Study on the Impact of the Single Market on Cohesion: Implications for Cohesion Policy, Growth and Competitiveness

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PREFACE

This report has been prepared by LSE Enterprise, drawing on work by the Centre for Social and Economic Research (CASE), the University of Helsinki, and Vienna University of Economics and Business.

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Executive summary

This is the final report of a study on 'The Impact of the Single Market on Cohesion: Implications for Cohesion Policy, Growth and Competitiveness', undertaken in 2010-11 following an invitation to tender published in February 2010 by the Directorate-General for Regional Policy of the European Commission.

Context and aims of the study

Over the last quarter of a century, the single market has been one of the most profound influences on the economic and social development of the EU. It has affected not only trade flows across national borders, but also patterns of economic specialisation, the level and composition of employment, and the spatial balance of economic activity. By stimulating migration and capital flows, the single market has shaken up factor markets, while the competitive pressures engendered have altered regional development trajectories.

Although the overall impact of the single market is generally agreed to have been positive, it was acknowledged from its inception, that it would have a differentiated impact across EU regions. In response to this, a comprehensive European policy was established to address some of the challenges faced by Europe's regions as a result of the creation of the single market. Cohesion policy, through its instruments of the Structural Funds and the Cohesion Fund, was complementary to the single market programme.

To shed light on how the single market has affected regional disparities in the EU and to deepen understanding of the role of cohesion policy in supporting the integration of regions into the single market, the Directorate-General for Regional Policy commissioned a study of the impact of the single market on cohesion. Its underlying purpose was to inform the preparation of cohesion policy for the 2014-2020 programming period. The study had three main components:

- First, it assessed the impact of the single market on growth, competitiveness and employment at national and regional levels.
- Second, it investigated the strategies and intervention logics developed in cohesion policy programmes in the 2007-2013 programming period, establishing a typology of these logics and appraising their effectiveness.
- Third, the study examined the policy linkages and institutional relationships between the Lisbon process and cohesion policy.

Drawing on the findings from this research, the study analysed a range of policy issues and discussed the implications for future cohesion policy in the 2014-2020 period. This analysis pays particular attention to the inter-actions between the Europe 2020 strategy and cohesion policy, taking into account the future role foreseen for cohesion policy in supporting smart, sustainable and inclusive growth.

The governance challenges

The ethos of the single market is that there should be a level playing-field on which regulatory barriers and other public policy interventions do not distort markets in ways that confer economic advantage on certain producers as a result of where they are based. Cohesion policy has a crucial role in ensuring that the level playing-field of common regulation is matched by a levelling-up of the capacity of regions and localities that start from a competitive disadvantage. In this way, cohesion policy seeks to prevent a spatial imbalance in economic development that would diminish the benefits of the single market.

In parallel to the increasing economic integration of Europe, based on the single market and reinforced by the creation of the euro, there has been a progressive integration of markets internationally, captured in the term 'globalisation'. Recognising that the EU has to compete with, and benchmark itself against, both traditional rivals (such as the US) and the dynamic emerging economies of Asia and Latin America, the Lisbon strategy – launched in 2000 and re-launched in 2005 – was intended to reposition the EU in global markets, with an emphasis on the knowledge economy. The Europe 2020 strategy, agreed in 2010, also has a substantial external orientation, but goes beyond the 'growth and jobs' agenda of the post-2005 Lisbon strategy to embrace sustainability and inclusiveness.

From a governance perspective, the single market, cohesion policy and the Lisbon/Europe 2020 strategies represent not only three distinctive pillars of public policy, but also three different modes of governance – the first predominantly regulatory, the second reliant on public spending and the third being about coordination of national policies in the common interest.

Consequences for regions of the single market

In this study, the impact of the single market was investigated empirically in three distinct, but complementary ways: through simulations using general equilibrium models; econometric work to elucidate the effects of closer alignment of economic cycles, foreign direct investment (FDI) and migration as key mechanisms of market integration; and qualitative case studies of 20 regions.

The modelling work assessed the impact of the single market by simulating what would have happened had the EU12 not acceded to the EU, distinguishing between the effects of participation in the single market and the additional benefits of becoming eligible for cohesion policy funding in the period 2007-2009. It is important to stress that this sort of modelling exercise is designed to answer 'what if' questions rather than to provide an exact measurement of what actually happened or predictions of future outcomes. However, it also provides a coherent framework for analysis that attempts to take into account the range of relevant variables and flows.

The modelling results suggest that accession to the EU, and thus fully to the single market, boosted the GDP of the EU12 by some 6.7%, even without cohesion policy funding, an outcome that is, principally, the result of greatly increased trade. The largest impact comes about because of the boost given to FDI by EU membership. An additional increase of 3.9% in GDP comes from cohesion policy, so that the aggregate effect of EU accession complemented by cohesion policy in the period 2007-09 is that EU12 GDP is 10.6% higher than it would have been. Previous studies have found even bigger benefits, but more conservative assumptions were built into these new simulations.

The other side of the equation is that there is some loss to EU15 because investment switches to EU12 – but it results in only a very small reduction of 0.2% of GDP – an outcome readily explained by the scale differences between the two country blocks. The main reason for the loss is lower levels of investment, but household income decreases only slightly and private consumption not at all. The effect on private consumption is zero because the small decrease in household incomes is compensated by slightly decreasing consumer prices. However, it is to be expected that in the longer term the benefits of integration will lead to higher aggregate EU27 growth rates.

The recent economic crisis demonstrated that a strong synchronisation of growth cycles is present in the EU. The economic crises affected all EU15 members at practically the same time and spread with only a short delay to the EU12. The extensive FDI linkages which have been established within the EU15 and recently between EU15 and EU12 appear not to be an important channel of transmission of growth and thus a source of growth cycle synchronisation, with most of the convergence arising because of trade links.

Further estimates reveal that manufacturing specialisation makes a positive contribution to growth cycle synchronisation in the EU15-EU12 pair and in the EU27 as a whole. Manufacturing specialisation arises from trade between EU15-EU12 and is linked to income differences in EU15-EU12 and in the EU27 as a whole. This is, in line with what might be expected from a well-functioning single market.

In the years leading up to the crisis, there were notable differences among regions in migration patterns, with net emigration from nearly all the regions of Romania, much of Poland, Latvia and Lithuania, the peripheral regions of Sweden and Finland, Southern Italy and Northern France. In the same period, Ireland, the South and North-Eastern part of Spain, the South-West and South of France as well as North and Central Italy, and Cyprus were heavy net immigration areas. Other than for Spain and Lithuania, the available data show that the share of high-skilled immigrants has increased.

The migration estimations provide strong evidence of convergence in unemployment rates among the regions analysed in this study during the period 2000-2007. In sum, the evidence suggests that migration did not have a statistically significant impact on the convergence of unemployment rates in the years 2000 to 2007, confirming previous research findings.

Migration has a positive impact on the GDP per capita in the receiving region, but ambiguous effects on productivity, depending on the composition of the migration. The economic structure of the receiving region also makes a difference. Migration has only a weak impact on productivity convergence.

The positive verdicts from the modelling and econometric work are, on the whole, corroborated by the case study interviews. Respondents believed that both the single market and cohesion policy had contributed to the development of their regions and that EU accession had brought tangible gains in prosperity. Some reservations were expressed about the uneven or incomplete impact of the single market on certain sectors of economic activity in EU15, and also among convergence regions in EU12. Although manufacturing, tourism and financial services were felt to have benefited, the incomplete single market for other service industries was noted, and some EU12 respondents expressed concern about external dominance of their banking industries.

The impact and focus of cohesion policy

There is ample evidence in the literature that cohesion policy has helped to reduce regional disparities over the last two decades and that it reinforces the trend towards regional convergence in GDP per head brought about by the single market. However, there are contrasting views in the evaluation literature about the effectiveness of cohesion policy in boosting growth rates, as opposed to GDP levels, suggesting that some of the convergence may be only because of the net fiscal transfer.

Overall, the empirical evidence reaffirms that the single market has reduced regional disparities and thus contributed to cohesion. But the complementary role of cohesion policy has been substantial in fulfilling the Treaty goal of a regionally more balanced economic development. Neither cohesion policy nor the single market would work as well if they did not function in tandem.

The survey work shed light on how cohesion policy has affected regional development. A sizeable majority of those questioned had positive views on the impact of cohesion policy, although some reservations were expressed about disappointing outcomes for certain groups in the labour market, notably youths and women. Cohesion policy has been influential in leveraging-in long-term private investment. Respondents also pointed to successes in increasing the number of SMEs supported, as well as the creation of new competitive firms in the national or regional economy as a result of cohesion policy support. One notable conclusion from the systematic review of programming documents, was that the effectiveness of cohesion policy largely depends on the quality of the business environment in which it operates.

However, these findings leave open the question of whether cohesion policy is configured optimally. To explore how different mixes of cohesion policy might affect outcomes, further model-based simulations were undertaken. Findings were as follows:

- A switch from ‘hard’ investments (principally physical infrastructure) to the ‘softer’ investments (notably human capital and research capacity) that are at the heart of the Europe 2020 strategy leads to improved long-run growth. While hard investments give a more immediate fillip to growth, the effect dissipates over time.
- There is only a minor effect on GDP from a switch of ‘soft’ cohesion spending away from the most advanced capital-regions in certain EU12 Member States to the other, less-developed regions. Aggregate EU GDP is very slightly reduced, principally because the shift restricts growth of knowledge industries in dynamic regions. Unsurprisingly, the scenario has a greater impact inside Member States, redistributing GDP away from the capitals, but lowering national GDP. Slovakia, however, bucks the trend, as the relatively prosperous Bratislava region is less specialised in knowledge-based industries.
- The opposite approach, of concentrating cohesion support in the most dynamic regions in selected EU12 Member States, results in very small gains for EU GDP. It also widens disparities inside most Member States.

In assessing wider impacts, a key issue is the extent to which cohesion policy has been shaped by the Lisbon strategy and, latterly, by the economic crisis. In both cases, the survey results suggest only a limited influence. Only a minority of 39% of all respondents (and an even smaller 35% in Convergence regions) think that the expectation that cohesion policy should be closely aligned with the Lisbon Strategy affected cohesion policy interventions in the current cycle.

Despite the seriousness, depth and duration of the economic crisis, the survey evidence is that the impact of the crisis on the programming of cohesion policy interventions has varied across Member States and regions. Overall, 49% of all respondents indicated that no re-programming had occurred as a result of the crisis in their respective Member State or region. Reasons included pressures to keep up levels of spending to avoid the risk of money being clawed-back, the fact that different measures cannot quickly be introduced and possible resistance from local actors.

These findings signal that cohesion policy in the 2007-2013 period continued to have goals and priorities which remain distinctive and which, although influenced by the Lisbon strategy, reflect an intervention logic attuned more to regional and national priorities. The forms of intervention do, however, vary, as explained in the next section.

The logic of intervention to promote socio-economic development

Although cohesion policy has common regulations and procedures, it is readily apparent that the approach (or ‘intervention logic’) adopted to achieve cohesion aims can vary considerably from one setting to another. Drawing on the qualitative research and examination of documents, seven intervention logics were identified. The first two have common features, but are distinguished by the degree to which the logic emphasises transport connections. They are:

- **Broad-based economic development** in which the interventions address a range of territorial development gaps which are pursued simultaneously, along with the building of institutional capacity. This logic is most characteristic of convergence regions and Member States and, within it, cohesion funding is at the heart of the public investment strategy of the territory. The resources received are of crucial importance in enabling the territory to integrate successfully into the single market and to boost its overall competitiveness, making it consistent with Lisbon/Europe 2020.

- **Transport connectivity** is also most frequently adopted in convergence regions, but is more narrowly concerned with bolstering the transport system. It may also, particularly where the next stage of transport development goes beyond provision of the most basic infrastructure, feed into Europe 2020 goals, notably by giving greater weight to sustainability.

- **Building on the position secured**, the third logic, is about a translation of the success achieved in recent interventions at the regional level to the broader territorial scale of the nation or to secure the progress made at the national level, and is typically ‘top-down’ in how plans are formulated. It is most in evidence in Convergence Member States with fdynamic capital regions (which are, themselves, more often ‘transition’ regions), where the lessons learned can be applied to other regions, but can also fit richer Member States.

- **Advanced and inclusive development**, the fourth logic, which is characteristic of Competitiveness regions. It encompasses development strategies very much in line with national objectives, particularly in areas such as sustainable and inclusive growth, so that it is generally a good fit with the Europe 2020 strategy.

Three further logics constitute a second ‘family’ in which there are common traits associated with the fostering or exploitation of emerging or existing regional strengths, but which have been distinguished because they imply different routes towards development.

- **Catalysts for regional economic restructuring** is a choice mainly in Competitiveness regions that are losing ground relative to their respective Member State. It concentrates the development effort on foundations for the economy that can lead to a transformation of its potential. Options may include promotion of innovation, diffusion of technology, sustainable energy, improved logistics or human capital development.

- **Advanced industrial development** is a logic also adopted in Competitiveness regions, but which has a more targeted approach to industrial transformation, and is aimed at encouraging the growth of new industry to replace declining industries. Thus, in contrast to the preceding logic, it has a sectoral rather than a transversal focus.

- **Leveraging region specific assets** is an approach that relies on exploiting the potential of regional natural assets that have not previously been sufficiently developed, such as climate or tourist appeal. It can be applied in all types of regions, but with the common feature of seeking to build on these assets as a means of drawing in other investment that promotes development. There is an obvious link to sustainable growth insofar as preservation of an attractive physical environment and sensitive exploitation of natural assets are central to this logic.

Cohesion policy, the Lisbon agenda and Europe 2020

The study also examined the ways in which the objectives of cohesion policy and of the Lisbon/Europe 2020 strategies coincide. Although their systems of governance differ, as do their timetables, complicating the inter-actions between them, evidence from the 2007-2013 period suggests that Managing Authorities took the Lisbon Strategy into consideration when devising the implementation strategy for cohesion policy programmes, at least at a nominal level.

For the 2007-13 programming period, Member States were asked to earmark a substantial proportion of their cohesion investments towards “innovation, the knowledge economy, the new information and communication technologies, employment, human capital, entrepreneurship, support for SMEs or access to risk capital financing”. The stated goal (strictly, only applicable to EU15, but accepted in practice by all Member States) was that this Lisbon earmarking should be up to 60% in Convergence regions and at least 75% for regional Competitiveness and employment programmes.

In Competitiveness programmes, data for the period 2007-2009 show that the target was exceeded, with 78.8% of funds earmarked for Lisbon-compatible projects. For the *Convergence* operational programmes Lisbon-related spending accounted for 64.5% of the total, again exceeding the target.

There were, however, pronounced variations between regions in the proportion of spending earmarked for Lisbon-related purposes, partly because the list of non-Lisbon projects contains many deemed valuable by Member States with a range of social and economic objectives. The largest non-Lisbon allocations are for national rail and road projects, the provision of adequate energy sources and environmental, culture and social services projects.

The findings from interviews with regional management authorities and stake-holders suggest that, up to 2009, there were few conscious attempts to favour Lisbon-related expenditures. In part, this may be because little effort seems to have gone into explaining to those managing programmes at the regional level what meeting Lisbon objectives entailed. Many interviewees also commented that the launch of Europe 2020 in 2010 occurred at an inopportune time in the cohesion policy cycle and was not properly prepared, with insufficient information on how the Europe 2020 targets and the seven flagship initiatives should be translated into action at the regional level. By contrast, national actors tended to be far better informed.

Together with the evidence that not much effort was made to distinguish between physical capital and the ‘softer’ innovation-related investments most directly associated with Lisbon/Europe 2020, the inference to draw is that earmarking has had a rather limited influence on shaping Operational Programmes.

The single market and cohesion policy priorities

Cohesion policy has long been linked to the single market programme, although it is overly simplistic to think of cohesion as merely a compensatory ‘side-payment’ or social policy for regions adversely affected by market integration. Instead it should be seen as a policy to restructure or develop regions, enabling them to take full advantage of the opportunities presented by the single market. It is a positive-sum game argument in which the pay-off from having cohesion side-by-side with open markets is a more productive EU as a whole.

A deeper single market tends to encourage greater regional specialisation in which either existing comparative or competitive advantages of a region are exploited, or policy attempts to shift the region towards different specialisations. This poses a key policy question as to the strategic direction in which public interventions try to steer the economy, such as the pursuit of particular market segments (final or intermediate goods or services) or types of economic activity (research, production or distribution, for example).

The combination of cohesion policy and the Lisbon strategy, and the closer alignment between them, has helped to underpin and consolidate the single market programme, but new challenges will arise in making a success of Europe 2020 alongside the proposed deepening of the single market published in October 2010 by the Commission. Although, traditionally, the single market has been perceived as primarily the domain of the private sector, there are some categories of public goods that have significant cross-border spillovers, for example: transport links, innovation networks and the environment. Public investment in such welfare-enhancing goods and services can have a reinforcing effect on the single market.

In the same vein, the single market can only function if the necessary infrastructure is put in place first. Regions lacking efficient transport connections with economic centres will not be among attractive locations for businesses that rely on timely delivery. For such regions, there is likely to be a threshold effect requiring the enhancement of key infrastructure as a precondition for full participation in the single market.

However, there is also a difficult issue for cohesion policy about infrastructure in richer regions. In particular, for regions that still have gaps – even if less acute than in convergence regions – the question that arises is which categories of such infrastructure can be defended as EU-funded projects as opposed to projects funded nationally. The regulations for the 2007-2013 period already provide some restrictions for Competitiveness regions, but with some exceptions, such as secondary road networks or regional networks.

A single market perspective points to awkward choices, especially around projects with high European added value such as the Trans-European networks designed to improve links across regions. Improved road links in eastern Poland, for example, might do more to connect Lithuania to the single market than domestic transport improvements, yet be stymied because Polish public investment priorities lie elsewhere.

Similar dilemmas arise in relation to secondary or regional networks designed to improve connectivity and accessibility for rural and peripheral regions, or between different growth poles. Some investment decisions might have been driven by the relative simplicity of road-building programmes relative to building other elements of the single market infrastructure (e.g. rail networks, modern communication networks, quality of governance and regulation, etc.), their political appeal and similar factors. Survey responses suggested that such sub-optimal choices occur regularly.

As stressed by the 2010 Monti report on the single market, there is still room for strengthening the Structural Funds' rules to ensure that they deter distorting decisions on allocation of economic activity. The Monti report also raised the issue of whether Structural Funds allocations could be used as a mechanism for incentivizing implementation of certain single market provisions.[1] In any event, such considerations show the inter-linkage between cohesion policy and the single market.

This study's findings suggest that the right combination of "soft" (human capital and R&D promotion) and "hard" (physical infrastructure and private investment support) instruments has to be targeted. In addition, the time dimension matters: the direct benefits of physical

[1] Whether such conditions would provide incentives to implement single market rules was not examined in this study, because it was not within the terms of reference.

infrastructural investments (such as investment in transport) are quickly exhausted and lose effectiveness if not complemented by R&D and human capital development which affect growth in the medium to long run term.

The findings also imply that ‘soft’ instruments are most effective in technologically more advanced regions where sufficient agglomeration of knowledge activities is found alongside dense interregional research collaboration linkages, high levels of social capital and good physical accessibility.

Policy questions, choices and dilemmas for future cohesion policy

Many crucial, yet difficult issues arise in contemplating the future structure and governance of the three core policies studied in this project. In particular, careful consideration is needed of how the traditionally separate domains of the single market, cohesion policy and the Lisbon/Europe 2020 strategies can be successfully integrated.

If Europe 2020 is expected to set the overall policy framework, it implies that the emphasis will be on how cohesion policy can contribute to the achievement of the Europe 2020 headline targets and advancing the aims of the Flagship Initiatives, rather than pursuing cohesion goals in isolation. Although this is consistent with statements in the Europe 2020 documents which signal that this is a role expected of cohesion policy, it is something which some regional actors, especially, find uncomfortable, and tends to be remote from their day-to-day preoccupations. A concern among many stakeholders is that the traditional goals of balanced development and support for lagging areas will be less central, even if the Europe 2020 objectives correspond in many cases to traditional cohesion policy areas of intervention – research, SMEs, ICT, energy efficiency, employment, skills and social inclusion. Equally, not enough effort has been made to correct the perceived asymmetry between what Europe 2020 ‘expects’ cohesion policy to do and what it promises in advancing cohesion.

Nevertheless, there is a willingness from cohesion policy actors to adapt policy interventions towards Europe 2020 goals and these will be important in defining the structural economic reforms national governments need to pursue in response to the crisis. A shift from ‘hard’ to ‘soft’ interventions in cohesion policy will, in turn, mean that difficult choices have to be made for the 2014-2020 programming period about the broad approach to adopt.

The empirical evidence on expenditures on R&D and human capital is that they can be rewarding investments, although the benefits will only manifest themselves in the longer term. But because ‘hard’ investment can often generate more immediate returns, a shift towards Europe 2020 instruments will ultimately be affected by political decisions and will need boldness from decision-makers.

The distinction between integrated and sectoral approaches to economic development is also germane as a challenge. For regional level officials, the integrated approach encouraged by cohesion policy has enabled regional and local administrators to create new forms of governance. Having integrated multi-sectoral and multi-annual operational programmes has encouraged more effective partnerships to emerge, comprising not just significant stakeholders, but also diverse groups in civil society.

Policy recommendations

Consistency with Europe 2020 goals

The Europe 2020 strategy manifestly establishes the broad framework for intervention and sets core aims, but in the formulation and design of new cohesion programmes, regions and

Member States also have to make careful use of the considerable latitude for different orientations consistent with certain Europe 2020 goals. Choices will need to be made about the underlying rationale and main orientations of cohesion policy to ensure coherence between European, national, regional and local needs. These choices will then affect intervention logics, the balance in Operational Programmes between the overall thematic priorities and the recasting of governance.

While recognising the broad reach and central role of Europe 2020 in revitalising the EU economy, it is important not to lose sight of the Treaty goal of reducing disparities. In this perspective, the Europe 2020 strategy has to ensure that the fruits of smart, sustainable and inclusive growth are available to all regions and that the objective of cohesion of countering disparities is not seen as, or allowed to become, a second-order goal; but rather achieved through investments in putting Member States and regions on a sustainable growth path.

Integration of regions into the single market

A first priority for the future is to ensure that cohesion policy continues to support the integration of regions into the single market. However, past experience shows that a renewed push for single market implementation is likely to have an uneven, if not easily predictable, impact on regional economies. For this reason, a one-size-fits-all approach is unlikely to be productive and should be avoided. Policies may also need to be sufficiently flexible to adjust to changing economic and social environments or policy strategies.

Quality of public investment

Quality criteria have to be prominent in the choice of public investments, but without being overly prescriptive about what forms of public investment to favour. This is also likely to be a difficult balancing act because what constitutes ‘quality’ in one place or context may be more central to promoting enhanced growth than the same sort of public investment elsewhere. Regional and national authorities will, therefore, need to be hard-nosed about selecting the intervention logics that are associated with the more successful outcomes, but will also need to review whether a past logic – even if successful – continues to be appropriate. In a period of fiscal retrenchment, special attention should be paid to quality of investment.

Role of leading regions

The strategic role of leading regions, particularly in ‘convergence’ Member States is vital to boost competitiveness and take on both the challenges and benefits derived from the single market. A careful balance will need to be struck in the policy mix chosen by the region between addressing single market challenges and territorial or inclusive objectives.

Recovery from the economic crisis

In addition, future intervention logics will have to take account of evolving national priorities, not least in relation to the recovery from the economic crisis. Three consequences of the crisis likely to be especially relevant and for which cohesion policy can provide a vital boost are:

- The need, in certain Member States, to deal with competitiveness shortcomings by accelerating structural reform, such as enhancing skills and human capital or boosting research, development and the rate of innovation. Cohesion policy can facilitate such reforms and, because it is a long-term policy, can help to overcome the political economy obstacles that arise, especially during the early stages of reform, which can be disruptive and contested in a way that undermines legitimacy.

- A legacy of higher unemployment which may require a fresh approach to employment, notably in maintaining employability and preventing ‘hysteresis’ (detachment from the labour market).

- A possible accentuation of social exclusion, whether from a widening of inequalities or an increased in vulnerability of segments of the population, such as youths or migrants.

Framework conditions for effective investment

Adequate framework conditions for the effective use of the funds also need to be ensured. Experience suggests that the outcomes of cohesion policy are sub-optimal if the wider economic and framework conditions are not supportive, however, well-conceived the sub-national intervention is, again highlighting the importance of policy coherence.

Improving governance

Achieving an effective integration and alignment of Europe 2020 and cohesion policy will require improvements in governance. There needs, first, to be a dialogue across the policy ‘silos’. Second, in the process of designing policy, active participation from relevant stakeholders is important and, to the extent it is possible, needs to be based on doing more to promote innovation, not just in leading-edge industry, but also in services and in public administration. Regional actors, especially, have to be brought into the process more convincingly.

1 Introduction

Growth, competitiveness and employment are core socioeconomic priorities of the EU, set out in the Treaty and reiterated in the Structural Funds regulations[2]. To achieve these, the EU needs to ensure the integration and coherence of different strategies already in place in order to maximize and exploit their full potential. European cohesion policy is at the heart of this challenge, and has to be structured so that it both achieves its Treaty goals and contributes to the aims of the Lisbon and Europe 2020 strategies. As stated in the project specifications published on 4th February 2010 in the Official Journal:

> "Since its inception, cohesion policy aimed at facilitating the integration of European regions into the single market and accompanying restructuring processes of important industrial sectors, such as coal, steel and textiles. In recent years, external challenges have shifted the focus of cohesion policy to supporting adaptations induced by the rapid integration and interdependence of the global economy and by the integration of the new Member States in the single market.
>
> Cohesion policy has undergone a fundamental paradigm shift, moving gradually away from the correction of structural weaknesses to focusing on growth-enhancing investments and unlocking untapped development potentials. In the 2007-2013 period European cohesion policy has been strategically aligned with the Lisbon process through various mechanisms (programming, monitoring, and reporting)".

The overall aim of this study is to examine the inter-play between the single market, cohesion policy and the strategies through which the EU seeks to advance its socioeconomic development, namely the previous Lisbon strategy and the Europe 2020 strategy. As EU governance is recast in the aftermath of the severe crises of 2008-11, fresh thinking is needed on how to achieve coherence between these different policy domains. This study provides some insights into these questions and will feed into the preparation of cohesion policy in the 2014-2020 period.

1.1 Aims, context and terms of reference of the study

A central purpose of the study is to investigate how cohesion policy in the post-2013 period can contribute to spurring growth, fostering competitiveness and creating employment, while continuing to promote an inclusive EU. It also inevitably bears on the future use of the EU budget. An evident risk is of relegating cohesion policy to being largely an instrument of the Europe 2020 Strategy, rather than being a policy with its own distinctive identity and rationale.

The debates triggered by the 2009 Barca report – with its championing of a place-based strategy – and the World Bank's 2009 World Development Report – which argued forcefully for an agglomeration approach to economic development – raise further issues. A territorial dimension to cohesion policy, taking its cue from the recasting of the cohesion objective in the wording of the Lisbon Treaty, implies a sharper focus on 'place', whereas an agglomeration approach could be seen as better attuned to the wider competitiveness imperatives facing the EU in responding to global challenges.

[2] Article 3 of the Council Regulation (EC) No 1083/2006 stipulates that the actions taken by the Funds shall incorporate, at national and regional level, the Community's priorities in favour of sustainable development, by strengthening growth, competitiveness, employment and social inclusion and by protecting and improving the quality of the environment.

Europe 2020 brings together a range of strategic aims previously spread among different processes and strategies. However, Europe 2020 is being implemented against the backdrop of extensive reforms of European economic governance triggered by the succession of crises between 2008 and 2011. Cohesion policy has, to a limited degree, been drawn in to the EU's response to the crisis, both as an element in the fiscal stimulus packages and because of the need to review co-financing in the context of austerity budgets in fiscally over-stretched Member States. A climate of austerity also has a bearing on the EU budget negotiations, notwithstanding the fact that the next Multi-annual Financial Framework (MFF) is only due to come into force from 2014.[3] There is, therefore, a complicated governance agenda to accommodate in rethinking cohesion policy.

In this context, this study's purpose is threefold:

- First, it assesses the impact of the single market on growth, competitiveness and employment at national and regional levels in EU27, in particular as regards its role in either accentuating generating disparities or promoting convergence.
- Second, the study examines the appropriateness of the strategies and intervention logics developed and deployed in cohesion policy programmes in the 2007-2013 programming period to achieve growth, competitiveness and employment at national and regional levels. This assessment draws from both the modelling and case study results and is completed by a comprehensive content analysis of all the national and regional programming documents (including sample territorial cooperation programmes). This analysis identifies 7 intervention logics under which regions and Member States can be grouped. Furthermore, a distinction between "soft" and "hard" interventions is made.
- Third, the study analyses the policy linkages and institutional relationship between the Lisbon process (now Europe 2020) and European cohesion policy. This was carried out through a complete desk survey of the 27 Member States and the use of a questionnaire.

Based on the premise that Europe 2020 will build on and learn from the achievements of the Lisbon Strategy, this study discusses four main policy questions that bear on the future of cohesion policy for the period post-2013:

- The role of public policy in enabling Member States and regions to reap the benefits of single market
- The role of cohesion policy in fostering growth, competitiveness and employment
- Ways to enhance the quality of public expenditure in support of Lisbon/Europe 2020 priorities
- Institutional governance mechanisms that can ensure the most effective delivery of public goods in support of the Europe 2020 strategy.

