in size to the EU average, Eurostat and the member state compiled an ad hoc set of non-administrative areas, by grouping together existing smaller administrative units. In the case of Portugal, for example, the NUTS III level was established by grouping the 305 concelhos used at Level IV to form 30 grupos de concelhos at Level III.

The use of administrative divisions meant that changes in administrative structures implied changes in the corresponding NUTS Level for the member state concerned. Accordingly major changes occurred in the 1970s in the United Kingdom, Germany, Denmark as a result of major reorganizations of subnational government. Fewer changes occurred in the 1980s and 1990s except for another major restructuring of UK subnational government in the 1990s and significant regional re-organisation in the eastern part of Germany.

Each potential new member state which has embarked on the path to accession has put in place a NUTS division of its national territory, and each wave of enlargement has seen the
extension of the NUTS system to cover the new member states. A NUTS classification was also established for the EFTA countries. In 1996-97, for example, Eurostat proposed a breakdown for each of the ten countries then in the Phare programme. These breakdowns were adopted in 1998. In 2002 an agreement was reached on the regional breakdown for Turkey, and in 2007 for Croatia and the former Yugoslav Republic of Macedonia (Eurostat, 2008).

In the case of many new member states in central and eastern Europe administrative structures have been the subject of administrative reforms. As a result, significant changes have occurred in the regional breakdowns originally agreed between them and Eurostat. In the case of Romania, for example, the administrative tier corresponding to NUTS II was re-organized while the NUTS III judet were retained. As a result some of the judet were transferred from one NUTS II area to another. In Poland a completely new structure was adopted and 49 NUTS III voivodships were replaced by 16 NUTS II voivodships; negotiations with Eurostat also led to the creation of a new NUTS III structure which grouped together NUTS IV regions. Major changes also occurred in the Czech Republic, Bulgaria and Slovakia. In 2001 Estonia modified three of its five NUTS III regions in order to better reflect the population distribution and economic structure of the country, and in 2003 a further NUTS III area was established in Poland (Eurostat, 2002).

Of successive implementations of the NUTS system, only the four latest NUTS versions of 1995, 1999, 2003 and 2006 have been published. Early NUTS versions were established in 1981 and 1985. Several further NUTS versions were established in 1981-92. None of these versions was published (Eurostat, 2002). Changes in this period are recorded in Table 1. A detailed account of territorial changes which led to changes in the NUTS classification, changes of codes not connected with territorial changes and of national changes which are not reflected in the evolution of the NUTS classification for the period up to 2000 is provided in a Eurostat publication (Eurostat, 2002).


<table>
<thead>
<tr>
<th>1981-1992</th>
<th>NUTS Level I</th>
<th>NUTS Level II</th>
<th>NUTS Level III</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td>Changed</td>
<td>Changed</td>
<td>codes only</td>
</tr>
<tr>
<td>Denmark</td>
<td>-</td>
<td>Suppressed</td>
<td>codes only</td>
</tr>
<tr>
<td>Germany</td>
<td>Changed</td>
<td>Changed</td>
<td>Changed</td>
</tr>
<tr>
<td>Netherlands</td>
<td>-</td>
<td>Changed</td>
<td>Changed</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>-</td>
<td>New</td>
<td>codes only</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>1992-1995</th>
<th>NUTS Level I</th>
<th>NUTS Level II</th>
<th>NUTS Level III</th>
</tr>
</thead>
</table>


In that period the NUTS classification was changed on the initiative of the statistical offices of the individual member states, although subsequent steps in the procedure were largely determined by the way in which the classification was compiled. If a national administrative tier was used to establish a particular NUTS Level, any change in that structure resulted almost automatically in changes in the NUTS classification. Examples include at NUTS II level the creation of a tenth province (NUTS II area) in Belgium and, at NUTS III level, the conversion of ‘planning regions’ to ‘regional authority regions’ in Ireland, the division of several Italian provincie and a regrouping of the Swedish lan (Eurostat, 2003).

If, however, a member state wished to modify a NUTS Level which had no counterpart in its administrative structure and had been created from the aggregation of smaller units, a different procedure applied. Then Eurostat examined, as for example, in the case of the creation of new NUTS II areas in the UK, the reasons for the change (whether, for example, it reflected an administrative reform which modified the units from which the NUTS Level was created, or whether it reflected the use of new criteria) and the extent to which the proposed new structure satisfied the underlying principles of the NUTS system. In some of these cases, negotiations with member states were protracted and difficult (Eurostat 2003). The reasons lay in the imprecision of statistical criteria and the room they left for manoeuvre in a situation where the change in classification might affect eligibility for Structural Fund support, and therefore have a budgetary impact.

Users have an interest in the stability of classifications, so that time analysis of the data is possible. For this reason, a planned NUTS Regulation was designed to fix a minimum period of 3 years when the NUTS will remain unchanged. No more frequently than every 3 years, there will be a revision which implements all NUTS modifications that have been notified and approved since the last revision.
From 1988 onwards (see Council Regulation (EEC) No 2052/88 on the tasks of the Structural Funds, Official Journal. L 185 of 15 July 1988), the NUTS classification has been used in Community legislation. Until 2002, however, the establishment of successive NUTS versions essentially involved so-called ‘gentlemen's agreements’ between member states and Eurostat. As indicated earlier, in some cases these agreements were reached only after long and difficult negotiations.

In 2003 a Regulation was approved by the European Parliament and enacted as EU legislation giving the NUTS a legal status. The Regulation was modified in 2005, 2007 and 2008 to reflect EU enlargements. The main aim of the regulation is to establish a common classification of territorial units in order to permit the collection, preparation and dissemination of harmonized regional statistics. Another important goal was to lay down clear rules for managing as smoothly as possible unavoidable changes in the administrative structures of member states and to minimize the impact of administrative changes on the availability and comparability of regional statistics.

The Regulation calls for the use of objective criteria to define regions, the stability of the nomenclature and the comparability in the sizes of the populations of areas at each level of the NUTS hierarchy. As far as population at different levels of the system is concerned, the Regulation specifies that the average size of the resident population of each class of administrative units in each Member State should lie within the thresholds set out in Table 2.

Table 2. Threshold population sizes for NUTS I, II and III areas. Source: EU (2003)

<table>
<thead>
<tr>
<th>Level</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>NUTS I</td>
<td>3 million</td>
<td>7 million</td>
</tr>
<tr>
<td>NUTS II</td>
<td>800,000</td>
<td>3 million</td>
</tr>
<tr>
<td>NUTS III</td>
<td>150,000</td>
<td>800,000</td>
</tr>
</tbody>
</table>

Also, it sets out the approach to be followed in cases where, for a given administrative level, no administrative units of a suitable scale exist. In such cases, the NUTS-unit concerned should be constituted by aggregating an appropriate number of existing, smaller, contiguous administrative units in a way that reflects geographical, socio-economic, historical, cultural, environmental or other relevant circumstances.
The Regulation lays down strict criteria relating to the amendment of NUTS areas. Among other things, it requires member states to inform the Commission of changes in administrative units that do, or may, affect the NUTS classification. Amendments are restricted to a six-month period every three years except in the case of a major administrative reform. In the case of non-administrative areas, change is only permitted if it reduces the standard deviation of the population sizes of all NUTS regions at the tier concerned. In addition, amendments will be decided by a committee set up under the Regulation and on which all member states are represented.

In 2003 the 1999 NUTS version was adopted. In 2006, for the first time in accordance with the new provisions, the 2003 version was adopted with the new version coming into effect at the start of 2008. In 2003 for example there was a reduction in the number of NUTS I areas in Italy from 11 to five. In 2006 major changes occurred in Denmark as a result of a regional reform that saw the creation of new administrative regions that are to comprise NUTS II regions and the abolition of 15 administrative regions that were formerly NUTS III areas. Municipalities were combined to create 11 new non-administrative NUTS III regions. In Sachsen-Anhalt in Germany three NUTS II regions were merged into one, while at the NUTS III level 24 areas were re-organized into 14 new NUTS III areas. The number of NUTS regions in 2008 is set out in Table 3. Non-administrative levels as defined in Annex 2 of the NUTS Regulation are shaded grey.
Table 3. Number of NUTS regions by Member State as of 2008. Source: Eurostat (2007)

<table>
<thead>
<tr>
<th>Country</th>
<th>Level 1</th>
<th>Level 2</th>
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<td>EU 27</td>
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8. Assessing the NUTS classification

The last section of this chapter indicated that the administrative systems in different member states differ sharply. These differences reflect different decisions about the division of responsibilities, estimates of the population sizes required to meet responsibilities efficiently and effectively and distinct histories of sub-national governance. Creating a harmonized EU system of sub-national territorial communities was consequently an extremely problematic task.
The two reasons for the choice of national administrative arrangements as the foundation for the NUTS classification are clear: data is produced for these entities at a member state level and sub-national administrations play a role in the design and implementation of EU-funded regional development programmes.

One consequence is the heterogeneity of NUTS regions. In part this derives from the fact that population is the only criterion for the allocation of national administrative and non-administrative areas to the various levels of the NUTS hierarchy. Even in narrowly demographic terms, however, the areas vary widely. The reason is that mean size is used to match administrative tiers and non-administrative areas to particular NUTS levels. The position is somewhat improved by, in the case of non-administrative areas, accepting changes only if they reduce the degree of dispersion, measured by the standard deviation of the populations of areas at that level in the EU as a whole. But it is clear from Figure 10 that, although the mean size of NUTS II areas stands at 1,831,000 and lies between the threshold values of 800,000 and 3 million, a substantial number of NUTS II areas lie outside these limits. The smallest has a population of just 26,400 while the largest has a population in excess of nearly 11.4 million.

Figure 10. Average population of NUTS II areas in 2004. Source: elaborated from Eurostat data

![Histogram of Average Population in 2004 (Thousands)]

- Mean = 1,830,73
- Std. Dev = 1,505,59765
- N = 367
- Minimum = 26.4
- Maximum = 11,358.6

Frequency

Average Population in 2004 (’000s)
Figure 11 uses box-and-whisker plots to indicate the degree of variation in the population of NUTS II areas by member state. Median populations, represented by the horizontal lines inside the boxes, differ significantly across member states. The degree of dispersion — measured by the inter-quartile range, which is represented by the boxes — is variable and in some cases large. The vertical lines denote maximum and minimum values excluding outliers (defined as lying between 1.5 and 3 times the inter-quartile range from either end of the box), and extreme values (defined as lying more than three times the inter-quartile range outside the box). The region of Ile-de-France (although in functional terms, it makes a degree of sense), Attiki in Greece and Kozep-Magyarorszag in Hungary are extreme values, and there are important outliers in Germany, Spain, France, Greece and the UK.

Figure 11. Distribution of the population sizes of NUTS II areas by Member State in 2004. Source: elaborated from Eurostat data

A more fundamental problem arises from the fact that the features of important geographical distributions do not necessarily coincide with administrative boundaries. Territorial units should ideally reflect the geographical distribution of the phenomena under investigation. In relation to many of the issues dealt with in EU Cohesion Policy, functional areas and, in particular, travel-to-work areas (TTWAs) would make more scientific and policy sense. Also,
the harmonized application of rules for defining functional regions would ensure the international comparability of the regions in individual member states. Insofar as Cohesion Policy deals mainly with issues related to the geography of economic activities and employment, TTWAs would make sense. The difficulty is that if a number of other distinct subjects requires analysis (access to schools, for example) the number of potential functional regionalizations increases.

As far as regional economic development is concerned, TTWAs have a strong rationale. A major dispute in regional economic policy concerns the extent to which differences in employment rates reflect ‘demand-side’ (differences in employment opportunities) or ‘supply-side’ (unemployed do not get jobs that exist) factors. In this context there is a significant difference between two types of area: areas with low levels of employment that are not within easy travelling distance of anywhere with a tight labour market; and areas with low employment rates that are within commuting distance of areas with tight labour markets. In areas of the first type that are a part of concentrations of TTWAs with low employment rates, demand for labour needs to be stimulated. If jobs are not created in such TTWAs only temporary or permanent migration affords an answer to low employment rates. In this case searching for TTWAs and in particular for concentrations of TTWAs (see Figure 12) with low employment rates plays a particularly important role in the diagnosis and design of regional policies.
Figure 12. Employment rates by travel-to-work area in Great Britain
To this important consideration must be added another. Areas defined as assisted areas should not be defined so narrowly as to cut them off, and hence lose the potential support of, nearby functionally-interdependent areas that are zones of potential growth.

The use of administrative areas that are not also functional areas raises a number of important difficulties in relation to one of the most important indicators used for EU Regional Policy, Gross Domestic Product (GDP) per head. GDP is usually measured by place of employment, whereas population is measured by place of residence. Measuring GDP by place of employment makes sense as regional policy is designed to augment the wealth-creating capacities of economically disadvantaged areas. If, however, GDP per head is calculated for administrative areas that are not, at the same time, TTWAs the GDP per capita indicator will be misleading, either because the administrative areas exclude the places of employment of the people who live there or the places of residence of the people who work there. At present, for example, in the UK, Inner London has by far the highest GDP per head of NUTS II areas in the EU (Figure 12). But this figure is artificially high. Inner London includes a large number of places of employment for people who do not reside in Inner London, while relatively fewer residents work outside of Inner London. Inner London, in other words, excludes many of the suburbs of London and a vitally important commuter zone that lies beyond the limits of Greater London. An examination of the second chart, which uses data on GDP and employment by place of employment to measure productivity, generates far fewer outliers in part as it is not subject to the same distortion as GDP per capita data. Greater London occupies on this indicator a far more modest position in the rank order of European regional economies.
Figure 13. GDP per capita and GDP per person employed at PPS in NUTS II areas in 2004. Source: elaborated from Eurostat data.

Measured indicators of disparities and, for example, the quality of maps showing the eligibility of disadvantaged areas for financial support, depend upon the ways in which
regions are created. Figure 13 explores a simple hypothetical example (Dunford, 1994). Suppose a country is divided into 16 areas (A1, A2, ..., D4) with identical populations but different levels of GDP per head, and that these areas are grouped first into four and then into two regions (Figure 13A). The standard deviation expressed as a percentage of the mean decreases from 38.5 per cent (16 areas) to 10.6 (4 areas: A1..B2, A3..B4, C1..D2 and C3..D4) and 3.22 (2 areas: A1..B4 and C1..D4). It is important to note, however, that the choice of regional boundaries can affect the result. If in Figure 13A the 16 areas are divided horizontally rather than vertically into two groups (A1..D2 and A3..D4) the indicator falls to 9.67 instead of 3.22. Alternatively if four areas are identified in the manner indicated in Figure 13B, the coefficient of variation will equal 24.7. It is clear from this that measured regional disparities depend not just on the degree of spatial concentration of economic activities, but also on the regional division of the country. The number of areas and the choice of boundaries affect the measure of disparity, just as the delimitation of electoral districts shapes the outcome of elections. Clearly the ideal solution is to use functional economic areas which combine places of work with corresponding places of residence, although disparities between politically identified areas are significant as determinants of the resources over which different communities can exercise political leverage.

**Figure 14. Measured inequality and regional division**

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The pertinence of this simple example is demonstrated in practice by the ways in which changes in regional boundaries have affected eligibility for EU regional aid. In the case of Ireland, for example, one NUTS II area covered the entire country after the EU Cohesion Policy reform of 1898. This remained the case until the higher levels of GDP per capita in the country’s more developed south and east were sufficient to raise Ireland’s GDP per head above the level of 75 per cent EU GDP per head. At that point in time, the Irish government negotiated in 2000 a division of Ireland into two NUTS II areas (Figure 14) in the context of the agreement on the third 2000-06 financial perspective. Also, a year previously, Ireland had established two regional assemblies comprising nominated members of elected regional authorities. As a result of this division into two NUTS II areas, the Border, Midland and Western region retained Objective 1 status for EU Cohesion Policy in 2000-06, still qualifying for intensive levels of financial support. The other NUTS II region, Southern and Eastern, qualified for EU Cohesion Policy assistance until end-2005 under the Phasing-Out regime for Objective 1.
A more recent example relates to the German Land of Sachsen-Anhalt which was divided into three NUTS II areas. For the period 2007-13 Magdeburg and Dessau were identified as Convergence regions as their average GDP per capita at PPS in 2000-02 was less than 75 per cent of the EU15 average. But Halle was identified as a Phasing-Out area since its average GDP per head at PPS exceeded 75 per cent of the EU average. Table 4 shows, however, that Sachsen-Anhalt as a whole is small enough to qualify as a NUTS II area. Had it in fact not been subdivided the whole of the area would have qualified for funding under the Convergence objective.
Table 4. Statistical indicators for Sachsen-Anhalt, 2000-04. Source: Statitisches Landesamt Sachsen-Anhalt, Eurostat, calculations of the Staatskanzlei Sachsen-Anhalt, my calculations

<table>
<thead>
<tr>
<th></th>
<th>Magdeburg</th>
<th>Halle</th>
<th>Dessau</th>
<th>Sachsen-Anhalt</th>
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<tbody>
<tr>
<td>Population</td>
<td>1178061</td>
<td>835933</td>
<td>521421</td>
<td>2535415</td>
</tr>
<tr>
<td>Demographic change, 2000-03 (%)</td>
<td>-3.00</td>
<td>-3.90</td>
<td>-4.90</td>
<td>-3.70</td>
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<tr>
<td>Employees</td>
<td>476971</td>
<td>339396</td>
<td>195632</td>
<td>1011999</td>
</tr>
<tr>
<td>Employee change 2000-03 (%)</td>
<td>-2.80</td>
<td>-6.40</td>
<td>-4.30</td>
<td>-4.30</td>
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<tr>
<td>GDP change 2000-03 (%)</td>
<td>9.20</td>
<td>3.80</td>
<td>8.40</td>
<td>7.20</td>
</tr>
<tr>
<td>GDP per employee in 2004 (€)</td>
<td>44455</td>
<td>44459</td>
<td>44171</td>
<td>44402</td>
</tr>
<tr>
<td>GDP per capita at PPS in 2003 (EU25=100)</td>
<td>75.50</td>
<td>77.60</td>
<td>70.90</td>
<td>75.20</td>
</tr>
<tr>
<td>GDP per capita at PPS in 2000-02 (EU25=100)</td>
<td>72.27</td>
<td>75.07</td>
<td>65.99</td>
<td>74.54</td>
</tr>
<tr>
<td>Unemployment rate in 2003 (%)</td>
<td>17.6</td>
<td>21.3</td>
<td>21.3</td>
<td>19.6</td>
</tr>
</tbody>
</table>

Finally, it is important to recognize that the generation of statistics for territorial entities involves a significant degree of information loss. These information losses are particularly problematic in situations like the one depicted in Figure 17, where there is a non-correspondence of administrative boundaries with one of the geographical distributions central to many policy areas. Figure 17A plots population density by LAU2 administrative units (Cubitt, 2007 on whose presentation this figure and the next three figures derive). Figure 17B, 17C and 17D plot the same data by NUTS III areas, NUTS II areas and NUTS I areas respectively. The figure makes clear that movement up the NUTS hierarchy results in extraordinary losses of detail, while the average values for NUTS I areas, in particular, can potentially be quite misleading.

One way to solve problems of this kind is to supplement data for administrative areas with grid square data. An example of grid square data is provided in Figure 17E which plots the same population density data at a 10 kilometer grid resolution. A movement in this direction is at present constrained, however, because few national statistical offices in member states collect this type of data. Nonetheless raster data for grid squares of equal sizes could provide additional and largely complementary data to that collected for administrative areas.
Figure 17. Geographies of population density. Source: Cubitt, 2007
A population grid of the kind used in Figure 17E offers a useful way of analyzing per capita indicators. One reason is that spatial modeling techniques permit grid data to be combined with other data sources to generate much more realistic representations of the distribution of population. Figure 18A plots population densities at the level of communes. This data can be combined with information from the Corine land cover GIS to allocate the area's population to grid squares in the light of information about the way the land in that grid square is used, ‘no population’ signifies that the areas are uninhabited, while areas of forest and areas of pasture have few if any inhabitants. The result is a geographical disaggregation
of the population data to generate a much more realistic representation of the distribution of the population (Figure 18C).
Figure 19. Grid and NUTS III estimates of nitrogen deposition. Source: Cubitt, 2007
Cubitt (2007) gives two other useful examples of the potential of these methods. The first (Figure 20) illustrates how information about nitrogen deposition recorded on the EMEP (Cooperative Programme for Monitoring and Evaluation of the Long-range Transmissions of Air Pollutants in Europe) grid system can be aggregated from grid cells to NUTS III regions and to special-purpose Euro farm regions for use in statistical modeling of nitrogen flows.

A further example deals with analysis of accessibility to primary schools in Austria. The starting point is the distribution of primary schools in Austrian communes (Figure 21A) and a grid distribution of the Austrian population. Figure 21B derives school vicinity areas allocating grid cells to the nearest school, and Figure 21C measures the actual distances from each grid cell to the nearest school to which that cell was assigned in the previous step. Figure 21D plots the location of schools and cell population which are used to weight the distances recorded in Figure 21C. In Figure 21E the results are aggregated to generate a map of weighted distances to primary schools at LAU2 and NUTS III levels.
Figure 20. Accessibility of primary schools in Austria. Source: Cubitt, 2007.
Although these methods offer important new possibilities, the existing NUTS areas provide a valuable foundation for new initiatives. One recent development involves classifying NUTS areas according to their urban and rural character in order to explore some of the implications of agglomeration and peripherality.45

Table 5. Agglomeration, urban proximity and economic performance. Source: Dijkstra, 2008

45 Some of this work makes use of the OECD classification of areas as Predominantly Urban, Predominantly Rural and Intermediate. To establish this regional typology the OECD used three criteria. The first criterion identifies a community as rural if its population density is below 150 inhabitants per square kilometer. The second criterion classifies regions according to the percentage of population living in rural communities. An area is Predominantly rural (rural), if more than 50 per cent of its population lives in rural communities, Predominantly urban (urban), if less than 15 per cent of the population lives in rural communities, and Intermediate if the share of population living in rural communities is between 15 and 50 per cent. The third criterion is based on the size of urban centres. A region that would be classified as rural on the basis of the general rule is classified as intermediate if it has an urban centre of more than 200,000 inhabitants representing no less than 25 per cent of the regional population. A region that would be classified as intermediate on the basis of the general rule is classified as predominantly urban if it has an urban centre of more than 500,000 inhabitants representing no less than 25 per cent of the regional population.

In the United Kingdom urban areas are defined by Department for Communities and Local Government (2002) as settlements with a population of 10,000 or more inhabitants. Under a new classification, Census Output Areas are described as urban or rural depending on whether the majority of the population falls inside a settlement with a population of 10,000 or more. To improve this definition of rural settlements, a more detailed classification for rural areas was developed. This classification was based on a settlement approach involving the identification of rural towns, villages and scattered dwellings within a grid framework of cell size one hectare (100 metre squares). This ‘settlement framework grid’ is then used to classify Output Areas and 2003 Statistical wards in terms of settlement context and settlement form.
As indicated earlier, the NUTS plays an important role in the making, implementation, monitoring and evaluation of a number of EU policies of which the most important is Cohesion policy. As far as regional classification is concerned it plays a vital role in establishing eligibility for EU Structural and Cohesion Fund support. In addition it plays a part in EU Competition policy which amongst other things involves the establishment of maximum national regional development aid levels in different regions in the individual Member States.

**9. EU Cohesion policy, 1989-93 and 1994-99**

EU Cohesion Policy was thoroughly reformed in 1989 on the basis of four guiding principles: concentration of resources; multiannual programming (involving the preparation of Community Support Frameworks and Single Programming Documents); partnership; and additionality.

For the periods of the first two financial perspectives, 1989-93 and the 1994-99, the principle of concentration involved a concentration of resources on (1) the worst-affected areas, and (2) four other priorities or objectives:

- **Objective 1.** promoting the development and structural adjustment of the worst-off regions, also known as regions whose development is lagging behind;
- **Objective 2.** converting the regions, frontier regions or parts of regions (including employment areas and urban communities) seriously affected by industrial decline;
• Objective 3. combating long-term unemployment, to which was added in 1994-9 the task of helping to integrate young people into working life as well as those exposed to exclusion from the labour market;
• Objective 4. facilitating the occupational integration of young people;
• Objective 5. with a view to reform of the common agricultural policy:
  (a) speeding up the adjustment of agricultural structures, to which in 1994-9 was added measures for the adjustment of fisheries structures, and
  (b) encouraging the development (and structural adjustment) of rural areas.

Of these objectives some were regional Objectives (1, 2, 5b and 6) which accounted for some 85% of the budget, and some were horizontal Objectives (3, 4 and 5a) applicable the whole Community territory.

In addition the 1989-93 and 1994-99 programmes saw the introduction of Community Initiatives to address Community-wide structural territorial problems.
To establish eligibility for regional aid, regions were classified using a number of indicators (Council of the European Communities, 1988).
Objective 1: regions at NUTS II whose per capita GDP over the preceding three-year period was less than 75 per cent of the Community average, plus Northern Ireland, the French overseas departments and other regions whose per capita GDP was close to the 75 per cent threshold and which had to be included within the scope of Objective 1 for special reasons.

Objective 2: regions, frontier regions or parts of regions (including employment areas and urban communities) that represent or belong to a NUTS III territorial unit which satisfied all the following criteria:

- (a) an average rate of unemployment recorded over the last three years in excess of the Community average;
- (b) a percentage share of industrial employment in total employment equal to or in excess of the Community average in any reference year from 1975 onwards;
- (c) an observable fall in industrial employment compared with the reference year.

In addition Community assistance was able to be extended to three types of area: (1) areas adjacent to those satisfying criteria (a), (b) and (c); (2) urban communities with an unemployment rate at least 50 per cent above the Community average and which had recorded a substantial fall in industrial employment; and (3) other areas which had recorded substantial job losses over the last three years or which either were, or were likely, to experience such losses in industrial sectors vital to their economic development, with a consequent serious worsening of unemployment.

Objective 5 (b): regions selected according to the degree to which they were rural in nature, the number of persons employed in agriculture, their level of economic and agricultural development, the extent to which they were peripheral and their sensitivity to changes in the agricultural sector, especially in the context of reform of the common agricultural policy.
In the 1994-99 period the classification of regions rested on similar principles. Objective 1 area were NUTS II areas whose per capita GDP over the preceding three years was less than 75 per cent of the Community average. To this group were added:

Northern Ireland; the five new German Länder, east Berlin, and the French overseas departments, the Azores, the Canary Islands and Madeira along with other regions whose
per capita GDP was close to the 75 per cent threshold which had to be included within the scope of Objective 1 for special reasons. Abruzzo in Italy was eligible for aid under Objective 1 for the period 1 January 1994 to 31 December 1995. In addition due to their position adjacent to Objective 1 areas and their regional GDP at NUTS III, the ‘arrondissements’ of Avesnes, Douai and Valenciennes as well as Argyll and Bute, Arran, the Cambraes and western Moray were considered eligible for Objective 1 assistance.

As far as Objective 2 was concerned eligibility was extended to (1) areas satisfying criteria (a), (b) and (c) that were adjacent to Objective 1 areas, (2) areas and especially urban areas that faced severe problems linked to the regeneration of derelict industrial sites, and (3) other industrial or urban areas where the socio-economic impact of the restructuring of the fisheries sector justified assistance.

In the case of Objective 5b eligible areas were ones with a low level of GDP per inhabitant which also satisfied at least two of three criteria: (a) a high share of total employment in agriculture; (b) a low level of agricultural income and especially of agricultural value added per agricultural work unit (AWU); and (c) a low population density and/or a significant depopulation trend. In addition Community assistance was extendable to other rural areas with low levels of socio-economic development that are outside Objective 1 regions if they met one or more of the following criteria: (a) peripherality relative to major centres of economic and commercial activity; (b) sensitivity of their agricultural incomes and the size of their agricultural labour force to developments in agriculture, especially in the framework of the reform of the common agricultural policy; (c) unfavourable structure of agricultural holdings and of the age structure of the gainfully employed agricultural labour force; (d) strong pressures on the environment and the countryside; (e) an unfavourable situation of areas within mountain or less-favoured areas; and (f) an unfavourable socio-economic impact on the area of the restructuring of the fisheries sector.

In 1995 (Council of the European Communities, 1995) the accession of Finland and Sweden saw the addition of Objective 6 (in a Protocol attached to the Act of Accession). The aim of Objective 6 was to promote the development and structural adjustment of regions with an extremely low population density. All of these areas were in the northernmost regions of these two new Member States. Areas covered by Objective 6 were to comprise regions at NUTS II with a population density of 8 persons per km² or less. Community assistance could extend however to adjacent and contiguous smaller areas fulfilling the same population density criterion. In identifying these areas attention was also paid to demographic trends and employment difficulties. In Finland, for example, the areas chosen included rural municipalities that had lost almost one-third of their population in the preceding thirty years, while very few regional and sub-regional centres had seen population increases. These regional and sub-regional centres were also included in the assisted areas in order to preserve the integrity of functional economic zones.
10. EU Cohesion policy, 2000-06

In 2000-06 EU Cohesion policy was reformed, in part to anticipate the enlargement of the Union to include a large number of new member States mainly in Central and Eastern Europe. One important change was a move in the direction of greater concentration: the number of objectives was reduced from seven to three and the number of Community initiatives was reduced from 13 to 4 (INTERREG; URBAN; LEADER; and a co-operative transnational programme designed to develop new ways of combating discrimination and inequality in the labour market, called EQUAL) and the share of the EU15 population covered declined from 50 to 41 per cent. In addition a Pre-Accession Structural Policy Instrument was established.

The three priority objectives now became:

- Objective 1: promoting the development and structural adjustment of the least well-off regions, those whose development was lagging behind;
- Objective 2: supporting the economic and social conversion of areas facing structural difficulties due to socio-economic change in the industrial and service sectors, rural decline, urban problems and depression due to their dependence on fisheries, and
- Objective 3: supporting the adaptation and modernization of policies and systems of education, training and employment.

All of these objectives were to be pursued in ways that contributed to ‘the harmonious, balanced and sustainable development of economic activities, the development of employment and human resources, the protection and improvement of the environment, the elimination of inequalities, and the promotion of equality between men and women’ (Council of the European Communities, 1999).
As in earlier periods the areas covered by Objective 1 were NUTS II areas where in the previous three years for which data was available in 1999 – the year of selection – per capita GDP, measured at PPS, was less than 75 per cent of the Community average. In the event, the Commission used 1979 European System of Accounts data for 1994 to 1996. Also included were the outermost regions (the French overseas departments, the Azores, the Canary Islands and Madeira), which were all below the 75 per cent threshold, and the areas
eligible under Objective 6 for the period 1995 to 1999. Areas which were eligible for Objective 1 support in 1994-9 but were no longer eligible in 2000-06 were designated as Phasing-Out regions entitled to transitional support.

Objective 2 support was confined to areas with a sufficiently substantial population or land surface where socio-economic restructuring designed to grapple with structural problems was to be supported.

Areas undergoing socio-economic change in the industrial or service sectors were eligible if they represented or belonged to a NUTS III territorial unit which satisfied the following criteria:

(a) an average rate of unemployment over the last three years above the Community average;

(b) a percentage share of industrial employment in total employment equal to or greater than the Community average in any reference year from 1985 onwards;

(c) an observable fall in industrial employment compared with the chosen reference year.

Eligible rural areas had to represent or belong to a NUTS III territorial unit which satisfied the following criteria: either

(a) a population density of less than 100 people per square kilometre, or a percentage share of agricultural employment in total employment which was equal to, or higher than, twice the Community average in any reference year from 1985; or

(b) an average unemployment rate over the last three years above the Community average, or a decline in population since 1985.

Eligible urban areas were defined as densely populated areas which also met at least one of the following criteria:

(a) a rate of long-term unemployment higher than the Community average;

(b) a high level of poverty, including precarious housing conditions;

(c) a particularly damaged environment;

(d) a high crime and delinquency rate;
(e) a low level of education among the population.

Areas dependent on fisheries were eligible if they were coastal areas in which the number of jobs in the fisheries industry as a percentage of total employment is significant and which were facing structural socio-economic problems due to a significant reduction in jobs in fisheries resulting from the restructuring of the fisheries sector.

The Council Regulation (Council of the European Communities, 1999) also envisaged an extension of Community assistance to Member State specific areas of significant demographic or geographical size which fell into one of the following three categories:

(a) areas meeting the criteria for areas undergoing socio-economic change in the industrial or service sectors which were adjacent to an industrial area or an Objective 1 area, and areas meeting the criteria for rural areas which were adjacent to a rural area or to a region covered by Objective 1;

(b) rural areas with socio-economic problems arising either from the ageing or decline of the agricultural working population;

(c) areas facing or threatened by serious structural problems on account of relevant, verifiable characteristics, or a high level of unemployment arising from an ongoing or planned restructuring of one or more activities in the agricultural, industrial or service sector.

In the case of Objective 2 areas for support (NUTS III regions, or the most seriously affected areas within those regions, or the areas satisfying the urban, fisheries or Member State specific criteria) were proposed by Member States, evaluated by the Commission and drawn up by the Commission in close co-operation with the Member State. At least 50 per cent of the population covered by Objective 2 in each Member State was to reside in areas undergoing socio-economic change in the industrial or service sectors and rural areas, unless there was strong objective evidence justifying a smaller percentage.

To help ensure that assistance was genuinely concentrated on the most seriously affected areas and at the most appropriate geographical level, Objective 2 support was confined to areas not exceeding 18 per cent of the total population of the Community. To this end the Commission established a population ceiling for each Member State. This ceiling depended on three factors:

(a) the total population in the NUTS III areas of each Member State which satisfied the criteria for areas undergoing socio-economic change in the industrial or service sectors and rural areas;

(b) the relative severity compared with the other member States concerned of the structural problems at national level measured on the basis of total unemployment and long-term unemployment outside the regions eligible under Objective 1; and
(c) a reduction in the population covered by Objective 2 that did not exceed one-third of the population covered by Objectives 2 and 5b in 1999 as set out in Regulation (EEC) No 2052/88, in 1999.

As far as area definition and classification was concerned the Council Regulation also gave the Commission the right to amend the list of areas in 2003 if a Member State proposed a change in the light of a serious national regional crisis.

11. Cohesion policy, 2007-13

2007-13 saw the introduction of a revised architecture for EU Cohesion Policy: the three Objectives and four Community initiatives were replaced by three objectives:

- Convergence whose aim is to speed up the convergence of the least-developed and poorest Member States and regions;
- Regional Competitiveness and Employment whose aim is to strengthen the competitiveness and attractiveness of regions as well as regional employment by anticipating economic and social change; and
- European Territorial Co-operation, whose aim is to strengthen cross-border, transnational and interregional cooperation.

These three objectives incorporated the missions of the previous three objectives and of three of the four Community Initiatives: Interreg III, Equal and Urban II.

The General Regulation (Council of the European Communities, 2006, Article 3(3)) indicates that ‘assistance from the Funds shall, according to their nature, take into account specific economic and social features, on the one hand, and specific territorial features, on the other. The assistance shall, in an appropriate manner, support sustainable urban development particularly as part of regional development and the renewal of rural areas and of areas dependent on fisheries through economic diversification. The assistance shall also support areas affected by geographical or natural handicaps which aggravate the problems of development, particularly in the outermost regions as referred to in Article 299(2) of the Treaty as well as the northern areas with very low population density, certain islands and island Member States, and mountainous areas.’

From the beginning of this 2007-13 period, the Cohesion Fund no longer functioned separately from the Structural Funds. The European Agricultural Guidance and Guarantee Fund (EAGGF) was replaced by the European Agricultural Fund for Rural Development (EAFRD), while the Financial Instrument for Fisheries Guidance (FIFG) became the European Fisheries Fund (EFF). These two funds were given their own legal basis and ceased to contribute in a formal way to EU Cohesion Policy. The Leader+ Community Initiative funded by the EAGGF (Guidance Section) was succeeded by Axis IV (LEADER) of a separate four-axis Rural Development Regulation (EC) No. 1698/2005. Axis IV was designed to promote ‘innovative governance and rural capacity building’.

A new Instrument for Pre-accession Assistance (IPA) replaced the financial instruments previously applied to candidate countries and potential candidate countries.
Figure 24. Areas eligible for Cohesion policy support in 2007-13

Structural Funds 2007-2013: Convergence and Regional Competitiveness Objectives

- Convergence Regions
- Phasing-out Regions
- Phasing-in Regions
- Competitiveness and Employment Regions

© EuroGeographics. Association from the administrative boundaries
Three types of area were eligible for support under the Convergence objective: Convergence regions, Phasing-Out regions (see below) and Cohesion countries. The criteria for Objective 1 status were the same as in the past: NUTS II areas whose GDP per capita at PPS in the three year period 2000-02 stood at less than 75 per cent of the EU25 average. Once Bulgaria and Romania joined the Community there were 84 Convergence Regions (many were formerly Objective 1 regions) with more than 153 million inhabitants (31.7 per cent of the EU27 total).

Enlargement of the EU to include EU10 substantially lowered the EU average GDP per capita at PPS. This fall meant that a number of regions lost their eligibility for EU funding at the intensity of the Convergence objective. NUTS II regions which fell into this category were accorded a special Phasing-Out status and granted transitional support under the Convergence objective. These regions were sometimes called statistical effect regions due to the fact that they lost eligibility for high intensity Convergence funding because of the statistical effect of enlargement. More than two-thirds of the people living in Phasing-Out regions are in Greece and Germany.

Areas eligible for Cohesion Fund support were those member states whose Gross National Income (GNI) per capita measured at PPS in 2001-3 was less than the EU25 average and which had put in place a programme for satisfying the economic convergence criteria specified in the Treaty. These criteria relate to price stability, government budget deficits, exchange rate stability and long-term interest rates. Spain was accorded transitional support as it was deprived of its Cohesion Fund eligibility due the effect of the accession of EU10 on average GNI per capita at PPS.

The areas eligible for EU financial aid under the Regional Competitiveness and Employment objective were all those regions not covered by the Convergence objective. Two types of area come under this heading: Regional Competitiveness and Employment regions and Phasing-In regions.

Areas classified as Phasing-In regions are NUTS II regions totally covered by Objective 1 in 2006 but whose nominal GDP level per capita at PPS in 2000-02 exceeded 75 per cent of the EU15 average. To the areas that satisfied this criterion, of which most are in Spain, Ireland and Hungary, was added Cyprus, as revised GDP estimates indicated that it should have been eligible for Objective 1 status in 2004-06. These areas were eligible for additional transitional financial support.
Figure 25. Areas eligible for cross-border co-operation, 2007-13
For the Territorial Co-operation objective there are three types of activity. Areas eligible for cross-border co-operation are NUTS III areas along all internal and some external land borders and all Community NUTS III regions along maritime borders that are in general not more than 150 kilometers apart. Transnational cooperation is confined to a set of eligible
transnational areas identified by the Commission (Figure 26). As far as interregional cooperation is concerned the entire territory of the Community is eligible.

**Part III: Conclusions**

The European Union is a union of Member States whose individual administrative structures are extremely diverse and whose administrative areas are very heterogeneous. This diversity is a serious obstacle standing in the way of establishing meaningful comparative regional statistics and conducting meaningful comparative policy research. The collection and comparison of regional statistics is also complicated by the fact that, while a functional regionalization would provide the most suitable framework for analysis, functional regionalizations and the administrative regionalizations used by governments and government statistical offices often do not coincide. The degree of non-coincidence can vary significantly from one Member State to another. A further difficulty in establishing a single regional statistical information system resides in the fact that the manipulation of regionalization arrangements can have a significant impact on the value of indicators that determine the allocation of resources.

In this difficult situation the European Union has steered a delicate course to create a regional classification and information system which, at the same time, respects different national administrative arrangements and yet provides a reasonably common and harmonized territorial system for EU policy-making. The NUTS classification system and the REGIO domain of the New Cronos information system have provided, since its thorough reform in 1989, a foundation for the implementation of EU Cohesion Policy, providing a moving image of regional disparities, assembled on a basis which allows comparison between the EU member states, and therefore permits policy to draw fine economic distinctions between regions and groups of regions. The adoption of the NUTS Regulation in 2003 helped cement earlier progress in establishing a common classification of territorial units for the collection, preparation and dissemination of harmonized regional statistics and in particular laid down a set of clear rules that established some order in the management of unavoidable changes in the administrative structures of member states and that reduced their impact on the availability and comparability of regional statistics. The construction of this system is a considerable achievement without which European Union Cohesion policy would have been impracticable.

The European Statistical Office, which manages the NUTS classification, has also developed its system of Urban audits adding a detailed socio-economic picture of cities and large towns to its regional data. This new initiative has been instrumental in increasing understanding of the ways in which wealthy cities – although they are the drivers of economic growth – still conceal large pockets of severe deprivation. The data collected by the Urban audits has been suggestive for the development of policy, indicating targets which might be pursued by policy-makers as they seek to reduce socio-economic disparities.

But EU Cohesion Policy operates in a context which is changing, new problems are coming forward creating a demand from users for new types of data. At the same time new methods of data collection and data handling are being developed. One example is provided by a growing unease over income data, of whatever sort, as the measure of people’s happiness. Academic work suggests that a bundle of factors provide a better measure of happiness than an income measure alone.
Indeed, wider concepts of human well-being have already had an impact on the implementation of EU Cohesion Policy in the Netherlands, where the government, in agreement with the European Commission, allocated the bigger share of its EU funding to better-off (in GDP per capita terms) regions in the west of the country rather than the slightly worse-off regions in the north. In this case the Dutch government successfully defended the argument that the higher incomes of the western regions did not adequately compensate for their lower quality-of-life.

Other areas which indicate a continuing need for better data range from those related to the need to reduce global warming and carbon emissions to those dealing with the need to exploit more effectively research endowments. It will be some time before new indicators are available in sufficiently long series to serve as the basis for the selection of policy areas. In relation to Cohesion policy income data will, therefore, continue for the time being to serve as the dominant yardstick. But the wider needs of the political context cannot be ignored and, while the new range of data series is being created, policy-makers will be looking for ways of using, for example, carbon emissions data, to modify the patterns of financial allocation.

The other important developments relate to the growing importance of geographical information systems. One way for example to solve some of the problems associated with the non-coincidence of administrative regionalizations with the underlying geography of the phenomena central to policy analysis is to supplement data for administrative areas with grid square data. At present a movement in this direction is constrained by the fact that few national statistical offices in member states collect this type of data. In the years to come it is however desirable that raster data for grid squares of equal sizes is exploited to provide additional and largely complementary data to that collected for administrative areas.

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The REGIO database system

General and regional statistics

European and national short term indicators (euroind)
Regional statistics (reg)
  Regional agriculture statistics (reg_agr)
    Agricultural accounts according to EAA 97 Rev.1.1 (reg_a2acct)
    Animal populations (December) (reg_a2animal)
    Areas harvested, yields, production (reg_a2crops)
    Land use (reg_a2land)
    Production of cows' milk on farms (1000 tons) (reg_a2milkpr)
    Structure of agricultural holdings by NUTS, main indicators (ef_r_nuts)
Regional demographic statistics (reg_dem)
  Population and area (reg_dempoar)
    Population at 1st January by sex and age, from 1980 to 1990 (reg_d2jan80)
    Population at 1st January by sex and age from 1990 onwards (reg_d2jan)
    Population at 1st January by sex and age (source: OECD) - in persons
      (reg_d2jan_oecd)
    Annual average population by sex (reg_d3avg)
    Average population by sex and age (reg_d2avg)
    Average population, total (source: OECD) - in persons (reg_d2avg_oecd)
    Area of the regions (reg_d3area)
    Area of the regions (source: OECD) (reg_d2area_oecd)
    Population density (reg_d3dens)
    Population density (source: OECD) (reg_d2dens_oecd)
  Population change (reg_dempch)
    Births and deaths (reg_d3natmo)
    Births by age of the mother (reg_d2natag)
    Deaths by sex and age (reg_d2morag)
    Infant mortality (reg_d2infmo)
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  Gross domestic product indicators - ESA95 (reg_ecogdp)
    Gross domestic product (GDP) at current market prices at NUTS Level II
      (reg_e2gdp)
    Gross domestic product (GDP) at current market prices at NUTS Level III
      (reg_e3gdp)
Gross domestic product (GDP) per capita at current market prices (source: OECD) (reg_e2gdp_oecd)

Real growth rate of regional GDP at market prices at NUTS Level II - percentage change on previous year (reg_e2grgdp)

Dispersion of regional GDP at NUTS Level II and 3 (%) (reg_e0digdp)

Branch accounts - ESA95 (reg_ecobrch)
  Gross fixed capital formation at NUTS Level II (reg_e2gfcf)
  Compensation of employees at NUTS Level II (reg_e2rem)
  Gross value added at basic prices at NUTS Level III (reg_e3vabp95)
  Employment (in persons) at NUTS Level III (reg_e3empl95)

Household accounts - ESA95 (reg_ecohh)
  Allocation of primary income account of households at NUTS Level II (reg_ehh2p)
  Secondary distribution of income account of households at NUTS Level II (reg_ehh2s)
  Income of households at NUTS Level II (reg_ehh2inc)

Regional education statistics (reg_educ)
  Number of students by level of education, orientation, sex and region (educ_renrlrg1)
  Number of students by age, sex and region (educ_renrlrg3)
  Regional indicators (educ_regind)

Regional science and technology statistics (reg_sct)

Regional structural business statistics (reg_sbs)
  Regional data (according to NUTS Level II003) (sbs_r_nuts03)
  Number of local units, persons employed and Wages and salaries by region (sbs_cre_rreg)

Regional health statistics (reg_hlth)
  Causes of death by region - Crude death rate (per 100,000 inhabitants) (Annual data) (hlth_cd_acdr)
  Causes of death by region- Absolute Number (3 years average) - Total (hlth_cd_ynrt)
  Causes of death by region- Absolute Number (3 years average) - Males (hlth_cd_ynrm)
  Causes of death by region- Absolute Number (3 years average) - Females (hlth_cd_ynrf)
  Causes of death by region - Crude death rate (per 100,000 inhabitants - 3 years average) - Total (hlth_cd_ycdrt)
  Causes of death by region - Crude death rate (per 100,000 inhabitants - 3 years average) - Males (hlth_cd_ycdrm)
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Hospital discharges by diagnosis (ISHMT) and region, in-patients, total number - Total (hlth_co_disch1t)
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Hospital days of in-patients (ISHMT) by region - Females (hlth_co_hosdayf)
Hospital days of in-patients (ISHMT) by region - Males (hlth_co_hosdaym)
Hospital days of in-patients (ISHMT) by region - Total (hlth_co_hosdayt)
Hospital discharges by diagnosis (ISHMT) and region, day cases, total number - Females (hlth_co_disch3f)
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Number of employees, hours worked and paid - Regional data (lc_r00num1)
Number of hours worked and paid per employee - Regional data (lc_r00num2)
Number of statistical units - Regional data (lc_r00stu)
Labour costs survey 1996 - Regional data (reg_lcs96)
Labour cost - Regional data (lc_r96cost)
Direct cost - Regional data (lc_r96earn)
Direct remuneration - Regional data (lc_r96wag)
Structure of labour cost as % of total cost - Regional data (lc_r96struc)
Number of hours worked by year - Regional data (lc_r96hw)
Number of statistical units - Regional data (lc_r96est)
Number of employees - Regional data (lc_r96e)
Coefficient of variation of labour cost - Regional data (lc_r96coef)
Number of apprentices - Regional data (lc_r96appr)

Urban audit (urb)
Key indicators for core cities (urb_ikey) Information on the table
Derived indicators for core city (urb_icity) Explanatory texts
(metadata) Information on the table
Derived indicators for larger urban zones (urb_iluz) Explanatory texts
(metadata) Information on the table
Derived indicators for sub-city districts (urb_iscd) Explanatory texts
(metadata) Information on the table
Reduced set of derived indicators for 570 cities (urb_ilca) Information on the table
Data collected for core city (urb_vcity) Explanatory texts
(metadata) Information on the table
Data collected for larger urban zones (urb_vluz) Explanatory texts
(metadata) Information on the table
Reduced set of data collected for 570 cities (urb_vlca) Information on the table
Perception survey results (urb_percep) Explanatory texts
(metadata) Information on the table

Non EU countries (noneu)
Mediterranean countries (med)
Economy and finance (med_ec)
Population and social conditions (med_ps)
Tourism (med_to)
Agriculture (med_ag)
Transport (med_tr)
Environment (med_en)
Energy (med_eg)

Candidate and potential candidate countries (cpc)
Key indicators on EU policy: Structural indicators (cpc_si)
Regional statistics (cpc_r)
Economy and finance (cpc_ec)
Population and social conditions (cpc_ps)
Industry, trade and services (cpc_in)
Agriculture, forestry and fisheries (cpc_ag)
External trade (cpc_et)
Transport (cpc_tr)
Environment and energy (cpc_en)
Science and technology (cpc_sc)

Eastern European Neighbourhood Policy countries (ENP) and Russia (enpr)

Key indicators on EU policy: Structural indicators (enpr_si)
Economy and finance (enpr_ec)
Population and social conditions (enpr_ps)
Industry, trade and services (enpr_in)
Agriculture, forestry and fisheries (enpr_ag)
External trade (enpr_et)
Transport (enpr_tr)
Energy (enpr_en)
Science and technology (enpr_sc)
Natura 2000

Natura 2000 is the centrepiece of EU and, in particular, DG Environment’s nature and biodiversity policy. It is an EU-wide network of nature protection areas established under the 1992 Habitats Directive and the 1992 Birds Directive, itself established to fulfill a Community obligation under the UN Convention on Biological Diversity. The aim of the network of sites is to help ensure the long-term survival of Europe’s most valuable and threatened plant and animal species and habitats (via monitoring, surveillance, reintroduction of native species, introduction of non-native species, research and education). The network is made up of Special Areas of Conservation (SAC) designated by member states under the Habitats Directive, and Special Protection Areas (SPAs) designated by member states under the 1979 Birds Directive. Natura 2000 is not a system of strict nature reserves where all human activities are excluded. The network will include nature reserves. Most of the land will however remain in private ownership with the emphasis placed on ensuring that future management is ecologically and economically sustainable.

Annexes I (Natural habitat types of Community interest) and II (Animal and plant species of Community interest) to the Directive list the habitats and species whose conservation requires the designation of special areas of conservation. Some of them are defined as "priority" habitats or species (in danger of disappearing). Annex IV lists animal and plant species in need of particularly strict protection.

Special areas of conservation are designated in three stages. Following the criteria set out in the annexes of the Directive, each member state must draw up a list of sites hosting natural habitats and wild fauna and flora. On the basis of the national lists and by agreement with the member states, the Commission will then adopt a list of sites of Community importance. No later than six years after the selection of a site of Community importance, the member state concerned must designate it as a special area of conservation.

Where the Commission considers that a site which hosts a priority natural habitat type or a priority species has been omitted from a national list, the Directive provides for a bilateral consultation procedure to be initiated between member state concerned and the Commission. If the result of the consultation is unsatisfactory, the Commission must forward a proposal to the Council relating to the selection of the site as a site of Community importance.
Member states must take all necessary measures to guarantee the conservation of habitats in special areas of conservation, and to avoid their deterioration. The Directive provides for co-financing of conservation measures by the Community.

Member states must also:

- encourage the management of features of the landscape which are essential for the migration, dispersal and genetic exchange of wild species;
- establish systems of strict protection for those animal and plant species which are particularly threatened (Annex IV) and study the desirability of reintroducing those species in their territory;
- prohibit the use of non-selective methods of taking, capturing or killing certain animal and plant species (Annex V).

The member states and the Commission must encourage research and scientific work that can contribute to the objectives of the Directive.

Every six years, member states must report on the measures they have taken pursuant to the Directive. The Commission must draw up a summary report on the basis thereof.

Following the accession of 10 new member states on 1 May 2004, the annexes to the Directive were amended to take account of their biodiversity. The new members had to submit their lists of conservation areas by 1 May 2004.
Appendix 3

Kunzmann and Wegener’s (1991) bunch of grapes
Chapter IV: Financing solidarity: matching resources and responsibilities through the budget for European Cohesion Policy and member state financial arrangements

by Michael Dunford

Introduction

In order to achieve their strategic goals and to meet their responsibilities governments require financial resources. This chapter deals with the way in which the European Union (EU) and its Member States acquire and allocate their budgets. It is in three parts.

- Part I sets EU Cohesion Policy – which incorporates the Union’s linked policies for regional development and for its labour market – into an overall context, paying special attention to the EU budget and to Cohesion Policy.
- Part II looks in detail at the ways in which the EU Cohesion Policy allocates its financial resources between Member States and regions in order that they may implement policies for the economic and social development of regions. It reveals the extent to which the policy’s formula-driven allocation mechanisms are overridden by politico-economic considerations before suggesting ways in which the policy might be reformed to give a more economically-sensitive treatment to growing regions.
- Part III takes account of a special aspect of EU Cohesion Policy, namely that its implementation is a shared responsibility between the EU and the Member States. This sharing of responsibilities impacts upon the EU budget. Alongside the EU finance, which is the subject of the second part of this chapter, each Member State provides co-finance for EU Cohesion Policy actions in its territory and finances its own actions. This part of the chapter, therefore, depicts the structure of national budgets and discusses questions related to fiscal transfer and fiscal equalization.
- An important point to keep in mind in studying the financial data in Parts II and III of this chapter is that they are of a different nature. The data given in the third part all relate to actual expenditure, that is, expenditure which has taken place. The data in part two relate, in effect, to intended expenditure. More precisely, they relate to budget commitments which, under Cohesion Policy rules, must be turned into actual payments within two-to-three years. The time-profile of budget commitments and that of budget payments will, therefore, differ.
- Part IV draws conclusions for the future of EU Cohesion Policy. In the light of the discussion in the second and third parts, it distinguishes between the EU ‘own resources’ share of EU Cohesion Policy finance and the national expenditure, or co-finance, which must accompany it. It focuses on seeking guidelines which might apply to the reform of EU Cohesion Policy which will doubtless take place in the context of the EU’s fifth financial framework which will probably apply from 2014 to 2020.

Clearly, the world of government finance has been turned upside down by the financial crisis, which began in 2007, and the economic slowdown (China) and recession (EU) it triggered. The slowdown in the world economy created an economic emergency and in both China and the EU. Governments
were compelled to boost their spending programmes. These fiscal stimuli have a double impact on this chapter, which describes circumstances in the EU: the snapshot of public finances contained in the third part is, because of anti-recession policy, already considerably out of date but, nevertheless, still relevant; EU Cohesion Policy, locked into a medium-term arrangement until 2013 remains, for the moment, the same and has perhaps added relevance as an anti-recession instrument.

To take first the state of national budgets, the financial structure described in the third part of this chapter still reflects “normality” – even if it seems distant in the immediate aftermath of the crisis. It depicts elements of the financial state to which EU governments aim to – and, especially in relation to their management of their debt, must – return. In the case of EU Cohesion Policy, which is the subject of the first two parts of the Chapter, the present effect of the crisis is to give added importance to its role in boosting the economies of less-well-off regions and Member States. It is the policy’s post-2013 future which risks to be most affected by present events, since many EU member governments will be focused on reducing their own indebtedness when negotiations begin for the fifth EU financial perspective in 2011. The last part of this chapter will return to questions related to EU Cohesion Policy’s future.

Part I: The overall budget context for EU Cohesion Policy

1. EU Cohesion Policy and multilevel governance

The EU is a union of sovereign nation states, which have different ways of exercising power. A few of them constitutionally guarantee power-sharing in federal structures (Germany, Austria and Belgium), while the others are unitary states, devolving power to regional and local authorities to a varying extent. Within a Member State, these variations may depend on the policy area in question as well as each state’s constitutional and administrative structure. The EU itself is a system of multilevel governance, which unites the Union with its Member States and their sub-national authorities through a network of law. Power and responsibility in the Union varies according to particular policy areas: in some cases it is exercised exclusively by one level of governance while in others it is shared between levels.

The EU’s objectives are set out in successive Treaties – the latest being the Lisbon Treaty – and its power is conferred on it by the Member States in order that these objectives can be met. The Union’s power varies in intensity and can be classified into five categories.

In the most recent consolidated version of the Treaty, the main objectives of the EU are expressed in the following way.

- The Union’s aim is to promote peace, its values and the well-being of its peoples.
- The Union shall offer its citizens an area of freedom, security and justice without internal frontiers, in which the free movement of persons is ensured in conjunction with appropriate measures with respect to external border controls, asylum, immigration and the prevention and combating of crime.
- The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance. It shall combat social exclusion and discrimination, and shall promote social justice and protection, equality between women and men, solidarity between generations and protection of the rights of the child. It shall promote economic, social and territorial cohesion, and
• It is most intense in those areas of policy in which the Treaties grant exclusive competence to the EU (competition policy, monetary policy for the Euro Zone, management of marine resources, commercial policy, customs union). The areas of exclusive competence are relatively limited.

• It is still considerable for those areas of policy where the Treaties oblige it to exercise shared competence with the Member States (internal market, territorial and social cohesion, agriculture).

• Three other categories reflect those cases where the Union’s power is less intense: policy areas where the EU has the competence to carry out actions but cannot prevent Member States from exercising their own competence (research, technological development, space); economic and employment policies in which the EU is granted a power of coordination and can establish framework arrangements for policy coordination; and, least intense of all, those areas of policy where it can carry out actions to support, coordinate or complement the actions of Member States (fiscal policies, health, education, welfare).

The Treaties leave a number of competences exclusively in the hands of Member States. Fiscal policies, health, education and welfare are examples.

In using these powers, the EU is called upon to abide by the principles of subsidiarity and proportionality. The former specifies that in areas which do not fall within its exclusive competence, the EU will act only if it will be more effective in pursuing the objective in question than national, regional or local government in the Member States. The latter confines the content and form of Union action to what is necessary to achieve the objectives of the Treaties.

This study deals with aspects of sustainable regional economic development and the social protection of workers and citizens which are areas of shared competence. As a result, in order to see the full picture of policy, it is necessary to pay attention to policy in Member States as well as to that at EU level. This need to consider both levels is especially true in relation to the geographical distribution of financial resources in support of regional development and welfare. In this, the EU is similar to China where a full picture of regional development policy requires an understanding of the policy and financial inter-relationships between central government and China’s other levels of governance. But, although this chapter will deal with some of these issues of redistribution due to their relevance in the Chinese context, it is important to emphasize that EU regional development policies are not simply policies of redistribution or of fiscal equalization.

solidarity among Member States. It shall respect its rich cultural and linguistic diversity, and shall ensure that Europe’s cultural heritage is safeguarded and enhanced.

➢ The Union shall establish the euro as its currency.

➢ In its relations with the wider world, the Union shall uphold and promote its values and interests and contribute to the protection of its citizens. It shall contribute to peace, security, the sustainable development of the Earth, solidarity and mutual respect among peoples, free and fair trade, eradication of poverty and the protection of human rights, in particular the rights of the child, as well as to the strict observance and the development of international law, including respect for the principles of the United Nations Charter.

47 The list of shared competences which affect regional economic development, including territorial co-operation, urban and rural development, is a long one. It includes economic and monetary integration, sustainable development, scientific and technological advance, balanced economic growth, a highly competitive social market economy, full employment, social progress, protection and improvement of the quality of the environment, economic, social and territorial cohesion, and solidarity among Member States.
The goal of EU Cohesion Policy is to sustainably augment the resources and the wealth-creating capabilities of the regions and the areas it supports and of the people who live in them. Much of its support is used to improve the quality of factors of production that encourage endogenous growth (education and training to improve human capital; research and development to increase the capacity for innovation; and infrastructure to improve physical capital). Through the upgrading of infrastructures, people’s education and training, and the productive environment, it increases the capacity of its target areas to meet their own needs. Thus, it plays an active role in the achievement of sustainable economic growth, general social progress, citizenship and political legitimacy. The policy prepares the target regions and their people for economic change and, thus, seeks to eliminate – or, at any rate, reduce – disparities in development and to make it possible for its target regions to share in the benefits of the EU’s economic growth and development.

2. EU Cohesion Policy and its budget 2007-13

Since its inception, the EU’s range of policy commitments has steadily widened and successive enlargements have increased the Union’s size from, at first six, to 27 Member States. As part of this process, the EU budget has grown in real terms and its appropriations in 2007 were € 115.5 billion. However, as a share of EU income and public expenditure, the EU budget is small, standing at less than 1 per cent of Gross National Income (GNI) and at less than 2.5 per cent of public expenditure. And, although the size of the budget has increased in real terms, it was reduced as a share of EU GNI when it was last fixed. The reduction was decided in May 2006 when the Union agreed its seven-year financial framework for the period until end-2013. The evolution of the EU budget until that point is briefly described in Annex 1 to this chapter.

The EU’s financial framework for the seven years 2007-13 is set out in the May 2006 agreement on budgetary discipline and sound financial management between the three main EU institutions – the European Council, the European Parliament and the European Commission. It sets the budget ceiling at €864.316 million in commitment appropriations (Table 1). This figure is 85 per cent of the sum which had been proposed by the European Commission as being necessary to implement the Union’s range of policies in a Union enlarged by 12 Member States in the three years 2004-07. The budget amounts to 1.048 per cent of EU GNI, whereas the Commission had proposed 1.24 per cent and a group of countries who are “net contributors” to the budget (Austria, France, Germany, Netherlands, Sweden and the United Kingdom) had advocated a figure closer to 1 per cent.

A comparison between the Commission’s proposed budget and that agreed by the European Council may shed light on those EU policies, or parts of policies, which the Members States considered to be of lower priority as it decided its seven-year strategy. Thus, while overall resources allocated to economic and social cohesion (including European Regional Policy and employment) were about 10 per cent less than the amount proposed by the Commission, there were bigger cuts for some parts of regional policy. Within the overall amount, the agreed budget for the part of European Regional Policy which deals with Competitiveness for growth and employment was 56 per cent of the amount proposed by the Commission. This situation can be partly explained by the fact that the Competitiveness objective of regional policy is less important in the Union’s 12 new Member States, to which the European Council wished to give priority.

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48 The European Parliament approved the financial framework but was in practice able to make only a few changes confined to small policy initiatives (Bachtler, Wishlade and Mendez, 2007:11).
Table 1. Multiannual financial framework, 2007-13

<table>
<thead>
<tr>
<th>Heading</th>
<th>2006 benchmark</th>
<th>COM allocations</th>
<th>Inter-Institutional Agreement allocations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>€ mill</td>
<td>%EU total</td>
<td>€ mill</td>
</tr>
<tr>
<td>1. Sustainable Growth</td>
<td>316,092</td>
<td>39.1</td>
<td>471,465</td>
</tr>
<tr>
<td>1a. Competitiveness for Growth and Employment</td>
<td>52,990</td>
<td>6.6</td>
<td>132,755</td>
</tr>
<tr>
<td>1b. Cohesion for Growth and Employment</td>
<td>263,102</td>
<td>32.6</td>
<td>338,710</td>
</tr>
<tr>
<td>2. Preservation/management of natural resources</td>
<td>387,877</td>
<td>48.0</td>
<td>404,655</td>
</tr>
<tr>
<td>of which: Agriculture market-related expenditure and direct payments</td>
<td>306,145</td>
<td>37.9</td>
<td>301,074</td>
</tr>
<tr>
<td>3. Citizenship, freedom, security and justice</td>
<td>7,833</td>
<td>1.0</td>
<td>24,705</td>
</tr>
<tr>
<td>4. EU as a global player</td>
<td>43,554</td>
<td>5.4</td>
<td>92,110</td>
</tr>
<tr>
<td>5. Administration</td>
<td>45,493</td>
<td>5.6</td>
<td>28,620</td>
</tr>
<tr>
<td>6. Compensations</td>
<td>7,287</td>
<td>0.9</td>
<td>800</td>
</tr>
<tr>
<td>Total commitment appropriations</td>
<td>808,136</td>
<td>100.0</td>
<td>1,022,355</td>
</tr>
<tr>
<td>GNI</td>
<td>73,686,239</td>
<td>82,448,058</td>
<td>82,448,058</td>
</tr>
<tr>
<td>as a percentage of GNI</td>
<td>1.10</td>
<td>1.24</td>
<td>1.048</td>
</tr>
<tr>
<td>Own resources ceiling as percentage of GNI</td>
<td></td>
<td></td>
<td>1.24</td>
</tr>
</tbody>
</table>

2006 figures are from European Commission, Multiannual Financial Framework 2007-13 Fiche 94
Cohesion policy was allocated €308,041 million in 2004 prices (€347,410 in current prices) for the period 2007-13. This sum was divided into a financial profile of annual allocations which is almost flat, rising from an initial €42,863 in 2007 to €45,342 million in 2013 (Figure 1).

Figure 1. Evolution of Cohesion policy commitment appropriations, 2007-13
Commitment appropriations (€ million, 2004 prices)

The revised Cohesion Policy architecture for 2007-13 identified three objectives and three financial instruments. It concentrates its resources on the Convergence objective, which aims to stimulate economic growth in the poorest regions of the EU, those which, in the selection period, registered an average income equal to or below 75 per cent of the EU average GNI per head.

- The Convergence objective is allocated 81.4 per cent of total Cohesion Policy resources (Table 2) and is supported by three funds (the European Regional Development Fund (ERDF), the European Social Fund (ESF) and the Cohesion Fund.
- The Regional Competitiveness and Employment (RCE) objective is allocated 15.8 per cent of Cohesion resources and is supported by two funds, the ERDF and the ESF.
- The European Territorial Cooperation objective, which covers cross-border, trans-national and inter-regional cooperation as well as the Northern Ireland Peace programme, receives 2.5 per cent of the Cohesion Policy budget and is supported by one fund, the ERDF.

Table 2. Allocation by objective, 2007-13
### Part II: Allocating EU Cohesion Policy finance to Member States and regions: a politico-economic compromise

#### 3. EU Cohesion Policy: allocating its budget between Member States and regions (1)

The most easy-to-understand way to describe the methods used to allocate financial resources between Member States and regions within the various components of EU Cohesion Policy is in relation to the 2007-13 financial framework. This description will be the business of this and the following section (section 4) before a brief discussion of some of the results (section 5).

The indicative financial allocation by Member State set out in table 8 below resulted from the application of published and unpublished criteria, which differ from one component of the policy to another. The outcomes, however, were not simply a result of the application of these (formula-driven) criteria but reflected also a set of overarching (politico-economic) constraints (see Bachtler, Wishlade and Mendez, 2007: 24) together with a series of compromises, made in particular during European Council negotiations on the revision of the policy and the size of its budget. These overarching constraints – which, in effect, limit and modify the scope and outcome of the formula-driven mechanisms – are described in section 4 below. In section 5 we shall see that this produces some surprising results, even to the extent of seeming to over-throw one of the often-stated political requirements of EU Cohesion Policy, the requirement that resources should be concentrated in the poorest regions of the Union.

This section will briefly outline the formula-driven mechanisms for allocating the financial resources of EU Cohesion Policy between Member States and regions and to its different objectives. It begins with the Cohesion Fund and then deals with the mechanisms which apply to the policy objectives which are financed from the combined European Regional Development Fund and the European Social Fund.

<table>
<thead>
<tr>
<th>Objective</th>
<th>Allocation (€ million)</th>
<th>Share of financial resources (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Convergence</td>
<td>282855</td>
<td>81.4</td>
</tr>
<tr>
<td>Cohesion Fund</td>
<td>69578</td>
<td>20.0</td>
</tr>
<tr>
<td>Convergence</td>
<td>199322</td>
<td>57.4</td>
</tr>
<tr>
<td>Phasing-out</td>
<td>13955</td>
<td>4.0</td>
</tr>
<tr>
<td>Regional competitiveness and employment</td>
<td>54965</td>
<td>15.8</td>
</tr>
<tr>
<td>Phasing-in</td>
<td>11409</td>
<td>3.3</td>
</tr>
<tr>
<td>Regional competitiveness and employment</td>
<td>43556</td>
<td>12.5</td>
</tr>
<tr>
<td>European territorial cooperation</td>
<td>8723</td>
<td>2.5</td>
</tr>
<tr>
<td>Other</td>
<td>868</td>
<td>0.2</td>
</tr>
<tr>
<td>Total</td>
<td>347410</td>
<td>100.0</td>
</tr>
</tbody>
</table>

The revised architecture moved previous programmes for rural development and for the restructuring of fisheries out of European Cohesion Policy, placing them into agriculture and fisheries policy. Thus, the Leader-Plus programme and its fund, the European Agricultural Guidance and Guarantee Fund (EAGGF), were replaced by a new fund within the EU’s common agricultural policy, the European Agricultural Fund for Rural Development (EAFRD). The Financial Instrument for Fisheries Guidance (FIFG) was renamed the European Fisheries Fund (EFF). The EAFRD and the EFF acquired their own legal basis.
i) Allocating financial resources from the Cohesion Fund

In the case of the Cohesion Fund a preliminary financial envelope obtained by multiplying an average per capita aid intensity of €44.7 by the eligible population was shared amongst Member States according to their land surface, population and GNI relative to eligible Member States as a whole.

Table 3 records the indicative allocation of Cohesion Fund resources in its first column, the percentage shares in its second and the annual per capita Cohesion Fund resources in its third. Average per capita resources varied from €122.4 in Hungary and €123.1 in the Czech Republic to just over €40 in Cyprus, Portugal and Bulgaria. The position for Cyprus is due to two factors: Cyprus GNI (at PPS) per head is relatively high compared with the rest of EU12; and the decision that the Cohesion Fund should comprise a high share of total funding is constrained in the case of Cyprus by its Phasing-In status. Spain’s low figure reflects the fact that its allocation was due to a transitional arrangement. Spain had moved out of Cohesion Fund eligibility prior to 2007-13 because the value of the eligibility threshold had declined due to the accession of EU10, which had caused a fall in the EU average GNI per head. If this enlargement of the EU had not occurred, Spain would have retained eligibility as its GNI per capita was less than 90 per cent of the EU15 average.
Table 3. Allocation of the Cohesion Fund

<table>
<thead>
<tr>
<th>Cohesion Fund resources (€ million)</th>
<th>Share of Cohesion Fund resources (%)</th>
<th>Per capita resources per year (€)</th>
<th>Area as share of area of eligible countries (%)</th>
<th>Population as share of population of eligible countries (%)</th>
<th>GNI per capita (Cohesion countries=100)</th>
<th>Corrected average of area and population shares (%)</th>
<th>Area and population share adjusted for relative GNI (%)</th>
<th>Adjusted shares where Spain is excluded (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td></td>
<td></td>
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<tr>
<td>Belgium</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bulgaria</td>
<td>2283</td>
<td>3.3</td>
<td>42.3</td>
<td>6.1</td>
<td>4.6</td>
<td>49.5</td>
<td>5.3</td>
<td>5.9</td>
</tr>
<tr>
<td>Cyprus</td>
<td>213</td>
<td>0.3</td>
<td>40.2</td>
<td>0.5</td>
<td>0.4</td>
<td>126.7</td>
<td>0.5</td>
<td>0.6</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>8819</td>
<td>12.7</td>
<td>123.1</td>
<td>4.3</td>
<td>6.1</td>
<td>103.5</td>
<td>5.2</td>
<td>5.8</td>
</tr>
<tr>
<td>Germany</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Estonia</td>
<td>1152</td>
<td>1.7</td>
<td>122.1</td>
<td>2.4</td>
<td>0.8</td>
<td>80.1</td>
<td>1.6</td>
<td>1.8</td>
</tr>
<tr>
<td>Spain</td>
<td>3543</td>
<td>5.1</td>
<td>11.7</td>
<td>27.9</td>
<td>25.8</td>
<td>145.0</td>
<td>26.8</td>
<td>23.0</td>
</tr>
<tr>
<td>Finland</td>
<td></td>
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<tr>
<td>France</td>
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<td></td>
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</tr>
<tr>
<td>Greece</td>
<td>3697</td>
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<td>122.4</td>
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<td>109.8</td>
<td>0.2</td>
<td>0.3</td>
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<td>1412</td>
<td>2.0</td>
<td>100.8</td>
<td>1.1</td>
<td>1.2</td>
<td>121.4</td>
<td>1.2</td>
<td>1.3</td>
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<td>80.3</td>
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</tr>
<tr>
<td>Total</td>
<td>69577</td>
<td>100.0</td>
<td>59.0</td>
<td>100</td>
<td>100</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
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</table>
The table shows that per capita support is not related in a clear way to relative GNI per capita. Some Member States with relatively high GNI per capita received high rates of per capita support and some with relatively low GNI per capita received low levels of per capita support. This outcome is in part a consequence of the application of two of the overarching criteria which will be discussed below. It is nonetheless informative to consider the implications of the main criteria identified as drivers of the distribution of resources. Accordingly seeks to replicate the calculations, using however Eurostat GNI data for the three years from 2003-2005 and data for the land surface and population for 2005, rather than the data which were used in establishing the 2007-13 financial framework.

The factors which drive the initial distribution of resources reflect needs.

- The first step is to calculate the arithmetic average (i) of each eligible Member State’s share of the total eligible population and (ii) of its surface area of the eligible countries, except where the population share exceeds the total surface area share by a factor of five or more in which case only the population share is used. These criteria ensure that aid is related to the land surface and the population to be served except where there are particularly high population densities.
- The second step involves adjusting the resulting shares by a coefficient equal to one-third of the percentage by which that Member State’s GNI per capita, measured in purchasing power parities, differs from the average GNI per capita of all the eligible Member States.

In Table 3 the combined area and population shares are scaled up or down in proportion to the size of negative and positive GNI deviations and the shares adjusted to add to 100 per cent.

The outcome of this method of assessing relative land area, population and GNI is recorded in Table 3, with Spain included and with Spain excluded. Two points are worth noting.

- The transitional support which was actually agreed for Spain (5.1 per cent of the total Cohesion Fund) is a good deal lower than the 23.0 per cent it would have received if it had remained eligible and the standard criteria had been applied.
- There are some considerable gaps between the actual distribution of resources and that which results from this particular way of assessing relative need. Bulgaria, for example, is actually receiving 3.3 per cent of Cohesion Fund resources and not the 8.0 per cent it would have received according to the land surface, population and GNI criteria when Spain is excluded (5.9 per cent when Spain is included). The actual shares for Greece and Portugal are also lower than the calculations suggest they might have been – as is also true, though to a smaller extent, for Cyprus and Latvia. On the other hand, the Czech Republic, Poland and Hungary receive much higher shares than the calculations suggest.

These outcomes illustrate the consequences of the application of the overarching criteria. As is indicated in Annex II of Council Regulation (EC) 1083/2006, the surface area, population and GNI criteria apply to Member States that joined before 1 May 2004. In the case of EU12 the Cohesion Fund resources were set at one-third of their total Cohesion Policy allocation (Cohesion Fund plus ERDF plus ESF) in order to increase the priority attached to transport and environmental infrastructural investments. The state of these basic infrastructures in many of the new Member States warrants this particular priority. The impact of this provision was however much less significant than the impact of the capping mechanism (see below) which offers the only conceivable explanation for the absence of a relationship between support and the formula-driven shares on the one hand and GNI per capita on the other.
ii) Allocating resources from the combined European Regional Development (ERDF) and European Social (ESF) funds: the Convergence objective, ...

The regions eligible for the Convergence Objective are NUTS 2 areas whose per capita GDP at PPS is less than 75% of the EU average.

The allocation of Convergence funds to each Member State is the sum of the allocations for its individual eligible regions. The way in which regional allocations are derived centres on the so-called Berlin mechanism implemented in 2000-06. Three steps are involved.

- First, each region’s population is multiplied by the difference between its GDP per capita measured at PPS and the EU25 average to derive a sum expressed in €.
- Next, these initial allocations are multiplied by a relative prosperity coefficient (Table 4) reflecting the relative GNI at PPS of the Member State in which the eligible region is situated. This weighting factor is intended to benefit regions in Member States with a lower GDP.
- Thus two factors are at work in fixing the basic regional allocation of Convergence funding: a region’s allocation will be higher when its own regional GDP is low and its Member State has a relatively low level of prosperity.

Table 4. The relative prosperity coefficient

<table>
<thead>
<tr>
<th>GNI at PPS per head (EU25=100)</th>
<th>Relative prosperity coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;82</td>
<td>4.42%</td>
</tr>
<tr>
<td>&gt;=82 and &lt;99</td>
<td>3.36%</td>
</tr>
<tr>
<td>&gt;=99</td>
<td>2.67%</td>
</tr>
</tbody>
</table>

- The third step involves the computation of an additional sum for regions which have relatively high unemployment compared with other eligible Convergence regions. This sum is derived by multiplying a premium of €700 by the number of people out of work in that region as a result of the fact that the unemployment rate is in excess of the average unemployment rate for all EU Convergence regions. An example will illustrate this. If 1,000 people are out of work in a Convergence region, the unemployment rate is 10 per cent and the average unemployment rate for Convergence regions is 5 per cent, excess unemployment stands at 500 and the region would receive an additional €350,000.

