

The Economics of European Regions: Theory, Empirics, and Policy

Dipartimento di Economia e Management

Co-funded by the
Erasmus+ Programme
of the European Union



Project funded by
European Commission Erasmus + Programme –Jean Monnet Action
Project number 553280-EPP-1-2015-1-IT-EPP/JO-MODULE

Davide Fiaschi Angela Parenti¹

November 29, 2019

¹davide.fiaschi@unipi.it, and aparenti@ec.unipi.it.

EU economy

- With over 500 millions of citizens, the European Union (EU) as a whole generates, in 2016, a GDP (nominal) of about 16.5 trillion euro (IMF source).
- This corresponds to about 22.8% of the nominal gross world product, which makes the EU the largest economy in the world.
- However, there are substantial **economical disparities** within the EU.
- In the European Union (EU) of 28 Member States, one in three EU citizens (170 million in total) now live in the poorest regions which receive assistance.
- Economic and social disparities have significantly deepened with the enlargements.
- In terms of per capita income, Luxembourg is now seven times richer than Romania.

Regional disparities

- At the regional level, the difference is even bigger: the richest region is Inner London in the United Kingdom with 325% of the EU's per capita income, while the poorest region is Severozapaden in Bulgaria with 30% of the EU.

https:

[//en.wikipedia.org/wiki/Economy_of_the_European_Union](https://en.wikipedia.org/wiki/Economy_of_the_European_Union)

- Similar discrepancies still exist even within countries: for example, the richest region in Italy Trento, had 130% of Italy's per capita income while the poorest, Campania, had 65.9% of the Italian average.
- EU regional policy** aims to create economic and social cohesion and to **reduce the gap** between the development levels of the various regions.

EU history

- The European Union (EU) comprises 28 member states.
- In 1957 six core states - Belgium, France, West Germany, Italy, Luxembourg and Netherlands - founded the EU's predecessor, the **European Economic Community**.
- Applying in 1969 were Britain, Ireland, Denmark, and Norway. Norway, however, declined to accept the invitation to become a member, leaving just the UK, Ireland and Denmark to join in 1973.
- A further enlargement took place in 1981 with Greece joining on 1 January, six years after applying.
- In 1985, Greenland voted to leave the Community after gaining home rule from Denmark.
- Spain and Portugal joined (having applied in 1977) on 1 January 1986 in the third enlargement.

EU history (cont.)

- In 1987 Turkey formally applied to join the Community and began the longest application process for any country.
- In 1989, the Berlin Wall fell, along with the Iron curtain. Germany reunified and the door to enlargement to the former eastern bloc was opened.
- With a wave of new enlargements on the way, the Maastricht Treaty was signed on 7 February 1992 which established the **European Union** when it came into force the following year.
- In 1995 Austria, Sweden and Finland joined the EU.
- At the start of 1999 the **euro** as a currency was launched and the European Central Bank was established. On 1 January 2002, notes and coins were put into circulation, replacing the old currencies entirely.

EU history (cont.)

- Eight Central and Eastern European countries (the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia), plus two Mediterranean countries (Malta and Cyprus) were able to join on 1 May 2004.
- In 2007, the fifth enlargement completed with the accession of Romania and Bulgaria on 1 January 2007.
- Also, in 2007 Slovenia adopted the euro, Malta and Cyprus in 2008 and Slovakia in 2009.
- The seventh enlargement was on July 2013 with the accession of Croatia.

EU history (cont.)

- **Brexit:** In a referendum on 23 June 2016 51.9% of the participating UK electorate voted to **leave the EU**.
- On 29 March 2017, the British government invoked Article 50 of the Treaty on the European Union.
- The UK was expected to leave the EU on 29 March 2019.
- Still on the way....

https:
[//en.wikipedia.org/wiki/Enlargement_of_the_European_Union](https://en.wikipedia.org/wiki/Enlargement_of_the_European_Union)

History of EU regional policy

- The establishment of the **European Coal and Steel Community** (ECSC) in 1952 was a first step towards a supranational Europe.
- The aim of the **ECSC Treaty** (1951), as stated in Article 2, was to contribute, *through the common market* for coal and steel, to economic expansion, growth of employment and a rising standard of living.
- With the **Treaty of Rome** (1957), the European Community undertook the objective of promoting, through the creation of a common market, **harmonious development** of the economic activities of the whole community.
- In the preamble, the signatories of the Treaty declare that: "anxious to strengthen the unity of their economies and to ensure their harmonious development **by reducing the differences** existing between the various regions and the **backwardness** of the less-favoured regions [...]".

History of EU regional policy (cont.)