1.2 Approach and methodology

Given its breadth of objectives, the approach and methodology adopted for this study have encompassed a range of complementary research methods. This report draws on a series of research tasks undertaken by the contributors to the study. These have included:

[3] Commission Communication (2011) 'A budget for Europe 2020' SEC(2011) 867 final, Brussels, 29.06.2011

- Desk-based research into a wide variety of official documents including published literature in relation to the single market, policy documents and previous work
    - Work scrutinised has come from different disciplinary traditions, notably economics, economic geography and regional science, political science, and institutional studies. This is because numerous factors have determined the single market outcomes at a regional level and these are related also to political economy aspects, governance mechanisms and quality of institutions.
    - To reflect the different facets of the single market, the literature review was organised around the key concepts raised by the study: growth, competitiveness and employment, as well as interregional convergence and the sectoral/spatial impacts of the single market.
    - A further organising principle for the desk research was necessarily longitudinal, because the single market programme is a long-run and evolving process that has, at different times, focused on different issues.
- Formal modelling using Computable General Equilibrium (CGE) models, well-suited to simulation exercises; and the innovative Geographic Macro and Regional (GMR) approach that incorporates geographical effects as well as macroeconomic variables, making it appropriate for assessing the impact of cohesion policy spending.
- Econometric investigations of key relationships between the single market and economic development
- To complement the quantitative assessment of the impact of the single market, a more qualitative analysis was conducted through 20 case studies covering different sorts of regions benefiting from cohesion policy. These encompassed an extensive programme of interviews with practitioners, policy-makers and other stakeholders.

The study also involved systematic examination of the national and regional programme documents, using a content analysis method. The aim was to analyse the policy linkages and institutional arrangements between the Lisbon process and cohesion policy programmes that in the 2007-2013 period. The categories of documents analysed are listed in Box 1.1.

Box 1.1 List of documents scrutinised

1. Nord Regio study
2. National Reform Programme (NRF) for 2008
3. National Strategic Reference Frameworks (NSRF).
4. National Strategic Reports (NSR) for 2009
5. Tables of categorisation of expenditures (provided by the Directorate General Regional Policy, European Commission)
6. Commission assessment of the National Strategic Reports (March 2010)
7. National Operational Programmes (39 ERDF and Cohesion Fund); 25 ESF)
8. Regional Operational Programmes (74 ERDF; 27 ESF)

9. Territorial Cooperation programmes (7)

10. Annual implementation reports* of national ERDF, ESF and Cohesion Fund programmes (39 ERDF and Cohesion Fund; 25 ESF);

11. Annual implementation reports of regional ERDF and ESF programmes (2008-2010 where available) (74 ERDF) (27 ESF).

*The most recent available report was analysed (2008-2009-2010)

The content analysis instruments had three main objectives:

- To identify conceptually the logic or rationale that informs the choice of policy interventions in different Member States and regions
- A qualitative assessment of the congruence of the strategic choices of interventions with the three Lisbon objectives: growth, competitiveness and employment
- Measurement of the specific investments that have been programmed as well as actually implemented.

1.3 Outline of the report

The next chapter reviews the impact of the single market and presents the results of the empirical analysis of how it has affected different EU regions. Chapter 3 assesses cohesion policy and its role in enhancing the economic performance of regions in receipt of funding. In chapter 4, the interplay between cohesion policy and the Lisbon/Europe 2020 strategies is examined. Chapter 5 explores the logic behind cohesion policy interventions, and a typology of intervention logics is set out and explained. The report is completed by an extended discussion of policy questions, together with concluding comments and recommendations. Background papers produced by the members of the study team provide much more detail on methodologies, data used and findings.

2 Impact of the single market on growth, competitiveness and employment

The single market and cohesion policy can, to some extent, be seen as alternative means of promoting the growth and competitiveness of the European Union. By accentuating market pressures, the former is expected to stimulate efficiency gains and thus to have a systemic effect on all regions, but it is recognised that the effect may be spatially unbalanced. Cohesion policy is partly about enhancing the position of less competitive regions, enabling them to converge towards the most competitive, but also has a positive aggregate impact by mobilising unused or under-used factors of production.

This chapter presents an overview of the findings on the impact of the single market. It draws, first, on an extensive literature survey that reveals the diverse ways in which the market opening associated with the single market affects convergence. A second section reports the results from the modelling work which used two simulation models: the GTAP world model and the extended GMR (Geographic Macro and Regional) modelling system. Subsequent sections present the findings of econometric analyses and qualitative case studies of 20 regions.

2.1 Insights from the literature

For many of its supporters, the single market was the logical next step in European integration, building on the achievements of the Common Market and the Customs Union. The single market went beyond the elimination of customs duties and tariffs to encompass the elimination of a variety of “non-tariff” barriers to the free flow of goods, services, capital and labour – also known as the four freedoms. Under the Slovenian presidency in 2007, free movement of knowledge was added as a fifth freedom. In his introduction to the Cecchini Report, Jacques Delors stated that the objective of creating a large and truly unified economic area in Europe by 1992 was formidable, but promised to provide substantial benefits:

> “This large market without frontiers, because of its size and because of the possibilities that it offers for scientific, technical and commercial cooperation, gives a unique opportunity to our industry to improve its competitivity. It will also increase growth and employment and contribute to a better balance in the world economy” (Cecchini, 1988: xi).

2.1.1 The single market’s regional impact

Delors argued that attention also had to be placed on improving the Community’s social “dimension” by providing an increase in resources to combat long-term and youth unemployment, spur rural development, help underdeveloped regional economies, and ameliorate industrial restructuring problems. Concern for economic and social cohesion had been a constant feature in the process of European integration, but with the creation of the single market it became a vital issue of concern. While the formation of the single market offered the promise of a significant increase in the output of the Community as a whole, the political viability of the project also required that the distribution of its benefits be perceived as fair by the Member States and regions (Leonardi, 1993a; De la Fuente and Vives, 1995). This concern had already been expressed in 1973 in the Thompson Report and in the 1987 Padoa-Schioppa report, both of which stressed that further market integration should not be achieved at the expense of low living standards and increased unemployment.

Eichengreen and Boltho (2008) estimate that the single market boosted output in the EU more than was occurring in the rest of the world: “the order of magnitude might suggest that EU GDP is some 5 percent higher today than it would otherwise have been” (2008, p. 42), and they argue that the single market significantly increased intra-European trade flows. In 1989 the Delors Report on economic and monetary union extended the argument to monetary union, again making the point that there were risks of accentuating regional disparities.

> “Historical experience suggests…that in the absence of countervailing policies, the overall impact on peripheral regions could be negative. Transport costs and economies of scale would tend to favour a shift in economic activity away from less developed regions, especially if they were at the periphery of the Community, to the highly developed areas at its centre. The economic and monetary union would have to encourage and guide structural adjustment which would help poorer regions to catch up with the wealthier ones (CEC, 1989, p. 22).”

Initial expectations of the impact of market integration on the less developed areas was not completely optimistic. In fact, a prevailing view in the Commission was that the impact would be adverse. Paul Krugman (1987) in his contribution to the Padoa-Schioppa Report pointed out some of the negative consequences that might emerge from further market integration, These included: increases in unemployment, agglomeration effects in particular industries, national competition/conflict over the rescue of national champions, uneven distribution of the gains from trade, management of migration flows, and poor coordination of monetary policies. Thus, the expectation was that through market integration there would be a significant *divergence* of economic performance and well-being of the core vis-à-vis peripheral areas. In other words, the fear was that the convergence of national and regional economies documented by Molle et al. (1980) during the 1950-70 period would be reversed because economic growth and job creation would take place in the core areas to the detriment of the peripheral ones. According to the Delors Report (1988) the single market was not viable from a political and social point of view without a parallel policy capable of absorbing the expected negative shocks of market integration on peripheral underdeveloped areas.

To avoid such an outcome it was felt that a pro-active regional policy could serve to alleviate the negative impact of opening the market on less developed areas and help to restructure regional economies so that they were able to gain from economic integration. In this manner, the Community would help to promote the forces of convergence against those pushing toward divergence. This approach to cohesion policy has been consistently reconfirmed from 1989 to the present (e.g., Monti, 2010). The question now is whether that policy has, in fact, promoted cohesion and how it squares, on the one hand, with the original single market and single currency programmes and, on the other, with the subsequent Lisbon Agenda and, now, with the Europe 2020 Strategy.

Lord Cockfield, the coordinator of the Commission’s White Paper on the single market (1985) admitted that the 1992 single market programme represented “an act of faith—confidence in the present and faith in the future—that we—the Community—embarked on this task”, but with the publication of the Cecchini Report:

> “…we are able for the first time to see the precise measure of what we are going to achieve. Now we have the hard evidence, the confirmation of what those who are engaged in building Europe have always known: that the failure to achieve a single market has been costing European industry millions in unnecessary costs and lost opportunities; that the completion of the Internal Market will provide the economic context for the regeneration of European industry in both goods and services; and that it will give a permanent boost to the prosperity of the people of Europe and indeed of the world as a whole” (Cecchini, 1988: xiii).

During the 1980s the expected increase in disparities through further integration was not only a theoretical expectation but also seemed to be an empirical reality. The four Periodic Reports produced by the Commission (CEC, 1981; 1984; 1987 and 1991) consistently reported that from 1975 across the EC-9, regional economic performance indicators tended to diverge. Numerous studies of individual regions reinforced these findings which, for some, justified cohesion policy as a form of compensation for being subjected to competition from better endowed regions. However, Padoa-Schioppa (CEC, 2008c) asserted that to “promote growth in poor regions has nothing to do with compensation” and that “only somebody who has something to lose can be a loser” (p. 5). On the contrary, his reasoning was that, with the combination of the single market programme and cohesion policy, everyone stood to gain. In summary, the academic literature suggests that the long-run growth effects of European integration have been mixed. Trade effects have been robust along with the employment effects and the spurring of FDI flows to countries that in the past would have had to struggle to attract sufficient capital (CEC, 2008d).

2.1.2 The EU12

The impacts of enlargement on the Member States of Central and Eastern Europe (CEECs) that joined the EU in 2004 and 2007 have been studied extensively, especially for Bulgaria, Hungary, Poland and Romania[4]. There are also several studies on the impact of the Common Agricultural Policy (CAP), trade, foreign direct investments (FDI) and economic and monetary union (EMU) on the CEECs. In practice, what these studies have examined is the effects on the EU12 of being exposed to the single market as they progressively become more integrated into the EU. With accession, the EU12 have increasingly aligned their production structures with those of the existing Member States. The service-based and knowledge-intensive economies have progressed in recent years: the share of services in EU12 GDP grew from 56% in 1995 to 63% in 2006, compared to 72% of GDP in EU15; the share of technology-intensive exports and employment in knowledge-intensive sectors rose to 3.5% of total employment compared with around 5% in EU15 in 2006 (SEC, 2009).

The impact of the CAP has been examined, for instance, by Dasa et al (2008) who found that the new Member States significantly increased their exports of agri-food products to the EU prior to and especially after accession (see also, Baun et al., 2009; and Kowalski et al., 2009). Among studies of FDI, Allard et al. (2008) find that the EU12 stand to benefit greatly from the inflow of EU funds. These funds could boost GDP per capita by as much as 5 percentage points between the years 2010 to 2020 – see also Chidlowa et al. (2009), Onaran and Stockhammer (2007) and Sass (2010). However, the size of benefits depend on the right institutional and policy framework.

In addition, labour mobility, productivity growth, migration and many other topics associated with enlargement have received considerable attention. Dobson (2008) has investigated how EU enlargement in 2004 affected labour mobility and comes to the nuanced conclusion that there are both positive and negative effects on EU12, but that these may become more significant in future. Kutana et al. (2007) investigated the impact of EU integration on convergence and productivity growth and found that accession increased rates of productivity growth and increased the pace of overall growth because of capital accumulation.

2.1.2.1 FDI and productivity improvement in EU12

[4] See, for example: Allard et al. (2008); Bacic et al. (2004); Crespo and Fontoura (2007); Dyson (2006); Winkler and Martin (2009); and Dabrowski and Rostowski (2006).

Many studies have investigated the mechanisms by which FDI has affected recipient economies, and notably its impact on productivity. These inter-actions are complex and show that the single market affects Member States through a variety of FDI-related mechanisms. These include:

- Deepening sub-contracting and intermediate good production – Lefilleur and Maurel (2009) find that a 10% increase in access to suppliers based in the FDI recipient country or access to the EU15 market for intermediate goods increases FDI by about 2% in Central European countries and by 1% in Eastern European countries. They argue that Central European countries specialize in growth industries and re-export goods toward FDI-origin countries, but Eastern European countries are involved in this production chain to a lesser extent.

- Reasons for FDI vary both within and between Member States. Chidlowa, Salciuvieneb and Young (2009) suggest that the main drivers for the inflow of FDI to the Mazowieckie capital region of Poland are knowledge-seeking factors alongside market and agglomeration factors.

- The short run results of Onaran and Stockhammer (2007) suggest that productivity has a weak effect on wages, strong on unemployment, positive on FDI and has no effect on international trade. FDI's positive effect is driven mostly by the capital intensive sectors and sectors that use skilled labour. The effect of productivity seems to be stronger in capital intensive sectors than in labour intensive ones, and the effect on unemployment seems to be stronger in sectors using unskilled labour. The effects of productivity remain modest, unemployment stronger and the effect of FDI turns negative in the long run. It seems reasonable to assume that there is also a relationship between FDI and productivity.

Intensification of competition consequent on market opening and liberalisation has substantial effects (Arnold, Höller, Morgan and Wörgötter, 2009), notably by raising productivity. Kutana, Taner and Yigite (2007) have investigated the impact of EU integration on convergence and productivity growth. Their results indicate that both the anticipation and the fact of EU membership boosted productivity growth and increased the pace of overall growth because of capital accumulation. Investment in EU12 increased during the accession period 1997/1999 – 2003/2006, and further doubled on average after full accession.

During the transition to full EU membership, all bilateral trade taxes and subsidies with EU15 were removed, a change expected to increase the volume of intra-EU trade. Caporale, Reault, Sova and Sova (2009) suggest that the impact of these interim free trade agreements (FTA) on trade flows is positive and considerable. They also show that after the FTA, trade growth was higher than in countries that did not sign an FTA.

2.1.3 The effects of migration: findings from theoretical and empirical literature

Because the single market substantially reduces barriers to the free movement of labour, it is expected to lead to an upsurge in migration, with a variety of economic effects. While such flows were relatively moderate in the EU15 in the 1980s and 1990s as the single market was advanced, the accession of the EU12 saw much higher rates of labour movement. Migration can have a variety of effects.

First, it clearly changes the overall labour supply, both in aggregate and in particular skill groups and therefore influences the skill structure in the destination and sending regions. Its impact depends on the nature of the economy. If capital is fixed, immigration to an economy with a small product range and little exposure to world trade will lead to long run employment and wage effects, because the inflow of labour will have a substantial impact on the capital-labour ratio. By contrast, open economies with a rich product mix should not see much long run effect from migration because there will be strong pressures for reallocation of labour to growth sectors (Borjas 1999, Card 2001). Since the first type of economy has no flexibility to change its output mix, immigration affecting the skill structure will lead to long-term wage effects, whereas the multi-product, open economy can adjust its product structure (Leamer and Levinsohn, 1995; Dustmann et al 2005; and Dustmann et al 2008).

Where capital is mobile, migration reduces the capital to labour ratio in the short run and thus makes labour less productive. However, since wage costs are lower, the return to capital increases. This increased profitability attracts international capital flows in open economies or increased internal investments in closed economies, which restores the capital to labour ratio and thus productivity (see: Barrell et al 2010; Ottaviano and Peri. 2006). Dustmann et al (2008) argue that immigration of a particular skill group used by an industry may also lead to change in the level of employed technology in that industry as a reaction to the excess supply, with about two thirds of labour market adjustments affected by technological change.

There is a considerable empirical literature which attempts to assess the effects of migration on unemployment. Some of these studies simulate the effects of potential migration in macroeconomic and general equilibrium models to see how a migration shock works through the economy and generate projections of the effects on employment, wages and output. Another strand of the literature uses econometric techniques to estimate the effects of observed migration trends.

The immediate post-2004 emigration from the CEECs was predominantly to the UK and Ireland, resulting in a significant labour supply shock of 265,000 persons in the UK and 62,000 in Ireland between 2004 and 2006.[5] Barrell et al. (2010) estimated the macroeconomic effects of these shocks, albeit without distinguishing between the skill levels of migrants and found that emigration reduced EU12 output by 1% and unemployment by 0.8%. The immigration shock would increase output in the UK and Ireland by 0.6% and 1.7% respectively. Since capital adjustment requires some time, immigration increases unemployment temporarily by 1% and 0.25% points in the UK and Ireland respectively, and reduces wages. Looking at Ireland, Barrett (2009) found that the immigration of 180 thousand persons resulted in wages being 7.8% lower than they would otherwise have been and helped to maintain Ireland's high growth performance (at least until 2008), raising GNP by up to 6%.

In simulations, Baas and Brücker (2010) arrive at a 1% increase of GDP associated with EU enlargement in both the UK and Germany. However, while the increase is trade driven in Germany it is largely immigration driven in the UK. Germany could, potentially, have benefited even more from enlargement if it had lifted labour market restrictions (see also D´Amuri et al., and Felbermayr et al., 2009). In contrast to model simulations, econometric studies based on actual developments in the data mostly fail to find any significant impact of migration on unemployment – for an overview, see Longhi et al (2006), who conclude that on average a 1% increase in immigration reduces employment of the indigenous workforce by a negligible 0.02%, the impact on existing migrants being slightly higher.

UK evidence is that immigrants were concentrated in a few, relatively closed labour markets (especially London and the South East) where no increasing outflow of native labour was observed, but do compete with low wage workers (Lemos and Portes, 2008). However, these authors could not identify any direct effect of migration on the unemployment rate overall or for different segments of the workforce, except an increase of youth

[5] Dependent on different data bases, other sources report a significantly higher number, namely 560,000 in the UK and 120,000 in Ireland (Lemos and Portes 2008 and Barrett 2009).

unemployment at the regional level by 0.10% points arising from 1% increase in the migration rate.[6]

A number of recent studies (Mas et al 2008, Paserman 2008, Huber et al 2010, Robinson et al., 2010) also focus on the impact of migration on productivity and growth. In this literature it is often argued that a larger pool of labour is likely to have a positive effect on productivity if the quality of migrant labour improves the quality of the workforce and that the different skills that migrant labour may potentially enhance technology adoption and adaptation, either by directly contributing to innovation (Mattoo et al, 2005), or by facilitating knowledge spillovers (Moen, 2005).[7]

In summary, there is substantial, albeit sometimes contradictory evidence on the effects of migration on unemployment and wages at the national level, little of which offers a pan-European perspective. There is also a relatively large literature on the effects of migration on convergence, which despite, substantial variations in individual findings, suggests that migration – at least in European countries – is only a minor factor contributing to convergence in GDP per capita. Interestingly, however, virtually all of this literature – when focusing on EU countries – has analysed only convergence *within* individual countries and on GDP per capita. In a European context, for example, it could be argued that freedom of movement of labour between countries could also have impacts on convergence *across* countries. In relation to cohesion policy, focusing on the contribution of migration to convergence of other indicators, such as unemployment, could be an important and policy relevant extension of the literature.

2.2 Modelling the impact of the single market

Models frequently applied in cohesion policy impact studies either follow the tradition of macro econometric modelling (like the HERMIN model – ESRI 2002), the tradition of macro CGE modelling (like the ECOMOD model – Bayar 2007) or the more recently developed DSGE approach (QUEST III – Ratto, Roeger and In't Veld 2009). They all have the common attributes of national level spatial aggregation. The novel feature of the GMR-Europe model system (Varga Járosi and Sebestyén 20009, Varga Pontikakis and Chorafakis 2010, Törmä and Varga 2010) applied in this research project for cohesion policy simulations is that it integrates geographical effects (e.g., agglomeration, spatial knowledge spillovers, interregional trade, migration) while both macro and regional impacts of policies are simulated. Also, the GMR system combines approaches frequently applied in policy impact models (CGE and DSGE modelling) with techniques that are adopted in econometric studies (the modelling of regional knowledge production). In addition, the impacts of both "soft" and "hard" cohesion policy instruments are modelled.

Although the single market has been subjected to extensive analysis, including a plethora of modelling exercises, it is important to recognise that geography plays a critical role in the analysis of economic policy. Interventions, such as cohesion policy support, take place in a certain place/space and the impacts for economic growth and employment may spill over into neighbouring locations. The initial impacts could be increased or reduced by short run static agglomeration effects. As an illustration of one such effect, the accumulation of high tech industry could advance or contract in a larger town or capital region.

[6] Similar results are obtained by Riley and Weale (2006) who also find an increase in youth unemployment for the UK.

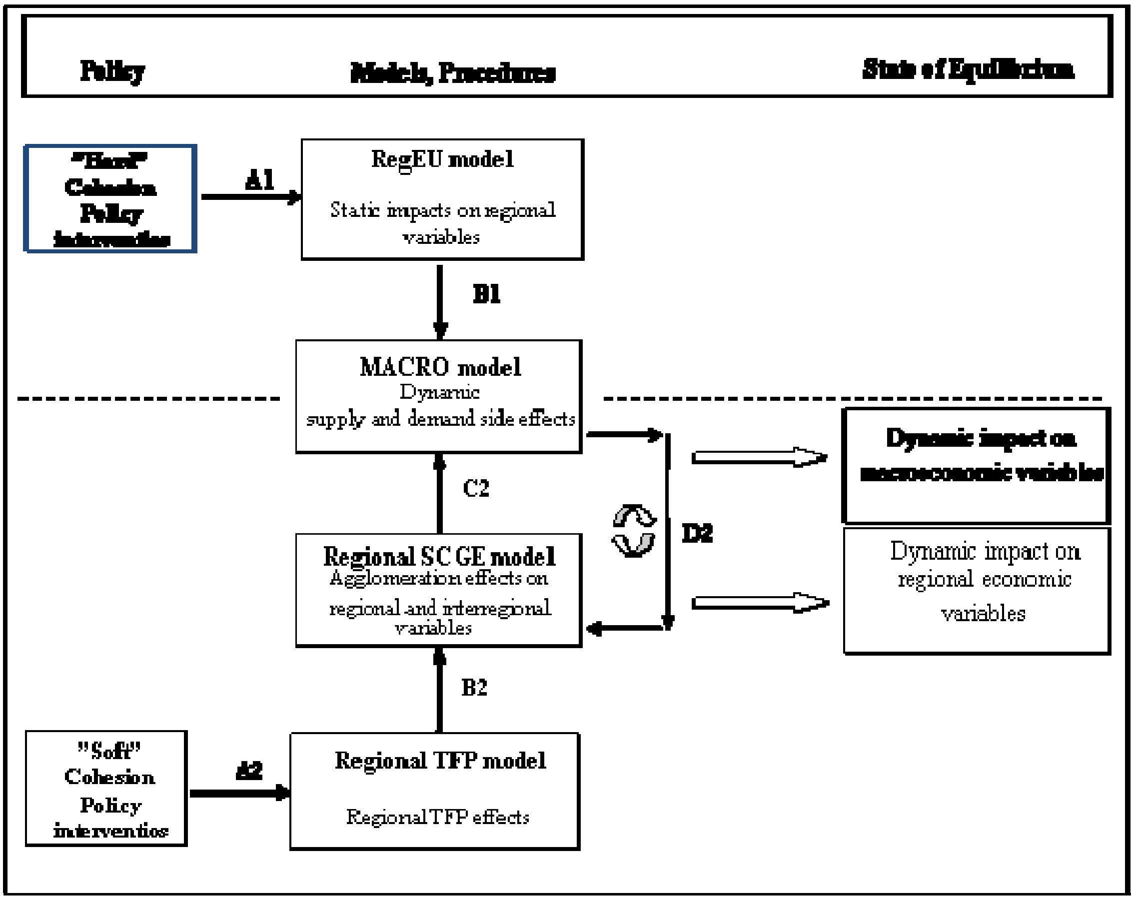
[7] In addition to this there is also a substantial literature devoted to the potential positive impact of migration on entrepreneurship (e.g. Wadhwa, Saxenian, Rissing and Gereffi, 2007), innovation (e.g. Hunt and Gauthier-Loiselle, 2008), foreign trade and foreign direct investments (e.g. Combes, Lafourcade and Mayer, 2005 and Kugler and Rapoport, 2005).

Cumulative long run processes resulting from interregional trade, labour and capital migration may further increase or reduce the initial impacts in the region resulting in a change of the spatial structure of the economy. These constitute dynamic agglomeration effects. As a consequence of the above effects, different spatial patterns of public support might result in significantly different growth, employment and convergence/divergence patterns. The business structure and economic position of the regional centres versus the periphery might, for example, change.

Economic modelling is widely used in evaluations of the impacts from changes in public policy. It is possible to estimate the approximate impact of cohesion policy investment on GDP and employment, with the impacts calculated as percentage changes from the baseline. Changing economic conditions are expressed as alternative scenarios and simulation models are used in calculating the significance of the impacts.

The main justification for choosing the extended GMR modelling approach is that it incorporates geographic effects (e.g. interregional trade, agglomeration, migration) while both macro and regional impacts of policies are simulated. The modelling system is set out in figure 2.1 which shows the theoretical setting and main blocks of the system.

Figure 2. The extended GMR modelling framework for estimating the impacts of hard and soft cohesion policy interventions



When changes in economic policy are fed in, the modelling system generates a harmonised solution and provides estimates of the anticipated impact on standard macroeconomic and regional variables such as GDP and employment. On the left, hard and soft interventions enter as changes in regional economic conditions (A1, A2). Their significance is assessed using an interplay between several simulation models. The modelling framework is described in detail in Törmä and Varga (2010), chapters 3.3.1 – 3.1.4.

Altogether, four model-based scenarios were developed for the investigation: a "Counterfactual scenario" to evaluate the economic impacts of the single market and cohesion policy in comparison to an alternative in which the twelve countries had not joined the EU. The other three scenarios – "Europe 2020", "Donut" and "Concentration and agglomeration" – analyse the consequences of possible changes in the focus of cohesion policy support. The first of these explores a change in emphasis of cohesion policy in favour of R&D and human capital formation ("soft" interventions) and away from investment in infrastructure ("hard"). The latter two look at the consequences of geographical shifts in future policy either to leading regional centres or away from these centres to peripheral regions in the same Member States. The results for these alternative cohesion policies are presented in chapter 3 of this report.

2.3 Simulation of the impact of EU accession: the 'Counterfactual scenario'

The analysis covered the impacts from six *'determinants'* or factors that influence how a Member State is affected by full integration into the EU: free movement of labour, remittances, FDI, productivity improvement, harmonization of trade taxes, and cohesion policy. While the results have been calculated for three groups of countries – EU12, EU15 and ROW (rest of the world) – the minimal impacts found for the last group are not reported. To avoid overstating the findings, conservative assumptions were made regarding all six determinants. To capture the effects emanating from cohesion policy interventions, they have been modelled by taking account of the thematic programming guidelines, interpreted as follows:

- Guideline 1: Attractive places to invest and work implies an increase in the net capital stock of the EU12. Investment related interventions in this guideline will increase the pre-membership capital stock so that the post-membership capital stock, allowing for depreciation, will be greater.
- Guideline 2: Improving knowledge and innovation for growth was parameterized as an increase in total factor productivity in the EU12. The size of productivity change was measured as interventions in this guideline per total factor endowments (labour, capital, natural resources).
- Guidelines 3 – 5: More and better jobs, the territorial dimension and technical assistance for the implementation of the cohesion policy programmes were treated as increases in public consumption of the EU12.

Starting with effects on GDP, the simulation results for this scenario are summarised in tables 2.1 to 2.3. For pragmatic reasons, the results exclude Cyprus and Malta, hence the findings reported are for the ten central and eastern European countries (CEECs).

The CEECs would most probably have received some FDI, with its beneficial effect on total factor productivity, even if they had not joined the EU in 2004/2007. It seems reasonable to assume that the negotiations would have continued and foreign investors would have behaved as they did during the accession period. Assuming this, our results indicate that the CEECs would still have enjoyed faster economic growth and welfare had they stayed outside the EU. The gains, however, would have been somewhat limited and the presumption is that full accession leads to much greater gains. Hence these counterfactual estimates can serve as a reference value against which to benchmark accession.

Table 2.1 Growth effects for the CEECs from the Counterfactual scenario by determinants of EU membership

(Changes in real % units, compared with the corresponding values of the benchmark year 2004)

GDP / determinant	free movement of labour	remittances	FDI	productivity improvement	harmonization of trade taxes	total
CEECs join, no Cohesion Policy impact	-0.5	0.1	5.6	1.5	0.04	6.7

Table 2.2 Macro effects from the Counterfactual scenario by options for the CEECs

(Changes in real % units, compared with the corresponding values of the benchmark year 2004)

Option / variable	GDP	household income	private consumption	investments	EV as % of GDP
CEECs stay outside the EU	3.1	2.6	2.1	0.2	2.0
CEECs join the EU, no Cohesion Policy impact	6.7	5.8	9.3	1.9	4.8
impact from Cohesion Policy 2007-2009	3.9	4.2	2.5	6.3	3.4
total when members of the EU	10.6	10.0	11.8	8.2	8.2

Results for EU15

Since CGE models requires that all markets have to balance and "everything affects everything" in a global economy, the flow of FDI to EU12 implies an outflow from EU15 that entails some loss of growth. A lower level of investment leads to slower growth of the capital stock in the EU15 economies which causes production or GDP to fall, at least temporarily.

Table 2.3 Macro effects from the Counterfactual scenario for the EU15

(Changes in real % units, compared with the corresponding values of the benchmark year 2004)

Option / variable	GDP	household income	private consumption	investments	EV as % of GDP
CEECs join the EU, no Cohesion Policy impact	-0.3	-0.2	0.0	-1.8	-0.2

The small fall in GDP comes from lower levels of investments, but household income decreases only slightly and private consumption not at all. The effect on private consumption is zero because the small decrease in household incomes is compensated by slightly decreasing consumer prices. These results are in line with the estimates from other research (for example, Kiander et al., 2002; Lejour and Nakuis, 2003, or Varga and In't Veld, 2009).