These steps are replicated in Table 5, although it is important to emphasize that there are differences in the information which was used to calculate the actual annual allocations for 2007-13 and that used in constructing this table. Instead of GDP and GNI data for 2001-03 which was used in to determine the financial perspective 2007-13, Table 5 uses data for 2003-05. The population figures

49 Average GDP per head at PPS was computed for the three years 2003, 2004 and 2005. In cases where data was missing, the average was computed from figures for fewer years (Brandenburg - Nordost, and Brandenburg - Südwest in Brandenburg, and Região Autónoma da Madeira (PT)).
were derived from per capita and aggregate estimates of GDP. Sachsen-Anhalt as a whole was classified as a Convergence region.\textsuperscript{50}

\textsuperscript{50} Sachsen-Anhalt as a whole was defined as a Convergence region as there was no separate data for the Convergence regions of Magdeburg and Dessau and for the Phasing-Out region of Halle.
Table 5. Allocation of resources to convergence regions

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of eligible NUTS 2 areas</th>
<th>Population ('000s)</th>
<th>GDP derived allocation (€ million)</th>
<th>Unemployment rate derived allocation (€ million)</th>
<th>Initial computed allocation (€ million)</th>
<th>Population as % of EU27</th>
<th>GDP derived allocation as % of total</th>
<th>Unemployment rate derived allocation as % of total</th>
<th>Computed allocation as % of total</th>
<th>Cap as % of GDP (using EU25 average)</th>
<th>Maximum allocation (€ million)</th>
<th>Capped</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>2.3398</td>
<td>2.4298</td>
<td>3.7893</td>
<td>5804</td>
<td>Capped</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>Belgium</td>
<td>9058</td>
<td>51360</td>
<td>3.7893</td>
<td>5804</td>
<td>Capped</td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>Cyprus</td>
<td>6095</td>
<td>2926</td>
<td>3.7893</td>
<td>5804</td>
<td>Capped</td>
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<tr>
<td>Czech Republic</td>
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<td>1431</td>
<td>3.7893</td>
<td>5804</td>
<td>Capped</td>
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<td>1822</td>
<td>6</td>
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<td>3693</td>
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<tr>
<td>Hungary</td>
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<tr>
<td>Total</td>
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<td>62919</td>
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<td>5804</td>
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</table>
Table 5 indicates that there are 84 eligible NUTS 2 areas; that 31.4 per cent of the inhabitants of EU27 live in these areas (154.6 million people); and that the main drivers for the allocation of resources are relative GDP per capita and relative unemployment. A comparison of Member State shares of allocated resources according to these two drivers shows, however, that the geographical distributions they generate are quite different: Poland gets 55.2 per cent of resources for high unemployment compared with 29.9 per cent of the income-driven resources. Slovakia gets 7.6 per cent against 3.9. The most striking result, however, is the way in which the unemployment-related mechanism generates additional resources for a number of EU15 Member States (Italy, Germany, Spain and France), according them a relatively high share.

Table 5 also shows that the formula-driven approach generates a strong differentiation of support in favour of areas with the lowest levels of GDP and GNI per head. In order to compare its outcome with the indicative allocation of resources set out in Table 8 (see below), the percentage resource distribution generated by this particular application of the formulae was used to estimate the allocation of the €199,322 million allocated to the Convergence objective. A comparison of the two tables indicates wide differences between the indicative allocation in Table 8 (see below) and the computed allocation. Instead for example of €4,391 million received, the calculations suggest that Bulgaria should receive €15,579 million.

This outcome can only be fully understood in relation to the “overarching criteria” which will be discussed below. As Table 5 also shows, the latter amount for the Convergence objective alone (€15,579 million) is in excess of the estimated cap on Bulgaria’s total Cohesion Policy allocation, derived by applying Bulgaria’s cap coefficient (3.7893 reflecting its low GNI per capita at PPS) to its 2005 GDP and multiplying by seven (to obtain a figure for resources for a seven-year period). This calculation is, of course, an approximation and makes no allowance for economic growth through the 2007-13 period. However, it does show that the formula-driven approach generates numbers that are inconsistent with the caps. In this particular case Romania and Latvia are other Member States where the computed allocation for the Convergence objective alone exceeds the cap for all Cohesion Policy support.

iii) … the Regional Competitiveness and Employment objective, …

The share of resources for each Member State under the Regional Competitiveness and Employment (RCE) objective is once again the sum of the shares of its eligible regions. The allocation method involves three steps.

- First a percentage share is derived for each region equal to a weighted average of the five indicators listed in Table 6.
- Second, these shares are adjusted according to relative regional prosperity. At this stage each region’s share is increased or decreased by 5 percent according as to whether its GDP per capita is below or above the average GDP per capita for the group.
- Third, historical precedent is brought into play and the share of each Member State is adjusted to ensure that it does not fall below three-quarters of its share, in 2006, of combined funding under Objectives 2 and 3.
Table 6. Allocation drivers for the regional competitiveness and employment objective

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Weight</th>
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</thead>
<tbody>
<tr>
<td>Total population</td>
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<tr>
<td>Number unemployed in NUTS 3 areas with above average unemployment rate</td>
<td>0.20</td>
</tr>
<tr>
<td>Jobs needed to reach employment rate of 70%</td>
<td>0.15</td>
</tr>
<tr>
<td>Number employed with low educational attainment</td>
<td>0.10</td>
</tr>
<tr>
<td>Low population density</td>
<td>0.05</td>
</tr>
</tbody>
</table>

iv) … the European Territorial Cooperation objective, …

A Member State’s financial allocation under the cross-border element of the European Territorial Co-operation objective was made according to the share of its eligible population in the total population of all eligible regions (NUTS 3 regions in terrestrial and maritime border areas). In the case of the transnational component, its allocation was made according to the share of the Member State’s total population in the total population of all the Member States concerned.

v) … and regions eligible for transitional support.

European Regional Policy recognizes three categories of transitional area.

- The first is made up of those areas which lost their eligibility for Cohesion Fund resources due to the fall in average EU GNI per head as a result of the Union’s enlargement in 2004 to include EU10.
- The second comprises NUTS 2 regions which, at the same time and for the same reason, lost their eligibility under the Convergence objective – that is, they would have remained eligible for the Convergence objective if the eligibility threshold had remained at 75 per cent of average EU15, rather than EU25, GDP per capita (GDP rather than GNI being the relevant measure for the Convergence objective). These areas are the Phasing-Out regions, sometimes called ‘statistical effect’ regions.
- The third comprises regions which were eligible for Objective 1 assistance in 2000-06 but ceased to be eligible for the Convergence objective 2007-13 because their GDP per capita came to exceed 75% of the EU15 average. These areas are called Phasing-In regions.

In the present application of Cohesion policy these regions qualify for tapering-off transitional support. In the case of Phasing-Out regions, this support is paid from the budget for the Convergence objective; for Phasing-In regions from the budget of the RCE objective. In the case of the Phasing-Out regions initial support for 2007 was set at 80 per cent of their individual 2006 per capita aid intensity (for Phasing-In regions, 70 per cent). Thereafter it reduces linearly so that it will reach the national average per capita aid intensity for RCE regions in 2013 (for Phasing-In regions, 2011). This degressive support is increased by an unemployment-related premium. In regions which have above-average unemployment for Convergence regions, this sum is derived by multiplying a premium of €600 by the number of people out of work in that region as a result of its unemployment rate being in excess of the EU Convergence region average.
4. EU Cohesion Policy: allocating its budget between Member States and regions, the politico-economic criteria

The introduction to the previous section already indicated that the formula-driven mechanisms for allocating EU Cohesion Policy resources between Member States and regions were overridden by a set of overarching constraints (Bachtler, Wishlade and Mendez, 2007: 24) and a series of compromises, made in particular during European Council negotiations on the revision of the policy and the size of its budget. The overarching constraints, therefore, are of considerable importance. There are three.

- First, and most significant, is the limit, or cap, placed on the amount of Cohesion Policy resources which can be received by any one Member State in the seven-year period of the financial framework. This ceiling is described as an absorption cap and is designed to restrict the allocation of Cohesion Policy finance to an amount equal to a pre-determined share of the state’s national GDP that, it was agreed, the state could invest effectively. If the investable resources granted to the Member State were to exceed that amount, there would be a risk that not all of it could be invested efficiently and effectively.

- Second was the transfer of a part of the resources allocated to regional convergence to the preservation and/or management of natural resources.

- Third was the decision to set the Cohesion Fund for Member States which had joined the EU on or after 1 May 2004 at one third of their total financial allocation (ERDF and ESF plus Cohesion Fund). The effect of this constraint is to increase the relative importance of Cohesion Fund resources which in contrast to ERDF resources are spent on a national rather than a regional basis and confined to investments in transport and environmental infrastructure.

In addition, in a number of situations, precedent played a role in qualifying the final outcome. In these cases the outcome of the resource allocation mechanism was modified in order to ensure that Member States eligible for various types of support in 2000-06 received levels of support in 2007-13 that did not fall beneath pre-defined shares of their 2000-06 allocations under Cohesion Policy.

The previous section referred to the overarching constraints referred to in the second and third bullet points above, neither of which affects a Member State’s total allocation of Cohesion Policy resources, merely the use to which it can be put. The rest of this section will therefore concentrate on the absorption cap, one of the principal innovations introduced into EU Cohesion Policy in the 2007-13 financial framework.

Of these overarching principles the absorption cap is particularly important. It places a brake on the principle that EU resources should be concentrated in the poorest areas. It aims to modify initial Cohesion Policy resource allocations to reflect the difficulty which the poorest Member States might encounter in carrying through sufficient investments to absorb EU resources in the time-frame of their seven-year programmes. This difficulty might arise from a number of factors: their administrative capacity to conceive and administer large investment programmes is probably the most important, but the size of the national budget is also key. The capping system simply limits a Member State’s financial support under Cohesion Policy.
to a particular share of its GDP. It over-rides, if necessary, two of the basic principles of Cohesion Policy: that

- resources will be allocated according to need;
- resources will be concentrated on certain objectives and on the most affected areas.

The capping mechanism works against the concentration of resources on the worst-affected areas, thus raising issues to do with area definition and geographical targeting of policy.

The ceilings themselves are set out in Table 7. As the table shows, the cap becomes less restrictive as GNI per capita increases. Member States whose GNI per capita is less than 40 per cent of the EU25 average are capped at 3.7893 per cent of their GDP, while those with a GNI per capita of at least 70 per cent and up to 75 per cent are capped at 3.2398 per cent of GDP. Beyond 75 per cent of EU average GNI, although the cap decreases, it has less effect due to the fact that GDP is rising. In fact, the caps only come into effect in low income countries and come into effect first in the poorest Member States.

The rest of this section sets out the different methods for arriving at the financial allocations for the Cohesion Fund and for the combined ERDF and ESF. Where appropriate, it will comment on the role played by the over-arching criteria in modifying the allocations.

Table 7. Absorption caps

<table>
<thead>
<tr>
<th>Average GNI per capita at PPS as share of EU 25</th>
<th>Absorption cap (% of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;40%</td>
<td>3.7893</td>
</tr>
<tr>
<td>&gt;=40% and &lt;50%</td>
<td>3.7135</td>
</tr>
<tr>
<td>&gt;=50% and &lt;55%</td>
<td>3.6188</td>
</tr>
<tr>
<td>&gt;=55% and &lt;60%</td>
<td>3.524</td>
</tr>
<tr>
<td>&gt;=60% and &lt;65%</td>
<td>3.4293</td>
</tr>
<tr>
<td>&gt;=65% and &lt;70%</td>
<td>3.3346</td>
</tr>
<tr>
<td>&gt;=70% and &lt;75%</td>
<td>3.2398</td>
</tr>
<tr>
<td>each further 5%</td>
<td>minus a further 0.09%</td>
</tr>
</tbody>
</table>

5. EU Cohesion Policy: Overall results of financial allocations, some striking results

Table 8 records the allocation of Cohesion Policy resources by Objective and by Member State. Here total budget allocations apparently support the rule that “Cohesion Policy support decreases as income increases.” The 12 Member States which acceded to the Union between 2004 and 2007 (EU12), which are almost all among the poorest in the Union, were allocated 51.3 per cent of the Cohesion budget although together they account for only a quarter of the Union’s population. Poland, one of the bigger states in the EU and the biggest of EU12, is the largest single recipient of Cohesion policy funds (19.4 per cent). The next largest recipient of

---

51 These ceilings include the contributions from the ERDF to the financing of the cross-border strand of the European Neighbourhood and Partnership Instrument and of the Instrument for Pre-Accession Assistance, and from that part of the EAFRD originating from the Guidance Section of the European Agricultural Guidance and Guarantee Fund, and from the EFF.
EU12 is the Czech Republic (7.7 per cent). Although some EU15 Member States also receive sizeable allocations – Spain (10.1 per cent), Italy (8.3), Germany (7.6), Portugal (6.2) and Greece (5.9) – this can be explained by the relative size of their populations. During the 2007-13 period, the allocated shares of EU12 increase for two reasons: first, the capping mechanism allows for an increased allocation as a state’s GDP increases; second, financial support for many of the eligible areas in the EU15 will decline as years pass because they are in transitional categories (see also Bachtler, Wishlade and Mendez, 2007: 30).
<table>
<thead>
<tr>
<th></th>
<th>Regional competitiveness and employment</th>
<th>European territorial cooperation</th>
<th>Total</th>
<th>Share of total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Cohesion Fund</td>
<td>Convergence</td>
<td>Phasing-out</td>
<td>Phasing-in</td>
</tr>
<tr>
<td>Austria</td>
<td>177</td>
<td>1027</td>
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<td>1461</td>
</tr>
<tr>
<td>Belgium</td>
<td>638</td>
<td>1425</td>
<td>194</td>
<td>2258</td>
</tr>
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<td>2283</td>
<td>4391</td>
<td>179</td>
<td>6853</td>
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<tr>
<td>Cyprus</td>
<td>213</td>
<td>399</td>
<td>28</td>
<td>640</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>8819</td>
<td>17064</td>
<td>419</td>
<td>26692</td>
</tr>
<tr>
<td>Germany</td>
<td>11864</td>
<td>4215</td>
<td>9409</td>
<td>26340</td>
</tr>
<tr>
<td>Denmark</td>
<td>0</td>
<td>510</td>
<td>103</td>
<td>613</td>
</tr>
<tr>
<td>Estonia</td>
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<td>2252</td>
<td>52</td>
<td>3456</td>
</tr>
<tr>
<td>Spain</td>
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<td>21054</td>
<td>1583</td>
<td>4955</td>
</tr>
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<td>1051</td>
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<td>1716</td>
</tr>
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<td>10257</td>
<td>872</td>
<td>14319</td>
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<td>9420</td>
<td>6458</td>
<td>635</td>
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<td>25307</td>
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<tr>
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<td>458</td>
<td>293</td>
<td>901</td>
</tr>
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<td>Italy</td>
<td>21211</td>
<td>430</td>
<td>972</td>
<td>846</td>
</tr>
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<td>Luxembourg</td>
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</tr>
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<td>Netherlands</td>
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<td>247</td>
<td>1907</td>
</tr>
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<td>Poland</td>
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<td>44377</td>
<td>731</td>
<td>67284</td>
</tr>
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<td>Portugal</td>
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<td>17133</td>
<td>280</td>
<td>448</td>
</tr>
<tr>
<td>Romania</td>
<td>6552</td>
<td>12861</td>
<td>490</td>
<td>19668</td>
</tr>
<tr>
<td>Sweden</td>
<td>1626</td>
<td>265</td>
<td>1891</td>
<td>5.5</td>
</tr>
<tr>
<td>Slovenia</td>
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<td>2689</td>
<td>104</td>
<td>4205</td>
</tr>
<tr>
<td>Slovakia</td>
<td>3899</td>
<td>7013</td>
<td>449</td>
<td>227</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>2738</td>
<td>174</td>
<td>6014</td>
<td>10613</td>
</tr>
<tr>
<td>Technical Assistance</td>
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<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>69578</td>
<td>19322</td>
<td>13955</td>
<td>11409</td>
</tr>
</tbody>
</table>

Table 8. Indicative allocation by Member State, 2007-13 (current prices, in € million)

But, when account is taken of aid intensity per head of population instead of total share of the Cohesion Policy budget, a different picture emerges. Now, instead of the rule being “Cohesion Policy support decreases as income increases” it appears to become the opposite. Until income per head reaches 84 per cent of the EU average, the rule appears to be “aid increases as income increases.” Figure 2 plots the relationship between aid intensity and relative national prosperity. Member States are ranked according to their GNI at PPS per head in 2003-5, while aggregate aid per capita is recorded on the vertical axis, using as a denominator national population figures. EU12 countries with the exception of the two newest Member States (Bulgaria and Romania) and Cyprus receive between €373 (Czech Republic) and €252 per head (Poland). The aid intensity reflects the national distribution of aid recorded in Table 3 which is a consequence of a number of factors: the Regional Policy categories into which regions in each Member State fall; the share of the population in Convergence regions; the eligibility for Cohesion Fund resources; and historical levels of funding as well as variations in aid intensities. The resulting relationship between aid intensities and relative prosperity shows a clear tendency for aid per capita to increase at first as GNI per capita increases and only to decline once GNI per capita reaches around 84 per cent (in the case of Slovenia) of the EU27 average.

Table 9 provides a simple analysis of the allocation of resources to regional economies, omitting those allocated under the European Territorial Cooperation initiative since relative prosperity is not a driver of the allocation of its resources. Instead its aim is the vital territorial objective for the EU of developing and strengthening cross-border, inter-regional and trans-national relationships (although it is worth noting that in China partnerships are also a tool for addressing a range of inequalities). In Table 4 the population figures used in computing aid intensities relate to the populations resident in eligible areas (and not national population figures as in Figure 2), which gives a closer measure of the intention of European Cohesion Policy-makers. Some of the results are particularly striking.
• Consider first the final row which records average annual aid intensity for the different objectives and classes of region. These figures indicate the decreasing nature of annual aid per capita to the four categories of regions: Convergence regions at €184 per head per year; Phasing-Out, €131; Phasing-In, €82; and Regional Competitiveness and Employment (RCE), €21.

• The second striking feature of Table 9 is that among the Convergence regions, the highest aid intensities are for Portugal (€344) and Greece (€333). Of the new Member States, the Czech Republic (€269) and Estonia (€239) are sharply different from Romania (€84) and Bulgaria (€81), which acceded to the Union the day the budget framework and revised policy came into force and whose per capita GNI at PPS stood at 32.7 and 34.4 per cent of the EU27 average compared with 71.8 per cent for the Czech Republic and 55.6 per cent for Estonia. The aid intensity for Poland (€166) is close to that for the UK (€163) and Germany (€155).

• Also striking is that Portugal’s Phasing-In assistance (€261) exceeds assistance for many Convergence regions. In this particular case the area concerned is Madeira, which receives additional assistance as one of the EU’s Outermost regions, being distant from the European mainland, although for Phasing-In areas and Phasing-Out areas historical precedent also plays an important role in setting initial aid levels.

In the case of RCE areas, aid intensities are in general smaller (however, with relatively high figures for Slovakia), although it is important to note that this category includes all areas not eligible for assistance under the other two objectives, amongst which are many high-income areas.
Table 9. Aid intensities and allocation of regional aid under the convergence and regional competitiveness and employment objectives

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of regions</th>
<th>Population (000s)</th>
<th>Aid per capita per year (€)</th>
<th>Number of regions</th>
<th>Population (000s)</th>
<th>Aid per capita per year (€)</th>
<th>Number of regions</th>
<th>Population (000s)</th>
<th>Aid per capita per year (€)</th>
<th>GNI in PPS per capita (2003-5, EU27=100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>1</td>
<td>279</td>
<td>91</td>
<td>8</td>
<td>7955</td>
<td>18</td>
<td>126.5</td>
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</tr>
<tr>
<td>Belgium</td>
<td>6</td>
<td>7719</td>
<td>81</td>
<td>10</td>
<td>9186</td>
<td>22</td>
<td>123.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bulgaria</td>
<td>6</td>
<td>7719</td>
<td>81</td>
<td>10</td>
<td>9186</td>
<td>22</td>
<td>123.1</td>
<td></td>
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<tr>
<td>Cyprus</td>
<td>7</td>
<td>9058</td>
<td>269</td>
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<td>758</td>
<td>75</td>
<td>87.9</td>
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<td>126.5</td>
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<td>239</td>
<td>55.6</td>
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<tr>
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<td>1392</td>
<td>225</td>
<td>4</td>
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<td>80.2</td>
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</tr>
<tr>
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<td>1</td>
<td>2300</td>
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<td>45.8</td>
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<td>16317</td>
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<td>106</td>
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<td>131</td>
<td>19766</td>
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</table>

165
As the data in Table 9 relate to regional economies Cohesion Fund resources are excluded. To see what happens if Cohesion Fund resources are included, Figure 3 plots the relationship between income per capita and aid intensities for regional economies (where the denominator is the population of eligible regions) and for the Cohesion Fund (where the denominator is the national population of eligible countries). The result is similar to that shown in Figure 2: at first aid intensities increase as GNI at PPS increases. Even in the case of the EU15 the rank orders on the three indicators differ quite strikingly.

Figure 3. Cohesion Fund and regional convergence and RCE aid per capita in 2007-13 (current prices) and GNI at PPS per head (EU27=100)

6. EU Cohesion Policy: the special needs of recovering regions

In outlining the methods used to allocate Cohesion policy resources to its different objectives, the last few sections have indicated the factors which come into play. They include formula-driven methods which seek to distribute resources relative to assessments of need and assessments of relative regional and national prosperity; a set of overarching criteria which over-ride the results of these formula-driven methods; and of ad hoc provisions which resulted from political negotiations.

The aim of this section is different. It enquires into the implications of the formula-driven approach to the allocation of financial resources to Convergence regions and to those subject to transitional arrangements – the Phasing-Out and the Phasing-In regions. A consideration of this approach is relevant to policy-making because the European Commission is now on the verge of creating a third permanent category of regions, “Transition regions” (European Commission, 2008). In the past transitional arrangements have always been considered as ad-hoc arrangements, their nature varying with each revision of Cohesion policy. Present Commission thinking would change this and establish the category of “Transition regions” alongside those for Convergence and RCE regions.
As indicated earlier the method of resource allocation for 2007-13 involved an assessment of GDP per head at PPS relative to EU25, national GNI per head at PPS relative to EU25 and regional unemployment relative to the average for Convergence regions. The results of applying this method but with 2003-05 data rather than with 2001-03 data, which was the latest available when the policy was revised and its budget established, are set out in Table 10. In the analysis discussed in this section, the two categories of transition region are allocated resources in the same way as Convergence regions, rather than in the light of precedent (80 per cent or 70 per cent of aid in 2006) with a linear tapering off of aid to the national intensities for RCE regions.

The analysis is given added interest when two further factors are borne in mind. First, the transition areas were all Objective 1 regions until 2006 and were characterized by having income levels below 75 per cent of the EU average – which, for most of them, had been a persistent state. Second, the reduction of aid over five or seven years appears to reflect an assumption that, within that time, the transitional regions will be on a par with average national regions. This assumption is questionable when it is remembered that regional imbalances are extremely persistent and, indeed, are dynamic in the sense that gaps between the regional incomes are constantly recreated as fast growth in some areas pulls the average up faster than low income areas can grow, or as structural change negatively impacts on the relative income of adversely affected regions.
Table 10. The Berlin mechanism as applied to eligible convergence and transition regional economies in 2007-13

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of regions</th>
<th>Population ('000s)</th>
<th>Allocation (€ million)</th>
<th>Number of regions</th>
<th>Population ('000s)</th>
<th>Allocation (€ million)</th>
<th>Number of regions</th>
<th>Population ('000s)</th>
<th>Allocation (€ million)</th>
</tr>
</thead>
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Computed allocation 214799 5493 4394
As Table 10 shows, however, the initial allocation of €13,955 million and €11,408 million to the two categories of transition regions is to their advantage. The formula-driven method would have assigned smaller sums of €5,493 million and €4,394 million to them. Of course this conclusion must be treated with considerable caution as the sums assigned to many new Member States contribute to overall sums that exceed the caps. A reallocation of the capped resources will result in increases in the resources for regions in Member States which have not reached their caps.

The results in Table 10 involve applying the Berlin mechanism to those regions eligible under the Convergence objectives and the two transitional categories for 2007-13, using economic data for EU25. Table 11 adapts the model in a minimal way to represent the situation after the accession of Bulgaria and Romania in January 2007. GDP at PPS per head and GNI at PPS are now computed for EU27 rather than the EU25 and for 2003-05 rather than 2001-3, the reference period for the present Cohesion Policy budget allocation. The addition of Bulgaria and Romania reduces average per capita income. When this fall combines with the increase in regional GDP at PPS per capita between 2001-3 and 2003-5, the number of Convergence regions falls from 84 to 67 and their total population from 154.6 million to 121.1 million. Some of these areas would have risen above the 75 per cent threshold if the only change had been the updating of average GDP at PPS per head for EU25. Mecklenburg-Vorpommern, Chemnitz, Dresden and Thüringen in Germany come into this category, as do Galicia and Castilla-la Mancha in Spain, and Peloponnisos and Kriti in Greece, although Kentriki Makedonia and Dytiki Makedonia drop beneath the threshold on this measure. The number of Phasing-Out areas rises from 14 to 25, while Slovenia is added to the Phasing-In category due to increases in its GDP per head between 2001-3 and 2003-5. These calculations accept the current division of resources between the three categories of area, even though the Berlin-mechanism-driven computed allocation to Phasing-Out areas exceeds the current allocation by a considerable margin (20,271 million instead of 13,955 million).
Table 11. The Berlin mechanism as applied to eligible convergence and transition regional economies in the EU27

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As a final set of experiments, we considered an alternative approach to the definition of eligibility for EU Cohesion policy resources. In the Fifth progress report on Economic and Social Cohesion, the European Commission (2008) provided an initial analysis of some of the characteristics of what it called ‘Transition regions’ (Phasing-Out and Phasing-In regions) and showed these areas suffer from a number of specific disadvantages. Extending this idea, it can be argued that the creation of an integrated and cohesive EU economy requires the adoption of measures to help raise incomes and employment in all regional economies that lie beneath the EU average. With this mind we classified NUTS level 2 regions into three categories: regions below 75 per cent of EU27 GDP per capita at PPS, those below 90 per cent and those below the average. This classification has the advantage of avoiding an abrupt change in the status of a region under European Regional Policy. Instead, as its income level rises, it will move into successive categories where aid is still available, although on a less intense basis.
Table 12. The Berlin mechanism as applied to regions with <75, <90 and <100 per cent EU-27 GDP per capita

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The initial outcome is recorded in Table 12. In addition to the 67 Convergence regions, another 41 fall beneath the 90 per cent of EU27 GDP at PPS per capita and another 31 beneath the average. Of the former most are in Germany (nine regions with 15 million inhabitants), Spain (six regions with 15 million inhabitants), and in Belgium, France, Italy and the UK (four regions each). The UK and France account for 18 of the 31 regions whose GDP per capita at PPS lies between 90 and 100 per cent of the EU27 average.

Table 13. Allocation of regional finance under four scenarios

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<th>EU 27 map of eligibility</th>
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<th>Three categories II</th>
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</table>

Table 13 compares the impacts on the national distribution of assistance for these categories of region. The first column records the current indicative allocation for the regions classified under the Convergence, Phasing-In and Phasing-Out objectives. The largest shares of these resources go to Poland, Spain and Italy. Column 2 results from the use of only the GDP at
PPS, GNI at PPS and relative unemployment indicators. This method significantly increases the shares of a number of Member States with low levels of GDP and GNI per head, including Romania, Bulgaria and Poland. Column 3 identifies the impact of adopting EU27 rather than EU25 as the standard. Spain’s share drops from 7 to 4 per cent. Germany’s share drops from 4 per cent to 2.5 per cent. Column 4 derives from the classification of the three new regional categories: regions below 75 per cent of EU27 GDP per head at PPS, those between 75 and 90 per cent and those between 90 and 100 per cent. The initial changes are not great although the French share increases from 0.7 to 3.1 per cent. More striking are the results reported in column 5. In this case two changes were made.

- First, logarithms of the two main drivers were used: the GDP and GNI per capita derived indicator and the relative unemployment indicator. The consequence of this transformation is that it reduces the relative importance of large deviations: it remains the case that a region’s allocation increases as its disparity with the EU average increases, but they do so at a slower rate.
- Second, the allocation of resources to the three categories of area was modified to coincide with the distribution generated by the income and unemployment criteria.

Compared with earlier analyses, the shares going to very low income areas decrease reducing the extent to which capping applies although these areas still get the greatest degree of support. The degree of concentration by Member State diminishes, and some Member States with large numbers of regions with a per capita income between 75 per cent of EU27 GDP and the EU27 average (France, Germany and the UK) see their shares increase.

7. European Cohesion Policy: elements of a summary

The analysis presented in the last four sections demonstrates the way in which the allocation of EU Regional Policy financial resources is driven by a number of factors.

- The first is the set of overarching criteria, of which the most important relates to the capping of resource allocations to match the recipient economy’s absorption capacity. The overarching criteria also include measures to shape in EU12 the composition of investment to favour transport infrastructures and environmental improvements.
- The second is a set of needs-driven formulae derived mainly from indicators of GDP at PPS, GNI at PPS, population and unemployment. Other indicators include educational attainment, employment rates, and land surface. A strong case can be made for increasing the weight attached, in particular, to employment rates as opposed to unemployment rates, to indicators of green GDP in view of the increased importance of sustainability, and to indicators of human development rather than simply of the wealth or income created in the regions in which people reside.
- The third driver is precedent, since, in the allocation of EU Cohesion Policy resources, previous levels of assistance provide a starting point. Granting a role to precedent is not without its justification. In politics ‘precedent is the keel of the political boat stopping it from tipping over’ (Meadows, oral communication, 4 September 2008), so it should also play a role in the establishment of successive compromises. The automatic application of tapering is however potentially problematic in that it
presumes that the situation will improve and that relative under-development is a relatively short-lived transitional state.

At the same time it was suggested that commitment to the creation of economic and social cohesion in an integrated Europe (overall harmonious development, greater economic, social and territorial cohesion and a reduction in disparities between the levels of development of the various regions) implies support for all areas lying beneath the EU average income, at rates differentiated according to income levels. We considered a threefold division of Europe’s less prosperous regions, to which one might add areas of more localized deprivation in areas with above average incomes (for example, the poorer parts of large cities). The analysis indicated that careful attention to aid gradients would allow two developments in EU Cohesion Policy; the continued use of Berlin- mechanism-type drivers of resource allocation to ensure that aid was proportional to need, and an expansion in the number of disadvantaged areas securing differentiated support, which would reduce the impact of the capping mechanism.

Attention has been confined to income and wealth-related mechanisms for resource allocation. Amongst the least-favoured areas, the Treaties also commit the EU to act to support particular types of territories: ‘rural areas, areas affected by industrial transition, and regions which suffer from severe and permanent natural or demographic handicaps such as the northernmost regions with very low population density and island, cross-border and mountain regions’ (Article 174, ex Article 158 TEC). It is important to note that these types of territories are identified as finding themselves amongst the least-favoured, so that territorial cohesion should not be seen independently of differences in well-being.

**Part III: Regional development and the structure of national budgets: some case studies**

**8. Government finance in EU Member States**

The first budget impacts of EU actions to counter the present recession are being felt in the national budgets of Member States. National actions to increase liquidity in capital markets, to save banks and to increase the money supply have caused a sharp leap in government indebtedness and the beginning of a much longer process of reducing expenditure on an array of policies so that debt can be brought down to more-normal levels. The photograph of budgets presented in this part of the Chapter should, therefore, be studied with caution. It will be several years before the 2006 relationship between expenditure and revenue can be re-established. However, the structure of budgets and the relative roles of the different levels of governance will change less and, anyway, will represent the position to which the disturbed budgets will be seeking to return, even if the process of return is a slow one.

In Section 2 above it was pointed out that in 2007 the EU budget appropriations were €115.5 billion, and that, as a share of EU income and public expenditure, they stood at less than 1 per cent of GNI and at less than 2.5 per cent of public expenditure. These figures are a clear indication that it is the Member States and sub-national tiers of national government which account for most European public expenditure. This part of the chapter will put some figures
to these roles before paying attention to some of the mechanisms for fiscal redistribution inside EU Member States.

Data on government revenues and expenditures are available from a number of sources. The Organisation for Economic Co-operation and Development (OECD) publishes revenue statistics of its members. For EU15 these data indicate that in 2006 tax revenues amounted to 39.8 per cent of EU GDP and had increased quite strongly in the 1970s and 1980s (see Table 14).

Tax collection is predominantly the business of central government. In 2006 it accounted for more than half of taxes collected (22.1 per cent of the 39.8 per cent of GDP). Social security funds accounted for another 10.9 per cent, while sub-national government accounted for just 6.1 per cent in spite of an upward trend since 1980. In the same year taxes on income, profits and capital gains accounted for 32 per cent of the total, social security contributions for 28 per cent, taxes on property for just 5.6 per cent and taxes on goods and services for 29.9 per cent (with Value Added Tax accounting for 14.6 per cent of this figure).

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<th>Total tax revenue</th>
<th>Taxes on income, profits and capital gains</th>
<th>Social security contributions</th>
<th>Taxes on payroll and workforce</th>
<th>Taxes on property</th>
<th>Taxes on goods and services</th>
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</table>
Table 15 indicates some of the main variations in 2006 tax revenues in a number of EU Member States. Taxes on income, for example, are relatively important in the UK (14.9 per cent of GDP) and Italy (14.0 per cent); much less important in France and Germany, where social security contributions account for 16.4 and 13.7 per cent respectively (although in Italy social security contributions at 12.8 per cent are also important); and extremely important in Denmark (29.3 per cent) as in other Nordic countries. Taxes on goods and services account for 10-11 per cent of GDP in France, Germany, Italy and the UK but 16.3 per cent in Denmark.
Table 15. Tax revenue as percentage of GDP in 2006 in selected EU Member States, elaborated from OECD, Revenue statistics of OECD Member Countries, Comparative Tables

<table>
<thead>
<tr>
<th>Country</th>
<th>Total tax revenue</th>
<th>Taxes on income, profits and capital gains</th>
<th>Social security contributions</th>
<th>Taxes on payroll and workforce</th>
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<th>Taxes on goods and services</th>
<th>Valu added taxes</th>
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A second source of data on non-tax sources of revenue and expenditure is EUROSTAT. In 2007, EU27 general government expenditure (excluding expenditure of public corporations) stood at 45.8 per cent of GDP (see Figure 4) while government revenues were equal to 44.9 per cent – so that expenditure exceeded revenues by 0.9 per cent. For EU15, expenditure stood at 46.1 per cent, which was 0.8 per cent above revenue. This difference between expenditure and revenue was considerably below the 1995 figure of 52.5 per cent.

Figure 4. Total general government expenditure and revenue as % of GDP, 1995-2007. Source: elaborated from EUROSTAT, Government Finance Statistics

The difference between general government expenditure and revenue is a surplus or deficit known in the European System of Accounts 2005 as “general government net lending or borrowing.” Article 104 of Treaty on European Union obliges Member States to avoid excessive government deficits. A protocol on Excessive Deficit Procedures annexed to the Treaty defines two criteria and reference values for compliance: a government deficit to GDP ratio of 3 per cent, and a government debt to GDP ratio of 60 per cent. In 1995 government deficits stood at 7.2 per cent of GDP (again see Figure 4, where the general government deficit is shown as the difference between expenditure and revenue). After 1995 governments actively sought to reduce their deficits in preparation for monetary union and they were helped in doing so in the last few years by an improvement in government revenues as a result of improved economic performance. In 2007 EU27 government debt stood at 58.7 per cent of GDP.
Table 16 shows wide variations in government expenditure per head in EU Member States. It records per capita general government expenditure in 2000 and 2007. Figures are expressed in € (Euros) and adjusted for Purchasing Power Parities (PPP) using the GDP PPP index. Setting aside Luxembourg, the highest scores for 2007 are for Sweden (€16,465), Denmark (€15,418), Austria (€15,320), the Netherlands (€14,907) and France (€14,451) – four of the five being net contributors to the EU budget (the other two, the UK and Germany, scoring somewhat lower, at €12,829 and €12,323 respectively). The former Communist countries which are the EU’s newest members scored lowest – Bulgaria (€3,580) and Romania (€3,723), approximately 22 per cent of Sweden’s general government expenditure per inhabitant. Expressed in Euros (without the PPP adjustment) the range extended from 28,787 in Luxembourg and 21,104 in Denmark to 1,421 in Bulgaria and 2,083 in Romania.

The rank order changes when general government expenditure is considered as a share of GDP: Hungary then joins Sweden, France, and Denmark in a group in which government expenditure exceeds one-half of GDP. In Estonia, Lithuania, Slovakia and Romania, but also Ireland, it lies beneath 37 per cent. Again it is the new Member States which have low scores. Of the older Member States Ireland has by far the smallest government sector (36.4 per cent).
The most important government expenditure item in all Member States was social transfers (see Table 17), which accounted for 41.7 per cent of expenditure in EU27 taking together social benefits and social transfers in kind. (Note that in Cyprus, Greece and the UK “social transfers in kind” are classified as intermediate consumption.) These transfers pay for social needs or risks, including health, disability, old age and unemployment. The second most important item was compensation of employees at 22.7 per cent. Comprising wages and salaries and employers’ social contributions, it varied in importance from 33.3 per cent in Cyprus and 33 per cent in Denmark to 15.7 per cent in Germany and 17.7 in the Czech Republic. In third place came intermediate consumption (14.0 per cent) comprising the value of goods and services used as inputs into processes of production but excluding those used in the production of fixed assets. Government expenditure on interest amounted to 5.9 per cent of government expenditure, with high figures for Italy (10.3 per cent) and Greece (9.9 per cent). Gross fixed capital formation accounted for 5.7 per cent with high percentage shares being recorded in Latvia (15 per cent), Romania (14.9), Lithuania (14.6), Estonia (13.1), Bulgaria (12.7), Ireland (11.5) and the Czech Republic (11.3). The existence of a high share devoted to capital formation is in all probability related to the scale of EU Pre-Accession spending and Cohesion-Policy-financed programmes in most of these countries, the EU financial contributions needing to be matched by national expenditure. In the main, the other category of expenditures comprises subsidies, other current transfers, and capital transfers (Paternoster, Wopzowczyk and Lupi, 2008).
Table 17. Total general government expenditure by main component and country in 2007 (as a % of government expenditure) Source: elaborated from EUROSTAT, Government Finance Statistics

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<th>Compensation of employees (D1)</th>
<th>Intermediation (P2)</th>
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Table 18. Government revenue by main sources and country in 2007 (% of total revenue). Source: elaborated from EUROSTAT, Government Finance Statistics

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<td>40.3</td>
<td>20.3</td>
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</table>

As for revenues (Table 18) the most important items are taxes and social contributions, which cover actual and imputed social contributions paid by employers and employees to social insurance schemes. Social contributions vary significantly in importance with high shares in Germany (37.6 per cent) and France (36.3) and low figures in other countries particularly Denmark where most welfare expenditure is financed out of taxes on income.
Table 19. Sources of government revenue

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes on production and imports</td>
<td>Value-added tax, import and excise duties, taxes on financial and capital transaction, taxes on land and buildings, payroll taxes and other products on taxes and production</td>
</tr>
<tr>
<td>Taxes on income and wealth</td>
<td>Taxes on income, on capital gains by households and corporations, current taxes on capital, taxes on international transaction, and payments for licences</td>
</tr>
<tr>
<td>Capital taxes</td>
<td>Taxes levied at irregular and infrequent intervals on the value of assets or net worth owned or transferred.</td>
</tr>
<tr>
<td>Social contributions</td>
<td>Actual and imputed social contributions paid by employers and employees to social insurance schemes</td>
</tr>
<tr>
<td>Other sources of revenue</td>
<td>Government sales, and ‘other revenue’ comprising ‘property income’, ‘other current transfers’, ‘other capital transfers and investment grants’.</td>
</tr>
</tbody>
</table>

Tables 20 and 21 indicate the respective roles of different tiers of the administration. In these tables, the term state government refers to the Länder authorities or their equivalent in Austria, Belgium, Spain and Germany. In the unitary states no state tier exists. All local and regional authorities and related administrative agencies are grouped under the local government heading. Table 20 identifies the respective contributions of central and local government and of social security funds to overall government expenditure (Note that the EUROSTAT figures in columns 2 to 5 do not sum to the figure in column 1). In the EU27, central government accounts for just 25.1 per cent of GDP, while Länder or equivalent (present in four countries) account for 4.2 per cent and local government for 11.2 per cent. These figures differ substantially from one country to another. In Denmark for example local government expenditure accounted for 32.3 per cent of GDP. In Sweden it accounted for 24.5 per cent and in Finland 19.3 per cent. In federal countries the sub-national tiers also account for 17 to 21.1 per cent of GDP. At the other extreme local government plays a very small role in small countries, in EU12 and in Greece and Portugal.

Table 21 highlights the importance of transfers in funding state and local government in the EU27. Transfers exist for two reasons. The first is that sub-national authorities do not raise sufficient revenue to pay for the services they are required to implement. This situation is referred to as vertical fiscal imbalance (VFI). In the UK, for example, local authorities account for just 6.4 per cent of tax revenue and 12.6 per cent of expenditure. The second reason is horizontal fiscal imbalance (HFI) which describes imbalances between local fiscal capacity and spending needs, imbalances which, in many cases, mean that areas with the greatest needs for action suffer from the weakest fiscal capacity. Critics generally argue that VFI reduces government accountability but not everyone accepts it as problematic. A large

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53 Critics of VFI argue that sub-national governments are not accountable for raising the revenue they spend, suffer from diminished government authority insofar as their spending decisions are limited by the distribution of financial resources and are influenced by their paymasters. Critics also argue that local government own resources derive from taxes that are insufficiently wide and involve too many exemptions.
VFI may be justified in a number of ways: it may reduce tax competition; centralised tax administration may be more efficient; it may better permit individual local governments to meet their service obligations (contributing to equal citizenship rights and greater equity); it may help to establish a wider interest especially in cases where there are conflicts of interest amongst sub-national administrations.

Table 20. Total general government expenditure by administrative tier in 2007 (as % of GDP)
Source: elaborated from EUROSTAT, Government Finance Statistics

<table>
<thead>
<tr>
<th></th>
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<th>Central government</th>
<th>State government</th>
<th>Local government</th>
<th>Social security funds</th>
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<td>:</td>
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Table 21. The main sources of state and local government revenue. Source: elaborated from EUROSTAT, Government Finance Statistics

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<td>government taxes</td>
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<td>(%)</td>
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<td>70.4</td>
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</table>
The argument over VFI brings into focus the issue of which principles can be applied in determining the sharing of expenditure and taxation responsibilities between different levels of government. It is frequently agreed that some degree of decentralization is desirable to permit local considerations to be taken into account in making decisions, particularly about the allocation of resources. Equity and economic stabilization, on the other hand, are usually seen as best pursued centrally.

9. National governance and fiscal equalization in EU Member States: three case studies

The national and sub-national structures of government in the EU are characterized by diversity. The same is true of their financial arrangements and responsibilities.

As emphasized in the last section Member States account for a large share of public expenditure, and are mainly responsible for a wide range of activities. An indication of the scale and scope of Member State activities is provided by the functional (as opposed to government departmental) analysis of UK public expenditure recorded in Table 22. It shows first that in 2006-07 UK public expenditure amounted to 41.3 per cent of GDP. Social protection (13.4 per cent of GDP), health (7.1), education (5.5), general public services (3.6), economic affairs (2.9) and defence (2.4) were the most important areas of activity.

At the same time, a discussion of national public expenditure should recognise the
degree of interaction between the EU and its Member States. In fact, as a result of a
number of factors, the EU exercises a significant degree of influence over the
allocation of national resources, especially in those Member States in receipt of the
largest EU resources. These factors include:

These factors suggest that ideally a functional analysis of public expenditure should
be carried out jointly for the EU and its Member States. In a recent report the Centre
d’Analyse Stratégique (2007) argues that an aggregate analysis is, in particular,
important for an evaluation of the overall budgetary importance accorded to different
political and economic objectives. In that report initial calculations show that almost
three quarters of public expenditure on agricultural policy occurs at EU level.
Conversely only a very small part of expenditure on public education takes place at an
EU level, yet, at an aggregate level, education receives nearly ten times more than
agriculture.

<table>
<thead>
<tr>
<th>Community budget</th>
<th>National budgets</th>
<th>EU total</th>
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<tr>
<td>as a % of GNP</td>
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</tr>
<tr>
<td>Agriculture</td>
<td>0.39%</td>
<td>0.16%</td>
</tr>
<tr>
<td>Research and development</td>
<td>0.04%</td>
<td>0.63%</td>
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<tr>
<td>Education and Training</td>
<td>0.01%</td>
<td>5.24%</td>
</tr>
<tr>
<td>Public development aid</td>
<td>0.03%</td>
<td>0.32%</td>
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</table>

Indeed, an enlarged vision of the debate over EU expenditure should go beyond an
examination of European public expenditures alone and might simultaneously
consider private expenditures and non-budgetary public interventions. An example of
the latter is the Lisbon Strategy: its success will depend largely upon the
implementation of the ‘guidelines for growth and employment’ which principally
• the co-financing arrangements of EU Cohesion Policy;
• the principle of additionality;
• EU regulation in a wide range of areas;
• European co-operation; and
• the open method of co-ordination in which the EU sets objectives to be attained by Member States while leaving them considerable choice in how to achieve them.

Compulsory co-financing at Member State level is, for example, a fundamental feature of structural and rural development policies, which, taken together, account for over 40 per cent of spending in the current financing period. The management of around 76 per cent of EU funds is delegated to Member States by the Commission, under ‘shared management’. About 4 per cent is managed with international organizations or by third countries, and 22 per cent is managed centrally by the Commission (European Commission (2008a).

In each Member State responsibilities are similarly divided between national and sub-national tiers of government. Generally speaking, sub-national government has sole or shared responsibilities for a wide but varying range of activities: land use planning, economic development, infrastructure provision, and the provision a range of local services that may include education, health and employment. Differences exist not just in the roles performed but also in the relative weight of choice (where local governments decide) and agency (where local governments merely implement central government measures). In the recent past the predominant trend has been towards greater decentralisation/deconcentration of responsibilities and associated increases in the agency responsibilities of local government although not necessarily towards increases in choice.

Variations in the responsibility of different tiers of government for collection and allocation of financial resources derive from a number of factors:
• the federal or unitary nature of the political system;
• the relative importance of income as opposed to property taxes (which tend to predominate in English-speaking countries);
• the degree of discretionary powers over the determination of the tax base and tax rates;
• the degree of dependence on government transfers, which may take the form either of stable tax-sharing arrangements (Germany, for example) or central government grants; and
• where grants are employed, the relative importance of general block grants and specific grants (which some see as an infringement of local self-determination) on the one hand, and the

address institutional and regulatory interventions. An example of the former is the target to raise European R&D expenditure to 3 per cent of EU GNP, with two thirds of it expected to come from the private sector. International comparisons suggest that insufficient private rather than public expenditure is the reason for the EU’s lag vis-à-vis its major competitors.
nature of the formulae that are employed to determine the allocation of grants on the other.

In recent years the general situation is one of fiscal constraint either as a result of the reduction in grants, the loss of tax revenue (especially in countries dependent on property taxes or in countries such as the UK subject to central-government rate capping and take-over of local taxes) and, in the UK, a decline in non-tax revenues as a result of the privatization of services.

The division of responsibilities across different tiers of government requires a corresponding allocation of financial resources, so that sub-national authorities can fulfill the responsibilities they have been given and, in particular, provide citizens with largely comparable services at similar levels of overall taxation. (The extent to which this ambition is achieved can vary quite significantly between and within EU Member States).

If all tax revenues are collected centrally, resources can be allocated so as to secure equal service provision. These allocations should take account of differences in needs and costs through formula-driven methods of resource allocation, allocating higher sums to areas with relatively high costs or greater needs. In this respect, it is important to note that centralized tax collection has advantages: it reduces the costs of collection and compliance through scale economies and it avoids tax competition and tax evasion.

If, conversely, some taxes are raised at a sub-national scale, the situation may arise in which there is a mismatch between the revenue-raising capabilities of sub-national government and the costs of providing similar services: some areas will have high tax revenues and low costs and others will have low tax revenues and high costs (see the earlier discussion of HFI and VFI). In this situation ensuring that citizens receive comparable services at similar levels of taxation requires movement in the direction of fiscal equalization either through fiscal redistribution (horizontally across tiers of government or vertically from higher to lower tiers of government) or tax sharing arrangements (where different tiers of government are entitled to fixed shares of specified taxes).

In this case the justification for intervention is the case for equity and equal citizenship rights. A second justification is that fiscal equalization can contribute to economic stability preventing asymmetric shocks from causing an amplification of economic cycles through their impact on government revenues: negative shocks for example will reduce government revenues restricting the capacity of government to counter cyclical downturns.  

A recent OECD report estimated that fiscal equalization is equal to from 0.5 to 3.8 per cent of GDP and 1.2 to 7.2 per cent of public expenditure, and that on average it reduces differences in fiscal capacity by two-thirds (OECD, 2007:6).

Critics conversely argue that rules of tax sharing and the tax redistribution can lead to a situation in which a large share of additional income raised in rich areas is transferred to central government or directly to other less affluent areas, while, in less-developed areas, increases in income reduce their eligibility for tax transfers. The consequence, it is argued, is that neither has an incentive to invest to increase its GDP and its tax base. This argument is too simple. In particular it fails to consider the implications of the interdependence of developed and less developed areas economies.
(i) Financing sub-national government in the UK

UK local government spending accounts for about 15 per cent of public expenditure and is mainly devoted to capital projects and revenue expenditure on schools, council housing, road maintenance and social and environmental services. Central government requires local authorities to provide these services to national standards. (Health services are provided mainly through the National Health Service).

Local authorities are funded mainly by central government grants, although they also raise, under supervision of central government, a local property-related Council Tax. Central government resources for local authorities comprise two elements. One is a number of ring-fenced and other specific grants (where local authority spending is controlled). In 2007/08 these specific grants constituted the bigger part of central government’s contribution to local authority finance, equalling £39 billion. The other is a general Formula Grant (£26 billion in 2007/08), made up of a Revenue Support Grant, redistributed business rates (a tax on business premises set by central government, collected by local government but transferred to central government) and a Police Grant. There are no restrictions on the way local government can spend these grants.


<table>
<thead>
<tr>
<th>Formula Grant</th>
<th>2006/07</th>
<th>2007/08</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue Support Grant</td>
<td>3378</td>
<td>4105</td>
</tr>
<tr>
<td>National Non Domestic Rates</td>
<td>17500</td>
<td>17500</td>
</tr>
<tr>
<td>Police Grant</td>
<td>3936</td>
<td>4028</td>
</tr>
<tr>
<td>Total</td>
<td>24814</td>
<td>25633</td>
</tr>
</tbody>
</table>

Examples of unfenced (Targeted) Grant
- Neighbourhood Renewal Fund: 525
- Planning Delivery Grant: 104
- Children’s Services Grant: 152
- Access and Systems Capacity: 546
- Carers Grant: 185

Examples of Ring-fenced Grant
- Dedicated Schools Grant: 26576
- Mental Health Grant: 133

The decision on the overall size of the grant to local authorities is made in each three-year central government spending review on the basis of central government’s view of how much – given the state of national finances – it can afford to spend. In this way, austerity in national finances is passed down the governance chain to be reflected at local level. Once central government has determined the overall size of the grant, it is allocated between local authorities.

- Ring-fenced and specific grants are allocated according to formulae, by other rules of entitlement or by the appraisal of competitive bids.
• Formula Grant is allocated by means of mathematical formulae with year-on-year changes limited by a floor (a maximum downward change). Since 2006/07 the allocation system uses four factors: a Relative Needs Formula (and a formula for police grant), a Relative Resource Amount, a central allocation (an amount per head) and a floor damping scheme.

- Under the Relative Needs Formula, services are divided into several blocks in the light of relevant indicators of needs – the blocks cover children’s services, adult’s personal services and environmental, protective and cultural services. In essence, an allocation determined on a per capita or per client basis is adjusted by an assessment of service-specific relative needs, determined by taking into account, chiefly, deprivation and other drivers of area service costs. Cash amounts are then derived for authorities delivering similar groups of these services.

- The Relative Resource Amount is a negative figure which takes into account that some local authorities can raise local tax revenue more easily than others. This assessment is again applied to groups of authorities which are similar in terms of the services they provide.

- The next step is the determination of the central allocation which reflects minimum values for needs and resources.

- Finally a floor damping mechanism sets a minimum increase in grant for each authority (where the floors reflect the range of services provided). These floors protect local authorities from detrimental grant changes by setting minimum increases in grant.

Once grant levels have been determined, a local authority will prepare its budget and set the level of its local Council Tax. In this process it will consider whether it can raise additional revenue (for London’s authority, for example, its traffic congestion charge provides additional finance) and decide how to use its financial reserves. The central government has a limiting control over the local authority’s power to tax and can cap increases in Council Tax. When this happens, the local authority concerned is required to revise its expenditure plans. Council tax accounts on average for some 20 per cent of revenue.

The outcomes at a regional and national level in the UK are recorded in Table 24. It is striking that the highest levels of per capita identifiable public expenditure are in Northern Ireland and Scotland. These figures are not predominantly the result of a needs assessment. In the case of these devolved administrations in the UK (which also includes Wales), the figures reflect the operation of the so-called Barnett formula which was first used in 1979. It applies not to needs but to historical levels of public expenditure and still reflects the high needs of these Scotland and Northern Ireland.

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56 The Barnett formula accords to the devolved administrations (Northern Ireland, Scotland and Wales) changes in revenue that are a fixed proportion (initially 10/85 in the case of Scotland reflecting its share of the population in the 1970s) of changes in comparable provision in England.
which existed when the formula was devised and which, over the thirty years since, have changed considerably.


<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
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<tbody>
<tr>
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<td>6316</td>
<td>6875</td>
<td>7258</td>
<td>7754</td>
<td>7982</td>
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<tr>
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<td>6556</td>
<td>6989</td>
<td>7380</td>
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<td>Yorkshire and Humberside</td>
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<td>6108</td>
<td>6524</td>
<td>6899</td>
<td>7111</td>
<td>7590</td>
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<tr>
<td>East Midlands</td>
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<td>5495</td>
<td>5910</td>
<td>6212</td>
<td>6468</td>
<td>6936</td>
<td>11.5</td>
</tr>
<tr>
<td>West Midlands</td>
<td>5424</td>
<td>5883</td>
<td>6356</td>
<td>6752</td>
<td>7090</td>
<td>7555</td>
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<tr>
<td>Eastern</td>
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<td>5569</td>
<td>5885</td>
<td>6177</td>
<td>6555</td>
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</tr>
<tr>
<td>London</td>
<td>6569</td>
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<td>7744</td>
<td>8265</td>
<td>8550</td>
<td>9099</td>
<td>-17.0</td>
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<tr>
<td>South East</td>
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<td>5244</td>
<td>5692</td>
<td>5921</td>
<td>6165</td>
<td>6512</td>
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<tr>
<td>South West</td>
<td>5101</td>
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<td>6003</td>
<td>6277</td>
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<td>6962</td>
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<tr>
<td>England</td>
<td>5522</td>
<td>6026</td>
<td>6442</td>
<td>6802</td>
<td>7076</td>
<td>7535</td>
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<td>6696</td>
<td>7213</td>
<td>7458</td>
<td>8077</td>
<td>8544</td>
<td>9179</td>
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<td>Wales</td>
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<td>6945</td>
<td>7315</td>
<td>7796</td>
<td>8172</td>
<td>8577</td>
<td>-11.8</td>
</tr>
<tr>
<td>Northern Ireland</td>
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<td>7868</td>
<td>8294</td>
<td>8672</td>
<td>8990</td>
<td>9789</td>
<td>-23.0</td>
</tr>
<tr>
<td>UK identifiable expenditure</td>
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<td>6225</td>
<td>6624</td>
<td>7012</td>
<td>7308</td>
<td>7790</td>
<td>0.0</td>
</tr>
</tbody>
</table>

(ii) The German federal financial equalization system

Germany is a federal state comprising sixteen independent Länder, with rights and obligations guaranteed by the German constitution. To fulfill the tasks allotted to them, the Länder (and the municipalities which for public finance purposes are considered to be a part of the Länder) require free and independent control of adequate financial resources. To guarantee adequate funding, four procedural steps are followed.

- All tax revenue is divided between the Federation and the Länder as a whole (with a supplementary grant for the municipalities).
- The tax revenue assigned to the Länder as a group is allocated to the individual Länder.
- A system of financial equalization transfers resources from rich to poor Länder.
- The Federation provides supplementary grants to poor Länder (See Bundesministerium der Finanzen, 2008, on which this account draws and which is illustrated with data from Gebauer, 2006).
The first step is the vertical allocation of joint tax revenues between the Federation and the Länder (see Figure 5). Corporation tax is shared by the federation and the Länder, and income tax and VAT are shared by the federation, the Länder and the municipalities. The federation receives 42.5 per cent of income tax, 50 per cent of corporation tax and in 2006 about 53 per cent (from 2007 on about 55 per cent) of VAT. The Länder receive 42.5 per cent of income tax, 50 per cent of corporation tax and in 2006 about 45 per cent (from 2007 about 43 per cent) of VAT. Municipalities receive 15 per cent of the income tax yield and around 2 per cent of VAT. In addition there are taxes that accrue solely to the federation (such as mineral oil tax), the Länder and the municipalities (though a share of the trade tax goes to the federation and Länder). The EU’s ‘own resource’ share of VAT is funded by the federation (see Figure 6 for the evolution of VAT shares).
Figure 6. VAT shares of the Federation, Länder, municipalities and EU

The second step is to allocate the global sum of Länder funding between the individual Länder. With the exception of VAT, individual Länder are entitled to the revenue collected by the local tax authorities. In the case of income tax, a principle of allotment ensures that each Land receives the taxes its inhabitants pay, while in the case of corporation tax, which is collected centrally, the tax is allotted to the Länder in which a company operates. VAT is allocated so that per capita VAT revenues are relatively high in economically weaker Länder whose per capita receipts from income tax, corporation tax and Land taxes are lower than the per capita average of all the Länder. Many of these Länder were part of the former German Democratic Republic (Figure 6).

---

57 Up to 25 per cent of the Länder’s overall VAT is allocated, in proportion to their populations, to those whose per capita receipts from income tax, corporation tax and the Land taxes are lower than the per capita average of all the Länder. The transfer is proportional to the size of this gap but does not remove it.
The third step is one of financial equalization, which is designed to ensure that each Land has sufficient finance to ensure that the population of Germany can enjoy equal living conditions – the equalization being carried out so that it does not fully remove differences in the financial resources of the various Länder, since to do would be considered incompatible with residual fiscal autonomy and sovereignty. The system assumes that the per capita financial requirements of the Länder are for the most part the same. An adjustment is made, however, for the three city states (a 35 per cent increase in their populations) which require more resources due to their dual role as Länder and municipalities, and for three sparsely populated Länder. Adjustment payments are then made by rich Länder to poor Länder. In both cases payments are proportional to the extent to which the Land’s fiscal capacities (as indicated by most but not all of the revenues of the Land and its municipalities) exceed or fall short of the average financial capacity per member of the (adjusted) population. In neither case is the difference completely eliminated, nor does the rank order of the Länder in terms of financial capacity change.

The fourth and final step is for the Federation to distribute general supplementary federal grants and those for special needs to poor Länder, which further reduces the gap between the financial capacity of the recipients and average financial capacity. Neither of these sets of grants is legally tied to special purposes. Instead they meet general financial requirements. General supplementary federal grants go to Länder whose financial capacity per inhabitant, after financial equalisation among the Länder, is less than 99.5 per cent of average financial capacity per inhabitant and are proportional to the size of the shortfall. Supplementary federal grants for special needs are used to compensate poor Länder for special burdens they have to bear.
Included is €10 billion allocated annually to the eastern Länder and Berlin to compensate for their weak infrastructure and the financial weakness of their municipalities (itself a part of Solidarity Pact II designed to rectify the consequences of the division of Germany) and another €1 billion to compensate for high structural unemployment.

Table 25 records the transfers involved in stages three and four. Together these steps significantly reduce disparities in fiscal capacity, while Figure 7 indicates the distribution of tax revenue and indicates the degree of support ultimately provided to the eastern Länder.


Federal transfers (€ million) | Länder transfers (€ million)
--- | ---
Recipient | Contributor

Fiscal transfers in France

More than twenty years ago Davezies, Larrue and Prud’homme (1983: 173-94) identified large redistributive impacts of the French state budget and the similarly-sized social security system. In 1976, under the social security system, the richest region, Ile de France, made a net contribution of French Francs (FF) 1,940 (about €296) per inhabitant to poorer regions, while Languedoc-Roussillon received FF 1,792 (about €273) per head, more as a result of differences in taxes and contributions than of expenditures and payments. State expenditure was also strongly redistributive. In this case the main winner was Corsica, while the main net contributor was the Seine Department in the Ile de France region.
Aid for regional development discriminated more strongly among regions than other state transfers. The value of aid per inhabitant was, however, far less than that of social security transfers. In 1960-73 the inhabitants of the Pays de la Loire received the highest regional development aids per head. These aids were worth FF 132 (about €20) per inhabitant or an average of just over FF 9 (about €1.4) per inhabitant per year. Yet in 1976 alone, the inhabitants of Languedoc received budget transfers of FF 1,224 (about €187) per head and social security transfers of FF 1,792 (about €273).

Between 1960 and 1973 the rankings of regions in relation to levels of regional aid and state budget transfers were similar, but not identical. Some of the areas which were most disadvantaged and which received most aid in the form of budget transfers (Languedoc, Midi-Pyrénées, and Auvergne) did not do well out of regional development aids which were directed more towards regions in the west (such as the Pays de la Loire) and north-east.


<table>
<thead>
<tr>
<th>State budget</th>
<th>Lowest taxes and highest expenditures and transfers</th>
<th>Highest taxes and lowest expenditures and transfers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenditures²</td>
<td>Corse 8745 Essonne 6335</td>
<td>Haute-Loire 5802 Seine 15888</td>
</tr>
<tr>
<td>Taxes</td>
<td>Haute-Loire 5802 Seine 15888</td>
<td>Corse 2938 Seine -7710</td>
</tr>
<tr>
<td>Net transfers</td>
<td>Corse 2938 Seine -7710</td>
<td>Seine 15888 Corse 2938</td>
</tr>
<tr>
<td>Social security budget</td>
<td>Ile-de-France 5705 Franche-Comté 4539</td>
<td>Languedoc-Roussillon 3756 Ile-de-France 7646</td>
</tr>
<tr>
<td>Expenditures²</td>
<td>Languedoc-Roussillon 3756 Ile-de-France 7646</td>
<td>Ile-de-France 5705 Franche-Comté 4539</td>
</tr>
<tr>
<td>Contributions</td>
<td>Languedoc-Roussillon 3756 Ile-de-France 7646</td>
<td>Ile-de-France 5705 Franche-Comté 4539</td>
</tr>
<tr>
<td>Net transfers</td>
<td>Languedoc-Roussillon 3756 Ile-de-France 7646</td>
<td>Ile-de-France 5705 Franche-Comté 4539</td>
</tr>
<tr>
<td>Regional policies</td>
<td>Languedoc-Roussillon 3756 Ile-de-France 7646</td>
<td>Ile-de-France 5705 Franche-Comté 4539</td>
</tr>
<tr>
<td>Expenditures³</td>
<td>Pays de la Loire 9</td>
<td></td>
</tr>
</tbody>
</table>

1. Columns 2 and 3 list the départements and regions which paid the lowest taxes and received the largest expenditures and transfers per head. Columns 4 and 5 list those with the highest contributions and the lowest expenditures and net transfers.
2. Average = FF 7070.

The study showed that redistribution was a product of differences in contributions and not of differences in expenditures. The levels of expenditure per head were not in general higher in the more underdeveloped areas than in richer areas. The transfers which occurred stemmed more from the fact that per capita taxes and social security contributions were lower in low-income areas. While, therefore, regional development funds did discriminate in favour of less developed areas, overall expenditure did not. A sensible treatment of spatial imbalances requires that the geographical impact of state expenditures as a whole be given much more explicit attention. Instead of a narrow focus on regional and other explicit spatial policies, a spatial dimension should be added to all state expenditures and revenues.
(iv) Fiscal transfers and multi-level governance

This particular challenge was taken up in research prepared for the European Commission’s first Cohesion Report. In this, Wishlade, Yuill, Taylor, Davezies, Nicot and Prud’homme (1996) estimated the size and impact of fiscal transfers in seven Member States (France, Germany, Italy, Portugal, Spain, Sweden and the UK). As Table 27 shows, irrespective of the measuring rod used for the distribution of expenditure – either a flow (in which regions is public money spent) or benefit concept (in which regions do the benefits of public expenditure accrue) – the richer regions in the eight countries transferred significant sums to the poorer regions.

At an EU scale, however, for a region with a particular level of GDP per capita it made a great difference whether a region was part of an economically strong or an economically weak Member State. As Figure 10 shows, areas with similar levels of GDP per head were net recipients of public expenditure flows if they were located in rich countries such as Germany but net contributors if they were located in poorer countries such as Spain.

Table 27. National fiscal transfers for selected EU regions. Source: elaborated from Wishlade, Yuill, Taylor, Davezies, Nicot and Prud’homme, 1996 and EUROSTAT
<table>
<thead>
<tr>
<th>Region</th>
<th>Net transfers (benefits) (ECU million)</th>
<th>Net transfers (benefits) as percent of GDP</th>
<th>Net transfers (flows) (ECU million)</th>
<th>Net transfers (flows) as percent of GDP</th>
<th>Net transfers (benefits) per inhabitant (ECU)</th>
<th>Net transfers (flows) per inhabitant (ECU)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hessen</td>
<td>-6778</td>
<td>-4.8</td>
<td>-6112</td>
<td>-4.3</td>
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<td>-1205</td>
</tr>
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<td>-10128</td>
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<td>25.3</td>
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<td>2512</td>
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Figure 8. National transfers and GDP per head in selected EU Member States in the early 1990s. Source: elaborated from Wishlade, Yuill, Taylor, Davezies, Nicot and Prud'homme, 1996 and EUROSTAT

The study also showed that the magnitude of transfers depends in part on the size of government budgets as a share of GDP. (In their study the exclusion of the social security systems in France and Germany reduces the measured size of the budgets and makes the data for these two countries not strictly comparable with those for the other countries). Transfers also depend however on the progressiveness of the tax system, the extent to which expenditure per head is equal and the size of disparities in income per head.

**Part IV: Conclusions**

Economic and social cohesion involving a reduction in regional development disparities is one of the fundamental objectives of European Union as enshrined in the Treaty. As recognized in a recent EU Budget Review (EU, 2008; Annex 4) a number of economic and political arguments justify this objective and policy. The main economic and political arguments are:

Economic and social cohesion involving a reduction in regional development disparities is one of the fundamental objectives of the EU as enshrined in the Treaty. As recognized in a recent EU Budget Review (EU, 2008; Annex 4) a number of economic and political arguments justify this objective and policy. The main economic and political arguments are:
• without public intervention at the EU level, there would be insufficient and suboptimal level of investment, particularly in less developed, remote regions of the EU;
• the EU is faced with marked development disparities, which are of a structural nature, are enduring and which therefore cannot be diminished without assistance;
• aid is not only required for the elimination of structural imbalances and for the strengthening of comparative advantages, but also for the successful functioning of the single internal market;
• Cohesion Policy is not just about equality in terms of the curtailing of disparities, but is also designed to ensure equal development opportunities for countries, regions and citizens; and
• Cohesion Policy is not only necessary for the “less developed”, but is also in the interest of the “more developed” since, in addition to facilitating the functioning and emergence of the internal market, it prevents bottlenecks and inflationary pressures from arising, thus also increasing growth potential of the EU level.

The report also states that politically “it is … difficult to imagine social cohesion in the EU without real convergence of its constituent parts, which is particularly relevant in conditions of significantly increased disparities between Member States after the last enlargement.”

The review concluded that ‘it is possible to conclude that deliberations regarding Cohesion Policy in the scope of an EU budget review will not go in the direction of “do we need Cohesion Policy or not”, but rather in the direction of an analysis of “what type of Cohesion Policy do we need”’.

This chapter has concentrated on the financing of Cohesion Policy and has sought to describe some aspects of the two sources of finance – EU and national. The national part of the policy’s budget is paid by each Member State when the EU policy is implemented on its territory, the level of governance which makes the payment being that which is most appropriate to the project in question. This national payment does not enter into the EU’s ‘own resource’ system. It is this national part of EU Cohesion Policy funding which is being first affected by the aftermath of Member States’ anti-recession policy. As governments set about reducing their levels of debt to come closer into line with the requirements of Euro-zone membership, one of the areas they examine is their national contribution to Cohesion Policy. They might seek to reduce this contribution in a number of ways. One approach might be to reduce the number of projects to be financed and, for those which are retained, to increase the percentage share of finance from EU ‘own resources’; another might be to seek to use EU ‘own resources’ to finance projects which would otherwise be wholly financed by national finance; or any combination of these and other approaches may be adopted. Whatever method is chosen, the result would be the same: the substitution of national by EU ‘own resources’ reduces total EU and national expenditure on equipping the national or regional economy for future growth and employment especially in economically disadvantaged areas.
These conclusions will, however, concentrate on the EU ‘own resource’ element in the funding of EU Cohesion Policy. The wide variations in amounts of EU resources allocated to Member States produces a wide variety of different cases. For those Member States (chiefly EU10) which receive a high level of EU funding – close, in some cases, to four per cent of their GDP – the combined effect of EU and national finance is of macro-economic importance, affecting the level of economic activity in a recession and, at other phases of the economic cycle, and needing to be taken into account in connection with anti-inflation policy. At the other extreme of the range are Member States in which the macro-significance of EU Cohesion Policy, including its national contribution, approaches zero – where it is felt only at regional level or, in many cases even, only at the level of a particular economic aggregate within a region, the best example being Gross or Net Domestic Capital Formation. This fact, however, does not deny the importance of even small amounts of resources used with geographical and sectoral precision to provide incentives for increased investments in strategic parts of a regional economy.

Some of the statistical analysis in this chapter has demonstrated that, even in the Member States which receive the biggest allocations of EU ‘own resource’ funds under EU Cohesion Policy, things are not quite what they seem. Judged according to the mass of finance which is allocated, there is evidence that the biggest financial allocations are made to the poorest regions. But when judgement is based on the allocation of EU finance per person in the affected area – in other words, on the intensity of aid – a different picture emerges. Now it is not the poorest who receive the most: in fact, up to a level equal to about 84 per cent of EU GDP per head, aid increases as income increases. This relationship appears to be the opposite of what is intended and may be considered as an argument for looking again at the detail of the allocation system for the EU ‘own resources’ allocated under Cohesion Policy.

That said, the conclusions of this chapter will focus on the limited, but relevant, question of how the EU ‘own resource’ arrangements for EU Cohesion Policy might be modified when the policy is reviewed in connection with the fifth financial perspective, to cover the period 2014-20. The aftermath of the financial crisis and recession will ensure that the fifth financial perspective follows the pattern established by each of its precedents. Until the end of 2013, EU Cohesion Policy – together with its financial envelope from EU ‘own resources’ – will be sheltered from budget upheaval by the medium-term nature of the financial perspectives agreement. But it is already clear that the political priority to reduce expenditure, which is affecting national regional and cohesion policies, will, in the negotiation of the fifth financial perspective, be applied to EU Cohesion Policy. The following points have been touched upon in this chapter.

The overall economic context is important. The pressure being felt by EU Member States is to reduce expenditure. This pressure will impel some of them to seek a reduction in the size of the EU ‘own resources’ budget and, therefore, their own financial contribution. But it is important to keep a sense of perspective. One of their other priorities must be to ensure that economic recovery from the recession is not ‘jobless’ and this policy aim argues in favour of continuing a certain level of EU Cohesion Policy activity, even in better off Member States and better off regions, both of which are frequently marked by high levels of persistent unemployment which, moreover, the current recession is likely to exacerbate. Another is to avoid the risk in
a set of highly interdependent economies in which the prosperity of a region in one Member State can depend closely on that in others of competitive deflation.

Linked to this, and mentioned above in this chapter, is the desirability of viewing the EU budget as an instrument of policy and not, as has been the case in the past, viewing policy as being an instrument of the EU budget. The difference in approach may seem small but can be vital. The former allows EU Cohesion Policy to take its place as one of the EU’s three policies in support of economic growth and employment creation and allows a political emphasis on regenerating sustainable economic activity and on carbon-neutral and equitable growth. The latter emphasizes the relative importance of EU Cohesion Policy in the overall EU budget and focuses on cost cutting. In present conditions this budgetary perspective might lead to decisions to withdraw the policy from the Union’s better-off Member States, thus weakening its overall effect.

Possibly the biggest weaknesses in the policy as it stands are its brutal treatment of growing regions, in particular, and its lack of sensitiveness to shifts in relative regional development. In what is in effect a binary, or on-off, policy system, EU Cohesion Policy support for a poor region which is improving its performance is rapidly reduced once it passes the trigger point equal to 75 per cent of EU GDP per person. This already low level of income, hallowed as the trigger point since the policy’s revolutionary reform in 1989, has been devalued by almost 20 per cent by the EU enlargements which have taken place since. Acknowledgement of this weakness would indicate that the next reform of the policy is the moment to install a more graduated approach. Accordingly, some of the analysis in part two of this chapter explored the effect of classifying regions into two extra categories, making four in all. Regions would then move from one category to another as their GDP per person rose or fell in relation to the Union average, while the degree of support could be more graduated. Such a reform would respond to the reduction in the policy’s trigger level as a result of the accession into the EU of poorer Member States; better reflect the economic reality that regional economies remain fragile as they regenerate from very low levels of income; recognize that there are powerful forces that constantly alter the relative position of regional economies of which the differential impacts of the latest recession is just one example; avoid abrupt changes in the intensity of funding; provide policy-makers with a revivified policy instrument with which to pursue economic modernization and the drive for greater competitiveness.

Such a change – which need not cause an expansion of the EU Cohesion Policy budget – would require policy-makers to revisit the Berlin mechanism which for several years has provided the basis for allocating EU Cohesion Policy funding, especially to the Convergence objective which accounts for about 80 per cent. A revision of this mechanism would enable policy-makers to address a number of factors including the length of time it will take for the economies of the poorest Member States and regions to grow beyond the 75 per cent threshold; the policy conflict between concentrating EU ‘own resources’ in the poorest regions and ensuring that they are invested in projects which represent high value for EU-‘own-resource’-money; and the apparently-aberrant result that aid intensities increase with income, rather than the opposite, at least until about 84 per cent of EU GDP per person.
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Annex 1

The increasing budget importance of EU Cohesion and Regional policies: the evolution of the EU budget until 2006

In the period up to 1970 the EU budget grew in line with the development of its policy commitments and the creation, in particular, of the European Social Fund (ESF) in 1957 and the European Agricultural Guidance and Guarantee Fund (EAGGF) in 1962. Between 1971 and 1975, a system of ‘own resources’ was introduced to replace Member State contributions – the ‘own resources’ being (i) customs duties and (ii) agricultural levies, stemming directly from the implementation of EEC policies; and (iii) a Value Added Tax-based transfer from each Member State, initially set at a maximum of 1 per cent of the share of the economy to which VAT applied.

In 1973 Denmark, Ireland and the United Kingdom joined the EU, and in 1975 the European Regional Development Fund (ERDF) was established. In the same year the European Court of Auditors was set up to verify and assess EU financial performance in the light of the ‘own resources’ system and increased parliamentary control over the EU budget. In 1981 Greece became a member to be followed by Spain and Portugal in 1986. In this period expenditure increased to fund the common agricultural policy, to reinforce the ESF and the ERDF, and to finance the new common fisheries policy, the first research framework programme and the integrated programmes for the development of Mediterranean regions, which were established to permit the adjustment of Mediterranean regional economies to the EU’s Mediterranean enlargement. This period also saw increased pre-occupation with net contributions, with the United Kingdom (UK) in particular securing in 1984 a rebate so that its net contribution to the EU budget through the ‘own resources’ system was more in line with its relative income.

The next step began in 1988 with the adoption of a political programme for the completion of the EU’s internal market by January 1993. Its main aim was the removal of non-tariff barriers and restrictions on the movement of people, goods and money. The first of the EU’s multi-annual financial perspectives was adopted in 1988 to cover the five years 1989-93, making it possible to reform EU Cohesion Policy with multi-annual programming as its foundation. This reform and the doubling of EU expenditure on the policy was intended to help economically disadvantaged areas to adapt themselves to the sharper competitiveness conditions which would be created by the Single Market. The reformed policy provided a mechanism to deal with the unequal geographical and national distribution of the costs and benefits of integration. The financial perspective also sought to limit expenditure on EU agriculture policy. In addition, it modified the ‘own resource’ system, introducing a new ‘own resource’ determined as a share of each Member State’s Gross National Product (GNP). This measure aligned Member State payments more closely with their wealth (for the UK, it permitted retention of its financial abatement mechanism). It also introduced a ceiling for ‘own resources,’ limiting the EU budget to a maximum of 1.20 per cent of EU GNP in 1992.
The six years from 1994 to 1999 were characterized by further EU enlargement and by moves towards economic and monetary Union. In 1995 Austria, Finland and Sweden became EU members. Two years earlier the Treaty on European Union (Maastricht Treaty) had come into effect, establishing a number of new policy areas (a common foreign and security policy and justice and home affairs) and creating the Cohesion Fund, to come into being in 1994, as a supplementary fund for Cohesion Policy (in addition to the ERDF and ESF). The Cohesion Fund was conceived as a counterpart to the implementation of convergence criteria for economic and monetary union in relatively poor Member States (at that stage in EU development, Greece, Ireland, Spain and Portugal). A new six-year financial perspective covered the period raising marginally the ceiling for own resources to 1.27 per cent of GNP in 1999. In this period, the programming period under EU Cohesion Policy was lengthened to six years – initially it had been five – and spending increased significantly. The longer programming period was intended to reflect the fact that certain types of structural investment take a long time to be programmed and implemented.

The third financial perspective, for 2000-06, further lengthened the programming period to seven years. It was adopted when further enlargement headed the EU’s political agenda. On the revenue side, this framework was constrained by the desire of Member States to contain public expenditure in order to satisfy Euro-zone fiscal discipline and to reduce the share of the largest net contributors to the EU budget (Germany, Netherlands, Austria and Sweden – the UK still being protected by its abatement mechanism). On the expenditure side the anticipated membership from 2004, the mid-point of the financial perspective, of the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia saw the establishment of a new pre-accession instrument to assist their economic development by stimulating the provision of basic infrastructure. In these circumstances, agricultural spending was held constant, while Cohesion Policy expenditure was checked and concentrated more strongly on areas with the greatest difficulties.

In 2007, at the beginning of the fourth financial perspective for 2007-13, Bulgaria and Romania became members, increasing the EU to 27 Member States. As far as the trajectory of the EU was concerned the Lisbon strategy of 2000 (designed to make Europe “the most dynamic and competitive knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion, and respect for the environment by 2010”) assumed a high profile. The ‘own resources’ ceiling was held at its previous level but recalibrated as 1.24 per cent of Gross National Income (GNI)), the UK correction continued, but in a revised form, and the contributions of Germany, Netherlands, Austria and Sweden were reduced. On the expenditure side, resources were concentrated on improving the EU’s competitiveness (the Lisbon Strategy for growth and jobs) and cohesion. Expenditure allocated to agriculture was set to decline over the seven-year period.
Over the period from 1958 and especially from 1989 to the present, the composition of the EU budget has changed significantly. In 1965 the Common Agricultural Policy (CAP) was allocated 35.7 per cent of budget. Twenty years later, in 1985, it accounted for 70.8 per cent, and in the first year of the 1989-1993 financial framework it still represented 60.7 per cent. By 2013, the share of traditional CAP spending (market-related expenditure and direct payments to farmers) is however expected to fall to 30.8 per cent (with another 9.4 per cent for rural development).

As the share for agriculture has declined, the share for EU Cohesion Policy has increased. In 1965 only 6 per cent of the EU budget was spent on Cohesion Policy. In 1985 it reached 10.8 per cent. A major change occurred with the adoption of the Single European Act which gave greater emphasis to economic and social cohesion. As a result, by 1988, Cohesion Policy’s budget allocation was 17.2 per cent and it will represent 35.7 per cent in 2013.

These changes in the composition of the budget were, at least until 2006, associated with the implementation of a succession of major political projects. The first was the internal market (1988-92); the second economic and monetary union (1993-99); and the third enlargement, principally to include former Warsaw Pact countries (2000-06). The most recent phase, conversely, was associated with the more narrowly economic and less compelling vision of the Lisbon strategy (compared with earlier political and economic projects to develop a single market, a single currency and successively enlarged communities). This strategy was reflected in a shift in the distribution of resources with in particular an emphasis on Competitiveness for growth and employment which will account for 10.2 per cent of the budget by 2013.
On the revenue side of the EU budget, three major changes have taken place. The first was the creation in the 1970s of an ‘own resources’ system, originally founded on EU customs duties and agricultural levies, in part to give the Union a greater degree of financial autonomy relative to its Member States. The second occurred with the establishment in 1980 of a national contribution made up of a share of Member State’s Value Added Tax (VAT) revenues. In this case the main motivation was to establish a financial system capable of supporting an increase in Community expenditure. The third occurred with the creation of Member State contributions related to national income. One of the justifications for this step was increased equity which was not provided by the VAT resource. 58

At present the main revenue source is that based on the Member States’ gross national income. Over the years this source has increased in size and importance to surpass the other traditional ‘own resources’ (customs duties, agricultural levies, and a VAT-based resource. In 1988, the GNI resource accounted for less than 11 per cent of EU revenue compared with 28 per cent provided by custom duties and agricultural levies and 57 per cent by the VAT-based own resource. In 2013, the GNI resource is forecast to provide about 74 per cent of the EU revenue compared with just 13 per cent for customs and agricultural levies and 12 per cent for the VAT-based resource.

58 Current discussions include proposals for a Community tax and for taxes designed to influence the conduct of economic actors to make it consistent with EU and Member State objectives of which a carbon tax and energy and fuel consumption taxes are examples.
In the EU, in principle, the European Commission, the European Council and the European Parliament settle the EU budget. In practice the main driving force in deciding on the resources available for Europe-wide policies is the Member States, which are all represented in the European Council. For Member States the notion of net resources and of a ‘juste retour’ – or some sort of balance between contributions and receipts – often dominate political debate about the EU budget, in part because Member States take the view that the ‘own resources’ of the Union are a form of national contribution rather than specific EU tax and revenue sources. This fact helps to explain why short-term national interests dominate in budgetary negotiations. In each negotiation on a new financial framework, most Member States seek to secure a short-term ‘net return’ and ignore the contribution of the EU budget to Union objectives. Instead of a goal- or policy-driven approach, budget negotiations proceed by first fixing an expenditure ceiling. At present this ceiling stands at 1.24 per cent of GNI. Once the ceiling is fixed, negotiations settle on the allocation of funding per policy area.

A recent analysis (Mrak and Rant, 2008) of the 2007-13 New Financial Framework – which is discussed in relation to Cohesion Policy in the principal chapter – confirmed that national interests played a dominant role in coalition formation and outcomes. It showed that ‘theoretical’ national interests, expressed in terms of global and partial (related to particular issues) net cash flows/net budgetary balances (NBB), gave rise to coalitions that corresponded very closely with the real-life coalitions that shaped the negotiation of the budget. The underlying data is plotted in Figure 11. On the vertical axis is plotted each Member State’s NBB defined as total expenditure allocated to a country less its total contribution (comprising traditional ‘own resources,’ the VAT source and the GNI source plus net receipts from the UK rebate). Net contributors have negative NBBs and net recipients positive NBBs. Each column also identifies partial NBBs defined as the net cash flows attributable to individual policy areas: Member State receipts from the policy minus Member State contributions to the financing of the policy. Figure 11 expresses all NBBs and partial NBBs as shares of GNI.

These data suggest that new Member States and old Member States which are net recipients wanted high spending, especially on agricultural (CAP) and cohesion policies. Old Member States wanted low spending especially on cohesion policy, and Belgium and Luxembourg, as well perhaps as the European Commission, wanted high administrative spending. Mrak and Rant (2008) showed that the main forces behind the New Financial Framework stemmed from (1) the existence of strong and opposing coalitions that prevented major reductions in cohesion spending, and (2) the effort by the six net contributor countries to secure low overall spending through a limited financial commitment to the Lisbon objectives, whilst retaining the October 2002 Franco-German agreement to extend the Common Agricultural Policy.
The inter-institutional agreement gave the European Commission a mandate “to undertake a full, wide ranging review concerning all aspects of EU spending, including CAP (Common Agricultural Policy), and of resources, including the UK rebate, to report in 2008/2009.” The Commission subsequently published “Reforming the budget, changing Europe.” In this document, it presents the EU budget as a “tool for changing priorities.” Subsequently it implicitly identified a set of future challenges – yet, those which are identified (transformation to a knowledge and service economy, environmental change, demographic change) are multi-dimensional and will affect a variety of different policy areas. It is difficult to see how they can determine the selection of the EU’s policy mix.

A well-functioning budget is a crucial instrument for the achievement of EU goals, and there is little doubt that the existing EU budget requires comprehensive reform. The way forward, however, should start from a political vision for the EU and its associated set of policy priorities (growth, cohesion, sustainability, security). It is on the basis of this vision that the structure and size of the EU budget should be determined. In relation to the make-up of EU expenditure, and to the respective roles in expenditure of EU and national budgets, the Communication pays particular attention to the concept of value added. In relation to the latter, it declares:

“In the budget as elsewhere, European action should provide clear additional benefits compared to action by individual Member States alone in pursuing policies that promote the European common interest. Subsidiarity and proportionality are therefore core criteria to determine the added value of EU spending. … The case for spending from the EU budget on these grounds is made if this is the most efficient [and least
intrusive] policy lever available to provide the appropriate response to a given problem. Subsidiarity and proportionality therefore require an assessment of the factors which will allow a policy to succeed, such as its transnational dimension, the potential for economies of scale or scope, critical mass requirements, local preferences, coordination costs and other political circumstances.” (p. 9)

Two remarks are relevant.

First, any discussion of the budget should take as its starting point the identification of the objectives and areas of policy intervention of the EU. In relation to the determination of policy areas the notion of value added is of only limited use. A technical assessment of economies of scale and the scale of externalities is not a substitute for identifying areas of political intervention such as the promotion of cohesion and solidarity in the EU or the construction a sense of European citizenship (which may require EU action in areas such as education and culture which are accepted as primarily national spheres of competence). In the past EU policy initiatives have evolved not to respond to all of the economic and social challenges with which European countries have been confronted, but to respond to the evolving project of European construction.

In this connection, the work of the Centre d’Analyse Stratégique (2007) is instructive. Of particular importance in shaping EU policy in the past, it says, were strategies designed to compensate for some of the potentially unequal effects of successive steps in economic integration and in the geographical enlargement of the EU and of the Single Market. It points out eight examples.

- The common agricultural policy was a result of a 1960s’ Franco-German compromise to support French agriculture once it was recognized that German industry would strongly benefit from the Common Market.
- The European Social Fund was established at the time of the Treaty of Rome to compensate for competitive shocks associated with the establishment of the common market and in particular to encourage the training and mobility of Italian workers.
- The European Regional Development Fund and associated regional policy was established after the adhesion of the United Kingdom. Since the UK contained a large share of the EU’s less developed regions, the policy and the ERDF would reduce the UK’s net budget contributions.
- The establishment of the Integrated Mediterranean Programmes coincided with the accession of Mediterranean countries whose economies posed direct challenges to the Mediterranean economies of France and Italy.
- The creation of the Single Market brought the decision to double the size of the structural funds, the ERDF, ESF and the Guidance element in the European Agriculture Guarantee and Guidance Fund (‘Delors’ Package 1’).
- The agreement on Economic and Monetary Union (EMU) saw further increases in the size of the structural funds (‘Delors Package 2’) and the establishment of the Cohesion Fund to offset
the impact on economically-weak Member States of meeting EMU convergence criteria.

- With the adhesion of Sweden and Finland, the structural funds were also used, somewhat symbolically, to support areas with very low population densities.
- The 12 countries that have joined the EU since 2004 and 2007 are to receive a large share of anticipated structural and cohesion fund spending in 2007-13.

Second, after identifying the EU’s objectives and areas of policy intervention, the next step is for the EU to identify the most effective instruments for achieving its policy outcomes and the scales of intervention. Such instruments might be EU expenditure, national expenditure, EU regulation, national regulation, or the EU as a catalyzer. At this point it is important to identify that the main objective of EU Cohesion policy is to promote the economic and social convergence of regions and Member States by promoting economic growth. The achievement of the Lisbon goals of EU competitiveness, innovation and growth can then be seen as one of the instruments by which economic growth will be achieved. Cohesion policy should therefore be assessed in the light of its contribution to this objective and to two other objectives that cannot be addressed through national action: territorial co-operation amongst territories forming part of different nation states, and territorial cohesion (ensuring ultimately that all EU citizens have equal access to life chances and public services no matter where they reside in the EU).

Two factors are useful in deciding the EU scale of intervention in any policy area. The notion of EU value added and considerations of EU administration and management costs relative to national administrations make good sense in requiring a functional justification of EU action. These two factors help counter the risk of the capture of EU spending decisions by national or sectoral interests and offer tools for evaluating different ways of organizing and co-ordinating “in an efficient manner the overlapping involvement of different tiers of government and different means of intervention in areas of shared competence.” (Notre Europe, 2008)
Annex 2

Additional provisions determining the allocation of Cohesion Fund resources for 2007-13

1. When in a given Member State the Phasing-Out regions defined in Article 8(1)) represent at least one third of the total population of the regions fully eligible for Objective 1 assistance in 2006, the rates of assistance will be 80% of their individual 2006 per capita aid intensity level in 2007, 75% in 2008, 70% in 2009, 65% in 2010, 60% in 2011, 55% in 2012 and 50% in 2013.

2. As far as the transitional arrangements under paragraphs 6(a) and (b) are concerned, the starting point in 2007 for those regions which were not eligible for Objective 1 status in the 2000 to 2006 period, or whose eligibility started in 2004, will be 90% of their theoretical 2006 per capita aid intensity level calculated on the basis of the 1999 Berlin allocation method with their regional GDP per capita level being assimilated to 75% of the EU15 average.

3. Notwithstanding paragraph 7, the Polish NUTS level 2 regions of Lubelskie, Podkarpackie, Warmińsko-Mazurskie, Podlaskie and Świętokrzyskie, whose GDP per capita levels (PPS) are the five lowest in the EU-25, will benefit from funding from the ERDF over and above the funding to which they are otherwise eligible. This additional funding will amount to EUR 107 per inhabitant over the period 2007 to 2013 under the Convergence objective. Any upward adjustment of the amounts allocated to Poland pursuant to paragraph 10 will be net of this additional funding.

4. Notwithstanding paragraph 7, the NUTS level 2 region of Közép-Magyarország will be allocated an additional envelope of EUR 140 million over the period 2007 to 2013. For this region the same regulatory provisions would apply as for the regions referred to in Article 8(1).

5. Notwithstanding paragraph 7, the NUTS level 2 region of Prague will be allocated an additional envelope of EUR 200 million over the period 2007 to 2013 under the Regional Competitiveness and Employment objective.

6. Cyprus will benefit in 2007 to 2013 from the transitional arrangements applicable to the regions defined in paragraph 6(b), its starting point in 2007 being established in accordance with paragraph 13.

7. The NUTS level 2 regions of Itä-Suomi and Madeira, while keeping the status of Phasing-In regions, will benefit from the transitional financial arrangements laid down in paragraph 6(a).

8. The NUTS level 2 region of the Canaries will benefit from an additional envelope of EUR 100 million over the period 2007 to 2013 under the transitional support referred to in Article 8(2).

9. The outermost regions identified in Article 299 of the Treaty and the NUTS level 2 regions fulfilling the criteria laid down in Article 2 of Protocol No 6 to the Treaty of Accession of Austria, Finland and Sweden will, in view of their specific constraints, benefit from additional funding from the ERDF. This funding will amount to EUR 35 per inhabitant per year and will be in addition to any funding for which these regions are otherwise eligible.

10. As far as allocations under the cross-border strand of the European territorial cooperation objective referred to in Article 7(1) are concerned, aid intensity for regions along the former external terrestrial borders between the EU-15 and the EU-12 and between the EU-25 and the EU ‘+2’ will be 50% higher than for the other regions concerned.

11. In recognition of the special effort for the peace process in Northern Ireland, a total of EUR 200 million will be allocated for the PEACE Programme for the period 2007 to 2013. The PEACE programme will be implemented as a cross-border programme within the meaning of Article 3(2)(c) and, in order to promote social and economic stability in the regions concerned, will include, notably, actions to promote cohesion between communities. The eligible area will be the whole of Northern Ireland and the border counties of Ireland. This programme will be implemented under the European territorial cooperation objective in full compliance with additionality of structural fund interventions.

12. The Swedish regions falling under the Regional Competitiveness and Employment objective will be allocated an additional ERDF envelope of EUR 150 million.

13. Notwithstanding paragraph 7, Estonia, Latvia and Lithuania, which represent single NUTS II regions, will each be allocated additional funding of EUR 35 per inhabitant over the period 2007 to 2013.

14. The Austrian regions falling under the Regional Competitiveness and Employment objective and situated on the former external borders of the European Union will be allocated an additional ERDF envelope of EUR 150 million. Bavaria will similarly be allocated an additional envelope of EUR 75 million under the Regional competitiveness and employment objective.

15. Spain will benefit from an additional allocation of EUR 2.0 billion under the ERDF to enhance research, development and innovation by and for the benefit of enterprises as set out in Articles 4(1) and 5(1) of Regulation (EC) No 1080/2006. The indicative split will be 70 % for the regions eligible under the Convergence objective referred to in Article 5, 5 % for the regions eligible for the transitional support referred to in Article 8(1), 10 % for the regions eligible under the Regional Competitiveness and Employment objective referred to in Article 6 and 15 % for the regions eligible for the transitional support referred to in Article 8(2).
16. Ceuta and Melilla will be allocated an additional ERDF envelope of EUR 50 million over the period 2007 to 2013 under the transitional support referred to in Article 8(1).

17. Italy will be allocated an additional envelope of EUR 1.4 billion under the Structural Funds as follows: EUR 828 million for the regions eligible under the Convergence objective referred to in Article 5(1), EUR 111 million for the region eligible for the transitional support referred to in Article 8(1), EUR 251 million for the region eligible for the transitional support referred to in Article 8(2) and EUR 210 million for the regions eligible under the Regional competitiveness and employment objective referred to in Article 6.

18. France will receive an additional allocation of EUR 100 million over the period 2007 to 2013 under the Regional Competitiveness and Employment objective in recognition of the particular circumstances of Corsica (EUR 30 million) and French Hainaut (EUR 70 million).

19. An additional allocation of EUR 167 million will be allocated to the eastern Länder of Germany which are eligible for support under the Convergence objective referred to in Article 5(1). An additional allocation of EUR 58 million will be allocated to the eastern Länder of Germany eligible for the transitional support referred to in Article 8(1).

20. Notwithstanding paragraph 7, an additional ERDF envelope of EUR 300 million is allocated to the European territorial cooperation objective as follows: EUR 200 million to transnational cooperation within the meaning of Article 7(2) and EUR 100 million to interregional cooperation within the meaning of Article 7(3).
European Investment Bank

The European Investment Bank is a European Union body. The bank is owned by the 27 Member States with shareholdings that are proportional to their economic weight at the time of accession. At present its subscribed capital is equal to more than Euro 163.6 billion. The EIB can have outstanding loans worth up to two and one-half times its total capital. At present its lending is close to Euro 300 billion (compared with an annual EU budget of over Euro 100 billion). The existence of a very high capital base ensures that the EIB enjoys the highest (AAA) credit rating from all of the major credit agencies giving it a strong borrowing position on capital markets. The EIB consults and co-operates with EU institutions and under its statute must get a Commission opinion on every loan.

Over the years about 90 per cent of the EIB’s lending has gone to projects located in the EU. In the EU the EIB’s main operational priority is cohesion and convergence, with lending aimed at reducing economic disparities between the regions. Other priority objectives are: support for small and medium-sized enterprises; environmental sustainability; implementation of the Innovation 2010 Initiative, designed to promote knowledge-based and innovation-led economic development; and the development of trans-European transport and energy networks.
Economic and social cohesion, with its special emphasis on reducing development disparities between regions, represents one of the fundamental objectives of European Union as enshrined in the Treaty. This objective and policy is based on a number of economic arguments. The most of important of these are as follows: (i) without public intervention at the EU level, there would be insufficient and suboptimal level of investment, particularly in less developed, remote regions of the EU, (ii) the EU is faced with marked development disparities, which are of a structural nature, are enduring and which therefore cannot be diminished without assistance, (iii) aid is not only required for the elimination of structural imbalances and for strengthening of comparable advantages, but also for the successful functioning of the single internal market, (iv) Cohesion Policy is not just about equality in terms of curtailing of disparities, but is also designed to ensure equal development opportunities for countries, regions and citizens, and (v) Cohesion Policy is not only necessary for the 'less developed', but is also in the interest of the 'more developed' since, in addition to facilitating the functioning and emergence of the internal market, it prevents bottlenecks and inflationary pressures from arising, thus also increasing growth potential of the EU level. In addition to economic arguments, an important political argument supports Cohesion Policy. It is namely difficult to imagine social cohesion in the EU without real convergence of its constituent parts, which is particularly relevant in conditions of significantly increased disparities between Member States after the last enlargement. Based on the aforementioned, it is possible to conclude that deliberations regarding Cohesion Policy in the scope of an EU budget review will not go in the direction of "do we need Cohesion Policy or not", but rather in the direction of an analysis of "what type of Cohesion Policy do we need". The segment of Cohesion Policy which is aimed at the least developed regions has the strongest theoretical foundation and the most support amongst Member States. Theoretically more questionable and with less support is that part of Cohesion Policy, which is earmarked for regions in more developed Member States, and which is based on the argument of ‘cost restructuring’, access to people (employment and inclusion) and political ‘visibility’ arguments.

Assessments regarding the effects of Cohesion Policy [vary] and criticisms [are made] regarding the efficiency of its implementation: Empirical evaluations regarding the effects of Cohesion Policy are mixed, whereby macroeconomic models for the most part identify a positive long-term effect of Cohesion Policy on economic growth, while econometric studies provide considerably more mixed results. Nevertheless,
there is relative consensus amongst the professional community that besides direct
effects on demand, Cohesion Policy also has longer-positive effects on strengthening
competitiveness on the supply side. Taking into account conceptual justification and
the positive effects identified, we can characterize Cohesion Policy as a necessary and
important EU policy for ensuring equal conditions on the single internal market.
Apart from insufficient concentration of cohesion funds, the strongest criticism is
directed towards complex, bureaucratized and rigid implementation systems, which
reflect themselves in high operating costs and over emphasis on 'disbursement of
funds' instead of their impact. One of the conditions for continued support to the
present Cohesion Policy model is, by some, argued to be increased efficiency of the
implementation systems. This efficiency is in turns strongly marked by the multi-level
governance context and associated complexity of allocation of responsibilities
amongst Member States and the European Commission. Apart from the definition of
the legal framework, the responsibilities of the latter should remain primarily limited
to ensuring and verifying that the management and controls systems function
effectively and to ensuring the effective use of resources on the basis of substantive
and financial monitoring and evaluation.
CHAPTER V: Mobility of economic activity through capital movement, industry transfers and innovation

by Peter Ramsden

1. Introduction

The content of European Union (EU) cohesion and regional policy has shifted over the past 20 years. In the 1980’s, it worked mostly with the public sector. Although some of its support was used to bolster state aids to large private companies, its financial focus was fixed on subsidies for improvements in basic infrastructure. Public funds from the EU were used to support those from national and regional governments for investment in publicly-owned infrastructure. Now, the private sector is key. The focus is on investments, which are appropriate to the needs of a knowledge economy – support for innovation, for example; for small and medium-sized businesses; and new financial instruments for private businesses. Now, more and more, public funds from the EU support investment in privately-owned businesses – the public funds becoming, therefore, private capital – and this shift has brought with it complex problems. Chief among them is the risk that public finance will distort private markets. Policy interventions in already complex market systems require sophisticated management to ensure, first, that the use of public funding is confined to areas of market breakdown; second, that the private projects it supports will bring a public benefit; and, third, that the projects, once implemented, will be carefully monitored and controlled. To ensure the best use of public money in the general interest, policy-makers require an ever-deeper understanding of how complex market and enterprise systems work.

This chapter looks at the sharpest challenge thrown down by this requirement that public funds should not distort markets – how can policy-makers meet the general-interest requirement and, at the same time, encourage capital to move to areas of market breakdown, in other words, how can capital be encouraged to move to places where returns on investment are lower? The same question can be expressed in terms of labour, as opposed to capital: if unemployed workers cannot, for one reason or another, move to places where functioning markets create jobs, how can capital be encouraged to move to the workers to create jobs near their homes? In this sense, the chapter deals with the ‘migration’ of capital and forms a pair with that dealing with worker migration, Chapter XI. We shall see that the answer is in two parts: the first helps economic actors in poor areas to borrow funds by widening the supply of capital; the second seeks to reduce the risks to lenders so that they have confidence to lend to businesses in riskier sectors of the economy or economically riskier parts of the EU. This second part of the chapter examines how, in mature economies, the need to encourage capital to migrate to places with lower returns or higher risks, or both, has led to the emergence of a ‘new regional policy’ which emphasises the role of indigenous potential and the development of innovation.

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60 European Commission regulations for the control of state aids in EU regions are discussed in Chapter II and X of this report.
Capital formation is an inherently uneven process. For a variety of reasons some regions – stimulated by innovation and driven by gains in productivity – develop at a faster rate than others and have done throughout history. A region’s success is created by the enterprises to which it plays host. On balance, successful regions tend to have a higher birth rate of businesses than death rate; more firms move into the region than move out; and more firms in the region expand their businesses than contract them. Although the balance between these three factors varies by region, there are strong positive correlations between entrepreneurial behaviour and levels of GDP growth. Early economists such as Alfred Marshall noted that there were strong centripetal forces at work in economic development which had the effect of producing specialised industrial districts. Gunnar Myrdal identified powerful agglomeration economies, and much of Michael Porter’s work on clusters continues this focus on why success leads to success.

Classical economists focus on the rational ways in which ‘economic man’ manages his capital, always deploying it in areas or businesses which generate the highest returns. Such classical economists argue that, in the long run, cheaper factor costs in less favoured areas – especially lower land and labour costs – coupled with the higher costs caused by congestion will encourage capital to move to less-favoured areas in order to increase potential returns. For a number of reasons, however, this does not happen – or, more exactly, does not happen quickly enough to satisfy the needs of policy-makers, who need to see results in terms of years rather than life-times. Defenders of the rationality of economic man say it might not be his fault that the reality of economic adjustment is slow to be realised. It may be that government actions “falsify” the working of the classical market – for example, the decision to build ring roads and motorways may reduce congestion costs. Even governments which boast of not interfering in the play of markets are constantly, and unwittingly, modifying market forces. Other classical explanations for the persistence of low-incomes in less-favoured areas may have an ideological tinge and see the cause in rigidities in the labour market which prevent wages from falling to the level which will attract capital; or it may be the social security system which, they say, besides being a cause of labour market rigidity, impairs the spirit of enterprise.

Whatever the explanation may be, the reality is clear. By omission, investors starve less-favoured regions of investment capital, leading to a slower creation, or even disappearance, of workplaces and to workers remaining idle. The judgement of the investor is that there are strong positive externalities in terms of skills, knowledge and markets in successful cities and regions which outweigh the negative effects of higher costs, congestion and pollution. Or the investor may be acting intuitively and gambling that if costs start to rise, together with those of other companies in the neighbourhood, government will take action to safeguard his business – in the dream-scenario for economic man, his business may be judged as being “too big to be allowed to fail.”

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61 Marshall’s classic work the Principles of Economics was published in 1890. Chapter 10 of book 4 concentrates on the concentration of specialised industries in particular localities – these have come to be known as Industrial Districts. [http://www.econlib.org/library/ Marshall/marP24.html#Bk.IV.Ch.X](http://www.econlib.org/library/ Marshall/marP24.html#Bk.IV.Ch.X)


Opposing explanations may doubt the ability of markets to always make rational economic decisions: they may point, for example, to the bouts of irrationality evident in booms and bubbles or financial panics like the collapse of the South Sea Company in Britain in 1720, the Wall Street Crash in 1929 and, more recently, both the Dotcom boom in the late 1990s and the sub-prime crisis of 2007-8. Such explanations see “irrationality” in the group behaviour of economic men – what we may term the behaviour of the “economic herd”. For example, the downside risk in the belief in positive externalities is that the concentration of investment capital in regions that are already successful will overheat local labour markets by creating even more workplaces where workers are already not sufficiently numerous. Or investors may continue to invest in a particular sphere long after the relationship between prices and earnings has broken.

Other explanations for the slow speed of spatial adjustment to new economic conditions leave to one side debates about the rationality or irrationality of investment decisions and concentrate on institutional rather than market factors. They may indicate the reluctance of banks to look beyond “safe” returns, thereby refusing to loan capital to businesses in riskier less-favoured areas. Such explanations may indicate that a desirable response of policy for economic development will aim to improve the availability of capital in less-favoured areas (responses along this line are dealt with below).

Public policy has been attempting to wrestle with these facts of economic geography for nearly a century. The first explicitly regional policies were developed as a response to the unemployment crisis of the Great Depression although there had been concerns in the United Kingdom about the decline of the Lancashire cotton industry 30 years before and public works were used to create jobs during the Irish potato famine of 1848. The key question asked after the Great Depression by the 1940 Barlow Report was whether work should move to the workers, or workers move to the work. To some extent this remains a key issue across the world. Out-migration from less developed regions and regions in a crisis of decline is a spontaneous effect (John Steinbeck’s The Grapes of Wrath is concerned with ‘dust bowl’ farmers leaving Oklahoma), whereas moving work to the workers usually requires specific, concerted and persistent government intervention. Regional policy takes an explicit position on attracting work, and the capital investment required to generate work, to regions and parts of regions that are falling behind. It is unusual for politicians to challenge the

64 The South Sea Bubble company was a government charter company licensed to trade with South America. In a complex swap arrangement with British Government Debt, the company’s share price rose from £100 to £1000 during the course of the year and then crashed back to £150 ruining many people in the process. http://en.wikipedia.org/wiki/South_Sea_Bubble

65 The Wall Street Crash of 1929 came at the end of a period in which the Dow Jones Industrial Average had risen by a factor of five times over five years. By the end of the slide, share prices had dropped 89% from their peak of 381.17 on September 3, 1929, and after Black Thursday (Oct 24), Black Monday and Black Tuesday and a steady slide thereafter, finally sank by 1932 to 41.22. In a single week in 1929, $30million was wiped off share values, more than double the size of US GDP.

66 The Barlow Report on the Distribution of the Industrial Population. It recommended that the distribution of industry and population should be influenced centrally with the object of redeveloping overcrowded urban areas, decentralising industry and achieving a regional balance of diversified industry and, by anticipating the decline of certain areas, encouraging development there before depression occurred. It advocated the use of satellite towns, garden cities, the expansion of rural towns and trading estates and the greater co-ordination of planning.
central tenet of regional policy that it should aim to bring work to the workers. (One example on the UK was Norman Tebbit, when he suggested that the unemployed should do as his father had done when he ‘got on his bike and looked for work.’67)

The ‘workers to the work’ aspect of adjustment raises issues of its own. Migration imposes significant costs on both sending and receiving societies. The sending regions pay through lost investment (in education and upbringing) and people, especially as migrants are typically more educated and younger than the labour force as a whole. Thus less developed regions lose some of their most dynamic workers. The more developed, reception regions pay for the costs of accommodating new workers and providing public facilities (schools, medical services and housing etc.), but often gain overall. Socially, the costs of migration may be higher than we think. Recent reports suggest that up to 100,000 children have been abandoned either with relatives or in orphanages by Polish parents moving to Ireland, Sweden and UK since Poland’s accession to the EU.68 In receiving areas, the strains of intercultural tensions have often broken out in urban violence. In some cases it takes a generation before intercultural tensions break to the surface of society: it was the sons and daughters of first-generation migrants in the Paris suburbs who were throwing petrol bombs in October 2005.

2. Old and new regional policy paradigms

This chapter is arguing that investments in EU Cohesion Policy have shifted to a new paradigm. Table 1 is based on work by OECD 69 and identifies the major characteristics of the shift from old to new. Traditional regional policy was centrally driven by national governments and used a combination of mostly automatic investment incentives and infrastructure development to improve the attractiveness of regions with high unemployment. New approaches are driven by lower levels of government (regions, city-regions, cities), are often based on an integrated approach, and introduce the idea of ‘soft infrastructures’, for example to stimulate innovation, SME development or access to capital. This change is only partial and varies across the EU member countries. In general the most rapid transitions have been made in the EU’s Competitiveness regions, which are undergoing structural adjustment. In the poorer Convergence regions, where GDP per head is lower than 75 per cent of the EU average, many investments are needed in hard infrastructures in order to catch up with the infrastructure endowment of more developed parts of the Union.

67 In the aftermath of urban riots (Handsworth riots and the Brixton riot) in the summer of 1981, Tebbit responded to a suggestion by a Young Conservative (Ian Picton) that rioting was the natural reaction to unemployment: “I grew up in the ’30s with an unemployed father. He didn’t riot. He got on his bike and looked for work, and he kept looking ’til he found it.”

68 Guardian October 2008

69 OECD presentation.
Traditional regional policy was a centrally managed system of reallocating resources within the State by subsidising investment in one region, and in some cases restricting development in advanced economic regions through forms of development control. This became known as the ‘carrot and the stick approach’. The UK was one of the first countries to introduce policies of this type in the 1930s in response to the Great Depression and the resulting collapse of demand for products in traditional industries (coal, steel, shipbuilding, cotton, etc.). A range of regional policy measures was put in place with the showpiece being industrial estates built at Team Valley in NE England and Treforest in South Wales. These were modern industrial estates containing ‘advanced’ factories – ‘advanced’ in the sense that they were built in advance of demand or tenants and were let to industrialists either with rent discounts or lengthy rent-free periods. Later, automatic investment incentives were built into the policy whereby government contributed a percentage of their investment. These industrial estates remained in national ownership and control and were managed by a national agency called English Estates.

The ‘advance’ factories at Team Valley were equipped with electricity, gas and water mains, two-storey office buildings, lavatories, hot water, central heating and private sidings to the estate’s internal railway system. Each group of factories was provided with its own canteens, kiosks, cycle sheds, etc. The industrial estate at Treforest even provided high temperature and pressure steam from the estate’s power station. Estate plans also included extensive provision for business services. For example a large administrative building was placed at the centre of Team Valley estate, around which were grouped banks, a post office, accountants and other services including a research and sales staff to advise tenants on raw materials, markets and sales methods – as well as business consultancy services, of particular value to small firms. Keynes noted in 1939 that locating rapidly expanding defence industries in these development areas

Table 1: The evolution of regional policy, showing its ‘traditional’ and ‘new paradigm’ forms.

<table>
<thead>
<tr>
<th></th>
<th>‘Traditional’ regional policy</th>
<th>‘New paradigm’</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Objectives</strong></td>
<td>Balancing economic performance by temporarily compensating for disparities</td>
<td>Tapping under-utilised potential to enhance regional competitiveness</td>
</tr>
<tr>
<td><strong>Strategies</strong></td>
<td>Sectoral approaches</td>
<td>Integrated development projects</td>
</tr>
<tr>
<td><strong>Tools</strong></td>
<td>Subsidies and state aids</td>
<td>Soft and hard infrastructures</td>
</tr>
<tr>
<td><strong>Actors</strong></td>
<td>Central government</td>
<td>Different levels of government and other actors</td>
</tr>
</tbody>
</table>

For example in the UK industrial development certificates were required for expansions or relocations to the more developed Southern region.
had the additional advantage of being non-inflationary, since, by definition, they were regions characterised by spare resources.\textsuperscript{71}

By the 1960s, however, the application of automatic capital allowances had revealed some weaknesses, notably the tendency to attract ‘assembly or ‘screwdriver’ plants, which focused on basic production processes but lacked higher-added-value elements such as management, Research and Development and marketing. There was also a tendency to attract capital-intensive industries that employed fewer workers, as these were most influenced by capital grants. Growth areas of the economy such as the service industries were not capital-intensive and consequently an approach was developed based on tax breaks on employment taxes. However, these employment tax breaks suffered the same problem as capital grants and because of ‘deadweight’ – the spending of public resources on investments which would have been made without any subsidy – they were found to be expensive to deliver and control. Governments across Europe also used the provision of materials and energy as a way of making particular locations more attractive. In France, a series of aluminium factories were attracted to alpine valleys by the provision of cheap electricity from hydroelectric schemes. In Germany, many industries continued to benefit from state aids to the coal industry that helped to keep electricity prices down. There has also been competition between governments on fixing taxes – notably with Corporation tax which the Irish government reduced to 10% in the 1990s. To date, the desire of several member countries in the EU to retain national control over tax rates has prevented serious attempts to harmonise rates of tax.

3. Problems with traditional approaches

There are major problems with traditional approaches to regional development through direct incentives to industries and through the subsidisation of factor costs.

In relation to regional development the most serious problem is that richer regions tend to outbid poor regions due to the simple fact that they have more resources at their disposal. Thus even within the EU, with a strong competition policy\textsuperscript{72} that attempts to level the playing field among the states, it is the wealthier Member States that are highest in the league table for state aids per capita (see table 2 below). Often within these countries it is the wealthiest regions that give the most aid. Bavaria in Germany has frequently been cited as an example.

Table 2 GDP per capita and per capita state aids in rank order

<table>
<thead>
<tr>
<th></th>
<th>GDP (mio €)</th>
<th>State aids per capita (EU25=100)</th>
<th>GDP (mio €)</th>
<th>State aids per capita (EU25=100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>2,708</td>
<td>186</td>
<td>Cyprus</td>
<td>6</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>13</td>
<td>184</td>
<td>Austria</td>
<td>66</td>
</tr>
<tr>
<td>Spain</td>
<td>960</td>
<td>134</td>
<td>Latvia</td>
<td>16</td>
</tr>
</tbody>
</table>


\textsuperscript{72}See Chapters II and X for a discussion of the regulatory framework for national state aids.
<table>
<thead>
<tr>
<th>Country</th>
<th>80</th>
<th>116</th>
<th>Sweden</th>
<th>58</th>
<th>37</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td>220</td>
<td>114</td>
<td>Czech Republic</td>
<td>60</td>
<td>33</td>
</tr>
<tr>
<td>UK</td>
<td>1,102</td>
<td>106</td>
<td>Portugal</td>
<td>58</td>
<td>32</td>
</tr>
<tr>
<td>Italy</td>
<td>1,065</td>
<td>104</td>
<td>Poland</td>
<td>197</td>
<td>29</td>
</tr>
<tr>
<td>Hungary</td>
<td>185</td>
<td>102</td>
<td>Slovenia</td>
<td>9</td>
<td>25</td>
</tr>
<tr>
<td>EU25</td>
<td>8,024</td>
<td>100</td>
<td>Lithuania</td>
<td>8</td>
<td>13</td>
</tr>
<tr>
<td>Finland</td>
<td>85</td>
<td>92</td>
<td>Estonia</td>
<td>3</td>
<td>12</td>
</tr>
<tr>
<td>Belgium</td>
<td>158</td>
<td>86</td>
<td>Netherlands</td>
<td>30</td>
<td>11</td>
</tr>
<tr>
<td>France</td>
<td>870</td>
<td>81</td>
<td>Denmark</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Slovakia</td>
<td>65</td>
<td>68</td>
<td>Malta</td>
<td>:</td>
<td>:</td>
</tr>
</tbody>
</table>

Significant efforts have been made over the past decade to reduce the size of areas in which higher intensities of state aids are permitted and there have been some successes in the Member States with the highest per capital expenditure especially in Germany which halved its expenditure and Italy by 80% (see table 3 below).
Table 3 amounts of state changes in selected Member States 1992/94-2002/04

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>6,140</td>
<td>2,944</td>
</tr>
<tr>
<td>France</td>
<td>774</td>
<td>904</td>
</tr>
<tr>
<td>UK</td>
<td>659</td>
<td>868</td>
</tr>
<tr>
<td>Italy</td>
<td>8,152</td>
<td>1,652</td>
</tr>
<tr>
<td>Spain</td>
<td>351</td>
<td>990</td>
</tr>
</tbody>
</table>

The competition between regions for foreign direct investment and other investment from outside the region can have the effect of stoking subsidy competition between regions. Each region effectively bids against its neighbours to attract new investors, driving up the price paid through grants. This causes the public grant or investment per job to rise over time unless controls are introduced. Private investors are adept at playing this game and may even attempt to hold regions to ransom for higher grants by threatening to leave if subsidies are not paid.

Such harmful competition between regions tends to bid up the cost of attracting investment so that it costs more and more to attract each job. In effect regions are subsidising capital from outside the region, with the net effect that taxpayers are subsidising shareholders. In a large economy there are clear negative effects – especially as many industries are likely to locate somewhere within the EU to serve its huge market. A tight control of state aids can serve to maximise the effect of smaller grants for regions that genuinely need to use subsidies to make themselves attractive to inward investment. The EU has not yet reached this stage but it has succeeded in controlling the worst excesses. Other firms from the same industry will protest and appeal against state aids that benefit industries at the moment of relocation but do not benefit industries that remain where they are. Giving grants to inward investors is widely resented by local companies in the same sector. Competition policies attempt to minimise these grant based distortions for this reason and because it is economically inefficient.

Finally, and crucially as regions become more complex and technologically advanced, these subsidies often start to lose their effect. What works for 'screwdriver’ or assembly plants does not work for the more advanced parts of the knowledge economy. Subsidies are just one of many factors that are critical to the investment

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73 The 1993 relocation of a vacuum-cleaner factory from Dijon in France to a Cumbernauld in Scotland reinforced the negative or zero sum game aspects of such capital movements.
decision. Krugman\textsuperscript{74} and his many followers have shown that other factors are often more important, including education of the workforce, infrastructure, and the presence of enabling institutions. However, somewhat paradoxically, he has also noted that the policy implications of this finding are not always clear. For example just boosting education or creating new enabling institutions will not necessarily make a region more attractive or help it to increase its productivity.

Regional incentives to individual companies can be very expensive per job created. Research on some of the large UK Regional Selective Assistance grants showed costs as high as £250,000 per job. Not only are they expensive but automatic incentives paid to all relocating companies tend to have very high deadweight.\textsuperscript{75} Inevitably, many businesses would have moved to the area anyway and do not relocate in response to the incentive but to other factors. One response is to be more selective with regional assistance (see Chapter II) so that a process of negotiation takes place. This is likely to reduce but will not eliminate deadweight. The quality of jobs created by incentives has also frequently been criticised. Only rarely do head office functions such as management, finance, research and development and marketing move to less developed regions. These are more likely to stay in the company’s home region.

In the EU’s Competitiveness regions, more than two-thirds of people employed are in service industries, which by their very nature tend to have low fixed-capital investment per employee. This makes incentive-led policies based on subsidising investment much less effective for attracting service-sector industries and rarely effective for attracting knowledge-intensive industry.

4. Evolution of the European Regional Policy response to the new paradigm

Productive investment has been a key emphasis of the European Regional Development Fund (ERDF) since its reform in 1989, until that point, from its creation in 1975, it had placed its emphasis on subsidising public infrastructure investment. However, since 1989, the content and emphasis of the policy has changed considerably. In the current programming period over a quarter of investments focus on stimulating innovation through the introduction of new products and processes in businesses. This section of this chapter will explore how this shift has taken place.

The current ERDF regulation\textsuperscript{76} links productive investment to the creation of sustainable jobs and allows for direct investment in SMEs, infrastructure and

\textsuperscript{75}15 ‘Deadweight’ can be defined as a result that would have happened anyway. It can also be described as the ‘policy-off’ scenario.
\textsuperscript{76}The Regulatory basis in the ERDF regulation (a) productive investment which contributes to creating and safeguarding sustainable jobs, primarily through direct aid to investment primarily in small and medium-sized enterprises (SMEs); (b) investment in infrastructure; (c) development of endogenous potential by measures which support regional and local development. These measures include support for and services to enterprises, in particular SMEs, creation and development of financing instruments such as venture capital, loan and guarantee funds, local development funds, interest subsidies, networking, cooperation and exchange of experience between regions, towns, and relevant social, economic and environmental actors; (d) technical assistance as referred to in Articles 45 and 46 of Regulation (EC) No 1083/2006. The range of investments and measures listed above under points (a) to (d) shall be available to implement the thematic priorities in accordance with Articles 4, 5 and 6.
endogenous potential through regional and local development. It refers to financial support and services to enterprises, and to financial instruments such as venture capital, loan and guarantee funds, local development funds, and interest rate subsidies. Figure 1 below based on work by Jakob Rasmussen on ‘changing place climates’ illustrates how policy has become more complex in this transition. The diagram shows a shift from a focus on post-war reconstruction and subsidies in the 1950s to a focus on innovation, clusters and sustainable development in the 2000s (see figure 1 below). It anticipates further changes towards new regional concepts and sustainable places over the next 25 years.

**Figure 1 Paradigm shifts in policy**

Source: Jakob Rasmussen

5. **New Regional Policy**

The so-called ‘New Regional Policy’ was articulated most clearly at EU level in the Delors White Paper on Growth Competitiveness and Employment. This drew in turn on an emerging body of evidence initially emerging in the USA, based on work by David Birch, and replicated in Europe, that suggested that most jobs were being created by smaller firms, that economies of scope had become more important than economies of scale in production, that SME clusters were frequently out-competing larger companies, and that these clusters themselves were the driving force behind national competitiveness. This orientation became the new paradigm articulated by OECD and a growing army of academics.

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78 Work on flexible specialisation in Northern Italy by Piore and Sable among others.

79 Porter’s book the *Competitive Advantage of Nations* had been published in 1990.
The Delors white paper was not directly addressed to the question of regional imbalances, but concerned itself with the central question of how to increase the productivity of the EU as a whole. However, the ideas embedded in it had a strong influence on the EU Cohesion Policy’s regional programmes negotiated in 1993 and 1994, and by 2000 when the third programming period started it had become the established orthodoxy. New types of measures focusing on regional venture capital, science RTD and innovation, cultural and creative industries and producer services began to be seen in ‘avant garde’ programmes as early as 1994.80 Regional innovation and ICT strategies started to emerge from about 1995 as pilot actions. There was a growing concern raised by Delors about the job intensity of job creation and a stronger focus on the SME base and ways of stimulating SMEs. Most importantly the new paradigm represented a shift away from state aids and incentives to individual enterprises and instead focused increasingly on horizontal actions that were intended to benefit the enterprise ‘fabric’ of the region.

There were pitfalls, however, in this progression. Many ‘new paradigm’ investments were much more complex to develop and administer than direct support and advanced factory building. Worse still, there was a risk that they would miss the target altogether. The past 15 years has seen examples of projects funded nationally and by the EU Cohesion Policy’s structural funds which have been supplier-led and which ‘chased’ the client SMEs who remained largely indifferent to the services provided. In innovation policy a key blockage has been the reluctance of SMEs to engage in innovation at all, let alone in cooperation with other SMEs. It turned out that there were wide variations in the capacity of organisations to innovate and that finding willing subjects was a major challenge. The need to evaluate these types of policies became more and more important so that the types of intervention that work and the cost of these types of intervention could be better identified and understood.

6. Academic basis for the new paradigms

The new paradigms have been based heavily on ideas of a new generation of thinkers. This includes important work on ‘clusters’ by Michael Porter, work on SMEs and their contribution to rapid development by the OECD, as well as Paul Krugman’s work on international trade. Much of this was brought together within the Delors White Paper of 1993 which contributed to a new focus for EU Cohesion Policy development programmes, highlighting improvements in the enterprise environment rather than being focused on direct mechanisms of support. The financial resources of the policy would be used to benefit groups of firms and other actors such as universities rather than an individual firm. Intermediary organisations would often be the main beneficiaries.

This indirect focus can lead to a paradox. Approvals of public subsidy are given in form of support for generalised investment schemes and the decisions are taken in a way remote from the individual businesses which will become the final recipients of grant schemes. The public support is then channelled through a set of specialised intermediaries, making it more difficult for individual businesses on the ground to (a)

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80 Merseyside launched its Merseyside Special Investment Fund in 2006. The programme also contained measures for innovation, SMEs, cultural industries and social inclusion – Pathways to integration.
be aware of available subsidy schemes and (b) perceive the economic benefits they may gain by participating. The biggest risk is that ‘fat intermediaries’ will obtain the financial benefits and that there will be little connection with individual businesses so that few wider economic benefits result. To be effective these indirect approaches predicated on channelling public finance through intermediaries require a much more careful selection of projects and a rigorous evaluation.

7. Clusters and regional competitiveness

Michael Porter’s ideas about clusters and regional competitiveness have been influential on public policy.\(^1\) He argues that clusters have the potential to affect competition in three ways:

- by increasing the productivity of the companies in the cluster;
- by driving innovation in the field;
- by stimulating new businesses.

Clusters are used by Porter and his disciples both as an analytical tool and as a framework for policy. As an analytical tool they are sufficiently elastic to allow a wide range of industrial groupings to be considered. The East Midlands along with most other UK regions claims to have a biotechnology cluster while at the same time supporting the sunset textile industry, albeit dressed up as technical textiles. Clusters can operate at a range of scales so that some similar financial services (for example in London) are ‘global clusters’, and even medium-sized towns may have ‘local clusters.’ The East Midlands considered itself to be at one end of an arc-shaped cluster in performance-engineering that connected Rolls Royce aero engines, at one end of the arc, with motor racing, at the other. This range of scales means that policy makers can seek to ensure that public subsidy schemes can offer something for everyone. Clusters have an implicit export base model in most formulations allowing agencies and cities to focus on higher-value-added sectors. Exceptions are allowed: the East Midlands has a ‘food and drinks cluster’ focusing on a regional market and most of its ‘cultural industry cluster’ serves local cultural markets in which the main customers are nearby citizens. Porter himself says that clusters are:

> ‘Geographic concentrations of interconnected companies, specialist suppliers, service providers, firms in related industries and associated institutions (for example universities, standards agencies, and trade associations) in particular fields that compete but also co-operate.’\(^2\)

Porter characterises his approach to clusters with a diamond diagram (see Figure 2). His ‘Diamond’ focuses on four main interacting parts

- factor conditions – essentially a reformulation of land labour and capital;
- rivalry or competition from other firms;

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\(^1\) Although highly critical of Porter, Ron Martin’s article with Peter Sunley recognises the emergence of clusters as a major concept.

• demand conditions – Porter frequently emphasises the value of having customers who demand improvements in performance and productivity;
• related and supporting industries – both the upstream and downstream supply chain and also the service industries that provide specialist support.
In different versions of the ‘diamond’ diagrams, the role of government is always peripheral. Porter is not a strong supporter of government intervention and arguably his work on clusters is more interesting for its analytical side than for answering questions about how to intervene. Despite this there is little doubt that clusters are a step beyond the type of sectoral analysis practiced by other economic geographers. Clusters are criticised by academic Ron Martin who asks whether clusters are not rather a chaotic concept that has become more of a brand than a rigorous method of analysis or policy prescription. Martin’s paper comprehensively demolishes Porter at the theoretical level. Nevertheless, back on the ground, clusters have gone from strength to strength, and Porter has become a source of policy advice for several EU governments. Specialised cluster consultancies have sprung up to serve the market demand. Commentators like Martin forget that in the battle for ideas simplicity can be critical. From the mid 1980s economic geographers had debated the inner workings of an arcane concept called flexible specialisation and Marshalian industrial districts in Northern Italian SMEs. It took Michael Porter to popularise the subject by giving it the name ‘clusters’. Unlike the old sectoral approaches, the concept of clusters opens up a discussion of key institutional support from development agencies and research centres, and allows the importance of the services sector to be underlined. Clusters also open up new fronts for cluster partnerships so that almost any potential actor whether a University or workspace builder can make a claim to be

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83 See for example, Fothergill and Gudgin “Unequal Growth” (1986).
contributing to the cluster. This inclusiveness of clusters is strength in terms of partnership-building, but it is also perhaps their greatest weakness as a policy tool.

Clusters allow policy makers to have it both ways by appearing to be both strategic and inclusive. In his earlier work Porter himself had always argued that strategy was about making choices. Clusters allow the illusion of being strategic by selecting clusters while encompassing a large proportion of firms and institutions. Even more scientific statistical definitions such as that used by the European Commission’s Directorate General for Enterprise and Industry in a recent staff report identify between 30 and 40 per cent of EU employment within starred clusters that are based on location quotients of more than 2. At regional level clusters are often selected to include an even wider spread of activity.

Whether cluster approaches do any harm is another question. There have been arguments (including by Martin) that the specific nature of support to each cluster makes it harder to build horizontal support services that benefit all small and medium sized businesses. This may also lead to a proliferation of business support services which are focused on specific clusters at a time when some Member States are trying to simplify and consolidate their business support systems.

A second downside of the cluster approach is that it may lead local or regional elites to favour sub-optimal projects which have weak or spurious relations to the cluster strategy and to offer them public subsidy, while leaving aside more useful projects that are not linked to the cluster. Projects applying for subsidy are prone to look for any hook to justify funding and may well latch on to a distantly related cluster as a way to approval for regional development funding. The downside for regional policy makers is that the best clusters are nearly always in the most developed core regions of Europe. Most less-well-off regions lack strong cluster development – especially of the quality labelled ‘world class clusters’ – and have only local or regional clusters. In older industrial areas there are political pressures to include sunset industries in cluster policy, even though the industries have already succumbed to global competition. The European Commission is attempting to address this problem under some of its regional policy initiatives – for example Regions for Economic Change seeks to help weaker regions learn from those which are stronger, an emphasis repeated under the CLOE project.

There are other problems with clusters. One is that by their nature clusters concentrate attention on the economy as it is now rather than how it might look in ten years’ time. Attempts have been made to identify ‘emerging clusters’ but this smacks of ‘picking winners’ – which always proves difficult for policy-makers – and is unscientific and prone to be driven by vested interests. Another difficulty is that dynamic firms may exist outside clusters and as a result are not supported by cluster focused policy.

86 Innovation clusters in Europe: a statistical analysis and overview of current policy support.
87 A location quotient of 1.5 means that the region has 50% more employment in that cluster (or sector) than would be expected if industry was evenly distributed.
88 The UK has organised a Business Support Network to support small businesses.
89 CLOE is an Interreg IIIc network http://www.clusterforum.org/
There are, however, advantages in a cluster policy, which may outweigh the possible difficulties. For example, cluster policy:

- allows a more nuanced and detailed analysis of the dynamics of particular clusters, which might normally escape attention. A good example is the cluster of cultural and creative industries, which had previously been unrecognised – cluster analysis revealed that it comprised important contributors to local economies;
- brings together in a coordinated way policies for innovation and SME development which have in the past tended to develop separately;
- allows SME policy to recognise the importance of large firms in regions as anchors or drivers of economic growth;
- encourages the analysis of upstream, downstream and horizontal linkages;
- focuses on knowledge spill-overs and regional innovation systems;
- allows policy-makers a rationale for concentrating resources on key groups of industries without falling into the trap of ‘picking winners’, an approach to regional development which has long been discredited in the EU;
- brings an academic justification for intervention at the regional (or city region) level.

Figure 3 Example of linkages within the music production cluster UK (source Comedia and CURDS Newcastle)

The diagram above illustrates that the cluster mapping approach which analyses upstream and downstream linkages, can be a fruitful exercise. Simplistic analyses of the cultural sector had previously focused on the performers and possibly backstage ‘road crew’. The diagram developed here illustrates the complexity and richness of
the sector and gives hints as to its enterprise and employment structure. The strong spatial concentration of clusters in the most developed regions of Europe is well illustrated by the report on ‘Innovation clusters in Europe’ produced by European Commission staff in 2008. This report used a sectoral analysis to identify clusters at NUTs 2 level (258 regions) and 38 cluster categories. They identified 2,000 clusters by this method and went on to give them star ratings by allocating one star for each of the following criteria:

- employment size in a particular industry cluster within a region;
- degree of specialisation with the region;
- cluster focus of employment within a region.

Figure 4 Regional employment share in strong clusters against regional GDP per capita (NUTs 2)

![Graph showing correlation between GDP per capita and share of employees in strong clusters.](image)

They identified 155 regional clusters scoring three stars; 524 scoring two stars; and 1,338 with one. The three-star clusters are overwhelmingly concentrated in high GDP regions. For example In France, the Ile de France and nearby regions contain the main three-star clusters while, in Germany, Stuttgart in Baden Wurtemburg, Darmstadt (near Frankfurt), Hamburg and Oberbayern (Munich) each have two three-star clusters. In the UK the two largest three-star clusters are in financial services and business services employing nearly half a million people. Both are located in London. Six of the seven other business service clusters are in the South East of England and extend along the M4 corridor to Bristol. Italy’s three-star clusters are in Piemonte, Emilia Romagna, Veneto, Marche and Friuli Venezia with Lombardia dominating the two star group. Figure 4 shows that there is a reasonable positive correlation between GDP per capita and the share of employees in strong (three-star) clusters. Like all correlations this may be spurious, there is also a close relationship between rich regions and regions with strong clusters which may be driving the causality.
The EU has supported the cluster concept through measures to stimulate cluster networks such as the European cluster alliance90 and by a 2008 communication91: ‘Towards World Class Clusters in the European Union’. This communication aimed to build on support for the concept in the Commission’s 2007 Green Paper on “The European Research Area: New Perspectives”92, which stated that the European Research Area “should … progressively structure itself along the lines of a powerful web of research and innovation clusters”.

The EU has also been promoting Europe INNOVA a network focusing on innovation and clusters which recently published a report reviewing experience in a range of different clusters. 93 Europe Innova is funded under the Competitiveness and innovation programme and focuses on the joint development of tools which may be used by cluster organisations in support of innovative SMEs. It has organised exchange visits and carried out research on good practice in EU development.

8. Supporting clusters through cohesion policy

Clusters have had many of their activities funded under ERDF and the European Social Fund (ESF), although it is difficult to quantify the amount of support since measures for clusters are difficult to separate from other innovation and SME measures. In the new programme period the Regions for Economic Change94 initiative aims at bringing in new ways to dynamise regional and urban networks and to help them work closely with the Commission. These networks will be able to test innovative ideas and rapidly disseminate them through the main EU Cohesion Policy development programmes. The initiative will be particularly important for less-developed regions which wish to adopt the experience of those which are more advanced. Finance the networks’ projects linked to the initiative is available under another EU Cohesion Policy initiative, INTERREG IVC, which promotes interregional cooperation, and URBACT II, which promotes cooperation urban issues. Successful practice in the area of cluster policy is being disseminated through the Cloe network.95

91 Com (2008)652 Towards world class clusters in the European Union: Implementing the broad-based innovation strategy
95 Cloe can be seen at http://www.clusterforum.org/
9. Competitiveness and the five drivers of productivity

The central aim of the Lisbon agenda was to develop the EU into a leading knowledge-based economy. This drive for increased competitiveness has reinforced a growing interest in ranking regions in global terms according to so-called competitiveness indicators. For example, the UK’s East Midlands went so far as to set itself the goal of becoming a Top-20 EU region. Regional competitiveness also owes much of its parentage to Michael Porter. He extended his work on strategies for achieving the competitive advantage of firms to nations, and, later, regions, in which firms were based. This extension has provoked many academic debates, in particular over whether regions really do compete with each other for investment. Leaving that debate aside, it is now widely recognised at the operational level that raising productivity is the major aim of regional policy alongside employment growth – both goals being necessary to avoid the phenomenon of jobless growth in which productivity gains are made at the cost of static or falling employment. On the UK, the government identified five drivers of productivity gain:

- investment;
- innovation – RTD, technology transfer, university /industry links, graduate placement, information society measured by business expenditure on Research and Development (BERD);
- skills – building high level skills;

Source: Innovation Clusters in Europe
enterprise – supporting entrepreneurship, higher levels of enterprise per head and churn;

compliance – which is a regulatory issue at both national and EU levels (more enterprise leads to more inter-firm rivalry and a more competitive environment, although sectors with few large firms, such as energy, often operate as quasi-monopolies).

These five drivers were adopted by the nine Regional Development Agencies in England and used by them as a framework for stimulating productivity. Simple frameworks like this enabled board members and partners to talk the same language and see how different policy areas interact to contribute to a single objective. Table 4 below shows how indicators have been developed to measure progress.

Table 4 Measuring the 5 drivers of productivity UK

<table>
<thead>
<tr>
<th>Productivity</th>
<th>Gross Value Added (GVA) per head and per hour</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment</td>
<td>Business investment as a percentage of GVA</td>
</tr>
<tr>
<td>Innovation</td>
<td>Business Enterprise RandD as a percentage of GVA</td>
</tr>
<tr>
<td></td>
<td>Gross Domestic Expenditure on RandD as a percentage of GVA</td>
</tr>
<tr>
<td></td>
<td>Proportion of enterprises with co-operation arrangements on technological innovation with other enterprises or institutions</td>
</tr>
<tr>
<td></td>
<td>Proportion of turnover accounted for by new or improved products</td>
</tr>
<tr>
<td>Skills</td>
<td>Highest qualifications of adults</td>
</tr>
<tr>
<td></td>
<td>16-19 year olds qualified to National Vocational Qualification (NVQ) level 2 and 19-21 year olds qualified to NVQ levels 2 and 3</td>
</tr>
<tr>
<td></td>
<td>Proportion of employees receiving training in the last 4 weeks</td>
</tr>
<tr>
<td>Enterprise</td>
<td>Total entrepreneurial activity</td>
</tr>
<tr>
<td></td>
<td>Business start-ups (VAT registrations) per 10,000 adult population</td>
</tr>
<tr>
<td>Competition</td>
<td>Exports as a percentage of GVA</td>
</tr>
</tbody>
</table>

10. Innovation as a driver in EU cohesion policy

As mentioned above, the EU has had a strong focus on innovation since the Delors White Paper on Growth, Productivity and Employment in 1993, which put innovation
and SME development at the centre of efforts to strengthen the EU economy. This early recognition of innovation as a driver of productivity was considerably strengthened by the Lisbon Agenda of 2000. At regional level, regions in Scandinavia, Germany, the UK, and the Netherlands emerge as the strongest regions in the EU for promoting innovation. Performance is below average in 86 regions which contain a third of the EU population and which are mostly sufficiently poor to be covered by the EU Cohesion Policy Convergence objective. Research, technological development and innovation (RTDI) was first given prominence in Cohesion Policy through a community initiative STRIDE in 1989-93. The early projects tended to have a strong focus on supply-side measures, mostly working with Universities for example by funding equipment purchase as well as investment in science parks and incubators. This can be characterised as a technology-push approach.

The focus after 1994 tended to work more with the demand side – and specifically on how to encourage the appetite for RTD from SMEs. Increasingly the policy treats innovation as being distinct from RTD, the first sign of this being the creation of a network of Business Innovation Centres – small-scale incubation facilities that aimed to link high tech start-ups with in-situ business support. It was accompanied by an emphasis on graduate placement schemes to bring technology capacity into SMEs.

Spain offers a striking example of how RTDI has grown in importance in Cohesion Policy programmes. From almost nothing prior to 1994, expenditure grew to €4billion on RTDI and information society based projects for the seven-years 2000-06. This included 13,000 RTDI-based projects with the participation of 100,000 researchers. There was support for over 1,000 technology and research centres, financing of 64 Spanish technology parks, support for around 250,000 SMEs in their technology-based activities and investment of nearly € 1 billion in ICT infrastructure. During this period, the piecemeal nature of investments in innovation was gradually overtaken by a more system-based approach (Regional innovation systems’), described by the European Commission as “involving a range of actors and resources interacting effectively with a view to stimulating innovation in the region.” The system is based on:

- identification of the infrastructures available and the regional sources of knowledge and expertise;
- access to services in relation to finance, exchange of experience, exploitation of knowledge (development agencies, chambers of commerce, foresight bodies, risk capital funds, etc.);
- effective transfers of competences and co-operation between the different regional development actors.

The Union has supported ERIK (European Regional Knowledge-based Innovation Network) which has an active membership of 51 regions. Its aim is to sustain and further develop networking and good practice exchange between European regions. It carries this out by

- benchmarking and disseminating good practices of innovation and knowledge-based policies;
- supporting inter-regional networking on technological innovation related topics;
• co-operating with European regional networks with similar objectives to create synergies and make networking activities more efficient and better targeted.

11. Policy innovation through – innovative actions

After the first appearances of research and technological development in Cohesion Policy development programmes in the early 1990s, the Commission, beginning in 1993, made a concerted effort to mainstream RTDI experience. Regional development programmes began immediately to see RTDI as a priority for investment and in the 2000-06 period there was further growth, so that investments in RTDI accounted for about 11 per cent of total programme expenditure. Now, in the 2007-13 programming cycle, RTDI investments account for 30 per cent of programme expenditures. This growth is the result of a consistently-pursued policy which began in 1993. It was evident at the outset that there was little understanding or familiarity with innovation measures – especially in the worst-off, or least developed regions. Actions were undertaken to raise the awareness of programme managers to the importance of RTDI and to develop their capacity to assess this new type of project. Most regions found little difficulty in adapting to the development of science parks or to the building of business incubators. It was the soft infrastructures – working to encourage SMEs to take on graduates or to partner with their local university, or launching a regional venture capital fund – which they found difficult. Such initiatives did not fit the standard ways of programme management because there were no project promoters, the managing authorities did not understand them and, most of all, they involved a much closer relationship with the private sector than more traditional building and infrastructure projects.

The Commission therefore encouraged regions to create their own Regional Innovation Strategies (RIS), also establishing a Regional Information Society initiative (RISI) to spread new approaches to information and communication technologies. These two approaches were successful on building a better understanding in the regions of what was required to make innovation measures work. They spread good practice by extensive publication and by encouraging programme managers to visit the regions which were making the faster headway. Over time RIS and RISI enabled regions to increase their ability to manage RTDI projects and, thus, their capacity to take advantage of the funding incentives on offer. They took a number of years to really make their mark but cost relatively little to implement. About 40 regions at first participated in these schemes, receiving only modest resources – typically a RIS was worth about €250,000. By 2006 the European Commission was funding 180 regions under its innovative actions programme at a total cost of € 400 million. Still relatively low cost compared to the resources at the disposal of the ERDF.

The European Commission has used its various pilot action and community initiative budgets to finance a range of EU networks, some with a regional focus, others aiming more widely, that do most of the work at arm’s length. Proinno Europe\(^6\) is an initiative of the Commission’s Directorate General Enterprise and Industry which

\(^6\) http://www.proinno-europe.eu/index.cfm?fuseaction=page.home
aims to become the focal point for innovation policy analysis, learning and development in Europe, with a view to learning from the best and contributing to the development of new and better innovation policies in Europe.
12. Conclusion

This chapter has illustrated the paradigm shift that has taken place in the content of regional development programmes financed by the EU. The programmes have moved away from being based on a traditional paradigm focused on grant programmes and ‘hard infrastructures’ to an approach that can be characterised as ‘new regional policy’ with a rapidly growing innovation content. This growth has been achieved by a concerted strategy that has been led by the EU itself. It is likely that most regions
will go through stages in the content of their regional programmes. Less developed regions tend to spend more on basic infrastructure and, even when they spend money on innovation, it is often through investments in science parks and other infrastructures. The key for each region is to find the right mix of actions that are relevant to its own economy. A focus on creative industry clusters might be relevant in metropolitan regions but would be inappropriate in a region with smaller cities focused on industrial production. Choosing the right strategy is all about horses for courses.
Doing complex policy – financial and technical assistance initiatives

by Peter Ramsden

1. Introduction

Time – although it does not feature in the Classical economic analysis of economic development – is the scarcest, and most important, resource in organising the economic development of regions. People, who are looking for work, want it now – not at some point in the medium-term future and yet rapid and sustainable change is often hard to secure. The importance of time, therefore, is emphasised in the implementation methods of EU Cohesion Policy which place an overall time-limit on development programmes and insist on a steady speed of advance – an incentive to advance continuously is offered by the regulatory provision that public resources which are not spent within two or three years of their being committed to programmes are withdrawn. This emphasis on regularly-paced implementation has raised policy-makers’ awareness that know-how, in the form of administrative ability to progress large infrastructure projects, and the speedy access to investment capital are largely determinant in the success of regional development programmes.

To address this issue, EU Cohesion Policy has developed a number of joint policy initiatives with the European Investment Bank (EIB) and other financial institutions, most notably the European Bank for Reconstruction and Development (BERD) – known by their acronyms as JASPERS, JEREMIE, JESSICA and JASMINE. The first, JASPERS aims to help programme managers to access the know-how and technical assistance they need to assess, manage and implement large infrastructure projects according to a fixed time-table. The others seek to improve access to loan finance for the sponsors of different kinds of project (support for micro to medium-sized enterprises; urban renewal and development; and micro-finance).

Financial initiatives, co-financed by Cohesion Policy’s structural funds, have been a part of EU regional development initiatives since the early 1990s and experience has shown that they are hard to develop and hard for the managers of development programmes to appraise. These complexities can lead to delays in implementation and to design weaknesses in their construction, affecting the instrument’s performance and reducing its practical value. The ‘Four Js’ offer the timely way to accelerate learning, to access technical assistance, and to provide or mobilise financial resources and so accelerate the development of complex fund-based financial instruments.

2. JASPERS (Joint Assistance to Support Projects in European Regions)
JASPERS is a technical assistance partnership between DG REGIO, EIB and EBRD to assist regions to prepare major projects. JASPERS is an additional technical assistance resource for both member countries and the European Commission’s Directorate General for Regional Policy. JASPERS draws on the previous experience of the EIB and EBRD in preparing large projects. It is provided free of charge to member states and regions. There is no obligation to borrow from the banking partners although they may lend to projects that they assist through JASPERS.

As in other large projects the legal responsibility remains with the member country responsible for the project and the use of JASPERS does not guarantee that the Commission will approve the project for EU subsidy when it is submitted. It was set up in 2006 and all potential beneficiary countries were asked to submit draft work programmes, so that the instrument’s resources could be effectively deployed. By early 2008, 112 project actions had been identified, and support requested in wide range of relevant horizontal issues. In addition to traditional infrastructure projects, there have been requests for assistance in some unexpected sectors (e.g. large energy, broadband telecom, tourism). The projects being assessed and managed with the assistance of JASPERS have requested from EU Cohesion Policy’s ERDF and Cohesion funds support to the total value of € 57 billion.

Main areas for which support is requested:

• public-private partnerships and grant blending approaches;
• support with state aid in new sectors;
• structuring projects in new sectors (e.g. power, energy efficiency, renewable energy, urban transport, flood protection, rolling stock);
• grouping small projects into larger projects (e.g. energy efficiency, water);
• public-private partnerships best practice/model approaches;
• guidance on new regulations (e.g. eligibility, revenue generating projects, grant rate calculation).

3. JEREMIE (Joint European Resources for Micro to Medium Enterprises)

JEREMIE is an instrument aimed at supporting SMEs and micro enterprises. It was launched in 2006 and was reinforced with the launch of JASMINE in September 2008. JEREMIE allows member countries and EU regions to transform part of their Cohesion Fund finance into financial products designed specifically for small and medium-sized enterprises.

Financial resources for the instrument are drawn from a variety of sources – ERDF; national funds; EIB and other international finance institutions (EBRD, Council of Europe Development Bank); private sector banks; and specialised financial intermediaries focusing on the SME sector such as KWF in Germany and the Caisse des Dépôts et Consignations in France.

JEREMIE works in three phases:

• preparation through action plans used in the writing of the operational programmes, which provide a gap analysis of the
supply, demand and access to finance (demand/supply) in the area in question;

- **implementation** – a managing authority (MA) signs a funding agreement with a holding fund, which it selects as its partner. In turn, the holding fund selects financial intermediaries, gives them accreditation and provides funds to them;

- **support** from financial intermediaries for SMEs and micro-credit through equity and venture capital, loans, guarantees, advice, etc.

JEREMIE resources are recycled at the closure of the ERDF programmes which co-financed them. The funds then belong to the member countries but must be reinvested in favour of SMEs. To qualify for recycling the funds must have been used at least once by being paid out by the financial intermediaries to finance SMEs and micro-credit beneficiaries. If money has not been cycled at least once in this way it has to be repaid to the European Commission.

Merseyside Special Investment Fund (MSIF) was one of the more significant early ERDF investments in financial initiatives for SMEs. Merseyside, as a poor region, lacked venture capital which was being focused on the South-East England, within a one hour drive time of London. Private banks were unable to offer loans at rates which would allow businesses in the region to be profitable and MSIF was established as a “funder of funds”

The first version of MSIF was approved in 1995 after a year of project preparation and discussions with the European Commission. It received a grant of € 20 million ERDF which financed operations connected with two loan funds (one for small businesses) and one venture capital fund. In addition the project secured an EIB loan facility of € 25 million. It received ongoing support after 2000.

Overall MSIF was one of the strongest performers in job and enterprise creation in the first development programmes for Merseyside. Between 1996 and the end of 2004 the MSIF:

- directly invested € 69 million;
- backed 785 businesses;
- created 3,984 jobs;
- protected 3,483 jobs;
- attracted € 169 million private sector funds into Merseyside.

The largest growth in jobs and enterprises out of the three funds came from the small firms fund which made investments of up to £50,000. It outperformed the mezzanine loan fund and the venture capital fund, both of which had more grant.
4. JESSICA (Joint European Support for Sustainable Investment in City Areas)

JESSICA is an optional facility which offers member countries and managers of regional programmes the possibility of using EU financial support from regional development as the basis for recyclable loan funds for public-private partnerships and other projects which aim for urban renewal and development. JESSICA can support urban infrastructure projects and networks, energy efficiency or ICT projects. JESSICA does not support projects which are concerned with the access of SMEs to loan finance. Such projects are supported by JEREMIE (see above).

JESSICA works by allocating programme finance to funds for urban development or holding funds. An urban development fund might then loan resources to Public-Private Partnerships or projects included in Integrated Urban Development Plans. Holding funds might loan resources to several funds for urban development, which, in turn, loan to public-private partnerships.

The need for such an instrument arises because, while investment needs in urban areas are increasing, available public funds are scarce. There is also a shortage of administrative and technical capacity to develop complex and innovative schemes involving uncertain risks and returns and which do not increase public debt. Such complex urban investments require the technical, financial and managerial expertise of specialists, banks and private sector.

JESSICA supports projects. Programme managers negotiate and sign funding agreements with selected funds or holding funds (for which there are detailed rules). Contributions from regional programmes to funds for urban development must be paid out at least once in the ‘payment lifetime’ of the programme, which for the current programmes is nine years (2007-15). Funds for urban development then invest in public-private partnerships or other urban projects, providing them with equity, loans or guarantees. The projects supported by urban development funds in this way could also receive grant assistance from operational programmes, so that a project might receive both grant and loan finance from the same EU Cohesion Policy development programme. For example, grant assistance from an operational programme might be used to finance the equity gap of a project, which was also
receiving a loan. When the loan is repaid to the fund for urban development, before or after 2015, it must be reinvested in urban projects.

JESSICA is new and there are, so far, few cases where it is operating on the ground, though many are being developed. An example of a similar type of approach has been developed by the East Midlands Development Agency (EMDA) in its Blueprint fund.

Blueprint is a €700 million fund jointly and equally owned by the public and private sectors in the East Midlands, which support public-private partnerships in developing the region’s urban areas. The public side is a joint venture between EMDA and the region’s development agency and the national regeneration agency English Partnership. Igloo is a private sector developer, which has a strong focus on socially, and environmentally beneficial developments.

Blueprint focuses on urban regeneration initiatives, including cultural quarters, science parks, mixed-use developments with particular emphasis on supporting projects brought forward by the region’s urban regeneration companies, which are themselves joint ventures between EMDA, English Partnerships and the relevant city authority.

Funding for Blueprint is made up of property and land provided by the public sector partners, equity investment and debt. Over ten years the fund is forecast to produce a 400 per cent return on investment for the public partners.

Figure 27: Blueprint financial model

Igloo has developed an innovative method of scoring in which social returns on investment are calculated according to a set of ‘scorecard’ criteria:

- location and connectivity;
- engagement and social capital;
- economic diversity and competitiveness;
- local economic impact;
- balanced communities;
neighbourhood integration;
• amenities and services.

5. JASMINE (Joint Action to Support Micro-finance Institutions in the EU).

The ambitious objective of the JASMINE micro-finance initiative was set out by the member of the European Commission responsible for Regional Policy when the fund was launched. "Micro-finance provides an opportunity that must not be missed to generate growth and jobs in Europe, as advocated in the Lisbon Strategy. There is currently a sizeable gap between the amount of micro-finance available in Europe, which is completely insufficient, and the number of persons wishing to create or develop their businesses but who lack access to traditional bank financing. The European Union is therefore launching an original initiative to give fresh impetus to this sector."

JASMINE is an initiative developed by the European Commission and the European Investment Bank Group (the EIB and its offshoot the European Investment Fund). It provides technical assistance and finance to micro-finance institutions to help them to become credible financial intermediaries so that they may obtain capital more easily.

A JASMINE unit created within the European Investment Fund (EIF) is responsible for vetting the business plans of applicant micro-finance institutions and for helping them to achieve a high quality of governance, financial management and commercial policy. The aim is to motivate the micro-finance institutions to adopt good practices so that they can be awarded quality labels. JASMINE will also help to create training courses and publicity campaigns on the European micro-finance initiative for the Member States, the regions, the banks and micro-finance institutions.

JASMINE will also finance operations by the most promising non-bank institutions so that they can grant more loans to project promoters. The JASMINE unit will examine the viability of applications and will make proposals concerning the co-financing of these operations by the EIB and private partners.