The main findings from the counterfactual scenario can be summarised as follows:

- **FDI is the most significant determinant of economic growth (GDP) in EU12**

It is FDI that has had the greatest effect on economic growth (GDP) in the EU12. FDI also determines the extent of the improvement productivity. Larger, modern and more productive capital stock – including new factories, machines and equipment – will improve the production capacity and sustain economic growth in the EU12.

- **Membership in the EU is quite beneficial for EU12**

The benefits in terms of economic growth of the EU membership for the EU12 appear to be considerable, even excluding the impact of cohesion policy investments between 2007 and 2009. While these countries would have been able to improve their economic growth and consequently their general welfare, even if they had stayed outside the EU, the accrued gains would have been more limited.

- **Cohesion policy adds to the gains in EU12 and more in the future**

The positive impact from cohesion policy investments between 2007 and 2009 interventions adds considerably to the gains. In the short term, private consumption will not grow as much because the increase in investments has to be financed by savings. However, the positive impact of cohesion policy will grow in the future when more of the available resources are used. In co-financing cohesion policy investments, this has a positive impact on private consumption and therefore more generally on economic growth.

- **The direct cost of enlargement to EU15 is small**

Since the EU15 are partly financing foreign direct investment in the EU12, this will tend to decrease investments that might otherwise have been made either domestically or in other EU15 Member States, at least in the short run. In turn, lower levels of investments in the EU15 cause production and GDP to fall, at least temporarily. Over the longer term however, the costs to EU15 countries of having the EU12 countries join the EU is relatively low. In part, this is explained by difference in scale between the economies of the two groups of Member States. It is to be expected that in the longer term the benefits of integration will lead to higher aggregate EU27 growth rates and that the small direct costs captured by the model will be offset by the dynamic gains arising from market growth and specialisation. For this reason, enlargement is expected to offer a win-win outcome.

Box 2.1 Summary of modelling results

- Being inside the single market has been beneficial for the EU12, raising GDP by over six percentage points compared with a 'counterfactual' of no accession.
- Cohesion policy has given a further boost EU12 to EU12 GDP, with the combined effect adding over ten percentage points.
- These effects on EU12 are offset by only a minimal reduction in EU15 GDP.
- It is the increase in FDI associated with the single market which contributes most to the GDP gains for EU12

2.4 *Econometric analyses of trade and investment*

To complement the modelling work, econometric analyses were carried out of specific aspects of the single market that the literature suggests have the greatest effects on the economies of lagging and less competitive regions.

Trade and FDI linkages constitute major channels through which business cycles are transmitted among Member States, and it can be argued that strongly correlated cycles bear on cohesion as well as affecting the functioning of European Monetary Union. While some research addresses the role of trade in the transmission of cycles, there is limited research examining the role of FDI. This part of the study investigates two main questions[8]:

- To what extent have business cycles been transmitted by FDI linkages within the European Union since the early 1990s? More specifically, the research explores the extent to which pairs of countries have become more synchronised.
- How important is the FDI channel compared with traditional determinants of correlation of business cycles, notably trade, monetary and fiscal policy coordination, and international debt?

The second strand of econometric work concentrates on how labour mobility contributes to the narrowing of labour market and income disparities in the EU. In recent years there has been substantial immigration, initially into Germany and Austria, then to the UK and Ireland and later also to Spain and Italy. Immigration from third countries was, for many Member States, even more important than intra-EU migration. This section reports on empirical analysis of:

- The extent to which migration flows in the EU affect unemployment rates in recipient and originating regions
- Whether migration has affected per capita incomes and productivity in home and host regions

2.4.1 The single market and its effects on business cycle convergence

The business cycle is a well-known concept in macroeconomics, and refers to the cyclical pattern of growth rates. Periods of slowdown or recession alternate with periods of more rapid growth, resulting in peaks and troughs in economic activity. The cycles of a pair of countries or a group of countries are considered to be "synchronised" if the peaks, troughs and turning points coincide.[9] Synchronisation of business cycles is an important issue for EU policy makers since a co-movement is a prerequisite for a common monetary policy and determines whether a coordinated or a more individual fiscal policy is appropriate. Hence the synchronisation of business cycles is an important issue when discussing the coordination of economic policies.

The past decade has seen an increasing synchronisation of business cycles in the EU – a period when the economic integration stimulated by the single market led to a major increase of intra-EU FDI and trade in the EU27. While trade and FDI linkages have become

[8] The analysis examines the bilateral synchronisation of business cycles within the EU using a simultaneous equation model, and seeks to explain not only the impact of FDI on business cycle correlation, but also the factors on which FDI depends, building on the approach of Siedschlag and Tondl (2010). Given that bilateral data on FDI and trade are only available at Member State level, this analysis only refers to the national level and not to the regional level.

[9] Note that growth cycle convergence does not necessarily mean that the two countries have the same levels of growth rates.

closer in the EU15 during the past decades as a consequence of the single market, EU12 countries have oriented their trade and FDI relations with the rest of the EU15 fairly quickly since the end of the 1990s. Today, that trade with EU15 accounts for two thirds of their trade relations and the EU15 has become the main investor in the region. Subsequently, economic integration developed further through EMU, while national fiscal policies have been constrained by treaty obligations to avoid excessive deficits and domestic fiscal rules. Despite increasing economic integration and policy coordination, the EU still has important income disparities between its members, in particular since the 2004/2007 enlargements. All of these developments are factors which potentially influence the synchronisation of business cycles.

The recent economic crisis demonstrated strikingly how closely synchronised the economies of the EU have become, given that it affected all EU15 members at practically the same time and spread with only a short delay to the EU12. The literature on business cycle synchronisation has identified several factors which may promote or reduce the synchronisation of growth. Among them are some of the factors which are mentioned above as key developments in the EU.

Trade between EU members is considered a major channel of transmission of growth. Trade integration is thus probably an important influence on business cycle synchronisation. During the recent economic crises, trade within the EU is the main reason for the spread of the economic crisis to EU12. The extensive FDI linkages which have been established within the EU15 and recently between EU15 and EU12 may constitute another channel of transmission of growth and thus a source of synchronisation. One can expect a positive effect in the case of vertical FDI where single production stages are dislocated abroad in search of cost efficiency. During the recent crisis, for example, the decline in demand for automobiles in Germany was translated into falling demand for components produced in German owned affiliates in Slovakia. However, if FDI is of a market seeking nature or serves to diversify risk by spreading business across many markets, it is likely that the economic activity in the mother company and in its affiliates are subject to different developments in demand. This type of FDI could have a de-synchronising effect on the correlation of business cycles.

A coordinated and common monetary policy may lead to similar developments in GDP growth – an effect often attributed to the EMS in the run-up stage of EMU. However, in the case of poorly synchronised business cycles, a common monetary policy may even increase diverging trends and individual exchange rates and separate monetary policies may result in closer synchronisation of cycles. A similar argument can be made about coordinated fiscal policy. This fosters synchronisation, but less policy coordination may also serve to bring diverging business cycles closer together.

Different sectoral specialisation may impede synchronisation of business cycles due to different demand shocks. It is however also possible that specialisation represents complementary forms of production so that this effect is missing. Finally, the question arises whether economies with deep income differences – mirroring differences in economic and institutional structures – are less likely to have common cycles[10].

While there is an elaborate literature on the empirical effects of trade, coordinated exchange rate policies and sectoral similarities on business cycle synchronisation (see for example Clark and van Wincoop 2001 and Siedschlag and Tondl 2010), the possibility of business cycle transmission via FDI has been largely neglected, with a few exceptions. Jansen and

[10] The nexus between these factors and growth is studied from a completely different perspective in the growth accounting and income convergence literature. Those analyses investigate whether the different performances in income growth can be attributed to differences in the openness of economies to trade, a high presence of FDI, different sectoral compositions, different fiscal policy, etc. This is not the focus of the present study which focuses on whether factors such as intensive trade and FDI relations are transmission channels of growth, promoting common growth trends between a pair of countries and within a group of countries.

Stockman (2004) test the impact of FDI on business cycle synchronisation between the G7 countries. Garcia Herrero and Ruiz (2008) test the effect of trade and financial linkages on business cycle synchronisation of Spain. There is also no study which looks at the effect of income disparities on business cycle synchronisation. Moreover, the literature on synchronisation in the EU27 and between EU15 and EU12 members is sparse.

2.4.1.1 Overview of empirical findings

For the econometric work, the data used were national level macroeconomic data from various official sources. The most challenging variable was the FDI data, because of the necessity to work with bilateral FDI stocks, for which FDI outward stocks were the main source[11]. Figures 2.2 to 2.4[12] – shown in full in the annex – present the trends for three of the main macroeconomic variables in the estimations, distinguishing as different sub-samples the EU15, EU15-EU12 and EU27[13].

Figure 2.2 shows the development of correlations in GDP growth rates. Evidently, growth correlations are highest in the EU15 group of countries, reaching a correlation of 0.8 in 2004-2008 against 0.6 in the EU as a whole. Nevertheless correlations in EU15 showed a decreasing trend for the observations 2000-2005, with a pronounced drop in 2003, covering the period 2001-2005. In contrast, the correlations showed a more constant increasing trend in EU15-EU12 and EU27. A look at the data shows that growth accelerated after the 2001/2002 slowdown in much of EU15, but that the speed and timing of the subsequent recovery was very uneven. This explains the drop in growth correlations in the observation for 2003. The impressive, steady increase of growth correlation in EU 27 from virtually nothing in 1995-1999 to 0.6 is particularly noteworthy.

Figure 2.3 shows the differential in government deficits as a proxy for dissimilarity in fiscal policies. The trends of this indicator are different for countries in the EU15 and in the EU15-EU12 combinations. Differences in budget deficits have increased throughout the period in the EU15, with a short period of stability during the 1999, 2000 and 2001 period as the Euro was being introduced. In contrast, differences in budget deficits increased between country pairs of the EU15-EU12 until 1999, then decreased sharply thereafter, reaching a distinctly lower level than in the EU15 in 2006. As a result, there is a slow decline of differences in budgetary deficits since 1999 in EU27.

Exchange rate volatility (see Figure 2.4) has decreased in the EU over the whole period. It was three times as high in EU15-EU12 compared to the EU15 in the period 1995-1999, but was only twice as high from 2000 onwards. Figure 2.4 shows the differences in per capita income which are a multiple between countries in EU15-EU12 compared to those within the EU15. Income differences in EU15-EU12 and in total EU27 have declined in the period concerned while there was a slight increase in the EU15. Inspection of the FDI and trade data shows that the intensity of linkages of both increased over the period examined and that bilateral trade intensity (bilateral trade as share of both countries GDP) is twice as high in the EU15 as in the EU27.

2.4.1.2 Results of estimations

Trade is the only factor which has a robust and significantly positive impact on the correlation of twinned countries' growth cycles. The positive impact appears in the two sub-

[11] Since there are missing data due to confidentiality requirements some intra- and extrapolation was done, starting from the trend observed in the series and extending the structure of higher level aggregates.

[12] Further data are presented in background papers.

[13] For simplicity's sake, the labels for the 'year' axis in all these charts refers to 1997, 1998 and up to 2006, but in fact the data points are 5-year moving-averages corresponding to 1995-1999, 1996-2000, etc.

samples, in sub-periods and for the EU27 as a whole. Moreover, the impact of trade is particularly pronounced among the EU15-EU12 members. Thus trade integration of the new EU members in the course of enlargement had a marked effect in aligning the EU12 cycles with EU15. This, however, also explains why the EU12 were rapidly affected by decreasing export demand from EU15 during the recent crisis, which translated into a drastic fall in GDP.

Bilateral FDI linkages do not reveal an impact on growth correlations according to the estimates, except for in the EU15-EU12 in the first sub-period where it shows a negative impact. Thus, FDI linkages between the EU15 and EU12 did not lead to growth transmission in that early period; rather, it had a de-synchronising impact on growth rates between the two partners. What explains the statistically insignificant impact of FDI linkages for growth correlations? The estimates are that for EU15-EU12 as well as in EU27 there is a significantly negative coefficient of growth correlations in explaining FDI stocks. This indicates that FDI seeks destinations which do not exhibit the same growth path, implying that much of this FDI may be to diversify risk and to benefit from differently developing markets.

In the EU27, this explanation is further supported by the positive coefficient of long term interest rate differences, GDP per capita differences and the differential in government efficiency and political risk. A significant part of FDI seems to flow to markets with a different income level and institutional differences. However, differences in regulatory quality discourage intensive FDI holdings. This signals that some part of FDI takes place between equally developed partners. The results indicate that there is a stronger presence of FDI in equally developed economies in the EU15 and that there are some positive growth spillovers in the EU15 arising from FDI. Although FDI has practically no direct effect on business cycle synchronization, it has a robust and statistically significant positive indirect impact on growth correlations via trade.

For differences in government budget deficits, there is a negative coefficient in the group EU15-EU12 as well as in total EU27, providing evidence that a decrease in government deficit differences has fostered growth correlations. By contrast, a positive coefficient for differences in government deficits in EU15 suggests that increasing differences in budgetary deficits in EU15 have not diminished growth correlations, but rather supported synchronization of growth cycles. Hence, divergent fiscal policies since 2003 seem to have been an increasingly important adjustment mechanism enabling EU15 economies to keep to a similar growth path. Among other factors that determine differences in fiscal policies, there is a significantly negative coefficient for long-term interest rate and GDP per capita differences in all samples, and a positive coefficient with differences in government efficiency and political stability. Thus disparities in budgetary deficits are not due to income differences and differences in interest rates. Rather, differences in budgetary deficits are found between countries that show disparities in government efficiency and different political stability.

Exchange rate volatility is an important negative factor impeding synchronisation in EU15. This does not appear in EU27 as a whole. For EU15-EU12, a positive coefficient for exchange rate volatility suggests that exchange rate alignments served as an adjustment instrument. As long as such adjustment via exchange rate flexibility is required in the EU, it will not discourage growth cycle synchronization. Exchange rate volatility is above all determined by inflation differentials and by differences in government deficits. The estimations also show that the need for exchange rate volatility arises in EU27 as a consequence of poor growth correlation. In EU15-EU12 income differences also play a role.

Unlike previous studies, the estimates reveal that manufacturing specialisation makes a positive contribution to business cycle synchronisation in the EU15-EU12 and in the EU27 as a whole. Manufacturing specialisation arises from trade in EU15-EU12 and is linked to income differences in EU15-EU12 and in the EU27 as a whole. In the EU15 specialisation comprising all sectors, is not a matter of income differences, and specialisation has no effect.

Finally, there is a statistically significant negative coefficient for income differences on growth synchronisation in the EU15-EU12 and EU27 as a whole. Thus the decline in income disparities in that group helped to align business cycles. In contrast, the slightly increasing income disparities within the EU15 did not harm synchronisation.

2.4.2 The effects of migration on convergence and divergence

The contribution of migration to convergence or divergence between the EU NUTS2 regions in unemployment rates, per capita income and productivity has been analysed using data from two different sources. The first is a special extract from the European Labour Force Survey (ELFS) provided by Eurostat. The second is a range of standard regional indicators from the Regio database, such as GDP and unemployment rates, together with data on migration.

The ELFS data cover the period 1995-2008 and provide information on the regional stock of active (aged 15 to 64 year old) native and foreign born population residing in NUTS 2 regions differentiated by region of birth (natives, foreign born from other EU15 countries, from EU12 and from third countries), by educational attainment levels (tertiary educated with ISCED level 5 or more education, intermediary education level – ISCED 3 or 4, and low educated with ISCED level 2 or less) and (ILO) employment status (unemployed, employed and out of the labour force). The data have shortcomings because of under-estimation of irregular migrants and are subject to incomplete response rates.[14]

2.4.2.1 Some empirical facts

Inspection of basic indicators reveals a number of interesting developments. Figure 2.5 shows trends in regional disparities in the EU27 by displaying the coefficient of variation for regional per capita income, productivity, the total unemployment rate as well as youth and long-term unemployment rates. Evidently, unemployment disparities among regions are much larger than income and productivity disparities. Youth and long-term unemployment disparities are largest, while productivity disparities are larger than those of GDP per capita. Per capita income, as well as productivity disparities, diminish over the whole period considered, although to a modest extent. Thus there is a steady process of income and productivity convergence taking place in EU27 between 2000 and 2007. Unemployment rates converged markedly over the whole period, despite an apparent cyclical pattern which reveals a peak in 2002 and a new increase in 2007. Unemployment disparities are larger than income disparities in the EU. One reason may be labour rigidities. The dramatic disparities in unemployment in the pre-2004 period can be attributed to the substantial unemployment in the EU12 which arose as a consequence of economic restructuring.

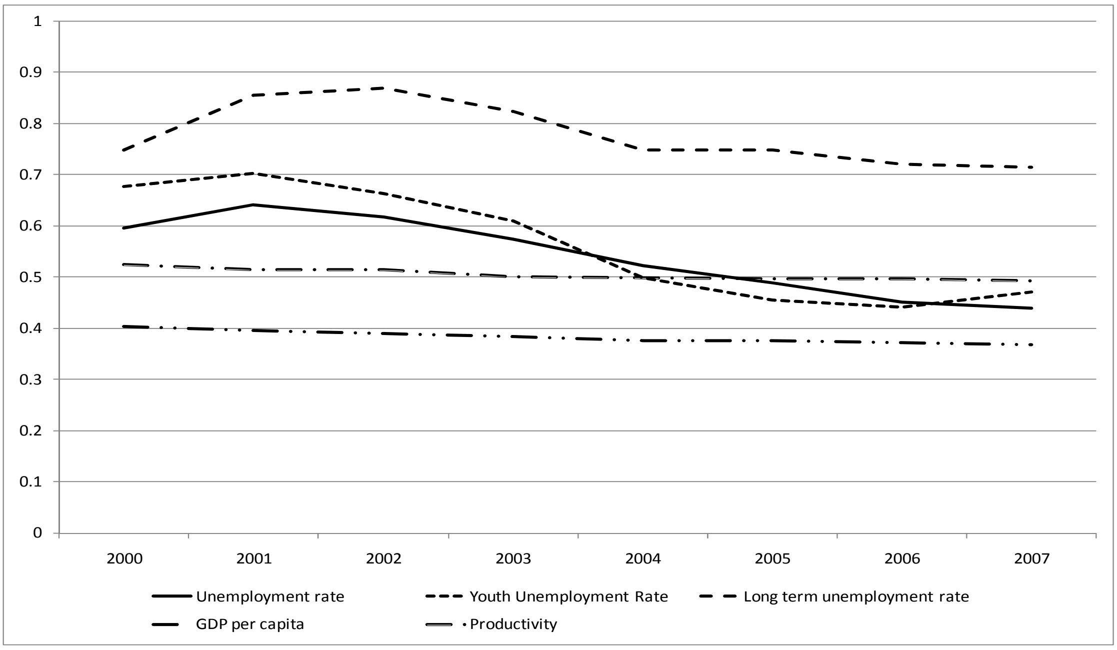
The steady income convergence process observable between EU27 regions result from the combination of some catching up and others losing ground. Figure 2.6[15] distinguishes between types of converging and diverging regions. Converging regions are either those with a per capita income below the EU average in 2000 and an above average growth rate in

[14] See background papers for more details on the data used, the specifications of variables and the problems of data consistency.

[15] This figure and subsequent figures and tables referred to in this section are presented in full in the annex.

2000-2007 (converging from below) or regions with an above average initial income and below average growth (converging from above). Similarly, diverging regions are either regions with a below average initial income and below average growth (diverging from below) or regions with above average initial income and above average growth (diverging from above). Most CEEC regions and the Iberian Peninsula are converging from below. In contrast, Southern Italy, the major part of Greece, several East German regions, the North of the Czech Republic and the South of Hungary are diverging from below. The main share of EU15 is converging from above. In addition a part of the EU15, (Ireland, the North-East of Spain, Cyprus, some regions of Belgium and the Netherlands as well as the majority of Finnish regions) is diverging from above.

Figure 2.5: Development of Regional Disparities in EU27: Coefficient of Variation of Unemployment and GDP Per Capita and Productivity



Source: EUROSTAT, own calculations.

Figure 2.7 shows total net migration rate by Member State[16], revealing significant variations. Leaving aside the extreme cases of Malta and Cyprus that received exceptionally high immigration, Spain, Luxembourg, Ireland, Italy and Portugal show the highest net migration rates, amounting to between 1.9-5.3% of the population from 2004 to 2007.[17] Only the Netherlands changed from an immigration to an emigration country between the pre- and post-enlargement periods considered here. Figure 2.7 also shows that, in contrast to the perception in the public debate, several of the EU12 countries (Czech Republic, Cyprus, Estonia, Hungary, Malta, Slovakia, Slovenia) are (and have been for the majority of the 2000's) net immigration countries. The only EU27 countries that are net emigration countries are Lithuania, Latvia, Poland and Romania and (since 2004) the Netherlands.

At the regional level, net emigration characterises practically all of Romania, much of Poland, Latvia and Lithuania, the peripheral regions of Sweden and Finland, Southern Italy and Northern France (see Figure 2.8). Ireland, the South and North-Eastern part of Spain,

[16] Since population data from EUROSTAT do not always accord with national sources, the migration data were checked for consistency and corrected for discrepancies using national sources in the critical cases of Poland, Slovakia and the Czech Republic. For the other countries (in particular, other EU10 countries, the Netherlands and Cyprus) national sources are consistent with the results in the literature (see e.g. Facchini, Mayda 2008).

[17] The UK which also has high migration is not included in our sample.

the South-West and South of France as well as North and Central Italy, and Cyprus are heavy net-immigration areas.

Table 2.3 shows the skill composition of international migration according to the ELFS for the years 2000 and 2008. Although missing observations for 2000 are a problem, the available data show that the share of high-skilled immigrants has increased. The most notable exceptions are Spain and Lithuania. Most countries receive the largest share of immigrants in the medium-skilled segment. Exceptions are Belgium, the Netherlands, France, Spain, Portugal, Italy and Greece in EU15 and Malta and Poland which received mainly low-skilled immigrants. Aside from these cases, low skilled immigration has generally decreased. The share of highly skilled foreign-born workers is greatest in most of the UK regions and Sweden, as well as in a number of countries with a rather low overall share of foreign born workers – for example in Romania and the Baltic countries. In these latter countries, high skilled migration can be associated with significant inward FDI. By contrast, a high share of low skilled migrants is found in Spain, Italy and France, while the regions in the Central European Countries (Austria and the Czech Republic, as well as most of Hungary and Slovakia) primarily host medium skilled foreign-born workers. This suggests a North-South divide in the skill content of migration in the EU 27 (Figure 2.9). The skill patterns for the Spanish regions are, however, an exception.

Finally, Table 2.4 shows the change in international migration by region of birth: EU 15, EU12 and rest of the world. The figures relate to total net migration in the segment of origin observed over the period 2000-2007 as a share of population in 2000. Clearly, migration flows with third countries are most important for EU countries. Cyprus, Spain, Austria, Sweden, the UK and Portugal have received important inflows, ranging from 2% of the population in 2000 in the UK to 8% in Spain (because of data limitations, others where there could potentially be high immigration from third countries, such as Germany, cannot be included for this indicator). In Spain, the UK, Sweden, Belgium and the Netherlands immigration from EU12 is second in importance (missing data for Ireland and Italy blur the picture from EU12). Luxemburg and Cyprus show sizeable immigration from the EU15.

2.4.2.2 Estimations

The empirical analysis of the impact of migration on convergence comprised estimation of three central equations (details on the estimations are explained in background papers).

- The first relates regional unemployment rates to the lagged unemployment rate and indicators of net migration, as well as a number of control variables.
- The second relates GDP per capita (at PPS) to lagged GDP per capita levels to measures of migration and a set of control variables
- The third relates productivity in a region (measured as real GDP per capita) to lagged productivity, migration indicators and a set of control variables.

There are known problems in estimating migration equations that have been taken into account in the estimation procedure. First, immigrants from outside the country will often select regions of residence where they find the highest return, (i.e. those regions with low unemployment and high income - Borjas 2001). This may result in a spurious positive impact of migration on the labour market due to a reversed causality. The standard way of solving this is by the econometric technique of ‘instrumentation’.

A second problem is that international migration may induce internal migration flows in the recipient country. Where this is substantial, assessing the unemployment impact over all regions of a country may result in a spurious positive impact of immigration on labour markets for this reason. This, however, is not relevant in the context of the present study since, in all the regressions, internal migration of nationals is included in the measures of migration or as a separate dependent variable, as recommended by Dustmann et al 2005.[18]

Finally, it is important to select the right regional aggregation level to draw conclusions on migration effects.[19] The region should represent a good approximation to a closed labour market, meaning that workers would only search for work within the region. If the aggregation level is too low, one will have the situation that workers might move (or commute) to surrounding regions if competing with migrants. With low-skilled work, the closed labour market is commonly found at a more disaggregated geographical level, since low paid workers typically cannot afford long commuting journeys. By focusing on the NUTS 2 level this is unlikely to be a great problem, although commuting flows can be important in some urban-suburban contexts even at the quite aggregated NUTS 2 level.

2.4.2.3 Results for convergence in unemployment

The results of estimations for five different specifications for the unemployment rate equation are summarised here and presented in more detail in the study's background papers.

- The estimations provide strong evidence of conditional convergence in unemployment rates among the regions analysed in this study during the period 2000-2007.
- To take account of possible heterogeneity in the regional impacts of migration, especially on different labour market segments, additional estimates were generated for youths and the long-term unemployed. The results confirm much of the previous analysis: there are also clear tendencies of convergence with respect to youth unemployment rates in Europe in the period from 2000 and 2007. These results therefore suggest at most a very mild impact of migration on youth unemployment rates.
- Results for the long-term unemployment rate, aside from pointing to rather rapid conditional convergence in long-term unemployment rates, suggest that higher immigration increases the long-term unemployment rate. This implies that the additional labour market competition of newly arriving migrants primarily works to the detriment of the long-term unemployed.
- In sum, the evidence suggests that migration had no significant impact on the convergence of unemployment rates in the years 2000 to 2007 and that any direct effects of migration on regional unemployment rates lack significance.

2.4.2.4 Results concerning GDP and productivity

The results for GDP per capita also imply conditional convergence, although at a much lower rate than for unemployment among the EU NUTS 2 regions in the period observed.

- Echoing the vast majority of the literature, investments have a significant positive effect and the share of young persons (which may be considered a proxy for labour supply growth) a significant negative impact on GDP per capita, while natural population growth, on account of its co-linearity with the share of young population has no additional significant impact.

[18] An alternative, probably superior strategy to identify effects of migration is to use the skill level of migrants distinguishing between occupational groups or different education or work experience (see: Bonin 2005, Card 2001 and Borjas 2003). We would have liked to follow this approach too, but unfortunately due to data constraints described above this avenue is not open to our analysis.

[19] Borjas (2006) recommends analysing the county and not district level.

- A low share of agriculture and (in most specifications) a more rapid structural change are also conducive to high GDP per capita growth, while the share of highly educated has a significant impact on GDP growth only when splitting the sample into emigration and immigration regions

- Even after controlling for endogeneity, migration has a positive impact on GDP per capita in the receiving region.[20] This corroborates the conclusion of much of the literature that, on average, migration has a slightly positive effect on GDP per capita growth (which could for instance be theoretically explained by the human capital gain implied by migration, complementary with existing skills and the additional regional demand it induces).

- Splitting the sample into immigration and emigration regions results in immigration having a positive impact in the first case and emigration a negative impact on the latter regions. Migration flows therefore tend to increase regional disparities.

The effects of migration on GDP per capita can be considered as a combined effect including supply and demand side effects of migration. Supply side effects in this respect may result from productivity changes due to changes in the skill structure and demand side effects from additional demand of migrants. In order to disentangle these effects and to provide some evidence on the impact of migration on the competitiveness of regions, the impact of migration on productivity was also estimated.

- The findings point to productivity convergence at NUTS2 level. The coefficients are small, implying that migration has only a weak impact on productivity convergence.

- As with the GDP per capita convergence, migration after controlling for endogeneity has a positive impact on productivity in the receiving region. This is primarily due to a significant positive impact of migration from abroad on productivity, while the impact of internal migration remains statistically insignificant (but also positive).

- In addition, a further division of the sample into emigration and immigration regions suggests that this effect is negative in emigration and positive in immigration regions. Emigration regions therefore lose while immigration regions gain skills.

- Finally, the results for this dependent variable imply that a high share of investments in GDP increases the productivity impact, while a high share of young population and a high share of agriculture in employment reduces productivity.

2.5 Case studies: results of the assessment of the impact of the single market

To deepen understanding of the impact of the single market, case studies were undertaken of 20 regions in four groupings, comprising:

- 10 '**convergence' regions**: Galicia (Spain), Malopolska and Mazowieckie – including Warsaw – (Poland), Southern Transdanubia (Hungary), Southwest

[20] As for the other estimates, this result is highly robust across different specifications. In particular (in results not reported here) we also estimated the specification with other instrumental variable techniques as well as without controlling for endogeneity. In all of the equations a positive co-efficient was found.

(Czech Republic), Northeast and Bucharest-Ilfov (Romania), South Central (Bulgaria), West Wales (UK) and the country of Lithuania.

- 2 '**phasing-out' regions**: Basilicata (Italy), Central Macedonia (Greece)
- 6 '**competitiveness' regions**: Niedersachsen (Germany), Skane-Blekinge (Sweden), Pays De La Loire (France), Prague (Czech Republic), Central Hungary including Budapest (Hungary) and Madrid (Spain).
- 2 '**phasing-in' regions**: Sardinia (Italy), Southern Aegean (Greece)

The case studies were based on analysis of programming documents and other official publications, complemented by interviews with three types of respondents who work on, or are knowledgeable about, cohesion policy: regional programme managers, national programme managers, and selected representatives of interest groups.[21] The interviews focused on the:

- ***region specific assessments of how the single market*** affects growth, competitiveness and employment in the region and on governance arrangements;
- ***response of cohesion policy*** to the single market in the current programming period, the aim of which has been to assess four different aspects of the response:
    - o the *logic and the strategic drivers* of cohesion policy programmes,
    - o the *alignment of cohesion policy* with the Lisbon Strategy,
    - o how the *economic crisis* has been taken into account,
    - o the *status of the debate* regarding the *Europe 2020* strategy and cohesion policy, that is in terms of awareness, proposals and prospects for the future of the two.

2.5.1 Findings: respondents' region-specific assessment of the single market

The findings of the survey work suggest that, overall, most respondents report a positive assessment of the impact of the single market on regional/national economies. The most common view among respondents is that the impact of the single market on their regional/national economy has been quite high. The single market is deemed to have been (very) significant in increasing the trade of goods by almost all of the respondents (as many as 92%), but less significant in terms of labour mobility, with only 47% of respondents viewing it in this light.

A positive but also mixed assessment of the impact of the single market in the EU12

Respondents in the EU12, while positive about the single market, were more nuanced about its implications than were respondents in EU15. The positive impacts of the single market were seen to be the liberalisation of trade and the need to comply with EU accession commitments that encouraged reform and modernisation. Doubts were, however, expressed about the impact of emigration of more qualified people, a phenomenon that subtracts

[21] In total, 240 interviews were conducted, a high response rate of 78% of the original sample of 306. The interviews comprised close-ended questions and more open-ended discussions.

valuable resources and could undermine growth prospects, although some respondents felt this was of limited significance and could act as a safety valve for regions that would otherwise experience high unemployment. Polish respondents observed that the single market had opened opportunities for Warsaw and the capital region as drivers of growth, and that this might subsequently trickle down to other metropolitan areas.

The single market as a driver of growth in EU15

EU15 respondents were overwhelmingly positive about the single market as a proven driver for growth. Mechanisms cited include widened market access for leading companies, the more open European labour market supported by mutual recognition of skills and qualifications, and the scope for specialisation in areas such as financial services and advanced manufacturing. FDI, often associated with know-how, has also been a positive influence, but modernization has also included the agriculture export sector.

A positive but differentiated assessment of the impact of the single market on different economic sectors in convergence regions in EU12

Manufacturing is singled out by an overwhelming 87% of respondents as having benefited from the single market and commerce and tourism by 79%. The banking/financial sector and the agricultural/fisheries sector are perceived by, respectively, 72% and 62% of respondents to have benefited from the single market. However, the respondents also pointed to aspects of the single market that remain unsatisfactory, such as other service sectors, while the opening of agriculture elicited some negative comment. The dominance of external interests in the banking industries of many CEECs is also a source of concern.

Box 2.2 Key messages from this chapter

- The single market has contributed to a substantial increase in intra-EU flows of trade and foreign investment.

- Economic cycles have become more synchronised in the EU. Looking at bilateral correlations of growth rates within EU15 and between EU15 and EU12 countries, business cycles are clearly more correlated among EU15 countries, but the trend for EU15-EU12 country pairs has been towards substantially greater synchronisation.

- Trade integration is the major factor contributing to the convergence of business cycles in the EU, one consequence of which is that the sort of downturn seen in the economic crisis spreads rapidly across the EU through trade linkages.

- Income convergence, in turn, is promoted by strong trade linkages and individual fiscal policies.

- In the years leading up to the crisis, there was net emigration from nearly all the regions of Romania, much of Poland, Latvia and Lithuania, the peripheral regions of Sweden and Finland, Southern Italy and Northern France. In the same period, Ireland, the South and North-Eastern part of Spain, the South-West and South of France as well as North and Central Italy, and Cyprus were heavy net immigration areas.

- Immigration has a positive impact on the GDP per capita as well as has a positive impact on productivity in the host region, whereas emigration leads to a reduction in GDP per capita and productivity in home regions.

- The migration estimations provide strong evidence of convergence in unemployment rates among the regions analysed in this study during the period 2000-2007.

- The evidence suggests that migration had no significant impact on the convergence of unemployment rates in the years 2000 to 2007.

- The positive verdicts from the modelling are, on the whole, confirmed by the case study interviews. Respondents believed that both the single market and cohesion policy had been good for their regions and that EU accession had brought tangible gains in prosperity.

- Some reservations were expressed about the uneven or incomplete impact of the single market on certain sectors of economic activity in EU15, and also among convergence regions in EU12.

3 The impact of cohesion policy

The economic significance of cohesion policy funding has been extensively studied in the literature. A good summary is presented in Varga and In't Veld (2009). Among the studies they review and the findings in them, some of the following are especially relevant:

- Burnside and Dollar (2000), argue that cohesion policy works best where there is a supportive policy environment.

- Herve and Holzmann (1998) analyse the potential absorption problems that arise from the large-scale fiscal transfers under cohesion policy. They consider several reasons why the actual increase in capital could be considerably smaller than what would be expected under an optimal use of transfers. The factors are: waste of transfers, administrative costs to ensure the best possible use of transfers, rent-seeking activities and diversion of funds to consumption. According to Hervé and Holzmann (1998), in some cases transfers may be harmful to economic growth and real convergence. They also argue that if transfers increase, the absorption problems will probably increase too.

Empirical assessments including, ex-post evaluation studies of previous programming periods of cohesion policy have also given only mixed support for large transfers. According to Boldrin and Canova (2001) there is no evidence that the economic performance of regions benefiting from the Structural and Cohesion Funds regions varies from others. Nor is there evidence of systematic catching-up. Similar mixed evidence on convergence is found in other studies as well. Cappelen et al. (2003) argue that EU's regional policy has become more effective at generating growth and contributes to greater equality in productivity and income in Europe, but an unfavourable industrial structure and lack of R&D hinder growth in poorer regions. This suggests that, in poorer regions, fiscal transfers should be accompanied by policies that facilitate structural change and increase R&D capabilities. Ederveen et al. (2002) and Ederveen, Groot and Nahuis (2006) argue that Structural Funds are ineffective on average, but are effective for countries with the right kind of institutions. Checherita, Nickel and Rother (2009) find that net fiscal transfers inhibit also output growth.

Mohl and Hagen (2010) find for 2000-2006 that Objective 1 payments promoted regional economic growth, whereas for the other Objectives (i.e., 2, and 3) no positive and significant impact on regional growth is found. They also show that the growth impact does not appear immediately, but that it occurs with a time lag of approximately two to three years. The Fifth Cohesion Report (2010c, p. 205) also provides empirical evidence of the higher growth rates among Objective 1 regions vis-à-vis non-Objective 1 regions during the 1995-2006 period.

In addition, Varga and In't Veld (2009) examined model based assessments. One example of a study that uses single country models to evaluate cohesion spending is Pereira and Gaspar (1999). They find that during the period 1989-1993, EU funds inflows of around 3.5% of GDP boosted growth by about 0.5% a year. They also imply that the growth impact was maximized when EU funds were allocated to infrastructure. Many country assessments of Structural Funds have been carried out with HERMIN models, such as Bradley, Herce and Modesto (1995) and Bradley, Morgenroth and Untiedt (2003). The results of the HERMIN models bring out considerable positive effects of cohesion policy in short run (Bradley and Fitzgerald, 1988).

Recently, three different models have been used to assess the effects of cohesion policy expenditure over the period 2007-2013; HERMIN (Bradley, Untiedt and Mitze, 2007), QUEST II (In't Veld, 2007) and EcoMod (Bayar, 2007). The results of all three models suggested that cohesion policy expenditure generates positive output effects, but in the short run the demand effects were smaller in the QUEST II than in the HERMIN. In the long run the output effects were larger in EcoMod than in the two others.

These mixed results on cohesion policy are partly understandable because the research focus differs, and model types and assumptions have been different.

3.1 Modelling of different configurations of cohesion policy

As explained in introducing the modelling work in section 2.2, three further scenarios were constructed, embodying different simulations of cohesion policy interventions.

3.1.1 The Europe 2020 scenario

The Europe 2020 strategy signals a shift from traditional investment in ‘hard’ infrastructure towards much greater emphasis on R&D and enhancement of human capital, a change central to debates on future cohesion policy. The Europe 2020 scenario simulates the likely impacts that may arise if the focus of cohesion policy changes from “hard” to “soft” oriented interventions. The simulations in this scenario model the effects of increasing R&D subsidies and decreasing “hard” subsidies – see box 3.1.

Box 3.1 The core equation in the model

The linear slope of the results comes from the specification of the tax rates in the model and small changes in them. The relationships between pre- and post-tax input and production costs are specified using a so-called ad valorem form. For the capital input the expression is:

PCAPPT = (1 + CAPTAXRATE) x PCAP

where PCAPPT is the post-tax rent for capital input paid by the firms, CAPTAXRATE is the tax rate and PCAP is the rent received by the owners of physical capital (machines, equipment etc.). The firms must pay the tax to the government which has set the tax rate.

The tax rate is fixed, but both prices are endogenous and are determined in the model. The change in the tax rate is small in the cohesion policy simulations because only one quarter of the resources had been used by the end of 2009. For this reason the two prices are quite similar and the effects become linear as the value of the tax rate decreases.

As a first step, the impact of hard subsidies alone (i.e., without taking into account the effect of “soft” interventions) on key macroeconomic variables was calculated. The results are presented in Table 3.1.

Table 3.1: The likely impacts of hard subsidies alone on key macroeconomic variables for the initial year of intervention

Geographic aggregation	Real GDP	Real consumption	Real total investment
Euro zone + CZ, HU, SK (15)	0.009	0.081	0.063
ROEU (12)	0.011	0.082	0.098

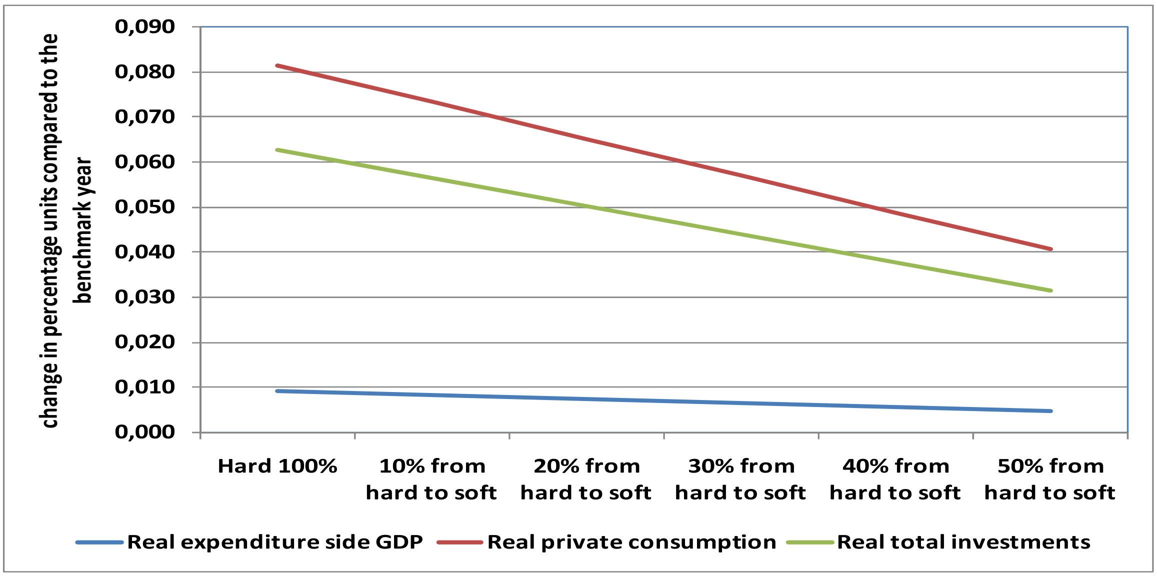
EU27	0.010	0.081	0.068

*Note***:** The Pan-European CGE RegEU model was run for the analysis

The effects on the key macro variables are small but positive. This is partly because cohesion spending has been slow to take-off, so that committed funds have not yet been substantially utilised. But it also has to be stressed that some of the policy interventions are qualitative in nature, and cannot easily be captured with the quantitative RegEU model.

How strong are the effects of those hard policy instruments on economic variables? Would their effect change rapidly when the policy shifts from hard to soft interventions? To investigate the strength of the effect of hard investments and to test whether it changes when there is a switch to soft interventions, the share of hard intervention is reduced stepwise in 10 percentage point intervals. As shown in Figure 3.1 the resulting effects are linear because only the shock parameter values change. The effects decrease with the falling share of hard interventions, but remain positive.

Figure 3.1: The Europe 2020 scenario: Impacts of hard subsidies on key variables as the share of hard subsidies declines for the initial year of intervention



Note: The Pan-European CGE RegEU model was run for the analysis

To assess the likely impact of a shift from hard to soft interventions, a comparative analysis drew on three scenarios using the extended GMR model system:

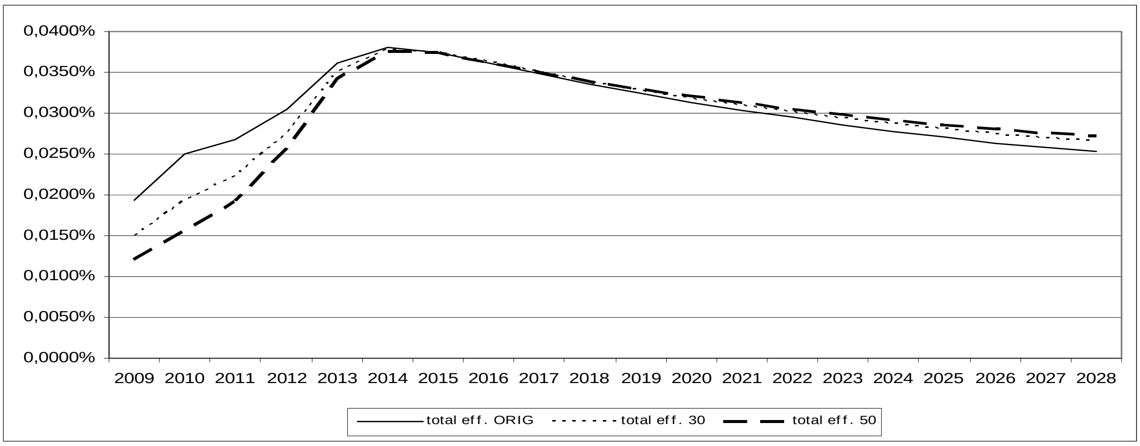
1. In the first scenario the distribution of funds between soft and hard interventions is taken into account according to their observed allocation.
2. In the second scenario the value of hard subsidies is decreased by 30 percent and the value of soft interventions increased by the same amount.

3. The same procedure is applied as in the second scenario with the difference that now the amount reshuffled from hard to soft subsidies is 50 percent of the total of hard subsidies. Figure 3.2 presents the results of the scenarios.

Figure 3.2 shows that up to 2014, when the impact reaches its maximum level, the effect of hard subsidies exceeds that of the soft instruments. However, after the peak in effect is reached (from 2015), the relative strengths of the instruments reverses. Subsequently, the impact of soft instruments becomes increasingly pronounced. The results suggest that reshuffling of support from hard to soft subsidies can result in sizeable impacts if the redistributed amounts are significant enough (note the increase in impacts as the share of soft subsidies increases), albeit only after a number of years.

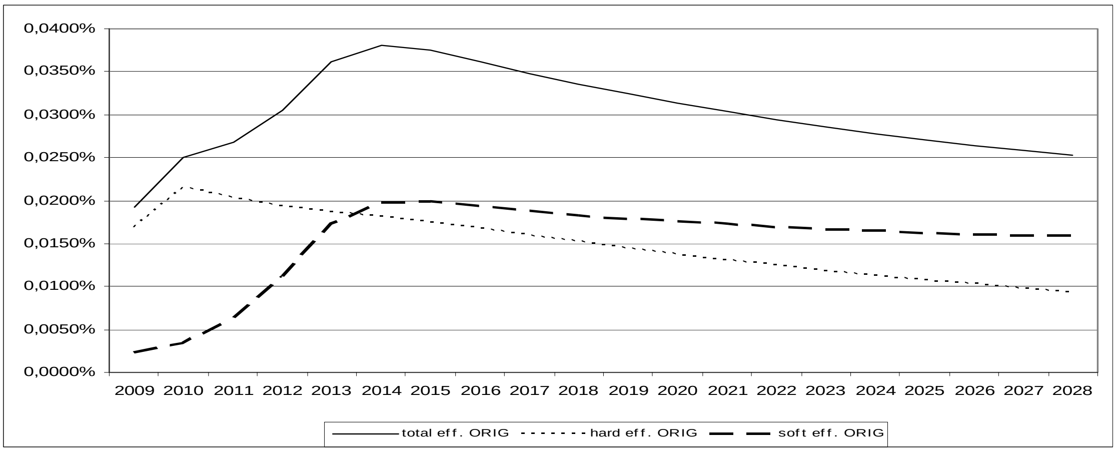
Figure 3.3 illustrates the mechanism behind the net impacts in Figure 3.2. After its peak in 2010, the effects of a one-time hard intervention (assumed to be spent in 2009) decline sharply over time. On the other hand, the decline in the effects of soft interventions after their peak (in 2014) is less dramatic (resulting from dynamic agglomeration externalities). As the share of soft subsidies increases, the curve representing them shifts upward, while the curve representing hard subsidies moves downwards. The positive impact on GDP resulting from the upward shift of the soft subsidy curve more than compensates for the falling impact of the hard effects. The outcome is that the net impact of reshuffling resources from hard to soft instruments is positive. The balance depends on the size of resources directed towards soft policy instruments and most probably on the geographical distribution of subsidies.

Figure 3.2: The Europe 2020 scenario: redistribution of Cohesion Funds subsidies from "hard" to "soft" instruments. Percentage differences between scenario and baseline GDP values for three cases: no redistribution, 30 percent of hard subsidies are redistributed, 50 percent of hard subsidies are redistributed



Note: The extended GMR Europe model system was run for the analysis

Figure 3.3: The impacts of hard and soft interventions on GDP over time – Europe 2020 scenario. Percentage differences between scenario and baseline GDP values



Note: The extended GMR Europe model system was run for the analysis

3.1.2 The "Donut" scenario

Some of the relatively most developed regions (especially the core capital regions) of the Member States that are substantial net beneficiaries from cohesion funding have already exceeded (or may soon do so) the eligibility threshold for cohesion policy support. What will be the likely impacts if this happens?

To model this phenomenon, the simulations in this section redistribute all the cohesion funding for the relevant Member State evenly from the core regions to other regions in five Member States: the Czech Republic, Greece, Hungary, Portugal and Slovakia.[22] Figure 3.4 (see annex) shows the results of the Donut scenario. The reshuffling of funds from the core regions has hardly any effect on the EU economy, with just a small decline in the aggregate GDP effect that persists over the whole period (see the last panel of Figure 3.4), partly because the share of core regions is already relatively limited in most of these Member States.

However it is also clear that there are pronounced variations across the countries considered. To understand the differences in the impacts, the relative strengths of agglomeration effects in the capital regions as compared to the rest of the country should also be taken into account. In the GMR model system, agglomeration is measured by the concentration of employment in science and technology intensive sectors (Varga 2009). It is expected that in countries where the relative concentration of knowledge intensive industries is high in the capital regions, the redistribution of human capital and R&D supporting financial resources to less agglomerated regions exerts a larger negative effect on GDP than otherwise.

The negative effect of the Donut scenario is strongest in Hungary. Significant agglomeration of knowledge industries in Budapest (35% of total of the country), along with a relatively large share of Hungary's cohesion funding (18%), explain this impact. Portugal represents the opposite case: despite significant agglomeration of technology intensive activities in Lisbon (36% of the national total) the small share of funding allocated to the capital (3% of national total) results in a relative small Donut effect. The sizeable positive effect of the redistribution from Bratislava to the rest of the regions confirms that the extent of

[22] In order to reach measurable impacts we used the estimated total value of the support for soft interventions for 2007-2009. This was done by multiplying the input data (which, on average, account for 20% of total subsidies) by 5. The same estimated input data were later used in the following Agglomeration and concentration scenario.

agglomeration and the amount of support redistributed determine the strength of the Donut effect. In the Slovak Republic, Bratislava represents the smallest concentration of knowledge sectors. Redistribution of the relatively large share of cohesion related funding (27 percent) to stronger agglomerations results in a higher impact on country level GDP than otherwise.

3.1.3 The Agglomeration and concentration scenario

In view of the Donut scenario findings, would the impact of cohesion spending be increased by targeting agglomerated industrial areas, as predicted, notably, by new economic geography theory and advocated by the World Bank (2009)? This section presents the results of an 'Agglomeration and concentration' scenario that addresses this question.

In the simulations for this scenario, 30% of the total support originally distributed to other regions of the Czech Republic, Greece, Hungary, Portugal and Slovakia is re-allocated to the economic cores: Prague, Athens, Budapest, Lisbon and Bratislava. (The support of each non-core region is decreased by the same 30%.) Figure 3.5 presents the simulation results. The net impact of redistributing subsidies from hard to soft categories depends on the size of resources directed towards soft policy instruments and most probably on the geographical distribution of subsidies.

As shown in Figure 3.5 (see annex) the impact of agglomeration targeting is visible even at the aggregate European level. The difference between the impacts on GDP resulting from the actual distribution of hard and soft instruments and the effect of agglomeration targeting stays about the same over time. Although the overall European impacts are small (which is in accordance with the relatively small amounts distributed) the relative effect of the agglomeration scenario is clearly visible in the last panel of Figure 3.5.

Similarly to the Donut scenario, there are significant national differences, broadly reflecting the same factors as in the previous section. Prague receives high amounts from the rest of the country which results in a high agglomeration effect, while the high agglomeration of knowledge industries in Budapest is behind the relatively strong impact on Hungarian GDP. The negative effect in the Slovak Republic is again proof of what is assumed about the agglomeration mechanisms: supporting Bratislava at the expense of more developed technology regions adversely affects Slovakia's GDP.

3.2 Case study findings on the impact of cohesion policy interventions on growth, competitiveness and employment

Although formal modelling provides a generally positive assessment of the impact of cohesion policy and allows the quantitative consequences of possible variations in the thrust of cohesion policy to be calibrated, it is also important to take account of the views of practitioners. The responses from a wide range of interviewees provide complementary insights into the impact of cohesion policy. This section summarises these responses.

Overall, 63% of respondents assessed as positive the impact of the current cycle of cohesion policy interventions. While the responses do not differ much across regions (60% in convergence and 58% in competitiveness regions), they are significantly different by type of respondent. Stakeholders are more critical of current interventions (only 45% express themselves positively), citing disappointing outcomes in terms of employment for selected groups: young people entering the job market, workers displaced by economic restructuring that has caused firm closure, and women expecting equal opportunities in employment. By contrast institutional respondents at both the national (72%) and regional (71%) levels are more positive when judging the effectiveness of the 2007-2013 programmes. This result is consistent with their role as implementers of cohesion policy.

Generally positive views on impact of interventions on private investments, SME and new competitive firms

The majority of respondents[23] have positive views on the impact of cohesion policy in leveraging long-term private investment. This is also the case for the increase in the number of SMEs supported[24] as well as the creation of new competitive firms in the national or regional economy as a result of cohesion policy support[25].

Modest alignment of cohesion policy and Lisbon Strategy

Only a minority of 39% of all respondents (and an even smaller 35% in convergence regions) think that the expectation that cohesion policy should be closely aligned with the Lisbon Strategy affected cohesion policy interventions in the current cycle. This implies that the push towards Lisbon earmarking had only a limited impact, although it appears to have been stronger in EU-15 than EU12. It should, in this context, be recalled that Lisbon earmarking was only formally obligatory in EU-15, even though all MS adopted the approach.

3.2.1 The impact of the economic crisis on cohesion policy programming

Changes in cohesion policy interventions were effective where they were made

The initial qualitative research for this study coincided with what was seen at the time as the aftermath of the one of the most serious economic crises facing the EU economy, although severe problems have continued as a result of the subsequent sovereign debt crises. Nevertheless, evidence from the research suggests that the impact of the economic crisis on the programming of cohesion policy interventions has varied across Member States and regions. For example, 49% of all respondents indicated that no re-programming had occurred as a result of the crisis in their respective Member State or region. Of the respondents who had identified changes brought about because of the crisis, 64% viewed them as having been effective in ameliorating the effects of the crisis. The interviews shed some light on how extensive and substantive the changes were. In some cases, the changes may have resulted in a diminished emphasis on Lisbon objectives.

Changes have not altered the original direction of the Programmes

The economic crisis seems to have had little impact on the overall strategy of the operational programmes. Indeed, most respondents confirmed that when changes were made to programmes, these were rather minor in terms of content and they were project targeted. Although they may have been more extensive in terms of project management and financing, in the end they did not significantly change the original direction of the programmes.

These findings signal that cohesion policy continues to have goals and priorities which remain distinctive and which, although influenced by the Lisbon strategy, reflect an intervention logic attuned to regional needs. The forms of intervention do, however, vary and the chapter 5 elaborates on these intervention logics.

[23] 66% of respondents; 71% in convergence and 66% in competitiveness regions.

[24] 64% of respondents; 71% in convergence and 63% in competitiveness regions; and 51% of stakeholders.

[25] 57% of respondents; 54% in convergence regions; and 77% in competitiveness regions.

4 Alignment between cohesion policy and Lisbon/Europe 2020

Given the distinctive aims and approaches of cohesion policy and the Lisbon/Europe 2020 Strategy, it is important to examine their structures and governance mechanisms, highlighting areas of common ground, but also potential incompatibilities. Both, plainly, contribute to Europe's over-arching economic strategy for achieving growth, competitiveness and job creation. It can also be argued that the Lisbon/Europe 2020 strategy in its three formulations (Lisbon Agenda as set out in 2000, Lisbon II as re-launched in 2005 and Europe 2020 since 2010) and cohesion policy (from 1989 to the present) have a shared objective of making a success of the single market. But they have developed under different rules and procedures.

The "Lisbonisation" of cohesion policy during the first three years of the 2007-2013 programming period not only constituted a fundamental shift in approach, but is also a positive example of new forms of governance for both cohesion policy and the Lisbon strategy (Mendez, 2011). It is also evident that this will be taken further with the realignments agreed in governance for Europe 2020 and, latterly, for macroeconomic policy (which continues to evolve as the EU overall and the euro area specifically seek a definitive resolution of the sovereign debt crisis). Evidence of this realignment is in the parallel formulation of the National Reform Programmes and Stability and Growth Programmes in 2011. Although the alignment of cohesion policy and the Lisbon strategy has helped to underpin and consolidate the single market programme, new challenges will arise in making a success of Europe 2020, alongside the proposed deepening of the single market encapsulated in the adoption by the Commission of the fifty 'Barnier' proposals that are expected to become a new single market Act[26].

This section starts by considering some general issues around aligning and reconciling different EU policies, then addresses two main issues:

- The "policy linkages" and "institutional arrangements" between the Lisbon process and cohesion policy programmes implemented in the current 2007-2013 period. In so doing, it examines to what extent earmarking of cohesion spending has contributed to delivering Lisbon priorities;

- How cohesion policy can contribute to the integrated delivery of the Europe 2020 strategy, especially the added value of the integrated versus sectoral approaches.

4.1 The challenges and complexities of reconciling policy strategies

Cohesion policy's primary goal since 1988 has been to support the catch-up of less developed regions in the EU in converging with their more developed neighbours, by spurring faster GDP growth and job creation.[27] The areas of policy covered by the Structural

[26] 'Towards a Single Market Act. For a highly competitive social market economy: 50 proposals for improving our work, business and exchanges with one another' Commission Communication Com(2010) 608, Brussels, 27.10.2010.

[27] The 2006 ERDF Regulation states that the Fund "is intended to help to redress the main regional imbalances in the Community. The ERDF therefore contributes to reducing the gap between the levels of development of the various regions and the extent to which the least favoured regions, including rural and urban areas, declining industrial regions, areas with a geographical or natural handicap, such as islands, mountainous areas, sparsely populated areas and border regions, are lagging behind." The 2006 ESF Regulation (1081) states that that "the ESF shall contribute to the priorities of the Community as regards strengthening economic and social cohesion

Funds have been wide ranging and cover investments designed to help less developed regions to restructure their economies in light of the more intensely competitive framework created by the single market programme. But it is also increasingly the case that the cohesion budget is seen as a vital resource for delivering the reforms under the Lisbon and Europe 2020 strategies, and increasing efforts to achieve policy coherence have become apparent since 2005.

For cohesion policy to contribute comprehensively to Europe 2020 objectives and, in turn, to see its own goals at the forefront of these wider objectives, fresh thinking is needed. A considerable amount of attention has been given to the past "Lisbonisation" of the cohesion policy. Indeed in the National Reform Programmes of the countries that are major beneficiaries of cohesion policy, the attempt to connect the two strategies is generally visible. A good example is provided by the Greek National Reform Programme which details the extent to which each Greek Regional Operational Programmes will serve the Europe 2020 flagship initiatives[28]. However, less attention has been paid to any parallel process of "Cohesionisation" of the Lisbon/Europe 2020 strategy, through which cohesion aims would be prominently incorporated in the latter's model of governance and implementation. To some extent a policy mimicking process would help the Lisbon Agenda/Europe 2020 to deliver through the empowerment of local authorities, as cohesion policy already has.

The significant differences between the systems of governance used to achieve cohesion policy objectives vis-à-vis those of the Lisbon/Europe 2020 strategies have created a substantial difficulty in permitting the two initiatives to interact in an effective and efficacious manner over the last two decades. One of the difficulties in comparing and contrasting the Lisbon/Europe 2020 strategies with cohesion policy is that the two have significantly different structures. "Europe 2020", as stated by one of the managing authorities of a national cohesion policy operational programme in Eastern Europe, "is not a strategy for change but rather a vision of what Europe should be in 2020. What is clear is the objective. What is not clear is how to get there."