JASMINE began in early 2009 with a three-year pilot phase. The initiative’s start-up capital will be about some € 50 million. The European Commission and the EIF will contribute to implementing this initiative by committing financial resources available under EU Cohesion Policy and funds made available by the EIB/EIF Group and other financial partners.

JASMINE was announced in the European Commission Communication on the development of micro-finance in Europe in November 2007 (see IP/07/1713). According to estimates based on Eurostat data, the potential demand for micro-finance in the EU could be for more than 700,000 new loans, representing a total of some € 6.3 billion in the short term. People excluded from traditional financial services are the main users of this form of micro-finance.


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97 In 2010, the EU announced the EU Progress Microfinance Facility to respond to the economic crisis.
Chapter VI: The integration of urban and rural development in the EU: the case of LEADER

by Laurent Van Depoele

Introduction

The rural-urban distinction is held to be important in the formulation of policy for economic development. Underlying it is the conviction that the socio-economic conditions facing people in the countryside differ sharply from those which govern in cities and towns. The distinction impacts upon the design of policy in China where policies which, through special measures, aim to speed the rate of economic development in rural areas and reduce poverty, are given priority. In China, employment in agriculture is high; agriculture is an important economic sector; the rural-urban wage differential is wide; central government is determined to reduce poverty, and especially rural poverty; and the economic growth of rural areas has beneficial effects in reducing urban as well as rural poverty. In the European Union (EU), however, there are grounds for believing that the rural-urban distinction is becoming less important; that the polycentricity of the urban mosaic means that most rural areas are in the economic orbit of cities and towns; that socio-economic conditions in the countryside are not dissimilar to those in cities and towns; and that the distinction between rural and urban is not now so great that the two sectors require the use of different sets of policy instruments. Indeed, the argument is being made in the EU that rural development may be more effectively pursued if the formulation of policy started from the view that instruments and techniques of development which have proved their worth in either a rural or urban setting would be equally effective, with little adaptation, in both rural and urban conditions.

This chapter will explore issues surrounding the rural-urban dichotomy from the rural viewpoint, while the next sees it from an urban point of view. In this chapter, the emphasis will be on policy for rural development. It will compare the design of policy in the EU, and especially the rural development initiative known as LEADER (hereafter Leader), with rural development policy in China, which is seen by China’s central government as the way to reduce poverty. It will be seen that one common thread runs through the design of rural development policy in the EU and China and between rural and urban development policy in the EU. It is that local communities can play an essential part in policy delivery, helping to increase the

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98 Professor van Depoele is from the Institute for International and European Policy in the Faculty of Social Sciences at the Catholic University of Leuven, Belgium.


100 The name LEADER is derived from the instrument’s French name Liaison Entre Actions de Développement de l’Economie Rurale, or, in English, Links Between Actions of Rural Development.
value gained from each unit of public expenditure by increasing the precision of its targeting. Indeed, it will become clear that in China – with its bigger area and bigger population – the government has moved within the last decade to adapt its rural development policy so that it is implemented at the micro level of townships and villages. The inevitable question, given its already-wide experience of implementing economic development at the micro-level in both the countryside and cities, is “Should the EU follow the same route?” Further, “Should it simplify its policy armoury to it would be opportune for the EU to follow the same route: to simplify its policy armoury by fusing together its policies for regional development and for rural development so as to pursue economic growth in both rural and urban areas with one and the same policy and, in each case, giving systematic priority to micro-delivery?”

This chapter is in three parts. The first discusses further the rural-urban distinction, noting that although it brings clarity to analysis in a China context, it is losing its usefulness at the EU’s stage of development and perhaps to EU policy-makers, except in some parts of EU12, the latest members to join the Union. It then outlines some aspects of China’s policy to reduce rural poverty through the economic development of its countryside and compares it with EU policy for rural development, noting their similarity in giving a key position to rural localities – in China’s case systematically, in the EU exceptionally. The second part evaluates the EU’s micro-approach to rural development which is encapsulated in the EU’s Leader initiative and notes its success in releasing the endogenous potential of rural localities to chart and organise their own development. The third part draws conclusions before the next Chapter passes to urban development. The Chapter carries an annex which gives more detail of the Leader-initiative.

Part I: Rural development and the reduction of poverty in the EU and China

1. The EU and China: facing dissimilar rural challenges

The rural situation in China is markedly different from that in the EU.\textsuperscript{101} China is going through the transition from a rural to an urban economy – a process which has been completed in EU15 in the past thirty years.\textsuperscript{102} In China, agriculture still accounts for about 10 per cent of national output and about 40 per cent of all employment. China’s predominantly rural population is unevenly distributed across its territory and

\textsuperscript{101} Despite the large differences in rural conditions in China and the EU, there is one similarity. If OECD population density criteria are used to define rural areas, about 56 per cent of EU27 population is found to live in rural areas. According to the Chinese census-based definition of rurality, its rural population is also around 56 %.
\textsuperscript{102} The Mansholt Plan sought in 1968 to accelerate the final stages of the rural-urban transformation in the original EU, EU6, by offering pensions for the early retirement of elderly farmers or those with small farms. Its aim was to reduce the number of farm holdings, increase farm size, raise labour productivity and thereby make it possible for farmers to earn incomes on a par with those in industry.
is concentrated in eight provinces; where agriculture remains the key activity, having a share of rural employment which, in several western and northern provinces, sometimes exceeds 70 per cent. In rural villages, therefore, there is little alternative to agricultural employment. In the EU, agriculture has diminished in importance as an economic sector (see Figure 1 in Annex 2). In EU27 the active population in agriculture averages six per cent, of which the great majority is over 55 years; and 60 per cent of farm households have multiple sources of livelihood (pluri-activity). It should be noted, however, that in some EU12 member states, notably Poland, Romania and Bulgaria, employment in the agricultural sector is well above the average figure (see Figures 2, 3 and 6 in Annex 2).

Experience and economic theory teach that although high economic growth will reduce absolute poverty, it will aggravate the problem of relative poverty by increasing income disparities or even creating new ones. This has been the experience of both China and the EU. In China, rapid growth has led to massive job creation in cities on the East coast and income-differentials have attracted millions of farmers as migrant workers in the construction and manufacturing sectors. Their remittances have become a critical income for their home villages. But, at the same time, growth has churned the economy and widened income disparities to the extent that relative poverty is emerging as a problem alongside absolute poverty. In the EU, economic growth boosted by the single market, the single currency and trade agreements with third countries, has raised average income levels and lifted the EU population further away from absolute poverty, yet income disparities between member states and between regions have proved persistent.

In China the reduction of absolute poverty in rural areas has been a constant goal of policy but, in the EU, widening income disparities have also called forth a policy response. The EU developed its Cohesion Policy in order to help regions with below-average incomes to grow towards the EU average, thus reducing disparities and improving conditions for the poorest areas. However, EU Cohesion Policy is not limited to just helping the poorest, it is a “policy for all”: it helps to improve the competitiveness of richer regions so that they, too, may grow faster; it helps rural as well as urban populations. Alongside Cohesion Policy, as part of its Common

103 India, with 800 million people in its rural areas, has a larger rural population than China. OECD Rural Policy Reviews CHINA, OECD, p51.
104 The phenomena of migrant workers in China is discussed in Chapter XI of this study.
105 Ravallion and Chen see the incidence of relative poverty becoming a more important concern for poverty reduction policy in China than in the past when the reduction of absolute poverty was the over-riding objective. (See work cited in footnote 2, p125).
106 The World Bank team of Ravallion and Chen comment on the respective roles played by macro-economic policy, trade and regional development policy in China’s rural development. Macro-economic policy has played a positive role by bringing stability and the avoidance of inflationary shocks; “the score card for trade reform is less clear,” it may bring longer-term gains but “the view that greater trade openness brings rapid gains to the poor is not borne out by our data;” regional development policy has created the rapid growth of China’s coastal areas and ‘poor area development programmes’ have brought a good rate of return in other areas. (See work cited in footnote 2, p124).
Agricultural Policy, the EU operates an additional policy for the socio-economic development of rural areas, with its own fund, the European Agricultural Fund for Rural Development (EAFRD). This fund was established in 2005 and for the seven years 2007-13 has been allocated a total budget of € 69.75 billion.\textsuperscript{107}

These EU policies for regional and rural development share with those in China a preoccupation with the socio-economic development of rural areas. In China, an even greater emphasis is put on helping rural communities. Indeed, Chongqing, the city-region of more than 30 million people, is viewed by China’s central government as part of a policy experiment in how to best coordinate rural and urban development and to maintain a balance between them. The heavy dependence of rural villages on remittances from their migrant workers – which frequently account for more than a half of village income – cannot be a permanent state and they will need to increase their own productivity and income to compensate for the loss of remittances from migrant villagers who eventually settle in cities. The transformation of subsistence families into small-scale farmers and entrepreneurs is the only route to the sustainable reduction of rural poverty. This is one of the prime targets of China’s rural development programmes.

The changes which have taken place, and are still going on in the EU rural sector are undermining the rural-urban distinction. Over a number of decades, the shrinkage of EU agriculture as a source of employment has changed the spatial distribution of farming production, which is now often concentrated in specific growth poles (intensive farming). At the same time, many large areas, which had been previously characterised by small-scale farming, have suffered from marginalisation and sometimes even from social and ecological desertification – the map in Figure 6 of Annex 2 shows that the distribution of full-time, “professional” farmers is comparatively limited within the EU. These changes have profound effects on the classifications that underlie the rural-urban distinction. The new spatial heterogeneity of farming means that classification typologies often exaggerate the importance of agriculture as an economic sector. A typology based on centre-periphery is as helpful as the rural-urban distinction in organising policy for the economic development of what are still called “rural areas.” In this centre-periphery classification, we may distinguish in the EU between rural peri-urban areas, outlying suburbs, remote and ‘most remote’ regions\textsuperscript{108} and mountain areas.\textsuperscript{109} Even in China, the traditional rural-urban distinction is of limited use and the OECD rural policy review finds it useful to

\textsuperscript{107} The EU financial framework 2007-13 has, alongside the European Agricultural Fund for Rural Development (EAFRD), the European Fisheries Fund (EFF) with a seven-year budget of € 3.8 billion. The objectives of the fund are to help match the size of the EU fishing fleet to the capacity required for the sustainable exploitation of EU fisheries resources; to strengthen the competitiveness and the viability of operators in the sector; to promote environmentally-friendly fishing and production methods; and to provide adequate support to people employed in the sector.

\textsuperscript{108} The EU has seven regions which it classifies as ‘outermost’ or ‘most remote’ regions. These are the Canary Islands (which is part of Spain), Madeira and the Azores (parts of Portugal) in the Atlantic Ocean, Martinique and Guadaloupe in the Caribbean (parts of France), Guyana in South America (part of France) and La Réunion in the Indian Ocean (part of France).

\textsuperscript{109} Chapter IV of this study also deals with systems of area classification.
distinguish five “rural Chinas”: the rural poor, the rural with strong outmigration, the rural dependent on grain production, the rural diversified, and the rural peri-urban.110

2. “Rural” areas and “rural” development policy, concepts in need of definition

The concept of a rural area was defined by the European Commission in its document “The future of rural society” (CEC, 1988: 5, 16) as territorial entities with a coherent economic and social structure of diversified economic activities. These territorial entities may include villages, small cities and regional centres (Terluin, 2001: 24). In addition to terms like rural economies, rural regions and rural municipalities, rural areas are also indicated as areas with a large share of agricultural employment or as non-urban. In 1991, when the Leader initiative was launched, the Commission referred to local communities with 5,000 to 100,000 inhabitants (CEC, 1991). Subsequently, in its proposals for “Agenda 2000” in 1999, the Commission defined rural areas as local communities with less than 100 inhabitants per square kilometre. The map in Figure 4 of Annex 2 designates rural areas in EU27 in 2000 according to OECD methodology.

With over half the population in EU27 living in rural areas, which cover 90 per cent of its territory, rural development is a vitally important policy area in the EU (CEC, 2004b). A distinguishing feature of Europe’s rural areas is their geographic and socio-economic diversity and the different challenges they face in seeking economic development and higher incomes. These range from the restructuring of the agricultural sector, remoteness, poor service provision and depopulation, to population influx and pressure on the natural environment, particularly in rural areas close to urban centres (CEC, 2003a). Such diversity calls for a flexible policy, tailored to the opportunities and needs of the rural areas. No “one-size-fits-all” recipe is possible.

Although less important in terms of their economic weight and share in employment, agriculture and forestry are the main land users, see Figure 5 in Annex 2. They play a key role in the management of natural resources in rural areas and in landscape and cultural heritage. As a result of technical progress and the continued liberalisation of markets for agricultural products, the number of agricultural holdings in EU15 has fallen drastically. The overall position for EU27 was, of course, considerably changed following the enlargements of 2004 and 2007, with some of the new member states being highly dependent on agriculture. But it can be expected that the trends which have been visible in EU15, of a diminishing number of farm holdings and a relative decline in the economic importance of farming and forestry, will reassert themselves in the enlarged Union.

The underlying problem of the agricultural sector is that it continues to shed employment faster than the rural economy can create workplaces in other sectors through the diversification of economic activity. The result is that former workers in the agriculture and forestry sector cannot find new jobs. Often this creates, as a main feature of the situation in many EU rural communities, a rate of unemployment above the national average. It also indicates the importance of the non-farm sector for the economic development of rural areas and the importance of placing rural development policy in the context of the policy for overall regional development.

Despite its reduced share in economic activity, however, the interdependence between agriculture, natural resources, landscape and cultural heritage means that agriculture and forestry still have a valuable contribution to make to the socio-economic development of rural areas and the full utilisation of their growth potential. Therefore, policy-makers have progressively adopted the view that rural development policy must place agriculture and forestry in a broader rural context in which it is one of a number of employment sectors – and is frequently not even the principal one, see Figure 5 in Annex 2. Thus, the EU Common Agricultural Policy (CAP) has steadily increased the importance of its objective of sustainable agriculture giving added importance to issues such as environmental sustainability, the viability of rural economies, food quality, and animal health and welfare standards. Policy-makers have gradually shifted the emphasis of the CAP towards the reinforcement of rural development measures (CEC, 2003a). The result of the Agenda 2000 reforms was a new emphasis on assisting rural areas and their economies and communities in their entirety, not just by assisting farming.\footnote{In this it parallels rural development policy in China, which also underwent substantial reform at the end of the 1990’s.}

Strange as it may seem, there is no specific definition of EU rural development policy. It is officially stated, however, that measures of rural policy should contribute to the common policy of economic and social cohesion in “regions whose development is lagging behind and regions facing structural difficulties.” Special attention is to be paid to the “particular nature of agricultural activity which results from the social structure of agriculture and from structural and natural disparities between the various agricultural regions” (Council Reg. 1257/99). Thus, rural policy is directly related to EU Cohesion Policy, in general, and to certain regions and must concern itself with more than agriculture, although the agricultural and forestry sector still has a special place. Rural development policy is therefore a component of regional development policy. It is not equivalent to regional policy in the broader sense, since it does not concern itself with socio-economic change in the industrial and service sectors outside rural areas, nor urban areas in difficulty (Brouwer, 2003: 13).

It has been argued that the main area of rural policy innovation in the EU concerns policies that aim explicitly at the development of rural areas and have developed as mainly localised and regionalised policies, albeit with some national and EU level support (cf. Brouwer, 2003). However, current EU rural policy goes wider. Not only does it concern itself with regional and local policies, it also encompasses measures to strengthen the competitiveness of the agricultural sector and promote environmental protection and sustainable land management. Rural development policy also aims to complement policy reforms in agricultural market sectors by promoting a competitive, multifunctional agricultural sector, by seeking to encourage alternative sources of income in rural areas through diversification of economic activities. Further reforms in 2003 strengthened EU financial support for rural development by transferring funds from what is known as the “first pillar” of the CAP – that part of the policy which seeks to protect rural incomes through market and direct income support – towards new measures for rural development, which has become known as the second pillar.

In “Rural Policy Lessons from OECD Countries” Mario Pezzini\footnote{In International Regional Science Review, n°24, January 2001, pp134-145.} points out that the changes in nature, content and administration of rural policies in many OECD countries in the 1990’s concerned “both shifts in policy focus and adjustments to
governance structure.” This is a particularly valid observation for EU rural development policy. Since the 1990’s, EU policy has, indeed, shifted in a number of ways: from a support mechanism for agricultural modernization to a redefined role of agriculture in society; from a sectoral to a territorial policy approach; from subsidizing declining sectors of agricultural production to strategic investments and to the development of new activities while focusing on local responsibilities and the decentralisation of policy administration.

3. Rural development in China, the reduction of rural poverty

Employment in the farm sector in China has fallen quickly since the opening of China at the end of the 1970’s. In the thirty years before 1980, farm employment had declined slowly from a little more than 80 per cent of the active population to about 70 per cent (setting aside the period of the Great Leap Forward, 1958-61, when it briefly fell to 60 per cent). But in the thirty years since 1980, it has declined steadily to about 40 per cent while the rural population as a share of total population has declined (1979-2008) from 81 to 54 per cent. In parallel, the sixty years since the founding of the People’s Republic of China has seen a constant decline in agriculture’s share of the total economy (exception being made again for the years following the Great Leap Forward). From about 50 per cent in the 1950’s, agriculture’s share of China’s output has fallen to 10 per cent. It is important to note that, even after these changes, 40 per cent of China’s work force (those engaged in agriculture) produce 10 per cent of its output – two statistics which help to explain the presence of rural poverty.

These years of structural change – which have been accompanied by urban expansion fuelled by China’s rapid industrial growth – have also been years of poverty reduction. In the last 25 years China has advanced from having the highest rate of poverty in the world to a position where it is slightly below the average for the world as a whole. The proportion of China’s population living in poverty fell from 53 per cent in 1981 to eight in 2001. About three-quarters of this gain has come from reductions in rural poverty, due to rural growth and remittances from migrant workers. But this rural advance conceals a number of factors: living standards tend to be lower in rural than in urban areas, with urban incomes about 70 per cent higher (though Ravallion and Chen dispute that the rural-urban income gap has widened appreciably when account is taken of respective costs of living); progress has been geographically uneven, with poverty in coastal areas reducing twice as fast as in inland areas; much of the benefit of poverty reduction has been achieved through one-off factors rather than the constant working of economic forces (the break-up and redistribution of collective farms after 1978; the increase of institutional support prices in the 1990’s).113

One important factor which can be deduced from the experience of the last 25 years is that economic advance in general – and industrial advance in particular – will not bring a rapid improvement in the wealth of China’s rural sector. Another is that although the faster growing rural areas show reductions in income inequalities, they persist in slower-growing rural regions. For both reasons, given its aim of reducing

113 See Ravallion and Chen “Learning from success: Understanding China’s (uneven) progress against poverty” in Lei et al Poverty Monitoring and Evaluation. (See full reference in footnote 2).
rural poverty and income inequalities, central government designs and implements policies for rural development, emphasising poverty reduction through economic development rather than through some kind of income relief or through price support. Policy experimentation is a part of the process and some experimental results indicate the complexity of developing policies which will actually work and bring about the desired effect. A World Bank poverty reduction project in South-West China – established in the context of the Chinese government’s policies for the development of poor areas – provides an example.

The aim of the project was to enable villages in 35 designated poor counties in Guangxi, Guizhou and Yunnan to reduce poverty by improving local facilities and by developing their farm businesses. Finance was used to initiate and support a range of projects to improve local facilities – in education (school construction, teacher support, training; subsidies for the poorest students); in health (village health centres, equipment, establishment of co-operative medical services); in infrastructure (village roads, rural drinking water, power supply). Alongside these improvements in public facilities were projects of direct interest to households. They aimed to improve labour mobility (establishment of labour mobility agencies to promote off-farm employment; loans to migrant workers; training); to support improved farming techniques (higher grain and livestock yields, afforestation) and township-village enterprises. Two evaluations of the results, from different points of view, suggest that the project was successful, that the rate of economic development in the beneficiary villages increased and that households benefitted.

Huang Chengwei sees the project as an important test of the present style of China’s rural development policy, which he describes as a comprehensive poverty reduction system, and which he defines as “an organic integration of two or more inter-connected, inter-dependent, inter-restricted, interactional poverty reduction projects.” Taking poverty reduction as its fundamental objective, it

“targets the several key factors that induce poverty, uses comprehensive treatments and packaged investments, and mobilises the participation of target groups. It is a comprehensive system of measures that can help the target area and target group to achieve sustainable development based on enhanced capacity.”

Although larger in scope and financial impact, the project shares some characteristics with Leader projects operated in the EU under its common agricultural policy, which also seeks to empower local communities to act through a broad range of investment and training projects.

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114 The Chinese government has specified 592 counties as being in need of poverty alleviation, 86 per cent of them in highland or mountain areas. Most of the poor counties are either in the west of China or in border areas between provinces. Dependence on agriculture is considerably higher than the national average (38 per cent dependence on the primary sector against the national average of 16 per cent. In 2000 they had an average GNP per head of RMB 4,380 per year, 48 per cent of the national average.

Huang compared the position of the beneficiary villages at the end of the project with their position at the beginning, using a range of income and structural indicators to judge the project’s impact on poverty reduction and productive potential. Among the factors measured were village and individual incomes and the size of houses; the technical ability of households; labour mobility; enrolment rate of school-aged children; the proportion of the population benefitting from new roads, safe drinking-water, power supply; the organic content of soil and the decrease in soil area subject to erosion. Studying randomly chosen villages which had benefitted from the project and which had not, Huang found that the project village had increased its average per head income, had expanded its homes, had better access to drinking water and medical services and had greatly reduced its poverty rate. In addition its farm businesses at the end of the project were on a better footing (better soil, less soil erosion, more animals, bigger planted area and an increase in productive fixed assets). He concluded: “The evaluation results ... demonstrate that comprehensive poverty reduction is an effective development model in constructing a well-off society in poor areas.” But his results, he said, also indicated that the sustainable development of poor areas required effective, on-going support: farmers quite-quickly reached the limit of their potential and needed external support to help them discover new ways to raise income, to adapt to changing market conditions, to exploit new processing technologies, and to use good environmental practice.116

The World Bank team of Chen, Mu and Ravallion studied the same project from an economic point of view rather than in terms of development potential. They looked in particular at the project’s lasting impact on the economic variables of income, consumption and savings. They sampled 2,000 households in 200 villages spread through 20 of the 35 counties covered by the project, 113 of them covered by the project, the rest not covered. Their objective was to use the project to evaluate the Chinese government’s overall policy for poor-area development and to discover whether it would bring lasting benefit, so their evaluation covered the five-year period of the project itself and the first four years after it ended. They too found that, although households in participating villages benefitted while the project was active in its support (households in participating villages benefitted from higher savings (consumption remaining about constant), extra schooling for their children (school enrolment rates were higher while financial incentives were available, but not afterwards), and the purchase of extra livestock (mostly cows), the benefits faded after the project was completed. They noted that the strongest longer-term gains were registered by the better-educated among poor households – leading to their recommendation that programmes of this sort would have a greater effect if they were focused on the relatively well-educated among the poor.117

Both evaluations note the difficulty of interpreting comparisons of the performance of areas which receive support and those which do not. Huang sees a gain if the economic performance of the poorest villages can be raised to the level of the better-off. The World Bank team accept that, even four years after the end of the project, the

116 See Huang Chengwei “Impact Evaluation Indicators and Models of China’s Southwest Poverty Reduction Project”. Cited above.
poorest villages covered by the project had made “sizeable economic gains” – of the same order as better-off villages – but could not decide whether this was due to policy (the project) or other factors which were affecting all villages. They are clear, however, that increased saving is one of the first things which the poorest households do when their income increases and that education is an important pre-requisite for raising farm productivity.

Even before the comprehensive poverty reduction project in China’s South-West ended, the Chinese government modified its angle of attack for poverty reduction. Up until the end of the 1990’s, on the grounds that its poor people were spatially concentrated, it targeted its poverty reduction at its poor counties – for simplicity a Chinese county may be taken to be broadly similar to an EU region. Movements in Chinese population, however, led over time to a reduction in efficiency and, instead of being able to capture 70 per cent of families through county-targeting, policy could reach only 50 per cent. Also, an evaluation disclosed that within the targeted counties, capital resources from central government were not being used especially for the poor but were benefiting the whole population. The combined result of these two factors was that only one-tenth of central government resources intended to help the poor were reaching the intended target. Around 2000, therefore, the government transformed its policy for poverty reduction and rural development into a micro-policy. It introduced two major changes: it changed its poverty standard to take account of the needs of poor farmers to increase their capacity for self-development as well as their other needs for non-food consumption and it modified its implementing mechanism to give direct help to poor villages and poor families.118

The validity of this new micro-approach to the reduction of rural poverty is confirmed by survey work which shows the amount of income variation within and between villages in the same county, Puding county in Guizhou Province, the poorest province in China. The survey covered 700 households in 286 natural villages and all households in three administrative villages – an administrative village may be a conglomeration of three or four natural villages. Its authors – Mi Xing, Shenggen Fan, Xiaopeng Muo and Xiaobo Zhang – wanted to better understand the workings of rural development policy: “China’s poverty alleviation strategy has shifted from regional targeting to community and household targeting. In order to better target the poor, it is essential to know who they are and why they are poor.”119

The survey shows that within and between villages income inequalities can be largely explained by access to land, which is important since farming accounts on average for 70 per cent of the income of rural households and in Guizhou Province the distribution of land is becoming more unequal; by human capital, including health and education (“in households with few family members of prime working age, falling sick is equivalent to a disaster, directly driving the household into poverty”); and by access to non-farm income. Two further factors make little difference to inequalities – income from natural resources (“natural resources nominally belong to the state and

farmers have no right to a share of the rent”) and government financial transfers ("largely because the amount of transfers is so small. Because of the high targeting cost, it is difficult to improve rural income inequality through greater transfers"). The survey also showed that large income inequalities between villages could be explained as the effect of location factors. “Therefore, when targeting the poor, both villages and households should be considered.” And the survey also confirmed the importance of the educational level of farmers and their families in improving rural productivity: “As labour quality is positively related to income level at the natural village level, improving rural education plays a positive role in achieving both equity and efficiency.”

There are arguments that the reform should go still further and that, most notably, present measures of absolute rural poverty should be modified to take account of the fact that they tend to work against the interests of the very poorest households. The first requirement, according to Qi Miao and Funing Zhong, is to allow the basic poverty line to vary between regions and types of households (taking account of the size of household, and gender, age, and property makeup) in order to take account of different food and non-food consumption needs and prices. By using indices which can take special account of the depth and severity of poverty, policy-makers will be able to give greater attention to the poorest households in the target areas. But Qi and Funing are aware of the policy implications of such a move: a higher standard for judging poverty will mean that more people fall below the poverty line which implies the need for greater public resources for rural development. “If more public resources cannot accordingly be invested, the result of uplifting the poverty line can be just the opposite of what is desired. The limited resources may go intensively to a great number of people near the poverty line for the sake of eye-catching achievement, while the poorest might be well forgotten.”

4. Rural development in the EU, releasing endogenous potential

The rural question in the EU is both shaped and being shaped by socio-economic change as well as by some major policy concerns.

Whereas in China, the main rationale for rural development policy is to lift the population out of absolute poverty, its rationale in the EU is to counter the relative poverty visible in socio-economic and territorial disparities and uneven development between regions. These disparities, whether in the EU or China, may be viewed as a loss of economic potential both for the areas concerned and their inhabitants, or as a potential cause of social and political stress, or as a mixture of these and other factors. The aim of the rural development policy in the EU is to improve the socio-economic situation in rural regions and, by raising their average income levels, to help reduce disparities.

It was recognition of the threat that regional disparities may cause to the functioning of the EU Single Market project, upon which the EU began intensive work in 1987, that led to the creation of the “economic and social cohesion” policy of the EU. The

120 Op. Cit. p263.
Single European Act of 1987 incorporated the commitment to economic and social cohesion and it was further strengthened in the Maastricht Treaty (1993), which laid the legal basis for EU rural development policies. The Maastricht Treaty anchored them firmly into the framework of EU efforts to achieve economic and social cohesion by adding the words “including rural areas” to the provisions covering EU Cohesion Policy. The Lisbon Treaty has further enlarged the notion of “economic and social cohesion” by introducing the concept of “territorial cohesion.”

Implementation of the economic and social cohesion objective has been carried out at regional level through the regional policy of the EU, which is a part of its Cohesion Policy. Rural development is frequently managed by Member States as a national policy. But, in addition, one of the preferred implementation methods of rural development has been through local development strategies targeting sub-regional entities. These have been developed by local groups either in close collaboration between national, regional and local authorities or designed and implemented through a bottom-up approach (“the Leader approach”). Leader’s place in EU Cohesion Policy is as a “Community Initiative”, giving it an almost-experimental status since community initiatives were special financial instruments of EU Cohesion Policy. The Leader initiative aimed to promote, through “the Leader approach,” a new grassroots approach to rural development, encouraging local communities to analyse their strengths and weaknesses and formulate a vision for their development. This enabled policy determined at the centre – by the European Council and specialist Councils of Ministers meeting in Brussels – to be differentiated and adapted by local communities to better target and respond to their local needs.

5. Theoretical underpinnings of the EU’s approach to rural governance

The approach of EU rural development policy and its implementation, in particular through the Leader initiative, which originated in the 1990’s, has been informed by recent academic debates. These have suggested that the capacity of any given territory to embed processes of economic development, which are increasingly global, rests in part on sub-national social, cultural and institutional forms and supports (Amin, 1999; Cooke and Morgan 1998; Storper, 1997). These approaches – which could equally be cited in support of policy developments in China – argue that economic development is facilitated by networking and interaction between a large number of bodies that represent firms and non-capital relations. Coalition building minimises rogue behaviour and incoherence in identifying a common territorial agenda and is a key to economic success. A territorial approach enables policymakers to consider rural space as a territorial entity with its local or regional economy comprising agricultural, industrial and services activities.

122 Article 158 of the Treaty establishing the European Community (TEC) reads as follows:

“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, including rural areas.”
Figure 1 is a conceptual model developed in Terluin (2001: 119), which depicts the force field of a rural area or region. It seeks to identify the factors which facilitate economic development. In this model, the current process of global restructuring usually intensifies the external integration of rural regions. In accordance with a territorial approach, the rural region is represented as a regional economy, which engages in all kinds of exchanges with the external world. Within the rural region, three closely related components are distinguished: local resources, economic activities and actors. Local resources refer to physical infrastructure (roads, railways, ports, etc), natural resources and rural amenities. Economic activities include all kinds of activities in the agricultural, industrial and services sectors. Actors are supposed to be endowed with capacity (knowledge, skills and attitude) and to interact with each other in networks. They can also be involved in all kinds of relations with the outside world, manifested by the exchange of products, services and know-how and by contacts with policy-makers outside the region. Actors are mobile and move into and out of the region – generally being economically active, entrepreneurs and retirees (Terluin, 2001: 118-9).

In this model, actors play the key role in rural development, reflecting the shift in emphasis towards local development potential, programming, partnership and subsidiarity in EU policy. This implies that local actors are given an active role in planning and implementing rural development policy. The term “bottom-up approach” is used when the role of local actors has evolved to such an extent that local actors are empowered to define their own needs and prioritise development schemes and projects (Terluin, 2001: 49). The bottom-up nature of the Leader initiative and its “Leader approach” is an example of the shift of emphasis in EU policy with efforts to build local capacities through community development programmes and empowerment of local actors.\textsuperscript{123}

The objective of EU rural development policy includes the aim to contribute to economic and social cohesion.

- Stakeholder participation is a priority and the aim is to devise and design appropriate and effective rural development measures by ensuring the participation of a wide range of stakeholders. They will have an active interest in ensuring the sustainable development of the economy of their rural area as well of its environment and social conditions.

- Partnership is another priority. Policy should be implemented by a partnership between public and private organisations and civil society (in line with the principle of subsidiarity, implying that each policy action will be implemented by the level of governance or the group of actors which is best qualified to carry it out). If a locally-designed programme is to be able to respond effectively to local and regional needs, it requires to be drawn up by the partnership through a full dialogue between rural stakeholders, including the local and other levels of governance, and this dialogue needs to continue through the programme’s subsequent

\textsuperscript{123} In this connection it is useful to keep in mind the results of evaluation and survey work in China’s provinces, townships and villages which emphasise the importance of the level of education of farmers.
implementation, monitoring and evaluation. Partnerships have great possibilities to learn from each other through networking and exchange of best practices (CEC, 2004b).

**Figure 1. A conceptual model: the force field of a rural region**

Source: (Terluin, 2001: 119)

**Part II: Rural development from the grassroots: fifteen years of the EU “Leader approach”**

6. The Leader initiative: the EU approach to rural development

The Leader initiative represents a bottom-up approach based on the selection of the best local development plans devised and designed by local actions groups (LAGs) representing public-private partnerships. The EU supports financially a range of actions – the operating costs of LAGs; projects which they carry out for inter-LAG co-operation; experimental and pilot projects; and the capacity-building and animation which is necessary for them to prepare local development strategies (CEC, 2004b). The Leader initiative is designed to help rural actors, as stakeholders, improve the long-term potential for the economic development of their local region.
It aims to encourage them to implement integrated, high-quality and original strategies for the sustainable development of their localities. It strongly emphasises partnership and networks for the exchange of good practice and experience.

The Leader initiative is now in its fourth generation. LEADER I (1991-93) marked the beginning of the new approach to rural development policy, making it territorially-based, integrative and participative. The experience of this first phase suggested that area-based programmes involving partnerships between the local community and other agencies and interests could play a meaningful role in promoting socio-economic development in rural areas, but also elsewhere. LEADER II (1994-99) saw the approach put to more widespread use, with a greater emphasis on its experimental nature in terms of the innovative aspects of projects. The third phase, called LEADER+ (2000-06), as well as the initiative’s present form as a special priority in EU rural policy’s mainstream development programmes (2007-13) continues its role as a laboratory. It aims to promote the emergence and testing of new approaches to integrated and sustainable development and, in this way, to influence, complete and reinforce EU rural development policy. A distinctive feature of the Leader initiative is the broadly-based nature of the local partnerships (LAGs) which draw up and implement the integrated development programmes for their local rural areas.

The Leader initiative and its distinctive “Leader approach” in many ways epitomises the EU’s approach to rural development policy. It involves:

- a broad policy framework, which comprises strategic aims;
- common rules and financing established at EU level by the member states and the European Commission;
- a bottom-up approach with rural stakeholders designing, at their local level, rural development measures which best suit their requirements; and
- regional and national selection and approval processes for LAGs (CEC, 2003a).

LAGs are selected under an open procedure based on the criteria laid down in the programmes. The number of LAGs selected by EU25 member states for LEADER+ (2000-06) was close to 900. National networks were created in a number of member states with the double objective of (a) sharing and disseminating information from the national level to the LAGs and (b) of acting as a forum for the exchange of information, experience and know-how between LAGs. They also deliver assistance for local and transnational co-operation between LAGs, an important element in disseminating and sharing good practice.

7. Characteristics of the Leader initiative

The approach embodied in the Leader initiative rests on a number of principles:

- elaborating and implementing a “local action plan” in rural areas of between 5,000 and 10,000 inhabitants;\(^{124}\)
- the local action plan will have a number of characteristics: it will

\(^{124}\)This population size would be larger than most of China’s administrative villages.
define a limited number of strategic priorities for
development (frequently known as development axes) and
corresponding measures, which will be put into action
during the period covered by the rural development plan;
be designed and implemented by a local partnership, which
will be the final beneficiary (or the financial conduit) of
the initiative; and
it will be multi-sectoral and involve the systematic
interlinking of development actions embedded in the
overall vision and strategy (CEC, 2003b).\(^{125}\)

One further factor became embedded in the approach – innovation. The
implementation of “innovative actions” by rural public and-or private actors – not just
any actions but “innovative” actions – became an explicit aim embodied in the Leader
initiative. The European Commission interpreted the concept of “innovation” in a
broad sense. It did not confine “innovation” to the method by which a project was
implemented. It interpreted it to pertain to the technical content of the project,
whether in the product, the production process, the market or some other aspect. And
the concept of innovation could be concerned purely with economic aspects or with
cultural and environmental aspects if they were closely linked to rural development.

In the method of the Leader initiative, the “Leader approach,” local action groups
consist of a combination of public and private partners jointly devising a strategy and
innovative measures for the development – or for an aspect of the development – of a
rural area on the scale of a community of, roughly, less than 100,000 inhabitants.
These partners are allocated an administrative and financial lead agency which has the
capacity to manage grants from public funds. The lead agency ensures full
participation of all of the local partners who are concerned with the strategy, including
leading figures in the economic and social life of the various sectors and in the
associations concerned with the environment, culture and social integration (CEC,
2003b).

In 1994 the European Commission adopted a decentralised approach towards the
initiative’s implementation, which works through the national or regional level but
which does not change its local nature. Accordingly, at regional or national level, a
planning and decision-making partnership is established, including all those who
provide part-finance at national level, such as the state or region. These partners draw
up a Leader-initiative programme at regional level, the programme being a synthesis
of specific operations already submitted by potential local beneficiaries. These
regional programmes are submitted to the European Commission, studied and then
negotiated in partnership with the member state, taking into account the degree of
innovation reflected in the programme, the rural character of the projects being put
forward and the degree of involvement of the rural population. When the programme
is approved, the regional level partners are then allocated a budget by the
Commission.

\(^{125}\) It may be useful to keep in mind Huang Chungwei’s description or definition of a
comprehensive poverty reduction system: “an organic integration of two or more
inter-connected, inter-dependent, inter-restricted, interactional poverty reduction
projects.”
In 2004, the European Commission spelt out the fundamental aspects of its “Leader approach” in its blueprint document “New Perspectives for EU Rural Development.” The decentralised approach is central, permitting the ‘multi-level’ character of policy implementation. Authorities at European, national, regional and local levels need to co-operate to identify needs within a pre-set overall concept for rural development, to define appropriate measures, and to manage EU instruments and programmes (CEC, 2004b). Rural development policy aims to respond to national as well as regional and local needs. It is member states which know best what national needs are and they are, thus, given a central role in drawing up rural development programmes and in their implementation. The programming phase begins with each Member State presenting its plan which has to take account of the overall EU strategy for rural development. It ends with the Commission approving them, after having assessed their consistency with the rural development regulation. The national or regional strategies must contain quantified objectives and result indicators. Current programmes cover a seven-year period (2007-13). More than € 5 billion was spent in the framework of the LEADER+ initiative (2000-06) of which about € 2 billion was paid from the EU budget (see Table 1).

Table 1.

The extent of Leader initiative programmes, 1991-2006

<table>
<thead>
<tr>
<th>LEADER INITIATIVE</th>
<th>NUMBER OF LAGs</th>
<th>AREA COVERED (1000 km²)</th>
<th>EU FUNDING (bio euro)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leader I (91 – 93)</td>
<td>217</td>
<td>367</td>
<td>0,442</td>
</tr>
<tr>
<td>Leader II (94 – 99)</td>
<td>906</td>
<td>1,375</td>
<td>1,755</td>
</tr>
<tr>
<td>Leader + (00 – 06)</td>
<td>893</td>
<td>1,577</td>
<td>2,105 (2)</td>
</tr>
</tbody>
</table>

(1) equal to 75 % of the rural territory of EU-15 and covering some 50 mio people

(2) plus 1,5 bio € by private contributions and some 1,5 bio € by the Member States of EU 15

In order to maximise the benefits of potential synergy and avoid losses, the New Perspectives blueprint calls for a better co-ordination between development programmes and other European or national support schemes (CEC, 2004b). The viability of rural areas is best maintained and enhanced through territorial approaches, which target multiple sectors in the rural economy. The key element of policy is that they should be based on strengthened local-and-regional co-ordination and management structures and be open to the bottom-up participation of local actors, beginning from the programming phase. Networking and exchange of good practice,
both nationally and cross-border, increase the effectiveness of programmes. This requires support already from the programming stage from both EU and national levels (CEC, 2004b).

The Leader initiative and its “the Leader approach” are marked by their high adaptability to different governance contexts – not only within the EU but also outside – and specific challenges for different rural areas. It is highly responsive to small-scale activities and it changes the social fabric in rural areas. It mobilises a high degree of voluntary efforts and fosters equal opportunities between women and men and social groups in rural areas of the EU (CEC, 2004b).

The method of the Leader initiative has eight specific features, which can be classified into vertical, local, and trans-local categories (CEC, 2003b) (see table 2). The following paragraphs enlarge the points listed in the table.

Table 2. Features of LEADER

<table>
<thead>
<tr>
<th>The local features</th>
<th>Area-based approach</th>
<th>Bottom-up approach</th>
<th>Partnership approach</th>
<th>Innovation</th>
<th>Multi-sectoral approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>The trans-local features</td>
<td>Networking</td>
<td>Trans-national co-operation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The vertical feature</td>
<td>Decentralised management and financing</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Represented by the local group and by the local development strategy
Emerge from interaction between local groups and their respective strategies
Represented and implemented by the programming authority. It provides the governance frame in which the local groups carry out their activities. However, the local partnership represents an important element of this feature, which can be considered as management’s “terminal” at local level

Source: (CEC, 2003b: 66)

Vertical features relate to the multi-level character of programme implementation and to decentralised management and financing.

Local features include an area-based approach, a bottom-up approach, partnership approach, innovation and multi-sectoral integration.

- The area-based approach, (see figure 2) as opposed to a sectoral approach, means that
  - development is focused on a specific territory, which is small, homogenous and socially-cohesive;
  - local activities are horizontally integrated; and
  - there are common identities and a shared vision.
It contributes to a more effective use of endogenous resources due to the closeness of programme delivery to the local community and the creation of new links between partners. These new links allow natural, cultural, technological and human resources to be mobilised and secured from oblivion and thus turn them into an economic value for the area.

An area-based approach also fosters strategic thinking (CEC, 2003b).

Figure 2. Area based local development

- The bottom-up approach refers to the active participation of all interested people and organisations in planning, decision making and implementation of social and economic development. By bringing the programme close to people new opportunities are created for the inclusion of new beneficiaries and weaker members of the population. It is an approach which allows the local community and local players to express their views and to help to define the course of development for their area in line with their own views, expectations and plans. The bottom-up approach has four levels of participation:
  - information through public meetings for the entire community (farmers, non-farmers, residents, etc);
  - consultation or a kind of “village audit” of active community groups;
  - joint development of projects by the Local Action Group; and
  - collective decision-making of the actions and strategies.
The advantages of the bottom-up approach include the clearer identification of local problems and needs, better organisation of development players, better understanding of local decisions by the community, greater acceptance of local decisions by the higher authorities and stimulation of ideas and project leading to innovative local actions.

- **The partnership approach** refers to the temporary coalition of individual persons or collective bodies, based on a contract binding all partners under the same conditions and for the same purpose. In this way new partnerships such as local development agencies and co-operation structures emerge and contribute to the diversification and dynamism of rural territories. Many partnerships evolve into permanent development agencies and, even where they cease to exist, a consciousness of the importance of local partnership as a place for negotiation and the concertation of divergent local interests remains. The effect of the local groups in creating links between activities is strongly influenced by the composition of the partnership. Despite the existence of good examples of both exclusively public and exclusively private partnerships, local groups showing a balanced representation of the private, profit-making and non-profit sector most likely achieve the best results (CEC, 2003b).

- **Innovative actions** give new answers to the existing problems of rural development, and therefore provide added value and an increased territorial competitiveness. One innovation path could be to discover and upgrade local resources and potential. Another could be related to the reshaping of local organisations and networks and to the methodological support for implementing participatory practices in local development. The “Leader approach”, in itself, constitutes an innovation when it leads to the creation of trust and confidence and makes people believe in change. The consequent awareness of local people of their own creative potential is the main source of innovation, which leads to an interest in learning and the quest for knowledge transfer (CEC, 2003b).

- **Multi-sectoral integration** refers to both (a) the combination of activities of different economic sectors or of public and private activities in one project and (b) the strategic coherence between different projects in accordance with a common vision. Integration requires that the actions are linked so that the rural innovations programme becomes more coherent. One example of the horizontal integration approach is when local restaurants include in their menus typical food products from local producers, thereby stimulating local tourism as well as sales of local products.

As to the trans-local features of the experience of the Leader initiative, networking and trans-national co-operation are the most important.
Networking emerges from interactions between local groups and between their strategies. It is the capacity and readiness for collective action with other independent actors for a common purpose. It is instrumental in strengthening the economic links of local players to the outside world, bringing in expertise and establishing commercial links at long distance. Networking facilitates the dissemination of information, the dissemination and transfer of know-how and good practice.

Transnational co-operation refers to the co-operation of LEADER groups located in at least two member states for jointly designing, producing and marketing goods or services. It brings a European dimension to the essentially local dimension of the Leader initiative and for many local groups constitutes the first step to networking across borders. It facilitates the dissemination of information and the transfer of know-how and good practice.

The priority themes laid down by the Commission for 900 LAGs under LEADER+ were:

- making the best use of natural and cultural resources, including enhancing the value of sites (selected by 34% of the total number of LAGs);
- improving the quality of rural areas (26%);
- adding value to local products, in particular by facilitating access to markets for small production units via collective actions (19%); and
- the use of new know-how and new technologies to make products and services in rural areas more competitive (11%) (CEC, 2003a).

The remaining 10 per cent of LAGs selected more than one priority theme.

Ever since 2007, the Leader initiative has been more closely embedded in the mainstream development programmes of EU rural development policy. In this way, it has lost some of its independence but it has gained in other ways. It has access to a larger amount of EU co-finance and, by being more closely related with the mainstream of development policy, its ideas and innovations can have a wider and more long-lasting impact. It has been embedded by declaring it as one of four priorities for rural development policy 2007-13, which is designed to pursue three major objectives. The first is to increase the competitiveness of the agricultural sector through support for restructuring, which would be built on measures relating to human and physical capital and to quality aspects. The second is to enhance the environment and countryside through support for land management and complies with certain standards in the field of environmental protection, public health, animal and plant health and animal welfare. And the third objective is to strengthen the quality of life in rural areas and to promote diversification of economic activities through measures targeting the farm sector and other rural actors.

In realising these objectives, the preferred implementation method of rural development policy is again bottom-up, from the grassroots – the “Leader approach.” The policy is being implemented through local development strategies which target
sub-regional entities and which use the method of the Leader initiative, incorporated in overall rural development programmes as a development priority (see preceding paragraph). This approach ensures that the method of the Leader initiative will be continued, consolidated and safeguarded whilst allowing member states, which wish to do so, to operate it more widely.

Part III: The role of local actors, a permanent feature of EU rural development policy

8. Some conclusions

There is a strong similarity between the EU’s experience with its Leader initiative and the present form of China’s policy for rural development and poverty reduction. Two similarities which are noteworthy are the benefits to be gained from a grassroots approach to economic development, operated within a centrally-determined set of development priorities and objectives, and from higher levels of education for farmers and other rural residents. Put another way, China decides the direction and objectives of its rural development policy at a macro-level and implements it at a micro-level.

The Leader initiative and its distinctive “Leader approach” has the same properties and it has generated results which have gone far beyond those which could have been achieved by central policy-makers acting alone. It has shown the importance for rural development of a territorial approach, of the participation of local actors and of the formation of networks between them. It has been instrumental in bringing a local and territorial identity, or dimension, to local development strategies, thus reinforcing the coherence of development projects and magnifying the effects of synergy. Areas which were formerly anonymous have become “unique” with their own strong identity. Placing an element of “local identity” at the core of a territorial strategy has made it possible for unused, neglected or even forgotten resources to regain their economic and social value. This has given rise to unique products resulting from unusual combinations of different elements and sectors. Good examples are the “Village of Bread” in Belgium and the “route du vin” in France, but there are many more.

Participation has enabled local actors to “imagine” a future for their rural area – to build a consensus around a “vision” for their socio-economic development – and this, in turn, has created opportunities for previously under-represented groups to play a role. For example, it is remarkable to note the strong participation of women in local action groups. Also, it has become clear that the decline of certain areas, even where it is well-advanced, is never terminal because local players make it possible to explore new avenues of development. In some cases visionary players came forward to present a totally new product or service which then has a multiplier effect. In addition, new technologies have been introduced, such as “tele-medecine” in France.

Networking has similarly led to exchanges of experience, to mutual willingness to learn from each other, and to the possibility of co-operation between rural areas by establishing vital European Leader-initiative networks of local groups. Cross-border co-operation has allowed the planning and implementation of joint projects and, even
more importantly, has provided a concrete demonstration of the possibilities for the development of rural Europe.

The “Leader approach,” incorporated into integrated rural development strategies, has allowed experiments with local (territorially-based) small scale actions (pilot projects) using the endogenous potential of the locality. The underlying assumption is that development processes involve a different mix of relevant factors that are unique and typical of a particular geographical space and time and, therefore, development programmes need to be conceived at local level. The actions are invented and executed by local players at the grassroots (bottom-up) and can often, if successful, be transferred to other territories.

Experience of the Leader initiative clearly illustrates that the success of the projects also depends on good management. There is an absolute need for young and intelligent people to be in the driver’s seat and the optimum arrangement is that the best people should be on duty in the most fragile areas. The mainstreaming of all features of the Leader methodology (bottom-up, territorial, partnership, integrated approach …) strengthens rural development policy by making it more adequate to deal with the increased diversity of EU27 but it should be handled in such a way that it does not lead to the loss of the many excellent and extremely motivated animators and managers of local Leader projects.

EU rural development policy continues to aim at the maintenance of a lively and healthy countryside. Its technique is the diversification of rural activities and the use of a set of simple transparent instruments for agriculture, environment, job creation, growth and sustainable development in rural areas on the basis of a territorial approach. This allows the valorisation of the Union’s immense territorial diversity and, at the same time, helps to preserve the Union’s cohesion. These essential objectives are achieved on the basis of the involvement of the local stakeholders, which serves as a Europe-wide example of participative democracy.

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OECD Rural Policy Reviews : CHINA, OECD 2009


Annex 1

The contribution of the Leader initiative to growth and sustainable development

Introduction

This annex will give more detail on how the Leader-initiative, working from the grassroots in rural communities, has contributed to a faster rate of economic growth in the EU, to greater competitiveness, and to job creation and sustainable development in rural areas. Especially, it will mention examples of projects, devised and developed under the Leader initiative, which constitute examples of good practice in rural development.

1. Historical background

In the early days of the EU initiative Leader I, which were in the pre-globalization era at the beginning of the 1990’s, EU agricultural policy-makers were more concerned about EU competitiveness in relation to the United States than with India or China. It was the decline in farm employment and the growth in the number of part-time farmers which began to inspire some of the first Leader-initiative groups to think about new jobs for rural areas, however without tangible results and without any regard for the sustainability and the quality of jobs.

Then, in November 1996, the Cork Conference – held in Cork, Ireland – introduced enduring new concepts into EU agricultural policy and into that for rural development. Two of them were (a) that rural areas could become competitive as long as government followed appropriate policies and (b) that the “Leader approach,” which sought to stimulate economic development from the grassroots of rural communities, was a relevant and effective means for diversifying the rural economy. These two concepts took on the power of shared truths. However, the scope of the conference declaration, which became known as the Cork Declaration, was limited because it underestimated environmental concerns, seeing them only in relation to agro-environmental measures. It did not grasp the changes which were taking place in the overall economic and social context of the EU, especially in the area of environment policy.

The Lisbon European Council, in March 2000, went much further. It fixed a strategic goal for the EU for the first decade of the twenty-first century – to boost employment, economic reform and social cohesion, within the framework of a knowledge-based economy. This was to be achieved through policies which were tailored to the needs of the information society and by research and development to increase competitiveness and innovation.

\[126\] See also John Bryden, “From Leader I to Leader+ and beyond the Leader axis” in Leader+ Magazine, n° 6, 2006, pp8-12.
Fifteen months later, the Gothenburg European Council (June 2001) introduced sustainability as a complement to the Lisbon goal. It approved an additional EU-strategy which had sustainable development as its core objective, and which addressed the economic, environmental and social dimensions of sustainability. Lisbon and Gothenburg set for the EU the target of creating a globally-competitive, sustainable, knowledge-based economy with a strong social dimension and a high level of care for the environment. The strategy for achieving the target saw research and innovation as being important to long-term investment.

The Lisbon and Gothenburg objectives were fully taken into account by the Leader-initiative for the first time in the design of Leader+.

2. The Lisbon strategy and the increased competitiveness through growth and employment

Globalisation – which is not unlike the EU’s efforts to develop its own internal market, only on a more vast scale – leads to the increased exchange of goods across the globe. Each European company has to find its way in this new global reality. Even micro-enterprises, small and medium-sized companies, and service providers have to concern themselves with innovations and alternative solutions if they wish to safeguard their economic futures. EU policies help in this effort by providing necessary instruments. Rural development policy and, in particular, the Leader initiative offer the chance to villages and rural areas to embed global processes in their own economic development by adapting their own regional, social, cultural and institutional elements. Research shows that the good performance of individual actors is not enough for sustainable success in innovation. Rather, economic development is facilitated by considering villages and their surroundings as a territorial entity, by networking, and by seeking interaction between the many bodies which represent firms and local stakeholders in the territorial entity. A territorial approach, coalition-building and the setting of coherent goals for villages and their surroundings are, therefore, vital keys to their achievement of a faster rate of economic growth.

Rural areas are not uniform. Many EU rural areas enjoy a relatively favourable situation, mainly because of their proximity to big urban centres from which they directly benefit. Others are still exposed to the risks of industrial recession, partly related to the current economic recession and the possibilities of company closures in their area. Still others have to cope with geographical constraints which prevent them from accessing the resources they require to increase their competitiveness. Development challenges, therefore, are greater when trying to establish or maintain a strong employment base in remote or peripheral areas.

Employment in rural areas is closely related to the development of the production structure of the regional economy. Since agriculture is no longer the engine of the countryside’s economy, rural development needs a strong and direct focus on the possibility of enhancing employment in off-farm and non-farm activities, taking into account at the same time the necessary involvement of farmers in multi-sectoral local

Meeting the needs of the present generation without compromising those of future generations
development strategies. This is a powerful argument for viewing rural development in the EU as a part of overall EU Regional Policy and thus ensuring a fruitful coordination between rural and urban – and thus overall – development. Most rural areas in the EU – see Figures 4, 5 and 6 in Annex 2 – can only develop satisfactorily in a close relationship with their local cities and towns.

Both specialization and diversification can be successful. Indeed, the Leader initiative has supported the creation of micro enterprises, SMEs, access to ICT links and technology, and, importantly, the development of human capacity (knowledge, skills and attitude). Many projects under Leader+ illustrate the importance of local actors in this field. The diverse range of food products and value-added primary products in rural areas creates significant employment and is a critical creator of jobs. A Leader “small food business” program in Ireland, for example, has played an important role in the ongoing development and growth of the food sector according to its coordinator Isobel Fletcher. In the Ardèche, in France, two local action groups are working together on job creation through the valorisation of their religious heritage.

The Lisbon strategy focuses, among other things, also on improving education and training, research and development and the creation of a “knowledge based” society. Developing, and exploiting, opportunities for growth and employment requires investments in human capital and skills. A changing job market requires a changing workforce. Raising education levels, strengthening indigenous entrepreneurship based on local natural and cultural resources, and up-skilling the existing workforce are all essential ingredients in the process of transforming the traditional economy of rural areas into a knowledge and service-driven environment. Examples are to be found among Leader+ projects: the “Women in Leadership” training course in North Cork and south-west Limerick, Ireland, is a perfect illustration of the impact the Leader initiative has had on rural women in helping them to access employment.

The study “Initial key findings of the Leader+ initiative” shows that 11 per cent of the total selected Leader+ projects (2003) are built around the priority entitled “the use of new know-how and new technologies.” They deal with information, communication, distance learning and training, environmental management, healthcare, renewable energy, processing land-based and marine products and the production of alternative crops and bio-technologies. The Leader+ project @CERCA, an innovative regional approach for an inclusive ICT strategy in Andalusia, is a perfect example of raising the quality of life for a rural population through the use of new technologies. Another example is the coordination by a Leader+ group in the

128 The overall finding from the case studies analyzed in the RUREMPLO project prepared by Ida Terluin and Jaap Post is that actors which have the capacity (knowledge, skills and attitude) are the essential and decisive element in successful efforts of job creation Agricultural Economics Research Institute, LEI-DLO, The Hague, 1999
129 See “Irish Leader Support Unit Newsletter”, Winter 2006, p8
130 Leader+Magazine n° 2, 2005, p40
131 Idem pp6-8
132 Idem, p12
northern part of Luxembourg of “Internet homes” in every municipality.\textsuperscript{133} Some Finnish projects deal with new technology for clearing snow from the streets and for processing farm waste products.

3. The Gothenburg agenda and the environment

Integrating environmental and sustainability considerations into all relevant Community policy areas is the basic requirement of the Gothenburg strategy. For rural areas, this translates into the requirement by consumers for food production which is safe and which comes from environmentally sustainable farms, which deliver the “public goods” of biodiversity, landscape enhancement, decrease of groundwater pollution, improved water management and reduction of CO2 emissions. This largely falls outside the Leader-initiative and is pursued under the agro-environmental measures of the EU common agricultural policy. In this way, the present boundaries of agricultural and rural policy in the EU limit the pursuit of environmental improvement to agricultural production as such, rather than aiming at the environmental improvement of the whole rural area with all its activities.

However, this does not exclude that some Leader-initiative projects aim at environmental improvement. “Living landscapes” is a successful project on the Isle of Wight, in the UK, helping rural employers to create more environmental employment opportunities. Another project in the UK, the “Sense of Place,” a trans-regional project in northern England, brings local people together to identify the value of their local heritage, culture and landscapes and to devise ways in which these amenities can be shared and developed to the benefit of the community as a whole.\textsuperscript{134} A project in Bavaria has investigated renewable energy, producing bio-diesel from rapeseed oil.\textsuperscript{135} Increasing the production of biomass and renewable energy not only helps in relation to the reduction of greenhouse gas but, equally, creates new employment opportunities in rural areas. But this is a part of the environment agenda which is related to mainstream agriculture policy which deals with financing for farmers producing energy crops.

4. Some conclusions:

Despite its limited allocation of funds, the Leader-initiative is producing positive results. The EU’s main drive towards competitive and sustainable agricultural production comes from agriculture policy. This is supported by other investments in support of a sustainable agriculture. Rural development measures seek to encourage the diversification of the countryside and thus to accelerate its economic growth. The Leader initiative and the Leader experience are proving themselves as useful instruments in providing a broader base for economic activity in rural areas and thus in promoting rural development.

\textsuperscript{133} Idem p13
\textsuperscript{134} UK Leader+Newsletter, Spring 2006, p.15
\textsuperscript{135} Leader+Magazine, n° 3, 2005, p. 3
Using a set of simple transparent instruments, the Leader-initiative demonstrates – as does rural development policy in China – that villages can be involved in the design and implementation of policy for their economic development and that they can deliver benefits for agriculture, the environment, job creation, and faster sustainable growth. It also shows that the success of projects depends on the presence of good and well-educated managers, bottom-up involvement, territorial coherence, and partnership. The Leader-initiative is allowing the valorisation of the territorial diversity of the EU, while preserving its cohesion.
Annex 2

1. Agriculture in EU 27 in % GDP
2. Agricultural employment in EU 27
3. Agricultural employment in 2006
4. Rural Areas in EU 27
5. Agriculture in rural areas in EU
6. Pluri-activity and diversification

Main Source: “Rural Areas, Overview, current situation and main characteristics”
Figure 1. Agriculture in EU 27 in % GDP
Figure 2. Agricultural employment in EU 27
Figure 3. Agricultural employment in 2006

**Employment in the agriculture, forestry, hunting and fishing sector (2006)**

**Employment in the agriculture, forestry, hunting and fishing sector (2006)**
Figure 4. Rural Areas in EU 27

Baseline Indicators
Context 1
Designation of Rural Areas
NUTS-3 LEVEL

Designation of rural areas according to the OECD methodology

- Green: Predominantly Rural
- Yellow: Intermediate Regions
- Red: Predominantly Urban

Source: OECD-DRE database
Year: 2008
Calculation: EX-ARES v1.2
Cartography: EU AGRIS-IS-Team (2008)
© EuroGeographics for the administrative boundaries

Legend:
- 0 km
- 250 km
- 500 km
- 750 km
Figure 5. Agriculture in rural areas in EU
Figure 6. Pluri-activity and diversification
Chapter VII: Urbanisation and Urban Development

by Peter Ramsden

1. Introduction – towards a new definition of ‘urban’

European Union (EU) urban policy has shifted in the last decade from a concern over urban areas as a problem towards recognition that cities are in fact sites of opportunity. With the end of the era of mass manufacturing in the last quarter of the 20th Century, many of the EU’s large cities and urban areas experienced a period of sharp decline, high unemployment and, at times, social disruption. Run-down urban areas bore the signs of economic restructuring – empty factories and textile mills; derelict steel plants, shipyards, and coal mines presented an overwhelmingly negative picture. They were places of persistent and high unemployment, often among young people, and of poor social infrastructure. But the perception has shifted. The last decade has been a period of revitalisation and renewal. New economic activities of the knowledge economy have grown-up – companies in the creative industry, financial and professional services, IT companies have taken the place of the old staples. Old industrial premises have been cleaned or demolished, sometimes to be replaced by landmark public buildings. What were seen as “urban problems” are now seen as by-products of the city’s role as a growth motor – evidence of the processes of social and economic transformation which are part of economic growth and development. In line with these changes, EU cohesion and regional policy has altered its approach and seeks to invest in cities as growth centres. Taking advantage of this changed perception is central to successfully building a better urban fabric and indeed a more robust EU economy.

This new-found faith in cities means that policy-makers in the EU are marching in step with those in China, for in China cities – or, to judge their size on a European scale, megacities – are seen as vital to the country’s economic development. But there are differences. China’s cities are new, products of the rapid transformation of a rural into an industrial and service economy, a transformation which is releasing much dynamism. China’s urban development is regulated to protect the interests of the countryside and the country’s agricultural sector, but its urban-rural boundary is still fluid and population movement is predominantly one-way. Debate on urban policy in the EU, on the other hand, is compelled to emphasise ‘making the most of’ the city. In the EU, as we have just seen, cities are already built. They were built in a different age for a different economy, and the objective of today’s policy is to adapt them to new circumstances. The structures that developed to transform Europe

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136 The term megacity is used in this chapter to describe a city of more than 10 million people which has a high density of population and is growing rapidly. In the EU, perhaps only London and Paris meet this description, while in China there are a number (Shanghai, Beijing, Guangzhou being three). Conglomerations of urban areas might also be described as megacities – in China, the Yangtze River Delta contains, besides Shanghai, Hangzhou, Nanjing, Ningbo, Suzhou; the Pearl River Delta contains Hong Kong, Shenzhen, Zhuhai and Macao.

137 Claude Jacquier: “Can distressed urban areas become poles of growth?” paper given at OECD LEED conference 2005 and reproduced on www.urbact.eu
in the industrial age are no longer relevant to the knowledge economy and, if they are
to prosper, EU cities require sophisticated urban renewal, both of spaces and of
citizens. Policies for this renewal will inevitably throw into the melting pot the old
urban-rural dichotomy.

The relationship between cities and rural areas is evolving. To some extent the
modern economic world is an urban world. Most people in EU27 already live in
towns and cities. In more developed member states many of those people living in the
countryside are living ‘urban lives’, influenced by television, the consumer society,
urban patterns of work and access to services. Agriculture is in decline as a source of
employment to the extent that in the UK – which, in this respect, has always been
atypical with respect to the rest of the EU – it makes up less than 1 per cent of total
employment. In other parts of the EU, particularly around the Mediterranean area and
in some of the new Member States, up to a third of the population is still involved in
agriculture but, in such areas, the task of policy is to promote the modernisation of
agricultural production and processing and the share of agricultural employment will
diminish. To absorb unemployed farm labour and to enhance livelihoods, rural
economies will need to diversify. Already, even in the most rural areas, the advent of
mass communications and modern transportation give an increasingly urban cast to
rural lifestyles.

Within this emerging debate are key issues about the relationship between urban and
rural areas, and how EU cohesion and regional policy should engage the two sectors
to achieve good results from an environmental, social and economic perspective. Key
questions include ‘Should cohesion and regional policy be crafted to intervene at
different spatial scales (region, city, neighbourhood and village) ?’ ‘What exactly is
meant by the idea of an integrated approach? Does it refer to the integration of
national policies with locally-perceived needs and the interests of local partnerships ?
or is it more about the connection between social and economic (work and
investment) and between both of these and concerns about environment and climate
change ?

Most of all there appears to be a compelling need to move beyond the old type of
urban-rural dichotomy and to recognise that in the rapidly-changing, “globalised”
economy , both urban and rural are influenced by external forces and are heavily
reliant on each other. Their best joint-hope for a viable socio-economic future may be
through a more cohesive policy for territorial development which exploits their inter-
connections. Perhaps this new urban-rural paradigm will focus on a more complex
model of urban-rural interdependency (of the type illustrated in Figure 1) which will
encompass work; migration; education; food, water and other resources; cultural
activities, leisure and recreation; and waste. By seeing urban and rural areas as parts
of an interdependent system it would be possible to develop mutually reinforcing
policies that support both types of areas.

EU cohesion and regional policy has laid the groundwork for a territorial development
policy which emphasises the interdependence of the two sectors. But it could do
more. It has promoted new working relationships between cities and their regions and
initiated processes of social innovation which have the potential to change the
working relationship between cities, neighbourhoods and citizens. In this process
some cities have become the key player in organising ‘the meeting place’ between
policies set at EU, national and regional levels, the place where policy objectives are
reconciled and translated into development priorities and projects by neighbourhood
partnerships involving civic society and a wide range of community-based organisations. But, too often, these processes of social innovation stop at the city’s administrative boundary despite the fact that its ‘economic boundary’ reaches further. If EU cohesion and regional development policy were to make it possible for these processes to spread to all parts of the Union’s territory, it would take a major step towards defining ‘territorial cohesion,’ a concept which has been introduced into the new Lisbon Treaty as an objective alongside economic and social cohesion but which does not yet have a clear definition in practice. For the moment, it is a concept which offers policy-makers a blank canvas.

Figure 28: Typical urban-rural linkages in a modern setting
Source: Nadin and Stead where it illustrates relationships in South West England.\(^{138}\)

This Chapter is in two parts. The first considers how the EU is composed of a mosaic of cities and towns and what this means for the urban aspect of EU cohesion and regional policy. It will seek to show that although policy-makers can do little to affect the established settlement patterns in the EU – a position which is in sharp contrast to that experienced by policy-makers in China – they can do a great deal to improve the competitiveness of cities and towns and help them increase their rate of economic development. The second part will discuss two ways in which policy-makers use EU cohesion and regional policy, which aims to increase the rate of economic development of entire regions, as an effective urban policy. The first treats urban areas as microcosms of regions, using EU regional policy procedures in miniature to help put neighbourhoods onto a growth path. The second draws on an understanding of the EU’s urban polycentricity to encourage cities to and urban areas to combine in networks to share knowledge and best practice and to pursue the common goal of

growth. The chapter will present project examples to illustrate these two components of EU urban policy. A side-product of this discussion will be demonstration of the similarity between rural and urban – or, in this case, urban and rural – policy instruments.
I. The city-region as a focus for economic development

2. The EU’s urban mosaic

There are many different ways of defining urban and rural populations. In China and the EU policy-makers define urban and rural areas differently. In China, ‘urban’ districts are those with a population density of at least 1,500 people per square kilometre which contain, or are contiguous, to the seat of local governance, which can be as close to citizens as the street level. Less heavily populated built-up districts of cities and towns are also considered to be urban when they contain, or are contiguous, to seats of governance. In the EU, the European Commission has approached the definition of what is ‘urban’ from the other end, defining a ‘rural’ area as one with a population density of less than 150 inhabitants per square kilometre. Perhaps, the most striking comparison between the EU and China is the ten-fold difference between the two thresholds – in the EU a rural area will have less than 150 people per square kilometre; in China, by and large, areas with a population density of below 1,500 people are considered to be rural. A great many rural dwellers in China would be considered urban dwellers in the EU.

Once policy-makers have decided on the difference between urban and rural, the next step is to measure the two populations and to understand the characteristics of the two sectors. In order to help build a coherent picture of the EU’s urban population, the European Commission enriches its statistical base with an Urban Audit. It published its first results in 1998. According to the Urban Audit, 74 per cent, or nearly three-quarters, of European citizens live in urban areas and 30 per cent live in 5,000 small towns of between 5,000 and 50,000 people. Only 14 per cent of the EU population live in cities of more than a million inhabitants, half of them in cities of over 5 million. In all, around 30 per cent of EU inhabitants live in about 1,000 small and medium cities. The remaining 26 per cent live in rural areas. Table 1 below gives the full breakdown.

Table 6: Distribution of EU population by size of urban area

<table>
<thead>
<tr>
<th>% of EU population</th>
<th>Size of urban area</th>
</tr>
</thead>
<tbody>
<tr>
<td>13.7</td>
<td>Population over 1million (20 cities of which Paris and London are ‘mega cities’)</td>
</tr>
<tr>
<td>12.3</td>
<td>Large, population 250,000-1million</td>
</tr>
<tr>
<td>17.9</td>
<td>Medium, population 50,000-250,000</td>
</tr>
<tr>
<td>29.8</td>
<td>Small, (towns) population 5,000-50,000</td>
</tr>
<tr>
<td>26.2</td>
<td>Rural areas and countryside</td>
</tr>
</tbody>
</table>

Source: Urban Audit 2008

The Urban Audit gives a first idea of the mosaic of cities and towns, large and small, which largely covers the EU territory. This is confirmed by studies carried out for the ‘European spatial development perspective’ study which uses six categories, not five, to illustrate the settlement pattern.\textsuperscript{140} When the urban mosaic is superimposed on a map of regions (see Figure 4) it immediately becomes evident that regional economies in the EU are rarely dominated by one big city – in fact, there are only about 20 cities in the Union which might claim to be mega-cities (though none of them would be able to do so if they were judged on a Chinese scale). The norm is the existence of a large number of smaller cities and large towns, with several to a region, and the mass of the population lives in small and medium urban areas that are neither mega cities nor countryside, but something in-between the two.

The six settlement categories used in the ‘European spatial development perspective’ policy document, therefore, help us to rethink the urban-rural dichotomy by including four types of urban area between the explicitly rural and the large metropolitan areas. The six categories were those:

- dominated by a large metropolitan area;
- densely populated urban regions with polycentric, or dispersed, economic development;
- regions with a high density of population in urban areas but containing rural areas and with polycentric development;
- rural areas under the influence of a metropolitan area;
- rural areas with small and medium sized towns;
- remote rural areas.

Figure 2 maps these categories across the EU27. It is clear that the remote rural areas cover a large space but are home to only a small population. This category contains mountainous regions (for example, some territories in the French Alps) and ultra-peripheral regions (for example, arctic Lapland and Greece, as well as parts of the islands in the Mediterranean). The core of Europe, including the areas of highest productivity in Germany, the Netherlands, Belgium, Luxembourg, parts of France, South Finland and Northern Italy, as well as most of England apart from London and Birmingham, are classified as being highly-urbanised regions, with a high density of urban and, perhaps, rural population, and with a number of urban centres giving a multiple focus to their economies (shown as blue and light blue on the map). These are the most-representative of the so-called ‘polycentric’ regions. Research in the EU has sought to understand the properties of these regions with a view to providing an input into policy formulation.

\textsuperscript{140} \url{http://ec.europa.eu/regional_policy/sources/docoffic/official/reports/som_en.htm}

1999-European spatial development perspective
Figure 29: The EU mosaic of cities and towns, European urban-rural morphology
3. Bananas, grapes and a pentagon – visions of the EU’s territorial structure

Policies for EU urban development can be evaluated against different representations of the Union’s territorial structure. Two interpretations predominate.

Figure 3: Brunet represented the EU’s urban and economic heartland as a banana

Source: R. Brunet. Les villes ‘Européennes’

In 1989, the first year of the EU’s reformed Cohesion and Regional policy, R. Brunet published in Paris his influential view on how the EU – then made up of 12

141 http://www.espon.eu/mmp/online/website/content/projects/259/649/index_EN.html
members – might develop. He interpreted and expressed the EU urban reality as a banana (see Figure 3), a continuously urbanised core which extended from London, via Germany to the north of Italy. On this view, a worthwhile objective of EU urban policy might be to better-connect and develop the component parts of the EU banana in order to strengthen its overall territorial and economic cohesion. Two years later, a different interpretation, with different policy implications, was put forward by Kunzmann and Wegener who said the EU was not a banana but a bunch of grapes (see illustration in Appendix 3, Chapter IV of this study). This representation of European territorial structure argues that the dynamic for economic growth can develop in all parts of the EU territory, even overcoming structural and territorial constraints. It emphasises the role of endogenous potential in economic development and suggests that a worthwhile objective of EU urban policy might be to help states, regions, cities, towns and rural areas to strengthen their social, economic and institutional capacities since these are, on this representation, important to economic growth.

Of the two interpretations, the “bunch of grapes” appears to fit better with EU historical experience and its political requirement. It corresponds to the widespread nature of development and urbanisation in the EU; does not appear to require the existence of a special economic or locational force to explain why maximum development is limited to the banana; and accords well with the Union’s political structure, which, only with great difficulty, would have supported an EU approach to urbanisation which left five of its 12 members out of its core area, as well as large parts of two more. It is the ‘bunch of grapes’ explanation of the Union’s territorial development which has underpinned EU cohesion and regional policy, and its urban component, since the mid-1990’s. Most notably, it is one of the central ideas in the ‘European spatial development perspective’ policy document of 1999. But, for this favoured explanation to be useful to policy-makers, it was necessary to understand more clearly the growth processes of the urban mosaic and, especially, the polycentric regions which are its most productive part.

The European Spatial Planning Observation Network (ESPON), which brings together experts from the European Commission and each of the EU member states, has created analytical tools to enable it to research the nature of polycentric regions with a view to understanding what role urban policy might play in accelerating their rate of economic development. Such research was given priority by the ‘European spatial development perspective’ policy document since it is clear that they are the most productive regions in the European economy, leaving aside the biggest cities (London, Paris, Berlin, Hamburg and so on).

Three of the analytical tools created by ESPON have helped in the search for policy guidelines in connection with the EU’s urban mosaic to secure for the Union a growth

\[143\] Brunet also identifies an emerging Mediterranean axis and on the west coasts of the EU an Atlantic periphery.
benefit from its urban morphology. First was the identification of functional urban areas and their ranking in order of socio-economic importance (Figure 3); second was a further examination and ranking of the most important group of functional urban areas (named as metropolitan growth areas, Figure 4); and, third, the mapping of the socio-economic influence of functional urban areas and metropolitan growth areas (Figure 5). Results from the analysis have increased understanding of the characteristics of polycentric regions and given policy-makers the opportunity to experiment with policy innovations. They have also provided insights into the complex governance arrangements which are needed to enable economic, social and environmental policy to work best for such regions.

In seeking to understand the ‘bunch of grapes’ concept the first question which might be asked by policy-makers is “Can the individual grapes be identified and delineated?” Research by the observation network (ESPON) developed a method to identify each urban core with its surrounding commuter catchment area, thus creating functional urban areas. The effect of this exercise is to enlarge urban boundaries into rural areas, see Figure 6 which depicts more fully the full extent of the urban mosaic. Even outside large cities and the densely populated urban areas (those areas shown as orange and blue in Figure 2), there is a widespread dispersion of urban growth points, many of which being in border areas and having transnational potential.

Further research then sought to rank the enlarged-urban-areas in order of importance according to criteria which included population, transport, manufacturing, tourism, knowledge basis, administration and decision-making – criteria which are important ingredients in the growth process. Those enlarged-urban-areas at the top of the ranking (named as metropolitan European growth areas (MEGAs)) were further ranked into five groups according to indicators of their mass, competitiveness, transport connectivity, and knowledge basis. The resulting highest-ranking metropolitan growth areas were, in effect, the choicest grapes in the bunch.

The map of these metropolitan growth areas (Figure 5) shows the urban centres in the mosaic which may produce the best value from public investment. Their distribution indicates that the highest ranking metropolitan areas are concentrated in an area bounded by the major cities of London, Paris, Milan, Munich and Hamburg, ‘the pentagon.’ This analysis was first carried out for EU15 in the ‘European spatial development perspective’ policy document: at that time ‘the pentagon’ covered 20 per cent of the EU area, contained 40 per cent of the population and produced 50 per cent of EU GDP. Enlargement of the EU to 25 member states added only one more metropolitan growth area and did not alter the dimensions of ‘the pentagon,’ which contained 14 per cent of the EU area, 32 per cent of the population and produced 46 per cent of EU GDP. For EU27 the figures would show the same tendency since the map reveals that it adds only two metropolitan growth areas, both of them in the lowest category of the ranking.