4.2 Cohesion policy and the Lisbon strategy

Cohesion policy has long been linked to the single market programme and – although this thesis is disputed by some commentators (Pollack, 1997; Allen, 1996) – it was always overly simplistic to think of cohesion as "only" a compensatory "side-payment" or social policy in favour of less developed regional and national economies adversely affected by market integration. Instead it should be seen as an economic policy designed to restructure or develop regional economies to enable them to take full advantage of the opportunities presented by the single market. This is a positive-sum game argument in which the pay-off from having cohesion side-by-side with open markets is a more productive EU as a whole. To this extent, there has not been a major difference between the socioeconomic objectives of the cohesion policy and those of the Lisbon/Europe 2020 strategies.

In analysing the governance systems and resources allocated to current cohesion policy and the post-2005 Lisbon strategy, several sources have been used. A first is data from the earmarking exercise carried out by the Commission in 2010 (CEC, 2010b), an exercise which reveals the somewhat "patchy" nature of the implementation. Second, the research draws on the key official documents: national and regional implementation reports on

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by improving employment and job opportunities, encouraging a high level of employment and more and better jobs" (Article 2). Finally, the Cohesion Fund has been given the objective in 2006 (1084/2006) of "strengthening the economic and social cohesion of the community in the interests of promoting sustainable development" (Article 1) through the pursuit of to fundamental lines of policy: financing trans-European transport networks and contributing in the pursuit of the Community's environmental objectives.

[28] Greece National Reform Programme 2011, pp. 56-58.

cohesion policy, as well as Lisbon National Reform Programmes (NRPs). Insights into how the mismatch between objectives and outputs associated with these NRPs and cohesion policy can be overcome have also been gleaned from numerous interviews conducted with European, national and regional officials involved in the management of the two strategies. Interviews at the national and regional levels derive from a sample of 20 regions and thirteen Member States, in addition to a number of stake-holders present at the national and regional levels. Where possible, the national and regional "Mr/Ms Lisbon" was interviewed.

4.2.1 The objectives of Lisbon

A key rationale for the 2000 Lisbon Agenda was the diagnosis that the EU was falling behind the United States which had enjoyed a period of rapid growth in the latter half of the 1990s and appeared to be building a strong lead in the knowledge economy sectors. Over this period, labour productivity fell in Europe relative to the US, and Europe was falling behind in the use of its labour force in terms of overall employment rates and the utilisation of female labour (Gordon, 2004). Johansson et al. (2007) report that by 2004, Europeans worked on average 15% fewer hours and had labour participation ratios that were 9% lower than their counterparts in the U.S. From the outset, cohesion policy was not assigned any explicit role in achieving the Lisbon Agenda objectives. In fact, the two programmes remained largely separate from each other until the Lisbon Agenda was evaluated by the Kok Report (2004) and subsequently modified in 2005 by the Lisbon II strategy.

The 2000 Lisbon Agenda did refer to social cohesion in terms of the creation of a more "competitive and dynamic knowledge-based economy...capable of sustainable economic growth with more and better jobs and greater social cohesion" (CEC, 2000, p. 2). But rather than referring to the role of cohesion policy in achieving this objective, the emphasis was placed on the modernisation of the European social model so that the pursuit of the new knowledge-based economy would "not compound the existing social problems of unemployment, social exclusion and poverty" (p. 8). To address these challenges, coordination processes adopting the open method of coordination (OMC) approach proliferated, covering not just employment but also various social initiatives. The governance model comprised Community Guidelines and National Action Plans for achieving the goals, together with scrutiny by the Commission and specialist committees made-up of Member State representatives (the Employment Committee and the Social Protection Committee).

It was expected that a strategy as ambitious as the Lisbon agenda would have at its base a larger budget and strong mechanism for implementation.[29] That was not the case, and five years later scholars and policy makers were critical of its progress (Zgajewski & Hajjar, 2004; Dehousse, 2004; Begg, 2005, 2008; Boyer, 2009; Rodrigues, 2009).

The European Council concluded in 2005 that the Lisbon Agenda objectives had not been achieved, nor would they unless major changes in the content and governance of the strategy were adopted. The Kok Report (2004) prepared the groundwork for the results reached by the 2005 European Council by concluding that action needed to be taken across a number of policy areas and governance mechanism. The revised Lisbon strategy had to:

- Make Europe a much more attractive place for researchers and scientists to move to or to remain. Such a policy would have to make R&D a top priority for governments and private industry. In addition, public policy had to promote the

[29] Lisbon European Council (2000), Presidency Conclusions of the Lisbon European Council, 23rd and 24th March 2000, (Rhodes, 2000).

use of ICTs as an instrument for daily activity in the economy and social interaction;[30]

- Specify that the single market had to be reinforced for services;
- Make changes in the labour market to promote lifelong learning and active ageing programmes;
- Provide for environmentally sustainable growth through the creation of incentives for the production and use of renewable energy;
- Substantially change the nature of the governance approach to assure better delivery.

4.2.2 The emergence of a more explicit governance approach to the Lisbon strategy

The 2005 reformulation of the Lisbon strategy put in place a new mix of Community Method and the Open Method of Coordination. With Lisbon II the Commission re-emphasized the challenge posed to the European economy of increased globalisation and technological change: “The goal of the Lisbon partnership for growth and employment is to modernize our economy in order to secure our unique social model in the face of increasingly global markets, technological change, environmental pressures, and an ageing population.” (CEC, 2005: 2).

The Lisbon Agenda’s principal governance innovation – the OMC – had a number of novel features designed to diffuse best practices among the Member States and promote greater convergence in the implementation of EU goals. The OMC was defined (p. 12) as:

- Fixing guidelines combined with specific timetables for achieving the goals in the short, medium and long terms;
- Establishing quantitative and qualitative indictors and benchmarks tailored to the needs of different Member States and sectors;
- Translating these European guidelines into national and regional policies by setting specific targets and adopting measures, taking into account national and regional differences; and
- Periodic monitoring, evaluation and peer review organised as mutual learning processes.

But the Commission also emphasized the need to undertake a combined strategy at the national and Community level to maximise the use of European and national financial resources to meet the challenge. It was in this context that the Commission first suggested the explicit use of cohesion policy, as operationalised through the Structural Funds and the Cohesion Fund, as a mechanism for achieving the Lisbon objectives, especially in those regions and countries where cohesion policy financed much of the public investment.

> “The Commission has proposed that programmes supported by the Structural Funds and Cohesion Fund target investments in knowledge, innovation and research capabilities as well as improved education and vocational training, thus equipping

[30] These objectives are close to the recommendation by Florida (2002) that in the last analysis what drives regional and national growth is technology, talent and tolerance—i.e., an area needs to be able to compete internationally for the top individuals capable of undertaking innovation and striking out into new fields of production.

> workers with the skills to master change and take up new activities. They will contribute to improving the attractiveness of Member States, regions and cities through support for economic infrastructure (CEC, 2005, p. 5)".

Given its timing, the Lisbon II strategy was – in contrast to what happened in 2000 when the Lisbon Agenda arrived too late to influence the formulation of Agenda 2000 – able to make a significant impact on the formulation of the new Community Strategic Guidelines for Cohesion and the Regulations for the 2007-2013 programming period. Though now explicit, the link between the Lisbon objectives and cohesion policy remained voluntary insofar as the Member States and regions were provided with the opportunity to link their National Strategic Reference Programmes and Operational Programmes to the Lisbon strategy, but not formally obliged to do so. Despite its explicit 'Lisbonisation' since 2005, cohesion policy remains imperfectly aligned with the objectives of the Lisbon strategy. Nor were any sanctions foreseen if the link proved to be unsatisfactory. Another factor was the economic and financial crisis of 2008-2009 which prompted reviews of a number of national reference frameworks for the 2007-2013 planning period to the extent that it pushed Member States and regions to undertake emergency responses to the crisis rather than continuing with existing plans.

4.2.3 Has earmarking helped to deliver the Lisbon objectives?

In Regulation 1083/2006 the Member States and regions were asked to allocate a certain percentage of cohesion policy funding to investments deemed to be in line with the Lisbon strategy. In Annex IV of Regulation 1083/2006 the 86 funding categories were listed. According to the Commission information paper on "earmarking" (CEC, 2007), Member States were asked to earmark their interventions such that the operational programmes would ensure sufficient investments "in innovation, the knowledge economy, the new information and communication technologies, employment, human capital, entrepreneurship, support for SMEs or access to risk capital financing" (p. 1). The stated goal was to achieve a Lisbon earmarking of up to 60% in Convergence and at least 75% for regional Competitiveness and employment programmes. Member States that did not join before the 1st of May 2004 were not obliged to adopt the above percentages for their Convergence and Competitiveness operational programmes but could apply them on their own initiative. However, the earmarking of expenditure in line with the Lisbon objectives was not presented in all annual implementation reports: some operational programmes did report the nature of their expenditures according to programme priorities and Lisbon earmarking while others did not. However, the Commission was given the data from the very beginning.[31]

In Competitiveness programmes, the data show that the target was exceeded, with 78.8% of funds earmarked for Lisbon-compatible projects, although there were quite substantial variations among the Member States. For the Convergence operational programmes Lisbon-related spending accounted for 64.5% of the total, again exceeding the target, though also with substantial variation across Member States. The variations between those with the least and most earmarking is partly explained by a predominance of soft types of Lisbon interventions in certain Member States, notably richer ones which have a competitive advantage in knowledge industries. However, the gap between the lowest and highest shares of Lisbon-related cohesion spending also reflects the fact that the list of non-Lisbon projects contains many that are valuable to Member States with a range of social and economic objectives. The largest non-Lisbon allocations are for national rail and road projects, the provision of adequate energy sources and environmental, culture and social services projects.

[31] These data are reported in the tables on the 2007 programme allocations and 2009 programme expenditures in the next section of this report.

It is also important to note that the data analysed were a snapshot at a particular point in time and that as more projects are implemented, the proportion of Lisbon spending could well increase or fall markedly. Tables 4.1 and 4.2 (see annex) nevertheless present data on the allocation of funds for the operational programmes negotiated under, respectively, the Competitiveness regions and the Convergence regions. The detailed findings for individual Member States should be interpreted with caution.

4.2.4 How the Lisbon strategy has been integrated into the operational programmes

The findings from interviews with the management authorities and stake-holders in the region suggest that up to 2009 there were few conscious efforts to favour Lisbon-related expenditures. Instead, the main general concern was to implement the entire programme given that the N+2 rules applied to the overall OP rather than to single parts. In the past the N+2 rule (which in effect became an N+3 after the prolongation of the time necessary to report 2007 and 2008 expenditures) tended to blur the distinction between hard and soft interventions and in this case between Lisbon and non-Lisbon priorities. The lack of emphases along these distinctions of expenditures on the OPs is also reflected in the discussion of programme implementation in the Annual Implementation Reports (AIRs). The inference to draw from those findings is that earmarking has had a rather limited influence on shaping OPs and suggests that, instead, the distinction is more of an ex-post accounting exercise than a deliberate choice.

Several respondents commented that the Lisbonisation of the policy that took place in 2007 was not adequately explained to those managing the programmes at the regional level. Instead, for regional officials, the Lisbonisation of the cohesion policy was seen as a top-down exercise with little operational relevance for programme implementation. At the national level, by contrast, there are officials fully informed on the influence of the Lisbon strategy in moulding national cohesion-related policies for the 2007-2013 planning period and the role to be played by Europe 2020, in addition to the designated Mr./Mrs. Lisbon. This was particularly apparent during the drafting of the National Reform Programmes (autumn 2010) that were submitted in April 2011.

Another contributing factor raising the awareness of national officials to the Lisbon objectives and the cohesion policy was the need in 2010 to re-programme the NSRFs and operational programmes as requested by the Commission in order to respond to the exigencies of the financial and economic crisis and to make the two sets of documents more Europe 2020 friendly. In most cases this re-programming was activated at the national level but less evident at the regional level. It was reported to have appeared to be a top-down exercise and the regional officials often had to deduce the Lisbon objectives from the Strategic Guidelines and the Regulations what underpinned the formulation of the National Strategic Reference Frameworks. The implication is that operational programmes were formulated without a full understanding of the implications of the strategy and how this was supposed to constrain local decisions.

4.3 Cohesion policy and Europe 2020

To achieve smart, sustainable and inclusive growth, the Commission sought to push Member States to re-launch the original Lisbon reform package with more focused and attainable objectives and five clearly specified headline targets. In addition, the Commission committed itself to the launch of seven flagship initiatives “to catalyse progress under each priority theme”. The Europe 2020 objectives have also been important in defining the structural economic reforms national governments need to pursue in response to the crises. It was noted by one survey respondent at the regional level that the crisis “made possible structural reforms within Member States that would have been unthinkable in the pre-2008 environment. Therefore, some good came out of the crisis".

Based on the views expressed during the interviews and the contents of the re-programming of the regional operational programmes, the greatest barriers to a common understanding of the link between the objectives of cohesion policy and Europe 2020 are at the regional level. Often, there is only a superficial understanding of what is at stake with Europe 2020. In a certain number of cases the "re-programming" that has been undertaken amounts to a repackaging of the original programming through a greater concentration of resources into fewer projects. What is most baffling to the regional level is how the initiatives taken to operationalise Europe 2020 (e.g., the seven flagship initiatives) can be translated into action at the regional level. Some have asked the question: "does this mean the end of the integrated territorial approach and its replacement by a national, sectoral one in the development of cohesion policy programmes?". Or will there be a new conceptualisation of the multi-level territorial dimension in order to link in a more productive fashion the European, national and regional levels? These are all legitimate questions which need to be answered in the preparation of the next round of cohesion policy.

Nor did the interviewees feel that the launch of Europe 2020 in 2010 was properly prepared. Many felt that there was a lack of the "thick" network of interactions among the three levels of policy management considered to be essential in explaining policy innovations to members of the network. A number of respondents at the regional level in France and Sweden (both among administrators and stake-holders) stated that the debate on Europe 2020 "does not exist", or is conducted largely in Brussels. The regional representative of a business interest group observed that:

> "the regions have never been informed or involved in this kind of debate. Maybe, it will be different during the next programming cycle in 2014-2020. Now, there is no well-informed socio-economic stakeholder in the region who is knowledgeable of these issues."

4.3.1 Europe 2020: needs and system of governance

Much of the Lisbon strategy approach is consistent with the underlying aims of Europe 2020, yet it is far from clear that further rounds of earmarking or the reconciliation of cohesion policy with Europe 2020 will be easily achieved. In addition, to the extent that Europe 2020 introduces new and, in some cases, more demanding targets, as well as expectations of how policies at the national level are structured, new expectations of what role cohesion policy will play are likely to surface. While some experience has been gained in reconciling the Lisbon strategy and cohesion policy, achieving full policy coherence will not be easy. An explanation put forward by a number of interviewees is that, so long as the European economies were making progress on their own in terms of the growth, competitiveness and employment objectives, it was difficult for the Commission to persuade Member States to follow its step-by-step approach in achieving the Lisbon objectives.

It is important to stress that Europe 2020 contains an explicit acknowledgement that economic, social and territorial cohesion remains at the centre of the new strategy:

> "Economic, social and territorial cohesion will remain at the heart of the Europe 2020 strategy to ensure that all energies and capacities are mobilised and focused on the pursuit of the strategy's priorities. Cohesion policy and its structural funds, while important in their own right, are key delivery mechanisms to achieve the priorities of smart, sustainable and inclusive growth in Member States and regions." (p. 20).

The contrast is striking between this statement in Europe 2020 and the broad, but vague allusion to social cohesion in the 2000 Lisbon Agenda, and shows the extent to which there has been integration of cohesion policy into the wider policy framework. As is evident in the National Reform Programmes of several Member States in Southern, Central and Eastern Europe, cohesion policy is expected to play a central role in achieving the Europe 2020 objectives. This role is most clearly spelled out in the NRPs where the ERDF supplies funds for the construction of basic infrastructure and where the ESF plays a crucial role in supporting the realignment of vocational training programmes and social inclusion policies.

However, in the initial Europe 2020 programme declaration it was clear that its ambitions were broader than those reflected in the objectives or Member States and regions covered by cohesion policy. On the one hand, Europe 2020 covers all Member States in terms of the economic and social objectives of the programme and, on the other, it is more explicitly tied to the contents of the Stability and Growth Programmes (SGP), the European Recovery Plan and the Euro Plus Pact than is (or ever was) the case for cohesion policy. For most practical purposes, Europe 2020 defines the overall economic programme. One Commission official observed that Europe 2020 "touches or has implications for all policy areas currently managed at the European level: from the Framework Programmes to Rural Development, to the TEN networks, to Social Policy and to Environmental Policy". In addition to European level programmes, Europe 2020 also has an impact on the objectives and means selected by Member States in undertaking structural reforms.

The conditions necessary for the success of the Europe 2020 programme are reflected in the changes made to the governing mechanism. Its system of governance has been tightened up for Member States in terms of reporting and achieving the Europe 2020 targets. One of the most significant changes has been the link between the reporting on Europe 2020 and the reporting on compliance with the Stability and Growth Programme. Thus, Europe 2020, in terms of its contents and governance system, finds itself midway between the cohesion policy, on one hand, and the Stability and Growth Programme, on the other. Within this redefined European policy context, the annual reporting on the cohesion policy, National Reform Programme, European Recovery Plan and SGP requires Member States to achieve a level of synergy that was not the case in the past and which now represents a new level of policy integration at the Member State and European levels. The constraints on government expenditures – as specified in the Stability and Growth Programmes, especially for those Member States in receipt of rescue packages – are substantial, and are likely to become more binding for other Member States as a result of the Fiscal Pact agreed in December 2011. These developments suggest that EU-Member State interactions will become closer than was the case under the two phases of the Lisbon strategy.

4.3.2 Cohesion in the headline targets and flagship initiatives

In practice, the correspondence between cohesion policy and Europe 2020 is most likely to be seen in how the five headline targets and the flagship initiatives connect to thematic priorities. The headline targets articulate goals that, at Member State level, are challenging for some, but are already attained or tolerably within reach for others. At regional level, however, how to accommodate the targets is considerably more problematic. Convergence regions, in particular, tend to lag a long way behind on the R&D and employment rate indicators, as well as on the two social targets (education drop-out rates and risk of poverty). Poorer regions tend to have lower carbon emissions, but may also lag behind in renewables.

An issue for cohesion policy, while taking account all of the headline targets in relation to the priorities to be emphasised after 2014, is whether there is a need to have customised targets that both reflect the region's responsibility towards meeting the respective national target and how to reinforce the capacities of regions to make progress towards these targets. This will be especially sensitive where expenditure to make it easier to meet a particular target risks 'crowding-out' another. A further consideration is whether any sort of conditionality is imposed on such progress and, if so, whether it obliges regional authorities to orientate OPs in a way that is disruptive to an intervention logic.

The Europe 2020 Flagship Initiatives map out a wide range of policies to be undertaken at both EU and Member State levels, but are less explicit about how the regional level should contribute. Moreover, a thread running through most of these FIs is that cohesion policy should be a resource, rather than cohesion outcomes a goal. This can be expected to be a source of some tension in the design of cohesion programmes.

Thus, *Resource Efficient Europe* calls for reform of major EU spending policies, including cohesion policy, to align them with 'the requirements of a resource efficient, low-carbon economy', but stops there. The *New Skills* Flagship Initiative mentions that cohesion policy 'contributes already to the development of new skills and to job creation, including in the expanding area of the green economy', signalling that this should remain a priority. But it does not go much further. In the *Digital Agenda* Flagship Initiative, the need for a commitment at regional level is mentioned, but otherwise references to cohesion issues are sparse. The *Youth on the Move* Flagship Initiative identifies the ESF as the main instrument for funding support for youth related objectives, but also has a general commitment to deploy other cohesion instruments for this purpose.

The *Industrial Policy* Flagship Initiative notes the important role of cohesion policy in upgrading infrastructure, but does not include visible commitments to the spreading of industrial development benefits. It identifies the quality and efficiency of communication, energy and transport infrastructure as a key factor in European competitiveness and mentions the significant role that cohesion spending should play (both the ERDF and the Cohesion Fund) in this regard. It also refers to their potential role in supporting innovation and in so doing, strengthening the resilience of local economies. An interesting reference is to assisting regions in moving up the value chain as a task for cohesion policy and one of the bullet points of Commission actions is a commitment to support Member States through cohesion policy in boosting industry. Again, however, the bulk of the flow is from cohesion spending to the FI, and not the reverse.

The *Innovation Union* devotes more attention than the other Flagship Initiatives to the linkages between cohesion policy and its goal of fostering a more research and innovation intensive EU. It mentions research infrastructure as a key area in which increased efforts are needed to attain the targets set in the 'roadmap' by the European Strategic Forum for Research Infrastructures (ESFRI). Member States are explicitly invited to review how such infrastructure is incorporated in operational programmes. There is, however, a tension which was highlighted in the Interim Evaluation of the 7th Framework Programme (Commission 2011). That report noted the relative under-performance in research of many of the Member States which obtain relatively generous levels of Structural Funds, notably in central, eastern and southern Europe, and raised the question of whether the Structural Funds could play a greater role in trying to redress this under-performance. EU research programmes have excellence as a core principle, so that it should not be a surprise that regions and Member States with strong research bases secure higher shares of EU funded research projects. The research and innovation elements of cohesion policy are more about capacity building, a different focus, but it can be argued that the overall policy mix is diminished by a lack of synergy between the policy domains.

The ESFRI roadmap is substantially about infrastructures for the EU as a whole, and although there is support for regional research infrastructures to foster long-term enhancement of research capability[32], there is a tension about how it should be funded. If cohesion policy supplies the funding, it crowds out other forms of public investments

[32] See, notably, the Fotakis report for the Expert Group that carried out the interim evaluation of FP7.

(infrastructure or SME investment, for example), while if the future research and innovation programme is expected to do so, it would be at the expense of other research priorities.

The Innovation Union Flagship Initiative does plead for a better integration and coordination of the research and innovation funding from different EU programmes, though it offers no strong clues about how impact, user-friendliness and added value (all cited as necessary attributes) are to be achieved. The Innovation Union communication devotes an entire section to ‘maximising social and territorial cohesion’ and, by so doing, has explicit ‘feeding-out’ that is absent in other flagship initiatives. Its key phrases include the promotion of smart specialisation and support for relative strengths which can become excellence. It also calls for cooperation between regions and use of public procurement financed by cohesion policy to support demand for innovative products and services. More generally, the need for a focus on regional innovation systems is highlighted.

The *European Platform against Poverty and Social Exclusion* Flagship Initiative lives up to its sub-title of ‘A European framework for social and territorial cohesion’ in a number of ways yet can appear to be somewhat oddly detached from regional policy. It refers to the importance of ensuring ‘coherence and complementarity between the European Regional Development Fund, the European Social Fund, the European Agricultural Fund for Rural Development and the European Fisheries Fund’ and embodying this coherence in the future Common Strategic Framework. The communication draws attention to the high levels of poverty in urban areas, but also stresses that poverty rates are often higher in rural areas and isloated communities. The difficulty is that this provides little guidance for how to relate the aims of the Flagship Iinitiative to regional policy developments, although one suggestion is to promote ‘greater complementarity and synergies between EU funds to promote community-based approaches, including for urban regeneration’. The Poverty/Exclusion Flagship Initiative also calls for more experimentation with small scale projects that can be used to identify worthwhile innovative approaches. This has echoes of the Community Initiatives philosophy of the 2000-06 programming period.

What emerges from this brief examination is that the balance is towards what cohesion policy can do to advance the aims of the Flagship Initiatives, rather than how the Flagship Initiatives can further cohesion goals. In other words, the implication is that cohesion policy should serve as an instrument of Europe 2020. Although this is consistent with statements in the Europe 2020 documents which make clear that cohesion policy has this role, it could be seen as at odds with the treaty goal of reducing regional disparities assigned to cohesion policy.

4.3.3 The Governance of Europe 2020 at the micro level: the sectoral versus the integrated approach and other problems

Any choice between the sectoral versus the integrated approach to the implementation of the Lisbon/Europe 2020 objectives brings to the fore the position of regional authorities within the governance mechanisms. The regional level has no direct role in the dialectic between the national and EU levels, nor any obvious input into the OMC, and the evidence is striking that the regions struggle to understand how Lisbon/Europe 2020 is supposed to interact with cohesion policy. This is especially the case where regional and local authorities are responsible for the policy sectors that need to be mobilised in delivering key objectives such as the financing of SMEs, the provision of vocational education, the stimulation of innovation, providing programmes for social inclusion and favouring alternative energy policies.

A second major difficulty in reconciling cohesion policy and Europe 2020 objectives at the micro level is the gaping difference in the availability of resources. Cohesion policy is financed by substantial EU funding, whereas up to now there has been no explicit budget for the Lisbon Strategy. Instead, Lisbon aims were supported, albeit indirectly, by national budgets for policies such as research and innovation and, increasingly over recent years, by mobilising the cohesion policy budget. The upshot is that in the Member States with substantial convergence programmes, a sizeable proportion of the public investment aimed at Lisbon objectives has been financed by the EU budget.[33] By contrast, in wealthier Member States, the financing comes predominantly from national funds.[34]

Tensions between regional and national/Europe 2020 goals can arise for capital regions in certain Member States, such as Prague, Bratislava, Budapest, Lisbon and Athens. These regions tend to be national hubs for research and development activities, but as competitiveness rather than convergence regions, they cannot benefit from substantial financing for R&D investments from cohesion policy. Such funding has to come, instead, from the EU's R&D Framework programmes or from national funds, highlighting a possible conflict between the rules of one policy and the objectives of another.

The distinction between integrated and sectoral approaches to economic development is also germane. Regional level officials consider the integrated approach encouraged by cohesion policy as (to quote one interviewee) one of "the greatest policy innovations of the previous century", not least for enabling regional and local administrators to avoid suffocating control from the national bureaucracy. In fact, in the minds of many regional officials, the concept of "integrated programming" signifies decentralised decision making and responsibilities for economic and social policies that are organised on a horizontal basis. Having integrated multi-sectoral and multi-annual operational programmes encouraged more effective partnerships to emerge, comprising not just significant stakeholders, but also diverse groups in civil society.

4.3.4 What needs to be done to bring cohesion policy into closer alignment with Europe 2020?

The different timetables of the cohesion and Lisbon/Europe 2020 strategies complicate interaction between them. The main features of cohesion policy were established in 2006-2007, well before the Europe 2020 strategy came into existence. Clearly, future cohesion policy has to be supportive of smart, sustainable and inclusive growth and the implications that these objectives have for detailed types of intervention in the fields of industrial policy, research and development, vocational training, renewable energy, and the environment. The integrated socio-economic programming approach does not mean that there necessarily has to be a co-sharing of responsibility for all aspects of the Europe 2020 strategy. There must, however, be a co-responsibility between different levels of government within a state in defining the policies for vocational training, infrastructure development, choice of types of R&D investments, the stimulation of renewable energy and environmental provisions and social inclusion and social welfare. Given the lessons learned from previous implementations of operational programmes across the EU, the investment priorities of each Member State need to be checked for the congruence of the thematic priorities with the EU's overall investment choices. It will also be important to take account of problems of implementation that have surfaced in the past, for example in overcoming the structural bottlenecks identified in previous analyses of social and economic sectors. In parallel, cohesion policy has to be sensitive to empirical outputs and eventual outcomes and relevant indicators need to be agreed before the cohesion policy goes into effect.[35]

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[33] This is abundantly clear in the conclusions drawn in the Hungarian and Lithuanian National Reform Programmes.

[34] See the German and the UK National Reform Programmes where little mention is made of EU funds aside from those provided by the ESF.

[35] See Barca and McCann (2011).

The control and oversight mechanisms put into place as part of the new system of economic and financial governance in Europe after 2009-2010 can provide further support and input into the definition of structural problems that need to be overcome for a smoother implementation of the next round of cohesion policy. In addition, a closer link between cohesion policy and the European semester of economic policy coordination may ensure stronger coherence between macroeconomic policies at national level and investments supported by the Structural Funds.

Conditionality may enter the equation for both cohesion policy and Europe 2020, and there are open questions about the degree to which it should apply to Europe 2020. How could it be operationalised in relation to the objectives and commitments contained in the National Reform Programme? What will constitute the triggering mechanism and what kinds of sanctions will be brought to bear in order to encourage compliance?

4.3.5 Europe 2020 and cohesion policy: awareness, proposals and prospects

Through open ended questions, respondents in the larger sample were asked to look forward and assess changes to cohesion policy that are in the making as well as being raised for debate. Respondents were probed on:

- The status of the debate in their country and region on the essence of Europe 2020 as the growth strategy for the coming decade
- The future of cohesion policy and the relationship that should be there between the two
- Proposals currently being considered for both cohesion policy and Europe 2020, and on the prospects they should have.

The findings are that in most regions and MS the essence of Europe 2020 is something obscure for the general public, although better understood by many of the respondents, and that the debate has been confined to policy circles. It is appreciated by the respondents that the priorities of Europe 2020, smart-sustainable-inclusive growth, are only three and its objectives five: employment, innovation, education, social inclusion, and climate/energy. They are clearer, respondents argue, when compared with the large number associated with the Lisbon Strategy. They are also ‘modern’, as one respondent stated.

A key issue is how priorities are established and whether Europe 2020 is expected to be the dominant governance mechanism, with cohesion policy obliged to follow rather than have its own distinctive logic(s) and focus. In particular, if Europe 2020 emerges as a central pillar of cohesion policy, a concern is to what degree it can also sustain its other pillar, namely overcoming of development differences between regions. On this, unsurprisingly, the interviews conducted for the case studies revealed diverging and, at times, irreconcilable positions. A selection of the points made is presented telegraphically below.

- Some German respondents queried whether cohesion policy should pay more attention to issues as diverse as health or urban regeneration, connecting this to the inclusive growth strand of Europe 2020
- Polish interlocutors felt that cohesion policy should be the main instrument of Europe 2020, have the strong feature of being a policy of regional capacity building, and be modified by elements of conditionality.
- The fieldwork in Bulgaria revealed that the Europe 2020 strategy and its priorities are the subject of a national debate that has a focus on economic growth, employment and funding. But the debate also stresses how cohesion policy

should continue to direct its attention to the regions facing structural difficulties and concentrate resources on the regions lagging behind.

- Some argued that future programmes, for example climate/environment, should not be sectoral in nature but rather horizontal.
- There is some support for a shift from hard to softer cohesion policy instruments, justified by the fact that these are seen as more in tune with the thrust of Europe 2020.
- A balance will have to be struck soon between weighting public investment towards the highest return on investment (invest where the return will be highest) and a more equitable return on investment (invest not just smartly but also inclusively). This is seen to be a deeply political issue.
- The debates are, typically, confined to elites or specialists and need to be communicated more effectively and transparently to citizens.

5 Intervention logics to achieve growth, competitiveness and employment

To obtain insights into the approaches to economic development adopted by Member States and regions, the study sought to document and classify the different ways in which cohesion policy is implemented. Although cohesion policy programmes are very diverse, there is, nevertheless, considerable common ground across regions in a limited number of broad approaches. The logic behind these interventions typically reflects thinking the most suitable mix of policy measures and methods. In practice, a relatively small number of distinctive 'intervention logics' can be identified.

5.1 The meaning of an intervention logic

In the context of cohesion policy, an intervention logic encompasses the vision for the future development of the territory, the identification of the challenges and obstacles, and the strategic direction of the chosen policy mix. It can also be viewed as a means of articulating a trajectory for economic development that should remain consistent over an extended period, rather than being subject to short-term reconfigurations. This conceptualisation of an intervention logic is consistent with the 'integrated development' approach that has been advocated in the regional development programming literature and central to cohesion policy since 1988.

More specifically, an intervention logic is characterised by a number of traits. These include being:

- *Territorially specific*. The logic has to be a good fit for the territory, reflecting both its needs and its potential, while also being attuned to the starting-point and scope for transformation, acquired through means such as a SWOT analysis.
- *Future orientated*. The logic has to make sense over the medium term and should be robust to short-term pressures. The understanding is that the change pursued to fulfil it is often structural in nature and cannot be achieved in the short term.
- *Problem solving*. The vision has a very pragmatic nature, seeking to secure change by having a clear roadmap for improving conditions in the territory in a way that is conducive to better performance, however measured. Tangible outcomes are sought.
- *Strategically informed*. The logic should not pursue change for the sake of change. Rather, it targets key needs and problems whose solution is the precondition for sustainability. Thus, it makes choices and selects objectives.
- *Operationally translated*. The logic has to be translated into technical programmes that can be undertaken effectively and efficiently.
- *Ultimately, a political project*. The choice of intervention logic and the policies it dictates have to derive from a political decision, not a technical one, although the technical side should lend essential support to it. In particular, a strong political commitment to carry it out until the outcomes are achieved is vital.

The choice of intervention logic for the 2007-2013 cohesion policy programmes has been shaped by a wide range of factors. In particular, it reflects the outcome of the negotiations within the region or Member State, as well as with the Commission, in the run-up to the start of the programming period in 2007, before the onset of the global economic crisis. It should be noted that the essence of a programming approach is that, once agreed, it should be a strategic and stable approach, not one subject to disruptive short-term change.

The sequence of crises since 2008 brought to an end the extended period of relatively robust growth across the EU since earlier in the decade. This is in stark contrast with the beginning of the programming period, where alignment of the policy with the Lisbon Strategy for Growth and Jobs took place in a much more favourable economic climate. Arguably, the programming for the 2007-2013 cycle reflected a sense of confidence and optimism in the continuation of the positive growth trend, together with a sense of accomplishment that cohesion policy had been an important factor in stimulating growth and convergence.

5.2 Typology of intervention logics

A proposed taxonomy of seven intervention logics has been derived from a combination of content analysis of programming documents, insights gleaned from interviews with practitioners, and interpretation of the implementation of programmes. The first two logics have much in common and can be considered as variations on ‘catch-up’ economic development, with the first broadly-based and the second more narrowly focused on transport connectivity. Similarly, the fifth, sixth and seventh logics can be viewed as a ‘family’ in which there are common traits associated with the fostering or exploitation of new or existing regional strengths, but which have been distinguished because they imply different routes towards development.

In each case, the research has identified the main thrust of the intervention logic, examples of how and where it has been adopted, and key attributes (refer to table 5.1 in Annex). In some cases, resort to the logic is determined by national priorities, while in others there is a much stronger regional/territorial dimension. In what follows, these elements are elaborated and, for each of the logics distinguished, there is a description, typical examples are presented and some comments on policy challenges that have to be confronted under the logic are briefly summarised.

5.2.1 Broad-based economic development

This logic is selected when there are significant territorial development gaps within the country or within one or more of its regions, or when the Member State as a whole has a significant development gap vis-à-vis other Member States. It has mainly been adopted by Convergence regions in which the reasoning is that development gaps cannot be overcome by a piecemeal sectoral strategy. Rather, the comparative economic underdevelopment of the Member State or region calls for a wide range of interconnected interventions to be pursued simultaneously. For Convergence regions, the strategic aim of the logic is to secure improvement in socioeconomic conditions. The underlying concept is constructing a new model of growth and employment, with a strong emphasis on integration into the single market. It entails examining and readdressing all aspects of market access, although the precise balance will inevitably vary from one setting to another, depending on the mix of initial attributes in the region. This intervention logic potentially incorporates the whole range of Europe 2020 goals and priorities. Cohesion policy investment acts as the linchpin of public investment, and consequently has a pivotal role in shaping the overall economic development strategy. In this approach, a typical economic development strategy encompasses – though in varying proportions – support for the following:

- Improving connectivity and accessibility for transport, ICT and energy networks
- Enhancement of environmental infrastructure and bolstering renewable energy

- Raising the intensity of R&D and promoting innovation
- Paying attention to inclusion
- Institutional capacity-building.

5.2.1.1 Typical cases

In Romania, the assessment is that there is a twofold challenge. Given the low but diverse levels of economic development of its regions and the ongoing institutional process of regional decentralization, the challenge in Romania is represented by the building of the learning capacity of regional authorities to perform the task of devising and carrying out a mix of programmatic interventions. Therefore, the strategy underpinning the current interventions has three main strands: the development of major connective transport infrastructure as well as of basic utilities infrastructure of European standards, together with investment in human capital to improve the skills of the labour force, and support for improving the institutional capacity of regional authorities. In the convergence region of Andalucia, the intervention logic is similar and has a dual aim of encouraging intra-regional convergence that reduces the gaps between prosperous urban and less prosperous rural areas, at the same time as catching-up with the rest of Spain.

5.2.1.2 Policy challenges

The sectoral approach implicit in the flagship initiatives of Europe 2020 needs to be successfully integrated into a single, coherent operational programme. This could be a source of tension. In particular, the *Industrial Policy for Globalization Era* and the *Digital Agenda for Europe* are Flagship Initiatives (FIs) that may need to be better accommodated by this intervention logic. More substantial investment in human capital is likely to be needed to ensure that the region is able to fulfil Europe 2020 commitments. Here the emphasis on territorial cohesion as a distinctive element of this logic needs to be bold and sharpened in order to create long term condition for sustainable growth. In addition, this logic may need to be extended to devote more attention to investment in, and retention of, human capital mobility – especially in peripheral areas of convergence regions subject to “brain drain”.

5.2.2 Transport connectivity

This intervention logic concentrates resources on modernising and expanding the transport system in the Member State or region and is mainly, but not exclusively, associated with convergence regions. It is selected when remoteness or poor transport connections are deemed to be the principal obstacle to boosting growth, competitiveness and employment. Unless such transport barriers are overcome, the region or Member State will be at a persistent disadvantage, hence transport investment is perceived as the precondition for other sectoral investments to be efficient in their return and, as a consequence, for broad-based development to occur. Whether as a precursor to a broader-based development strategy or as a focused attempt to deal with significant transport bottlenecks, it does not exclude investments in human capital or institutional capacity. It is presented as distinctive from and narrower than the first logic because it is dominated by the emphasis on a better transport system, reducing isolation and countering remoteness.

Transport investments focus on: Ten-T; multimodal transport; ports and airports; and may extend to telecommunications and energy infrastructure that can be built alongside the corresponding transport connections. Transport related energy investments focus on: strengthening energy efficiency in sustainable and eco-friendly infrastructure. These clearly address the need to promote sustainable development transport and to remove bottlenecks in key network infrastructures, identified as priorities in the EU 2020 strategy.

5.2.2.1 Typical cases

In Bulgaria, in this cycle of programming the logic is one of ‘transport based connectivity’ in support of the accelerated growth of private business. The assessment of the very inadequate endowment of transport infrastructure and of environmental protection projects is similar to Romania’s, because in Bulgaria it is singled out as the sectoral driver to be focused upon. Additionally, the limited functional scope of the regional planning authorities in Bulgaria has maintained the focus of the interventions on strategic, large scale trans-European transport networks that are managed centrally. On the other hand, because the great benefit of these projects is expected to be for business and its prospects for modernization and growth, a commitment is also made to using a wider array of financial instruments, as well as to putting more emphasis on research and innovation projects.

The phasing out region of Basilicata has adopted a similar logic in which the regional ‘accessibility deficit’ is recognised as the main brake on maintaining and further enhancing the region’s acquired position of a leader in the management of natural resources (water and oil) in Italy. In this small and mountainous region, the improvement and completion of highway and road connections to the ports and the airports of the large neighbouring regions of Puglia and Campania are the main focus of the current programming effort and the precondition for investment in the exploitation of its natural resources.

5.2.2.2 Policy challenges

For any region, resort to this intervention logic should be relatively short-lived and will be less compelling once the major connectivity barriers are diminished. Initially, it could be seen as being simply about creating transport capacity, but could subsequently be broadened to embrace sustainability of transport systems, and thus to embrace the cohesion policy priority on “energy and climate change”. If so, the logic would need to evolve to give greater weight to qualitative aspects of hard infrastructure, including a greater emphasis on modernising and decarbonising the transport sector. Investments are also likely to be needed to deal with problems of congestion and to ensure that in the process of over-coming the region’s own bottlenecks, European added value is promoted by contributing to the upgrading of Europe’s networks, potentially including Trans European Energy Networks. Finally, it may be necessary to balance other demands on cohesion policy notably social and human capital development.

5.2.3 Building on the position secured

This intervention logic envisions a translation of the success achieved in recent interventions at the regional level to the broader territorial scale of the nation or to secure the progress made at the national level. This logic is chosen when a particular approach or ‘model’ of intervention has proven to be particularly effective in some areas of the country, and thus may be worth extending to other areas of the country or region. The approach has been used mainly in competitiveness regions and transition regions. It could also apply to the ‘donut’ regions, particularly in some of the EU12 where the model of development has very much favoured capital regions.[36] The emphasis is on maintaining overall momentum by accelerating the pace of investments that can reinforce structural change and is likely to involve a considerable degree of top-down steering from the national level. This approach encompasses the following priorities central to Europe 2020:

[36] As seen in the modelling results on the donut scenario from the previous chapter.

- Strengthening research, technological development and innovation;
- Enhancing accessibility to and use and quality of information and communication technologies;
- Enhancing the competitiveness of small and medium-sized enterprises;
- Supporting the shift towards a low-carbon economy in all sectors;
- Promoting climate change adaptation and risk prevention;
- Protecting the environment and promoting the sustainable use of resources.

5.2.3.1 Typical cases

In Poland, great weight is attached to accelerating the pace of catching-up – literally 'building on the position secured'. Much of the country's relative success is attributed to the catalytic role that the capital region of Warsaw has played, and the intervention logic is about broadening this approach to allow other regional centres to follow in Warsaw's footsteps. To this end, in the current cycle it is considered to be important to accelerate the pace in the direction of: further infrastructure improvements particularly in IT communication, focus on environmental infrastructure including energy security, and continued improvement in the quality of human capital linked to the promotion of innovation.

In the Competitiveness region of Eastern Finland the vision is to extend and secure for the region the gains in growth, competitiveness and employment that have been achieved nationally. The successful Finnish model is built on the creation of innovative and competitive enterprises in IT sectors. In Eastern Finland its adoption implies the targeting of cohesion policy resources into enterprise spin offs and the improvement of research capabilities.

5.2.3.2 Policy challenges

The main challenge is to consolidate and sustain growth by creating spill-over effects in surrounding areas, particularly by spreading innovation and industrial development. For regions pursuing this logic, the single market is largely seen as an opportunity. The region has modernised its industry, but now needs to focus on better use of resources, invest in new skills, promote innovation in SMEs and smart specialisation. Attention may also need to be paid to rendering sustainability consistent with "Resource Efficient Europe" objectives to help decouple economic growth from the use of resources, and to support the shift towards a low carbon economy. Moreover, a stronger investment in human capital is likely to be needed to push the region closer to the technological frontier and to boost innovation.

5.2.4 Advanced and inclusive development

This logic is mainly adopted by Competitiveness regions in some of the most developed Member States of the EU15, with development strategies very much in line with national objectives, particularly in areas such as sustainable and inclusive growth. A feature of the approach is to reinforce the ability to sustain the advanced development model already implemented. Cohesion policy support under this logic is designed to promote greater social cohesion and economic and environmental sustainability where growth, competitiveness and employment goals have largely been achieved. Interventions are intended to focus on population sub-groups and on territorial niches, such as deprived urban neighbourhoods or peripheral areas, whose contribution to development is marginal within the scope of the advanced economy. This logic, which is already aligned to the inclusive and sustainable elements of Europe 2020, may be oriented to boosting employment rates and reducing poverty through the European platform against poverty. This initiative addresses the specific circumstances of groups at particular risk, but with different groups targeted in different regions, depending on the incidence of exclusion.

5.2.4.1 Typical cases

In Germany, current interventions build on synergies between cohesion policy and a national employment policy that has more flexible provisions and feature strong gender mainstreaming, on innovation targeted to SMEs, but also on the continued support for investments to counter Germany's spatial inequalities, particularly the persistent East-West divide and the related problem of social exclusion. The regeneration of urban centers is crucial. This is to be supported by: the revitalization and conversion of 'brown-field' sites; regeneration of urban and local areas with specific needs; ecological and social development, including much greater resort to recycling; the safeguarding and expansion of competitive urban and suburban structures; and support for creative industries.

On its own smaller scale, Luxembourg's logic is similar, as the country faces issues of less advantaged social groups and neighbourhoods whose conditions need to be improved through a targeting of the investment generated by the policy.

5.2.4.2 Policy challenges

In many regions espousing this logic, the scale of cohesion resources will not be large, certainly relative to funding from national sources and development programmes. Consequently, in contrast to regions for which cohesion funding is pivotal to public investment, a policy issue will be to identify the much more specific and targeted roles that cohesion policy can play in fulfilling development priorities that are dominated by national considerations. Cohesion funding may have to be confined to a limited number of policy themes (for example a social cohesion dimension) but will also have to demonstrate an added value.

5.2.5 Catalysts for regional economic restructuring

This logic is found in Competitiveness regions in more developed Member States that have areas and sectors that are losing out in a relatively fast-growing national or economy. The approach favours a limited number of objectives – typically established through bottom-up initiatives – in particular boosting growth in certain areas of the territory that are lagging behind in the economic restructuring process. Here the sectoral approach suggested by the 7 flagships initiative may be well deployed, indeed there is some catching-up to do – beyond the five headline targets of Europe 2020 – for example to attain some of the more detailed targets for sustainable development, innovation and so on. In this sense this logic highlights the diversity in scope and purpose of cohesion policy and Europe 2020. This logic could, conceivably, be adjusted and dedicated entirely to an urban integrated approach.

5.2.5.1 Typical cases

In Sweden, the logic that drives cohesion policy interventions is the commitment to help the areas and the sectors now most in need. Notwithstanding the general performance of the country's economy the assessment is that it is built on the success of selected sectors where Sweden has gained a strong national competitive advantage. However, less skill intensive sectors have been left behind. Thus, the cohesion policy interventions even with their limited amount of resources are seen as catalysts, that is as the opportunity to spur new regional development, generating positive synergies with national policy interventions and allowing more structural and strategic work in terms of innovation where it is lacking. A focus is the diffusion of entrepreneurship and innovation to where it is lacking. Current cohesion policy interventions in Slovenia are intended to be catalysts to promote development, but appear to do so in a manner in which the country's hinterland and rural sub-areas are bypassed.

Italy's cohesion policy interventions continue to concentrate on the still less developed South, and the logic driving the national effort around reducing the North-South divide. The vision is to use cohesion policy resources to ignite a development process that results in the creation of new competitive sectors in the South with greater capacity to export and higher value added services. The latter include renewable energies and logistics to serve the increase in trade in the Mediterranean, so that these sectors contribute to the strengthening of the country's economy. Cohesion funding is to be used in close relationship with national investments, but the focus rests on the specific regions' needs. Indeed, a thorough analysis of the NSRF, suggests that the Italian strategy encompasses a plethora of objectives and priorities which mirror the variety of regional characteristics and requirements.

5.2.5.2 Policy challenges

As an approach that emphasises spatial targeting, eligibility criteria will need care and there may be a case for at least some competitive allocation of future funding. A particular connection with the Industrial Policy FI can be envisaged, in which the interplay between national and regional industrial development is stressed. To the extent that the logic is about re-drawing the map of regional specialisation, balancing national and regional priorities, one possible direction would be a clustering strategy which attempts to stimulate the emergence of viable new activities that can become foundations for more competitive regional economies.

5.2.6 Advanced industrial development

Facilitating regional transitions to new competitive sectors, especially where there has been industrial decline, is central to this logic. This logic is chosen in cases where there is the heritage of an important industrial past and a still viable industrial base, which has either suffered or is under threat of losing ground. The assessment is made that the transformative trends of globalization have already brought a downturn to the industrial base or that they are threatening its viability. The essence of this logic is to prevent and reverse the industrial downturn, by leveraging the policy resources to create the conditions for attracting domestic and foreign investments into the modernized productions and enhance the skills of the workforce in the supportive service sectors.

The main difference from logic (5) is that these interventions aim at improving manufacturing in the form of high quality productions that are competitive and supported by financial and advanced services, whereas (5) is broader and encompasses the overall economic restructuring process of areas, with more emphasis on transversal interventions. This can touch on a number of Europe 2020 goals and priorities, but is arguably most in tune with the "Innovation Union" flagship initiative.

5.2.6.1 Typical cases

In the UK, the logic underpinning the current cohesion policy interventions reflects two related phenomena. On the one hand, the harsh reality is that much of the country's once industrial heartland has lost its economic base and is significantly lagging behind in this phase of globalization. On the other hand, the country's economic engine is recognized to be the financial hub of the City of London and its regional spin-offs into the South-East.

Therefore, the focus of the ESF and ERDF interventions is the development of skills for employment in the advanced industrial sectors and the complementary improvement of knowledge and innovation to promote such sectors particularly in the UK's lagging regions.

In Tuscany, a Competitiveness region where an established strength is vibrant SMEs located in thriving and well-embedded industrial districts, policy interventions are based on maintaining the dynamism of these industrial districts. The policy encompasses a pro-active approach from regional and sub-regional level institutions, together with strong partnerships with stakeholders. Part of the approach is to the restoration or updating of high quality craft skills as value added components of product innovation, and to support them with district-wide advanced services. Initiatives also include forming alliances with equivalent industrial districts in neighbouring regions to compete globally and to facilitate the setting-up of subsidiaries and joint ventures abroad.

5.2.6.2 Policy challenges

The single market has posed major challenges for these regions because of industrial restructuring, and intensified competitive strains on certain sectors. A key component of the approach is to improve framework conditions and access to finance for research and innovation, so as to ensure that innovative ideas can be turned into products and services that create growth and jobs. In addition a focus on human capital is needed, therefore the logic could be refined to achieve a better match between labour supply and demand – as declared in the "agenda for new skills and jobs initiative".

5.2.7 Leveraging region specific assets

This intervention logic is centred on exploiting significant but unrecognized and underutilized assets that characterize the territory, and using these assets as a means of drawing in other investment that promotes development. The leveraging of the under-exploited assets is, therefore, the defining feature, and policy seeks both to build-up the relevant assets and to strengthen the leveraging effect. It is very much a place-based approach insofar as these assets are an endowment rather than created, as opposed to (5) where 'softer' capabilities are more prominent. It is applicable to both Convergence and Competitiveness regions in which prominence is given to local initiatives. Unlike logic (5), this one can be narrowed towards green industry specialization and tourism. This supports the following two initiatives "An industrial policy for the globalization era" and "Resource efficient Europe".

5.2.7.1 Typical cases

In the phasing-in region of Sardinia, the model of place-based development focuses on the value added of the great natural and tourism resources that typically characterise island territories. A key element is to create new synergies so that tourism-driven development is more sustainable in economic and environmental terms. This implies the promotion of investment opportunities and human resources development, as well as stimulating entrepreneurship in new economic sectors, such as renewable energies, and the re-launching of craft industries that have great potential and the marketing of their output.

Similarly, in the phasing in region of Southern Aegean, a focus on cultural conservation initiatives and renewable energies is the means of building on the success of the modernised and expanded tourism sector.

5.2.7.2 Policy challenges

For regions that rely on natural endowments, a likely dilemma is how to go beyond these assets to generate alternative sources of activity or to anticipate subsequent phases of development. In other words, is the approach sufficient from a longer-term perspective, as opposed to being a means of reaching a better level of economic performance in the short- or medium-term. If not, then the key challenge will be how to move beyond this intervention logic and whether a natural successor logic can be articulated.

5.3 Choice of intervention logics by Member States and regions in 2007-2013 Operational programmes

Examination of the 2007 NSRFs for all MS, shows that the four most frequently singled out 'main objectives' are all Lisbon oriented:

- Human resources
- Transport networks
- Entrepreneurship
- Innovation

The next most significant are environment/risk prevention, sustainable development and (another Lisbon objective), regional competitiveness. The importance accorded to two other objectives that are not Lisbon oriented is also noteworthy: governance, as well as transnational and interregional cooperation

The choices of intervention logic by the Member States is based on the content analysis of 64 national programmes encompassing all 27 Member States. There is not a clear divide in the choice of logics between EU15 and EU12, even though only the former were formally obliged to earmark their cohesion policy investments while the EU12 did so voluntarily. The Lisbon Strategy appears to have influenced the choice of logic, and two intervention logics stand out in this regard.

First, broad based economic development has been widely espoused including in four EU15 Member States (Belgium, Portugal, Ireland, and Greece) and six of the EU12 (Malta, Czech Republic, Hungary, Latvia, Romania, and Lithuania). Under this logic there is a relatively greater focus on system wide transport improvements and development of new business support infrastructure in the EU12. Conversely, in six of the EU15 there is a greater reliance on the capacity to attract, and the benefits produced by, venture capital and innovative pilot schemes in the drive to increase growth, competitiveness, and employment in the lagging regions. Investments in renewable energies and services for ICT companies are important interventions in both sets of Member States. The second most commonly embraced logic is 'catalyst for new regional development', adopted by 9 Member States.

Although employment, as an important Lisbon Strategy objective, was to be addressed in the national programmes it was a priority in only 8% of cases; in 38% only a general reference was made to it. However, clearly in over a third of the cases (35%) employment was singled out specifically in terms of the discussion of the resources to be allocated to it.

Not unexpectedly, the results of the content analysis of the regional programmes for the 73 regions are quite nuanced. They are reported for the four types of region in Tables 5.2 and Table 5.3 (presented in full in the annex), respectively covering the ERDF and the ESF. Table 5.2 shows two key Lisbon objectives pursued through ERDF supported interventions stand out across the 73 regions: innovation and competitiveness. While these two objectives are more significant in competitiveness regions they are also important in convergence regions. But at the regional level there are other important objectives that are also shared by these two types of region, namely urban development, governance, entrepreneurship development, and environmental sustainability. Certain regional objectives are more place-specific. Thus, tourism and transport/infrastructure are more prominent objectives in convergence regions, while improving business environment is more so in competitiveness regions.

Given the more specific scope of the ESF and lesser resources, the regional objectives tend to be more aggregated. The results in table 5.3 show a mix of Lisbon and non-Lisbon objectives, with one of the former, improving the quality of human capital, as the most frequently adopted regional priority objective.

The importance accorded to two other objectives that are not Lisbon oriented is also noteworthy: governance, as well as transnational and interregional cooperation. This underlines how widespread the view is across regions that they could and should learn more from each other and have more opportunities to adapt and incorporate the experiences of other regions. Results from the interviews conducted in the 20 case study regions are in line with and reinforce the finding that regions have acknowledged the need to share experiences and they indicate their receptiveness to more benchmarking in the implementation of ESF interventions.

5.3.1 Examples

The content analysis brings out a number of examples of how the logic of cohesion policies connects to other policy aims.

- Austria's NSRF is clearly based on and aligned with the Lisbon strategy and the EU's Sustainable Development Strategy, relaunched in 2006. The fundamental theme in the country's strategic approach is innovation defined as a 'complex societal process' demanding the contribution of multiple elements and agents to fulfil the aim of sustainable growth.
- Bulgaria's NSRF strategy has a strong Lisbon component aimed at increasing the productivity levels and value added of goods and products. Furthermore, it focuses on accelerating the development of the information society, and investment in training and assistance for SMEs.
- Denmark's NSRF includes a significant commitment to Lisbon for jobs and growth, to which it allocates 92% of resources.
- For Germany, the Lisbon strategy is a key element guiding its actions at the national and European levels, visible in attempting to meet three main challenges: accelerated technological change, globalization, and demographic changes. To this end, the National Reform Programme's strategy interacts with the Lisbon strategy to frame the cohesion policy interventions.
- Spain's first priority is investment in innovation, including in its lagging regions, and environmental issues are also prominent.
- In Poland negotiations with the Commission helped to increase the focus on the Lisbon objectives. The national strategy reflects the territorially differentiated nature of the country. An example is in Maloposka calling for improvement in ecological conditions and the securing of existing jobs at the same time.
- Italy's 'Research and Competitiveness' programme stresses Industrial Innovative Projects (IIP) as one means to spur patent creation and product oriented research in the four Southern regions. To support the preparation of the young for better jobs, Italy's

'Learning Environment' programme targets educational institutions for upgrades in technology to bridge the digital divide, and in science laboratories.

- Slovakia's 'Research and Development' programme singles out investment in educational institutions of higher learning and R&D as the means to transform its economy into a competitive knowledge economy and attain the Lisbon objectives. Slovakia's 'Transport' programme seeks to create synergies with the former by increasing the mobility of the workforce.
- Lithuania's 'Economic Growth' programme looks to accelerate growth over the long haul and thus close the development gap with the rest of the EU. It focuses on boosting productivity by creating favourable conditions for innovative SMEs.
- In Greece the 'Accessibility Improvement' programme, with its emphasis on the development and modernization of transport infrastructure is a key element of the investments characterized as 'drivers of growth'.

5.4 Intervention logics and Europe 2020

The analysis of intervention logics brings out a number of findings that bear on the alignment between cohesion policy and Europe 2020, and how to enhance the synergy between the two. An initial observation is that the 2007-2013 operational programmes predate not only the Europe 2020 Strategy, but also the new demands on cohesion policy emanating from the economic crisis. Because of the substantial institutional 'investment' involved in elaborating and agreeing these programmes, a key part of which is the adoption of an intervention logic, there is limited flexibility in adapting them to new exigencies.

Nevertheless the timing of development of intervention logics meant that they incorporated the innovation and employment targets of the Lisbon agenda. Similar targets for R&D and the employment rate are central to Europe 2020 and this may provide a rationale for retention of an intervention logic. Even though Member States largely committed themselves to the Lisbon strategy, the intervention logics chosen by the regions have been shown to have a broader scope vis-à-vis the objectives of the Lisbon Strategy. For example, in many cases, these logics have a more inclusive approach to development and social cohesion, including specific territorial components such as action on cities.

However, there is not necessarily a close link between the National Strategic Reference Framework (NRSF) – the national programming document for cohesion policy – and the National Reform Programme which is the programming document for Europe 2020. Often, these documents are produced by different ministries and to different timetables, and are also subject to different forms of scrutiny by the EU level (Directorates-General of the Commission and, in the case of the NRPs, the Economic Policy Committee and the Employment Committee). The intervention logic for a regional OP will be shaped more by the relevant national economics ministries and their Commission counterparts.

For the next programming period, Europe 2020 is bound to be a pervasive influence and it is therefore important to consider how intervention logics may have to evolve to accommodate not only the strategy itself, but some of the other changes to be anticipated in the economic and political context. These include the aftermath of the crisis, and evolution of the single market and macroeconomic governance innovations.

5.4.1 Cohesion policy principles and future development of logics

A core question is whether, in shaping intervention logics, the principles of cohesion policy need to be re-thought, thereby not only facilitating alignment with Europe 2020, but also recasting the linkages with the single market. How these issues are resolved will be crucial in determining what future cohesion policy is expected to deliver and how to enhance its effectiveness. Research has shown that here are continuing obstacles to the full completion of the single market. Therefore, cohesion policy itself should work towards a more complete and effective free economic area, mainly supporting those sectors and job categories affected by the changes in the regulatory framework and legislation.

At the same time, systematic review of programming documents reveals that the effectiveness of cohesion policy largely depends on the quality of the business environment in which it operates, emphasising the importance of continued efforts to strengthen the institutional framework for the market to function well. Cohesion policy should act as a tool to assess these effects and partly compensate their short term negative impacts on private initiative, enterprise systems and labour markets.

Diverging trends in competitiveness revealed by the crisis highlight the need for redoubled efforts to foster structural reform at national and regional level. However, it has to be recognised that such reforms can be costly for public administrations. There is, consequently, a case for allocating some funding specifically to facilitating administrative modernisation, with the expectation that these should be one-off expenditures, rather than having to be renewed. On the same lines, the reluctance of Managing Authorities to change strategies in response to the crisis was not necessarily because the initial intervention logic was consistent and well suited to face the new challenge. Instead, the reasoning appears to have been that to keep the ‘extant’ intervention logic was safer and would make it easier to resist pressures to cut public spending. Therefore it may be useful to consider the possibility of allocating a reserve fund for regions to invest in innovative measures.