The territorial footprint of the ‘pentagon’ bears a considerable resemblance to Brunet’s banana. But the advantage of this investigation of the ‘bunch of grapes’ concept is that it demonstrates that the ‘banana’ itself is only a part of the story. The

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146 Chapter III of this study discusses functional areas.
147 These MEGA’s, of which ESPON identifies 20, are not to be confused with mega-cities, of which there are two in the EU (see footnote 2).
approach pinpoints other areas which may have the same importance and potential for economic growth as those in the pentagon but lie outside its footprint. A comparison of the two maps (Figures 5 and 4) clearly shows that each of the metropolitan growth areas, wherever it appears in the classification, is at the centre of its own piece of the mosaic, its own zone of polycentricity, and therefore has growth potential. Figure 6 takes this analysis a stage further, aiming to show each of the growth points, not as an island, but in relation to its potential labour market – or the most immediate market for its products or services.
Figure 4: Identifying the grapes, the typology of functional urban areas in the EU – with the choicest grapes shown as Metropolitan Growth Areas. 

Source: ESPON.
Figure 5: The pick of the crop, Metropolitan Growth Areas ranked according to their socio-economic importance, showing the ‘Pentagon’.

Source: ESPON
Figure 6: Another view of polycentricity, functional urban areas and their overlapping labour markets
Source: ESPON

Comparisons between the respective populations of a functional urban area and its 45 minute drive area – the area which is within commuting distance (in work terms) or shopping distance (in consumption terms) give insights into the socio-economic nature of polycentricity (see Figure 6). Contrast two capital cities: when London is mapped with its 45-minute drive area, its population rises by 40 per cent; when Paris
is mapped with its 45-minute drive area, its population does not change. Contrast Benelux and Germany’s old Länder with Spain: labour and consumption markets in Benelux and the old Länder overlap to produce intense polycentricity and growth potential; in Spain the greatest connectivity and polycentricity appears to be limited to distinct areas. Compare Finland and the Baltic member states, which form a continuous region in which urban areas and their 45-minute drive zones are either monocentric, like Paris, or show only a faint form of polycentrism.

This should not disguise the fact, however, that “polycentricity” – the quality which is shared by the Union’s highly-urbanised high-population-density regions (those covered blue and light blue in Figure 2 and orange and red in Figure 6) – is not well defined. It appears to have a number of meanings but for the sake of this chapter is used to refer to regions which are both highly populated, highly urbanised and show considerable overlaps with their 45-minute drive areas. ESPON analysed the qualities of such regions and five of the characteristics it noted are important to this discussion of urban policy in the EU.

• The concept of the ‘bunch of grapes’ describes well the mosaic of cities and towns which makes up the settlement pattern of the EU. It can be applied with equal value at the EU level (see the illustration in Appendix 3, Chapter IV), at the national and inter-regional level and within regions. It supports an atomistic explanation of EU urbanisation and economic growth which fits hand-in-glove with both the political nature of the EU and the theories which underpin its cohesion and regional policy, as well as its programming structure.

• It sits easily with the factual observation that the location of smaller, medium-sized and larger cities in the EU is the fruit of a long historical process and is only slowly influenced by location decisions and migration tendencies. It follows from this that EU urban policy will have little effect, even in the long run, on the distribution of population, buildings and infrastructure through EU territory.

• But the ‘bunch of grapes’ concept and the attendant concept of polycentricity do indicate a clear role for urban policy in stimulating the economic growth of urban centres. The ‘economic’ attractiveness of a place is largely influenced by its socio-economic specialisation, the development of its key competences, and the existence of business clusters. This aspect of ‘polycentricity’ can be influenced through public sector policy.

• The existence of many economic centres, rather than just one per region, places a high value on accessibility or connectivity – for example, through information networks or transport links. High connectivity can endow cities and towns with considerable potential for development and connectivity can be improved through urban policy. This is, therefore, another aspect of ‘polycentricity’ which can be influenced, in particular through public investment policy.

• The evaluation of ‘polycentricity,’ through consideration of urban centres and their 45-minute drive areas, indicates that even some
capital cities may suffer from a degree of socio-economic isolation (in addition to Paris, ESPON mentions Athens, Lisbon, Madrid, Riga, Rome, and Warsaw). This would, in turn, indicate that even capital cities can benefit from being able to develop as part of a group. Specialisation and accessibility will both increase a city or town’s economic potential but, alone, they cannot determine whether the city’s potential is realised. This can only be fully achieved if the city succeeds in ‘embedding’ itself in networks with other similar or complementary cities. Yet again, this can be heavily influenced by public policy.  

Four of these five characteristics point to ways in which urban policy can affect the economic development of cities in the EU. They would apply equally to towns and cities in China. The odd one out is the role of policy in influencing the distribution of population, infrastructure and buildings. Urban policy in the EU is unable to influence settlement pattern, except in a marginal way and then in the very long term. But as China moves through its transformation from a rural to an urban economy, it is clear that government policy and that of the provinces can affect its settlement pattern. It is policy decisions by different government institutions in China which focus resources on the expansion of megacities as major poles of economic activity; which regulate the spread of cities into the countryside to control the loss of farm land; which create city specialisations in different sectors (the car industry in Wuhan, for example).

4. Self-propelled cities? China’s urbanisation

Which explanation – banana or grapes – will explain China’s urbanisation? Probably neither, it is more likely that another will be necessary. And the starting point in constructing such an explanation is to note that China’s stage of development is different to that of the EU. The EU has reached an advanced state of territorial development; urbanisation is high and stable, except in those newer member states which are still undergoing agricultural restructuring. Urbanisation in China is taking place rapidly, a function of its on-going transformation from being an agricultural economy to one which will soon be predominantly based on industry and services. Some forecasts have about one billion Chinese people living in cities by 2025 – about 350 million more than at present and equal to about 77 per cent of the population. This level of urbanisation will be slightly lower than in the EU but the pattern of settlement will be different – instead of the EU’s urban mosaic where only 35 cities have a population of one million, China’s is expected to contain 221 cities of more than one million by 2025, and 23 of them will have a population of more than five million.

Urbanisation has driven China’s economic growth for the past two decades and will continue to do so and government policy focuses urban development on a number of

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mega-cities in its Centre, North-East and Eastern Coast regions and on a smaller number of mega-city networks. Eight of the megacities would be Beijing, Shanghai, Tianjin, Wuhan, Chongqing, Chengdu, Guangzhou, Shenzhen – all of which already have a population of nine million or more; two mega-city networks would be the Yangtze River delta and the Pearl-River delta. The effect of this policy on the constancy and pace of GDP growth was evident, even through the worldwide recession following the 2008-09 financial crisis. In summer 2009, when the recession was shrinking economies in many countries and China’s national growth rate had been reduced, its mega-cities were still scoring double-digit GDP growth. An explanation of China’s urbanisation, therefore, would need to afford an important place to the role of government policy in creating mega-cities – which develop ahead of the regions around them. These are not cities in regions or city-regions dependent in some way on their surroundings, these are cities which are self-propelled (which might be one element of a definition of a ‘mega-city’). They make their own “economic weather” by drawing the resources they need from the whole of China and, even, from the rest of the world. They serve as focal points in the present stage of urbanisation and may affect the pattern of future city creation, their spill-over effects onto cities and urban areas in their “geographic shadow” helping them to grow. In this way, each mega-city would create its own urban mosaic.

A study by the McKinsey Global Institute (from which the figures in the preceding paragraphs of this section are also taken) may throw light on the workings of the process. It identified a number of obstacles to the process of urbanisation in China – the need for land and the conflict with agriculture; congestion; the need for resources, especially water and energy; pollution; skill shortages in particular places; the need for public funds for infrastructure and to provide services to migrant workers. The study examined possible urbanisation strategies for China and found that “concentrated urbanisation” – in the form of mega-cities and mega-city networks, where cities are linked by common interests – produced a number of advantages.

The McKinsey study looked at four paths which China could follow as it pursues its transformation into an urban society. Mega-cities, with populations of about 20 million, and mega-city networks made up one of a pair of strategies for “concentrated development,” the other being a hub-and-spoke model. The other two strategies implied a more dispersed pattern of urbanisation – one being a large number of cities with a population of 1.5-5 million people and the other being a “township model.” Mega-cities brought the economic advantages of higher productivity and greater efficiency. They

- create faster growth of GDP per head, due to the benefits of scale (concentrated markets, extra business opportunities) and higher productivity. (The study suggests the gain could be as much as 20 per cent against the least-concentrated “township” model.)
- use energy more efficiently. “Concentrated development” may have a greater need for energy but it brings higher energy productivity. (It is interesting to note that China’s cities are making a determined effort to use alternative energy sources to meet their extra energy needs.)

• make less claim on agricultural land for expansion, using 10 per cent less than the more dispersed “township” cities. (The spread, or sprawl, of cities in China is controlled by government regulation. The controls will need to remain in place and be rigorously applied if China is secure the benefits of “concentrated urbanisation.”);
• show a clear economic and environmental gain in the provision of mass transit. The more dispersed models of urbanisation require heavy investment in both mass transit and inner-city roads;
• produce less emissions and are more effective in applying and enforcing environmental legislation;
• attract skilled labour and talent.

The study’s findings on the needs for public funds are less clear, suggesting that one of the tasks of government – both central and provincial – would be to find the public funding model which best suited its urbanisation strategy.

The performance of the four strategies is reflected in Figure 7.

**Figure 7: The advantages and disadvantages of four urbanisation strategies for China**

Source: McKinsey Global Institute

The development of megacities is only a part of the rapid urban transformation taking place in China. Insights which can be gained from the ‘banana’ and ‘bunch of grapes’ explanation for urbanisation in the EU can also be helpful in understanding current developments in China, where, so far, urbanisation has been managed without the emergence of slums or ‘bidonvilles.’ One such insight is the overall economic and environmental benefit which can be gained in both China and the EU by policies which seek to improve the productivity of urban areas by, for example, seeking a more efficient use of resources like water, energy and land; by improving the
education and skill levels of the urban work force so that urban businesses can meet better-value investment opportunities; by reducing or managing congestion; by improving the quality of public services. This chapter will later discuss ways in which policy in the EU seeks to promote this process through pilot projects and urban-region networks.

5. What city size is best for the knowledge economy? Mega or medium?

The EU moved to engage with cities rather slowly from about 1989. This was partly because there was no urban competence in the original EU Treaty of Rome. As a result relations between the EU, national governments, and regional and city authorities are governed by the subsidiarity principle which reserves sub-national issues for EU member states. Despite this, the EU has nevertheless in recent years stimulated a discourse about the concept of polycentric urban development as the Union’s best route to faster economic growth. This balanced development of the whole urban hierarchy is considered to be a better option for the Union than dependence on a limited number of ‘mega cities’. The EU has moved to expand its cohesion policy (consisting of employment and social policy and regional policy) to address urban issues and the extent of its engagement has grown with time.

It may be Europe’s relative lack of world cities that has stimulated the debate about polycentricity. The EU ideal is to have balanced and harmonious regional development and there is little doubt that the primate city, or mega city, exacerbates regional disparities. London and Paris are Europe’s only mega cities and both UK and France have high primacy indices compared to other EU Member States. It is hard to pursue balanced and harmonious growth when one conurbation is so much larger than the rest of the urban fabric; and this mega-city dominance has in fact affected both the UK and France by weakening the relative power of their regions. The UK has experienced a century of unbalanced development. The failure of the great industries in the 1920s and 1930s was followed by a long boom in which regional policy was used to redistribute growth to the still-lagging industrial regions. In the 1979-83 recession, high exchange rates further damaged the remnants of steel, engineering, and shipbuilding in the northern cities leading to very high unemployment. From 1988 onwards the ‘Big Bang’ deregulation of the banking sector set off a 30-year long roller coaster in which London and the southeast played host to the business cluster focused on financial services, the UK’s only world-class cluster. Government policy focused on supporting this growth and even key decisions, such as whether in 2002 to replace the national currency with the Euro, were predicated on their impact on the City of London. Until 2008 the booming, and often overheated, London/southeast region was the result.

In large parts of the ‘old Europe,’ partly as a result of the nation state arriving late in European history, the pattern of urban development is based on medium-sized cities. This is particularly evident in Germany and Italy where unification was only completed in the second half of the 19th Century from a starting position of principalities and city states. The resulting polycentric pattern seems to be a factor in

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151 Primacy is the ratio of the size of the largest city to its second largest.
achieving a higher quality of life and a better quality environment (with less car use by ordinary citizens) with lower levels of income inequality between population groups. Achievement of this more-balanced growth demands that cities are carefully managed in terms of planning control, transportation, economic and social development to ensure that decentralisation does not degenerate into sprawl. Good examples of urban management include the Ring City of Ranstädtt Holland.

Polycentric development also relates better to a new urban-rural vision. It allows a hierarchy of urban forms in which even small cities provide high quality services to their rural hinterlands. This is exemplified by the small cities approach in the north of Sweden, where towns of only 5,000 provide excellent services to large and sparse rural areas. The success of this approach represents an innovation in thinking on territorial cohesion. The new perspectives that are embodied in this thinking require new forms of governance that connect local municipal governments with the delivery of national and regional policy. The local level of governance is thus enabled to play an important role in the national-local governance chain of policy delivery.

The downside risk for Europe is that polycentricity, based on medium-sized cities of under three million inhabitants, will in the end turn out to be a less economically efficient model of urban development than the concentrated mega-cities that exist in the United States and that are being created in many parts of the developing world, especially in China, South-East Asia, India and Latin America. At the moment it is impossible to predict whether this will be so. In the industrial age, urban size was undoubtedly important. Myrdal’s analysis of cumulative causation and urban agglomeration economies suggests that size was a sure route to competitive advantage. In the knowledge age we have already seen the emergence of Silicon Valley in the U.S. as a ‘non-urban’ urban form, but one that in fact looks more polycentric than monocentric. For Europe the risk is that polycentric cities will be the urban version of the European social model – they will provide high levels of wellbeing but lower levels of productivity and growth. The truth is that we don’t yet know which paradigm of city development works best in the knowledge economy. Is size the most important factor in economic efficiency, and is the mega city doomed to providing lower quality environment?

**Part II: two uses for one policy, turning cohesion and regional policy into a policy for urban development**

6. **Cohesion policy in regions and in cities**

In keeping with the two perceptions of the EU’s urban areas – cities as problem areas and cities as growth opportunities – the instruments used by EU urban policy may be divided into two groups. The first grew out of mainstream actions to stimulate the economic development of wider regions. It began from instruments and actions used for mainstream regional development, seeking to adapt and evolve them under particular EU initiatives for urban development so that they were better-suited to

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urban conditions. These actions will be discussed in the first part of this section. A second set of instruments owes its development to the growing understanding of the possibilities presented by the urban mosaic. These actions seek to exploit the EU’s polycentricity by encouraging cities and towns to develop in a network partnership with others, identifying common themes of particular interest and exchanging knowledge and good practice. If the word ‘cluster’ is used to describe businesses that find advantage in co-location and shared knowledge, the cities and towns in polycentric partnerships and networks might be termed ‘virtual’ clusters, not co-located but seeking a common advantage in shared practice and knowledge. This effort to create new policy instruments based on the new understanding of polycentricity will be discussed in the second part of this section.

The early steps towards a distinctive EU urban policy grew from the perception that cities can be centres of economic growth but can also be afflicted by concentrations of social, environmental and economic problems. At first, thinking behind the policy seemed to be that there was a necessary two-step sequence to be followed in stimulating regional growth from urban areas – step one, socio-economic and environmental problems had to be overcome; step two, policy-makers could then turn their attention to organising a policy for growth. With experience, it became apparent that socio-economic and environmental problems and economic development co-existed, there was, in fact, no sequence – problems could be tackled and growth pursued at the same time.

The first realisation was that, because of the concentration of citizens in urban areas and the importance of these for production, the urban question was in some ways fundamental to economic and social cohesion. Then, by the year 2000, it was clear that socio-economic problems and growth were part of a joint agenda. In launching the debate at the turn of the century on priorities for economic and social cohesion in the first decade of the 21st century, the European Commission in its second report on economic and social cohesion stated that:

"The urban question… is at the heart of economic, social and territorial change. Cities are a key location for the pursuit of a strategy for cohesion and sustainable development."

This same report identified four key urban issues:

- disparities within individual cities were often greater than disparities between the regions of the EU;
- environmental pressures are particularly acute in cities;
- cities act as motors of growth for their region; and

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153 2001 - Second report on economic and social cohesion (In particular, see section 1.3.2 "Urban areas")

154 Disparities are illustrated by inner London. It has a GDP per capita that is three times the EU average – the highest GDP of any area of its size in the EU. But it also has the largest concentration of poor people in the EU. Fifty percent of children in inner London grow up in poverty, where poverty is defined as parental income being less than 60% of median income.
• small and medium-sized cities have the potential to achieve a more balanced and polycentric development in Europe.

Another problem facing many EU cities is the integration and absorption of migrants, both second and third-generation. They come to France, UK, Netherlands and Germany from their former colonies, as well as, in the first decade of the 21st century from war zones, third countries and even from other parts of the EU.\textsuperscript{155} New waves of migration have transformed countries that were historic sources of migration into reception countries – including Italy, Greece, Ireland, Spain and Portugal. The bulk of migrants of all descriptions settle in cities. They represent a considerable economic potential but it is a potential which can only be realised through sensitive policy-making\textsuperscript{156} since migration and deprivation combine to exacerbate problems of community cohesion. Tensions occasionally lead to uprisings and riots, often led by second-generation migrants discontented with poor access to job markets and heavy-handed policing. The UK and France have experienced long and violent riots. In the UK, these included Brixton and Toxteth (1981), Toxteth and Broadwater Farm (1986), and Bradford, Burnley, and Oldham in 2001. In France, residents in some Paris suburbs rioted in 2005: 9,000 cars were set on fire and 5,000 people arrested.

There is, then, a definite and clear ‘urban agenda’ for city governments, which they have to tackle at the same time as they seek to increase the pace of their economic development. Faster income growth and a more balanced distribution go some way to reduce socio-economic problems and to increase life quality, but policies for

\textsuperscript{155} Chapter VIII of this report looks into workers’ migration in China and the EU.
\textsuperscript{156} The initiative ‘Pathways to Integration’ operated in the Liverpool-Merseyside region of England (which will be discussed below in Section 7) demonstrated this sensitivity in its actions and projects for the training of unemployed people. Among other things, it co-funded:

- customised training programmes involving one-to-one mentoring of the \textit{voluntary} trainees;
- non-vocational training operating on a non-formal basis to serve as a ‘bridge’ to orthodox training programmes generally perceived by potential trainees as being distant and ‘not for us’;
- outreach delivery of computer training (using laptop computers) in community venues (again geographically and socially distanced from orthodox training provision);
- outreach educational provision for young children and, through them, their disadvantaged young parents;
- the establishment of centres which combined individual-centred educational and employment guidance with active labour-market placement.

These projects recognised the social and geographical dimensions of exclusion from the labour market and were ‘closer’ in both a social and geographical sense to those excluded. The projects also recognised the multi-dimensional nature of exclusion. One example, a project targeting young homeless people, perhaps best captures this sensitivity. Homelessness was not seen as the ‘problem’ but as a symptom of a range of interrelated problems (such as family breakup, alcohol/other drug dependency and unemployment) which needed to be addressed in an holistic manner if inclusion is to be achieved
development have to be accompanied by a broader range of initiatives. There is now a growing consensus from commentaries – including the EU’s own regulation governing its cohesion and regional policy and its URBACT programme (see below) – and from academic commentators that the solution to problems in urban areas is to be sought through an integrated approach, both to policy and policy delivery. This consensus is founded on the observation that EU cohesion and regional policy can, at one and the same time, be a distinct policy and the instrument for other policies.

This understanding that cohesion and regional policy can be both a policy in its own right and the instrument of other policies is easily illustrated. As a distinct policy, it has the objective to eliminate, or at least lessen, the disparities between the incomes of lagging regions and cities and the EU average. It pursues this objective by promoting the economic development of the lagging regions and cities through the subsidising of investments in public and private infrastructure and services. It is this role as co-sponsor of investments that enables cohesion and regional policy to play its double role, as policy and as instrument – in pursuing its own objective, it helps other policies to achieve theirs. When, in order to promote the economic development of a region or city, cohesion and regional policy financially supports investment in education and vocational training, in road or rail construction, in waste disposal facilities, in the production of energy from biomass, and when, in doing so, it insists on the qualities and conditions insisted upon by EU policy-makers in these other areas of policy, cohesion and regional policy is acting as an instrument for education, or transport, or environment, or energy policy. This is the important benefit which arises from an integrated approach. It will fuse together the cohesion policy’s roles as policy and as instrument producing several benefits. It secures greater value for public money, since a given sum is used to further a number of policy objectives. It produces an administrative saving since one policy-delivery-mechanism can serve several policy masters.

But there is a cost. The integrated approach to policy-making and delivery, involving, as it does, different agencies and policies, and organised by different levels of government requires ‘modernised’ governance arrangements – what, in current jargon, would be called ‘smart’ government. These must link EU, national, regional, and city governance as well as the private and third sector. Indeed governance – and, in particular, the challenges of uniting in a common purpose different levels of government and a range of local actors – emerges as such an important feature of the integrated approach to policy that it could be considered as an integral part of sustainable development. Good examples of the integrated approach include the URBAN initiative (see Section 6 of this chapter) and the UK’s Merseyside Objective 1 programme (see section 7). On the other hand, there are signs that city, regional and national authorities lack a clear understanding of the efforts they must make if their governance is to reap the benefits of the an integrated approach to policy delivery.157

In this vein the European Parliament in its resolution in the year 2000 on the Community initiative for policy action in urban areas, URBAN II,\textsuperscript{158} stressed:

“[There is a] need for an integrated approach to urban policy as currently this looks to be the only way to address economic, social and environmental problems in urban zones.”

The EU Committee of the Regions, in an opinion on the Urban Action Framework, underlined the same point:

“The decisive role of cities in the implementation of the EU’s main objectives - economic and social cohesion, employment, competitiveness and environmental sustainability…. this demonstrates the need for close involvement of local and regional authorities in all future policy formulation, and recognises that cities… should be true partners in the process.”\textsuperscript{159}

European ministries and cities came together in May 2007 to sign the Leipzig Charter on Sustainable European Cities.\textsuperscript{160} It focuses on support for integrated urban development policies in which the spatial, sectoral and temporal aspects are coordinated, and which pay special attention to deprived areas within the context of the city as a whole. It assigns ‘crucial importance’ to three objectives: creating and maintaining high-quality public spaces, modernising infrastructure networks and improving energy efficiency, and delivering proactive innovation and education policies. In deprived areas the Charter suggests the pursuit of strategies for upgrading the physical environment, strengthening the economy and local labour market, developing proactive education and training policies for children and young people, and for promoting efficient and affordable urban transport.

Thus, over 20 years of urban policy-making, a consensus has emerged on the desirability of targeting urban regeneration on deprived areas and of a sustained and integrated approach to achieve results both for the people and places concerned. At the same time, it has also become clear, that policy integration – the task of knitting together different strands of policy to maximise the value gained from public investment – requires modernisation of all links in the governance chain, from the EU link to the national, the regional and the city. There are signs that where this modernisation does not take place, there is a loss of policy effectiveness.\textsuperscript{161}

\section*{7. Urban Dimension in Cohesion Policy – the URBAN initiatives}

\textsuperscript{158} Official Journal C 339 29.11.2000 pp44-47.
\textsuperscript{159} Opinion of 3 June 1999, CdR 115/99 fin on Comission COM/1997/197 final Towards an Urban agenda
\textsuperscript{160} Leipzig Charter
The urban dimension has grown steadily in cohesion policy since the first reform of the Structural Funds in 1989, beginning as isolated pilot projects and ending as the experimental element in cohesion and regional policy. The phase of pilot projects culminated in the completion of the URBAN Community initiatives in 2006. Then, beginning in 2007, and lasting until 2013, the current programming period ushered in a period of urban ‘mainstreaming’ in which the experience of urban innovation was incorporated into the main convergence and competitiveness programmes.

Urban pilot projects started off this phase of policy innovation. From 1989-1993 there were 33 urban pilot projects – with an approved EU contribution of € 101 million. This was the first instance of the European Regional Development Fund (ERDF) being explicitly used to support innovative urban regeneration and planning activities. Success in these pilots led to the launch of a full-scale URBAN Community Initiative (hereafter referred to as ‘the Urban initiative’), which applied across the EU, started in 1994 and ran for two programme cycles, concluding in 2006.

A second wave of 26 urban pilot projects was launched in 1997 with an ERDF contribution of € 63 million. These were conceived as a laboratory to test original ideas and innovative approaches to urban problems by funding projects that were often small scale, were led by municipalities or Non-Governmental Organisations (NGOs) and focused on intractable urban problems in disadvantaged areas. The evaluation and review of these urban pilot projects after ten years identified that the integrated approach, through which policy instruments were combined to tackle economic, social and physical problems together, was critical to successful urban renewal.

Experience of this first wave of urban pilot projects was used to help formulate the first Urban Community initiative which was launched in 1994 as an instrument of EU cohesion and regional policy and targeted at the regeneration of urban areas and neighbourhoods-in-crisis. A particular feature of the Urban initiative was the intensive involvement of local government and local partnerships. In most cases, local government was responsible for day-to-day implementation of projects, advised by local community groups and in partnership with national and regional authorities and the European Commission.

The EU co-funded 118 programmes under this first Urban initiative, covering a population of 3.2 million people. The programmes were integrated and brought together funding for physical investment (from the ERDF) and for improving people’s

162 Urban Pilot Projects
163 Review of Urban Pilot Projects
qualifications and social conditions from the European Social Fund (ESF). They spent € 951 million of EU-finance from the two funds as part of a total eligible investment effort of € 1.8 billion (approximately € 16 million for each programme). This represented a per capita expenditure of € 560 per person.165

Besides its integrated approach, the first Urban initiative was characterised by innovative approaches to combating poverty – through employability, vocational training and inclusive entrepreneurship. Local economic development frequently emphasised the importance of new sectors, such as cultural and creative industries, to urban development, as well as RTD and innovation.

This first Urban initiative was made up of smaller scale actions and projects than would normally feature within a mainstream programme. Examples included restoration of historic town centre areas (such as in Bari, Italy) and renovation of key buildings (such as the Lasipalatsi, Helsinki, a run-down functionalist building which was transformed into a centre for media-related activities including internet access for immigrants, young people and the unemployed). Many actions focused on local economic development and aimed at promoting both entrepreneurship and employment. One small-scale example was an employment bus in Porto (Portugal) disseminating employment and training information wherever it stopped. Action in Vienna focused on the revitalisation of a local market and support to immigrant businesses, while in Barcelona the focus was placed on reducing school dropouts and absenteeism by smoothing the transition from school to work. Throughout the initiative there were many examples of local communities being empowered and taking over the management, and sometimes ownership, of buildings and services, a form of socio-economic development which has become known as asset-based development.

The first Urban initiative was evaluated166 and the main findings published in 2003. It concluded that the projects the initiative had co-funded had largely fulfilled their objectives. The study classified the initiative’s projects and actions into four types which emphasise the importance of the so-called integrated approach:

• A broad integrated approach: a balanced set of economic development, social integration and environmental measures (such actions were present in 45 per cent of the initiative’s programmes);
• An integrated approach with a particular focus – economic, social or environmental (present in 26 per cent of programmes);
• A community-focused strategy, with a particular emphasis on local community involvement in the programme (present in 19 per cent of programmes); and
• A “flagship” strategy, which used a limited number of visible or flagship projects, as a means of generating interest in the programme (present in 10 per cent of programmes).

A summary of the final evaluation, ‘Partnership with the Cities’, published in 2003, outlined the parameters of the first Urban initiative programme. It made special mention of the partnership aspects and the new multi-level governance arrangements by which civil society and the third sector played an increasingly important role in actions to improve neighbourhoods and to boost their economic development. This reinforced the conclusions of the programme’s interim evaluation.

The second Urban initiative programme ran for seven years from 2000 to 2006. It was made up of 70 individual action programmes covering parts of different cities across the EU, affecting about 2.2 million inhabitants – a small population footprint in an EU with 15 Member States and a population of over 250 million people. The areas were selected on the grounds that they faced severe deprivation and specific challenges. Average unemployment and crime rates in the 70 individual areas were twice the EU average. The areas also tended to have more migrants from third countries and tended to lack amenities, including green spaces.

Between 2001 and 2006, the EU invested approximately € 728 million of ERDF money in these areas, about 0.35 per cent of its total structural fund budget. The total investment of the programmes, when national and private sector funds are added together, amounted to approximately € 1.6 billion. As under the first Urban initiative, the funding was concentrated on physical and environmental regeneration, social inclusion, training, entrepreneurship and employment. This second Urban initiative had multiple aims. It sought to promote the sustainable economic and social regeneration of small and medium-sized towns and cities, and of distressed neighbourhoods in larger cities. It emphasised the formulation and use of innovative strategies in each case so as to enhance knowledge and experience. It also stressed the exchange of knowledge and experience in relation to sustainable urban regeneration and community development. It was hoped that the pursuit of these objectives would facilitate the transition of innovative actions into the mainstream of urban development.

Guidelines for the new programme emphasised again the integration of objectives. They asked that development should be for mixed-use, be environmentally-friendly; and should where possible incorporate the reuse of brownfield sites; they also asked that these objectives should be pursued in a way which created employment; integrated local communities (including ethnic minorities); improved security; and generally improved urban life. Actions were also required to focus on support for entrepreneurship and employment; integration of excluded persons; affordable access

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168 The first progress report on economic and social cohesion published in 2002 reported on developments with URBAN II. 2002 - The Programming of the Structural Funds 2000-2006 An initial assessment of the URBAN Initiative (COM/2002/308 final). This was followed up in 2003 - Second Progress Report on economic and social cohesion which included further analysis on the URBAN II programmes and contained a specific section (1.3.2) on urban areas]
to public services; developing more environmentally friendly and integrated public transport systems; waste minimising and treatment, noise reduction and encouraging more efficient energy use; and developing the potential created by information society technologies in the economic, social and environmental sectors. There was also recognition that governance was a major problem within cities. Programmes were asked to ‘demonstrate a commitment to organisation change, participatory governance, empowerment and capacity building transferable into mainstream practice.’

There were key innovations. The inclusion of small and medium sized cities was achieved by modifying the population threshold – a population maximum of 100,000 for the city as a whole was abolished and replaced by a population minimum of 20,000 inhabitants, or even 10,000 in duly justified exceptional cases. The use of a single Fund, the ERDF was aimed to bring about administrative simplification and the second Urban programme halved the administrative effort involved in certain aspects such as payment claims. Exclusion of the European Social Fund did not lead to the loss of training and other social actions to tackle exclusion, since special conditions allowed them to be financed from the investment fund ERDF.

The second Urban initiative was complementary to other cohesion and regional policy investment in urban areas. In programmes with a high intensity of funding (Objective 1 programmes) its main thrust was to promote the role of towns and cities as motors of growth for regions as a whole. In programmes with lower rates of funding (Objective 2 programmes), there was a dedicated urban strand accompanied the industrial strand (which was also largely urban) and covered about 7 million people. Where areas covered by the second Urban initiative were within the geographical boundaries of larger cohesion and regional policy programmes the Urban initiative actions were designed to be complementary to the mainstream programme.

The distinctiveness of the second Urban initiative was to focus on the economic and social regeneration of cities and neighbourhoods in crisis. The target areas were therefore usually small pockets of severe deprivation requiring the integration of different policies in both the conception of the actions and their implementation. Measures tended to focus on social inclusion and physical urban regeneration and most had a strong emphasis on partnership and on the participation of communities themselves in the regeneration process.

8. Regional policy in an urban-setting, urban regeneration as a case study

A regeneration initiative carried out in Liverpool and Merseyside, north-west England, initially for the period 1994-1999 but subsequently extended until 2006, provides an example of regional policy working as urban policy. A feature of the regional programme for Merseyside in this period was the targeting of significant spending on 38 distinct parts of the city-region, home to about 500,000 people and experiencing marked concentrations of disadvantage. Part of the extra finance (about €268 million at today’s exchange rates) was channelled through specially-formed partnerships in the target areas which were required to contain representatives from local residents and community organizations alongside representatives of public agencies, the private sector (where it existed) and voluntary organisations. (In many
respects, the initiative bears a resemblance to the actions under the Leader initiative operated under EU rural development policy, see Chapter IX of this report.)

The instrument for this urban regeneration at the micro-level was EU cohesion and regional policy operated in miniature. The main tools for the policy’s implementation at regional and national level are multi-year development programmes. These set out the priorities for physical investment and investment in people, allocate resources between the projects and establish a calendar to guide progress. For this initiative the 38 parts of the city – the smallest was four streets – followed the same procedure: they drew up multi-year programmes for the regeneration of their area, established priorities and allocated resources. Once the mini-programmes were approved by the city-region, local partnerships representing the regeneration areas worked to put them into effect. The initiative proved, among other things, the versatility of EU cohesion and regional policy procedures.

Objective of the initiative was to help people in the disadvantaged areas of the city-region, who were in danger of being excluded from society and the mainstream economy, to reintegrate themselves. Their areas were characterised by high rates and long-periods of unemployment; insufficient and inappropriate skills among those wanting work; and a heavy reliance on state welfare services. It offered residents of the selected areas a range of ‘pathways’ towards social inclusion – it was called ‘Pathways to Integration’ – involving schemes for education and skills training; jobs; and a better quality of life. Further, it gave residents in the areas assistance (appropriate training) so that they could take a full part in the design, implementation and monitoring of the projects and actions which the initiative would fund in their areas – in other words, so that they were directing their own development policy.

Tackling social exclusion of the depth and scale experienced in the targeted urban areas of Liverpool-Merseyside would take several decades – certainly longer than the initiative’s lifetime. But as an experiment in encouraging local participation in all stages of policy management – design, negotiation with budget authorities, implementation, monitoring – the initiative was a success and was valued by the

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171 Interviews with policy-makers and practitioners and community representatives in the targeted areas revealed the interlocking causes of social exclusion (fragmenting local labour markets, the ‘poverty trap’, caring responsibilities for parents or family members, poor health, poor quality housing) and its (often ‘hidden’) effects (high dependence on tranquilisers, debt, coping with the disappearance of local shops). What came out strongly from the interviews and discussion groups was a near-consensus that social exclusion in the Merseyside city-region was heavily linked to exclusion from the labour market. By the late 1990s, the city-region stood out as having the highest levels of ‘worklessness’ or economic inactivity in Britain (with an economic inactivity rate of just over 30 percent compared with the corresponding figure of 17.5 per cent in South East England). The mapping of ‘Pathways’ areas revealed that worklessness was highly spatially concentrated.

172 At the end of the first programming period there were some 260 residents/representatives of community organizations sitting on the boards or area groups of the 38 ‘Area Partnerships’. The constituencies of these community representatives varied significantly in size from small neighbourhood forums or church groups to large Residents Associations.
inhabitants of the target areas. Elements of it have been incorporated into UK national initiatives for urban regeneration, in particular the current Neighbourhood Renewal Strategy. The local communities felt that their participation in the urban regeneration process should be regarded as a key outcome of the initiative.

One clear result of this experiment in community participation was to demonstrate the complexity of new forms of governance and the consequent need for policy-makers to keep an open-mind in framing and delivering support for urban regeneration. It demonstrated the increasing complexity of modern urban governance. Implementing policy through a multi-layered “partnership” – of EU, national and city government, and local partners – represented an innovation in governance, with several changes taking place at the same time. For example, there was a growing influence of the EU on local policy-making; there was the ongoing re-positioning of central and local government in relation both to each other, to the private and voluntary sectors and to actors drawn from beyond formal institutions of government. These innovations made an already-complex process more so.

It demonstrated the obstacles to full consensus which are represented by such factors as unequal power relations; the clash between professional ‘governance’ cultures and their community-based counterparts; resource and cultural constraints on community participation; the difficulty of ‘reflecting’ fairly the views of heterogeneous communities. It made clear also the importance of trust between local communities and governance ‘experts’ and the crucial importance of time and political commitment – for building the knowledge and human capital and the trusting networks that social capital and participatory policy require.

The ‘Pathways’ initiative did show that communities are willing to engage in policy if there is a genuine desire for their engagement. It also showed that their participation will be sustained and sustainable where a number of conditions are fulfilled: where power is devolved; informal institutional capacity is developed to encourage collaborative working; and trusting relationships are developed between local authorities, agencies and participating citizens. The fragility of this process of social

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173 An evaluation discovered that there had been a rapid growth of third sector businesses in the target areas, providing people with a first step towards full involvement with the local labour market. It noted:

- an evolving institutional diversity – social businesses were establishing themselves alongside more hybrid organisations operating under one umbrella organisation with trading activities and charitable operations funded through a mix of market and non-market sources;
- examples of intermediate labour market projects offering (social) enterprise-led training for individuals and groups of people particularly prone to exclusion from formal labour markets and with employment outputs better than those from orthodox training schemes;
- examples of environmental projects which were particularly important in a local context where environmental improvement was proving difficult to secure;
- the formation of a network of social economy practitioners – the ‘Social Enterprise Network’ – to support and promote the sector locally. The network has gone from 10 founding members to 170.
learning, however, cannot be overstated and efforts are needed to translate it from ‘oral’ culture to a knowledge which is systematized and widely available.

9. URBACT: speeding up policy innovation in the urban mosaic

The EU’s understanding of its own urban mosaic and polycentricity was deepened by work undertaken by ESPON, the European spatial planning observation network (see the first section of this chapter). It was immediately obvious that many parts of the mosaic operate in similar socio-economic conditions, face similar problems and are seeking the same goal of economic growth. It was equally obvious that they were already learning from each other and that there were likely to be gains in policy efficiency if these learning processes could be speeded up and made more effective. Too often, cities were working to invent the wheel when the wheel had already been invented somewhere else in the mosaic.

ESPON research has now gone further and has codified and suggested initiatives which would enable urban policy-makers to benefit from existing knowledge and, with other regions, test out in practice new ideas for policy action. In a recent report, it suggested eleven ways in which public policy in the EU could help cities and towns in polycentric regions to improve the speed of innovation and, thus, their economic development. Half of them suggest the forging of closer links and networks with other cities and towns, either in the same region, its neighbours or even across national boundaries. This section deals with networks for innovation but the full ESPON list was:

- strengthening of several larger zones of global economic integration in the EU, equipped with high-quality, global functions and services, including the peripheral areas, through transnational spatial development strategies;
- strengthening a polycentric and more balanced system of metropolitan regions, city clusters and city networks through closer cooperation between structural policy and the policy on the Trans-European Networks (TENs) and improvement of the links between international/national and regional/local transport networks;
- promoting integrated spatial development strategies for city clusters in individual Member States, within the framework of transnational and cross-border cooperation, including corresponding rural areas and their small cities and towns;
- strengthening cooperation on particular topics in the field of spatial development through cross-border and transnational networks;
- promoting cooperation at regional, cross-border and transnational level; with towns and cities in the countries of Northern, Central and Eastern Europe and the Mediterranean region; strengthening North-South links in Central and Eastern Europe and West-East links in Northern Europe;
- expansion of the strategic role of metropolitan regions and ‘gateway cities’, giving particular attention to the development of peripheral regions of the EU;
• improvement of the economic basis, environment and service infrastructure of cities, particularly in economically less favoured regions, in order to increase their attractiveness for mobile investment;
• promotion of an economic diversification strategy in cities which are too dependent on a single branch of economic activity, and support for the economic development of towns and cities in less favoured regions;
• promotion of integrated urban development strategies sensitive to social and functional diversity. Particular attention should be given to fighting social exclusion and the recycling and/or restructuring of underused or derelict urban sites and areas;
• promotion of a wise management of the urban ecosystem;
• promotion of better accessibility in cities and metropolitan regions through an appropriate location policy and land use planning that will stimulate mixing of urban functions and the use of public transport.  

URBACT (hereafter written as Urbact) is one of the ways in which EU cohesion and regional policy has helped to organise efficient networking systems. It is a spin-off of the second Urban initiative, created to allow cities running programmes and projects under the Urban initiative to exchange experience and share information on techniques for achieving sustainable urban development. Thus it provides support for networks of cities and regions – sometimes as few as five, sometimes as many as 25. The first generation of Urbact networks proved that cities could learn from each other by developing methodologies for the exchange of experience and knowledge. This breakthrough enabled the more rapid dissemination of new ideas and techniques by finding a common format through which the knowledge transfer could take place. Urbact thus became a knowledge exchange, a vital link in creating and spreading innovations in urban policy and practice.

The second phase of Urbact began in 2007 and will run until 2013. It has built on experience gained under its predecessor and introduced a number of innovations.
• Experience had shown that very large networks were hard to manage and the second phase of Urbact has limited the number of cities in each network to ten, or eight for a working group.
• As part of a more rigorous experimental approach, a six-month preliminary phase before the launch of a network is used to complete a study of the subject the network will develop. This baseline study reviews the state of play in the specific policy field in each of the participating cities and thus produces an account of the ‘state of the art’ on the thematic topic. In this way, the second phase of Urbact is becoming a useful source of current, and innovatory, urban practice.

• It is important that the ideas and innovations tested by Urbact frameworks are put into practice. It therefore requires each partner city to produce an action plan to show the innovation under investigation will be put into practice in the framework cities. The action plan, which has to be elaborated by a local support group of stakeholders in the city, will often draw financial resources from the city’s mainstream European cohesion and regional policy programme. This approach takes learning into action and fertilises mainstream development activity with the latest policy innovations.

The programme is also developing methodologies for involving the managers of mainstream EU regional development programmes – known as managing authorities – in the preparation and development of policy innovations. This is already a requirement for some of the ideas investigated under the second Urbact initiative but it is now being generalised and is bringing immediate success. The 19 networks which successfully completed their development phase in December 2008 involved 180 managing authorities – about half the total number in the EU. This is raising the awareness and understanding of urban needs among the bodies which are managing the financial resources of EU cohesion and regional policy – about €50 billion a year – and giving them the opportunity to incorporate state-of-the-art policy into their development practice.

The sharper focus on bringing the results of network-based learning back to each city is already bearing fruit. Cities are now using case studies and field visits to help city managers and politicians to make decisions about future directions of development. For example, cities are taking a prominent position in debates about how to innovate to tackle problems related to climate change, the economic crisis, demographic issues and migration and globalisation itself. The second Urbact initiative is a small programme in terms of cost, costing approximately €30 million over six years, about one ten-thousandth of total EU cohesion and regional policy expenditure, but is already having a significant impact. It is proving a cost effective means of kick-starting policy innovation in mainstream development programmes.

10. Mainstreaming urban policy in regional development programmes

The role which the EU urban mosaic can play in securing a faster rate of economic growth for the Union is now firmly entrenched in the policy’s implementation. All EU cohesion and regional policy programmes approved since 2007 are recommended to contain a development priority to support urban development – before that date some programmes made no mention of their distinct growth potential. This priority may take the form of a specific urban ‘vertical’ priority in the programme, or be present as a cross-cutting theme. Now, it is sure that urban and economic development can take place in a more integrated way, so that the benefits of infrastructure investments, for example, and schemes for the support of SMEs and innovation will be more accessible for urban businesses.

Some programmes delivering a high intensity of financial support to lagging regions had emphasised since 1994 urban aspects of growth and had integrated urban
investments with other priority actions. The programme for the city-region of Liverpool-Merseyside with its ‘Pathways to Integration’ initiative has already been mentioned and is an example. ‘Pathways’ was intended to assist residents of the 38 poor areas to gain access to economic opportunities being developed through other investments by the main programme for regional development – for example the redevelopment of the Speke Garston industrial area. The region also sought to develop its cultural industries and such actions built a strong platform of event spaces and activities which helped Liverpool to become the EU Capital of Culture in 2008, with consequent growth in the tourism sector.

But it took a change in the law which underlies EU cohesion and regional policy to drive home the lesson that the EU’s urban mosaic is a generator of economic development and growth. The current maw states:

‘In view of the importance of sustainable urban development and the contribution of towns and cities, particularly medium-sized ones, to regional development, greater account should be taken of them by developing their role in programming to promote urban regeneration.’

This reflects the EU’s new determination to make specific provision in its cohesion and regional policy to support sustainable urban development. The law also mentions supporting polycentric development including the improvement of urban networks and urban-rural links as well calling for strategies to tackle common urban-rural problems.

According to an analysis carried out by the European Commission in 2007\textsuperscript{175}, for the first 300 programmes to be approved by the European Commission for the years 2007-2013 about six per cent of the total finance had been ‘earmarked’ for urban regeneration and development. Within this envelope, approximately £ 3.3 billion was intended to prepare former industrial sites, brownfield sites, for re-use; £ 8.3 billion was set aside for the regeneration of urban and rural areas; and £ 7 billion for investment in urban transport infrastructure. In addition, £ 900 million had been allocated for the improvement of housing.

A detailed analysis of 23 programmes, about five per cent of the total, showed planned expenditure on urban investment is a good deal higher than 6 per cent, in fact between 10 and 30 per cent with the higher figures in EU15 Member States where the urban mosaic and polycentricity of cities are most dense. In programmes delivering the highest intensity of financial support – those in the poorest regions – urban operations are generally focused on improving the natural and physical environment, accessibility and mobility as well as social inclusion and support for SMEs. In regions where the emphasis is on improving competitiveness and where aid is less intense, there is a concentration of financial support on innovation and actions for SMEs which will heighten their links with the knowledge economy as well as integrated actions targeting disadvantaged neighbourhoods.

\textsuperscript{175} The Territorial and Urban dimension in the National Strategic Reference Frameworks and Operational Programmes (2007-2013). A first assessment – May 2007
As well as the formal programme activity described above the European Commission has also stimulated a wider dialogue on urban matters using a range of new instruments. These have included regular city summits since 1999.

The European Commission and European Parliament have continued an ongoing discourse on urban issues. This included the 1999 Action Plan for Sustainable Urban Development\(^{176}\) Framework for action for sustainable urban development'. In 1997 an observatory was established to carry out an Urban Audit\(^{177}\) to create a new set of urban indicators that can work in different EU Member States.

**Part III: Conclusion**

11. Where next? Should urban policy in the EU continue to be part of cohesion and regional policy? Or should it become a distinct entity?

This chapter has related how an urban policy has developed out of EU cohesion and regional policy in response to the understanding of the nature of the Union’s urban mosaic. Whereas, the first awareness of cities and towns was of the problems caused by industrial restructuring or the existence of areas of severe deprivation, they are now seen as the important motors of growth and development. In line with this changed perception, EU cohesion policy has developed new instruments for urban areas: its first step demonstrated that the policy could operate at the micro-level by ‘miniaturising’ its programming and implementation procedures (examples, the Urban initiatives and ‘Pathways to Integration’); its second step has been to promote networking between cities and towns so that they form ‘virtual’ clusters sharing knowledge and experience in the search for a development advantage (example, the Urbact initiative). Does this indicate the path for policy development through the mid-term, with urban policy remaining as a component of cohesion and regional policy?

Continuation among this route would ensure that faster economic growth and greater competitiveness remain the ultimate targets both for cohesion policy and urban policy, although it would be pursued – as it is now – within the constraints imposed by other policies, for example on global warming. In other words, the dual nature of cohesion and regional policy – and, thus, of its urban policy component – would continue to be important. It would continue to be a policy in its own right, with its own objectives, and at the same time it would remain the instrument of other policies, helping them to achieve theirs.

But, as this chapter has also pointed out, the new Lisbon Treaty has introduced the concept of territorial cohesion. Does this mean that the way forward for policy is to distinguish between types of territory – urban, rural, mountain regions, sparsely-


\(^{177}\) *Urban audit* [http://ec.europa.eu/regional_policy/urban2/audit_en.htm](http://ec.europa.eu/regional_policy/urban2/audit_en.htm)
populated regions, islands, border regions? At present EU cohesion and regional policy distinguishes between regions on economic grounds. There are those which are poor, where GDP per head lags well behind the Union’s average (the threshold being at 75 per cent of EU GDP per head) and those which need to improve their competitiveness in order to compete in globalised markets (in effect, all other regions, or parts of all other regions). A third category is the regions taking place in trans-frontier or trans-national activity – which, again, is an opportunity open to all regions. Should this economic classification be dropped in favour of one based on geography or topography?

This chapter – and the preceding one in this study – have discussed the dichotomy between urban and rural regions. Although it is useful to policy-makers in China, who are pursuing their policy objectives in a country making a rapid transition from a rural to an urban society, it has less value, or no value, in EU policy-making. This chapter has shown that the EU’s urban mosaic exerts a major socio-economic influence over EU territory and, indeed, a study of the map in Figure 6 shows very few areas which are not within a 45 minute drive-time of an urban centre – in other words, within a convenient commuting or shopping-journey. On this basis, persistence of the urban-rural dichotomy in the EU may be considered as an anachronism, a reflection of the inability, or reluctance, of policy-makers to convince people living in the countryside that their socio-economic position is tightly bound to the fortunes of urban areas. This suggests that the socio-economic problems of rural areas are dealt with equally well – perhaps, even, better – by regional policy as by rural policy.

Then, there are the city interests. Are the problems and interests of cities and towns similar regardless of the socio-economic position of the wider region, just differing in degree if the whole region is poor? Or are there qualitative differences which merit different policy treatment? Expressed in concrete terms, should EU policy treat the poverty problems of inner-London, for example, in the same way that it treats them in Romania? Will the same policy frameworks function with a different balance in the menu of actions?

Similar problems exist when the focus switches to mountainous regions or to islands or to sparsely populated or border regions. Is the purpose of cohesion policy to compensate them for their less favourable topographical or geographical position – which will be a permanent task because their topographical or geographical position will never change? Or is the policy’s purpose to incite them and help them to discover and exploit their potential for economic improvement, so that their rate of economic development increases and the disparities between their socio-economic position and the Union average diminish?

It may be that some of these questions will become prominent as the Union seeks to define its new policy concept of “territorial cohesion.” But this chapter has not set out to answer them, although discussion of polycentricity does throw light on the urban-rural dichotomy. Instead this chapter has sought to show that while EU urban policy remains as part of cohesion and regional policy:

• there need be no conflict of interest between the two, though this will depend on different levels of government working towards common aims;
• the objectives of cohesion and regional policy are valid for urban policy and serve to stimulate urban development;
• urban policy within cohesion and regional policy can also contribute to the wider objective of faster EU growth by being the instrument of other policies, but the policy will need to adapt and support working arrangements at the level of functional urban areas that operate at the sub-regional level and across regional and, at times, national boundaries;
• cohesion and regional policy can enable its urban policy element to tackle ‘pockets’ of urban deprivation since its basic mechanisms (programming, partnership) can be ‘miniaturised’ to provide a micro-policy; a “fractal” approach to programming, for example, might encourage the development of programmes at the micro-spatial level which be integral to regional and national plans; indeed, such “fractal” programmes could be the building blocks of regional and ultimately, national plans;
• urban policy has been able to develop its networking instruments to gain a benefit from the EU’s urban mosaic.

There is, therefore, no conflict for EU cohesion and regional policy in operating at different levels –regions, smaller city-regions, neighbourhoods. Indeed, operating urban policy as part of wider cohesion and regional policy enables it to confront urban deprivation with tried and tested techniques for implementing development policy – techniques which have proved their value in city neighbourhoods and in rural villages, since the Leader initiative, in effect, applies regional instruments on a micro-scale. A policy that is sensitive to the different scales of intervention is better adapted to maximising economic efficiency and to the needs of multi level governance arrangements.

The main advantage of organising development assistance for neighbourhoods or rural villages as part of a city-region or region-wide programme is that poorer localities can more easily tap into the economic development opportunities that are stimulated at regional level. For example, the organisation and timing of local training schemes, investment projects, and community development can all benefit by being integrated into the wider effort for regional development – as the ‘Pathways to Integration’ initiative was integrated in Liverpool-Merseyside. There will also be advantages of flexibility in financing and in programming which would not be available in smaller, more narrowly-drawn programmes. This would suggest that policy-makers seeking urban development should oppose any fragmentation of cohesion and regional policy. They might even seek to ensure that it covers rural communities to counter any tendency to replace its economic growth objective with one which seeks to compensate for territorial handicaps. A second advantage of operating neighbourhood policy with an eye on the city region is that it helps to avoid the negative externalities and spill-over effects which may result from targeting only some of the disadvantaged neighbourhoods in a city.

One factor of overwhelming importance whatever structure is chosen for urban and rural development policy – and for cohesion and regional policy in general – is the availability of qualified personnel to implement and manage the development effort. In both urban and rural areas, this is frequently done with local partnerships and, as
we have seen, the task of ensuring that local people can work in harmony with other levels of government is complex. Experience with the ‘Pathways to Integration’ initiative and in the first and second Urban initiatives demonstrates that a common factor in their success is the added concentration and extra effort put in by personnel at all levels of government. Such close attention helps these schemes and others like them, to work on an experimental scale and to achieve important results with relatively small amounts of finance. But the fruits of such experimental work can only be achieved when the innovations are rolled out across the whole region, and across all regions. This is the ultimate challenge and it is one which is difficult to meet – too frequently the construction of policy is blamed for indifferent results when the fault has been poor and patchy implementation. In this respect, innovations in policy and its implementation are similar to those in industrial processes; they require knowledgeable staff to make them work.

Policy-makers and practitioners in the EU who are working for regional, urban and rural development are pursuing multiple goals. They seek to devise policies to enhance economic efficiency and competitiveness and to improve the life quality of citizens. But their objectives all reduce to one: they are looking for ways to make regional and local economies, whether urban or rural, grow more quickly, and in a more balanced way. If they succeed in this quest they will reduce income and wealth disparities both at the regional level and for citizens. The urban and regional strategies which they choose will have a decisive effect on the environmental, economic and social impact of cohesion and regional policy and, in this increasingly complex world, arrangements for governance are of critical importance.

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Chapter VIII: The Challenge of Migration: Contrasting Experiences of Europe and China

by Jon Bloomfield

1. Introduction

The movement of people has been a historic constant, an endless reminder that the only absolute is change. This paper has been written in Birmingham, a classic example of a city created by migration. In 1750 its population totalled 24,000. With the onset of the Industrial Revolution, canals and the steam engine, the place changed beyond all recognition. By 1801 its population had trebled to 71,000 and from then it grew nearly six-fold to reach 401,000 by 1881. By World War I it had more than doubled again.

This picture was reproduced all over Great Britain. This was the era of the enclosure movement as peasants and labourers left the land to work in the new factories and furnaces of industrial Britain: the classic picture captured by Friedrich Engels in *The Condition of the Working Class in England* and more literally in the novels of Charles Dickens. Throughout the 19th century this was a story repeated across Continental Europe. Indeed, as the tens of millions leaving the land were unable to find enough work in the mills, mines and plants of Europe, so they also emigrated, above all to the United States. In the century after 1820, sixty million Europeans crossed the Atlantic to settle abroad. From 1892-1924, 5,000 migrants a day passed through the emigration offices on Ellis Island, passing New York’s Statue of Liberty.

Migration is a constant accompaniment to economic and social development. Yet with globalisation it has assumed renewed political prominence. This paper analyses the scale and flows of migration within Europe in more recent times and compares it with migration flows within China, which is at present passing through that stage of economic development characterised by high migration from the countryside to cities. It assesses the range of responses that are open to policy-makers in response to these developments. It suggests some common as well as distinctive options that are open to policy-makers in both Europe and China. An annex examines in more detail the recent influx of East European, mainly Polish, workers into the West Midlands region of England and looks at the arrival of newcomers onto China’s eastern coastal seaboard, above all Beijing.

2. Comparisons and Contrasts

There is no doubt that large-scale and rapid migration flows present major dilemmas for policy makers. In looking at this issue, the significant differences between Europe and China...
must be stated at the outset. Europe is a mosaic of nation states, most of which are of relatively recent creation. By contrast, China’s foundation can be dated from the Qing dynasty more than 2,000 years ago. As such it is the world’s oldest unitary state, perhaps better conceived as a civilisation rather than as a very large nation state. Europe is composed of well over thirty sovereign nation states, most with their own distinctive culture, language and political institutions again in contrast to China’s relatively unified polity – although the degree of autonomy exercised by China’s thirty-one provinces should not be overlooked. Furthermore, the history of Europe has been one of sharp internal conflicts and bitter wars, which have left their trace in historic enmities between neighbours. Thus when large numbers of migrants come to European cities from other parts of their Continent they are crossing historic borders, speaking a different language, often using a new currency and moving to a country with which historically their ancestors may have been at war in the relatively recent past. Little of this applies to Chinese rural labourers moving into Chinese cities.

Of course, these elements apply to the millions of non-European migrants who have entered Europe since the Second World War from the developing world, who in addition have had to encounter the reality of racial discrimination. To date, the phenomenon of non-Chinese migration into China has been relatively rare, although the emergence of China as a powerful, dynamic economy may begin to change that in the decade ahead. Furthermore, China has not been a destination for asylum seekers and refugees, which has been a significant additional pressure point upon European countries. Thus while the policy of the European Union (EU) on population movement has to take account of these three elements – internal; from beyond the EU; and asylum seekers and refugees, Chinese policy has to date focussed almost exclusively on the issue of internal population flows.

3. Population movement within and into Europe

Since the Second World War the trend of rural de-population has intensified across Europe. The pace and timing of this phenomenon has varied but not its direction. The concentration of economic activity, at first manufacturing and later tertiary within urban areas has accelerated while the automation of many agricultural activities has reduced the need for farm labour. In the decades after the war the powerhouses of Germany, France and Northern Italy drew labour firstly, from their rural hinterland and then beyond their borders from Spain, Greece, the former Yugoslavia and Turkey. The major colonial powers, notably Britain, France and the Netherlands found alternative sources of labour from their recently independent colonies. The status of these migrants varied enormously from country to country but by the 1980s many of Europe’s major cities were increasingly multi-ethnic.

The impact of globalisation has reinforced these trends. Firstly, the collapse of the Berlin Wall and the integration of the former state socialist systems into the world economy have given a huge boost to economic activity and trade. Secondly, the ease of global

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A sign of possible future trends is that an estimated 10,000 African migrants trade and work in Guangzhou. See *Monocle* February 2008
communication – internet, mobile phone, satellite television – and extensive, cheaper air travel has expanded people’s horizons. Thirdly, the disarray arising from the end the Cold War led to an explosive cocktail of civil wars and conflicts causing new flows of refugees and asylum seekers.

The impact on Europe has been enormous. Accurate figures are hard to come by, partly because countries count newcomers in different ways, partly because much of the migration is illegal and therefore unrecorded in the official statistics. Table 1. illustrates the long-term trends and shows clearly the consistently higher levels of net migration which Europe has been experiencing over the last two decades.

Table 1. Net Migration 1960-2005 within the EU 25

The following examples indicate the scale of change.

- Spain offers the most dramatic picture of these accelerating trends. Official estimates are that 4.5 million people have migrated to Spain in the five years from 2000-2004, equivalent to a 10 per cent increase in the population, with large numbers coming from both North Africa and Latin America as well as significant numbers from the former Eastern bloc.181
- Italy also illustrates the rapidly changing picture. In 2006 regularised immigrants amounted to 3.7 million people around 6.2 per cent of the total population, with more than 700,000 having come in a twelve-month period. Romanians form the largest component (15 per cent) followed by Moroccans, Albanians, Ukrainians and Chinese.182
- In response to the situation of illegal migrants who had entered their country to work both the Italian and Spanish governments have organised amnesties. In July 2006 the Italian government regularised the position of 517,000 previously clandestine workers, many working in the agricultural sector while in 2003 the previous government had regularised the position of 690,000

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181 Financial Times 25 May 2005
irregular migrant workers. In the most recent amnesty organised by Spain 700,000 migrants were registered.

- The emergence of a rising number of refugees has also affected the number of newcomers to Europe. In 1987 the number of new asylum applications to the EU stood at 163,000. By 1991 they had risen to 511,000 and from 1991-1993 a total of 1.7 million applications were made. Numbers then fell, rose around the turn of the century and are now falling sharply again.

These examples give a flavour of the tempo of migratory change within Europe. The number of third-country nationals – that is legal migrants from non-EU countries – residing in Europe in January 2006 was 18.5 million, almost 4 per cent of the total EU population. When the children of migrants are taken into account, the total percentage of those legally residing within the EU whose origins are from outside it is significantly higher. The reality today is that the EU15 is an immigrant bloc with countries on its periphery that used to be large emigrant countries such as Ireland, Portugal, Italy and Greece as well as Spain having been transformed within a generation into majority immigrant receiving countries.

4. The Move from East to West

While all three elements of the migratory picture described above have been present, there is no doubt that the fall of the Berlin Wall has had a profound effect on the population movement of Europeans within Europe. This was most dramatically indicated by the mass exodus of hundreds of thousands of East Germans into West Germany immediately after 1989. This wholesale population shift has decimated scores of East German cities, denuding them of many of their most talented and younger citizens, leaving whole housing areas empty and derelict. Since then large numbers of Eastern Europeans have sought – legally or illegally – to make their future in other parts of the EU 15.

The official entry of eight central and eastern European states into the EU along with Malta and Cyprus on 1 May 2004 has further accelerated these trends. Initially only three countries – Sweden, UK and Ireland – gave citizens from these states – the A8 countries as they were termed – unlimited access to employment. The other states introduced transitional arrangements which deferred the introduction of part of Community law on the free movement of workers across the enlarged EU for a maximum seven year period. Yet EU membership gives citizens the unrestricted right to travel and there are no barriers to self employment or undeclared or ‘black market’ work. Furthermore, individual countries are able to issue work permits. Official data shows high numbers of short-term work permits issued to A8 nationals in both Germany and Austria during 2004 and 2005.

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183 Le Monde 23-24 July 2006
184 Data on new Asylum applications to the EU drawn from Eurostat.
The first wave of post-2004 migration has undoubtedly had the most impact in the UK and Ireland. Official statistics indicate that more than 750,000 east and central European immigrants, an overwhelming majority of them Polish, have flocked to all parts of Britain since the eight former eastern bloc countries joined the EU in 2004. After the entry of the A8 countries on 1 May 2004 125,880 people moved to the UK. This rose to 204,970 in 2005 and increased further to 227,875 in 2006, while dipping slightly to 206,905 in 2007. However, it is believed that the actual numbers of East Europeans working in the UK economy is significantly higher, since there are no restrictions to working on a self-employed basis and there is widespread evidence of the engagement of European workers in the informal and underground economy.

The Case of Poland

The extent of Polish out-migration has been very substantial but the authorities have found it difficult to track. The Polish National Statistical Office issued an official document in autumn 2007 which gave their best estimations of the total number of Polish persons staying abroad for longer than two months at a given moment in time. The core figures are set out in the table below.

Table 2. Polish Temporary Out-migration 2002-2006

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<tr>
<th></th>
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<tbody>
<tr>
<td>Total</td>
<td>786</td>
<td>1000</td>
<td>1450</td>
<td>1950</td>
</tr>
<tr>
<td>Europe</td>
<td>461</td>
<td>770</td>
<td>1200</td>
<td>1610</td>
</tr>
<tr>
<td>EU 25</td>
<td>451</td>
<td>750</td>
<td>1170</td>
<td>1550</td>
</tr>
<tr>
<td>Austria</td>
<td>11</td>
<td>15</td>
<td>25</td>
<td>34</td>
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<tr>
<td>Belgium</td>
<td>14</td>
<td>13</td>
<td>21</td>
<td>28</td>
</tr>
<tr>
<td>Finland</td>
<td>0.3</td>
<td>0.4</td>
<td>0.7</td>
<td>3</td>
</tr>
<tr>
<td>France</td>
<td>21</td>
<td>30</td>
<td>44</td>
<td>49</td>
</tr>
<tr>
<td>Germany</td>
<td>294</td>
<td>385</td>
<td>430</td>
<td>450</td>
</tr>
</tbody>
</table>

Following Poland’s accession to the EU the number of people leaving Poland – temporarily or permanently – has risen sharply. In 2002 some 0.8 million Poles stayed abroad for longer than two months. This number rose to one million by the end of 2004 and to almost two million by the end of 2006. The direction of migration has changed too, with the EU now accounting for 80 per cent of Polish migrants, displacing the previously dominant position of the United States. Three key factors stand out. Firstly, the huge rise in the numbers going to the UK. Secondly, the very fast growth in migrants to Ireland from a negligible base. Thirdly, the continuing large numbers working in Germany despite the controls of their work permit system.

In comparison to most other parts of Europe, Poland retains an extremely high rural population amounting to 38 per cent of the total. In this sense, there are some parallels with China. The expectation must be that this population will fall rapidly in the coming decade, providing a new flow of migrants into either urban Poland or the rest of the EU. It is noticeable that to date it appears to have been mainly urban Poles and young people with higher education who have migrated to the EU 15.

The Polish economy shows renewed signs of growth. At the same time Poland is the beneficiary of the largest investment of EU resources to a single Member State within the 2007-2013 Structural Funds programme. This programme will be worth more than €65 billion to Poland over a nine-year period. Following from that of its predecessor from 2004-2006 it is already stimulating significant development within the Polish economy and modernising its infrastructure. However, the migration of labour to the EU15 is causing acute difficulties for employers and public authorities. An indication of the extent of the difficulty facing Poland is evident in the type of events which employers’ organisations are currently hosting. For the British Polish Chamber of Commerce in Lower Silesia the shortage of skilled labour is “the most pressing topic for Poland’s entrepreneurs and business leaders in the coming years.” It states unequivocally that “the single biggest economic challenge

<table>
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<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td>10</td>
<td>13</td>
<td>17</td>
<td>20</td>
</tr>
<tr>
<td>Ireland</td>
<td>2</td>
<td>15</td>
<td>76</td>
<td>120</td>
</tr>
<tr>
<td>Italy</td>
<td>39</td>
<td>59</td>
<td>70</td>
<td>85</td>
</tr>
<tr>
<td>Netherlands</td>
<td>10</td>
<td>23</td>
<td>43</td>
<td>55</td>
</tr>
<tr>
<td>Portugal</td>
<td>0.3</td>
<td>0.5</td>
<td>0.6</td>
<td>1</td>
</tr>
<tr>
<td>Spain</td>
<td>14</td>
<td>26</td>
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<td>Sweden</td>
<td>6</td>
<td>11</td>
<td>17</td>
<td>25</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>24</td>
<td>150</td>
<td>340</td>
<td>580</td>
</tr>
</tbody>
</table>

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facing Poland’s business and government today is its people – skilling and re-skilling, recruiting, retaining and developing them. As the exodus of the country’s talent continues, new solutions are needed if the country is not to be left without a workforce sufficient to maintain its social infrastructure.”

Poles and the West Midlands of England

The West Midlands, with 5.3 million people, contains almost 10 per cent of the UK population. It combines a traditional industrial heart now rapidly being transformed with a significant rural hinterland. Both parts of the region have seen a significant influx of overseas labour in recent years. The official Labour Force survey for 2006 stated that the region had 122,000 migrant workers, representing 4.9 per cent of the total labour force. The Workers Registration Scheme is the documentation scheme which operates for A8 nationals officially employed within the UK. The data shows that from May 2004 up to March 2007 there were 47,000 approved applications for work within the West Midlands from A8 nationals. Of these applications Poles accounted for 69 per cent.

A sample of the views of these newcomers to the West Midlands drawn from focus group sessions undertaken as part of this study is attached in the annex to this paper.

The region has been accustomed to migrant labour since the Industrial Revolution. Originally, people came from other parts of Britain. Since the Second World War there have been flows of newcomers from Ireland, the West Indies and India, Pakistan and Bangladesh. In the urban core of the region, approaching one-fifth of the current population is of recent immigrant origin. The large inflow of newcomers from Central and Eastern Europe is a new phenomenon however. The official figures are believed to under-estimate severely the actual number of migrants since they do not count either the self-employed or those working in the ‘informal’ economy.

A report by Warwick University shows that recent migrants to the region have a mixture of origins and that there is a significant element from the Asian sub-continent as well as from the A8 countries. The report undertook a sample survey of 712 recent migrants. This found that migrant workers are predominantly young with more than four-fifths from A8 countries under 35 years of age. They are heavily concentrated in lower skilled jobs, as factory operatives or in elementary manual work including cleaning and personal services, as well as warehousing. There are also a significant number engaged in farm work, notably fruit and vegetable picking and packing. Many of these migrant workers had previously been in higher skilled jobs or had been students. The reasons for coming to the UK were primarily economic, a chance to earn more money than was possible in their native country but also to improve their English language, which is seen as a major asset for their latter career. A

189 All data drawn from The Economic Impact of Migrant Workers in the West Midlands.(November 2007) Anne E. Green, David Owen, Paul Jones, Institute for Employment Research, Warwick University.
large majority of the A8 nationals live in private rented accommodation, often sharing with others. As a new phenomenon, there remains uncertainty as to how permanent the migration of A8 nationals will be. Indeed, the survey and follow-up focus groups confirmed this. Whereas, the picture with most migrants from the Asian sub-Continent is clear, that of the A8 migrants is far less certain. The survey showed considerable doubt as to how long they intend to stay in the UK; significant fluidity in their plans and thinking on the topic; and strong indications that developments in their home country would influence their decision. As one interviewee expressed it, “now is not a good time to go back to Poland. Maybe I think that the next three to four years will be better.”

This presents genuine difficulties for policy-makers. The speed and scale of the inflow of migrants from A8 countries was a big surprise. Employers have welcomed the chance to recruit able and committed staff at relatively low rates of pay. The survey of 223 West Midlands employers in the Warwick University report cites three main advantages in using A8 nationals: they are hard-working; reliable; and have a good work ethic. Of the employers surveyed, 90 per cent were either very or quite satisfied with their experience of employing migrants. Yet there is consistent polling evidence that the extent of migration has caused unease amongst the wider population and resulted in mixed policy messages from the main political parties. Nobody is sure whether present trends will continue or if the influx of labour from the A8 countries was a one-off surge which will now abate. With the Polish economy already growing at an impressive rate, there are the first indications that some migrants are returning home and that the flow to the West is slowing. A return of the majority of recent A8 migrants remains improbable but the sheer uncertainty amplifies the difficulty for policy-makers to achieve effective integration.

Wider Implications

The extent of the new migrant influx, then, has taken the authorities by surprise. It has been welcomed by many employers who have found a ready supply of cheap labour and the Governor of the Bank of England has noted that this influx of labour has helped to keep down wages rates. However, there are indications of considerable public disquiet at the scale and speed of this migration with many negative stories in the newspapers. As a consequence the UK government decided to apply the option of transitional arrangements for Romanian and Bulgarian citizens when they entered the EU in January 2007. For these A2 countries, the UK has deferred the introduction of part of Community law on the free movement of workers across the enlarged EU for the time being. The available evidence suggests that this has significantly restricted the numbers entering the UK from these countries.

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190 Ibid. pp36-78
191 Ibid. pp80-82.
192 Ibid. pp89-100
The extent of political unease cannot be underestimated. Large migrations are one of the most obvious signs of globalisation and the scale and pace of the change reinforces a feeling amongst many citizens that this process is uncontrolled and unmanaged. It appears to have been a factor in the rejection of the Lisbon treaty by Ireland in the referendum on 12 June 2008, while it undoubtedly played a major role in the Italian general and Rome municipal elections in spring 2008. Here, the extensive influx of Romanians, including many gypsies, into the country became a key election issue with the winning parties indicating a wish to exclude or at least severely restrict their numbers.

Yet some perspective is needed when these figures on population movement across Europe are considered. The general position remains that most Europeans are extremely reluctant to look for work in another EU country. Currently, less than 2% of EU citizens live and work in a member state other than their country of origin. This figure has not changed for more than three decades. It remains to be seen as to whether the sudden influx from a number of A8 and A2 countries into parts of Western Europe is a short-term one-off or whether it will become an established pattern which signals a shift in European labour mobility.

The free movement of people is one of the fundamental rights guaranteed by Community law, yet up until the 2004 enlargement there was no large scale take-up of this right by Europeans. A survey of 24,000 EU citizens in 2005 found that concerns over a lack of language skills (50 per cent) and adapting to another culture (20 per cent) were key factors in discouraging people from looking abroad. In addition, people did not want to lose direct contact with their family and friends as well as crucial support for every-day life in terms of childcare or care for the elderly. The survey also confirmed that there is a weaker labour mobility culture in Europe as compared to the United States with the average duration of employment in the same job being 10.6 years compared to 6.7 years in the US. This complements other studies which show much lower labour mobility across Europe when compared to the United States. Such findings suggest that within Europe the impetus for labour mobility occurs when there are sharp wage disparities, so that those migrating can earn considerably more than in their own country; that migration is a more attractive proposition for younger people without family responsibilities; and that those with relevant language skills are more likely to consider it.

5. Europe’s Changing Labour Market

Migration is just one element of Europe’s fast-changing labour market. The reality is that contemporary European working patterns are vastly different from those of three decades ago. The age of large-scale, smoke-stack industry has gone from Western Europe. The impact of the ICT revolution means that the nature of work and the average size of the workplace has changed and continues to change apace. In terms of factories and offices there has been a reversal of the trend towards larger workplaces. Instead of a concentration of labour, there is now dispersal. Accompanying and reinforcing this shift, the last three decades has seen a vast expansion of female employment, a significant rise in part-time

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193 Eurobarometer 64. Survey on geographical and labour market mobility.
working and a significant increase in numbers of migrant workers. In sociological terms, what we have seen since the 1970s is the demise of the traditional, male, white manual working class and the appearance of a much more heterogeneous, diverse labour force. Today, the world of work, the very nature and character of that work has been enormously transformed. This means that coping with differentiation is crucial to the success of the European labour market.

In shaping its response to these changes European policy, in its turn, is shaped by a number of core principles. At their centre are three values whose origins spring from the Enlightenment and the French Revolution of 1789, encapsulated in the slogan of liberty, equality and solidarity. As political parties began to form in 19th century Europe they drew these values into their political philosophies, all three being enhanced by the gradual movement towards universal suffrage. The emphasis on each value has varied, depending on whether the party was of the Right, Centre or Left, but within mainstream parties the three values are ever-present in their philosophies and policies. This was reinforced by the experiences of the inter-war Depression, the rise of fascism and the Second World War. After the War, a commitment to the social market economy and welfare states emerged in the core countries of Continental Europe as a compromise between social and Christian democracy and this development shaped the development of the European Community.

While initially Europe’s focus was on removing trade barriers and boosting agricultural production, the European project was never just the creation of a free trade area. In accordance with its values, economic efficiency goes hand in hand with social justice and gradually, in response to major socio-economic changes, the Community developed appropriate policies and funding programmes. In particular, it recognised that as it moved towards a single market it needed to develop its labour market and to introduce instruments to reduce economic imbalances and uneven development across the European economic area. In particular, it introduced multi-annual Cohesion Policy, Regional Policy and Employment Policy programmes to deal with the consequences of socio-economic transformations occurring within Member States as national economies became more integrated. During the 1980s and 1990s these programmes grew vastly in importance and size, accounting by the end of the century for approaching 40 per cent of the EU budget. Two main funding instruments were developed: the European Social Fund (ESF) which is designed to promote employment, skills and training across Europe; and the European Regional Development Fund (ERDF), designed to renovate the physical and economic infrastructure and business capacity of lagging regions.

Not only has the EU tried to ensure solidarity and social cohesion, it has also responded to growing pressures for equality. As the Community developed a more democratic dimension with the establishment of a directly-elected Parliament, it came under more pressure from growing social movements, above all feminism, and some Member States to embrace a wider equality agenda. Thus today, equality of women and men is a fundamental principle of EU Law and as such is enshrined in EU Treaties. According to Article 2 of the EU Treaty it is one of the tasks to be promoted by the Community. Article 3 lays down the principle of gender mainstreaming by stating that: “in all its activities referred to in this Article, the Community shall aim to eliminate inequalities and to promote equality, between men and
women.” Further, Article 13 which was introduced by the Treaty of Amsterdam in 1997 provides for pro-active measures “to combat discrimination based on sex, racial or ethnic origin, religion and belief, disability, age or sexual orientation.” As these additions have been made, the European Commission has attempted to integrate the dimension of equality into EU funding programmes. In several respects this has mirrored activity in a number of Member States where a variety of schemes – positive action, positive discrimination, targeted programmes – have been introduced in order to tackle discrimination, whether of gender, race, age or disability, and to promote equality.

This process has not been without controversy. Over the last three decades the ‘social Europe’ outlook has been fiercely challenged by the neo-liberal Washington consensus and the advocates of a more Anglo-Saxon model of economic and social development. This thinking has undoubtedly shifted the EU’s centre of political gravity, as advocates of small government, supply-side economics, and less regulation have assumed the political ascendancy. Thus the size of the EU budget as a proportion of EU GDP has continued to shrink so that it is now less than 1 per cent, while measures to adopt European-wide regulations to limit the working week to 48 hours or to offer protection to the growing numbers of temporary and agency workers have been fiercely contested.

In 1997 the EU adopted an employment strategy which aimed to reduce unemployment and gender gaps while promoting sustained increases in employment rates. This policy is further evident in the so-called Lisbon Guidelines adopted in 2000 as the means for the Union to improve its economic record. The objective of the guidelines – which have a strong supply-side emphasis – is for the Union to become the world’s most successful and dynamic economic region by 2010. But progress proved extremely disappointing and the Union was compelled in 2005 to provide a tighter focus on growth and jobs by outlining a set of Guidelines with 24 key tasks, the first sixteen relating to broad economic policy and the last eight relating to employment policies.