As far as possible, innovative approaches to financing should be deployed, for instance by making as much use as possible of revolving credit mechanisms (EIB loans are an example) rather than grants in order to (i) generate a financial return and to be able to reinvest the funds (ii) leverage in complementary private investments. More generally, efforts to increase the leverage of complementary private investment should be reinforced in all intervention logics.

The additionality principle states that, for the Structural Funds to have a genuine impact, public investment by Member States should not be reduced. In practice, this is difficult to achieve when cohesion funding is a very substantial proportion of public investment over an extended period. Nevertheless, it may be valuable to carry out a qualitative assessment of whether there is sufficient domestic expenditure on the main growth-enhancing priorities, namely education and skills, R&D and innovation, and investment in networks (such as high-speed internet, energy and transport interconnections). Such an exercise would help to align cohesion policy to the thematic areas of the Europe 2020 strategy.

In addition, co-financing is one of the fundamental principles of cohesion policy, and is a key means of ensuring ‘ownership’ of the policy on the ground. However, in a period of austerity and fiscal stress for some regions, further relaxation of the co-financing rules – perhaps by accelerating the EU component of spending and deferring the national contribution, as well as altering the co-financing rate – may be warranted. Alternatively, increased competition for funding could be adopted. The Italian system of *premiality* is a good example of a competitive incentive system for additional resources. This system contains an innovative initiative aimed at improving the quality and the availability of public services, a provision of key importance for citizens’ well-being and relevant for regional policy action. Specific targets are set for the provision of public services, measured through 11 indicators in the areas of Education, Child and Elderly Care, Urban Waste Management and Water Service.

5.4.2 Do individual logics need to be rethought?

For some of the intervention logics to be better attuned to Europe 2020, a number of changes could be envisaged, some about emphasis, some about the overall direction for development. This section highlights some of the potential changes that could be put forward, and presents some examples for the various logics.

Among the themes that cohesion policy embraces is a concern to redress physical deterioration and social exclusion in cities, something that can be seen as a facet of Europe 2020 sustainability objectives, as well as bearing directly on the inclusiveness agenda. It is a priority that could be given greater attention in relation to territorial cohesion. Hence, there could be some shift within *broad based development* towards the quality of urban environments, as well as under *transport connectivity*, where a greater emphasis on sustainable transport would make sense.

'Smart', as used in Europe 2020, implies looking for forms of growth that go beyond a narrow conception of competitiveness, and could be especially influential in refining the *Catalysts for Regional Restructuring* and *Advanced Industrial Development* logics. One direction for change could be to revisit the balance between and integration of ERDF and ESF to respond to SMEs' needs for skilled workers in specific sectors, such as the green economy.

Some of the intervention logics may need to be updated to take more account of the risks that the current high rates of unemployment of those aged 16-25 persist, so as to avoid the spectre of a lost generation. It is already consistent with *Advanced and Inclusive Development* and thus applicable to the Competitiveness regions in which this logic is found, but the legacy of the crisis in many of the southern Member States suggests that the logics applied in Convergence regions might also be adapted to this end. For the ESF, this would imply a greater focus on this population cohort and reinforced efforts to stimulate labour mobility. Educational systems have to become more effective by reducing early school leaving and increasing the number of tertiary graduates.

The crisis has amplified some of the challenges of the sustainability of public finances and potential growth, but also the destabilising role of imbalances and competitiveness divergences and social exclusion. While these phenomena have to be taken into account in all the logics, it may be that greater emphasis needs to be placed on territorial balance, and that the ideas behind the *Building on the Position Secured* logic need to be more widespread in their application.

There may also be scope for new intervention logics to be developed, either as a direct response to the crisis or, at the opposite end of the spectrum, to move towards a new model of development, for example around the knowledge economy. The former might be labelled *Crisis Management and Exit* and could embrace a phased programme for dealing with the immediate consequences of the crisis, including through palliative measures, but with a more strategic vision of how exit and recovery would be managed. Public investment is likely to be vital to restore growth.

A logic around *Fostering the Knowledge Economy* could fit into the family of 'new regional strengths' as a special case which is distinctive because it would be about a broad shift in the comparative advantage of the economy. Seeking to steer an economy along these lines would be in tune with the smart growth dimension of Europe 2020 and would be applicable to all categories of regions. While it would be important to avoid unrealistic aspirations to replicate the likes of Silicon Valley, a substantial shift towards creative industries and human capital based strengths would be viable.

6 Policy implications and issues

The future shape of cohesion policy in the period beyond 2013 will be influenced by a range of factors, and will need to take account of the broad development of economic and social governance in the EU, as well as the evolving economic context and political decisions affecting EU resources. The purpose of this chapter is to flesh out some of the policy issues that emerge from the analytic work of this study and to discuss their implications for the future of cohesion policy.

This chapter is orientated around four broad questions that bear on the future cohesion policy mix to be chosen by regions and Member States. However, there are also choices to be made about the underlying rationale for and orientations of cohesion policy. How closely should it be linked to and possibly embedded in the Europe 2020 strategy – acting as one of the primary instruments for EU funding of policies to achieve the 2020 goals – as opposed to retaining a distinctive purpose and identity? How wide a reach should the policy have, both among regions and across areas of intervention? Does the logic that has governed cohesion policy remain valid, or are new approaches to governance needed, whether in response to the changed post-crisis policy environment or the new constellations of problems revealed by the financial-economic crisis of 2008-2010 and the sovereign debt crises since 2010?

6.1 Policy question 1: In what ways can public policy intervene to enable European regions to fully benefit from the single market?

To benefit from the single market, any region has to be prepared for, and/or responsive to, the changes being wrought in the single market rules and the resulting sectoral shifts. Regions also have to take account of how their prospects are affected by a rapidly changing global economic environment, the national initiatives under the Lisbon/Europe 2020 strategies, and the impact of spatially orientated policies, including the ERDF and the ESF. Further effects will stem from Cohesion Fund investment, both as a result of direct outlays in the region and indirect effects, notably from network enhancement.

The responses to the impacts generated by the single market also pose specific challenges to public policy. These include:

- The strategic direction in which policy tries to steer the economy, such as the pursuit of particular specialisations, market segments or types of economic activity;
- Whether the most intensive efforts should be made at national or regional level, and how to deal with the inevitable trade-offs;
- The timing of interventions and the criteria or milestones to be adopted in moving between phases of regional transformation;
- The importance of lead regions (most often the national capitals) in creating growth poles and connection hubs for major networks;
- The extent to which ‘place’ should feature in the design of policy and whether the regional level is sufficiently aware of the single market as a goal to pursue in regional development policy.

6.1.1 Context

The link between deepening economic integration in the EU and the socio-economic development of regions has been debated for several decades now. The implementation of the single market is generally viewed as enhancing growth and competitiveness and the modelling results reported in earlier sections confirm this general wisdom. However, there is much more controversy on the distributional effects at the regional level, the type of adjustments needed to overcome challenges stemming from deepening integration and how to maximise the associated benefits. The renewed push for single market implementation will undoubtedly have an uneven and heterogeneous impact on regional economies. However, the specific effects that will materialise are not easy to predict. It is no coincidence that one of the key recommendations of the Monti (2010) report is to evaluate the potential impact on EU regions of the re-launch of the single market. The single market is always developing and its completion proceeds at speed that varies between sectors as well as geographically. This implies that public policy interventions to enable regions to obtain the full benefit from the single market should be aligned to the uneven progress of economic integration. A one-size fits all approach is unlikely to be productive. Also, these policies need to maintain flexibility to adjust to changing policy, economic and social environments as they arise.

One of the study’s main findings is that the quantitative impact of the single market on regional/national economies has been quite high. In assessing the impact of the single market on the different sectors of their regional/national economy, interview respondents were positive across all the sectors, albeit with some degree of differentiation. For example in Poland, the need for full implementation of the Services Directive was pointed out, together with that of increasing the export of Polish food products. In the UK, the view was that the single market has increased the international competitiveness of companies and greatly benefited UK manufacturing and financial services. In France, the assessment made was positive across all sectors, but at the same time it was pointed out that the need to harmonize Member States’ policies in matters such as taxation and budget should complement financial liberalization for a genuine single market to be in place.

6.1.2 Opportunities and constraints

Deepening market integration creates opportunities for regions to exploit their comparative advantages more effectively and can be achieved in a number of ways. It may, in particular, imply aiming for a stronger specialisation in certain sectors of activity, although it is important to recognise that a relatively narrow specialisation may render a region more prone to asymmetric shocks if these industries are affected and hence vulnerable to the negative consequences of external shocks. This poses a key policy question as to the strategic direction in which public interventions try to steer the economy, such as the pursuit of particular market segments (final or intermediate goods or services) or types of economic activity (research, production or distribution, for example). There is no single answer to this question and regions and countries need to consider carefully what their principal assets are, the risks of competing approaches to development, the preferences of the population and the external environment. To complicate the situation, there is a nontrivial question as to the governance level at which particular policies should be designed and implemented. European, national and regional levels may have their merits in addressing several of the issues discussed below.

One potentially important constraint to the successful implementation of the single market and its regional dimension in particular concerns public perceptions. As observed by Monti (2010), among others, there is a widespread propensity to blame restructurings and delocalisation of companies (with their sometimes substantial economic and social costs at the regional level) on the single market and/or to insufficient protection granted by the EU vis-à-vis the rest of the world.

Weak public support for the single market is likely to have tangible negative effects on implementation of single market policies. Also, as suggested by some of the interviews (e.g. in Romania) there may not be enough information on the single market available to people not professionally involved in the process or who experienced the full impact of the single market more than fifteen years after it was introduced for the original fifteen Member States. Hence, as emphasised by the Committee of Regions (2010a) it is very important that all relevant stakeholders, and specifically at the regional level, are involved in the debate on single market implementation.

6.1.3 Infrastructure and networks

In several areas, the single market can only function if the necessary infrastructure is put in place first. One example concerns the transport network (road, rail, and air). Remote areas lacking efficient transport connections with economic centres will not be among attractive locations for businesses that rely on fast goods delivery by road or rail. One obvious policy implication therefore is that enhancing key infrastructure may be a precondition for regions' full participation in the single market. It is in this sphere that cohesion policy interventions have a particularly large role to play in enabling the implementation of the single market. These threshold effects are likely to be qualitatively much more crucial for some regions than for others.

However, there is also a difficult issue for cohesion policy about infrastructure in richer regions. In particular, for regions that still have gaps – even if less acute than in convergence regions – the question that arises is which categories of such infrastructure can be defended as EU-funded projects as opposed to projects funded nationally. The current regulations already provide some restrictions for Competitiveness regions, but with some exceptions, such as secondary road networks or regional networks.

The optimal choice of cohesion policy spending on network enhancement is complex. What analysis of spending patterns shows is that several of the EU12 Member States with underdeveloped transport infrastructure (especially roads) have devoted substantial resources to road building and upgrades. To a certain extent these investments have helped to overcome bottlenecks in some regions' connectivity. However, it cannot be excluded that some of the investment decisions might have been driven by the relative simplicity of road-building programmes relative to building other elements of the single market infrastructure (e.g. rail networks, modern communication networks, quality of governance and regulation, etc.), their political appeal and similar factors. Some interviews carried out as part of this research suggest that such sub-optimal choices occur regularly.

Looking forward, it will increasingly be necessary to ascertain which forms of infrastructure are most needed in relation to the single market. Should this infrastructure include projects with high European added value such as the Trans-European networks, designed to improve links across regions in the single market? Or should this infrastructure also include secondary or regional networks designed to improve connectivity and accessibility for rural and peripheral regions or between different growth poles? Well-designed evaluations of past investments are therefore crucially important to help inform policy decisions. These evaluations should, in particular, look at the effects of Structural Funds' investments in unleashing the potential of the single market (European Parliament, 2005).

Apart from hard infrastructure in the form of transport, energy, communication networks (including for high speed data transfers), etc. there is a broad range of regulatory policies that can also be considered as providing basic infrastructure for market functioning. Regulatory policies need to be understood widely, for example to include pro-market initiatives, such as effective opening of public procurement or liberalisation of network industries. This is an area ripe for public policy intervention. The precise character of these regulatory measures should be determined by specific local conditions (in a given group of regions or countries or in certain economic sectors).

Several barriers to the successful implementation of the single market are related to differences in national regulations and as a result they fragment the market along national lines[37]. This might be particularly detrimental to regions adjacent to national borders, especially if they are not well connected to national economic centres. In view of this, there is room for stronger public support for cross-border regional cooperation programmes, especially the ones focusing on removing the barriers to cross border mobility of goods, services, and people.

6.1.4 Adjustment and conditionality

Decisions on relocation of business activity outside a given region often constitute a negative shock to the region in question, at least in the short- to medium-run. What matters then is the ability of the regional economy to adjust smoothly to the new circumstances and to take advantage of new opportunities. A similar challenge is posed by outmigration, especially of the most active and creative people with the highest human capital stock. Fears related to these processes have been confirmed in our interviews in some EU countries.

There is considerable scope for public policies which can enhance the adjustment capacity of regions. A broad range of interventions may be useful in this regard, although in many instances their effects can only be expected to be visible in the longer term. Examples of these types of interventions are to improve the overall quality of governance, general improvement in human capital levels and in particular focusing on infrastructure for (and general attitudes towards) life-long learning, transportation and communication infrastructure (fostering commuting and distance work), etc.

As mentioned in chapter 4, the relocation of production is an important aspect of the implementation of the single market. Such mechanisms can be fundamental to improving efficiency and have to be regarded as a routine element in the normal functioning of a market economy. However, for these efficiency gains to materialise, forces driving business locational choices need to be free from damaging distortions, a concern that can often prove to be very sensitive in discussions about public assistance.

One element in this equation is the possibility for cohesion policy resources to be used by certain Member States and regions to subsidise companies (whether explicitly or indirectly) making certain locational choices. Such incentives do, however, have to confront two difficulties. First, they can cause disputes between regions and among Member States if there are fears (warranted or not) that economic activity or jobs will be displaced. The second concern is that there will be no overall advantage for the EU, making EU funding especially hard to justify. Risks of such *fund-shopping* have been acknowledged from the beginning by the introduction of certain preventive rules in the funding of capital investment projects. Article 57 of the General Regulation for the 2007-2013 period contains provisions to reduce the risk of the Structural Funds being (ab)used for subsidy-hopping and relocation.

However, as stressed by Monti (2010) there is still room for strengthening cohesion policy rules in the next programming period to ensure that they can deter distorting decisions on allocation of economic activity. In particular, it may be worthwhile to establish appropriate

[37] As an example, there have been substantial differences in national regulations governing professional cash transportation leading to very little cross-border cash transportation. The Commission has recently proposed common EU rules that would make it easier to transport euro cash across borders in the euro area. See http://ec.europa.eu/economy_finance/euro/cash/transport/index_en.htm

channels to coordinate the use of EU cohesion funding and the authorisation of state aid support in favour of the same company (Monti, 2010). Equally, public support is only one of many factors that influence location decisions, and rarely the crucial one.

One issue recently receiving much attention is whether cohesion policy allocations could be used as a mechanism for incentivizing implementation of certain single market provisions. Among its recommendations, the Monti (2010) report proposes to introduce a conditionality clause in the cohesion policy regulatory framework to reward Member States most disciplined in transposing single market directives.. A recent report by the EPRC (2010) highlights a range of ways in which conditions could be imposed and makes the point that there are already conditions in current cohesion policy. However, these conditions are mainly around procedural compliance, whereas in other contexts, much more demanding conditions could be applied, such as macro-conditionality (possibly encompassing compliance with the Stability and Growth Pact), different forms of strategic, regulatory and institutional ex-ante conditionality, or insistence on governance reforms. The draft Commission proposal for a general regulation[38] for the 2014-20 period signals that the preferred approach is for a combination of incentives and conditionalities to ensure that the appropriate framework conditions are put in place to maximise the effectiveness and added value of EU co-financed investments.[39]

6.1.5 Some directions and implications for future policy include:

- **Balance between growth/productivity and loss/closure.** The single market is an important driver of development, but can also pose challenges in terms of greater competition from other regions. Public policy needs to be able to balance the potential to accelerate growth and productivity, including by ensuring a more effective competition policy, with the risks associated with closures of uncompetitive activity and the resulting losses of economic activity and jobs.

- **Growth poles and territorial cohesion.** The strategic role of leading regions, particularly in convergence Member States is vital to boost competitiveness and take on both the challenges and benefits derived from the single market. However, this also requires ensuring that a careful balance is struck between enhancing growth and productivity in the central leading (often capital) region and addressing territorial imbalances across the entire Member State.

- **Focus on cross-border spillovers.** Investment in the provision of public goods that have significant cross-border spillovers, such as transport or innovation networks and environmental protection, is important to enhance the benefits of the single market.

- **Public investment is not enough.** Public investment, in particularly EU co-financed public investment is itself insufficient to reap the benefits of the single market. Most single market measures have institutional or regulatory implications, which, in order for regions to benefit fully from the single market, require effective implementation.

[38] Published 5.10.2011.

[39] Investigating whether the introduction of these conditionalities can help to incentivize implementation of certain single market provisions was not one of the specific aims of this study.

6.2 Policy question 2: In what ways can European cohesion policy focus more strongly on growth enhancing investments in the less-developed regions of the Union?

The modelling and survey work presented in chapters 2 and 3 identifies a number of variables that are associated with stronger and more sustained growth at regional level. This provides a menu for the sort of policies that should be given priority if growth is to be enhanced. The results from modelling indicate that FDI and productivity improvement are the strongest determinants of growth in the EU12, especially the CEE countries. These factors produce the largest economic impact, while the impacts from other determinants are considerably lower. Larger, modern and more productive capital stock, including new factories, machines and equipment that replace outdated capital, tend automatically to boost production possibilities in Member States that accede to the single market. Thus, the study has confirmed that membership of and participation in the single market has paid off in terms of growth and productivity gains. The positive impact from cohesion policy 2007–2009 interventions adds to such gains for Member States who joined the EU after 2004. In addition, the "counterfactual" scenario also posits that the contribution of cohesion policy will grow in the future once more of the available resources are used.

However, as with all quantitative analysis, there is a risk that the specific circumstances of individual regions are not taken into account. In cohesion policy terms, this raises the question of whether there is a policy gap. In deciding what EU policy should concentrate on, a first issue is whether, as a result of policies implemented by other tiers of government, there is a need for additional interventions from EU policy. In addition, even if there is a policy gap, it is important to show that any EU intervention has genuine added value, rather than just being a substitute for national or regional choices financed from national sources.

6.2.1 Key processes and mechanisms

There is a growing consensus among academics and policy makers that regional growth and competitiveness are tied to sustainable production (labour productivity and employment). In turn, this is determined by factors such as foreign direct investment (FDI), research and development, presence of a skilled labour force, good networks and institutions, knowledge creation and absorption capabilities and good accessibility in terms of technological and geographical assets. Different theories exist as to which one of these factors is the most vital. Neoclassical economics focuses on assets such as labour and capital, while endogenous growth theory emphasizes the role of knowledge (Romer 1990, Aghion and Howitt 1998). The new economic geography literature incorporates space into the endogenous growth framework and stresses that spatial agglomeration and localized knowledge spillovers are among the most critical determining factors for macro and regional growth (Baldwin and Martin 2004). Most of the empirical work which has examined the role of agglomeration regions characterized by the concentration of diverse industries has concluded that these types of regions are the most productive in innovation and eventually in economic growth (de Groot, Poot and Smit 2007).

Turning to the specific kinds of inputs the empirical literature underlines the significance of human capital and R&D (Fagerberg et al., 1997; Rodriguez-Pose, 2001; Sterlacchini, 2008; Rodriguez-Pose and Crescenzi 2008; Vargaet al., 2010), on the one hand, and physical infrastructure development and private investments (Aschauer, 1989, Biehl, 1991, Seitz and Licht 1995, Varga and Schalk 2004, Li and Liu 2005), on the other, for regional economic growth.

The role of cohesion policy in reducing regional disparities across Europe is more extensively debated in the academic literature. Econometric studies vary on the extent to which cohesion policy impacts on growth and productivity (se overview in Begg, 2010).

Some authors acknowledge the effectiveness of cohesion policy in promoting growth in less developed regions, while others argue that physical infrastructure investments in particular tend to benefit strong regions more than weak ones (Evers, 2010). A more subtle analysis might be that as the most significant, and often debilitating, gaps in infrastructure are filled, the net gains from further investment tend to diminish.

The results of empirical academic research have also been shaped by the lack of attention paid to regional spillover effects. Cohesion policy investment may contribute to growth in one particular region, which, in turn, may influence neighbouring regions' growth rates as well (Mohl and Hagen 2010, Ramajo et al. 2008).[40] In this respect, public investment is not just about high visibility new projects, but is also about the effective maintenance and upgrading of the existing stock of public capital[41].

Other research has shown that the right combination of "soft" (human capital and R&D promotion) and "hard" (physical infrastructure and private investment support) instruments in any mix of policy measures needs to be targeted in order to reach the desired impacts (Zaman and Goschin 2010). The time dimension should also be taken into consideration while designing such policy packages: the direct benefits of physical infrastructure investments (such as investment in transport) are quickly exhausted and lose effectiveness if not complemented by R&D and human capital development which affect growth in the medium to long run term (Crescenzi and Rodriguez-Pose 2008).

6.2.2 Capturing cumulative effects though modelling

The modelling work conducted for this study estimates that the impact from the EU membership for the CEEC group is that economic growth is some 6.7% higher than it would have been compared to 2004, in spite of the economic crisis. The corresponding impact from cohesion policy 2007-2009 interventions is 3.9 %. The results of the scenarios are in line with estimates from previous research, confirming that EU membership was a good choice for the CEECs as measured by macroeconomic indicators. The modelling results also confirm that the costs of enlargement for the EU15 (those that were members before 2004) were relatively low. In sum, what the results show is that the combined impact of the single market and cohesion policy is that there is a positive sum game in terms of GDP and employment outcomes. What the study has also shown however, is that stakeholders do not always share this view, despite the evidence.

The modelling results confirm that the regional (and macroeconomic) growth effects of physical infrastructure and private investment tend to be more immediate but less enduring than investments in human capital and R&D. Indeed, depending on the relative strength of soft instruments, the impact of R&D and human capital on regional growth may exceed those of the hard instruments even in the medium term. However the relative strength of regional R&D and human capital is conditioned by a number of regional factors which could be important when the particular combination of cohesion policy instruments is designed.

6.2.3 Policy orientations

The results of the study show that investing in soft instruments such as R&D and human capital are most efficient in technologically advanced regions where sufficient agglomeration

[40] The 1996-97 LSE study on the socio-economic impact of large Cohesion Fund infrastructure investments in contiguous areas (.e.g., Portugal and Spain) identified significant "ripple" effects extending out from the location of the investment to other regions inside or outside of the country, depending on the physical or economic inter-connection between regions (CEC, 1999).

[41] Kalaitzidakis and Kalyvitis (2004) find that redirecting pubic funds to maintenance of public capital, rather than new projects can often achieve better results for growth.

of knowledge activities is paired with dense interregional research collaboration linkages, high levels of social capital and good physical accessibility. Does this mean that cohesion policy should not co-finance R&D, innovation and human capital to support the development in less advanced or even peripheral regions, concentrating instead on 'hard' investments in fixed capital? Though it is certainly true that a "one size fits all" approach is less than ideal, a regional typology such as that developed by the expert team of the OECD (OECD 2010) can be helpful (Wintjes and Hollanders, 2010, offer a similar alternative).

This typology suggests that in less developed regions, policies should address the bottlenecks in local agglomeration of the knowledge industry, in physical accessibility, in human capital development or in interregional innovation-related interactions. For peripheral rural regions with limited research capabilities where the growth impact of R&D support is very limited, there is a need to address knowledge exploitation capabilities to promote incremental innovations via the transfer of more advanced industrial technologies, improvements in the local skill base or the development of physical accessibility (Varga et al., 2010).

In rural areas where a research university is present, there is a need to strengthen international research collaborations and develop the industrial base in line with the scientific profile of the university (via the attraction of major international companies' R&D and production facilities or supporting academic entrepreneurship). In addition, improvements in localised academic-industry collaborations and in physical accessibility are likely to be necessary.

In de-industrializing regions or old manufacturing centres, policies should help to shift and diversify the local industrial base by strengthening research in local universities, and build up linkages with scientifically and technologically more advanced regions that might help generate collaborative innovations in the "smart specialization" manner (Foray, David and Hall, 2009; McCann and Ortega-Argilés 2011). Also, policy should seek to advance the level and type of education most appropriate for the emerging industrial profile of the region.

6.2.4 Some directions or implications for future policy include

- Membership of the EU and participation in the single market has had positive albeit differing effects for less developed and more developed Member States alike, both in terms of growth and productivity gains. For those Member States which joined after 2004, the combination of public investment from cohesion policy and membership of the single market has been very positive. The combination of market access and cohesion policy should continue to be at the heart of economic development policy. Future cohesion policy should continue to stress the benefits of being part of the single market and to ensure that policy interventions reflect this imperative.

- Although public investment in less developed regions should initially focus on hard investments to address gaps in infrastructure, over time investments should focus on R&D, innovation and human capital, given that their growth effects are more long term. Nevertheless, the right policy mix between investment in 'hard' instruments such as infrastructure and 'soft' instruments such as R&D, innovation and human capital depends on specific contexts.

6.3 Policy question 3: In what ways could the quality of public expenditure in support of Lisbon/Europe 2020 priorities be enhanced?

What should be understood by high quality public expenditure is open to question. The most straightforward interpretation is that it should be growth enhancing, implying that it should be orientated towards investments which can be expected to boost growth and productivity. This can be done through a variety of mechanisms, such as alleviating a constraint on growth (for example, an infrastructure bottleneck), facilitating a shift in specialisation towards activities with higher productivity potential (notably, a transition from agriculture to industry), or by mobilising under-utilised factors of production.

Afonso et al. (2005) and other work identifies a range of quality considerations, not all of which bear on cohesion policy to the same degree in linking public spending to growth. The findings from the quality of public spending literature, echoing the endogenous growth literature (see, also, section 2 of this report), suggest that public investment in human capital is most effective, followed by (though subject to conditions) spending on research and innovation, whereas the gains from investment in physical infrastructure are less clear-cut. But it would be a mistake to infer that these findings should dictate cohesion policy choices, as the most binding constraints on development in some regions may well be in hard infrastructure.

There is also a time dimension to consider. Growth potential may mean making strategic investments today to enable growth to accelerate tomorrow. Education, especially, exemplifies this aspect of 'quality' because the return on the investment will only start to become visible a decade or more after the expenditure is incurred. The Lisbon/Europe 2020 Strategy has emphasised the knowledge economy as a key orientation for EU development and it follows that policies which help to position a regional economy to exploit these opportunities will be part of 'quality'.

6.3.1 Boosting the quality of public spending

It would, though, be dangerous to advocate a one-size-fits-all approach to quality of expenditure, because the main obstacles to growth will differ from region to region. These have to be reconsidered in the aftermath of the economic crises of recent years. The crisis had different roots in different Member States. But their responses to the crisis in the context of cohesion policy are also noteworthy, as this study has shown. The results of the interviews conducted with representatives from Managing Authorities reveal that, in most cases, the onset of the economic crisis did little to change the strategy or intervention logic of cohesion policy programmes. Indeed, despite the flexibility offered by the European recovery package (which encouraged Member States and regions to modify their programmes in light of new challenges), very few undertook substantial changes to the strategy of their programmes. Possible reasons could include reluctance to risk interrupting the project pipeline, unwillingness to undertake major changes which require extensive consultation with stakeholders and political resistance to shifting away from popular project choices, such as roads or cultural projects. Changes to the programme only 2 or 3 years into the programming period could also disruption the implementation of projects, thereby increasing the risk of automatic decommitment of funding.

Although for the current programming period it is perhaps too early to discern the balance between investments in Lisbon/Europe 2020 areas and traditional cohesion policy investment areas, beyond what is required for the Lisbon earmarking provisions, a number of conclusions can be drawn from the study. First, it showed that in the current round of cohesion policy programmes, there were pronounced variations between regions in the proportion of spending earmarked for Lisbon-related purposes. The largest non-Lisbon allocations were for national rail and road projects, the provision of adequate energy sources and environmental, culture and social services projects.

Second, the findings from interviews with regional management authorities and stakeholders suggest that, up to 2009, there were few conscious efforts to favour Lisbon-related expenditures. In part, this may be because little effort seems to have gone into explaining to those managing programmes at the regional level what meeting Lisbon objectives entailed. Many interviewees also commented that the launch of Europe 2020 in 2010 occurred at an inopportune time in the cohesion policy cycle and was not properly prepared, with insufficient information on how the Europe 2020 targets and the seven flagship initiatives should be translated into action at the regional level. By contrast, national actors tended to be far better informed.

A third conclusion from the study is that together with the evidence that not much effort was made to distinguish between physical capital and the 'softer' innovation-related investments most directly associated with Lisbon/Europe 2020, the inference to draw is that earmarking has had a rather limited influence on shaping Operational Programmes.

6.3.2 Some directions or implications for future policy include:

- Placing greater emphasis on the quality of public spending is not something limited to cohesion policy, especially in a period of constraints on public spending. In particular, it is likely to be a difficult balancing act because what constitutes 'quality' in one place or context may be more central to promoting enhanced growth than the same sort of public investment elsewhere.

- Concentration of funding will be important to reach critical mass. Although concentration is not new in cohesion policy, arrangements for the 2007-2013 have shown mixed results. Experience suggests that Managing Authorities have not fully taken on board the Lisbon earmarking provisions or indeed, the Europe 2020 targets and flagship initiatives. Thus, ensuring that public investment is directed towards Europe 2020 priorities will require strengthening mechanisms designed to focus public expenditure on certain priorities and ensuring that, at an operational level, quality considerations are understood and applied.