The 2005 document again has a strong supply-side emphasis and sets the objective of drawing more European citizens into work. Thus the employment guidelines seek to achieve an overall employment rate of 70 per cent by 2010, with a specific target of a 60 per cent rate for female employment (Guideline 17). Seven further guidelines outline a range of activities that Member States are expected to pursue in order to achieve these targets, a number of which are relevant to Europe’s migrant workers. For instance Guideline 19 states the need to “ensure inclusive labour markets, enhance work attractiveness and make work pay for job-seekers, including disadvantage people.” It lays emphasis on action to promote access to employment for immigrants and minorities, as well as disabled people. Further, Guideline 20 speaks of the need to “improve matching of labour market needs through... removing obstacles to mobility for workers across Europe ... and appropriate management of economic migration.

Overall, these Lisbon Guidelines are designed to help Member States to promote labour market participation from all sectors of the population. Contemporary reality suggests that

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in an era of globalised financial markets, very high levels of labour force participation are required in order to provide the tax revenues necessary for the strong social and welfare policies which have traditionally been enjoyed in many parts of Europe. This requirement is reinforced at a time when wider changes in society are having an economic impact. Medical and social advance means that people are living much longer, which is putting new strains on European pensions and social security systems. This reinforces the drive to draw more people into work and lift overall economic activity rates.

For policy-makers, maximising the capabilities of migrants is a particular objective, although it should be noted that their prime concern is migrants from the Mediterranean basin, North Africa and the Asian sub-continent where the economic participation rate of women is especially low. The overall employment rate of non-EU nationals is on average much lower than that for EU nationals while the unemployment rate is often more than twice as high. Thus, for policy-makers a number of different elements converge. Discrimination in the labour market – both in access to the market and within it – is contrary to both European values and European law. Also, in an era of globalised financial markets and a healthy, ageing population, the EU needs to bring more people into employment in order to provide sufficient tax revenue to sustain high social expenditure. Each Member State pursues its national policies in these areas but there are a set of European instruments and programmes, above all the European Social Fund, which are designed to fight discrimination in access to employment, to increase migrants’ participation in work and thereby strengthen their social integration.

6. Chinese Migration

Since the creation of the People’s Republic of China in 1949 there have been four distinctive phases in the country’s urbanisation and population movement. From 1951-1960 there was extensive rural to urban migration as the country underwent extensive industrialisation. By 1960 20 per cent of the population lived in cities. From 1961-1965 after the serious famine and the shortcomings of the Great Leap Forward there was a period of sharp urban retrenchment and more than twenty million people returned to the countryside. This trend was exacerbated during the upheavals of the Cultural Revolution from 1966-1977 with the urban population stabilising at around 17% of the population.

The fourth phase began in 1978 and has gained pace since the Deng Xiao Ping southern tour of 1992. This has seen a sustained and substantial period of rural-urban migration on a scale and at a speed unsurpassed in human history. The opening of China to the global economy; the changes in agricultural production and advances in productivity sharply reducing the need for agricultural labour; and huge new foreign investments in the Chinese economy, especially its eastern coastal regions have combined to generate a massive explosion in China’s urban population (see Table 3.)
Table 3. The Urbanisation of China

<table>
<thead>
<tr>
<th></th>
<th>1949</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cities over 1 million people</td>
<td>5</td>
<td>40</td>
</tr>
<tr>
<td>Cities 500,000 – 1 million</td>
<td>8</td>
<td>53</td>
</tr>
</tbody>
</table>

The pace and scale of this population movement is phenomenal. By 1996 China’s urbanisation rate had risen to 30 per cent. Within a further decade it has reached 43 per cent. By 2010 it is estimated that it will reach 47-50 per cent and by 2020 it is predicted to reach 55-60 per cent.197

The Shift from Country to City

This unprecedented shift of population from countryside to city has taken place within the household registration system – the ‘hukou’ – which has operated in China since 1955 to regulate population movement. This control mechanism enabled the government, within the era of the centrally-planned economy, to regulate rural-urban migration and control the expansion and industrialisation of urban China. But, since market reforms were introduced after 1978, it has lost its power as an instrument of control as large numbers of Chinese living in the countryside have sought to make their living in the towns and cities without being officially registered as urban dwellers. Hence they are termed a ‘floating population’, migrants living in cities but without the full rights of urban residents. Pensions and medical care are not available to them in their adopted homes and their children are often not allowed to enrol in local public schools. In some respects their position could be viewed as analogous to Turkish ‘Gastarbeiter’ in Germany.

Chinese census and survey data now seeks to define floating migrants as those who have resided in a town for at least six months. In 1982 at the start of the reform process there were around 7 million migrants who had crossed provincial boundaries to look for work in the cities. By 1990 this had risen to 22 million. A decade later the figure stood at 79 million.198 Thus approximately the population equivalent to that of Britain or France had within a decade left their settlements and villages and headed for cities and towns. The remittances of the migrant workers are an important element in the incomes of their native villages – where it is common for remittances to account for more than a half of total village income.

Alongside this floating population there is a significant number of permanent migrants, although these tend to move shorter distances and be more frequently associated with marriage and study. When both types of this cross-provincial-border migration are counted together with migration within provinces, the total migration figure is estimated at 144 million, amounting to more than 10 per cent of the population.\textsuperscript{199} There is no sign that this movement is abating. The 2004/5 Rural Household Survey by the National Bureau of Statistics was based on 69,000 households across 857 counties. This indicated that during these two years alone the number of migrants from the countryside had risen by a further 12 million people and that in 2005 as much as a quarter of the rural labour force was involved in migration and that altogether they account for 46 per cent of the country’s urban labour force.\textsuperscript{200}

\textbf{Moving from West to East}

Data clearly show that increases in the floating population are much higher in the eastern coastal areas than elsewhere in the country. (See Table 4). The province with the largest number of floating migrants is Guangdong on the South East coast with 21 million followed by Zhijiang in the East with 5.4 million. The more-than-doubling within five years of Shanghai’s floating population is largely accounted for by the rapid growth of Pudong in eastern Shanghai and illustrates the city’s prominence in the country’s economic hierarchy. The pull of the coastal zones is clearly demonstrated by the Table. Xinjiang is the only non-coastal province in the top six, while the country’s three major metropolitan urban areas lead the list with Shanghai ranked highest with 27 per cent of its population classified as floating, followed by Guangdong with 25 per cent and Beijing with 19 per cent. The experiences recounted in the annex to this chapter give a flavour of migrants’ lives in the capital.

\textbf{Table 4. Main Concentrations of China’s Floating Population by province}\textsuperscript{201}

<table>
<thead>
<tr>
<th></th>
<th>Total Population</th>
<th>Provincial % share of total population</th>
<th>Floating population</th>
<th>Floating as % share of provincial population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beijing</td>
<td>13,569</td>
<td>1.1</td>
<td>2,603</td>
<td>19.2</td>
</tr>
<tr>
<td>Shanghai</td>
<td>16,408</td>
<td>1.3</td>
<td>4,360</td>
<td>26.6</td>
</tr>
<tr>
<td>Zhejiang</td>
<td>45,931</td>
<td>3.7</td>
<td>5,426</td>
<td>11.8</td>
</tr>
</tbody>
</table>

\textsuperscript{199} Ibid. p475.
\textsuperscript{200} Summary Report Urban Poverty Strategy, II TA 4694, p5.
\textsuperscript{201} Data drawn from Population Census Office 2002.
Characteristics of Migrants

Data from the Rural Household Survey confirms trends evident in previous Censuses and surveys. The vast majority of migrants (80 per cent) are lone individuals. The number of households which migrate is low, due partly to the nature of the Chinese land tenure system where plots are leased from the local council for a set period on a renewable basis which makes formal transfer difficult, especially as rural households get no compensation for giving up user rights on allocated lands. The age of migrants is heavily skewed to the younger age groups with 15-30 year olds accounting for 62 per cent of the migrants even though they only account for 32 per cent of the rural labour force. In contrast those aged over 40 account for 15.3 per cent of migrants although they comprise 42.1 per cent of the rural labour force. Women make up one-third of migrants, especially in the younger age group. Generally, migrants are relatively unskilled, with 84 per cent having no more than lower middle school education.202

Conversations with village leaders in Sichuan – one of the provinces which has large number of inhabitants working away from their villages – revealed that remittances from migrant workers account in many cases for more than a half of total village income; that a period of work as a migrant is prized by families; and that county administrations seek to increase the possible earnings for migrant workers by providing appropriate training courses before they leave home. A survey carried out by Chongqing University showed that the vast majority of migrant workers did not wish to return to farming.

Generally, the trends shown in the Rural Household Survey mirror those evident amongst newcomers into Europe’s cities coming from outside the EU. Furthermore, similar patterns were evident in earlier phases of European migration in the decades after World War II. However, there is a distinction to be drawn with the most recent wave of migrants from A8 countries post-2004 and with refugees and asylum seekers. Both these categories tend to have a much higher proportion of skilled and highly-trained people amongst their number.

Migrants and the urban labour market

Migrant workers have had a substantial impact on the functioning of the urban labour market, both in terms of labour supply and wages. They are concentrated in manufacturing

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202 Urban Poverty Strategy op.cit pp5-7
and construction which accounts for more than half of total migrant jobs, while social care, hotels and catering account for a further 17 per cent. Like their educational attainment, their skill level is low, with 71.8 per cent having received no technical or vocational training. The Urban Poverty Strategy succinctly summarises their position: “Generally, migrant workers tend to hold jobs that are unskilled and low-paid. These jobs tend to be physically hard and unpleasant and involve long working hours. Many of the jobs held by migrants tend to be dead-end jobs.”

The EU study group gained first-hand experience of this when it visited a modern privately-owned, shoe factory in Dongguan on the Pearl River Delta making high quality shoes and boots for both the US and European markets. The 600 strong workforce is very young. The manager told us that they come from villages in the provinces of Central China. They live in dormitories on site, either eight or twelve to a room. Workers on the shop-floor told us that they worked from seven in the morning until either nine or eleven at night depending on the order book, with an hour and a half for lunch. For this they earn around 1,400 yuan a month, significantly more than they could earn in their home villages and well above the national average of migrant workers pay.

This picture is confirmed by data from a National Bureau of Statistics survey conducted in 2006. This showed that migrant workers work substantially longer than their urban counterparts. On average they work 6.29 days a week and 8.93 hours a day, with only 15.6 per cent working five days a week as most of their urban counterparts do. The survey found that migrants on average earn less than half as much as their urban counterparts with a national average of 966 yuan, which rises to 1,090 yuan in the wealthier coastal regions and even higher in the capital (see annex). Furthermore, they often suffer delays in the payments of wages which, while less frequent than previously, still affected 10 per cent of the sample at the time of the survey, with 13.6 per cent saying this was a frequent occurrence and 86.4 per cent saying that it happened occasionally.

In addition, a high proportion of migrants do not have formal employment contracts and, where they do, they are typically short-term. Furthermore, the survey found that no more than 30 per cent of migrants participated in one or other social insurance scheme and that indeed, this figure was probably inflated since the survey excluded both self-employed and casual migrant workers.

The data shows the extent to which China’s industrial revolution has so far been underpinned by the development of a two-tier urban society. Much of the academic discussion has focused on the fact that this rural migrant section of the population has less benefits and privileges in terms of access to housing and schools than those with an urban ‘hukou’ registration. Yet, this focus on the ‘hukou’ seems misplaced. Rather, it is the discrepancies and distortions in the evolving labour market especially in relation to employment contracts, labour law, wages and conditions, and social security, which the government is seeking to address in a raft of policy proposals.

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203 Ibid. p15.
204 Ibid. pp14-16 for results of the survey.
7. Options for Policy Makers

Migration is one of the most politically sensitive and explosive issues in contemporary politics. It is one of the most visible signs of globalisation and across Europe many citizens are showing their discomfort at its pace and scale. In a number of countries public fears are being roused further by scare stories in newspapers. Populist politicians are taking up an anti-migration stance and mainstream politicians in many governments take the same line. The topic is increasingly highlighted in opinion polls as a major concern amongst the general public.

This is the European context within which politicians and policy-makers have to consider the issue. Put at its simplest there are three broad responses to the migration question: one, prevent cross-border migration; two, end restrictions and open borders; and, three, manage the process. These three categories are not necessarily exclusive and policy responses to different aspects of this issue may contain elements of more than one category.

The protectionist response – preventing cross-border migration – has been gaining ground within Europe as is evident in wide swathes of public opinion and among nationalist parties, particularly but not exclusively of the political Right. There are calls for an end to all immigration, repatriation of existing migrants within individual countries and at a European level for a ‘Fortress Europe’ policy, closing Europe’s borders to all future migration. Part of the widespread resistance to the entry of Turkey to the EU undoubtedly arises from a fear that millions of Turks would then flood onto European labour markets. This protectionist point of view is also evident within part of the US but to date seems to have little echo within China. However, this may be due to the fact that China has experienced almost no migratory pressures from beyond its borders. Should this situation change, then it is possible that new political pressures would begin to find expression.

Opening borders is the classical neo-liberal response of the free market. It is part of the founding document of the EU, the Treaty of Rome, with its core commitment to the four freedoms, “the free movement of persons, goods, services and capital”. Some economists believe the four freedoms should apply across the globe and that the success of globalisation would be enhanced if the principles of free trade and free movement that increasingly apply to capital, goods and services were to apply to people too.205

There are policy-makers in China who argue for this course of action most notably with regard to the household registration system. The most ardent neo-liberals within the Chinese policy establishment argue for the abolition of the ‘hukou’ so that farmers and rural labourers can freely and easily migrate to the towns and cities. In an echo of Europe’s Enclosure movement the same policy-makers argue that these migrants should lose their right to keep their land.206 Such an attitude ignores the fact that, at present, the migrants regard their land as an insurance in case of misfortune, since they have no pension rights or

205 See Philippe Legrain op. cit.
medical insurance in their adopted urban areas. In gambling parlance, the household is spreading its bets. This may not necessarily maximise the productive capacity of agricultural land. Hence, the policy proposition to force those transferring from rural to urban areas to relinquish their land holdings.

Managing migration is the route which the EU has been inching along over the past decade, ever since its initial discussions on recent Enlargements in 1999. The Member States have found this a very difficult topic on which to reach meaningful agreements. Yet the realities of globalisation and the public unease over the issue mean that the issue requires more-or-less constant political management.

In a very different context migration is also a central topic for the Chinese government. Since 2002, under Hu Jintao, the Chinese government has stressed the need for balanced development and the requirement to create a harmonious society. With growing disquiet over China’s increasing income inequalities and signs of popular unrest over unpaid wages to migrant workers, the government has recognised the need to lay renewed stress on the ‘social’ elements of development. Thus in his address to the 17th Congress of the Chinese Communist Party Hu Jintao devoted one section of his speech to promoting balanced development among regions and another to improving people’s livelihoods through building a sound social security system covering both urban and rural residents. “Social security is an important guarantee of social stability” he declared. With migrant workers accounting for nearly half the urban labour force, the management of the migration process and the effective integration of migrants has become a key issue on the Chinese domestic agenda.

8. Managing Migration

Focusing, then, on the management of migration, there are three key elements that governments have to consider:

- regulations designed to control the flow of migrants from their places of origin;
- measures taken by policy-makers to help the integration of migrants at their place of destination;
- wider policies of economic development that policy-makers and governments introduce in migrants’ places of origin in order to promote economic growth and make these areas more attractive so that income differentials and the pressure to migrate is reduced.

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207 See Yu Zhu, “China’s Floating Population and their settlement intention in the cities. Beyond the ‘Hukou’ reform”. Habitat International No.31. 2007. This article surveyed 250 ‘floating’ migrants in the Fujian province working in five towns. Only one-third said they would bring their whole family to the city if they got ‘hukou’ status but the figure dropped even further if this meant they had to give up their land in their village.

208 For the classic assessment of this process of Enclosure see K.Marx, Capital Volume 1.

209 At the time of writing, migration is presented as one of the top priorities of the European Commission’s political programme 2009-2014.

It is the author’s view that a policy which integrates these three elements offers the best way to respond to the issue of migration. It will maximise the economic, social and cultural benefits of the process and enable its costs to be controlled. Without a balance of measures, the process may get out of hand, causing turmoil and disruption. Policy should be seen as a strategic package in which the three elements are linked to each other.

Internal controls on migrants

The EU proclaims the principle of the free movement of labour but when the opportunity arose to apply the principle in 2004, twelve of the existing fifteen EU member states took the option to introduce transitory arrangements which restricted application of this principle. This reflected the deep political unease across Member States about the potential destabilising consequences of large-scale, uncontrolled migration. The last decade has seen the rise of a number of explicitly anti-immigration, populist parties which have gained influence on government in a number of EU member states, such as Denmark, Holland and Italy. There is also evidence of a wider unease about the consequences of the type of neo-liberal globalisation which has dominated the thinking and practice of the European Union and the European Commission. These concerns underpinned the rejection of the Draft Constitutional Treaty in France and Holland in 2005. They have emerged more forcefully with the onset of the global economic recession. In response, a number of prominent European leaders from across the political spectrum have acknowledged the need for a more social Europe.

In May 2004 only the UK, Ireland and Sweden applied the principle of free movement of labour, the freedom to work. Official UK Home Office estimates suggested that perhaps 10-20,000 people would come to Britain. The surge of newcomers took officials by surprise. While the newcomers met with relatively little overt discrimination, extensive public unease at the large numbers of newcomers, reinforced by much negative press coverage, meant that UK government policy changed. When Bulgaria and Romania joined the EU in 2007, the UK government decided against free movement of workers and introduced the transitory arrangements it had declined to introduce in 2004. Thus, across Europe, Member States have tempered their commitment to the principle of the free movement of labour within the EU and recognised the need to exert controls on the process.

There can be no doubt that rural-urban migration will continue to be an on-going feature of Chinese society. All analysts suggest that there is a considerable labour surplus in rural areas. Thus, the transfer of agricultural labour to non-agricultural employment must remain as part of the strategy of Chinese modernisation. However, the terms on which that transfer is undertaken and on who bears the costs should remain open for discussion.

The school of thought which argues for the abolition of the ‘hukou’ as a restriction on the free movement of labour argues that the country would produce more if labour mobility
was lessened.\textsuperscript{211} This school of thought is reflected in official circles as evidenced by the Foreword to the Regional Development and Policy anthology which states that “restrictions on labour force movement should be reduced as much as possible”\textsuperscript{212} Indeed, some authors go further in noting the sharp increase in income inequality that has accompanied China’s three decades of rapid economic growth and assert that it is precisely the existence of the ‘hukou’ regime “that prohibits rural-urban and inter-provincial migration (and) is responsible for the particular pattern of inequality in personal income distribution in China.”\textsuperscript{213}

However, a range of factors gives cause to question this thinking. First, and most obviously, the sheer scale of the population movement to date must lead policy-makers to doubt whether existing regulations pose any hindrance to labour mobility or are unduly restrictive. The last three decades has seen the largest and fastest migration in world history. This suggests that the ‘hukou’ registration system has not hampered the movement of people across China. As Professor Zhang Juwei from the Chinese Academy of Social Sciences expresses it: “The ‘hukou’ is important to the design of social security. It is not important with regard to the movement of labour.”\textsuperscript{214}

Second, the argument that the ‘hukou’ regime is responsible for China’s income inequality is an ideological assertion. As confirmed by the 2006 NBS survey the reality is that the large influx of migrant labour has kept urban wages low and working hours long: it has served as ‘a reserve army’ of labour. Removal of the ‘hukou’ system might depress wages – and remittances – and lead to a worsening of living conditions for many ‘floaters’ and their families.

Third, calls to abolish the ‘hukou’ prioritise “economic growth at all costs” and ignore social and environmental consequences. When the 11\textsuperscript{th} Five Year Plan calls for ‘harmonious development’ this is no longer a viable strategy. For example, it cannot be healthy for the future of the country that this migration leaves tens of millions of children growing up without their parents.\textsuperscript{215}

Fourth, the disappearance of the ‘hukou’ might lead to an even more uneven spatial development than at present. The government has since the mid 1990s taken a limited number of steps to address regional income disparities. But the attraction of labour to China’s coastal provinces remains overwhelming. By increasing the rate of migration, the abolition of the ‘hukou’ might create serious problems for the development of central and Western China.


\textsuperscript{213} Zhang and Harvie op.cit p82. Author’s emphasis

\textsuperscript{214} In discussion with the author. 9\textsuperscript{th} May 2008. Furthermore, the relative insignificance of the ‘hukou’ was confirmed in discussions the author held with a number of younger migrant workers in Beijing in May 2008. When asked where their ‘hukou’ card actually was, several of them were uncertain. In the end, they thought it was probably at home with their parents.

\textsuperscript{215} The precise number is not known and remains a subject of controversy. Numbers fluctuate between 22 and 29 million, while some suggest it could be far higher.
Finally, there is much talk of freedom: the abolition of the ‘hukou’ would enable the free movement of labour and that this would be a ‘free’ choice. However, the evidence so far is that many ‘floaters’ wish to hold onto their land in their native villages. This is anathema to convinced neo-liberals since it hampers the maximisation of rural production. Hence the call from some analysts to oblige migrants who reside in cities to give up their land. In other words, the ‘free’ choice would become a ‘forced’ one.

Yet the political and policy-making climate in China is changing. The current emphasis is on balanced and harmonious development. Rather than stepping further down the neo-liberal path, policy-makers are considering a number of alternative options. In particular they are looking at the needs of the current floating population, improving their working conditions and exploring the potential of allowing them to access a range of medical, insurance and social services. This is explored in more detail in the Section below.

More radically, the government could ask the Provinces to follow the approach which many EU Member States have adopted and introduce a control system on migrant labour from other parts of the country. This could take the form of a quota system, stating the maximum number of migrants any province will take and could operate for a set number of years. It would be designed to prevent the overheating of the Eastern coastal provinces and give time for other measures to come on stream in the central and Western provinces. Such measures were tried briefly and with little success in 1994. Their re-introduction would represent a departure from prevailing orthodoxy but events may prove that a shift from ‘development at all costs’ to ‘harmonious development’ may require radical measures of this kind.

Integration policies

The second key element of an overall policy will concentrate on the effective integration of newcomers. In dealing with the EU, this paper concentrates on policies for integrating newcomers from other EU member states, although a number of the measures apply also to migrants from outside the EU and to asylum seekers and refugees. The EU sets a political framework with its Charter of Fundamental Rights which establishes a common framework of equality, non-discrimination and a set of social rights. These are not always enforced and the incidence of illegal working, weak inspectorates not enforcing regulations and a spread of low wages has been exacerbated by the impact of extensive migration. Illegal working and low wages causes growing concern among many citizens on low incomes. Hence, the increasing calls to strengthen Europe’s social dimension.

At the same time the European Commission is aware that despite this framework of equal rights, barriers to labour mobility remain. This situation arises largely from the EU being a combination of sovereign Member States which have a wide variety of social security, insurance and pension policies. The perception is that these often act as a discouragement to the easy movement of labour, with citizens anxious that they will lose benefit and pension.

216 Charter of Fundamental Rights of the European Union Agreed at European Council meeting in Nice on 7 December 2000.see especially sections on Equality and Solidarity Articles 20-38.
entitlements if they move to another Member State. However, the extent to which these issues act as an impediment to labour mobility is unclear. It certainly does not feature prominently in the Eurobarometer survey and has not stopped the large recent influx of Polish and Baltic state citizens into the UK and Ireland and Romanians into Italy and Spain. More probably, these are issues that act as a disincentive to labour mobility for middle-ranking professional staff and slightly older citizens with a family. An EU Action Plan has identified four main areas where action is required including the need to improve the co-ordination of social security schemes so that people working in a Member State other than their own do not lose their social security protection. Improving access to these systems across all Member States would contribute to easier labour mobility across Europe, although there is little evidence to suggest that such reforms would result in a significant increase in movement across borders.

Labour Market Policies

Alongside this political and legal framework the EU devotes a significant proportion of its budget to improve and upgrade the skills of its workforce, in line with the development of its knowledge economy. While significant number of unskilled jobs will remain, the overall proportion of semi-skilled and skilled jobs is rising, requiring a better trained and capable workforce. At the same time the shift away from large-scale factory production and the re-emergence of small companies, artisanship, and the creative industries associated with the computer and IT revolutions means that there is a greater emphasis on innovation and entrepreneurship. Thus Europe has both to draw more people into work and to lift the quality and skills of its employees.

Its main instrument for achieving this is European Labour Market Policy, for which the strategy and budget are decided by the Member States, the European Parliament and the Commission. This policy is supported by a financial instrument, the European Social Fund (ESF). The ESF uses EU budget resources to co-finance agreed, seven-year programmes in the Member States. Over the period 2007-2013 some €75 billion will be distributed to Member States and regions to achieve labour market goals. In accordance with the priorities of the European employment strategy and the Lisbon Employment Guidelines, a significant part of this expenditure will be devoted to both recent and long-term migrants and is designed to provide them with language training and employment support measures to aid their integration into the labour market and, through that, to wider society. The integration of long-term migrants is seen as a priority and current regulations call for attention to migrants’ needs – sometimes through specifically-targeted actions – in all ESF co-financed programmes.

Cities and regions have tried a big variety of projects and initiatives over the last two decades to facilitate the economic integration of newcomers – specialised community centres; ethnic entrepreneurship programmes; outreach projects in neighbourhoods where large numbers of newcomers live; support for the self-organisation of minority communities;

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training programmes geared to the specific needs of new communities. Policy practitioners and project leaders have shown imagination and innovation in creating actions to find effective ways to bring training and employment opportunities to migrant communities. Usually ESF funding has been the catalyst which has helped to generate and stimulate these programmes and projects.

ESF is by far the most significant EU instrument for promoting the employment and integration of migrants. But, as the issue grows in importance, other EU programmes seek to complement the work. Here are three examples. The Commission has established for 2007-2013 an Integration Fund totalling €825 million. Its aim is “to support the efforts of Member States in enabling third country nationals of different economic, social, cultural religious, linguistic and ethnic backgrounds to fulfil the conditions of residence and to facilitate their integration into European societies.” For asylum-seekers, the EU has created a new Refugee Fund with a budget of €600 million. There is also the potential to use EU Lifelong Learning Programmes to support the vocational training needs of newcomers.

Yet the harsh reality is that despite these efforts discrimination in the job market remains a reality for many migrants across Europe.

China’s New Policy Instruments

For China – where the cultural homogeneity of the country reduces some of the problems of mass migration – population transfer on the present scale inevitably throws up major social problems. In comparison to many other parts of the world China’s new migrants normally have access to running water, electricity, shelter and paved streets. Population density is often extremely high but the shanty towns evident in other parts of Asia, Africa and Latin America are absent in China. However, the current operation of the ‘hukou’ system continues to inhibit the integration of China’s newest urban citizens218 and limited access to health care and medical insurance presents major problems. Here are two examples. First, millions of these migrant workers are doing difficult, dirty or dangerous jobs, in construction, furnaces and manufacturing where industrial accidents inevitably occur. Those without an official urban ‘hukou’ have fewer rights to medical insurance coverage in the event of accident. Second, a concentration of population of this size and youth presents a public health challenge in the areas of reproductive health care, HIV and sexually transmitted diseases. The denial of equal access to health care on these matters presents not just a danger to the floating population but to all citizens.219 As Europeans learnt during their Industrial Revolution public health diseases do not respect social or class barriers.

The philosophical shift to a model of harmonious development makes it imperative for the Chinese government to address these issues. It is now doing so in a determined fashion, focussing on tackling the daily issues facing migrants rather than seeking to reform the ‘hukou’. In 2006 it introduced State Council Regulation No.5. ‘Some opinions on Solving

218 See Zai Liang and Zhongdong Ma op.cit. p484.
219 ibid. p484.
Problems Concerning Migrant Workers’ which laid down four principles including the fair treatment of migrants, an end to unfair discrimination and improvement in labour market services such as job search and training. In consequence a number of measures have been introduced including the establishment of a joint office to integrate labour markets, which is designed to provide vocational skills training for up to 40 million workers in rural areas by 2010. It would be interesting, and perhaps useful, for the EU to explore this training programme in relation the European Social Fund.

More significantly on 1 January 2008 a new Labour Contract Law came into effect. Its centrepiece is a written contract for all forms of employment and its greatest effect will be on migrant workers. The contract must specify scope and place of work; working hours, rest and leave; wages; participation in social insurance; and working conditions. The obligation of meeting these requirements rests with the employer and the conditions also apply to temporary agencies. In addition, the Law seeks to tilt the balance of incentives towards open-ended contracts and gives workers the new right to apply to local courts for the mandatory payment of outstanding wages. Trade unions are given a recognised role in representing the interests of employees and, in general, the law extends significantly the scope for collective bargaining. Discussions on this law provoked heated debate, which is continuing with its implementation. The institutional infrastructure to monitor compliance is rudimentary and a careful evaluation of the Law’s impact will be necessary before an accurate judgement of its impact will be possible. However, there can be no doubt of the government’s desire to shift the balance of power in labour relations and above all to ensure a fairer deal for migrant workers.

Another area which concerns migrant workers as well as those living in rural areas is social security. The Chinese government has an ambitious programme to improve Social Insurance. The current system covers less than half the urban population and excludes the rural population. The intention is to move to a sustainable social security system which guarantees accessible, adequate and affordable social security benefits to all. The Social Insurance Law will cover all the branches of social security – pension, work injury, medical, unemployment and social care. The Law is intended in principle to cover the whole population but it remains to be decided how and when the rural population and the floating population will benefit from effective protection. Issues still being discussed include the best level for pooling resources and how to ensure transferability of acquired rights from one regional/provincial scheme to another or from rural to urban schemes. Currently, there are more than two thousand different insurance and social security systems operating in the country. The disparities in income both between provinces and often within them is so great that setting a common, nation-wide social security or pension level is extraordinarily difficult. It has been estimated that such a scheme would raise enterprise labour costs by 30-40 per cent[220] which would also have the effect of lessening the demand for migrant workers among employers in the Eastern coastal provinces. The extension of social insurance provision to cover all migrant workers would considerably help with their integration into Chinese urban society. Considerable difficulties remain but new Regulations, Laws and proposals indicate the depth of the government’s effort to address the inequalities arising

from the country’s rapid industrialisation and urbanisation. A leader article from China Daily in October 2009 illustrates the sort of difficulties faced by the Chinese government as it tries to eradicate inequalities (see Annex 2).

**Balanced spatial development**

The third track of a managed migration policy is to encourage jobs to come to the people rather than move people to jobs. Geographically-weighted policies aim to achieve this by helping geographical areas which face severe disadvantages to improve their economic capacity. EU Structural Funds are designed to rectify spatial disparities at an EU-wide level. They have had a profound impact on older industrial towns and regions affected by the collapse of traditional heavy industry and Fordist manufacturing in the 1980s and 1990s. These funds have facilitated the modernisation and partial transformation of many of the EU 15’s older industrial areas within Germany, France, the UK and the Netherlands over the last two decades. At the same time they have enabled the less-developed, newer Member States to develop speedily and renew their economies. The transformation of Ireland and Spain has been one of the success stories of these Funds.

Since the establishment of the People’s Republic, the Chinese government has fluctuated in its emphasis on balanced spatial development. For three decades after 1949 balanced development among the regions was pursued in a planned, centrally-directed system. The extremes of the policy before and during the Cultural Revolution prompted a rebound from such policies during the drive for growth after 1978. From then until the mid 1990s the emphasis was placed on the eastern coastal areas as China focussed on international markets and the development of an export-oriented economy. Since the mid 1990s there has been a switch in emphasis with the focus on regional policies designed to promote harmonious regional development and inter-regional justice. This has meant specific attention being given to the development of the West of the country and the revitalisation of the older industrial regions of the North East. Now, the 11th Five Year Plan lays special emphasis on balanced economic development. “We will continue to carry out large-scale development of the western region, rejuvenate northeast China and other old industrial bases in an all-round-way….in locating major projects we must give full consideration to supporting development of the central and western regions.” 221 Thus “the Chinese government has attached great importance to reducing regional disparities.”222

The policy aims to encourage enterprise in rural areas and smaller towns as well as to promote major urban development away from the East coast. The headlong development of Chongqing as the gateway to Western China represents the most dramatic expression of this policy, with the core city growing by 20 square kilometres a year since 1998 with an annual population growth of 300.000. A historical comparison is with the growth of 19th century Chicago: both cities symbolising the transformation of their countries from coastal to

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221 Hu Jintao op.cit Report to 17th Party congress Section 5.
continental economies. However, the pace of Chongqing’s development dwarfs that of Chicago’s highlighting again the compression of developmental time which is the hallmark of China’s economic transformation.

Yet these efforts at a more balanced development both in major centres like Chongqing and with rural enterprises in small towns do not appear to deter rural migrants from the attractions of the Eastern zone. The magnetic pull of the Eastern coastal zones remains exceptionally strong. Dongguan is an example. It sprawls alongside the eastern edge of the Pearl River Delta. Its population approaches ten million yet the Mayor told this study that only 1.7 million are permanent residents. Of the remainder, 5.2 million are migrants who have been registered in the city for more than six months, while a further three million are short-term migrants who have been in Dongguan for less than six months. Overall, 90 per cent of the cross-province transient labour force has come from central and western areas while more than four-fifths have ‘floated’ into the eastern zone. This has promoted regional economic growth, “yet aggravated the disequilibrium in economic development.” Thus the question remains of how best to pursue the overall goal of harmonious development.

In addressing this issue on a comparative basis one must recall the observations at the start of this article about the profound distinctions between the EU and China. In Member States across Europe, governments undertake fiscal transfers of various kinds to sustain viable communities and provide employment. For example, in the UK the government has located a number of its benefit agency functions in the North East of England to provide a source of employment in a disadvantaged area. Furthermore, the UK government uses formulae in the allocation of resources for economic development and public services which give additional money to poorer cities and regions.

A distinctive factor of EU regional policy is that it applies this thinking across the EU as a whole. The agreed EU position is that balanced economic development across the entire Single Market is best served by a focussed policy operated over a sizeable time period with specified budgets. That is the purpose of EU Structural Fund and EU rural development programmes. In 2007-2013 the EU is making its greatest effort in Poland where it has allocated €65.6 billion to promote economic modernisation and renewal. The belief is that this concerted effort will act as a catalyst to bring about a transformation in Poland’s economic fortunes in the way that similar funding has dramatically boosted Spain’s economic and social prosperity over the last two decades. Over this period both Spain and Ireland have turned being from net exporters of labour to becoming strong attractors of labour. Many commentators believe that as Poland begins to grow it will cease to be a net exporter of labour.

Is there a parallel here for China to draw on? Its western and central provinces need similar substantial investment. Dedicated, ring-fenced resources are required. Simple fiscal transfers will not suffice. At the same time the magnetic pull towards the Eastern coastal provinces has to be stemmed, if the country is to achieve more balanced development. This

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224 Wang Yiming op.cit p40.
should involve “efforts to nurture several rising city clusters in regions under priority development”\(^{225}\) and also make a concerted drive to stimulate non-agricultural employment in rural areas and smaller towns. Here, the development of township and village enterprises is a priority. The use of ring-fenced funds through rural development programmes is another example of an EU policy instrument which it would be valuable to explore.

9. Conclusions

These are tumultuous times. Both Europe and China face major challenges, some of which are distinctive, others which are similar. Both are experiencing the effects of uncontrolled migration and the resulting inequality. This paper argues that there are three dimensions to managing this issue, namely controls on the flow of migrants, their effective integration at their place of destination and concentrated programmes of economic development in their home regions, so that these themselves become places of sustainable growth. On the issue of migration a balanced package of measures which addresses all three aspects is crucial. Both the EU and China are addressing elements of this approach but neither is tackling all three in a coherent and co-ordinated fashion.

For the EU this is becoming a more pressing issue, especially as it has greater pressures from beyond its borders than China currently faces. EU politicians rarely address this issue in a comprehensive manner, yet it has a number of policy instruments which it can use or re-fashion.

- First, as it looks to the future, the European Social Fund, perhaps re-titled as the Fund for Combating Inequality, could be promoted as a broad, cross-cutting programme to tackle the specific skills, educational and training issues affecting low income, low-skilled workers, including migrants, across the whole of Europe. The new name and purpose would signal to the general public the EU’s determination to address its main social challenges and to tackle inequality.

- Second, the EU could also emphasise that the express purpose of the European Regional Development Fund is to promote balanced growth across the whole EU territory. It is a policy for coherent spatial development. One objective which should be stated explicitly is that of boosting lagging regions so that they retain rather than discard labour.

- Both of these funds are key instruments in showing that EU policies are designed to promote economic, social and territorial cohesion which over time will reduce migratory pressures from within the EU and ensure the more effective integration of those citizens who do migrate.

- Third, the implementation of the provisions of the Charter of Fundamental Rights and agreement on EU wide frameworks on working time and agency working would provide political and legal backing to the EU’s social dimension.

Migration need not provoke resentment and anger. If action is taken in all three areas discussed here, then population movement can be a more controlled process, bringing all-

\(^{225}\) *Ibid.* p50
round economic benefits and reducing the degree of social upheaval and public unease. Without this, there is a danger of significant public turmoil and a pattern of development that will be neither stable nor harmonious. The suggestions made in this article propose a course of action which could enable both China and the EU to pursue a course of economic growth which is both geographically balanced and socially just.
The experience of migrant workers – snapshots from the EU and China

Annex

1. Introduction

This annex is designed to give a flavour of the experience of migrant workers in the EU and China. The comments of migrant workers in the West Midlands of England are drawn from a study of the economic impact on the region of EU migrants which involved eight focus groups across the region. These discussed a wide range of topics affecting the lives of migrant newcomers. The comments from China are from interviews carried out by the author. A comparison of the two offers similarities and contrasts.

2. West Midlands

Economic Motives

The very rapid rise in the numbers of migrants coming to the West Midlands and the rest of England from some new Member States after EU-Enlargement in May 2004 was largely driven by economic factors: high unemployment in Poland and the Baltic States; a ready supply of unskilled work in the UK; wage rates which were significantly higher than those on offer in their native countries but which were low by UK standards and therefore unattractive to UK citizens.

- “Money is the most important thing.” (Polish woman, late 20s)
- “I left Poland because it’s hard to find a job in Poland, even if you have qualifications and you finish University or something, it’s difficult.” (Polish man, late 20s)
- “I finished at medical college, I’m a dental technician and I was working in Poland three to four years in my profession, but the problem was that the wage wasn’t very high.” (Polish woman, late 20s now packing DVDs in a warehouse)
- “For example at the moment the minimum in Poland is £2.00 per hour. Here it is minimum of £5.25.” (Polish man, late 20s)
- “Good money. All of us that’s why we come here.” (A general comment from the focus group of those East Europeans working at the Airport)

English Language
However, the desire to learn and/or improve their English is an additional motivation. As English increasingly becomes the language most widely used in the worlds of commerce, computing and travel, so the ability to speak and read English becomes a major asset. Many economic migrants from the new Member States see the opportunity to acquire good English as a valuable asset for their future working life.

- “Well I just wanted to learn the language, I just graduated from High School at home and I desperately wanted to learn some English and I figured the best way to learn it is to come to England and learn it from native speakers.” (Slovakian woman, early 20s)

- “It’s good opportunity to improve our English, find a good job. But then most important to improve English.” (Polish woman, mid 20s)

**Socio-economic Background**

This helps to explain why a significant number of migrant workers in the West Midlands are either students who have completed their degrees or professionals who are prepared to take a manual job for several years. In this way, migrants in the West Midlands are significantly different from those in China, where it is mainly low-skilled, poorly-educated farmers and rural labourers who are migrating from the countryside into the cities. It is also different from the initial flows of emigration which the West Midlands experienced in the 1960 and 1970s when large numbers of rural labourers from Mirpur and Bangladesh came to the region.

- “When I came here I tried to get a job in my profession because I like this job. I thought it would be for me easier to get this job here. But maybe it's because I don’t speak very well in English, and I didn’t know how to prepare to get this job, so I couldn't find anything for me. So I decided to work in a warehouse.” (Polish woman, late 20s)

- “I have finished at University of Technology, I'm an engineer. But I couldn't find a job. So I came here.” Tried to get engineering jobs: “but two problems, I don’t have experience and language.” (Polish man, late 20s)

- “I would like to work in my profession, I don’t want to spend all my life in a warehouse. So it's very difficult. And in Poland I might have another job in my profession but the wage is so low it's better work here in the warehouse than in your profession.” (Polish woman, late 20s, previous experience of work in health and beauty salon).

- “It’s very boring. … Yes I tried [to get a better job] but it's very difficult. First of all I have to improve my English. Sometimes you feel it's shame for us, for our country. We are good educated ….. But we are working as packers, it's quite difficult situation to understand us, how we feel.” (Polish woman, mid 20s, packing)
Working Hours

As ever, migrants work long hours. Employers know that and seek to use it to their advantage. Some migrants eager to maximise their wage are happy with the potential for working extra hours; others look to a different future.

- “There is 70% of Polish people in warehouses. They want Polish people because they know they work hard.” (Polish man, late 20s)

- “We show that we can work harder.” (Slovakian females, 20s)

- “I think they're pushing all the Polish people… they want them to work faster and faster and even if you finish a shift, at the end of the shift the Manager says, ‘Oh you were great today, your performance was perfect’ but the next day they want more. They want more, because they know that we can work so hard, so they always want more.” (Polish man, late 20s)

- “You find for us the best present they give us is more hours. That's the best present for us. You know, if some guy from England, the Manager says to him, ‘Can you stay 5 hours longer?’ the answer is ‘No.’ Crazy, you know. But for us, we say, ‘No problem, it's great.’ We work like a horse you know.” (Polish man, 20s)

- “I work more hours and I don’t have life actually… but when I have the language I can get a better job, I can start at 8 and finish at 4 and then I can spend more… with my wife and everything. Now it's job, job, job.” (Polish man, 20s)

- “I want to earn £10.00 – £12.00 per hour, work a normal 38 hours would be good.” (Polish man, 20s)

Routes to work

People have found their jobs through a mixture of agencies, family friends and contacts and networks.

- “Through an agency at home, there's like au pair agencies at home you can register with and they will find a family for you, so that's how.” (Slovakian women, early 20s).

- “Through friends. Informally” (Slovakian women, early 20s)

- “My friends call me. They say we have a job for you.” (Polish male, 20s – employer recruits workers through his current workers)
Many use an agency at first, often working in warehouses or factories and then seek to move on.

- “I gave 40 CV and I get maybe six answers. I found this job (in a pub) by myself. But my first job it was in a warehouse, the agency helped me.” (Polish man, late 20s)

- “It's good to start there because I think a lot of Polish people start there and then after three to four weeks they left this place and go somewhere different.” (Polish woman, 20s)

- “It was difficult at first. The job was about 20 miles far. It was very, very hard work and there was always cold, wet ….. So when we see other people friends and we met old friends, so we ask each other and try to find some more job. We were five, I think and just one stayed at work in the cheese factory … but the others found another job.” (Polish woman, 20s)

**Housing**

Accommodating migrants is always an issue. Newcomers are vulnerable to both overcrowding and living in housing provided by the employer.

- “In Poland you live alone, but look what is happening here, of course people can't afford it. People live 5, 4, 6 sometimes in the house. So you all the time you have to live with somebody. For example for me it's terrible, when I have to live with 5 people in the same house. Of course it's cheaper because I pay for only 1 room.” (Polish woman, 20s)

- “I feel a bit trapped because I'm renting a flat from my boss’s brother. So what I'm thinking now if I leave this job I need to move as well.” (Slovakian woman, 20s)

Yet many of the newcomers come from urban rather than rural areas and experienced their own housing problems back home. So for some, they find greater independence open to them.

- “I don’t agree because in Poland I lived with my parents, because even if I worked in my profession I couldn't afford to rent a room - not a flat a room - and live alone. And here I have 2 part-time jobs and I can afford to rent a room. In the next month I will pay £50.00 per one week, it's not a problem for me.” (Polish woman, 20s)

**Length of Stay**
As economic migrants many of these newcomers remain uncertain about their future. For some it is an interesting and enjoyable experience. For others, they live life for the moment and let the future look after itself. Some wait to see how the economy develops in their own country.

- “I finished school in Poland and I start here… so I don’t live with my parents and this is a new life for me. Now I want to stay here, maybe later I change my mind, I don’t know.”

- “I don’t know I guess it’s kind of changing all the time. Well I never actually planned to stay here.” (Slovakian woman, early 20s)

- “I think I would like to go back to Poland but not now, I just have to stay here for a while, we will see what happens. Now is too early to decide.” (Polish male, 20s)

- “Maybe all life or maybe 5 years, I don’t know.” (Polish woman, 20s)

- “The economy is getting better and better in Slovakia.” (Slovakian woman, 20s)

- “If somebody gives me the job right now in Poland in my country you know, for very good money, it’s one second and I would go back. A lot of people, believe me, stay over here only for money.” (Polish woman, 20s)

- “Now is not a good time to go back to Poland. Maybe I think that next three-four years will be better.” (Polish man, late 20s)

**Beijing**

Gerry is bright, energetic and talented. Last year he finished university. He had done well in his English degree but there were limited prospects locally. He was attracted to the big city. So he looked on the Internet, saw a job in a hotel, was interviewed over the phone and got the post. It sounds a familiar story. And it is now a similar one world-wide for Gerry lives in Qitai, a four hour bus ride from Urumqi in far Western China. From there it’s a 43 hour train journey to the job in Beijing.

Gerry has been in the capital for well over a year. He has become the manager of a small up-market hotel. He is learning his trade, works hard, earns four times what he could in Urumqi and like most Chinese saves for his future. He’s part of the new wave of migrants, the youth generation drawn to the capital by the Beijing boom.

Official figures indicate that up to 7 million of the capital’s population are migrants, people drawn mainly from Central and western China. Everywhere on China’s eastern coastal seaboard you find migrants. They are the most dramatic social feature of China’s economic explosion. This has brought more than 150 million migrants to China’s cities in less than two decades. In other words, a
population two and a half times that of England or France has moved from the countryside to the cities, and from West to East in less than twenty years. They’ve come to factories and manufacturing plants; to hotels and restaurants; to clean and service the new offices; but above all they are building the new China. In Beijing, enormous building sites are everywhere. The normal apartment block now stands thirty storeys high; the main ring roads with five lanes each way are lined by massive office blocks and flats; brand new Tube lines were opened in time for the Olympics, as well as the new, dramatic Norman Foster-designed airport terminal.

Building workers are organised by a labour contract foreman – not dissimilar to a gangmaster - who brings a group of workers from a village to the capital to work as a team on a major construction job. Often the Communist Party structures are used to organise the recruitment. Construction workers labour for anything from ten to sixteen hours a day. Accident rates are high – second only to mining - but they earn the highest sums amongst migrant workers, sometimes reaching 4000 yuan a month. They tend to be a bit older than other migrant workers and are often married men with families.

The routes by which many others reach Beijing are varied. Some like Miao come through family connections. Her young daughter has worked in the capital for four years having lodged with her aunt. Once settled in a job with an insurance company, the daughter encouraged her mother to come to the city. Chen is a cook. He came as an apprentice, when his master got a job in the capital. Youngsters, especially students, find jobs via the Internet. Gerry is one example; Lin Jia is another. She needs a job to pay for her expensive English training so she searched on the Net and found work as a hotel receptionist. Earning 1400 yuan a month, she can save enough to pay off her debts.

The original generation of migrants often made their own way without contacts. Zhu Li Kun was a rice farmer. He has been coming to Beijing since 1990. He lives a 10 hour train journey away in Anhui province in central China. He has had a variety of building, electrical and maintenance jobs in the capital. “It is difficult being away from the children and my mother. I speak to them on the mobile once a month. But I can save money here to send home for their education.” The migrants are attracted by the money. Currently Zhu Li earns 1700 yuan a month in Beijing and it is guaranteed. By contrast he can get around 50 yuan a day on casual construction and maintenance work in his province. Miao works as a cleaner. She earns 1200 yuan a month, significantly more than she could get in her home province of Henan.

Yet if the wages are always more than they can earn in their home villages, conditions are tough. Building workers live in portakabins on site. Most other workers are in tied accommodation, often lodged in same sex dormitories, eight or more to a room. That means migrant married couples have to live separately. Migrants work long hours with at best one day off a week. On the building sites the hours are longest, often 12 hours, sometimes more and seven day working is not uncommon despite the regulations forbidding it. And with the mass migration has come the sex trade with numerous massage parlours, fake barber’s shops and a rising incidence of HIV and sexual disease. The official figure for the incidence of HIV is 650,000 across China as a whole but there are real concerns that its incidence is spreading and that migrant workers are a key transmitters.

Yet as Zhang Juwei a professor at the Chinese Academy of Social Sciences, points out, however tough the conditions “we have no slums here. It’s not like South Asia, Africa or Latin America.” There are huge high-rise tower blocks with running water and electricity all round the city and where the old
narrow-laned, single storey ‘hutong’ remain they bear no resemblance to the slums of Johannesburg, Mumbai or Nairobi. Dongdan hutong is less than 30 minutes walk from the Forbidden City and Tiananmen Square but it’s a hive of business, commerce and social activity. And here too in the alleyways and backstreets there’s a building boom going on, if on a smaller scale. Piles of bricks, roof tiles, wooden beams and sand are stacked by the side of the lanes, while bricklayers and plasterers renovate and rebuild the old houses and courtyards. The houses are small and often there are no indoor toilets. But unlike the slums of Mumbai and Nairobi there is electricity and running water; there are numerous public toilets; the streets are properly paved; and the rubbish is collected. There are small workshops and bigger workplaces. Furthermore, one can walk around safely at night, as I did in Dongdan.

The scale and speed of China’s internal migration is unprecedented. At no time in human history have so many people migrated so quickly. China’s rulers know that vast economic change often brings social upheaval in its wake. That’s why they have changed tack. From talking about ‘development at all costs’ and ‘enrich yourselves’ they now speak of ‘balanced development’ and creating a ‘harmonious society’. In particular they know that the growing inequalities between rural and urban China have to be addressed and that the conditions of both the rural poor and migrant workers have to be tackled. Recent State Council regulations have already begun to improve migrant workers’ access to schools and public services. On 1 January 2008 a new Labour Contract Law was introduced after much debate. It strengthened the legal rights of all employees and obliged employers to pay medical insurance for all their employees including migrants and had the potential to increase labour costs by up to 20%. Legislative timetables to extend social insurance are in hand, as well as for the introduction of a comprehensive pension system covering rural as well as urban areas. At the same time the government is seeking to develop major urban centres – mega-cities – in the centre and West of the country, to reduce the pull of the eastern coastal seaboard.

The philosophical shift from Deng Xiaoping to Hu Jintao is like that from Margaret Thatcher to Jacques Delors. Listen to policy-makers and government advisers for a week and the model that comes to mind repeatedly is that of the social market economy, of economic efficiency combined with social justice. The talk is of development with equity. And for some, equity means the right of ordinary people to organise and bargain. For Cui Chuanyi, a professor on migration at the Development Research Council, an official advisory body, the welcome changes underway have to be taken further. “We need to improve the job security and rights of migrant workers. They should be able to join a trade union and negotiate better rights.” There is resistance from employers and he acknowledges that the government “fears for social order but it wants to strengthen migrants’ rights.”

But if these debates amongst the policy-makers and in the wider press indicate a recognition that there are different class and social interests at play in today’s China, will the country be able to manage this explosive rate of change? The country needs to be able to shift its economy from an export-dominated focus to its domestic market, which is why the introduction of a social insurance and pension system is so vital. It will give citizens the confidence to save less and spend more.

Yet the great unknown relates to the future of migration. As Cui Chuanyi points out “more than 70% of migrants were born after 1980. They are ‘the new generation’ who are not so keen on farming, like city life and are more aware of their rights.” Specialists estimate that there are still more than
100 million surplus rural labourers. The migration genie is out of the bottle. Gerry symbolises the trend. But even more revealing is to listen to Zhu Li Kun. When we spoke, the rice farmer hadn’t seen his children for more than a year but he had sent home 20,000 yuan to his mother, who looks after his two children. Half the money is to pay for his teenage daughter to get through high school. Zhu Li will return to his village eventually to look after his elderly mother but ask him about his children and it’s clear that the future is urban. He says firmly, “They are getting educated. I want them to find a good job in the city.”
Chapter IX: Civil Society as a partner in economic development: the case of European Union Cohesion Policy

By Tony Venables

Introduction

The main theme of this chapter is that European Union (EU) Cohesion Policy should make more use of the contribution which Civil Society can make to help it achieve its policy objectives, a contribution which is as yet largely untapped. But it has a wider significance in that experience with EU Cohesion Policy illustrates both the benefits which can be gained by involving Civil Society in the implementation of development policy and also the difficulties in ensuring the sector’s close involvement. The discussion below, therefore, might be relevant to China as China’s policy-makers seek to develop implementation systems for economic and regional development policy. The annex is divided in three parts.

- The first part begins with some considerations about civil society before looking at how EU Cohesion Policy has gradually enlarged its principle of partnership.
- The annex then indicates the contribution and types of activity which civil society contributes to the implementation of EU Cohesion Policy.
- The third part contains recommendations for new implementation procedures which would enable policy-makers to tap into the full potential of civil society.

I. Civil Society and partnership in the governance framework of EU Cohesion Policy

Civil society

Strengthening the role of Civil Society requires an understanding of its existing contribution to economic development and of its potential to increase its role. Three points are relevant.

First, there are barriers to understanding what “civil society” is. Within the context of EU Cohesion Policy, there is often emphasis on definitions which stress the contribution non-governmental organisations (NGOs) make at the local level, such as “community development”, or their contribution to those parts of the economy which are more “social” than “market.” Thus, for example, in some countries, NGOs are seen as part of a broader “social economy” grouping associations, co-operatives, mutuals, and foundations. The notion of the “Third Sector” as distinct from the other two – the public and private sectors – denotes something similar. The label “voluntary sector” is also useful because it stresses the huge asset of NGOs in their ability to mobilize citizens and benefit from volunteers. All these labels are valid but none is entirely adequate for a sector which escapes easy categorization. The advantage of the label “Civil Society” is that whilst it includes NGOs, it is broader and can cover a wider range of interests.

That is why the broad term “Civil Society” fits well according to the European Commission’s definition:

“‘NGO’ and ‘civil society organisations’ are not legal terms. The specific criteria on which an organisation is considered eligible for EU funding are detailed in individual
calls for proposals. Nevertheless, ‘NGO’ is a useful shorthand term to refer to a range of organisations that normally share the following characteristics.

- NGOs are not created to generate profit (although they may have paid employees and engage in revenue-generating activities, they do not distribute profits to members);
- NGOs are voluntary;
- NGOs must have some degree of formal or institutional existence (e.g. statutes or other governing documents setting out their mission, objectives and scope). They are accountable to their members and donors;
- NGOs are independent, in particular of government, public authorities, political parties or commercial organisations;
- NGOs are not self-serving in aims and related values. Their aim is to serve the public as a whole, or specific groups of people.
- NGOs’ size as well as the scope of their activities can vary considerably. Some NGOs consist of a rather limited number of persons; others may have thousands of members and hundreds of professional staff.
- In functional terms NGOs can focus on operational and/or advocacy activities. Operational NGOs contribute to the delivery of services (such as in the field of welfare), whereas the primary aim of advocacy NGOs is to influence the policies of public authorities and public opinion in general.226

Second, policy makers are unaware of the sheer size of the sector. A study of global civil society in 40 countries conducted by the Johns Hopkins University has revealed that national and international quantitative and qualitative surveys of the sector tend to underestimate its real economic value, partly because it is not recognised as such in national accounts and official statistics. NGO institutions are, in fact, a major economic and social force in virtually every country throughout the world (i.e. both industrialized and developing countries).

For example, in some countries, the Third Sector employs around seven times more than large private companies; in Europe, it is about as large as the construction industry and the pre-crisis financial services sector; also, the Third Sector has been the most significant source of new jobs compared to other traditional sectors of the economy. The same study drew a similar picture from data on expenditure. Overall, the Third Sector represents about 5 per cent of the combined GDP in the countries studied. Comparative research also demonstrated that even in periods of recession the sector can grow and that it is the fastest creator of new jobs to meet new social needs in the services sector.227 It is an actor to which policy-makers in the EU – and elsewhere – should give more attention as part of its jobs and growth strategy.

Third, it is difficult to grasp the range and complexity of the sector. Policy-makers tend to equate civil society with multinational NGOs such as WWF, but in reality 90 per cent of the sector is at local community level. Nor can it be characterized like small and medium-sized enterprises. Most NGOs are in the category of SMEs, but some have accumulated – perhaps

227 For further information see www.jhn.edu/CCSS or contact mimi@jhu.edu Lester Salomon is the coordinator of the research carried out by John Hopkins. Interviewed by the author at the European Foundation Centre General Assembly in Istanbul on 29 May 2008, he estimated that in EU-27, 9-10 per cent of the active population, including volunteers, are made up by the non-profit sector. The percentages vary from 14.5 per cent in the Netherlands to 3 per cent in the EU’s new member states in Central and Eastern Europe.
over centuries – important assets in land and property and are now large institutions. The sector is, in fact, very diverse:

- people may be doing the same work behind very different facades: lay or church-connected, single-issue or more general purpose, and marked by very different traditionalist or more modern management styles;
- the same activity can take different legal forms – for example, an association in one country is equivalent to a cooperative in another;
- sources of funding, apart from individual donations or membership fees, vary; and government and EU procedures are becoming more complex with grants, service contracts, and demands for guarantees subjected to rigorous standards of financial management.

The EU is well ahead of the United States when it comes to public funding, but behind when it comes to corporate sponsorship, although corporate social responsibility is becoming a more important element in Europe – as well as in China. Similarly, traditional philanthropy managed by Trusts and Foundations is taking on new more entrepreneurial forms such as venture philanthropy. The styles and methods of action of NGOs vary but can be classified in two categories: advocacy and service delivery, although many organisations cover both. Since Civil Society is an expression of practically anything which concerns citizens at a given time in a society, classification should be treated cautiously. However, it is possible to make a crude division between addressing certain themes and responding to the needs of certain target groups of the population (see box).

**Civil society as a partner**

It is already widely accepted that Civil Society is a valid partner in implementing economic development policy. In the EU, the Lisbon Treaty tasks the Union with implementing a “principle of participatory democracy”. For example, it makes it possible for 1 million citizens from a significant number of the 27 member states to propose that the European Commission introduces a legislative initiative. The Treaty also strengthens representative democracy giving more legislative power to the European Parliament and a stronger role to national parliaments. Its Article 11 places an obligation on all institutions to “give citizens and representative associations the opportunity to publicly exchange their views in all areas of Union action” and to “maintain an open, transparent and regular dialogue with representative associations and Civil Society.” The question immediately arises of how such requirements may be put into practice. A European compact on the basis of a number of national models is one possibility. Compacts provide a framework for expressing partnership between Civil Society and public authorities, and are relevant in the context of European Cohesion Policy since they can be replicated at different geographical levels.

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228 Compacts express the relationship and respective roles of the government and civil society and underlying principles such as respect for freedom of association. They also address practical issues of consultations, funding and dispute settlement (www.thecompact.org.uk).
But the EU does not start from scratch. There are rules on access to documents and minimum standards of consultation adopted by the European Commission in December 2002 in the wake of the White Paper on European governance. Experience has, however, revealed problems with these principles and standards: they are not always applied uniformly across different policy areas; and they apply only to the activities of the European institutions and not to those many cases where member states apply European policies.

In the case of Cohesion Policy and its structural funds, a multi-level approach is needed. How can policy-makers ensure that involvement of Civil Society occurs at local/regional, national and European level, and that NGOs have the necessary capacity to make a valid contribution? There is a strong case for going further than the general standards of consultation and the citizen’s right to be heard and establishing a genuine partnership. ‘Partnership’ means the involvement of significantly different bodies or entities as partners, working together (in spite of their differences) to attain a particular aim. The term ‘partnership’ applied to socio-economic development, conveys the idea that cooperation between different bodies or institutions or territorial actors can achieve very good results and increase the quality of territorial development.

From an EU perspective, the ‘partnership principle’ was first introduced into Cohesion Policy in 1988 as one its four fundamental principles. Since then, the principle has evolved significantly. Starting from a narrow definition, which only included the Commission and the intermediate levels of governance in member states, it has widened to include the social partners and, as defined by the Commission, ‘other competent public authorities.’ While this development shows progress in the involvement of Civil Society in the processes of decision and policy-making, progress is still inadequate.
In negotiations for the regulations governing Cohesion Policy for 2007-2013, EU member states were reluctant to accept at the instigation of the European Commission, the European Parliament, and a coalition of European NGOs the following broadening of the partnership principle – although they finally did so.

“(c) any other appropriate body representing civil society, environmental partners, non-governmental organisations, and bodies responsible for promoting equality between men and women.”

However, the way in which this commitment is to be implemented is left to each member state, in accordance with “the principle of subsidiarity”. The new governance architecture of the funds with its clearer distinctions between strategic, programming and evaluation phases should make including civil society easier.

In its guidelines for Cohesion Policy, the Commission shows itself to be a strong advocate for partnership which:

“applies not only to the economic agenda but also to the broader effort to involve citizens who, through the partnership and multilevel governance arrangements under which cohesion policy is managed, can become directly involved in the Union’s growth and jobs strategy.”

Furthermore, the guidelines state:

“Developing innovative projects based on partnership, promoting civil participation in the formulation and implementation of public policies, as well as improving interaction between and within the communities can contribute to the creation of human and social capital, leading to sustainable employment, growth, competitiveness and social cohesion.”

and

“Partnerships, pacts and initiatives based on the networking of relevant stakeholders, such as social partners and NGOs also have a key role to play in the field of employment and labour market inclusiveness.”

II. The benefits of involving civil society

Civil Society is a key player in conceiving and implementing policy for economic development. Economists frequently view the EU Lisbon Agenda as the cornerstone of its Cohesion Policy in terms of competitiveness and economic globalization. But they should also recognize that a purely economic vision is not enough, even on economic grounds. In the partnership between public authorities and the private sector, Civil Society should be included as a third partner for a number of reasons.

• Associations and NGOs reach parts of society which the market cannot reach or which it does not find profitable to reach. But these parts of society should not be regarded, or regard themselves, as being outside the economic mainstream. Indeed, as we have

seen, NGO’s have a larger share of the economy in terms of employment, volunteering and service delivery, particularly to vulnerable groups in society and in certain regions, than is generally supposed.

- New investments through EU Cohesion Policy and new partnerships must result in more than just large-scale projects. Where big projects work best in terms of modifying economic structures, it is often because they have been accompanied by a cluster of smaller initiatives: for example, to clean up the environment; tackle social problems; bring new life to the community.
- “How to make Europe’s cities attractive places to live?” is a theme of EU Cohesion Policy. If we think about the cities which have achieved this, they combine economic activity with a critical mass of Civil Society and social capital. And, the reverse is true.

The European Commission’s Third Cohesion Report, presented in May 2004, states that “to promote better governance, the social partners and representatives from civil society should become increasingly involved, through appropriate mechanisms, in the design, implementation and follow-up of the interventions.”

There are three main types of contribution Civil Society can make to EU Cohesion Policy:

- **A link to the citizen.** A paradox of EU Cohesion Policy is that, despite its tangible relevance to the daily lives of citizens at the local level, it has less connection to Civil Society than other EU policies which would appear more remote and supranational, like trade for example. The following is an extract from the Budapest declaration on “Building European civil society through community development.”

  “Community development is a way of strengthening civil society by prioritizing the actions of communities, and their perspectives in the development of social, economic and environmental policy. It seeks the empowerment of local communities, taken to mean both geographical communities, communities of interest or identity and communities organizing around specific themes or policy initiatives. It strengthens the capacity of people as active citizens through their community groups, organizations and networks; and the capacity of institutions and agencies (public, private and non-governmental) to work in dialogue with citizens to shape and determine change in their communities. It plays a crucial role in supporting active democratic life by promoting the autonomous voice of disadvantaged and vulnerable communities. It has a set of core values/social principles covering human rights, social inclusion, equality and respect for diversity; and a specific skills and knowledge base.

  “The majority of NGOs are either local and/or target particular groups (see box). Their importance in organising economic development was made clear in a document produced in October 2003 by the Italian Presidency of the European Council: “A paradigm shift in development policies has been taking place in recent years,” it said, whereby “the traditional sectoral approach is being superseded by place-based policies”
which require “fully exploiting the knowledge of local actors about the main challenges and opportunities faced by each territory.”

It would be useful to undertake research into the ways in which EU Cohesion Policy involves and responds to local community advocates on concerns such as protecting the environment, choices of energy supply, transport, crime prevention. It would be interesting to look into innovative methods of citizen participation in economic development programmes and operations, such as citizens’ juries, town hall meetings, and deliberative polling. Moreover, participatory budgeting has spread from Porto Alegre and Latin America to over 100 European cities.

- **A targeted approach to job creation.** NGOs have relevant experience, and are already working with EU Cohesion Policy programmes, in combating unemployment, especially among those most in need or with difficulties that require special or individual approaches or intense support (for example, people for whom vocational training may not be sufficient to ensure their entry into the labour market, like some migrant workers or former prisoners). A wide range of third sector organizations may be involved with programme operations in areas such as:
  - Culture, sport, or leisure activities, which may be an important element in cross-border cooperation as well as mainstream programming. In addition, social or rural tourism is often part of the non-profit sector.
  - Environment – preservation of the countryside may be the responsibility of non-profit associations in some countries or regions, just as they may be involved in cleaning up former contaminated industrial sites.
  - Health – whether concerned with health promotion or defending patients’ interests, many non-profit associations are very significant contributors to medical research and may run special services or institutions (such as cancer clinics or hospices or campaigns to help prevent the spread of AIDS).
  - Social service – the largest group, covering a wide range of activity in combating social exclusion and poverty as well as all forms of discrimination.

- **A wide range of involvement.** The involvement of non-profit bodies with Cohesion Policy programmes ranges from providing advice, support and training, to running services for disadvantaged groups, including the young or long-term unemployed or drug users. The following quotation from the Commission’s cohesion guidelines is a good indication of areas of territorial planning where civil society should be mobilised:

  “In this context, measures are important that seek to rehabilitate the physical environment, redevelop brownfield sites especially in old industrial areas, and preserve and develop the historical and cultural heritage with potential spin-offs for tourism development in order to create more attractive cities in

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231 These approaches continue to be advocated. See for example, the European Commission’s green paper on territorial cohesion and the Committee on the regions’ white paper on multilevel governance (governance@cor.europa.eu)
which people want to live. The regeneration of existing public spaces and industrial sites can play an important role in avoiding suburbanization and urban sprawl, thereby helping to create the conditions necessary for sustainable economic development. More generally, by improving the planning, design and maintenance of public spaces, cities can 'plan out' crime helping to create attractive streets, parks and open spaces which are safe and feel safe. In urban areas, the environmental, economic and social dimensions are strongly interlinked. A high quality urban environment contributes to the priority of the renewed Lisbon Strategy to make Europe a more attractive place to work, live and invest.²³²

• A capacity for European networking. Networking, whether within regions, across internal borders, or with countries bordering on EU territory under the new neighbourhood instrument, is an increasingly important part of EU Cohesion Policy, symbolized by “promotion” of the Interreg programme from being a kind of add-on “Community initiative” to becoming a priority for mainstream policy. But finding the right networking partners is not easy – what is done by one third sector organisation on a local or regional basis in one country may be carried out nationally in another. In some cases there is no equivalence since different societies translate social needs and issues in different ways.

There are real risks with artificial networks or consortia set up without proper groundwork, which have as the main purpose for their existence the accessing of public sector funds in poorly-defined, joint projects. This suggests the usefulness of a micro-project-fund as a light, flexible instrument to help explore partnerships – ideally, in the EU, it would be co-funded by the EU and social economy banks and foundations, which are well aware of the needs of the third sector.

If difficulties can be overcome, there are significant advantages for policy-makers to work with NGOs on networking and cross-border projects:

- NGOs are often be ahead of regional or national authorities in exploring cross-border links since they do not have to overcome administrative or legal constraints. In creating networks at a local level in their work on restructuring projects, many NGOs have become aware of counterparts carrying out similar activity in neighbouring regions or countries and therefore seek them out as partners. In this way, bottom-up trans-national networks emerge.
- Networks may also emerge in a more top-down manner since many NGOs are members of European associations which will alert them to the potential benefit of adopting practice in other regions or countries. In such cases the European associations may provide advice to help NGOs “hook” their projects to EU policy.
- NGOs have created consortia in their home countries and thus increased the efficiency of EU Cohesion Policy programmes like Equal, Leader or Urban through creating links with civil society.

But this list of advantages also points to a difficulty encountered by NGO’s in their efforts to be involved in the mainstream implementation of policy for economic development – a difficulty which leads to the under-use of the potential which the non-profit sector can bring to policy implementation. EU or government programmes are frequently implemented in ways which do not take into account the administrative capabilities of NGO’s. In the EU, for example, many programmes have been discontinued which encouraged NGO involvement and allowed them to develop their know-how and create useful networks. This points to the conclusion that policy-makers should take account of the conditions facing NGO’s when they decide their procedures for policy delivery. It remains true that the easiest way to involve civil society in EU Cohesion Policy, for example, would be the introduction of special programmes which were designed to be implemented by NGOs and local community groups.

III. The advantages claimed for partnership – but also some of the obstacles

A key resource manual is the Guidebook “how European Social Fund (ESF) managing authorities and intermediate bodies support partnership” produced by the Community of Practice on Partnership, which in turn grew out of the collaboration of a group of managing authorities in the EQUAL programme. The first part of the study analyses ten reasons for partnership, which are summarised below, but also the obstacles faced. The second part called the Key Success Factor Framework starts with “overarching pointers” of good governance: accountability, participation and engagement, skills-building, appreciation of time. It then provides detailed framework that shares a series of factors that have been successfully used in different EU member countries to promote partnership during each distinct phase of the programme cycle:

- Operational programme analysis and design – carrying out a contextual analysis, promoting an enabling environment, identifying synergies with other programmes, and encouraging stakeholder engagement in the analysis and design process.
- Operation programme delivery planning – integrating stakeholders into programme procedures and setting up mechanisms for stakeholder involvement in projects
- Calls for, and appraisal of, project proposals – supporting incorporation of partnership in project proposals and assessing partnership rationale and implementation mechanisms.
- Animation during project implementation – providing ongoing support to partnership projects and building the capacity of stakeholders to actively participate in programme governance.
- Monitoring and evaluation – reporting on the status of partnership projects, promoting participatory evaluation at both programme and project level, and systematically feeding back lessons about partnership into practice.

At each stage of the cycle, the Guidebook gives examples of practices that have worked successfully to endorse partnership in different Member States. It also provides a series of partnership pointers and tips from programme and project representatives, individual experts, NGO and social partner groupings.
Advantages claimed for partnership

This ten point rationale for partnership is extracted and summarised from the Guidebook.

- **Focus** – a partnership is more able to more clearly identify gaps, needs and priorities...and develop targeted approaches to address them.
- **Coordination** – working in partnership can improve and synchronise policy coordination so that reach of policy is improved and duplication is avoided.
- **Access to resources** – partnership is able to access a range of diverse resources from different stakeholders in order to address particular problems and challenges.
- **Social Capital** – partnership connections reinforce social networks while also promoting a deeper shared understanding.
- **Innovation** – partnerships are able to develop more creative approaches because they share diverse perspectives, ideas and resources.
- **Capacity building** – working in partnership with different actors can also enhance the opportunities for improving strategic and operative capacity.
- **Empowerment** – direct engagement with target groups should enable those who are disadvantaged or marginalised to have a stronger voice in the political arena.
- **Legitimacy** – partnership delivers wider stakeholder mobilisation which can give the implementation of policy a more ‘democratic mandate’ as involvement and support of organisations that are ‘trusted’ by society can increase public acceptance of necessary reforms.
- **Stability** – the inclusion of civil society concerns in policy implementation can contribute to a more integrated and cohesive society.
- **Sustainability** – working in collaboration can promote long-term, durable and positive change.

The obstacles to partnership

The spread of good practice on partnership, however, faces obstacles which are often of a basic kind, before a partnership has even been bought into existence. When it has, as the ESF guidebook points out, “working in partnership” is not an easy option. Combining diverse organisational approaches resources and styles requires a considerable investment of time and energy “Moreover, partnership has come under increased scrutiny to show that it makes an impact” and that the sum is genuinely more important than the parts. This is not always easy to demonstrate. Obstacles include:

- **Information gaps** – to potential partners. Whilst information on EU Cohesion policy has improved, stakeholders in either vertical or horizontal partnership do not always have a clear perception of the European policy context within which they are working. It helps if the European context is closely linked to the national development plan or regional policy. However, it is significant that a region like Lazio in Italy which is advanced in terms of the application of participatory democracy, feels that it is necessary to launch a new website on regional policy. Without better information and understanding, many actors whose participation is
voluntary, do not make a link between their own activity and the policy and do not know where to start. Requirements for information and training are often too sophisticated and target those which are already “insiders”.

- The difficulty of adding horizontal to vertical partnership. The partnership between national and regional authorities and with the European Commission is in itself not an easy option, with many studies pointing to the distrust which can exist among different levels of governance. The additional of the consultation and participation of stakeholders is seen as an additional burden. The latter often feel they are boarding the train late without a clear sense of its destination and the rules of engagement. Partnership can often create expectations which are not fulfilled, with NGOs finding that some of their arguments progress only to be rejected at the point of decision-making by powerful line ministries or regional authorities. The implication is that social partners, civil society and other stakeholders need to shadow the vertical partnership and also link up and operate at different geographical levels.

Other difficulties in running a successful partnership. Although the difficulties could be encountered in almost any setting and in relation to any policy, there is still a sense that the most serious of these relate to the difficulties of managing a particularly demanding and complex policy, rather than resistance to partnership as such.

- Lack of time is the most frequently mentioned obstacle to creating partnerships. Such are the demands of management, reporting and the increasing frequency of checks and audits that it becomes increasingly difficult to add on partnership. This is even more the case, when all the advice goes in the direction of the need to make a considerable prior investment in preparation and in on-going efforts to nurture the partnership.

- Lack of capacity of the partners. Particularly in the new member states, authorities point to the lack of capacity of civil society organisations to engage with national and regional economic policy and their lack of resources to become active participants. Equally, whilst there are solutions to such problems, they require time and effort to introduce facilities such as the use of technical assistance for capacity building or global grants.

- Lack of stability. Despite the broad acceptance of partnership, it still meets with resistance from “silo working” by both public officials and NGOs or other civil society organisations. Regional case studies also point out that there are inevitably different levels of engagement, with some partners more active than others and not necessarily sharing the same interests. In general, partnerships are a network of people, and so are not helped by frequent changes in personnel both in the administration and among stakeholders.

IV. How to bridge the gaps and develop partnership
In the EU, as we have seen, Civil Society is supported by the legal texts and policy statements in its role as a partner. One difficulty which persists – although a good deal of progress has been made – is in the availability of information at all levels of governance. Information about the possibilities offered by EU Cohesion Policy has improved so that it is now possible to navigate on the internet from the overall architecture of the funds to national and regional plans. As part of a European transparency initiative, websites have begun to include lists of final beneficiaries of the funds. More needs to be achieved since information and transparency are the keys to securing better access for Civil Society to policy implementation.

There are few studies of the partnership principle in practice. Evidence is often anecdotal and scattered. Some general observations can, however, be made.

- Performance by member states is highly variable, with some organising regular hearings, whilst others pay only lip service to the partnership principle.
- Inclusion of NGOs in monitoring committees in “old” and “new” member states has progressed.

To improve standards across EU-27, there is a widespread consensus that formal mechanisms, must be complemented by increased capacity building and technical assistance to allow Civil Society organisations to relate to and participate in multi-level governance, from the making of EU Cohesion Policy to its programming. This has implications for the future shape of the policy itself since, with the exception of specialised programmes, it has not been designed to tap the potential of civil society.

Consultation

From examining the national strategic reference frameworks and the operational programmes of EU member states and regions we can distinguish roughly three categories:

- Regions/governments which pay lip service to the principle, giving purely formal and general accounts saying Article 11 of the basic regulation has been implemented, but without saying how. Some authorities do not even appear to acknowledge that there is a specific requirement. However, most do so. Not surprisingly, partnership tends to be viewed in this formalistic way particularly in new member states, where the emphasis is on compliance with the letter rather than the spirit of partnership and the overriding priorities are proper financial management and absorption of the funds.
- Those which go further and also describe a mixed picture, stressing both the advantages of partnership, but also some of its shortcomings, such as the lack of knowledge, organisation and commitment by the socio-economic partners and NGOs. Adding “civil society” to the regulation appears to have encouraged more thinking about how to consult more widely. This is an interesting group, probably willing to learn more from best practice in more advanced regions.
- Those which go much further – mostly the regions rather than the governments – in developing wide-spread publicity and a well organised consultation plan. They also provide more details about what has been done: meetings, hearings, results and assessments of how partnership worked.
However, it has to be concluded that extracting any worthwhile or comparable information from the national strategic frameworks and the operational programmes is a daunting task. Enforcement is difficult therefore and can only be achieved gradually. In the policy papers and academic literature, a distinction is made between horizontal partnership involving the European Commission, the member states and regions, and vertical partnership with socio-economic actors. The authorities find difficulty in reconciling partnership among different layers of government which is obligatory with partnership towards societal actors.

Attempting to implement partnership across the EU is made more difficult because Europe is a constitutional mosaic. Federal states favour management by the regions. Others do the same but with national cooperation or leadership. In a number of smaller EU member states, the national government manages the policy.

The participation of Civil Society needs to be actively encouraged by policy-makers. In the EU, for example, the European Commission, as guardian of the Treaty, should be given the task of encouraging the inclusion of Civil Society as a new partner. Detailed decisions on which organisations to involve and how to set up and involve the partnership at all stages could then be left, in line with the subsidiarity principle, to EU Member States. The regulations should require Member States to set down a consultation plan and publish a report on how the partnership principle is being observed and the development plan implemented.

There should be a Commission communication to drive-up standards of consultation for the structural funds. This might cover:

- minimum standards for the consultation of final beneficiaries, target groups, non-governmental organizations and civil society groups;
- a model consultation plan adopting best practice in terms of consultation, with details concerning schedules, systems of notification, criteria, multiple forms of consultation, and the making available of documents;
- a defined role for the European institutions in working with the non-governmental community;
- the structures of NGO participation, such as working groups, steering groups, monitoring committees, selection committees;
- recommendations as to how national governments may resource the participation of the non-governmental and civil society community;
- systems for the post-hoc reporting and evaluation of the consultation process.

**Capacity building**

There is a general consensus that even with better, more coherent standards applied to policy implementation across the EU, the involvement of Civil Society will not occur without capacity building. Ideally, simplification and reform should make it possible for NGOs to work on the implementation of EU Cohesion Policy without having to introduce new financial and other management skills into their operations. Perhaps an important starting point for a capacity building effort would be for NGOs themselves to state what skills and resources they require to represent their particular sector in programme management committees and in their service delivery roles. NGOs might be skilled “niche” players fitting in well with the contents of a programme but still have difficulty meeting the formal requirements of working with the policy’s regulatory requirements. The problem here is that whilst **in theory** EU Cohesion
Policy offers a range of possibilities and funding to enable Civil Society to play a part in economic development, the opportunities do not in practice appear to be available to NGOs.

There are four main routes towards improving the capacity of civil society organizations to work with economic development policy.

- **Intermediary structures.** In several countries, running the partnership is a task delegated to existing or specially created bodies. For example, one of the German Lander Saxony-Anhalt has a “competence centre for partnership” which helps prepare social partners for meetings, informs and trains them and assists them to prepare strategies. Austria has a strong tradition of formal mechanisms for partnership building. Sweden has a national thematic group on partnership. In Ireland, a special company called Pobal has been given this task.

- **Capacity building by the third sector.** In newer EU member countries, foundations, which were active in, first, building the civil society sector, are now devoting attention to building its capacity to implement EU Cohesion Policy and take advantage of its funding opportunities. They are examining to what extent they can support NGOs in this task through training, co-funding projects or providing guarantees. In older Member States, a number of banks and financial institutions are close to the sector and can play a decisive role in supporting NGOs. Also, NGOs themselves need to come together in coalitions of interest or through umbrella bodies to consider how to adapt to working in policy implementation. The proposal made earlier for some kind of fund to explore and create partnerships is relevant here.

- **Global grants.** The general regulation for EU Cohesion Policy envisages the inclusion of global grants as part of the funding system. However, it is silent on the amount of money which may be devoted to such grants. As a result, the possibility is rarely used. A minimum threshold of policy funding should be used under the global grants procedure and this would provide a valuable access point for NGOs.

- **Technical assistance** has as its main purpose the improvement in performance of measures co-financed by policy. Technical assistance may take a wide variety of forms: feasibility studies, training for project managers, exchange of experience and information, as well as the financing of monitoring and evaluation. It is – and must remain – a flexible tool for the benefit of all partners at different stages in policy implementation. However, although technical assistance funding is available under EU Cohesion Policy, it does not reach Civil Society organizations, which generally need to strengthen their management capacity to discharge the complex regulatory requirements of projects and programmes, especially in the operational phase at regional and local level. Technical assistance is primarily needed by the public authorities which manage programmes, but it should be extended to help beneficiaries, like third sector organizations, to improve their contribution to implementation.

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The conclusions and recommendations of this chapter can be summed up in a word, COOPERATE:

Civil society’s role as a partner in EU Cohesion Policy must be advocated.
Organisations of the third sector should put forward their joint demands for national and regional strategies.
Organise a broad cross-sectoral coalition at the EU level and extend consultations to Civil Society.
Partnership between local administrations and the third sector is the key to added-value in policy delivery.
European Commission should require Member States to publish a “Consultation Plan.”
Regulations on the structural funds should provide a better balance between economic, social and environmental policies.
Access for local groups and small and medium-sized NGOs to EU cohesion programmes must be assured.
Technical assistance and global grants should be guaranteed for third sector organisations.
Europeanise the debate on EU Cohesion Policy and involve citizens.

V. Conclusions

Mobilising the largely untapped potential of Civil Society in European regional policy has to be approached, with political will, from different perspectives.

• The legal texts and policy statements already exist to extend the partnership principle to include Civil Society in EU Cohesion Policy. There are examples of guidelines, such as the OECD handbook on information, consultation and participation which are available to national and regional authorities. The problem now is one of implementation.

• This is not just a regulatory issue. There has to be a perceived mutual advantage. Public authorities have to be convinced that not everything can be done by the public sector and private industry, so that they see more clearly the role of the “third sector”. This sector, in turn, has to be convinced about its own role in economic and local community development in partnership with other actors. European funding mechanisms must be made sufficiently user-friendly. Instruments such as global grants, technical assistance and European programmes can help improve the capacity of Civil Society to play its part in policy implementation.

• Reforming and developing the governance framework to improve transparency would create a more enabling environment for Civil Society. This should apply not only to consultation but a more participatory democracy in which not just Civil Society and stakeholders have a say, but ordinary citizens too.

234 This the acronym for a programme run by ECAS with the support of the San Paolo Foundation.
Chapter X: European Union rules on state aids – how the EU sets the framework for member countries’ own regional policies

By Steve Fothergill

Introduction

For at least a decade there has been a strong interest in the European Union’s (EU’s) spending on regional development through its three Structural Funds – the European Regional Development Fund, the European Social Fund and the European Cohesion Fund. But what most observers have failed to grasp is that this only one of the mechanisms through which the EU exerts a dominating influence on regional policy throughout the EU territory.

Rules on the use of State Aid are the other controlling mechanism. These determine the extent to which member states are allowed to provide financial assistance to firms to protect or create jobs. In effect, they govern how far member states can use their own money to assist their own regions. With the notable exception, for example, of work by Yuill and Allen (1987), Armstrong (2001) and Wishlade (1998, 2003, 2007), the EU State Aid rules which govern the regional policies of member countries have been subject to remarkably little academic scrutiny or comment.

The rules which govern member countries’ own regional aid are determined on the same periodic cycle as the EU Cohesion Policy and its three Structural Funds. The Union is now half-way through its 2007-13 period, the preceding phase having ended on 31 December 2006. The next is scheduled to begin on 1 January 2014. This chapter will seek to explain why EU rules to control national State Aid matters so much. Its second part will explain the background; its third will explain the evolution of the rules which apply in the current 2007-13 phase; and this will be followed by an assessment of the impact of the present rules on regional development in the member countries. The final part of the chapter will move into controversial new territory and will argue that the European Commission is going too far in constraining member countries’ regional policies, and that, in future, the EU control of national regional aid needs to be based on a different set of principles.

But, first, the chapter will try to set the question of national aids for regional policy in a wider context by discussing the four factors which affect the pace of regional economic development in the EU. The objective of the discussion will be to show that the terms “EU regional policy” – meaning the activities carried out via the Structural Funds – and “regional policy in the European Union” are far from being the same thing. And it is important to keep the difference in mind when comparing regional development policy in China with that in the EU. The European model of regional development is about a lot more than EU Cohesion Policy and its Structural Funds.

Take my own experience. For twenty years I have been closely involved in efforts to regenerate Britain’s former mining areas, and for a decade have spearheaded the lobbying for Britain’s older industrial areas more generally. My firm impression would be that EU

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215 Steve Fothergill is a Professor in the Centre for Regional Economic and Social Research at Sheffield Hallam University, City Campus, Sheffield S1 1WB, UK.
Cohesion Policy and its regional policy component (Convergence objective, Competitiveness objective, Objectives 1 and 2, and so on) accounts for no more than between a quarter and a third of the overall regional development effort in these areas. And this holds true whether the discussion in question is about spending, impact or profile. I suspect that this impression would be confirmed by an examination of policy implementation on other EU member countries.

1. Four other instruments for the economic development of EU regions

Beyond EU Cohesion Policy, there are at least four other instruments contributing to the economic development of regions in the EU: market forces, fiscal transfers, state aids, and member countries’ own regional development policies. This section will deal with each in turn.

a) Market forces as a tool for development

This is a surprisingly serious element in the regional development jigsaw. Neo-classical economic theory argues that in an economy where labour and capital are mobile, market forces should work to narrow differences in regional growth. Capital will flow to low wage and low land-price areas; labour will flow to the high-wage areas, easing wage pressures there and eroding labour surpluses in the low wage areas. Of course, the real world does not work smoothly in this way but market forces are unquestionably at work in the development of regions. Taken in the round, they may be having a bigger impact on the pattern of regional development across Europe than conventional regional interventions.

So, before the onset of the financial crisis and ensuing depression, private sector investment was flowing eastwards from the countries of EU15 to countries like Poland, boosting Poland’s growth, whilst Polish workers migrated to places like the UK, where it was evident that their arrival helped hold down wages in segments of the UK labour market (see Chapter XI of this report). These movements of capital and labour between countries were producing a market-led regional convergence.

Similar processes are at work within bigger member states as well. Why are new telephone call centres located in former mining villages in England’s Yorkshire? Answer: because cheap labour is in ready supply there. Why does manufacturing investment mostly steer clear of London? Answer: because land is too expensive.

The promotion of market forces can be a conscious, integral part of regional development strategy. The United Kingdom provides an example: numerous official documents in recent years have made clear that it is an explicit objective of regional policy to tackle ‘market failure’. In this way, the UK government is seeking to promote regional development by improving the efficiency of market forces – thus drawing on the conclusions of the neo-classical economic model for part of its policy implementation mechanism. This illustrates that EU regional development policy uses market mechanisms as one of its tools.

b) Fiscal transfers

The term ‘fiscal transfers’ is used here to mean money collected by the central state from richer regions and then redistributed to poor regions to pay for public services or social security benefits. In the EU, something similar to fiscal transfers takes place at the level of

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the Union through the operation of EU Cohesion Policy’s three structural funds but this is
dwarfed by the fiscal transfers which take place within member countries.

In fact, such fiscal transfers would not normally be considered in the EU to be a part
of regional development policy – their prime policy relevance being in the field of social
cohesion. However, such fiscal transfers appear to be central to China’s conception of policy
for regional development – for example, the transfer of central government revenue to finance
education and health services in poorer provinces.

These sorts of fiscal transfers have a huge impact on regional development. They support
massive numbers of jobs directly in the poorer regions and they underpin the development of
the local skills base necessary to allow development. They also give non-employed people an
income.

Communities which are being affected by economic restructuring have in many cases lost the
economic base which brought them into being. Yet – despite the fact that they may be badly
served by transport and other infrastructure – they continue to survive. For some workers,
despite transport difficulties, commuting to jobs in the nearest town may provide income. But
for the community as a whole, the answer lies in a combination of public sector jobs and
welfare benefit payments – both supported by fiscal transfers – that, in turn, supports a
residual consumer services sector. Some rough estimates put as high as 50 per cent the
working age employment rate which may be maintained by fiscal transfers in such
communities, even if no goods and services are sold to consumers outside the community.

c) Member country regional policy

This is a huge area of activity, of which state aid (see below) is one component part. The
other parts include:

- physical planning policy;
- infrastructure investment;
- development agencies;
- tax breaks;
- relocate central government jobs away from richer cities;
- activity by regional and local government.

These elements of regional policy are furthest developed in the larger member states, and
those with a longer history of regional development activity.

It is easy to underestimate the impact of physical planning controls, yet physical planning has
a big impact on regional development. In the United Kingdom, the application of a “green
belt” policy squeezed London’s population down from a peak of 9m in the late 1930s to a
trough of 7m in the early 1990s. Its effect was to push people and jobs out beyond the green
belt but also to other more distant regions. If a similar approach were to be applied around
Shanghai, would it have a similar effect?

Infrastructure investment – road and rail networks particularly – is only occasionally justified
by reference to regional development, but, again, its development impact can be enormous.
Indeed, it may be argued that it is a prerequisite for successful regional development. The EU
participates in the funding of some of this investment – but, except in the newer member
countries, the biggest share of investment for infrastructure comes from national public and private finance.

Regional development agencies proliferate. In purely financial terms they are often big spenders – the twelve agencies in the UK, for example, together spend more than €2.3 billion a year. A new national agency in England – the Homes and Communities Agency – which is additional to the regional agencies, will have an annual budget of €4.5 billion. Often, when EU Cohesion Policy resources from its three funds are channelled through such agencies, EU Cohesion Policy is reduced in status to be just one of several funding streams being implemented by such agencies. In the English coalfields the most important intervention to promote regional development over the last decade has been the English Partnerships coalfield site programme – now covering 107 sites; matching more than €800 million of public sector spending from a variety of sources with €1.75 billion of expected private sector spending; and aiming to create 40,000 new jobs, 2 million m² of new commercial floorspace, and 12,000 new homes.

Then there are Enterprise Zones with their attendant tax breaks. How do you get new jobs into villages in the heart of the old South Yorkshire coalfield in England? Answer: put in new roads, prepare development sites, and then grant Enterprise Zone status with tax breaks on property investment. Such a policy created 10,000 jobs.

Or how do you keep afloat the Tyneside economy when the shipyards and armament factories have all gone? Answer: relocate civil service jobs. 20,000 central government jobs are now located to Newcastle – by some margin the largest concentration of civil service jobs anywhere in the UK outside London. Offices for the UK’s Department of Work and Pensions in the Newcastle suburbs employed, at one time, more people on one site and in one organisation than any other office complex in Europe.

d) State aids

The bigger, older EU member states – Germany, France, Italy, Spain and the UK – spend billions of their own public resources on regional financial incentives to companies in order to create or protect jobs in less prosperous regions. Go back far enough in time, before EU Cohesion Policy became a big spender in the regions, and this sort of state aid was regional policy.

Member country state aid policies are regulated through the provisions of EU Competition Policy which provides an interface with Cohesion Policy, since the two operate in coordination whenever necessary. EU Competition Policy starts from the premise that national state aids distort the operation of markets and are a wasteful use of public resources (regions may enter into a bidding war with one another to try to “win” an investment). It therefore takes a negative view of state aids, except in certain limited circumstances, and has worked to reduce the amount of national spending on such aid. But national state aid still keeps flowing – even if it is at a lower rate – and the present phase of EU Cohesion Policy is again accompanied by an “assisted area” map showing the areas in which regional state aid is permitted by Competition Policy rules. What is more, under some of the other special-purpose state aid schemes – supporting, for example, “economically desirable” objectives like research and development, small and medium-sized businesses, and training – there is provision for higher grant rates in “assisted areas” where state aid is allowed.
This important part of EU Cohesion Policy and its regional development component – where the regulation of the public sector seeks to increase the added value of private sector resources – is often ignored in discussions of the policy’s implementation and performance. It will therefore be discussed at greater length in the rest of this chapter.

2. Spending on state aids

Under the EU Treaties, financial assistance to firms is deemed incompatible with the internal market because such aid distorts competition by favouring certain firms or the production of certain goods and services. However, there have always been allowable exceptions to the general rule, where aid is deemed to serve desirable objectives. ‘State aid’ is the general term use to describe the financial assistance given to companies under these rules. In 2006 (the final year before the new state aid rules discussed in this Chapter came into force) a grand total of € 66 billion was spent on state aid – slightly more than the annual Structural Fund budget (which averages €53 billion a year for 2007-13).

State aid is made up of a lot more than just regional aid. In 2006, regional aid accounted for just under € 11 billion, or 15 per cent of the total. This is the money paid to firms by national, regional and local governments specifically in pursuit of regional policy objectives and authorised under the regional aid rules. The other 85 per cent of state aid went on a wide variety of schemes including aid to agriculture (€ 12 billion), the coal industry (€ 4 billion), environmental projects (€ 15 billion), research and development (€ 7 billion) and small firms (€ 5 billion).

Table 1 shows the distribution of regional state aid by EU member country. The figures are a snapshot for 2006 but the pattern was not fundamentally dissimilar in the four or five preceding years. The key point is that the vast majority of spending on regional aid took place in the five largest, longer-standing member states – France, Germany, Italy, Spain and the UK. These five countries accounted for three-quarters of all the regional aid permitted under the old EU rules. Germany alone accounted for 30 per cent of the total. What this means, in effect, is that the EU rules on regional aid are primarily an issue for these five countries, who have by far the most to lose from any tightening of the regime.

The EU State Aid rules do not determine how much each member state spends on regional aid – that remains for national governments to decide – but they do set the framework which determines where the money can be spent, how much can be given to an individual project, and exactly what the money can be spent on. Subsidies to operating costs are ruled out except in a few extremely restricted circumstances. Subsidies to capital investment in plant, machinery and buildings are, however, permitted, and it is these that absorb nearly all the total expenditure.

Table 1: Regional state aid by member country, 2006

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<th>Country</th>
<th>million euro</th>
<th>per capita EU25 = 100</th>
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<tr>
<td>Germany</td>
<td>3,178</td>
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<td>France</td>
<td>1,968</td>
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</tbody>
</table>
Regional aid programmes obviously vary from country to country. In the UK, the EU State Aid rules have provided the legal underpinning for a range of investment incentives dating back to the 1970s. Since 1988, when automatic capital grants were abolished, the main scheme has been Regional Selective Assistance (later re-branded in England as Selective Finance for Investment). This provides discretionary capital grants to firms investing in less prosperous regions (“Assisted Areas”) and is the main tool used to attract mobile investment projects, particularly foreign direct investment. The EU rules also underpin public sector gap-funding of private sector property investment in the Assisted Areas. In recent years in the UK, annual spending on Regional Selective Assistance has been around € 350 million. Up to 2006, before the present state aid rules came into force, total UK spending authorised under the regional state aid rules averaged around € 1 billion a year. This was broadly the same as annual average EU spending in the UK under EU Cohesion Policy’s Objectives 1 and 2 (2000-06).

Across the EU15 spending on regional state aid has been falling – by 2006 it was only around half what it had been a decade earlier. This is partly a reflection of changing fashions in regional development, with less emphasis on financial subventions and more on indirect methods of promoting growth, competitiveness and employment. However, at least part of the reduction is attributable to the EU rules, which were revised in 1994 and again in 2000, with the effect of reducing both the eligible areas on which state aid could be granted and the permitted aid intensities.
Table 2 shows the figures for the five largest member countries. What is evident here is an element of convergence. Germany and Italy were huge spenders on regional aid in the early 1990s – presumably in Germany because of assistance to firms investing in the former GDR and in Italy because of grants to firms in the South. German and Italian aid has since been curbed substantially. In contrast, in France and the UK spending on regional aid has risen a little, and in Spain, where it started at low levels, it has grown to levels closer to those in the other big member states.

### Table 2: Trends in regional state aid in the five largest EU member countries

<table>
<thead>
<tr>
<th></th>
<th>1992-94 annual average m.euro (2004 prices)</th>
<th>2004-06 annual average m.euro (2000/8 prices)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>6,140</td>
<td>2,916</td>
</tr>
<tr>
<td>France</td>
<td>774</td>
<td>1,516</td>
</tr>
<tr>
<td>UK</td>
<td>659</td>
<td>907</td>
</tr>
<tr>
<td>Italy</td>
<td>8,152</td>
<td>1,188</td>
</tr>
<tr>
<td>Spain</td>
<td>351</td>
<td>1,153</td>
</tr>
</tbody>
</table>

Source: European Commission

### 3. The evolution of the revised state aid rules

Revised rules governing regional aid for 2007-13 were agreed by the European Commission in December 2005 (Commission of the European Communities 2005a). The development of the revised rules was a lengthy and contested process.

The starting point for the Commission was the view expressed on several occasions by the Council of Ministers that there should be “less and better targeted state aid”. This statement applies to all forms of state aid, not just regional aid, and it lies behind a much wider restructuring of state aid rules of which regional aid is just one part (DG Competition 2005). Less and better targeted state aid is one of those goals that sounds so eminently reasonable that no-one can disagree, and member state governments have been reluctant to challenge this basic principle. Appplying it in a way that commands their support has been much more problematic.

On state aids the European Commission’s role is different to that on Structural Funds, where the key decisions are taken by the Council of Ministers. The Commission acts as the legal
guardian of the competition rules enshrined in the EU Treaties. It alone has final powers of decision. It is, in a sense, prosecutor, judge and jury, and, on matters of practical detail, it is the legislator as well. The real world operates a little differently: whatever its theoretical powers, the Commission does not act in a wholly unilateral way on new regional state aid rules. Member state governments are always consulted, even if their approval is not ultimately required.

The Commission’s first formal shot in the debate about the revised rules was a consultation paper sent to member country governments in April 2004 (DG Competition 2004a). This did not flinch from seeking to implement the ‘less and better targeted’ agenda. Under the 2000-06 rules, the areas eligible for regional aid had covered 42 per cent of the EU15 population. With EU enlargement, this rose to 52 per cent of the EU25 population and the Commission proposed reducing this to just 35 per cent. It proposed to do this by aligning eligibility for regional aid with Objective 1 status under the Structural Funds – that is the group of worst-off regions where incomes were lower than 75 per cent of the Union’s average GDP per head.

At this point an explanation of the technical status of different assisted areas is useful. Within the EU Treaties there is provision for two types of assisted area:

- **Article 87.3(a) areas.** These are the areas where the standard of living is deemed to be abnormally low. They are, in effect, the top priority category of assisted area.
- **Article 87.3(c) areas.** These are other areas where it is desirable to promote development provided such aid “does not adversely affect trading conditions to an extent contrary to the common interest”. They are the lower priority category.

Under the rules which applied for the 2000-06 period, Article 87.3(a) areas were the same as Objective 1 areas under the Structural Funds – in other words NUTS 2 regions where GDP per head was below 75 per cent of the EU15 average. Article 87.3(c) areas overlapped quite a lot with Objective 2 areas – areas considered to be undergoing economic restructuring – though in detail the maps differed. In its April 2004 consultation paper the Commission proposed that for 2007-13 ‘assisted area status’ should be limited to:

- Post-2006 Objective 1 areas, defined as those with GDP per head below 75 per cent of the EU 25 average. These would get Article 87.3(a) status.
- Areas that would have got Objective 1 status in the absence of EU enlargement (‘statistical effect’ regions) and those losing Objective 1 status because of economic growth (‘economic development’ regions). These would get Article 87.3(c) status.

In addition there was to be minor provision for low population density areas and the EU’s outermost regions (in the Atlantic, Caribbean and South America, and the Indian Ocean). The significant point about these proposals was that they would have eliminated ‘assisted areas status’ for just about all the areas which had had Article 87.3(c) status for the period 2000-06.

For the EU12 member countries the changes would have been negligible. But for Germany, France and the UK – three of the big spenders on regional aid - the change would have been dramatic. For Germany, all assisted area status outside the former German Democratic Republic would have disappeared. France would have been left with ‘assisted area status’ for its overseas territories but for none of mainland France. In the UK, ‘assisted area status’ would have disappeared from the whole of the North East of England, the whole of the
English Midlands and all of central Scotland, as well as large parts of Yorkshire and the North West.

The Commission argued that although it was proposing to withdraw eligibility for regional aid from large parts of EU15, firms in these areas would remain eligible for financial assistance under other aid schemes, for example assistance with Research and Development and training costs. It was right to make this point but its argument overlooked three issues. First, the incentives paid under the regional aid rules are often the key tool used to attract mobile investment, and none of the other available schemes could really plug this gap. Second, aid under the other schemes can be granted anywhere in the EU, so less prosperous regions would lose their advantage over other areas. And third, there is actually a feedback loop from the regional aid rules to the aid intensity ceilings allowed in some of the other schemes: areas with assisted area status, under the regional rules, can also offer higher rates of assistance for Research and Development, training and so on. Loss of assisted area status would therefore reduce the value of other aid schemes as well.

Unsurprisingly, the Commission’s April 2004 proposals came in for criticism from the affected areas and from their national governments. Behind the scenes, senior officials within the Commission dropped hints about possible concessions. It was very surprising, therefore, that when the Commission issued a revised proposal – in the form of a ‘non-paper’ on the regional aid guidelines in December 2004 (DG Competition 2004b) – it proposed no changes on the most contentious points.

The French, German and British governments now took positions of trenchant opposition. Finally, the Commission saw sense. The next version of the proposals – now in the form of draft guidelines issued in July 2005 (Commission of the European Communities 2005b) – conceded substantial ground. Crucially, the Commission accepted that there was a legitimate role for ‘assisted area status’ well beyond just on-going or former Objective 1 areas. It proposed that the original target of 35 per cent of the EU25 population to be covered by assisted area status should be raised to 43 per cent.

The additional coverage proposed by the Commission was in the 87.3(c) category. The allocation between member countries would be based on a complex formula, essentially the one used for 2000-06, which took account of the prosperity of each member state relative to the EU average and the prosperity of each region (defined in this instance at NUTS 3 level) in relation to the member state average. The scale of 87.3(c) coverage in each member state was also subject to a safety net that limited the reduction in total assisted area status (‘a’ and ‘c’ together) to a maximum of 50 per cent.

The Commission proposed that the allocation to regions and localities of this 87.3(c) coverage would be for member state governments to determine, subject to transparent procedures and to final agreement by the Commission, which represented a modest relaxation of the more prescriptive approach adopted in drawing up the 2000-06 maps. However, to be eligible for the full range of financial incentives, areas designated for ‘assisted area status’ would have to have a minimum population of 100,000, as in 2000-06. In addition, the Commission proposed a ‘filter’ whereby candidate regions (NUTS 2 or 3) should have either GDP per head below the EU25 average or unemployment of at least 115 per cent of the national average.

The reception for the July 2005 proposals was much better. Nevertheless, the proposals continued to come in for criticism because they would still result in large reductions in
‘assisted area status’, especially in the member countries that traditionally make most use of regional aid. The final rules, in December 2005, therefore included a number of further concessions. The most important were a loophole allowing member countries to argue a special case for small areas within prosperous regions that failed to meet the filter criteria, and additional 87.3(c) coverage, for 2007 and 2008 only, to limit the initial reduction in 87.3(c) coverage to no more than one-third. Temporarily, this last provision added a further 17 million population to the assisted area map across the EU, equivalent to 4.5 per cent of the EU25 population. It is hard not to interpret this particular provision as anything other a final attempt by the Commission to buy off its critics.

There are two alternative ways of interpreting the Commission’s handling of the new regional aid rules.

One is that the Commission was very stupid, driven by an ideological opposition to state aid and out of touch with the thinking of member countries and others engaged in regional development on the ground. The initial proposals certainly proved to be some considerable distance from those that were finally agreed. In the process, the Commission antagonised many people and forced many officials and politicians to expend time and effort trying to salvage what first appeared to be a disastrous situation.

The alternative interpretation is that the Commission was very clever. In putting forward draconian early proposals, it may have deliberately intended to lower expectations about the extent of regional aid that would be allowed after 2006. That it subsequently had to give ground misses the point: even after the concessions to critics, the assisted area map within the EU15 member countries is a lot smaller after 2006 than it was before. It may indeed be the case that the Commission was driven by ideology and out-of-touch with development needs on the ground. Nevertheless, in the new rules it has perhaps got what it always wanted.

4. The implications of the 2007-13 rules

Table 3 shows the regional aid coverage allowed under the 2007-13 EU rules. The transitional areas, eligible for coverage only in 2007 and 2008, are excluded to give a clearer picture of their full impact. The new Article 87.3(a) areas are the same as the post-2006 Objective 1 areas (re-branded now as ‘Convergence regions’) under EU Cohesion Policy. The ‘statistical effect’ regions – those which would have qualified for the worst-off category if it had not been for the fall in the EU average GDP per head as a result of the Union’s enlargement to include EU10 – are also the same as for EU Cohesion Policy. The allocation of Article 87.3(c) coverage to specific areas is approved country by country, on the basis of proposals from member state governments.

The newer member states are mostly eligible for a high (and in several cases comprehensive) level of regional aid coverage. The coverage in the richer, older member states is far less extensive. This is the converse of the pattern of spending on regional aid noted earlier in this Chapter. Of the five big spenders, Spain has 60 per cent population coverage, Italy 34 per cent, Germany 30 per cent, the UK 24 per cent, and France just 18 per cent.
Table 3: Eligibility for regional state aid, 2007-13

<table>
<thead>
<tr>
<th>Country</th>
<th>Article 87.3(a)</th>
<th>Statistical effect</th>
<th>Other article 87.3(c)</th>
<th>Total coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estonia</td>
<td>100</td>
<td>-</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Latvia</td>
<td>100</td>
<td>-</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Lithuania</td>
<td>100</td>
<td>-</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Malta</td>
<td>100</td>
<td>-</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Poland</td>
<td>100</td>
<td>-</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Slovenia</td>
<td>100</td>
<td>-</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Hungary</td>
<td>72</td>
<td>28</td>
<td>-</td>
<td>100</td>
</tr>
<tr>
<td>Greece</td>
<td>37</td>
<td>56</td>
<td>8</td>
<td>100</td>
</tr>
<tr>
<td>Slovakia</td>
<td>89</td>
<td>-</td>
<td>-</td>
<td>89</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>89</td>
<td>-</td>
<td>-</td>
<td>89</td>
</tr>
<tr>
<td>Portugal</td>
<td>70</td>
<td>4</td>
<td>3</td>
<td>77</td>
</tr>
<tr>
<td>Spain</td>
<td>36</td>
<td>6</td>
<td>18</td>
<td>60</td>
</tr>
<tr>
<td>Cyprus</td>
<td>-</td>
<td>-</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>Ireland</td>
<td>-</td>
<td>-</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>Italy</td>
<td>29</td>
<td>1</td>
<td>4</td>
<td>34</td>
</tr>
<tr>
<td>Finland</td>
<td>-</td>
<td>-</td>
<td>33</td>
<td>33</td>
</tr>
<tr>
<td>Germany</td>
<td>13</td>
<td>6</td>
<td>11</td>
<td>30</td>
</tr>
<tr>
<td>Belgium</td>
<td>-</td>
<td>12</td>
<td>14</td>
<td>26</td>
</tr>
<tr>
<td>UK</td>
<td>4</td>
<td>1</td>
<td>19</td>
<td>24</td>
</tr>
<tr>
<td>Austria</td>
<td>-</td>
<td>3</td>
<td>19</td>
<td>23</td>
</tr>
<tr>
<td>France</td>
<td>3</td>
<td>-</td>
<td>16</td>
<td>18</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>-</td>
<td>-</td>
<td>16</td>
<td>16</td>
</tr>
<tr>
<td>Sweden</td>
<td>-</td>
<td>-</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>Denmark</td>
<td>-</td>
<td>-</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>Netherlands</td>
<td>-</td>
<td>-</td>
<td>8</td>
<td>8</td>
</tr>
</tbody>
</table>

NB Excludes areas eligible for transitional assistance for 2007-08

Source: European Commission

Table 4 shows the reduction in assisted area coverage in the EU15 member countries caused by the differences between the 2007-13 and 2000-06 arrangements. Again it ignores the short-term transitional coverage for 2007 and 2008. Across the EU15, areas covering nearly 41 million people have dropped off the assisted area map. The big reductions are in France (11.2m), Spain (7.9m), Italy (5.5m), Germany (4.4m) and the UK (4.1m) – the five countries where expenditure on regional aid is greatest. There is no doubt that reductions in assisted area maps of this magnitude are proving hard to accommodate, and it is clear that areas with a legitimate case for assistance have fallen off the map. The selection of areas for removal from
‘assisted area status’ depended mainly on how member countries exercised their discretion to allocate coverage, but the driving factor was the constraint imposed by the new EU rules.

Table 4: Reduction in regional state aid coverage between 2000-06 and 2007-13, EU15 member countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Reduction (population coverage)</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>11,150,000</td>
</tr>
<tr>
<td>Spain</td>
<td>7,900,000</td>
</tr>
<tr>
<td>Italy</td>
<td>5,500,000</td>
</tr>
<tr>
<td>Germany</td>
<td>4,360,000</td>
</tr>
<tr>
<td>UK</td>
<td>4,120,000</td>
</tr>
<tr>
<td>Portugal</td>
<td>2,400,000</td>
</tr>
<tr>
<td>Ireland</td>
<td>1,950,000</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1,200,000</td>
</tr>
<tr>
<td>Austria</td>
<td>670,000</td>
</tr>
<tr>
<td>Belgium</td>
<td>520,000</td>
</tr>
<tr>
<td>Finland</td>
<td>480,000</td>
</tr>
<tr>
<td>Denmark</td>
<td>460,000</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>60,000</td>
</tr>
<tr>
<td>Sweden</td>
<td>50,000</td>
</tr>
<tr>
<td>Greece</td>
<td>0</td>
</tr>
<tr>
<td>EU15</td>
<td>40,820,000</td>
</tr>
</tbody>
</table>

NB Reduction includes areas eligible for transitional assistance for 2007-08 only

Source: Author’s calculations based on European Commission data

The UK illustrates the point. A generation ago the whole of the North East of England, the whole of central Scotland, the whole of Wales and the whole of Northern Ireland, plus other areas in the North and Midlands, were included on the Assisted Area map. Regional assistance has delivered real benefits to these areas but it has had to swim against the tide of wider economic change, so that in the intervening years the gap in prosperity between these parts of the country and the South has barely narrowed. Successive versions of the Assisted Area map, not least the one necessitated by the 2000-06 EU rules, had already reduced the map to the point where even in the least prosperous regions the coverage was partial and contorted. The new UK Assisted Area map, approved by the Commission at the end of 2006 (Department of Trade and Industry 2006), takes this process a step further, removing for example significant parts of Merseyside, South Yorkshire, Greater Manchester, the West Midlands, and central Scotland.
The squeeze imposed by the new rules also extends to aid intensities. These are the ceilings on the grants to firms and are expressed as a percentage of the cost of a project. The detailed rules on aid intensity ceilings are complex, hedged around by links to GDP levels, cross-border comparisons and other considerations. In addition, the ceiling for medium-sized firms (50-250 employees) is 10 per cent higher than for large firms, and for small firms (fewer than 50 employees) 20 per cent higher – the logic here being that grants to small and medium-sized enterprises are less likely to distort competition across the EU as a whole.

Table 5: Maximum allowed aid intensities to large enterprises, 2007-13

<table>
<thead>
<tr>
<th>Article 87.3 (a)</th>
<th>40-50%</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Poorest regions)</td>
<td></td>
</tr>
<tr>
<td>Article 87.3 (a)</td>
<td>30%</td>
</tr>
<tr>
<td>(GDP 60-75% of EU25)</td>
<td></td>
</tr>
<tr>
<td>Article 87.3 (c)</td>
<td>30% to 1.1.2011</td>
</tr>
<tr>
<td>(Statistical effect regions)</td>
<td>20% thereafter</td>
</tr>
<tr>
<td>Article 87.3 (c)</td>
<td>25% to 1.1.2011</td>
</tr>
<tr>
<td>(Economic development regions)</td>
<td>15% thereafter</td>
</tr>
<tr>
<td>Article 87.3 (c)</td>
<td>15%</td>
</tr>
<tr>
<td>(mainstream)</td>
<td></td>
</tr>
<tr>
<td>Article 87.3 (c)</td>
<td>10%</td>
</tr>
<tr>
<td>(high GDP, low unemployment)</td>
<td></td>
</tr>
<tr>
<td>Article 87.3 (c)</td>
<td>15%</td>
</tr>
<tr>
<td>(low pop density, borders)</td>
<td></td>
</tr>
</tbody>
</table>

Source: European Commission

Table 5 shows the maximum aid intensities payable to large enterprises in the main types of assisted area. The ceiling varies from 10 to 50 per cent, but in the larger member states which account for most of the spending (France, Germany, Italy, Spain and the UK) the 87.3(a) rate of 30 per cent and the 87.3(c) rate of 15 per cent are the key figures. The 87.3(a) rate is down on what it was previously (35 per cent in most areas). The 87.3(c) rate is unchanged. However there have also been detailed changes to the accounting rules, involving the way that taxation is handled, which effectively reduce the real value of any given percentage grant compared to what it was previously. There must be a serious question mark about whether aid intensity ceilings at some of the lower levels now set by the Commission can really deliver changes in investment decisions.
Are grants of this magnitude really likely to change firms’ behaviour, or will they merely provide firms with a windfall by part-funding investments that would anyway have gone ahead on the same scale, in the same place and on the same timescale? The doubts probably exist for grants of 15 per cent and the doubts are even greater for those as low as 10 per cent.

5. The failings in the current approach

Drawing up the EU rules for regional state aids for the 2007-13 period proved contentious. The final rules are deeply flawed and their implementation will damage regional development across a substantial part of the EU. Something serious has gone wrong.

The issue is not whether there should be any EU rules at all. In a single market it is only reasonable that there are rules ensuring fair play. In particular, it is important to ensure that regional aid is not used as a backdoor route to provide general industrial subsidies that unfairly distort competition. The principle of having EU rules on regional aid is therefore sound. The flaws lie in the conceptual framework and detailed design.

At the core, the problem is one of conflicting perspectives. The Commission takes an EU-wide perspective. From its vantage point in Brussels, the whole of the European Union is made up of ‘regions’. The Commission weighs up the needs of Latvia against Tees Valley, Andalucía against Ile de France. The poorest regions across the EU as a whole are the ones it deems most in need of regional assistance. The Commission does not see it as its task to worry unduly about exactly how these regions are distributed across the member countries – it is the distribution of economic activity across the EU that should drive the system. This is unquestionably the perspective that lay behind the Commission’s original April 2004 proposals.

The member countries, and their constituent regional and local authorities, see things differently. From their perspective what matters are the internal disparities within their own country. What matters, for instance, is that Tees Valley is a great deal less prosperous than Greater London. That Tees Valley is more prosperous than Latvia is irrelevant. Member countries want the flexibility to support economic development in their own poorer regions, irrespective of whether these regions are rich or poor on an EU-wide scale.

There is little dispute that the regional aid disbursed by the EU itself, through the Structural Funds, should be concentrated on the poorest regions of the EU. This is what is happening in 2007-13, and whilst there are regrets that so much funding is moving eastwards to the newer member countries there has been little serious opposition to the principle. However, member countries and their regions find it hard to understand why the EU should then step in, through the EU State Aid rules, to add further restrictions on what they spend from their own resources on their own regions. In the context of the present reforms, many poorer regions in the EU15 face a double blow: less funding from the EU, and reduced eligibility for aid from their own government because of the new EU rules. On the ground this seems illogical because when EU funding is being reduced it seems only reasonable to allow greater leeway for national aid to fill the gap.

This is not the only paradox arising from the present reforms. What has happened is that eligibility for regional aid, especially at the higher Article 87.3(a) level, has been granted to many regions in member countries that have historically made little use of these provisions.
They have never been the big spenders on regional aid, and it is not even evident that they want to become big spenders. Meanwhile, the biggest cuts in eligibility have fallen on France, Germany, Italy, Spain and the UK – all large countries with substantial populations, where regional disparities are considerable and where the need and willingness of national governments to intervene is well proven.

Furthermore, in several cases – Estonia, Latvia, Lithuania, Malta, Poland, Slovenia, Hungary and Greece – the new EU rules grant assisted area status to the whole of the member state’s territory, including comprehensive Article 87.3(a) coverage to the first six countries on this list. In these circumstances the aid really ceases to be ‘regional’ at all – it is not about narrowing internal differences but about promoting national economic development. Thus if any of these member countries chooses to do so, they can introduce an across-the-board national subsidy to capital investment and it would be perfectly legal within the EU rules. But this is the sort of subsidy, which is likely to distort competition and which the EU State Aid rules were originally intended to prohibit.

Finally, there is a complete failure to address the quality of regional aid. The emphasis in the new rules is solely on eligible areas, aid intensities and the definition of costs. There is a complete silence on the types of schemes that member countries should bring forward. This is odd, given the Commission’s enthusiasm to reduce overall spending on state aid, because there is much that could have been done to promote schemes that try to avoid ‘deadweight’ – subsidies to projects that would have gone ahead anyway. It is deadweight spending, above all, that the Commission might have targeted in its drive to eliminate subsidies that merely distort competition.

6. The direction for reform

The present shift to the east in funding and aid eligibility could be only a foretaste of what is to come. Bulgaria and Romania joined the EU in 2007, the former Yugoslav republics are waiting in the wings, and Ukraine and Turkey may come later. All of these have a stronger claim on EU Structural Funds than the regions of the old EU15. If the Commission maintains its present approach, eligibility for regional aid will shift further in the same direction. The outcome would be the end of much of traditional regional policy in the EU15.

It is too late to change the State Aid rules for 2007-13. What is important is that a new philosophy underpins the next set of rules. This needs to be based on six principles.

- First, the Commission should acknowledge that the provision of regional aid is a legitimate and desirable national government activity. This is, in a sense, an issue of subsidiarity. EU member countries need the flexibility to address their own regional problems in their own way, without undue interference from Brussels. Funding from national budgets can and should co-exist with the Structural Funds. There is still a need for EU rules to govern regional aid to firms, to ensure fair play, but this control from Brussels should be exercised with a ‘light touch’.

- Second, the EU State Aid rules should be decoupled from the Structural Funds. So long as they remain linked (at present by eligibility for Convergence status and Article 87.3(a) status) eligibility for EU aid will
drive eligibility for national regional aid. In the context of a European Union that is expanding to the east, this no longer makes sense. The role of the Structural Funds should be to assist in the development of the EU’s less prosperous regions. The role of national regional aid should be to tackle imbalances within member countries.

- Third, the population coverage of the assisted areas in each member country should be determined by the extent of disparities in that member country. If the purpose of national regional aid is to allow member countries to address their own internal imbalances, the coverage to which they are entitled under the EU rules should be calculated in relation to those imbalances, not EU-wide statistics.

- Fourth, the detailed designation of assisted areas should be devolved to member country governments. Quite why the European Commission should interfere in national government decisions about exactly where they chose to spend their own money remains unclear, and the technical competence of the Commission to do so in an EU of 27 member countries, or more, is questionable. There needs to be a basic set of principles, and beyond that member countries should be allowed to get on with the job.

- Fifth, the aid intensity ceilings should be raised to levels more likely to influence firms’ investment decisions. This is an issue mainly for Article 87.3(c) areas – but, as from 2007, they make up the vast majority of the remaining assisted areas in the old EU15. The grants on offer to firms have to be sufficient to make a difference. At 15 or 10 per cent, as at present, it is doubtful whether they always do so, or whether the potential of capital grants to raise regional investment levels is fully exploited.

- Sixth, there needs to be a new emphasis on the quality of aid schemes. This is the one tightening of the rules that could be justified. It would be reasonable for the Commission to ask member states to introduce mechanisms intended to filter out projects that would anyway have gone ahead without state aid. This would help hold down the overall level of state aid and would be a meaningful quid pro quo for the devolution of other aspects of regional aid decision-making from the Commission to member states.

The EU State Aid rules for 2014 will soon become the object of discussion and the Commission’s initial thoughts on the next round will soon begin to crystallise. A new framework of the sort outlined here would represent a substantial shift and cannot be delivered overnight.
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CHAPTER XI: Achieving Sustainable Resource Use in the EU

by Richard Harding

1. Introduction: the challenge of sustainable resource use

Whilst economic development has brought increased wealth to both the European Union (EU) and China it has also resulted in greater demand for natural resources, increased pollution of land, water and air and negative effects on biodiversity and risks to human health. Economic development without concern for environmental protection is unsustainable because, clearly, development needs natural resources of all kinds to support itself. Environmental protection therefore must be integrated into different levels of economic development policy. This applies to China just as to the EU, although there are notable differences in terms of the policy instruments each uses to achieve this objective and in the way they are applied.

This Chapter compares the ways in which China and the EU address the challenge of sustainable resource use in their current regional development investments. China’s rapid development and urbanization call, in particular, for urgent measures to safeguard water resources and curb pollution from power generation and heavier industrial operations. The EU is still dealing with a legacy of pollution from its industrial past, whilst striving to accelerate the provision of basic environmental infrastructures in its new Member States. The challenge of sustainable resource use also places demands on other key policy fields including agriculture, fisheries, industry and trade in both China and the EU.

Global warming represents a major challenge to the EU and China and is dealt with in the following chapter. The EU and China are cooperating in a number of ways to jointly promote solutions to pressing environmental problems. The two sides established in 2003 the European Commission-China Ministerial Dialogue on Environmental Protection which continues today to initiate co-operation in the areas of climate change, pollution control, natural resource management, biodiversity conservation, water management, chemicals management and sustainable consumption and production. The European Commission also participates in the high-level China Council for International Co-operation on Environment and Development, established by China in 1992 to strengthen international co-operation on development and environmental protection. The two sides also co-operate in the EU-China Partnership on Climate Change (see next Chapter).

Policy for protection of the Environment operates through rules which are designed to guide investment towards environmentally sustainable options and thus ensure sustainable development. This aspect of policy is clearly regulation-based. But the policy also includes incentives to spread best environmental practice as rapidly as possible. In this area of activity there are a number of projects in China which represent EU-China co-operation.

- In Liaoning Province, where the economy is dominated by coal mining and heavy industry, the EU has contributed € 37 million towards the Liaoning Integrated Environment Programme to support environmental planning, management and
enforcement capacities and to encourage cleaner production, waste minimization and recycling.

• In the three provinces of Hainan, Hunan and Sichuan, the EU contributes €16.9 million to the five-year Natural Forest Management Programme which seeks to help local communities make better use of forest resources and to diversify their economies. Six counties, 11 townships and 58 villages participate.

• The Environmental Management Co-operation Programme, to which the EU contributes €13 million, aims to improve the capacity of policy administrators in China in the fields of environmental management and sustainable development. It is structured around demonstration projects in seven model communities in Hailin (sustainable tourism in mountain and forest areas); Huairou, Beijing (ecological land use and city planning); Jinan (air quality management); Jiang’an, Wuhan (urban renewal); Jinniu, Chengdu (community management); and Nanyang (integrated water resource development).

• The EU contributes €30 million to the EU-China biodiversity programme which operates a series of projects to raise awareness and create appropriate institutions; €25 million towards the EU-China River Basin Management Programme in the Yellow and Yangtze river basins; and €20 million towards an Energy and Environment Programme which contributes towards sustainable energy production and consumption, and improved energy security.

• In addition, the EU-China Policy Dialogue Support Facility on Environment currently supports Training and exchange of experience on Integrated Pollution Prevention and Control (IPPC), Registration, Evaluation and Authorisation of Chemicals (REACH) and Globally Harmonized System (GHS) on Classification and Labelling of Chemicals.

The first sections of this chapter describe how the EU Cohesion (regional development) and Environment policies work together to secure sustainable development and place the EU on a sustainable development path. They illustrate the two important aspects of the work: the regulatory aspects which govern investment and which are the province of Environment Policy (sections 2 and 3); the instruments in a wider range of policy which guide investment (section 4) and the two aspects of Cohesion Policy which are of fundamental importance, the environmental priorities which is supports financially (section 5) and its governance aspects which support environmental protection (section 5).

### 2 Legislation in the EU

At EU level, environmental legislation incorporates over 200 legal acts. This framework covers all environmental sectors, including waste, water, air and nature. All investment in regional development must comply with EU environmental law, whether it is financed from public budgets of the Member States, from EU funds, from private companies, or from a combination of these sources. The main legal provisions concern the following fields:

**Waste** – The Waste Framework Directive (2006/2/EC) lays down basic requirements regarding the handling of waste. It establishes the hierarchy for waste management options, in order of decreasing preference, as (i) prevention, (ii) recovery and reuse (material recycling, energy recovery), (iii) disposal. It stipulates that waste disposal and recovery should not present a risk to the environment or human health. It lays down
rules on the prohibition of uncontrolled waste disposal, on establishing permits for waste treatment operations, on the elaboration of waste management plans and the creation of networks of waste disposal plants. Within the Waste Framework Directive, the Landfill Directive (1999/31/EC) sets out detailed rules to prevent or minimise the negative effects of landfill sites for waste, including pollution of soil, air and water and risks to human health, as well as to reduce the quantities of biodegradable waste going to landfills. The Incineration Directive (2000/76/EC) aims to prevent or limit as far as practicable the negative effects on the environment from the incineration of waste. It imposes stringent operational conditions and technical requirements and sets emission limit values for waste incineration plants within the EU. A number of “recycling” Directives – for example those on waste from packaging, electrical and electronic equipment, vehicles, batteries – set binding targets for the recycling of waste or specific materials contained within waste. Most of them explicitly foresee that the producers of the products are financially responsible for the proper treatment of waste.

**Water** – The Water Framework Directive (2000/60/EC as last amended by 2008/32/EC) brings together earlier separate Directives and establishes a framework for the protection of all water bodies in the EU – i.e. rivers, lakes, transitional waters, coastal waters, canals and groundwater. Its central objective is to achieve good quality status for all water resources by 2015, including through integrated management in 15 major river basin districts. It contains specific provisions for the assessment of infrastructures with potential risks of water resources deterioration, for example related to inland waterway projects. A particular feature of the Water Framework Directive is that it applies to water as it flows, rather than to specific administrative boundaries. It therefore requires strong cooperation between water authorities in different Member States and regions.

**Air** – The Directive on Ambient Air Quality and Cleaner Air for Europe (2008/50/EC of May 2008) brings together earlier Directives covering sulphur dioxide, nitrogen dioxide and oxides of nitrogen, ozone, particulate matter, lead, benzene and carbon monoxide in ambient air, as well as the reciprocal exchange of air quality data. It may also be extended to embrace the current Directive 2004/107/EC on arsenic, cadmium, mercury, nickel and polycyclic aromatic hydrocarbons in ambient air. The new Directive requires air quality plans to be developed for zones within which concentrations of pollutants in ambient air exceed the relevant limit values. These should be consistent and integrated with plans prepared in relation to other Directives – e.g. on the limitation of emissions of certain pollutants into the air from large combustion plants (2001/80/EC), the assessment and management of environmental noise (2001/81/EC and 2002/49/EC), as well as where permits are granted for industrial activities pursuant to Directive 2008/1/EC concerning integrated pollution prevention and control.

**Nature** – is covered by the Birds Directive (79/409/EEC) and Habitats Directive (92/43/EEC) in particular in relation to impacts on the network of Natura 2000 sites – the European ecological network of protected areas, which has become the centrepiece of EU nature and biodiversity policy. The selection of a site for the Natura 2000 Network rests on the particular natural habitat(s) and species on the site and the degree to which it meets the specific Natura 2000 selection criteria used by the European Topic Centre on Biological Diversity. The Directives require a comprehensive identification of all the
potential impacts likely to be significant on a Natura 2000 site of any development plan or project, taking into account cumulative impacts. They also require application of the best available techniques and methods to restore or maintain a favourable conservation status for the site’s natural habitats and species. The Habitats Directive contains specific provisions regarding mitigation measures, as well as eco-compensation in other locations in cases where environmental damage is done to a Natura 2000 site.

**Environmental Impact Assessment (EIA)** – The Directive (85/337/EEC as last amended by 2003/35/EC) requires Member States to carry out an assessment before they are authorised on certain (usually large) public and private projects likely to have a significant impact on the environment. This is a procedural Directive requiring the evaluation of a wide range of environmental impacts and consultation with environmental authorities and the public (including trans-border consultations). The Directive encourages consideration of alternative, less environmentally harmful approaches to the implementation of projects subject to EIA. It also encourages the use of mitigation measures which aim to minimise, or even cancel, the negative environmental impacts that are likely to arise as a result of a given project. However mitigation and consideration of alternatives are only voluntary in terms of the Directive and not compulsory as in the case of the Habitats Directive referred to above. The Directive takes account of the provisions of the Aarhus Convention and places special emphasis on public participation and access to justice in environmental matters.

**Strategic Environmental Assessment (SEA)** – The Directive (2001/42/EC) covers similar issues to project-level-EIA, such as waste, energy use, land use, and nature conservation. However, SEA relates to entire development plans or programmes which are likely to have significant impacts on the environment. SEA therefore addresses cumulative issues arising from a range of different investments over time. Consultation with environmental authorities and the public likely to be affected are key aspects of SEA – as they are with EIA – together with a systematic examination of alternative means of delivering similar economic outcomes with different environmental impacts. Although SEA studies are carried out ex-ante, SEA is also intended to be an iterative process into which monitoring data is fed during implementation of the plan or programme concerned. The partners involved in the SEA may then decide on improvements to be made from an environmental point of view to the relevant strategy, or to the way it is delivered, during its phase of implementation.

**Environmental Information** – the freedom of access to information on the environment Directive (90/313/EEC as amended by 2003/4/EC) aims to make information held by public authorities on the environment more accessible to the public, and to ensure that fair standards of access to information are applied across the EU.

Under EU environmental laws, the **precautionary principle** is followed wherever impacts are not known or are poorly understood from a scientific point of view. This means that whenever there is doubt as to whether an environmental measure should be applied, or whether a study should be carried out, the environment is given the benefit of the doubt: in such circumstances, the measure or study must be carried out. EU legislation also aims to encourage a **preventative approach** to environmental protection, on the basis that
preventing environmental damage is more cost-effective than remediation after it has taken place. However, where environmental damage has already taken place, the ‘polluter pays’ principle, which is written into the EU Treaty, is enacted by the Environmental Liability Directive (2004/35/EC). This obliges companies and public operators which have caused land contamination that creates a significant risk to human health, water pollution or damage to habitats to pay for the clean-up and for the restoration of habitats to their original state.

Focus 1: eco-compensation

Ecological compensation is required by the Habitats Directive (92/43/EEC) in cases where preliminary assessments show that a plan or project will damage a site designated under Natura 2000, but that the “plan or project must nevertheless be carried out for imperative reasons of overriding public interest, including those of a social or economic nature”. These compensatory measures should be used only when mitigation measures and other safeguards are ineffectual and the decision has been taken to consider a project or plan which has a negative effect on a Natura 2000 site. Compensatory measures are independent of the project, including any associated mitigation measures. They are intended to offset the negative effects of the plan or project so that the overall ecological coherence of the Natura 2000 Network is maintained. Compensatory measures should therefore:

- address, in comparable proportions, the habitats and species negatively affected;
- provide functions comparable to those which had justified the selection criteria of the original site, particularly regarding the adequate geographical distribution.

Building a programme of compensatory measures

Compensatory measures can consist of restoration or enhancement in existing Natura 2000 sites, or creation of a new habitat on a different or enlarged site, which would be incorporated into Natura 2000.

The programme of compensatory measures must address all issues which are necessary, whether they are technical and/or legal or financial, to accomplish the objective of offsetting a plan or project’s negative effects. A good quality programme of compensation should include:

- tight coordination and cooperation between Natura 2000 authorities, assessment authorities and the proponent of the compensatory programme (i.e. the plan or project promoter);
- clear objectives and target values according to the conservation objectives of the site;
- analysis of the technical feasibility of the compensatory measures in relation to their conservation objectives;
- analysis of the legal and/or financial feasibility of the compensatory measures according to the timing required;
- explanation of the time-frame in which the achievement of the conservation objectives is expected;
- timetable for implementation of the compensatory measures and their co-ordination with the schedule for the plan or project implementation;
- public information and/or consultation stages;
- specific monitoring and reporting schedules based on progress indicators according to the conservation objectives;
- the appropriate budget which has been approved during the suitable period to guarantee the success of the measures.
Measures which later show in practice to have a low level of effectiveness should be modified over time so that their effectiveness increases. Binding enforcement tools should be devised at the national level aimed to ensure the full implementation and effectiveness of compensation.

**Timing of compensation**

Programming the timing the compensatory measures demands a case-by-case approach. The adopted schedule must ensure the continuity of the ecological processes essential for maintaining the biological structure and functions that contribute to the overall coherence of the Natura 2000 network. This depends on issues such as the time required for habitats to develop and/or for species populations to recover or establish in a given area. Among other factors and processes which must also be considered are the following:

- A site must not be irreversibly affected before compensation is in place.
- The result of compensation should be effective at the time the damage occurs on the site concerned (where this cannot be fully achieved, over-compensation is required for the interim losses).
- Time lags might only be admissible when it is ascertained that they would not compromise the objective of ‘no net losses’ to the overall coherence of the Natura 2000 network.
- Time lags must not be permitted if they lead to population losses for any species protected in the site.

All necessary provisions – whether technical, legal or financial – which are necessary to implement the compensatory measures must be completed before beginning the implementation of the plan or project. In this way, there should be no unforeseen delays that may hinder the effectiveness of the measures.

**Habitat ‘banking’**

Habitat banking is a trading instrument sometimes used in eco-compensation. Such schemes transform environmental liabilities into marketable assets. Specialised companies create, for example, wetlands and then sell wetland credits to developers who are required to provide eco-compensation on their planned projects. This ensures that environmental objectives are met with no net loss of total value and at the same time leads to a competition among companies to establish new wetlands cost-effectively. Like tradable permit schemes in general, such schemes help to integrate conservation objectives into mainstream business, thus helping to overcome business resistance. However, equivalence of habitats must be maintained and there must be measurement criteria to enable monitoring of effectiveness. In the case of Natura 2000 areas, the basic principle still applies – i.e. that compensation for habitat loss should only be applied as a measure of last resort.

**Who bears the cost of the compensatory measures?**

In line with the ‘polluter pays’ principle, the promoter of a project bears the cost of the compensatory measures. Where these are included as eligible costs in the total budget of an application for support under EU Cohesion Policy, they may be co-financed by EU funds (ERDF or Cohesion Fund) according to the provisions of the operational programme concerned and the funding decision taken by the programme authorities.

**Further information**
3 Enforcement of environmental legislation in the EU

**Member State legal systems**

The principal legal instrument used in the EU for the enforcement of environmental rules is the Directive. A Directive is an instrument agreed and adopted at EU level which obliges the Member States to achieve specific results without necessarily stipulating the means by which these results should be achieved. Directives must therefore be transposed into the legal system of each Member State to enable their implementation. EU Environmental Directives are generally implemented through Member State laws on physical and spatial planning, or laws governing the issuance of permits for particular economic activities. Penalties for non-compliance with EU environmental rules are imposed through the legal system of the Member State in question and may vary between Member States. Generally, such penalties will involve fines, withholding or removal of permits or forced cessation of activities contributing to the legal infringement. Penalties are levied at national, regional or local level in the EU depending on the features of the Member State legal system and the type of infringement concerned.

**Role of the European Commission and Parliament**

The European Commission monitors the implementation of EU environmental legislation by the Member States and presents an Annual Report to the European Parliament, accompanied by a Communication on implementing environmental law plus a detailed Annex. These can give rise to debate in the European Parliament in its Environment Committee and at Plenary level and can lead to Parliamentary Resolutions. In addition, the Environment Commissioner appears before the Parliament’s Environment Committee once or twice a year and can be asked questions about implementation. Members of the European Parliament can also table Written and Oral Questions at any time and can initiate Petitions. Although the Commission is responsible for enforcement of EU environmental legislation, cases can be launched on the basis of information received in Parliamentary Questions and Petitions.

**Recourse to the European Court of Justice**

A special feature of EU-level policies, such as Environment Policy, is the additional recourse which the European Commission has to the European Court of Justice. This mechanism is
used in cases where the Commission considers that the Member State’s legal system is not acting effectively or quickly enough on committed infringements. Where the Commission’s legal action is successful, substantial penalties may be imposed on Member State governments by the Court of Justice. Usually these penalties will be fines – in extreme cases levied by the day, week or month until the infringement has been rectified.
Focus 2: recycling old electrical and electronic equipment

In 1998, about 6 million tonnes of electrical and electronic equipment were disposed of as waste in the EU of 15 Member States. The amount has been rising ever since. Until the nineties, most of this waste ended up on scarce landfill space where the hazardous substances it contained threatened to contaminate land and leak into local water supplies. In response to this situation, the EU Directive on Waste Electrical and Electronic Equipment (WEEE, 2002/96/EC) came into force in 2003 alongside the related Directive on the Restriction of the Use of Certain Hazardous Substances (RoHS, 2002/95/EC).

In order to reduce the stream of electrical and electronic equipment waste going to landfills, the WEEE Directive imposed a tight timetable. It obliged Member States to transpose the Directive into national legislation by 13 August 2004 and then, within one year, by 13 August 2005, it obliged them to have a number of new systems in place:

- member states had to set up systems to achieve the separate collection of WEEE and allow the return of WEEE free of charge by the final holder;
- retailers had to ensure that WEEE could be returned on a one-to-one basis when a new and equivalent type of product was supplied;
- all WEEE collected from private households had to be transported to authorised treatment facilities;
- systems had to be set up by producers to provide for recovery, recycling and re-use of separately collected WEEE according to pre-set recovery, re-use and recycling targets.

By December 2006 Member States had to achieve targets under the WEEE Directive of 50 per cent recycling and 80 per cent recovery of waste electrical and electronic equipment. The minimum target rate of separate collection from private households was set at 4kg per inhabitant per year.

Member States have considerable freedom in their national transposition of the Directive. The "tried and tested" system is a nation-wide collection scheme such as in the Netherlands, Belgium and Sweden. Another is the "clearing house model" like in Germany. The published figures for France show that it is close to achieving the EU target of recycling 4kg of waste per capita per year. Sweden is much further ahead and is recycling over 15kg of waste per capita per year.

Some of the Directive’s central points are currently being reviewed by the Commission:

- revision of targets for WEEE collection, reuse, recovery, and recycling;
- the scope of the Directive, for example the inclusion of large scale stationary industrial tools;
- operation of the producer responsibility provisions.

Legislation is under discussion to take greater account of the entire product lifecycle - from production to use and after-use. This will favour more products which are easy to dismantle or made out of recyclable material. Examples of such products include a computer designed to be 100 per cent reusable or an eco-designed vacuum cleaner with mono-material plastic shell.

See research studies about WEEE at http://ec.europa.eu/environment/waste/weee/studies_weee_en.htm
4. Market-based instruments in the EU to encourage sustainable resource use

The use of market-based instruments in EU environmental policy has gained ground substantially since the mid-1990s. This evolution has mostly taken place at Member State level, including the 12 new Member States, although increasingly such instruments are also being applied at regional and city levels. Market-based instruments include measures such as environmental taxes, charging schemes and subsidies. The economic rationale for using market-based instruments is founded on their ability to correct market failures in a cost-effective way. Unlike regulatory or administrative approaches, market-based instruments have the advantage of using market signals to address market failures. Environmental tax reform, for example, which shifts the tax burden from welfare-negative taxes, (e.g. on labour), to welfare-positive taxes, (e.g. on environmentally damaging activities, such as resource use or pollution) can be a win-win option to address both environmental and employment issues. Experience in recent years shows that using market-based instruments, alongside other environmental measures such as regulations, can offer the best chance of success in meeting environmental in combination with economic and social objectives.

Environmental taxes – At EU level the use of environmental taxes is extremely limited since taxation is a policy instrument which remains under Member State sovereignty. Any decision to change this situation would require unanimity in the Council of the EU and is unlikely to be adopted in the foreseeable future. Environmental taxation in the EU is therefore largely at the initiative of individual Member States, although there is a high degree of information-exchange and shared-learning between Member States.

Taxes on motor fuels, applied in all Member States, together with taxes on the sales or registration of motor vehicles, account for over 90 per cent of the total environmental tax revenue in the EU. Taxes make up 40–60 per cent of the sales price of motor fuels in European countries, a considerably larger share than in the US. The European car fleet is consequently more energy efficient than that in the US, with unit emissions of CO2 two or three times lower. Tax differentiations in the EU for low sulphur and unleaded fuels have been particularly effective in changing producer and consumer behaviour, promoting demand for innovation and prompting purchasing decisions that reduce air pollution.

There is no single recipe for a successful and effective tax scheme. Different factors determine the functioning of specific schemes, each in their own context. Examples include the Danish waste-disposal tax (high tax rates), the London congestion charge (strong champion; rather high charge), the Dutch nutrient surplus tax in agriculture (flexibility), and the Irish plastic bag tax (awareness of the advantages and simplicity of alternative behaviour). The European Commission launched a Green Paper consultation exercise in March 2007 to canvas views on how best to strengthen coordination of environmental

1 For a summary of decisions by the European Court of Justice regarding EU Environmental law, see: http://ec.europa.eu/environment/law/pdf/leading_cases_2005_en.pdf.
taxation and other market-based instruments across the EU. In the light of the replies to the consultation, the Commission is currently reviewing the Energy Taxation Directive to better reflect EU environmental policy objectives and analysing the possibility of allowing reduced VAT rates for energy-efficient equipment and services. It has also launched studies to analyse the scope for tradable permit systems for air pollutants and to evaluate different market-based instruments for enhanced conservation and sustainable use of biodiversity in general.

**Environmental charges** – Progressively-graduated water prices have been particularly effective in helping to reduce consumption over time in some countries (e.g. Denmark, Hungary). Charging for waste collection at the household level is sometimes based upon combinations of bin size, frequency and weight and helps to increase awareness of the problem of waste generation and to reduce waste supply. In the Netherlands, charges to reduce waste water emissions at source have been levied alongside investment in treatment facilities. This approach has provided a more cost effective outcome in terms of meeting pollution reduction targets than in countries where the primary focus has been on capital investments alone.

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**Focus 3: Environmental taxes and charges in Europe**

- **CO2 taxes**: While attempts to introduce a CO2/energy tax at the EU level have failed, CO2 taxes have been widely adopted in the Member States. The first CO2 tax was levied in Finland in 1990, and there are now CO2 taxes in Denmark, Finland, Germany, the Netherlands, Norway, Poland, Slovenia, Sweden and the UK. Estonia introduced a charge on CO2 emissions in 2000. These taxes are often additional tax levied on some energy carriers, not always differentiated according to their carbon content, and with many exemptions.

- **Air pollution**: A levy on NOx is in place in France, Italy and Sweden. SO2 levies are in place in Denmark, France and Sweden. More comprehensive, multi-pollutant systems of air pollution charging are in place in some of the new EU Member States (Czech Republic, Estonia, Latvia, Lithuania, Poland, Bulgaria and Romania).

- **Products**: There are taxes or charges on a wide range of polluting products, including: batteries (Belgium, Bulgaria, Denmark, Italy, Latvia, Lithuania and Sweden, with a take-back scheme in place in Austria and Germany); plastic carrier bags (Denmark, Italy and Ireland); disposable beverage containers (Belgium, Denmark, Estonia, Finland, Latvia, Lithuania, Poland and Sweden and deposit-refund schemes in Austria, Germany and the Netherlands); tyres (Bulgaria, Denmark, Finland, Latvia and Sweden); chlorofluorocarbons (CFCs) and/or halons (Latvia and Denmark); disposable cameras (Belgium); lubricant oil (Denmark (now abolished), Finland, Italy, Latvia, Slovenia, Spain and Sweden); and oil products, to combat and compensate oil pollution damage (Finland and France).

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• Waste: User charges are in place in most EU Member States. There are waste taxes (landfill tax) in many EU Member States; hazardous waste taxes or charges in a number of countries (notably Belgium, Denmark, Finland, France, Germany and Poland); and differentiated user charges in many municipalities in a wide range of Member States, with the aim of making this compulsory across all municipalities in Ireland and Italy.

• Water: User charges for water are in place for all EU Member States, though with different levels of cost recovery implicit in the price. There are water abstraction tax/charges in Denmark, the Netherlands and the majority of the new EU Member States and applicant countries; wastewater tax/charge — effluent charges in several EU-15 Member States including Denmark, France, Germany and the Netherlands, and in several new EU Member States.

• Fisheries: While not strictly speaking an environmental charge, there are economic instruments that apply to fisheries. The EU pays access charges on behalf of its long-distance fleet for access to the fisheries resources of some third countries. In some cases, these countries also levy additional charges directly on the boat owners. These may be flat rates or linked to catch levels. The levying of charges on recreational fishing is common throughout the EU.

• Others: Aggregates taxes, covering sand, gravel and/or crushed rock, are in place in Belgium (Flanders), Bulgaria, Denmark, Sweden and the UK.

• In addition, there are already, or are seriously proposed, taxes/charges on: air transport (noise charge), chlorinated solvents, disposable tableware, light bulbs, PVC, phthalates, junk mail; vehicle scrapping charges (already in place in Slovenia and Sweden), electronic and electric waste (already in place in several EU countries), nuclear waste management, and air polluting emissions from incinerators.

For further information regarding taxes and charges listed above or in the tables, see the OECD/EEA database on environment-related taxes at http://www.oecd.org/env/tax-database; BEF (2003); OECD (2003a); Speck et al. (2001a); and the websites of Ministries of Finance and Environment of the European countries.

Effectiveness of environmental taxes and charges – Ex-post evidence

Ex-post evidence from Nordic countries shows that environmental taxes and charges have a clear potential to lead to significant overall improvements in energy efficiency and emission reduction, whilst the effect on employment and GDP is neutral or slightly positive. All the Nordic countries carried out important environmental tax reforms in the 1990s focusing on the energy and transport tax base. Energy-related taxes are estimated to have reduced total industrial CO2 emissions by 9-11 per cent between 1992 and 2000 in Denmark. In Sweden it is estimated that 60 per cent of emission reductions between 1987 and 1994 are attributable to the energy tax system. Ex-ante evidence obtained from model-based studies shows that when the revenues accruing from higher energy taxes in the EU are recycled in the form of reductions of the employers’ social security contributions, the impacts on employment are always positive. This holds both in the case where energy tax increases are modest and in the case where they are sufficiently large to achieve substantial reduction of CO2 emission in the whole EU. However, the models indicate that the positive employment effect is not achieved if the tax revenues are not used to decrease labour costs.

Focus 4: How the revenues from environmental taxes and charges are used

- CO2/energy tax revenues go to the national exchequer and are sometimes linked to reductions in labour-related costs, as in Germany, the Netherlands and the United Kingdom. Since 2004, part of the CO2 tax revenue in Slovenia has been used to support energy-efficiency projects and promote the use of renewable energy.
- NOx charge in Sweden: revenue is recycled to liable payers (larger energy producers).
- Aggregates tax: The revenue of this UK tax will be recycled in part to businesses via the reduction of national insurance contributions and via a new sustainability fund delivering environmental benefits to local communities affected by quarrying.
- Landfill tax revenues in France are recycled mainly to municipalities via funds/investments and some private sector and research activities. In Austria, they fund the clean-up of contaminated sites and are used for investments at landfill sites. In the United Kingdom, the revenues are used to offset reductions in national insurance contributions, and also to support environmental projects.
- Batteries tax: In Belgium, the revenues fund the Belgian batteries collection and recycling scheme (BEBAT).
- Revenues from environmental levies, such as waste-disposal charges, wastewater charges and charges for groundwater extraction, are allocated to an environmental fund in Flanders, Belgium, and used for financing a range of environmental projects in different sectors.
- Revenues from a wide range of environmental charges, including pollution charges levied on air and water pollutants, charges on fossil fuels and resource extraction charges, have often been earmarked for environmental investment via environmental funds in some of the new EU Member States.

Environmental subsidies and incentives are widely used and effective for supporting the development and more rapid diffusion of new cleaner technologies, such as catalytic converters, low CO2 vehicles, and renewable energies especially wind and solar power. Experience suggests that the application of subsidies at an early stage leads to further (non-subsidised) technological developments. EU subsidies through EU Cohesion Policy (see later section), supported by legislation, have also helped build the infrastructures for environmental services such as water supply, waste water treatment plants and waste treatment services. More limited funding is available from the Commission’s LIFE+ instrument which provides specific support for the development and implementation of EU Environmental Policy and legislation, focused, in particular, on nature and bio-diversity, environment policy and governance and environment-related communication. The European Commission adopted revised Guidelines for Environmental State Aid in January 2008. In new guidelines a 10 per cent aid bonus State Aid may be granted where an investment improving on Community Standards or improving the level of environmental protection in the absence of standards involves eco-innovation. The table below shows the

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overall maximum aid intensities applicable to different environment-related investments by different sizes of company under the new guidelines. It should be noted that the aid referred to in the Guidelines and the table represents the extra investments by companies necessary to achieve adopted EC environmental standards.

‘Green’ public procurement – Each year European public authorities spend the equivalent of 16 per cent of EU GDP on the purchase of goods, such as office equipment, building components and transport vehicles, as well as services relating to building maintenance, transport, cleaning and catering. Public procurement can shape production and consumption trends. A significant demand from public authorities for ‘greener’ goods will create or enlarge markets for environmentally friendly products and services. This will, in turn, provide incentives for companies to develop environmental technologies. The European Commission’s recent Communication on Green Public Procurement (GPP) points the way forward for a more coherent EU-wide policy in this field. The Communication also highlights current obstacles to increased take-up of GPP, such as:

**Focus 5: extract from new EC Guidelines on Environmental State Aid - 2008/C 82/01 (January 2008)**

| TABLE ILLUSTRATING THE AID INTENSITIES FOR INVESTMENT AID AS A PART OF ELIGIBLE COSTS |
|---------------------------------|---------------------------------|---------------------------------|
the lack of established environmental criteria for products/services – and where these do exist there are often insufficient mechanisms, such as databases, to publicise them;

- insufficient information on the life-cycle-costing of products and on the relative costs of environmentally friendly products/services;
- low awareness of the benefits of environmentally friendly products and services;
- uncertainty about the legal possibilities of including environmental criteria in tender documents;
- lack of a coordinated exchange of best practice and information between regions and local authorities.

Nevertheless, some environmental criteria do exist at the EU level, such as those under the Directives for the EU Eco-label, the Energy Star Regulation and the Ecodesign for energy-using products. More criteria have been recently developed for product and service groups in 10 sectors which have been identified as most suitable for implementing GPP. Where appropriate, these criteria have been based on existing European and national eco-label criteria, as well as on information collected from stakeholders of industry and civil society. An expert group has been established to bring together Member State representatives active in the field of GPP and this has cooperated with Commission services in the criteria-setting exercise. The Commission has also recently developed a web-based GPP Training Toolkit242, directed at purchasers, policy-makers, managers, and consultants, which is available in all EU languages.

The Commission communication on green public procurement fixes a formal GPP target, that by year 2010 the average level of EU GPP should be the same as the 2006-level of the best performing Member States. On this basis, the Commission proposes that, by 2010, 50 per cent of all tendering procedures should be green, where "green" means "compliant with endorsed common 'core' GPP criteria." The Commission is encouraging EU member states to develop national GPP action plans. Several front-running Member States in the field of GPP have set ambitious targets: the Dutch government has set a 100 per cent Sustainable Procurement target to be reached by 2010; the Austrian Government has identified different targets to be met by 2010 for five product groups: IT: 95 per cent, electricity 80, paper 30, cleaning products 95, vehicles 20. In France, 20 per cent of total annual renewal of vehicles purchased by central government should consist of "clean" vehicles, 20 per cent of new construction should be compliant with the highest environmental quality standards and 50 per cent of all wood products should be legally sourced and sustainable by 2010.

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A Supplement to Section 4: further information on selected examples of market-based instruments in environmental policy

This section seeks to provide more detail on several of the market-based instruments, referred to above, which have been introduced by EU Member States in the area of environmental policy. The information is based on a report by the European Environmental Agency.\(^\text{243}\)

**London’s congestion charge**

A congestion charge was introduced in central London in February 2003. The main aim of the scheme was not environmental, but to reduce traffic congestion in and around the charging zone. It was noted that, on average, vehicles spent half their time in queues, and that the average speed was only 15 km/hour. The charge was also expected to raise revenues to improve transport in London more generally. Vehicles entering, or parked on the streets in central London on weekdays during daytime (07h00 to 18h00) were subject initially to a GBP 5 daily charge (rising to GBP 8 in 2005), which can be paid electronically. The charging zone covers 40 km\(^2\) (since February 2007). Certain vehicles, (for example taxis, motorcycles, buses and alternatively fuelled vehicles) are exempt, while some users, for example residents and the disabled, benefit from discounts.

A review of the charging system undertaken by Transport for London in June 2006 found that congestion within the charging zone had reduced by 26 per cent and the volume of traffic by 15 per cent, and that there was no sign of significant adverse traffic effects outside the zone. Bus services in the zone had improved and public transport, more generally, had coped with the displaced car users, although some users disputed this. The evidence suggests that the charge has had little direct negative impact on business, but has had benefits in terms of environmental amenity and reduced traffic emissions.

**UK landfill tax**

The United Kingdom generates about 29 million tonnes of municipal solid waste a year and in 2002 approximately 77 per cent of this went to landfill. The United Kingdom introduced the landfill tax in 1996 with the intention of internalising the “externalities” associated with landfill. The initial tax rate was derived from assessments of these external costs, and based on consultations with industry, local authorities and environmental groups.