6.4 Policy question 4: What types of institutional governance mechanisms could ensure the most effective delivery of public goods in support of the Europe 2020 strategy?

Europe 2020 calls for both national and EU level actions through the headline targets and flagship initiatives. In particular, the seven flagship initiatives under Europe 2020 (the core of the policy agenda) each contain EU level and national level programmes of action. These are being put into place based on the first round of National Reform Programmes submitted in April 2011. Although the National Reform Programmes cover a broad range of areas where cohesion policy co-finances public investment, such as research, business environment or active labour policies, there is limited coverage in the NRPs on cohesion policy or on cohesion policy objectives. At the same time, as foreseen in the current regulations, cohesion policy programmes in the 2007-2013 period continue to have substantial earmarking of funds towards the original Lisbon strategy objectives. These processes work to different timetables and with different mixes of funding. This is despite the fact that cohesion policy spending constitutes a substantial proportion of public investment in the so-called cohesion Member States, for which cohesion policy often constitutes the largest source of financing for Europe 2020 objectives. For these Member States in particular, cohesion policy resources are, and will remain, a vital contribution to the realisation of Lisbon/Europe 2020 goals, especially in fiscally-constrained regions which have few alternative sources of investment for headline targets, such as R&D spending. In today's climate of austerity, this role is especially important.

Among the key questions to be explored for the successful alignment of cohesion policy and Europe 2020 are:

- The interaction between the formulation and delivery of the NRPs and the design and implementation of cohesion policy programmes, notably because the latter have a strong territorial or regional dimension;

- How to ensure better communication and coordination between different tiers of government so that regional and national goals can be reconciled in determining national public investment strategies to achieve both the Europe 2020 objectives and cohesion policy objectives;

- Whether national Europe 2020 strategies should be complemented by explicit regional 2020 strategies. This is particularly relevant for some Member States where policy areas under Europe 2020 fall under the competence of regional and local governments.

- How to monitor delivery and progress towards outcomes as opposed to outputs (Barca and McCann, 2011). This is likely to need a nuanced approach towards relevant indicators and resort to interim targets that can be used where Europe 2020 headline targets are distant from the regional staring-point;

- Understanding the intervention logic in regions and what influences it. For example, has the logic changed as a result of the pressure to introduce growth enhancing policies or does a previous logic remain dominant? How coherent and targeted is the intervention logic?

6.4.1 Coherence between cohesion and Europe 2020

Understanding the intervention logic for both cohesion policy and Europe 2020 generates a number of interesting conclusions in terms of the coherence between cohesion policy and Europe 2020. In relation to Europe 2020, the National Reform Programmes are designed to focus on areas where structural change is needed and to overcome identifiable problems that are specific to the Member State. While this is partly a matter of well-chosen public investment projects, public spending is not the only means by which reform aims can be achieved. Indeed, it is evident from a reading of any NRP, that many of the planned interventions are regulatory in character. In each of the seven flagship initiatives under Europe 2020, a similar emphasis on regulatory measures is found. Others however require a combination of regulatory measures and public investment.

It is generally accepted that cohesion policy has been substantially 'Lisbonised' since the start of the 2007-13 programming period, although the analysis reported above shows that there are pronounced differences among the Member States in this regard. There is also a nagging question about whether the designation of initiatives as Lisbon-compatible is real or at least partly opportunistic.

The five headline targets provide very broad signals about what Europe 2020 is intended to achieve and feature prominently in the National Reform Programmes submitted by Member States. Indeed, both the headline targets and flagship initiatives feature prominently in the menu of thematic objectives and investment priorities proposed by the Commission in the draft legislative proposals for cohesion policy 2014-2020, adopted on 6 October 2011.

But how suitable are they? Clearly, Member States differ hugely in their starting-points in relation to these headline targets and these differences are multiplied at regional level. This is a reason why the European Council has called on Member States to establish national targets vis-à-vis the headline targets corresponding to their specific circumstances. Top-down measures need to be reconciled with bottom-up approaches, taking due account of national circumstances.

A further conclusion to draw here is that since the intervention logic of the National Reform Programmes has focused on both national public investment strategies and areas of structural change, maximising the coherence of Europe 2020 and cohesion policy will require the latter to focus also on structural change. A Commission evaluation of the Lisbon Strategy[42] found that 'the impact of structural funds can be enhanced by improving underlying structures (e.g. in research and innovation and/or labour markets), simplifying regulatory frameworks (e.g. business environment, infrastructure development) and by further strengthening administrative capacity and efficiency'. It follows that aligning cohesion policy with Europe 2020 will require going beyond re-directing cohesion policy resources towards Europe 2020 objectives and flagship initiatives. It will also require the provision of adequate framework conditions for the funds and ensuring that the intervention logic of cohesion policy focuses on areas of structural change, including regulatory change and administrative/institutional capacity-building.

6.4.2 The consequences of the 2008-11 crises

Preparations for the 2014-2020 programming period cannot ignore the consequences of the severe economic crisis and the likely recovery trajectory. In this regard, clear divisions are emerging among the Member States that will require careful thought in the post-2013 programming period.

A possible typology of for how the crisis will shape governance challenges is as follows:

- *Business as (more-or-less) usual* for those Member States for which the crisis has been more a hiccough than a severe affliction. The existing intervention logic might need to be adapted, but not *because* of the crisis so much as a natural evolution in its development strategy.

- *Bolstering competitiveness* has become a pressing priority in several Member States in which the relatively benign macroeconomic circumstances of the period up to 2008 had disguised a steady erosion of competitive advantage. That it was manifest in the yawning current account deficits balance of payments is, with hindsight, obvious, but there is now recognition that far-reaching structural reforms are needed to address the problems. Much of the focus will have to be on raising productivity. Some of the required reforms are very long-term (educational systems, for example), while others involve politically sensitive choices such as modernisation of employment protection or pensions systems.

- *Countering pervasive unemployment*, the more so where it is concentrated in groups such as youths, is likely to be a medium-term problem for certain Member States which have not only seen pronounced falls in their aggregate employment rates, but need to raise productivity against a backdrop of anaemic growth. On the assumption that recovery will take hold, choices will have to be made about the thrust of employment measures. In particular, the balances between, first, job preservation and job creation, and second, between training and employment subsidy will require further reflection.

[42] "Lisbon Strategy evaluation document" Commission Staff Working Document, SEC(2010) 114 final, 2.2.2010.

- *Institutional reform* will be needed as a response to failings that have been highlighted in the economic crisis and the subsequent 'euro' crisis. There are very diverse priorities for such reform, and issues of sequencing and accountability are bound to arise.

- *Consolidation of public finances* is plainly high on the agenda for different reasons. Some Member States have had to bail-out the financial sector, others have seen what could be enduring worsening of their structural deficits and there are also specific problems about tax collection.

- *Palliative action to mitigate adverse social consequences* may need to be re-thought where the aftermath of the crises has led to new or more intense problems of exclusion, poverty or inequality.

- *Adaptation to changing economic circumstances*: The crisis has also shown that the global context in which the funds operate can rapidly change and new priorities for increased public investment may emerge. Therefore, while maintaining long-term stability for cohesion policy interventions, the framework should be sufficiently flexible to adapt to changing economic circumstances.

Countries or regions will not fall neatly into the above categories. The crisis has shown that some Member States have been affected by multiple problems and it is clear that the intensity of these problems is greater in some regions than in others.

6.4.3 The logic of policy intervention

The analysis has revealed a wide range of intervention strategies to respond to single market challenges. Most still encompass substantial investments in hard infrastructure and many cohesion policy programmes in the current period tend to be relatively light in investments that are likely to encourage longer-term growth, such as research and human capital. The analysis of the case studies and the assessment of cohesion policy interventions discussed in chapter 5 points to seven distinct forms of 'intervention logic' behind the strategies underpinning cohesion policy programmes and investments.

Table 6.1 presents a synthetic summary of these forms of intervention and attempts to relate them to single market and Europe 2020 considerations. The table also tries to identify policy orientations that flow from these issues and to relate them to the likely themes of future cohesion policy (see box 6.1).

Box 6.1 Proposed thematic objectives 2014-2020

For the 2014-2020, the Commission has a proposed a common menu of thematic objectives based on the Europe 2020 objectives, the Integrated Guidelines and the seven flagship initiatives for the five so-called Common Strategic Framework Funds[43].

(1) Strengthening research, technological development and innovation;

[43] Proposal for a Regulation of the European Council and Parliament laying down the Common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund, COM (2011) 615, 6.10.2011.

(2) Enhancing access to and use and quality of information and communication technologies;

(3) Enhancing the competitiveness of small and medium-sized enterprises, the agricultural sector (for the EAFRD) and fisheries and aquaculture sector (for the EMFF);

(4) Supporting the shift towards a low-carbon economy in all sectors;

(5) Promoting climate change adaptation, risk prevention and management;

(6) Protecting the environment and promoting resource efficiency;

(7) Promoting sustainable transport and removing bottlenecks in key network infrastructures;

(8) Promoting employment and supporting labour mobility;

(9) Promoting social inclusion and combating poverty;

(10) Investing in education, skills and lifelong learning;

(11) Enhancing institutional capacity and an efficient public administration.

Table 6.1 Different forms of intervention logic compared

Intervention logic	Main features and objectives	Baseline and nature of regions	Connections to single market and Europe 2020	Policy thematic aims
1. **Broad-based economic development**	Overcoming the GDP gap by constructing a new model of growth and employment, with a strong emphasis on integration into the single market; examining and redressing all aspects of market access. Cohesion policy investment acts as the linchpin of public investment strategy	Usually adopted by Convergence regions in which there are development gaps that cannot be overcome by a piecemeal sectoral strategy. The comparative economic underdevelopment of the region calls for a wide range of interconnected interventions to be pursued simultaneously for socioeconomic conditions to be improved.	Consistent with the comprehensive upgrading of the supply-side at the core of Europe 2020. Implies being more receptive to the single market; scope for dynamic gains to be especially valuable in stimulating economic growth	Main thematic objectives: • mix of all thematic priorities, but with economic development as the core. Emphasis on connectivity and accessibility for transport, ICT, energy and environmental infrastructure, R&D, renewable energy, all complemented by institutional capacity-building.
2. **Transport connectivity**	Ensuring that gaps in transport infrastructure are filled, enabling a better connectivity. This can be seen as a more targeted and much narrower variant of (1).	Usually Convergence regions with significant transport bottlenecks. Likely to be especially relevant in peripheral areas or those facing natural barriers, as well as those where investment in transport has been insufficient, ineffective or poorly targeted. Because of the focus on transport, territorial dimension is prominent. Other challenges include how to balance other demands on cohesion; notably social and human capital development.	Upgrading of infrastructure is designed to improve connectivity and accessibility, improve trade links and attract investment.	Main thematic objectives: • promoting sustainable transport and removing bottlenecks in key network infrastructures. Transport investments focus on: Ten-T; Multimodal transport; telephone infrastructure; ports and airports; Energy investments focus on: strengthening energy and efficiency in sustainable and environmentally eco-friendly infrastructure.

Intervention logic	Main features and objectives	Baseline and nature of regions	Connections to single market and Europe 2020	Policy thematic aims
3. **Building on the position secured**	Consolidation of economic development and extending model of development to surrounding areas. Emphasis is on maintaining overall momentum by accelerating the pace of investments that can reinforce structural change. Main challenge is to consolidate and sustain growth by creating spill-over effects in surrounding areas.	Most likely to be followed by Competitiveness regions and Transition regions concerned to replicate and extend a successful approach to sustained economic growth and development. New targets are Convergence regions that have lagged behind core region but may also be relevant for regions that have stabilised competitiveness loss and now seek to regenerate, e.g. in urban areas.	Single market is largely seen as offering opportunities. Region has modernised its industry, but now wants to focus on better use of resources, invest in new skills, promote innovation in SMEs and smart specialisation.	Main thematic objectives: • strengthening research, technological development and innovation; • enhancing accessibility and quality of information and communication technologies; • enhancing the competitiveness of small and medium-sized enterprises; • supporting the shift towards a low-carbon economy in all sectors; • promoting climate change adaptation and risk prevention; • protecting the environment and promoting the sustainable use of resources.
4. **Advanced and inclusive development**	Regional objectives very much in line with national objectives, particularly in areas such as sustainable and inclusive growth. Focus on the ability to sustain the advanced development model already implemented.	Mostly, Competitiveness regions in EU15. In these regions, there is already progress towards higher growth and employment, and enhanced, competitiveness. Under this intervention logic, these regions now focus on ensuring greater social cohesion and economic and environmental sustainability.	Single market is largely seen as an area of opportunity. Region already has strong links to the knowledge economy and digital agenda. Emphasis is more on sustainable and inclusive growth. Cohesion policy supported interventions are intended to focus on sub-groups and on territorial niches, such as deprived urban neighbourhoods or peripheral areas, whose contribution to development is marginal within the scope of the	Main thematic objectives: • supporting the shift towards a low-carbon economy in all sectors; • promoting climate change adaptation and risk prevention; • protecting the environment and promoting the sustainable use of resources; • promoting employment and labour mobility; • promoting social inclusion and combating poverty; • investment in skills, education and

Intervention logic	Main features and objectives	Baseline and nature of regions	Connections to single market and Europe 2020	Policy thematic aims
			advanced economy.	lifelong learning.
5. **Catalysts for regional economic restructuring**	Focus is on a limited number of objectives, in particular boosting growth in certain areas of the territory that are lagging behind in the economic restructuring process, and therefore *vis-à-vis* the growth sectors of the country's economy, Main difference from (3) "Building on the position secured" is a more bottom-approach to finding region specific solutions.	Mostly Competitiveness regions in more developed Member States that have areas and sectors that are losing out in a relatively fast-growing national or economy. These regions seek to redefine their competitive position *vis-à-vis* the most advanced regions.	Single market has posed and continues to pose a challenge in many specific economic sectors (e.g. E-services; multimodal communication infrastructure). There is some catching-up to do in some sectors, which are creating new regional development gaps. Cohesion policy supported interventions are designed to act as catalysts for new regional development in specific areas of the country/region.	Main thematic objectives: • strengthening research, technological development and innovation; • enhancing the competitiveness of small and medium-sized enterprises; • promoting employment and labour mobility; • promoting social inclusion and combating poverty; • investment in skills, education and lifelong learning.
6. **Advanced industrial development**	Facilitating regional transitions to new competitive sectors, especially where there has been industrial decline. Main difference with (5) is that these interventions aim at improving manufacturing in the form of high quality productions that are competitive and supported by financial and advanced services, whereas (5) is broader and encompasses the overall economic restructuring process of areas.	Intermediate or competitiveness regions in richer Member States where there is the heritage of an important industrial past and a still viable industrial base, which has either suffered or is under threat of losing ground. Some attention to overcoming skill and human capital gaps and attention to SMEs.	Single market has posed major challenges for such regions as they pursue industrial restructuring, placing competitiveness strains on certain sectors. The assessment is made that the transformative trends of globalization have already brought a downturn to the industrial base or that they are threatening its viability. Strategy focuses on both resource efficiency and boosting competitive standing by repositioning the economy within	Main thematic objectives: • strengthening research, technological development and innovation; • enhancing accessibility to and use and quality of information and communication technologies; • enhancing the competitiveness of small and medium-sized enterprises (e.g. marketing of products; support of exports; • promotion of risk capital provisions and financial services; • promoting employment and labour

Intervention logic	Main features and objectives	Baseline and nature of regions	Connections to single market and Europe 2020	Policy thematic aims
			the single market. Movement of labour may be prominent; focus on encouraging FDI or creating conditions to attract it in order to modernize productions; and enhance the skills of the workforce in the supportive service sectors.	mobility; • promoting social inclusion and combating poverty; • investment in skills, education and lifelong learning; • investment in protecting the environment (e.g. control of pollution, etc.).
7. **Leveraging region specific assets**	Identifying and mobilising under-exploited natural regional assets, hence strongly place-based, as opposed to (5) where 'softer' capabilities are more prominent.	Mix of both Convergence and Competitiveness regions. Especially relevant for regions with obvious natural assets, irrespective of level of development. Focus on smart specialisation and sustainable growth to protect natural assets, but also to take advantage of place-specific attributes that can underpin industries such as tourism or transport services.	Emphasis on new sectors of activity to underpin change; potential to encompass 'green' specialisations and to be a leader in the sustainable dimension of Europe 2020 (e.g. sensitivity to climate change) or move up the value chain in industries such as tourism.	Main thematic objectives: • enhancing the competitiveness of small and medium-sized enterprises; • supporting the shift towards a low-carbon economy in all sectors; • promoting climate change adaptation and risk prevention; • protecting the environment and promoting the sustainable use of resources; • promoting sustainable transport and removing bottlenecks in key network infrastructures. Specific priority is also given to investment in cultural infrastructure and promotion of cultural heritage and investment that reinforces the scope for exploiting natural assets.

6.5 Concluding comments

As outlined in the various Commission proposals on the Multi-Annual Financial Framework and the legislative proposals for cohesion policy 2014-2020, growth will remain at the heart of cohesion policy. While Europe 2020 sets the tone by demanding that growth be smart, sustainable and inclusive, it is more how this is approached that matters for cohesion policy. Thus, it is important in preparation for the next generation of cohesion policy programmes to examine the sources of growth.

A traditional approach to growth is what might be called 'extensive' and stresses factor accumulation (the traditional Solow model), with the growth of the capital stock, especially, as the variable that accounts for differences in growth performance. In extensive growth models, technology is considered exogenous and is freely available to all economies and economic agents. An economy that succeeds in increasing its stocks of capital and labour will expect to grow. Cohesion policy has facilitated this sort of growth by boosting public investment.

Other theories start from the proposition that the technology variable is not exogenous, but is instead the result of specific characteristics of the economy, including policy choices. The scale of investment in R&D or human capital, institutional quality and appropriate infrastructure are among the factors considered to bear on the outlook for growth, and there has been a profusion of models establishing the contribution of one or the other factor. Public investment has an important role in promoting growth and has been associated in some econometric work with very high rates of return, although other findings are much more circumspect[44]. A clear policy message from the modelling exercises conducted for this study is that there are categories of public investment that offer better outcomes, notably those that augment human capital, although it is important also to stress that not all public investment is necessarily growth enhancing.

A second main conclusion from the empirical work done for this study is that the impact of the single market arises mainly through the trade channel. There are less substantial impacts through migration, although from the perspective of the least developed regions, migration can have an adverse effect from loss of skills. This is most pronounced in border areas. Cohesion policy has traditionally supported enterprise creation, as well as encouraged private investment; and the indications are that it has supported the emergence of more competitive firms. In all these ways, cohesion policy has made it easier for less-favoured regions to compete within the single market and, to this extent, the long-standing goal that cohesion policy would complement market integration has been realised.

These conclusions on the single market are reinforced by the fact that there has been convergence both in productivity at regional level and in economic cycles, despite the extent of migration from some regions and the fears that this would lead to brain drain. Although survey respondents in EU12 expressed some reservations, the overall verdict on the single market, especially for industrial development, was positive. There are, though, some concerns that the single market remains incomplete and that in some service sector activities, less favoured regions are not fulfilling their potential. A policy implication could be that there should be greater emphasis on service industries in future cohesion programmes, but that these also require complementary regulatory action at EU level if the full benefits are to be realised.

[44] One of the most widely quoted early studies (by Aschauer, 1989) found substantial effects, but subsequent work has challenged his findings. As Shioji (2001) notes, 'the empirical evidence on public capital productivity is mixed, to put it mildly', with many panel data studies showing poor return on public capital.

A third main conclusion of this study is that, despite some of the reservations articulated by regional interviewees, regional programmes took into consideration the Lisbon strategy when devising the implementation strategy, at least at a nominal level. This shows that the 'Lisbon strategy paradigm' has, albeit to a varying extent, penetrated the national and regional strategy for growth and development in all Member States. For the 2014-2020 period, there are some nuances which need to be taken into consideration. The launch of the Europe 2020 Strategy in early 2010, through its five headline targets and seven flagship initiatives, should in principle make it easier to identify how cohesion spending can contribute. The trouble is that when the wide range of measures in each of these Flagship Initiatives is totted-up, it is easy to identify well in excess of 300 different reform objectives or policy orientations.

In addressing this range of reforms, the sheer scale of cohesion funding is an element that has a considerable bearing on the approach that can be countenanced at regional level and how closely it can fit with Europe 2020. For those Member States where cohesion policy expenditure is near the ceiling of 4% of GDP (or 2.5% in the 2014-2020 period, as proposed by the Commission)[45] it will be a sizeable proportion of gross fixed capital formation and, in many instances, the lion's share of public investment. By contrast, in areas in which the expenditure is much lower relative to these indicators, it simply cannot play as prominent a role and, in most cases the impact of cohesion policy is bound to be more marginal.

Consequently, the interplay between the scale of funding and the future intervention logic a region chooses is of relevance for the reshaping of cohesion policy after 2013. Some regions are likely to have much reduced budgets and may, purely for this reason, have to rethink their approach to development. Those which continue to obtain funding that is a substantial proportion of public investment will have to consider whether their approach should be modified to take account of orientations that flow from Europe 2020, because what they choose will impinge directly on the Member State's aggregate effort to fulfil its Europe 2020 commitments.

Similarly, following from the recommendations of the Barca report (2009) and the ideas put forward in the EU budget review, there is something of an expectation that cohesion policy, too, should be concentrated on fewer priorities, yet as discussed above, there is a plethora of 'intervention logics'. Equally, an important function of what might be called the cohesion policy paradigm, arguably transcending the different intervention logics, is that there is a considerable top-down push to accelerate and intensify structural reforms. The extent to which this re-structuring of cohesion policy can make its way into the legislative proposals for cohesion policy from 2014-2020 or, indeed, the next generation of cohesion policy programmes, depends on the outcome of the negotiations with the Council and the European Parliament in the first instance, and later, with Member States and regions on the content of the programmes.

Equally, the choice of intervention logics should be accompanied by efforts to ensure that the right framework conditions are in place. Experience suggests that the outcomes of cohesion policy are sub-optimal if the wider economic and framework conditions are not supportive, however, well-conceived the sub-national intervention is, again highlighting the importance of policy coherence. The Commission's proposals for cohesion policy 2014-2020 adopted in October 2011 propose a number of conditionalities to ensure that the right framework conditions, whether macroeconomic, regulatory, strategic or institutional, are in place to maximise the effectiveness of cohesion policy investment.

Perhaps the key governance issues are who does what and what accountability channels are in place. The Europe 2020 National Reform Programmes 'belong' to the Member States,

[45] In its Communication of 29 June 2011 on the next Multi-annual financial framework, the Commission proposed to reduce the ceiling for the cohesion policy financial allocation from 4 % to 2.5% of GDP.

and they will be held accountable for what they contain and how they are implemented. A number of strategic priorities in the cohesion policy programmes can dovetail readily with NRP priorities, good examples being those that make a strong contribution to national competitiveness or to sustainability targets. But it is conceivable that others (precisely because they are targeted at the regional level rather than the national level) may be less easily compatible. A regional government is, in the first instance, accountable to its own citizens and less directly to the rest of the Member State, let alone the EU as a whole, and therefore has strong incentives to pursue policies that boost regional well-being, irrespective of any national impact. However, in terms of ‘who does what?’ it is important to recognise that sub-national authorities – in federal and unitary systems alike – often have competences for major policy areas that impinge on Europe 2020 objectives, such as education or active labour market policies.

6.5.1 Policy recommendations

The Europe 2020 strategy manifestly establishes the broad framework for intervention and sets core aims, but in the formulation and design of new cohesion programmes, regions and Member States also have to make careful use of the considerable latitude for different orientations consistent with certain Europe 2020 goals. Clear policy choices will need to be made about the underlying rationale and main orientations of cohesion policy if competing demands on the policy are to be reconciled. These choices will then affect intervention logics, the balance in Operational Programmes between the overall thematic priorities and the recasting of multi-level governance.

A first priority for the future is to ensure that cohesion policy continues to support the integration of regions into the single market. However, past experience shows that a renewed push for single market implementation is likely to have an uneven, if not easily predictable, impact on regional economies. For this reason, a one-size-fits-all approach is unlikely to be productive and should be avoided. Policies will also need to be sufficiently flexible to adjust to changing economic and social environments or policy strategies.

In parallel, cohesion policy can facilitate the consolidation of the single market, especially by support for projects or initiatives that offer the prospect of a ‘double-dividend’ by advancing cohesion and overcoming obstacles to an integrated market. Completion of networks, for example, can achieve both simultaneously.

The strategic role of leading regions, particularly in ‘convergence’ Member States is vital to boost competitiveness and take on both the challenges and benefits derived from the single market. A careful balance will need to be struck in the policy mix chosen by the region between addressing single market challenges and territorial or inclusive objectives. As the ‘donut’ simulation shows, the impact within Member States may be significant, but for the EU as a whole, the net impact is minimal.

Regional and national authorities will, therefore, need to be hard-nosed about selecting the intervention logics that are associated with the more successful outcomes, but will also need to review whether a past logic – even if successful – continues to be appropriate. In a period of fiscal retrenchment, special attention should be paid to quality of investment.

In addition, future intervention logics will have to take account of evolving national priorities, not least in relation to the recovery from the economic crisis. Three consequences of the crisis likely to be especially relevant and for which cohesion policy can provide a vital boost are:

- The need, in certain Member States, to deal with competitiveness shortcomings by accelerating structural reform. Cohesion policy can facilitate such reforms and, because it is a long-term policy, can help to overcome the political economy obstacles that arise, especially during the early stages of reform, which can be disruptive and contested in a way that undermines legitimacy.

- A legacy of higher unemployment which may require a fresh approach to employment policy, notably in maintaining employability and preventing ‘hysteresis’ (detachment from the labour market).

- A possible accentuation of social exclusion, whether from a widening of inequalities or an increased in vulnerability of segments of the population, such as youths or migrants.

Achieving an effective combination and alignment of Europe 2020 and cohesion policy will require improvements in governance. There needs, first, to be a dialogue across the policy ‘silos’. Second, in the process of designing policy, active participation from relevant stakeholders is important and, to the extent it is possible, needs to be based on doing more to promote innovation, not just in leading-edge industry, but also in services and in public administration. Regional actors, especially have to be brought into the process more convincingly.

A last recommendation is that, while recognising the broad reach and central role of Europe 2020 in revitalising the EU economy, it is important not to lose sight of the treaty goal of reducing disparities. In this perspective, the Europe 2020 strategy has to ensure that the fruits of smart, sustainable and inclusive growth are available to all Member States and regions and that cohesion is not seen as, or allowed to become, a second-order objective. The aim should remain the reduction of disparities through a range of investments which allow for putting Member States and regions on a sustainable growth path.

More specifically, the following policy recommendations should be noted:

- **Balance between growth/productivity and loss/closure**. The single market is an important driver of development, but can also pose challenges in terms of greater competition from other regions. Public policy needs to be able to balance the potential to accelerate growth and productivity with the risks associated with closures of uncompetitive activity and the resulting losses of economic activity and jobs.

- **Growth poles and territorial cohesion**. The strategic role of leading regions, especially in convergence Member States, is vital to boost competitiveness and take on both the challenges and benefits derived from the single market. However, this also requires ensuring that a careful balance is struck between enhancing growth and productivity in the central leading (often capital) region and addressing territorial imbalances across the entire Member State.

- **Focus on cross-border spillovers**. Investment in the provision of public goods that have significant cross-border spillovers, such as transport or innovation networks and environmental protection, is important to enhance the benefits of the single market.

- **Public investment is not enough**. Public investment, in particular EU co-financed public investment is itself insufficient to reap the benefits of the single market. Most single market measures have institutional or regulatory implications, which, in order for regions to benefit fully from the single market, require effective implementation.

- **Investment priorities.** Although public investment in less developed regions should initially focus on hard investments to address gaps in infrastructure, over time investments should focus on R&D, innovation and human capital, given that their growth effects are more long term. Nevertheless, the right policy mix between investment in ‘hard’ instruments such as infrastructure and ‘soft’ instruments such as R&D, innovation and human capital depends on the characteristics of the region.

- **Improving the quality of public spending is important**. The earmarking of expenditure in favour of specific policy areas needs to be approached with care. Experience from the current period suggests that Managing Authorities have not fully taken on board the Lisbon earmarking provisions or indeed, the Europe 2020 targets and flagship initiatives. Thus, ensuring that public investment is directed towards Europe 2020 priorities will require strengthening mechanisms designed to focus public expenditure on certain priorities and ensuring that, at an operational level, quality considerations are understood and applied.

- **Coherent governance**. Close attention needs to be paid to the interaction between the formulation and delivery of the NRPs and the design and implementation of cohesion policy programmes, in particular because the latter have a strong territorial or regional dimension. As part of this, better communication and coordination between different tiers of government needs to be assured, so that regional and national goals can be reconciled in determining national public investment strategies to achieve both the Europe 2020 objectives and cohesion policy objectives.

- **A regional dimension to Europe 2020?** Whether national Europe 2020 strategies should be complemented by explicit regional 2020 strategies should be examined. This is particularly relevant for some Member States where policy areas under Europe 2020 fall under the competence of regional and local governments.

- **Stress on outcomes**. Policy progress and delivery needs to be monitored on the basis of outcomes in terms of societal objectives, and not just operational outputs. This is likely to need a nuanced approach towards relevant indicators and resort to interim targets that can be used where Europe 2020 headline targets are distant from the regional staring-point.

- **The right framework**. Aligning cohesion policy with Europe 2020 will require going beyond re-directing cohesion policy resources towards Europe 2020 objectives and flagship initiatives. It will also require ensuring adequate framework conditions for the funds and that the intervention logic of cohesion policy focuses on areas of structural change, including regulatory change and administrative/institutional capacity-building.

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