The tax is applied to all waste that is disposed of at licensed landfill sites, although there are some exemptions. There are two rates of tax, a lower rate of GBP 2 per tonne that applies to inert/inactive waste (typically construction waste) and a standard rate applicable to all other types of waste, originally GBP 7 per tonne, increasing by

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GBP 1 per tonne each year. From 2005/06, to help reaching the targets of the Landfill Directive, the standard rate was set to rise by at least GBP 3 per tonne per year until it reaches GBP 35 per tonne. The rate in 2005 was GBP 15 per tonne.

Some revenues have been earmarked for waste management research and investment projects in landfill areas. The UK Treasury is working on mechanisms to earmark revenues from the increasing tax to help businesses to address issues of waste management, in particular approaches to improve resource efficiency through waste minimisation.

**Danish packaging tax**

The tax on packaging introduced in Denmark in 1999 replaced another, more narrowly defined tax, which only applied to bottles and jars. The old tax was volume based and applied only to liquids such as drinks, vinegar, edible oil and methylated spirits.

From 1999, the packaging tax was broadened to include sales packaging and multipacks with volumes of less than 20 litres for the packaging of specific articles. Initially, the tax remained based on weight, irrespective of the character of the packaging material. The aim of 'fiscal equality' of materials was changed in the revision of the tax in 2001, when the government decided that the environmental impact of different packaging materials should be reflected in the tax rate. Originally the same for all materials, tax rates were then differentiated on the basis of an index of environmental impact, CO2 emissions, primary energy use, fossil resource use and waste, with glass as the benchmark. Different rates were applied to packaging intended for one-trip from that designed for multi-trip, with the tax base being the weight for the former and the volume for the latter. This reflects the fact that multi-trip packaging generally needs to be heavier to withstand the handling associated with products which have to undergo several journeys.

**The Irish plastic bag levy**

Prior to the introduction of this levy, some 1.2 billion plastic shopping bags were provided annually free of charge to Irish consumers (about 325 bags per person per year). They were a highly visible component of litter and had negative impacts on habitats and wildlife. The possibility of an Irish plastic bag levy had been on the political agenda since 1994 and the levy was finally introduced in March 2002 as a point-of-sale charge. The levy was fixed at € 0.15 per bag (to rise to € 0.22 from July 2007 onwards), which was thought to be sufficiently high to stimulate consumers to avoid paying by bringing their own ‘permanent’ reusable shopping bags with them. There was no attempt to identify the marginal external costs and determine the optimum level of tax. Retailers have reported a reduction of over 90 per cent in the provision of disposable plastic bags since the levy's introduction, amounting to around 1 billion plastic bags.

The revenues from the levy have been assigned to a new environmental fund and are used for a variety of purposes such as to defray the costs of administration, support
and promote any programmes established for the prevention or reduction of waste, and research and development in the waste area. The costs to the government are modest. Furthermore, retailers face lower costs because they do not have to purchase the plastic bags which were provided free of charge.

The design of the levy is simple and transparent, and immediate environmental benefits are discernible because there is less litter on the streets. Own-bags can easily be used as substitutes for plastic bags and this is also responsible for the success. The experience gained in Ireland has led several other countries and regions, such as Australia, the United Kingdom and New York City, to discuss the introduction of such a levy.

In this regard it has to be pointed out that the Irish plastic bag levy is a classic example of a tax that was introduced purely for environmental purposes and lacks the traditional revenue generating feature of a tax.
5. EU Cohesion Policy and Environment – a casebook study

Although EU Cohesion Policy accounts only for a part of the total public investment in regional development in the Member States, it generally strives for (as shown elsewhere in this study) the most innovative approaches to regional development in terms of conception, content and method. This is particularly true in the integration of environmental concerns into development investment decisions. EU Cohesion Policy leads by example in the vertical and horizontal integration of environment, as well as in the practice of environmental governance. Moreover, of all EU policies it is the one which provides the highest level of financial resource to implementing the EU’s Environment Policy in investment terms.

Sustainable development principles in EU Cohesion Policy

Under the EU Maastricht Treaty signed in 1992, further environmental objectives were added to original objectives in the Treaty of Rome, stating that “the Community shall have as its task, […] a harmonious and balanced development of economic activities, sustainable and non-inflationary growth respecting the environment … .” . In 1993, the Council of Ministers adopted the 5th Environmental Action Programme (5EAP) “Towards Sustainability”, covering the period 1993-2000, which committed the EU to promote sustainable development through its policies and actions. The EU Treaty of Amsterdam in 1998 went further by stating that “environmental protection requirements must be integrated into the definition and implementation of community policies and activities […] in particular with a view to promoting sustainable development”.

At the Gothenburg Council in 2001, the summit adopted the EU’s first Sustainable Development Strategy (SDS), encouraging the assessment of environmental aspects, as well as social and economic aspects, in the drafting of all future policy documents. The SDS was revised in 2006 and has the following priorities:

- energy and climate;
- sustainable transport;
- sustainable production and consumption;
- conservation and management of natural resources;
- public health.

The Sixth Environmental Action Programme (6EAP) ‘Environment 2010: Our Future, Our Choice’ is the EU’s main operational framework for putting the Sustainable Development Strategy into practice.

The Lisbon Strategy, which underlies EU Cohesion Policy, concentrates on competitiveness, growth and jobs in the EU. The 24 Integrated Guidelines for Growth and Jobs, adopted in 2005 as part of the Lisbon package, include Guideline 11 on the sustainable use of resources and the strengthening of synergies between environmental protection and growth. More specifically, this covers:

- energy efficiency;
- renewable energies;
- environmental technologies;
internalisation of environmental costs;
halting biodiversity decline;
fighting climate change.

Strong synergies exist between these priorities and the Community Strategic Guidelines which govern planning and programming under the current 2007-2013 phase of Cohesion Policy.
Focus 6: linkages between EU Cohesion Policy 2007-2013, the 6th Environmental Action Plan (6EAP) and Thematic Strategies (TS) of the Sustainable Development Strategy 2006 (SDS)

Source – Ideas Paper (ENEA) 2008

<table>
<thead>
<tr>
<th>6th EAP Priority/Cohesion Objective</th>
<th>Convergence (ERDF/ESF/CF)</th>
<th>Regional Competitiveness and Employment (ERDF/ESF)</th>
<th>Co-operation (ERDF)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Climate change</td>
<td>*** (sustainable energy and transport, better urban planning)</td>
<td>*** (sustainable energy and transport, better urban planning)</td>
<td>*** (risk prevention)</td>
</tr>
<tr>
<td>Environment and Health</td>
<td>*** (Investment in environmental assets bringing health benefits)</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Air TS COM(2005) 446</td>
<td>*** (Investment in air quality)</td>
<td>** (environmental technologies)</td>
<td>** (Investment in monitoring of transboundary air pollution)</td>
</tr>
<tr>
<td>Waste and Recycling TS COM(2005) 966</td>
<td>*** (Investments in air quality)</td>
<td>** (environmental technologies)</td>
<td>** (cross-border waste management)</td>
</tr>
<tr>
<td>Urban TS COM(2005) 718</td>
<td>**** (sustainable urban transport, sustainable construction, renewable energies and energy efficiency, assistance to SMEs for environmental technologies, waste and water systems, urban air quality, restoring contaminated sites and land, tourism and cultural heritage, public health, risk prevention – climate change)</td>
<td>**** (sustainable urban transport, sustainable construction, renewable energies and energy efficiency, assistance to SMEs for environmental technologies, waste and water systems, urban air quality, restoring contaminated sites and land, tourism and cultural heritage, public health, risk prevention – climate change)</td>
<td>**** (sustainable urban networks; SME networks; exchanges of experience; best practices on sustainable urban development; statistical data; joint management of the environment, risk prevention – climate change)</td>
</tr>
<tr>
<td>Solid TS COM (2006) 231</td>
<td>**** (prevention of soil threat, in particular soil contamination and land disasters)</td>
<td>**** (prevention of soil threat, in particular soil contamination and land disasters)</td>
<td>**** (prevention of soil threat, in particular soil contamination and land disasters)</td>
</tr>
<tr>
<td>Fisheries TS COM (2006) 327</td>
<td>*</td>
<td>*</td>
<td>*</td>
</tr>
</tbody>
</table>

Reference: *** = high, ** = medium, * = low, - = not relevant

Supporting the Environment: candidate countries and the *acquis communautaire*

The *acquis communautaire* is the name given to the 32 Chapters representing the body of EU legislation to which all EU Member States must adhere. States which are becoming members of the EU must adopt the *acquis* before their accession to membership. Its Environment Chapter is often one of the most arduous Chapters during EU accession negotiations with candidate countries. However there is no relaxation of the 200 legal acts which make up the Environment *acquis* – they must all be transposed in full into the candidate country’s legal system.

Nevertheless and particularly in the case of the new Member States from central and eastern Europe which have acceded since 2004, the European Commission has granted periods of derogation for them to achieve the necessary environmental standards. In addition, because of the shortage of public funds in the countries needed to upgrade their environmental infrastructure, the EU has provided substantial funding through EU Cohesion Policy to support their adoption of the environmental *acquis*.

Romania, for example, which acceded to the EU in 2007 is a relatively poor country with a population of 21 million and GDP per capita of approximately € 6,000 (around 33 per cent of the EU average). The country’s environmental infrastructure, particularly in water supply, waste water treatment and solid waste management is well below EU standards. For instance, over 40 per cent of households, mainly in rural areas, do not have access to mains drinking water. In Romania’s case a period of derogation up to 2018 for compliance with EU Environment Directives was agreed as part of the accession package. Total costs for Romania’s compliance with the environmental *acquis* are estimated at around € 29 bn, of which nearly € 10 bn (34 per cent) are expected to come from EU funds, € 5.5 bn (18 per cent) from national and local budgets and the remaining 48 per cent from a combination of international loans and the private sector.

The Environment Operational Programme 2007-2013 for Romania, adopted under EU Cohesion Policy, represents a first stage in this process. Financial commitments foreseen under the Operational Programme from EU and national sources are set out below. The EU contribution to the Environment Operational Programme of just over € 4.5 bn represents around 23 per cent of the EU Cohesion Policy’s entire financial allocation to socio-economic development in Romania for 2007-2013.
Focus 7: Romania’s environment operational programme 2007-2013

<table>
<thead>
<tr>
<th>Priority Axis</th>
<th>Total public cost (€ million)</th>
<th>EU contribution (€ million)</th>
<th>National contribution (€ million)</th>
<th>Intervention rate (% of public cost)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Extension and modernization of water and waste water systems</td>
<td>3,265</td>
<td>2,777</td>
<td>490</td>
<td>85%</td>
</tr>
<tr>
<td>Integrated waste management systems and rehabilitation of contaminated sites</td>
<td>1,168</td>
<td>934</td>
<td>234</td>
<td>80%</td>
</tr>
<tr>
<td>Restructuring and renovating urban heating systems</td>
<td>458</td>
<td>229</td>
<td>229</td>
<td>50%</td>
</tr>
<tr>
<td>Implementing adequate nature protection systems</td>
<td>215</td>
<td>172</td>
<td>43</td>
<td>80%</td>
</tr>
<tr>
<td>Infrastructure for natural risk prevention in the most vulnerable areas</td>
<td>329</td>
<td>270</td>
<td>59</td>
<td>82%</td>
</tr>
<tr>
<td>Technical Assistance</td>
<td>173</td>
<td>130</td>
<td>43</td>
<td>75%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>5,610</strong></td>
<td><strong>4,512</strong></td>
<td><strong>1,098</strong></td>
<td><strong>80%</strong></td>
</tr>
</tbody>
</table>

The allocation of EU funds under Cohesion Policy to investments in basic environmental infrastructures to comply with the Environment *acquis communautaire* accounts for some € 58 bn, 17 per cent of the total budget of the EU Structural instruments for 2007-2013.

**Environmental investments of the EU Structural Instruments**

In addition to vital investments in water supply and waste water treatment infrastructure, as highlighted by the Romanian case, EU Cohesion Policy is active in supporting many other environmental fields. The main investment themes covered are listed below and illustrated by using examples of individual projects from different regions.

(a) **Integrated waste management:** Reducing the volume of waste going to landfill is a top priority for the EU, as is the separation of waste streams in order to make it possible to raise the rates of recycling/recovery and to secure the correct disposal of hazardous materials. Integrated waste management involves the complementary use of a variety of practices to handle solid waste safely and effectively. EU Cohesion Policy has assisted many projects in this field in different Member States.

**Example 1 – Lisbon waste management (Portugal)**

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245 Romania – Sectoral Operational Programme for Environment 2007-2013  
[http://www.mmediu.ro/proiecte_europene/01_integrare_europeana/02_POS_mediu/00_Pos_Mediu/SOP_EN_V_EN.doc](http://www.mmediu.ro/proiecte_europene/01_integrare_europeana/02_POS_mediu/00_Pos_Mediu/SOP_EN_V_EN.doc)

246 Source - Environmental Projects Financed by the EU Funds - Selected Experiences and Challenges – ENEA Working paper (June 2006)  
Until the 1980s the dominant form of waste management in Portugal was landfill disposal. As the two existing sanitary landfills in Lisbon and the surrounding area filled up, demand emerged for an integrated waste management system. A proposal for the system was prepared and submitted for Cohesion Fund support and also to the European Investment Bank for loan support in 1994. The plan involved the construction of an incinerator, a sanitary landfill, a sorting plant and an organic recovery plant. As it was to be the first incinerator in the country there was a great need for technical expertise. Foreign experts and the Portugal Electricity Company (EDP) provided technical assistance for the incinerator. For the aerobic digestion plant, Austrian consultants were brought in.

Valorsul waste management company, a private enterprise, won the tender for the project and developed an integrated waste management system for processing and recovering the solid waste of five municipalities. The incinerator plant was constructed in parallel with the sorting plant and by 1998 it was operational. The sorting station took three years to complete and the digestion plant two further years. In 1995 Valorsul entered into a 25-year concession. It sells electricity produced during incineration to the national grid at a price paid for renewable energy. The incinerator generates 28 MWh and also covers its own electricity demand.

Valorsul manages a complex system with seven different shareholders (five municipalities, the state, and the Portugal Electricity Company) about 250 employees, and four treatment facilities located in four different municipalities. The five municipalities represent only 1 per cent of the country’s area but 16 per cent of the municipal waste is generated there. In the waste management system the non-separated waste is incinerated. The bottom ash is separated into ferrous and non-ferrous ashes. The ferrous component is sent for recycling. The separately collected waste (including glass and paper) is sold to a packaging recovery organisation. Of the revenue received from selected waste, 75 per cent is channelled back to the municipalities to cover their collection costs. The organic waste is collected exclusively by Valorsul and used for biogas production.

The total initial investment cost was € 234 million, which by 2020 is projected to reach € 331 million. The Cohesion Fund and the European Regional Development Fund (ERDF) covered 33 per cent of the total cost, while a soft loan received from European Investment Bank provided 28 per cent. The remaining 39 per cent was secured with equity capital. The refurbishments of the municipal sanitary landfills were financed by ERDF. Tariffs are revised yearly and private clients pay double the municipal rate. Municipalities are exempt from paying fees for organic waste and sorted waste delivery. Since incineration is often subject to public opposition, Valorsul makes big efforts to inform and involve the public, including publishing emissions data on information boards.

Success factors identified by Valorsul were the elaboration of effective and innovative technical solutions. The transparent work arrangements with authorities and NGOs were also highlighted, along with public involvement. The project managed to find a delicate balance between economic, social and environmental interests. It was noted that the employment of motivated young staff was a key criterion for success.
(b) Rehabilitation of contaminated land

In many parts of the EU there is a shortage of land for economic development, since strict environmental planning laws seek to maintain green areas around cities. Project selection criteria for funding under EU programmes generally favour developments on formerly-used, polluted ‘brownfield’ sites rather than on ‘greenfield’ land, since this can bring about the double-dividend of economic development and environmental protection in the same investment. As a general rule, the ‘polluter pays’ principle applies to the rehabilitation of polluted sites. However in older industrial regions it can be difficult to locate the body which caused the worst pollution on a site which may have had many different occupants during its operational lifetime. In such cases, EU funding (ERDF) can be used to support the costs of de-polluting and developing sites for new economic activities. The basic principle is that the EU funds should only intervene to help bridge the gap between the costs of rehabilitating the site and the increase in value of the land after completion of these works.

Example 2– Former steelworks reclamation, Ebbw Vale, Wales (UK)

Heavy industry began on the Ebbw Vale site as early as 1780 with iron works located close to neighbouring iron ore and coal mines. Throughout the 19th and 20th centuries, the site was used primarily for steel making and was re-configured continuously, growing to its massive dimensions of 80 hectares. Steel production in the area began to decline from the mid 1970s and the steelworks contracted significantly, finally closing down in 2002. The resulting unemployment in the adjacent town of Ebbw Vale was particularly severe. Because of the town’s location in the predominantly rural area of the South Welsh Valleys and the scarcity of alternative local job opportunities, this difficult economic situation has persisted, leading to depopulation and threatening the death of the town itself.

Corus (formerly British Steel) began to clear the heavily polluted site in 2003. The clearance work was completed at the end of 2005. Rather than let the town die out, a partnership was set up between the local authority, Blaenau Gwent County Borough Council, and the Welsh Government to undertake an ambitious redevelopment of the site. In this way, the partnership plans to transform an environmental blackspot into an exciting opportunity to generate diverse new economic activities and almost double the population of the town. The redevelopment is fully in line with the Welsh Government’s Sustainable Development Strategy – particularly the re-use of ‘brownfield’ land and retention of population within existing centres, rather than forcing people to relocate to larger urban areas. Moreover, it aims to exemplify the sustainable development approach in its entirety.

A key feature of the redevelopment strategy is the recycling of materials already present on the site – especially steel (600m$^3$) and concrete (using some 110,000m$^3$ of aggregate) and soil restoration, with no net import of fill material for the site. There will also be a sustainable urban drainage system for the entire development using the latest environment-friendly waste water treatment methods, as well as a wetlands park area to enhance bio-diversity.
The Master Plan to implement the strategy has been produced through extensive ongoing consultation with the local community. In addition to new housing of various types, the redevelopment will include light industrial units and business incubator facilities, a hospital, a primary school, a higher education learning campus, a theatre, sports facilities, and an environmental resource centre. A new railway line will provide sustainable local public transport along the whole length of the site and a funicular system will link the older part of town with the new development. All new buildings on the site will be constructed to the highest environmental standards and rated ‘carbon zero’. There will be extensive use of community heating, renewable energy, rainwater harvesting and household waste recycling.

The regeneration of the Ebbw Vale steelworks site will provide housing for thousands of people, new jobs, new higher and primary education places, as well as over a hundred new hospital beds. For further information see - www.theworksebbwvale.co.uk

(c) Sustainable transport

Evaluators of the contribution of EU Cohesion Policy to environmental protection have considered, in various studies, a number of different types of transport infrastructure as ‘sustainable transport’: rail, cycle tracks, ports, waterways, urban transport, multimodal transport, intelligent transport systems have all been labeled ‘sustainable.’ However they recognize that this definition is not fully satisfactory, as some railway and underground lines may not be environmentally-sound, whilst some road infrastructure may make an important contribution to the reduction of noise and air pollution. Similarly, expenditure on ports should be carefully assessed in terms of emissions, including sea dumps, as well as land use and costal management.

Example 3 – Athens Metro System (Greece)

Athens, with four million inhabitants, had a reputation of being one of the most polluted cities in Europe. With 1.4 million vehicles on the road, public transport had been reduced to one over-ground electrified line (“Line 1”) and a completely inadequate bus service. This public transport system was so poor that the level of usage had effectively collapsed by the mid-1990s and air quality in the city was bad, particularly during the summer months.

Due to the difficult topography of the city, including an underground lake, construction of the metro system was complex from a technical point of view and consequently very expensive. EU funds from Cohesion Policy contributed over € 900 million to this vast project which cost over € 18 bn in total. Without this support and the favourable loans provided by the European Investment Bank, the Athens Metro would not have been possible. During construction, pumping was necessary in order to avert flooding and make the infrastructure watertight. Instead of digging below multi-storey buildings, the...
metro system had to follow the route of the main streets. Added to this were delays and route modifications caused by the discovery of numerous archaeological remains at the construction sites.

The first two underground lines were brought into service in early 2000, comprising 18 km and 19 stations. A further 42 km was completed by-end 2008 in two additional lines. The metro has brought a breath of fresh air to the city, with an estimated drop of nearly 500,000 in the number of daily trips by private vehicles. It has helped to achieve significant savings in time and energy, a better quality of life for residents, a better urban environment, and a better image for the city in general.

The public corporation Attiko Metro S.A., which manages the new Athens metro system, has created 800 permanent jobs. Attiko Metro also financed the largest archaeological excavation project ever undertaken in Athens, which cost a total of € 50 million. Sites covering a total area of 69,000 m² have been explored and more than 50,000 artefacts have been discovered, dating back to between the Neolithic and Turkish periods.

(d) Clean technology development

Environmentally-friendly or ‘clean’ technologies, rather than the more traditional end-of-pipe solutions to pollution reduction, may one day provide the key to environmental sustainability. However, research and commercialisation of this kind of technology is generally characterised by high costs and high risks. EU Cohesion Policy supports a wide range of investments in this field from building technology transfer centres to improving access to finance for companies looking to promote clean technologies.

Example 4 – Centre for Fuel Cell Technology, Duisburg (Germany)

The Centre for Fuel Cell Technology develops and integrates fuel cell systems in different fields of application. These include their integration in gas, power and heating provision that improve the climate and technological infrastructure.

The centre is a member of the Fuel Cell Competence Network and was founded at the University of Duisburg. Therefore a link between research and practical application of the technology is guaranteed. It has the function of a “nucleus” for the development of a Future Energies Cluster playing a leading role in the region Nordrheine-Westphalia.

The project was developed at a total cost of € 16 million, with a contribution from EU Cohesion Policy (ERDF) of almost € 7 million. A significant part of the project budget relates to the provision of grants to help ‘spin off’ small and medium enterprises (SME) from the centre to go to market with fuel cell and other renewable energy related technologies.

The Centre has 500 m² of office space and 2,000 m² of laboratory area. With 20 new employees it has so far developed 5 new methods, 10 new products and set up 10 new contracts abroad.
(e) Improving the environmental performance of businesses

There are many ways in which EU Cohesion Policy can improve the environmental performance of businesses. A common approach is through business support schemes which carry out environmental audits of individual businesses and their operations. Such audits can be highly revealing and often encourage businesses to make improvements in, for example, their waste management or transportation arrangements. Although process improvements of this type may be quite simple, they usually have the effect of reducing a company’s environmental ‘footprint’ and at the same time saving the company money. Increasingly, initiatives to support improvements in the environmental performance of businesses are encouraging more widespread use of renewable energy. All public assistance granted to businesses in the EU must, of course, comply with the aid intensities laid down in the EU’s State Aid rules.

Example 5 – Grant schemes for renewable energy in enterprises 2000-2006 (Austria)

During 2000-2006, EU Cohesion Policy provided a total of €29 million to support grant schemes aimed at environmental measures undertaken by enterprises in Austria with a total public cost of € 61 million. The grant schemes assisted over 1,000 investments by enterprises totalling € 244 million.

The breakdown of EU funding for promoting energy efficiency and renewable energy use by type of energy investments made by the enterprises was as follows:

<table>
<thead>
<tr>
<th>Energy Investment</th>
<th>EU Funding (€ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Biomass heating systems</td>
<td>8.5</td>
</tr>
<tr>
<td>Biomass CHP</td>
<td>7.6</td>
</tr>
<tr>
<td>Biomass for SME</td>
<td>4.0</td>
</tr>
<tr>
<td>Small hydro power</td>
<td>3.3</td>
</tr>
<tr>
<td>Energy saving</td>
<td>1.1</td>
</tr>
<tr>
<td>Thermal solar energy for SME</td>
<td>0.9</td>
</tr>
<tr>
<td>Thermal insulation for SME</td>
<td>0.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>26.3</strong></td>
</tr>
</tbody>
</table>

The schemes produced some impressive environmental results, including:

Reduction of...

- Oil: 2.5 Million GJ/a
- Natural gas: 0.5 Million GJ/a

Production of...

- Electricity: 231,500 MWh/a
- Heat: 1.4 Million MWh/a
At the same time, the schemes generated €156 million in net income for the companies and created 2,600 new full-time jobs. These results provide a clear illustration of the positive link between economic development and good environmental performance.

(f) Training and education for the environment

Raising awareness on environmental issues and training on particular ecological practices and techniques is vital to securing the environmental benefits of physical investments. Under EU Cohesion Policy, training in environmental matters is supported by the European Social Fund (ESF). In addition to training for both unemployed and employed persons, the ESF also finances targeted investments in education and in training and education systems. The amounts of money concerned are relatively small in comparison to the EU funds made available for physical investments, but the positive environmental impact can be very high.

Example 6 – Environmental education in Finland

The Rantasalmi Environmental Education Institute, which is run by the Finnish Environmental Education Foundation, educates people to be more environmentally aware, more responsible and to think more critically. Each year tuition is given to 3500 adults and 2500 children at kindergartens, primary, secondary and upper secondary schools, universities and at camps and on various courses. Environmental education is not limited to care for the living environment - it also means securing the conditions for a decent life. In particular the Institute aims to raise the ability of teachers to pass on environmental awareness and skills to children and young people. The institute has a tailored education programme of 40 study credits for qualified schoolteachers, the theme of which is environmental education. The programme comprises both theory and practical applications because teachers need to be able to use new technology and to test the educational tools they use. The total cost of the project is € 1.5 million with an EU contribution of € 0.5 million.

Taken together, the different environmental investments of EU Cohesion Policy account for a substantial volume of funds and follow a strongly rising trend. During 2000-2006, the EU Structural Instruments provided some € 40 bn for environmental investments, representing approximately 17 per cent of the total for that period. For 2007-2013, funding for environmental investments from the Structural Instruments has more than doubled to € 105 bn – over 30 per cent of the current total allocation. These investments reflect what is known as the ‘vertical’ integration of environment in EU Cohesion Policy.

Environmental governance features of EU Cohesion Policy

In addition to the vertical integration, environment is a key ‘horizontal’ theme of EU Cohesion Policy, together with equal opportunities. This means that all investments made by the EU Structural Instruments should represent some form of good environmental practice, as should the funding programmes themselves in a strategic sense. EU Cohesion
Policy has evolved its own form of environmental governance to ensure both the vertical and horizontal integration of environmental concerns.

(a) Strategic Environmental Assessment as a governance framework

The Strategic Environmental Assessment (SEA) Directive came into full force in 2005 and was applied under EU Cohesion Policy for the first time during the programming exercise for 2007-2013. As a condition of EU funding, all Operational Programmes of the 2007-2013 phase were therefore required to undertake a formal SEA study prior to their submission – with the exception of programmes unlikely to have significant environmental impact (for example, those dealing solely with soft investments such as administrative capacity development or technical assistance). Although valuable experience had been built up during the earlier policy phases, in particular through incorporating environmental dimensions into ex-ante programme evaluation, the more explicit requirements of the SEA Directive represented a challenge for most Member States.

The SEA process involves a number of stages:

- Screening is undertaken to determine whether there are significant environmental effects, and whether an SEA is required.
- Baseline environmental information is collated to provide a background for further stages.
- A ‘scoping’ analysis determines the range and detail of information which will be needed, and the criteria to be used in assessment. A ‘scoping’ report is produced for comment by the designated SEA Consultation Bodies.
- The likely environmental effects of the plan, including alternatives, is assessed and this forms the main element of the SEA.
- The assessment, together with an explanation of the process followed and the results obtained, are published in the environmental report, in parallel with the consultation draft of the plan itself.
- Public consultation on the draft plan and Environmental Report is undertaken to gather feedback from stakeholders.
- Taking consultation responses into account, the plan and environmental report are finalised. The report highlights changes that have been made in the final plan, in relation to environmental matters taken into account in the Environmental Report, the consultation responses, and final proposals for monitoring.
- Monitoring and review are undertaken throughout delivery of the plan to help identify adverse effects and to provide information for the next programming iteration.

The likely environmental effects of the plan should include effects on bio-diversity, soil, water, air and climatic factors, as well as effects on population, human health, architectural and archaeological heritage and landscape. When considering possible
alternatives to the plan, the ‘zero option’ (that is, the non-implementation of the plan) are also considered.

Experience with applying the SEA Directive for this first time to EU Cohesion Policy was mixed. On the one hand, it represented the first widespread simultaneous undertaking of SEA studies in the EU and thus provided an important landmark for implementation of the Directive. On the other hand, some Member States did not prepare sufficiently and experienced problems because they did not give themselves sufficient time to carry out a thorough SEA before their plan had to be submitted for approval. There is also evidence that public consultations in certain Member States were not sufficiently rigorous. Nevertheless, the iterative nature of SEA is particularly important. It will place environmental concerns much more in the centre of strategic decision making than was previously the case. As more experience is gained in implementing the Directive, SEA is likely to become the key platform for environmental governance in EU Cohesion Policy.

(b) Environmental friendliness as a criterion for selecting projects

As mentioned above, all projects supported by EU funds under Cohesion Policy – not only those investments directly related to the environment – should demonstrate environmentally positive qualities. This might include, for example, use of the latest environmentally-friendly building materials, ecological waste treatment techniques or power generation from renewable sources in the case of physical projects. In the case of support to enterprises it might cover inclusion of advice on how to improve environmental performance, or specific instruction on relevant environmental matters under training projects. Alternatively it might relate to the functioning of the project applicant organisation itself in terms of recognised environmental standards.

Use of environmental criteria in the selection systems for all projects under EU Operational Programmes has become widespread and is now the norm in most Member States. It might take the form of a numerical score allocated to a project application in relation to its environmental-friendliness as part of an overall scoring system for project appraisal. Depending on the type of programme, it might instead take the form of a series of questions designed to probe the applicant’s whole approach to environment in the conception of her/his project. An example of a basic project-level environmental questionnaire, of a type which would be used in parallel with a project application form, is given below (see Focus 5).

Focus 8: An environment questionnaire for project applications

- Please describe your organisation’s environmental policy...
- How has your organisation addressed the environmental impact of the whole life-cycle of the project?
- How will the project aim to minimise waste?
- How will the project aim to reduce resource consumption (energy, water, raw materials, etc.)?
Projects which gain maximum appreciation from appraisers in this kind of assessment are those which not only score well against the environmental criteria and questions asked. They are usually those which also include certain demonstration elements to help disseminate good environmental practices to other project promoters.

(c) Project compliance with environmental legislation

Whether they are funded from EU sources or not, all projects must of course comply with EU environmental legislation. This is a quite different consideration from the environment-friendliness of projects described above. If an EU-funded project fails to comply with environmental legislation during its lifetime, the rule is very simple – EU funds are withdrawn from the project.

This additional governance feature of EU Cohesion Policy secures a high level of regulatory compliance.

(d) Promotion of partnership and an integrated approach to environmental issues

EU Cohesion Policy has long been known for its integrated approach to socio-economic development. This approach is embodied in the partnership principle which lies at the heart of EU Cohesion Policy. It can be seen in the work of Monitoring Committees which meet regularly for each Operational Programme and comprise representatives of different sectoral ministries and different regional and local authorities depending on the focus of the programme, as well as persons representing different interests in non-governmental sector and civil society. A Monitoring Committee will generally set up cross-sectoral sub-committees and other formal or informal partnership groups to focus on different issues under an Operational Programme. The integrated approach is particularly valuable in the case of environment. Environmental issues generally have impacts across different sectors, just as solutions to environmental problems invariably require cross-sectoral action.

In the management of the Scheldt river basin, for example, the Water Framework Directive requires a strong cooperation between six different water authorities across five regions in three EU Member States – France, Belgium and the Netherlands. However, the existence of a cross border INTERREG Operational Programme under EU Cohesion Policy for the same area helps to integrate this cooperation into a broader partnership for the socio-economic development of the Scheldt river basin – in a manner similar to inter-regional co-operation in river basins in China. This serves to increase the relevance and effectiveness of the environmental measures undertaken under the so-
called Scaldit\textsuperscript{248} project. A further support is provided to the Scaldit partners by the existing administrative structure of the International Commission for the Protection of the Scheldt (ICPS) established 1994. Taken together, these elements represent a possible model for successful integrated river basin management in the EU – an area of inter-regional co-operation where China has established a ‘best-practice’ reputation. Similar partnerships are coming together with EU support for other important European river basins, such as the Danube.

(e) Brokering consensus on solutions to environmental problems

Sometimes the involvement of strong conflicting interests in socio-economic development projects can make environmental progress hard to achieve. Whilst this is clearly a danger of the partnership approach which has developed under EU Cohesion Policy, the Policy and the way it integrates EU environmental legislation also provides the means by which conflicts can be overcome and consensus reached.

The development of the new container port at Le Havre in France provides a telling example. In the early 1990s it became evident that Le Havre needed to build a new container handling facility if it was to maintain its competitive position as a port beyond the year 2000. A major project with a value over € 100 million was designed and sought co-financing from EU funds under the Operational Programme for Haute Normandie. But it was immediately clear the project would have serious environmental consequences. The EIA which was carried out for the project showed that, among other effects, it would divert currents affecting fish in the Seine estuary and destroy wetlands which constituted an important habitat for birdlife. The public consultation on the EIA revealed strongly divergent interests between the local Council and port authority who needed the new container facility to secure the economic future of the town, local fishermen who worried about the disappearance of their livelihood, hunters, farmers and naturalists. Arduous negotiations took place and the positions of the different interest groups became more entrenched before a consensus was finally reached, nearly five years later, on a package of mitigation and eco-compensation measures. Although the length of the negotiation process shows that this was an extreme case, the resulting consensus increased the success of the project and increased the local community’s sense of ownership of it. There is also general agreement that the Operational Programme partnership structures and the involvement of European Commission officials from outside the area in explaining the relevant EU legislation played a vital role in brokering this consensus.

(f) Involvement of the Environmental Authorities in EU Cohesion Policy implementation

The regulations governing EU Cohesion Policy have required the involvement of the designated Environmental Authorities from the Member State/region concerned in programming and implementation tasks since 1994. Over the years, the role of the

Environmental Authorities has strengthened significantly. Generally the designated Environmental Authorities for Operational Programmes under EU Cohesion Policy will be involved in the following governance tasks:

- environmental data collection and profiling and coordination of the SEA exercise;
- advising on all aspects of compliance with environmental legislation, in particular on the conducting of EIAs on project applications and related public consultations;
- designing and applying environmental selection criteria for projects;
- preparing guidance materials for applicants and beneficiaries on how to enhance the environmental aspects of their projects;
- monitoring the environmental performance of the Operational Programme.

Under some Operational Programmes, the Environmental Authorities are highly proactive members of the partnership, proposing items for discussion during Monitoring Committee meetings, providing training to project applicants and coordinating the work of environmental NGOs. The volume of tasks they undertake depends largely on capacity. Some Operational Programme Authorities will appoint additional environmental ‘theme managers’ to support the work of the Environmental Authorities. Each Operational Programme contains a Technical Assistance budget to help finance this kind of activity.

Networks between the regional Environmental Authorities within most Member States have already existed for some years. In 2004, the European Network of Environmental Authorities for EU Cohesion Policy (ENEA) was set up.

ENEA now comprises representatives from:

- the 27 designated EU Member State Environmental Authorities for Cohesion Policy;
- Environmental Authorities from the Candidate Countries;
- International environmental organizations and EU initiatives:
  - Regional Environment Centre (REC);
  - Greening Regional Development Projects (GRDP);
  - Environment Platform for Regional Offices (EPRO);
  - Environmental Conference of the European Regions (ENCORE);
- Environmental NGOs’ Coalition - represented by World Wildlife Fund, Birdlife International and Bankwatch (observers).

ENEA meets twice every year and is chaired by the European Commission (DG Environment), with participation from other relevant Commission DGs (Regional Policy, Employment, Transport and Energy, Agriculture). The meetings allow the Commission to bring the Environmental Authorities up-to-date on the evolution of environmental issues related to EU Cohesion Policy and enable them to share good practices. During 2005-6, ENEA formed a series of specialist working groups, including:

  Strategic Environmental Assessment and Cohesion Policy
  Water Framework Directive and Cohesion Policy
Impact of Structural and Cohesion Funds on Environment

Environmental Capacity building

Further working groups are set up as the need arises. The website of ENEA\textsuperscript{249} contains a wealth of documentary information about EU Cohesion Policy and environment and related governance issues.

6. Opportunities for future EU-China collaboration on sustainable resource use

Both China and the EU have particular strengths and weaknesses in implementing sustainable resource use through regional development. China’s key strength is its ability to mobilize environmental protection activity quickly and on a grand scale as can be seen from recent examples of afforestation and wind power generation. For the EU, the main strength lies in the maturity and comprehensive nature of its environmental governance as illustrated in this chapter. Co-operation between China and the EU on environmental policy is already well-advanced but the importance of environmental protection and the shifting nature of sustainable development priorities will always dictate the usefulness of further and closer co-operation. Some potential fields for further co-operation might be:

- further ways to improve national, regional and local enforcement of environmental regulations – including environmental taxation;
- strategic environmental assessment as a means to give added sustainability to regional development;
- the closer integration of sustainability into the economic governance of regional development;
- the further development of ‘green’ public procurement;
- better interregional cooperation in economic development, along the lines of integrated river basin management;
- a closer involvement of Environmental Authorities in regional development policies – networking and capacity building – to achieve a closer partnership between developers and environmentalists.

\textsuperscript{249} ENEA website - \url{http://ec.europa.eu/environment/integration/cohesion_policy_en.htm}
Chapter XII: Combating Climate Change

by Richard Harding

1. Introduction: the challenge of climate change

When the Kyoto Protocol was negotiated in 1997, climate change was discussed mainly in the future tense. Today, just over 10 years later, we discuss it in the present. Climate change is already happening and its effects are becoming visible from observations of increases in global average air and ocean temperatures, widespread melting of snow and ice, the weakening of the Arctic ice cap, and rising global mean sea level. The Earth's average surface temperature has risen by 0.76°C since 1850. According to its Fourth Assessment Report, the Inter-Governmental Panel on Climate Change (IPCC) projected global warming this century is likely to trigger serious consequences for mankind and other life forms, including a rise in sea levels of between 18 and 59 cm, which will endanger coastal areas and small islands, and a greater frequency and severity of extreme weather events.\(^{250}\)

Human activities that contribute to climate change include in particular the burning of fossil fuels, agricultural techniques and land-use changes like deforestation. These cause emissions of carbon dioxide (CO\(_2\)), the main gas responsible for climate change, as well as of other 'greenhouse' gases (GHG). To bring climate change to a halt, global greenhouse gas emissions must be reduced significantly. Without further action to reduce greenhouse gas emissions, the global average surface temperature is likely to rise by a further 1.8-4.0°C this century, and by up to 6.4°C in the worst case scenario. Even the lower end of this range would take the temperature increase since pre-industrial times above 2°C – the threshold beyond which irreversible and possibly catastrophic changes become much more likely.

\(^{250}\) Intergovernmental Panel on Climate Change Fourth Assessment Report – IPCC (2007)
http://www.ipcc.ch/ipccreports/ar4-syr.htm
The EU and China are among the highest emitters of GHG in the world. China’s total CO2 emissions are approximately 50 per cent higher than those of EU 27 and are now surpassing those of the United States until 2007 the world’s highest emitter. Although also high, EU 27 CO2 emissions are beginning to follow a slightly downward trend year on year, whilst China’s are increasing sharply with the country’s rapid economic growth. CO2 emissions per capita in China, however, are only around one third of those in the EU. Recent research by WWF shows that around 5 per cent of China’s CO2 emissions result from the manufacture of goods which are exported and then consumed in the EU.

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251 Source – Parry et al. (2001)
**Focus 1: bringing global warming under control**

“To avoid the severe risks that would result from a rise in global average temperature of more than 2°C, we must get global concentrations below 450 ppm. This will require a cut in annual global emissions from about 50 gigatonnes of CO2 equivalent to below 35 gigatonnes in 2030, and less than 20 gigatonnes by 2050.”

“Today, the per capita annual emission in the European Union (EU) and the US is 12 tonnes and 23.6 tonnes respectively, compared to 6 tonnes in China and 1.7 tonnes in India. Since projections for 2050 suggest that the world’s population will reach about 9 billion, the per capita emission has to be cut to about 2 tonnes of CO2 equivalent, on average, if we want to keep the global annual total to less than 20 gigatonnes.”

Sir Nicholas Stern, October 2009

The Kyoto Protocol represented an important beginning, but only a beginning. Its targets are not sufficiently demanding to limit global temperature increase to the 2°C threshold discussed above. The challenge facing both China and the EU today is to greatly reduce the carbon content of their economic growth. This will be difficult since it implies reformulating their development models. It will have far-reaching implications for regional development policies.

One of the most consistent messages to emerge from current literature on climate change is that a ‘business as usual’ approach to development will not succeed in combating climate change effectively. The Stern Review, an independent study carried out for the UK Government in 2006, concluded that policy to reduce emissions should be based on three essential elements – carbon pricing, technology policy, and the removal of barriers to behavioural change. The omission of any one of these elements would significantly increase the cost of action. Policy frameworks must deal with long time-horizons and success will depend on shared understanding of the long-term goals for climate stabilization. Policies should also build on diverse national conditions and approaches to policy-making. But strong links between current actions and the long-term goal should be at the forefront of policy.

The approach of the Copenhagen Climate Change Summit has caused a flurry of political plans to combat global warming. Most notably, the G20 – which has now become the world’s premier forum for international economic cooperation and which has China and the EU as members – agreed to “spare no effort to reach agreement in Copenhagen through the United Nations Framework Convention on Climate Change (UNFCCC) negotiations.” At Pittsburgh, the G20 announced that amongst its core values was the determination to address climate change: “We have a responsibility to secure our future through sustainable consumption, production and use of resources that conserve our environment and address the challenge of climate change.”

254 See China Daily, October 16 2009 (p9).
256 See the Leaders’ Statement, Pittsburgh Summit, G20, September 24-25 2009.
The Pittsburgh Summit agreed that G20 members would work towards enhanced energy security through market reforms (greater transparency, more pro-active regulatory oversight, the replacement by 2020 of inefficient fossil fuel subsidies by targeted measures) and by renewed efforts to stimulate the production and use of clean and renewable energy and the adoption of technologies that will reduce greenhouse gas emissions. One of the Leaders conclusions made this clear:

“Increasing clean and renewable energy supplies, improving energy efficiency, and promoting conservation are critical steps to protect our environment, promote sustainable growth and address the threat of climate change. Accelerated adoption of economically sound clean and renewable energy technology and energy efficiency measures diversifies our energy supplies and strengthens our energy security. We commit to:

- Stimulate investment in clean energy, renewables, and energy efficiency and provide financial and technical support for such projects in developing countries.
- Take steps to facilitate the diffusion or transfer of clean energy technology including by conducting joint research and building capacity. The reduction or elimination of barriers to trade and investment in this area are being discussed and should be pursued on a voluntary basis and in appropriate forums.

As leaders of the world’s major economies, we are working for a resilient, sustainable, and green recovery.”

Pittsburgh also put on record the G20 leaders wanted a green recovery from recession, echoing a proposal in a report by Edenhofer and Stern which had been submitted to the G20’s earlier meeting in London. 257

2. Strategies to combat climate change

The EU has been taking steps to address its own greenhouse gas emissions since the early 1990s. In 2000 the European Commission launched the European Climate Change Programme (ECCP). The ECCP has led to the adoption of a wide range of new policies and measures. These include the pioneering EU Emissions Trading System, which has become the cornerstone of EU efforts to reduce emissions cost-effectively, and legislation to tackle emissions of fluorinated greenhouse gases.

In January 2007, as part of an integrated climate change and energy policy, the Commission set out proposals and options for an ambitious global agreement in its Communication "Limiting Global Climate Change to 2 degrees Celsius: The way ahead for 2020 and beyond". EU leaders endorsed this vision in March 2007. They set the following key targets with reference to 1990 levels:

- reduction of at least 20 per cent in greenhouse gases (GHG) by 2020 – rising to 30 per cent if there was an international agreement committing other developed countries to "comparable emission reductions and economically more advanced developing

countries to contributing adequately according to their responsibilities and respective capabilities; 

- 20 per cent reduction in energy consumption by 2020 compared to predicted trends; 
- 20 per cent increase in the share of renewable energies in EU energy consumption by 2020.

Sources of greenhouse gas emissions in the EU (European Environment Agency 2005)

In January 2008 the Commission proposed a major package of climate and energy-related legislative proposals under its Communication “20 20 by 2020” to implement these commitments and targets. The proposals rest on five key principles:

- targets must be met – with mechanisms for monitoring and compliance in place; 
- measures for meeting the targets must be flexible enough to take account of the different starting points of Member States and their different circumstances; 
- the costs of change and the consequences for the Union's global competitiveness, and employment and social cohesion, need to be kept at the forefront in designing the right structure; 
- the EU must drive on beyond 2020 to make even deeper cuts in greenhouse gases to meet the longer-term target of halving global emissions by 2050; 
- the EU must do everything possible to promote a comprehensive international agreement to cut greenhouse emissions.

The proposals were discussed at international level at the UN conference in Poznan in December 2008 and were formally adopted by the European Parliament and the Council of the EU at the beginning of 2009. EU leaders have expressed their wish for this package to occupy a central position in the international climate change negotiations beginning in Copenhagen in December 2009. Some of the key features of the EU policy on climate change are explored below.
(i) Carbon pricing and emissions trading – Market based instruments, such as environmental taxation and charging, as discussed in the previous Chapter, are equally important for climate change reduction where they can be developed towards the carbon pricing approach. The Stern Review states, “Greenhouse gases are, in economic terms, an externality: those who produce greenhouse-gas emissions are bringing about climate change, thereby imposing costs on the world and on future generations, but they do not face the full consequences of their actions themselves. Putting an appropriate price on carbon – explicitly through tax or trading, or implicitly through regulation – means that people are faced with the full social cost of their actions. This will lead individuals and businesses to switch away from high-carbon goods and services, and to invest in low-carbon alternatives.” Taxes levied by EU Member States on vehicles and motor fuel, for example, although not originally conceived as carbon taxes, are already having this effect. Automobile-related taxation rates in European countries are increasing in accordance with emission levels.

Emissions trading is the central pillar of the of the EU’s strategy on carbon pricing. Since it does not require unanimity between Member States, emissions trading is easier to organize at EU level than environmental taxation. The EU’s first emissions trading scheme (EUETS) was formally approved in the form of a Directive in July 2003 and runs in two phases — a first ‘pilot’ phase ran from 2005 to 2007, a second substantive phase from 2008 to 2012. It is the first international trading system for CO2 emissions in the world. It covers over 10,000 installations in the energy and industrial sectors which are collectively responsible for almost half of Europe’s emissions of CO2 – combustion plants, oil refineries, coke ovens, iron and steel plants, factories making cement, glass, lime, brick, ceramics and pulp and paper.

At the heart of the EUETS is the common trading 'currency' of emission allowances. One allowance gives the holder the right to emit one tonne of CO2. For each trading period under the scheme, Member States draw up national allocation plans which determine how many emission allowances each installation receives. The ‘cap,’ or limit, on the total number of allowances granted is what creates scarcity in the market. Since the EUETS gives CO2 a price, companies under the scheme are looking for new technologies to reduce the costs of CO2 pollution. The scheme is estimated to allow the EU to achieve its Kyoto target at an annual cost around € 3–3.7 billion (less than 0.1 per cent of GDP in the EU) compared to nearly € 7 billion without it.
Focus 2: How companies benefit from emissions trading

Let’s say that companies A and B both emit 100,000 tonnes of CO2 per year. The government gives each of them 95,000 emission allowances. One allowance represents the right to emit 1 tonne of CO2. So, neither company is fully covered for its emissions. At the end of each year, the companies have to surrender a number of allowances corresponding to their actual emissions during the year. Companies A and B both have to cover 5,000 tonnes of CO2, and they have two ways of doing this. They can either reduce their emissions by 5,000 tonnes, or purchase 5,000 one-ton allowances in the market. In order to decide which option to pursue, they will compare the costs of reducing their emissions by 5,000 tonnes with the market price for allowances.

For the sake of the example, let us say that the allowance market price is €10 per tonne of CO2. If Company A’s reduction costs are €5 (i.e. lower than the market price), it will reduce its emissions because it is cheaper than buying allowances. Company A may even reduce its emissions by more than 5,000 tonnes, say 10,000 tonnes. For Company B, let’s say that the situation is the opposite: its reduction costs are €15 (i.e. higher than the market price) so it will prefer to buy allowances instead of reducing emissions.

Company A spends €50,000 on reducing emissions by 10,000 tonnes at a cost of €5 per tonne and receives €50,000 from selling allowances for 5,000 tonnes at a price of €10. So Company A fully offsets its emission reduction costs by selling allowances, whereas without the Emissions Trading Scheme it would have had a net cost of €25,000 to bear. Company B spends €50,000 on buying 5,000 tonnes at a price of €10. In the absence of the flexibility provided by the Emissions Trading Scheme, company B would have had to spend €75,000.

Since only a company that has low reduction costs and therefore has chosen to reduce its emissions, like Company A, is able to sell emission allowances, the allowances that Company B buys represent a reduction of emissions, even if Company B did not reduce emissions itself. This is important to remember. The trading system ensures that the cheapest reductions are made first. Since the scheme is EU-wide, companies will seek out the cheapest reductions in the whole of the EU. It is this flexibility in the system which makes emissions trading the most cost-effective manner of achieving a given environmental target. The overall cost to industry would have been higher if Company B had been forced to reduce emissions at its own plant at a higher cost.

The price of allowances is determined by supply and demand as in any other market. The market in allowances continues to develop strongly. In the system’s first year of operation, 2005, at least 270 million one-tonne CO2 allowances were traded, with a value of around €5 billion. In 2006, trading volume rose to more than 800 million allowances, and in 2007 this level was reached after only seven months of the year. European trading constitutes some 80% of the global turnover of CO2 allowances and credits, which was valued at €14.6 billion in 2006. In the second trading period, from 2008 to 2012, emissions of nitrous oxide are also included.

In addition to domestic action by Member States, the Kyoto Protocol allows Member States to invest in Joint Implementation (JI) and Clean Development Mechanism (CDM) projects in other countries and use credits from these for compliance purposes towards part of their emission reduction commitments. The reasoning behind JI and CDM is similar to that behind emissions trading: climate change is a global problem and it does not matter where emissions reductions are achieved. The important thing is that they take place and are achieved in the most cost-effective way. All credits except those from nuclear facilities and land use, land-use change and forestry activities may be accepted. This has encouraged additional investment in environmentally-friendly projects and consequently promotes sustainable development goals. The potential private sector demand generated by the EU ETS for credits from CDM and JI projects between 2008 and 2012 is valued at almost €1.4 bn. Companies are not the only ones looking for emission reduction credits through the CDM and JI. A number of EU Member States intend to use such credits themselves to help meet their emission targets under the Protocol. Governments plan to buy around 550 million tonnes of CO2 credits for the period 2008–12 and have budgeted some €2.9 billion to pay for them. Since the majority of CDM and JI projects tend to generate emission reductions averaging between 500,000 and 1 million tonnes of CO2, EU countries’ demand for emission credits can be satisfied only through a high number of such projects.

(ii) Eco-innovation – the EU’s Environmental Technologies Action Plan (ETAP) is designed to help overcome barriers to developing environmental technologies in such fields as:

- renewable energy generation;
- cleaner vehicles;
- ‘passive’ buildings – independent of fossil fuels.

Since 2004, ETAP has covered a spectrum of actions to promote eco-innovation. This has included priority actions promoting research and development, mobilising funds and helping to drive demand to improve market conditions. ETAP is to be strengthened under the Commission’s new policy proposals for combating climate change.

The European Forum on Eco-innovation brings together business and policy perspectives in a twice-yearly event that explores strategic orientations for eco-innovation and environmental technologies, in support of the EU Environmental Technologies Action Plan (ETAP). Eco-innovation in the EU is a fast-moving area. For further information see the ETAP website - http://ec.europa.eu/environment/etap/.

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Focus 3: Technology transfer under the UN Framework Convention on Climate Change (UNFCCC)\textsuperscript{260}

Among the 192 countries that have ratified the UN Climate Change Convention, the developed country parties commit themselves to

"promote, facilitate and finance, as appropriate, the transfer of, or access to, environmentally sound technologies and know-how to other Parties, particularly to developing countries to enable them to implement the provisions of the Convention."

Technology transfer is therefore one of the core issues of the Convention. In 2001, a 'technology framework' was agreed in Marrakech, which covers the key themes of:

- technology needs and their assessment;
- technology information;
- enabling environments;
- capacity-building;
- mechanisms for technology transfer.

The technology framework has been further developed over the years, including new methodologies for 'needs assessment' and the launch of a technology-transfer information clearing house TT:CLEAR, which is a web-based tool that enables different international stakeholders to find information on:

- technology transfer projects and programmes;
- case studies of successful technology transfer;
- environmentally sound technologies and know-how;
- organisations and experts;
- methods, models, and tools to assess mitigation and adaptation options and strategies;
- relevant Internet sites for technology transfer;
- ongoing work of the Parties and the EGTT, such as issues under negotiation, documents and meetings, and implementation of the technology framework.

The Marrakech Accords also provided for the establishment of an Expert Group on Technology Transfer (EGTT) that comprises 20 experts from industrial as well as developing countries and relevant international organisations.

Further information can be found on: \url{http://ttclear.unfccc.int/ttclear/jsp/}

\textbf{(iii) Adaptation} - The European Commission adopted its first policy document on adapting to the impacts of climate change in June 2007 – the Green Paper "Adaptation..."
The paper argues that we are now faced with a double challenge: next to deep cuts in greenhouse gas emissions we also need to adapt to changing climate conditions. Climate change has significant influence on the probability and hazard of natural risks in all regions. The most vulnerable areas in Europe are:

- southern Europe and the entire Mediterranean Basin due to the combined effect of high temperature increases and reduced precipitation in areas already coping with water scarcity;
- mountain areas, in particular the Alps, where temperatures increase rapidly leading to widespread melting of snow and ice changing river flows;
- coastal zones due to sea level rise combined with increased risks for storms;
- densely populated floodplains due to increased risks for storms, intense rainfall and flash floods leading to widespread damages to built-up areas and infrastructure;
- Scandinavia where much more precipitation is expected and a larger part in the form of rain instead of snow;
- the Arctic region where temperature changes will be higher than in any other place on Earth.

Many economic sectors depend strongly on climatic conditions and will directly feel the consequences of climate change on their activities and businesses: agriculture, forestry, fisheries, beach and skiing tourism, and health. For example, reduced water availability, wind damages, higher temperatures, increased bushfires and greater disease pressure will lead to damage to forests. Increase in frequency and intensity of extreme events such as storms, severe precipitation events, sea floods and flash floods, droughts, forest fires, landslides cause damage to buildings, transport and industrial infrastructure and consequently impact indirectly on financial services and insurance sectors. Even damage outside the EU could significantly affect the Union’s economy, e.g. reduced timber supply to European processing industries.

The European Commission’s 2007 Green Paper describes possible avenues for action at EU level. The main areas under discussion for future adaptation policies are:

- climate ‘proofing’ of all medium and long-term investment projects – not as a luxury but as an economic necessity;
- impacts on water cycle and water resources management and prediction of extreme events;
- marine resources and coastal zones and tourism;
- human health;
- agriculture and forestry;
- biodiversity;
- regional planning, built environment, public and energy infrastructure;

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• urban planning and construction.

Adaptation is complex because the severity of the impacts will vary from region to region, depending on physical vulnerability, the degree of socio-economic development, natural and human adaptive capacity, health services, and disaster surveillance mechanisms.

Multilevel governance is vital for climate change adaptation involving all actors from the individual citizens and public authorities to the EU level. Whatever the level of governance, action should be taken at the most appropriate level, be complementary, and based on joint partnerships. Division of competence between states and their regions varies significantly across the EU and the examples below should therefore be adapted to the national situation. Close coordination between national, regional and local authorities and other authorities such as river basin administrations will be crucial for building effective adaptation strategies which are also cost-effective.

(iv) Behavioural change – Public awareness raising, education and training are needed in large measure to promote widespread change in human behaviour needed to combat climate change. The European Commission has launched its own campaign, which can be followed on the site http://ec.europa.eu/environment/climat/campaign/index_en.htm.

As in many Member State and local initiatives, the campaign centres around giving individuals the information they need to assess the carbon ‘footprint’ of their activities and the of the products they buy and then by encouraging them to reduce it.

3. Towards a new development model for regional policies

Concrete action against climate change requires investment in huge volumes on global scale. In EU policy terms, Cohesion Policy – in its leader role – will be at the spearhead of investments to implement on the ground the new development model. Bold choices will be called for to focus regional development resources exclusively onto investments which will really contribute to reducing GHG emissions. By definition this will mean stopping certain types of investment which have become traditional fields for EU Cohesion Policy. The independent review of Progress under the EU Sustainable Development Strategy 262 carried out for the Commission in February 2008 notes that at present: “The relation between the EU Sustainable Development Strategy (SDS) and the Structural Funds is controversial. In the 12 New Member States, vast investment programmes in infrastructure are on their way. In Poland for instance, the Operational Programme for Infrastructure represents an EU investment of € 27 billion for the period 2007-2013 – of which a considerable part will be invested in roads. The impact on sustainable development is at least uncertain.” Moreover, a much higher volume and an accelerated rate of investment to combat climate change in all regions will be needed to implement the Commission’s new package of climate of legislative proposals. Many of these investments are likely to be of an inter-regional or transnational character.

262 Progress on the UU Sustainable Development Strategy (ECOTEC) – (February 2008)
The reorientation of EU Cohesion Policy after 2014 to support more strongly the EU Strategy on Climate Change is already a subject of wide-ranging debate. In the period 1990 to 2004, Ireland, Greece, Portugal and Spain – the ‘Cohesion Countries’ of the EU, in which over 70 per cent of the resources from EU Cohesion Policy have been concentrated – achieved significant economic growth. However, over the same period (see graph below) a substantial increase in GHG emissions was also recorded, against the trend of slight decrease in EU 15 overall.

This kind of experience cannot be repeated if EU Cohesion Policy is to remain a credible weapon in the EU’s future armoury in the fight against climate change.

(i) Moving away from GDP as the sole means of measuring regional development disparities

A key feature of the current debate on the future of EU Cohesion Policy is the idea of moving away from GDP as the sole means of measuring development disparities between regions and of re-directing funding allocations from the EU Structural Instruments. The GROW Regional Framework Operation within the INTERREG IIIC interregional cooperation programme brings together five European regions – South East England (UK), Emilia-Romagna (Italy), Noord-Brabant (Netherlands), Malopolska (Poland) and Andalucía (Spain). The GROW partners are proposing a classification system known as RAMEA for the post-2014 phase of EU Cohesion Policy. RAMEA is a Regional NAMEA (National Accounting Matrix with Environmental Accounts), an environmental accounting system which combines economic accounts (measured in monetary terms) and environmental accounts (measured in physical units) into a single framework useful for the evaluation of the integrated economic-environmental-social performance of regions. RAMEA can be used to support decision-taking, and to inform and help regional policy-makers to

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263 Source – Friends of the Earth / Bankwatch - ENEA (May 2007)
identify and quantify potential environmental and economic impacts associated with regional development policy measures.

RAMEA’s framework is based on an established approach (SEEA 2003 and Eurostat Guidelines) and robust data from official statistics: it is coherent with similar tools at national level (NAMEA) and is compiled in a relatively inexpensive way, deriving its numbers from national and regional accounts. RAMEA enables analysis of the pressures placed on the environment by the economic sectors and households, with the possibility of extracting sustainability indicators to examine more effectively the relationship between economic development and environmental pressures. Data provided by RAMEA, in combination with environmental input-output analysis, allows a deeper insight into regional production chains and indirect effects caused by the final demand for goods of which production is intensive in terms of pollution.

(ii) Integrating carbon pricing into regional development policies

Whether the RAMEA were to be adopted or not, there would need to be a stronger and more consistent use of carbon pricing and some form of environmental accounting – i.e. counting the full environmental costs of different investment options. At project-level, this would entail, for example, applying a financial cost value to the GHG emissions which would result from car journeys to and from an out-of-town science park development under consideration for funding. If the buildings on the science park were to be powered by burning of fossil fuels, the costs of the respective GHG emissions resulting from this power generation would need to be taken into account and added in. A thorough assessment system for such a project might even factor in the future costs of medical treatment of persons likely to suffer from respiratory illness due to the pollution resulting from those extra car journeys, as well as from the fossil-fuel power generation during the lifetime of the science park.

Applying carbon counting principles to project selection procedures, including EIA for larger and more environmentally sensitive projects, could have a major influence on individual funding decisions. If they were to be applied as part of the criteria used in plan or programme level SEA, a range of new alternative approaches could emerge in forms which are markedly different from the EU’s current development model.

(iii) Priority investments for EU Cohesion Policy to combat climate change

The following examples of key investment fields to maximize EU Cohesion Policy’s future impact on climate change are proposed in the ENEA ‘Ideas Paper’ 264.

• **Energy efficiency – and especially in the new Member States**
Energy efficiency improvements can reduce the energy bill and improve economic performance in the new Member States. There is very high energy intensity in the new Member States and a lack of institutional capacity. More efficient energy use will lead to important reductions in GHG emissions.

**Priority investment fields:**

- promoting more energy efficient modes of transport, such as clean urban transport (see also ‘Sustainable Transport’ below);

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- upgrading and refurbishment of district heating installations in the new Member States (new Member States have extensive district heating networks with more than 35 per cent of people connected);
- implementation of the Directive on the promotion of Combined Heat and Power (CHP), including using biomass;
- improving energy efficiency of buildings (including implementation of the Directive on the Energy Performance of Buildings);
- improving energy efficiency of industrial installations and equipment (e.g. electric motors);
- improved implementation of the Directives on energy labeling for domestic appliances;
- fuel switching and stimulation of clean low emission and renewable source based technologies for domestic heating and cooling (temperature control);
- upgrading/replacing large coal combustion plants using clean coal techniques;
- implementation of the Directive on end-use energy efficiency and energy services;
- increasing capacity building for establishing energy efficiency agencies;
- promoting green public procurement regarding energy efficiency;
- training and awareness raising programmes on energy efficiency;
- higher support for mandatory energy audits at conditions acceptable for small scale energy consumers, especially in new Member States.

- **Promotion of renewable energy**
  Renewable energy investments use local energy resources and contribute to regional development, innovation and increased employment. Whilst such investments promote environmental goals, they must themselves respect the environmental *acquis communautaire* (especially EIA and Natura 2000).

  **Priority investment fields:**
  - windfarms, bio-energy, small scale hydroelectric generation, geothermal, photovoltaic and solar;
  - improving grid connections for renewable energy strategy (RES), preparation of adaptation to electricity network infrastructure to exploit local RES;
  - development of infrastructures for biomass production and biomass supply chain;
  - setting-up of renewable energy agencies – physical establishment of agencies capacity building and training related to renewable energy;
  - implementation of the Directive on RES;
promoting the development of active buildings self-producing energy from renewable sources;
implementation of the Directive on biofuels and establishing the supply chain for biofuels;
identification of RES resources and innovative project areas, feasibility studies;
programmes for exploiting the potential of biomass, solar and geothermal for heating and cogeneration applications including conversion of conventional district heating installations and associated networks.

• **Sustainable transport**
In both the EU15 and the new Member States, it is the transport sector that continues to show rising GHG emissions and hence requires particular attention. Transport related actions to be financed should be part of a comprehensive national plan and contribute to achieving a sustainable transport system. Since transport can be conceived as a derived activity, actions in other sectors should be assessed to minimise their impact on transport volumes. The revised TEN-T guidelines already place a clear emphasis on favouring sustainable transport modes over less sustainable modes. Support for improvements in public transport in urban areas is a key priority for reducing pollution and congestion in cities, as well as GHG emissions. To ensure that the co-financing on urban transport operations achieves its goals, the city in question should have an integrated urban transport strategy. This strategy should seek to ensure access to goods and services by all citizens at a reasonable cost in an environmentally safe and healthy way.

**Priority investment fields:**

- elaboration of emissions (air pollutants and CO2) inventories and diagnostics, as well as preparation, monitoring and implementation of public plans or programmes aiming to control transport emissions;
- public investments aiming to improve passenger and goods transport in order to achieve a more balanced modal split between road transport, rail and inland waterways;
- promotion of transport modes fueled from renewable sources;
- implementation of integrated city-wide strategies for clean urban transport, including investments in metro systems, tram systems and light rail, bus lanes, cycle lanes and pedestrianisation

No transport investments should be supported by EU Cohesion Policy in the future which do not fully embody sustainable transport principles.

• **Urban environment**
The quality of the urban environment within cities and the environmental performance of cities are essential components of any future approach for the development of urban areas. Urban environment issues are inextricably linked with Cohesion Policy and other existing EU legislation such as Directives on air quality, noise assessment, water quality and urban waste water treatment.

**Priority investment fields**
urban renewal (making the city a fit and attractive place to live, work and invest);
rehabilitation of the physical environment (increasing the use of underused buildings to reduce pressure for urban sprawl, providing play spaces, new green areas);
improving the quality and energy efficiency of the housing stock;
development of historical and cultural heritage;
measures to promote entrepreneurship, local employment and community development – particularly in fields relating to emissions reduction.

Any buildings constructed or renovated through these investments should be of the highest environmental standard and take the environment into account in the design and construction techniques used.

**Adaptation to climate change**
Climate change will require substantial mitigation measures over the next 50 years. There will be implications for management and spatial planning which will need to incorporate risk prevention approaches. Manmade and natural areas (including Natura 2000 sites) will be threatened. Ecological resilience could be affected. Cohesion Policy aims at reducing the disparities between EU regions. Climate change affects regions differently, potentially further increasing disparities.

**Priority investment fields:**
- measures to adapt to climate change – building environmentally sensitive flood defences, ecological management and relocation of manmade activities;
- ‘climate proofing’ of all infrastructures – including already existing infrastructures and buildings.

**Education, training and capacity building**
Throughout the EU Cohesion Policy system there is considerable need for increased awareness and knowledge relating to climate change, as well as for related institutional capacity building – particularly in the new Member States. This will provide the key to the behavioural changes required to combat climate change effectively.

**Priority investment fields:**
- Training in application of carbon pricing techniques to project proposals and selection systems, as well as to EIA and SEA;
- Training to enable effective monitoring of individual projects and Operational Programmes from the point of view of emissions reduction;
- Specific training for in EU monitoring and reporting requirements under the Emissions Trading Directive and in implementation of Kyoto flexible mechanisms;
Training to encourage energy efficiency and the development of renewable energy;

Education of children and young people about combating climate change.

Curbing deforestation is also a highly cost-effective way of reducing greenhouse gas emissions. Emissions from deforestation are very significant – they are estimated to represent more than 18 per cent of global emissions, a share greater than that produced by the global transport sector. Action to preserve the remaining areas of natural forest is needed urgently. This will have strongly positive impacts on soil stabilisation, flood protection and water resource management – in addition to significant carbon ‘capture’ effects.

(iv) Towards ‘carbon neutral’ regional development programmes

Many EU Member States and regions are beginning to consider building a carbon neutral approach in their Operational Programmes under the next phase of EU Cohesion Policy. Through this approach, economic development investments which generate GHG emissions would need to be completely offset by carbon-reducing investments, such as those highlighted above, in the context of a regional development programme as a whole.

No Member State has progressed as far in this direction as France, which has already committed to implement all of its 26 ERDF Operational Programmes for the current 2007-2013 period as carbon neutral. The French approach to carbon neutrality is thorough, covering the entire life-cycle of the investments to be financed – in some cases up to 60 years. The key tool to achieve this is a computer programme known as NECATER, which is able to estimate the likely GHG emission effects of different types of projects on a given territory, thereby helping to guide project selection towards a carbon neutral position. As projects are implemented, NECATER can provide more precise information on the carbon intensity of expenditure actually incurred. NECATER is still at an early stage in its development and is relatively crude at present. It is also important to note that NECATER relies on homogeneity of territorial-level data to function correctly. However, NECATER is far in advance of any other similar tool existing in this precise domain of EU Cohesion Policy implementation. For further information on the French carbon neutral programme approach, contact necater@diact.gouv.fr.
As a conclusion to this section, it is clear that there is a great deal of strategic reflection already underway in different parts of the EU as to the potential of EU Cohesion policy to promote climate-friendly development on a large scale. The post-2014 phase of Cohesion Policy looks likely to provide a real opportunity to help bring about the decarbonisation of regional economies across the EU and of EU economic performance as a whole.

4. Costs and benefits of combating climate change

Fossil-fuel based emissions can be greatly reduced by adopting a combination of concrete technical options in four sectors - power sector, industry, buildings and transport. These options are available today and could be implemented on a grand scale. Combating climate change is technically feasible. It is also economically affordable and has major potential benefits for both environment and regional development policies, not to mention positive synergies with other important policy areas.

Besides helping to avert the most damaging impacts of global climate change, reducing greenhouse gas emissions will bring the EU a range of co-benefits. These include improving energy security, reducing air pollution and its associated health and control costs, and increasing employment.

- **Improving energy efficiency and security**
  Security of supply is a growing concern as the EU becomes increasingly dependent on imported energy, especially in the context of rising fuel costs. With ‘business as usual’, the Union’s energy import dependence will jump from 50 per cent of total EU energy consumption today to 65 per cent in 2030. Reliance on imports of gas is expected to
increase from 57 per cent to 84 per cent by 2030, and of oil from 82 per cent to 93 per cent. There is thus a very strong economic case for making more efficient use of resources, as a contribution towards improving EU competitiveness, even before the associated benefits of cutting emissions are taken into consideration.

- **Reducing air pollution and health costs**
  Cutting greenhouse gas emissions will also reduce air pollution, which still causes 370,000 premature deaths in Europe every year. The associated air quality benefits of bringing down CO2 emissions by just 10 per cent by 2020 would yield healthcare savings of up to €27 billion per year. The reduced need for measures to control air pollution will bring additional savings of €11 billion per year in 2020.

- **Increasing employment**
  Eco-industries are one of the most dynamic sectors of the European economy, growing at around 5 per cent a year in response to global demand for green technologies, products and services. They employ some 3.4 million people in Europe and offer particular growth potential. Renewable energy technologies have already created 300,000 jobs and it is estimated that a 20 per cent share for renewables will take this to almost 1 million by 2020. The EU is a major player in the global eco-industries market, which is worth around €1.000 billion in 2005 and expected to rise to €2.200 billion by 2020.

- **Opportunities from adaptation measures**
  Adaptation will also bring about new economic opportunities including new jobs and markets for innovative products and services, for example:
  - New markets for climate-proof building techniques, material and products.
  - Beach tourism in Mediterranean countries would be expected to shift to spring and autumn where tourist resorts may become too hot during summers, while favourable climate conditions during summer would turn the Atlantic and North Sea into potential new tourist destinations for beach holidays.
  - Adapting local agricultural management practices in Scandinavia to longer growing seasons.
  - Insurance sector could develop new insurance products for reducing risks and vulnerability before disasters strike. Insurance premiums anticipating climatic changes could provide incentives for private adaptation actions.

The Stern Review estimates that stabilising emissions at around 550ppm CO2e by 2050 is likely to cost around 1 per cent of global GDP per year (with a range from –1 per cent to +3.5 per cent of GDP). The Review also models likely ‘business as usual’ scenarios that include the risk of abrupt and large-scale climate change. These models estimate that if GHG emissions are not substantially reduced and global temperatures rise to over 3°C, the world might expect an average 5-10 per cent loss in global GDP to result by the end of the century, with poor countries suffering costs in excess of 10 per cent of GDP. The message from Stern’s analysis is not so much to question whether the world can make the necessary investment, but whether it can afford not to.
Focus 3

“No-one can predict the consequences of climate change with complete certainty; but we now know enough to understand the risks. Mitigation - taking strong action to reduce emissions - must be viewed as an investment, a cost incurred now and in the coming few decades to avoid the risks of very severe consequences in the future. If these investments are made wisely, the costs will be manageable, and there will be a wide range of opportunities for growth and development along the way.”

Stern Review 2006
http://www.hm-treasury.gov.uk/Independent_Reviews/stern_review_economics_climate_change/sternreview_index.cfm

5. EU-China cooperation to combat climate change

Greater international co-operation is needed to accelerate technological innovation and diffusion will reduce the costs of mitigation. The private sector is the major driver of innovation and the diffusion of technologies around the world. Governments will also need to promote international collaboration to overcome barriers in this area, including through formal arrangements and through arrangements that promote public-private co-operation.

International co-ordination of regulations and product standards can be a powerful way to encourage greater energy efficiency. This can raise cost effectiveness, strengthen incentive to innovate, improve transparency, and promote international trade. The reduction of tariff and non-tariff barriers for low-carbon goods and services could provide further opportunities to accelerate the diffusion of key technologies.

Technology co-operation enables the sharing of risks, rewards and progress of technology development and enables co-ordination of priorities. These may be embodied in formal multilateral agreements including demonstration projects and dedicated international programmes to accelerate key technologies. Formal agreements are only one aspect - informal arrangements for greater coordination and enhanced linkages between national programmes can also play a very prominent role.

(i) Joint Declaration on Climate Change between China and the EU

The Joint Declaration was signed in 2005 with the aim of setting up a Partnership on Climate Change. This Partnership provides a platform for cooperation and dialogue, the following key areas for technical co-operation:

- energy efficiency, energy conservation, and new and renewable energy;
- clean coal;
- methane recovery and use;
- carbon capture and storage;
- hydrogen and fuel cells;
- power generation and transmission.

265 EU-China Joint Declaration on Climate Change (September 2005)
Two joint EU-China projects are underway.

- The EU-China CDM Facilitation Project (€2.8 million)\(^{266}\), launched in June 2007 will strengthen the Clean Development Mechanism (CDM) as a central pillar within China’s path to sustainable development. The focus is on China’s policy and regulatory regime, bringing together a wide range of stakeholders at public and private sector levels involved in CDM projects. On the national level, the project will among other things assess effectiveness of technology transfer through CDM. Several EU Member States have shown interest to be involved in the activities on regional level.

- The Carbon Capture and Storage Project ("Zero-emission" demonstration plant) has the aim of developing and demonstrating advanced near-zero emission coal (NZEC) technology through carbon dioxide capture and storage (CCS). This technology will allow for the capture of CO2 emissions from coal-fired power plants and its subsequent storage underground, thereby avoiding CO2 emissions into the atmosphere. Memoranda of Understanding have been signed between the European Commission and China and the United Kingdom and China. Phase 1 of the project is mainly research (in collaboration with the EU 6\(^{6}\) Framework Programme), knowledge sharing and capacity building for which the results are expected in 2010. The second phase is the UK's NZEC Initiative leading to phase three (to be completed by 2020,) the construction and operation of a commercial scale demonstration plant fired by near-zero-emissions coal with CCS technology. The UK's NZEC project has a budget of €3.5m, while the EU project has a budget of €2.6m (including €1.5m EC contribution).

(ii) Scope for EU-China collaboration on regional development and climate change

There is tremendous potential for mutually beneficial collaboration between China and the EU to integrate emissions reduction into the heart of regional development policy. The field is still relatively new for both partners. Most aspects mentioned in this Chapter can provide practical subjects for collective work - from the use of carbon pricing in strategic and project-level environmental assessment to the planning an implementation of regional investment programmes which embody a low-carbon, or carbon neutral approach.

One obvious opportunity for the Chinese partners in this field is to become associated with the preparation of the post-2014 phase of EU Cohesion Policy, which is already being discussed between EU Member States and the Commission. An important first step in this direction would be for the EU to involve Chinese officials in the activities of ENEA, the European Network of Environmental Authorities, discussed here and in the previous Chapter.

\(^{266}\) Project website at [http://www.euchina-cdm.org/](http://www.euchina-cdm.org/)
Useful international links for China and Climate Change

European Commission Delegation in China
http://www.delchn.ec.europa.eu/

China Council for International Cooperation on Environment & Development (CCICED)
www.cciced.org

A Canadian-based council which holds regular high-level meetings with China’s environmental decision-makers.
www.harbour.sfu.ca/dlam/index.html

Woodrow Wilson Environmental Change and Security Project (ECSP) – China Environment Series

Contains articles on China’s environment and current environmental research projects, and a bibliography of literature on China’s environment.
www.ecsp.si.edu/default.htm

U.S. embassy website - Environment, Science, and Technology in China
Features reports on current environmental issues in China.

World Resources Institute (WRI) - China’s health and environment
Contains general information on air and water pollution, as well as environmental laws and policies in China.

China Development Brief
Information on social development, rural development, poverty alleviation, and environment protection projects in China.
www.chinadevelopmentbrief.com

World Wildlife Fund China
Research on China’s ecological footprint and EU-China ‘hidden’ emissions. Various environmental projects in China, including solar and biogas.
http://www.wwfchina.org/english/