- Thus, with the Treaty of Rome the **European Social Fund** (ESF) was created with the function of improving job opportunities for workers, rising employment of young people and women, growth in educational attainment and increase in R&D and to raise the standard of living.
⇒ ESF is the *first instrument* of the Community Structural Policy.
- Afterward in 1962, the **European Agricultural Guidance and Guarantee Fund** (EAGGF) was created to achieve the objectives of the Common Agricultural Policy (CAP) defined in the Treaty of Rome (Articles 38 to 47).
- This fund was settled as a part of CAP and structured in two sections: Guarantee and Guidance.
The first should be devoted to the general objective of market unity with guaranteed supply and price stability, while the EAGGF-Guidance should have the mission of promoting structural reforms for the development of the primary sector.
⇒ EAGGF became the *second instrument*.

The Community Regional Policy

- In 1975 the **regional imbalances** start to be considered a community problem instead of exclusive for each country.
- A **Community Regional Policy** was established with a specific instrument, i.e. the **European Regional Development Fund (ERDF)**.
- The ERDF was set up for a *three-year period* with a budget of ECU 1300 million and with the objectives of *correcting regional imbalances* due to predominance of agriculture, industrial change and structural unemployment.
- In that period the ERDF could finance three actions, eligible for up to 50% of public expenditure, preferably to be carried out in national state aid areas:
 - ① investments in small enterprises creating at least 10 new jobs;
 - ② investments in infrastructure related to point 1, and
 - ③ infrastructure investments in mountainous areas, which had to be eligible under the Agriculture Guidance Fund.

The Community policy of economic and social cohesion

- In 1987 *legal foundations* to address economics and social imbalances at Community level were introduced by the *Single European Act* (SEA).
- The SEA established a **Community policy of economic and social cohesion** to counterbalance the effects of the completion of the internal market on the less developed Member States.

The Community policy was intended as promoting the **competitiveness** of European regions (Articles 130(f)-130(p), Single European Act, 1987) and, at the same time at **reducing disparities** between the levels of development of various regions, and the **backwardness** of the less-favoured regions (Article 130(a), Single European Act, 1987).

1989-1993: A More Genuine EU Cohesion Policy

- Regional disparities in EU12 widely increased after the accession of Greece in 1981 and Portugal and Spain in 1986.
- As a result, in **1988** the first **great reform** of the Structural Funds was effected and the concept of “**economic and social cohesion**” was incorporated for fear of maintaining the regional disparities during the process of constructing Europe.
- In March 1988, the European Council in Brussels decided to allocate **ECU 64 billion** (at 1988 prices) to the **Structural Funds** which represented a doubling of annual resources over the period 1989-93.
- The reform was an attempt of changing the different funds into *real instruments of economic and social development*.
- Key principles were introduced, such as focusing on the poorest and most backward regions, multi-annual programming, strategic orientation of investments and the involvement of regional and local partners.

1989-1993: A More Genuine EU Cohesion Policy

In particular, four principles were introduced to ensure that funds were rationalized and well defined:

- 1. **CONCENTRATION:** In order to reach the greatest possible effectiveness of Structural Funds, their application obeyed the principle of concentrating on functional objectives. These objectives were five:
 - **Objective 1:** promoting the development and structural adjustment of the less-developed NUTS 2 regions, that is:
 - (i) regions whose **per capita GDP was lower than 75%** of the Community average, taking the figure for the three last years;
 - (ii) Northern Ireland and the French overseas departments;
 - (iii) other regions whose per capita GDP was close to that of regions mentioned in (i) and for which particular reasons existed for their inclusion on the list.

1989-1993: A More Genuine EU Cohesion Policy

- **Objective 2:** converting the regions, border regions, or part regions (including employment areas and urban communities) seriously affected by industrial decline, that is regions were to be designated at NUTS level 3 and had to have:
 - (i) an average **level of unemployment** higher than that of the Community during the previous three years;
 - (ii) **industrial employment**, as a percentage of employment, in excess of the Community average in any of the previous 15 years;
 - (iii) and an observable **fall in industrial** employment relative to the reference year.

1989-1993: A More Genuine EU Cohesion Policy

- **Objective 3:** combating **long-term unemployment**, that is people over 25 and out of work twelve months or more, but this minimum period was waived in the case of women returning to work and people with disabilities;
- **Objective 4:** facilitating the **occupational** integration of **young** people that had to be over compulsory school age and under 25;
- **Objective 5:** with a view to reform of the *common agricultural policy*:
 - *Objective 5a:* speeding up the adjustment of **agricultural and fishing sectors**;
 - *Objective 5b:* promoting the development of **rural areas**, that is areas with a below average level of economic development, employment dominated by the agricultural sector and poor level of agricultural incomes.

1989-1993: A More Genuine EU Cohesion Policy

Therefore, three objectives had a **territorial nature** (objective 1, objective 2 and objective 5b), while three a **horizontal nature** (objective 3, objective 4 and objective 5a).

The Structural Funds contributed to the attainment of objectives on the basis of the breakdown given below:

- Objective 1: ERDF, ESF, EAGGF Guidance Section;
- Objective 2: ERDF, ESF;
- Objective 3: ESF;
- Objective 4: ESF;
- Objective 5: EAGGF Guidance Section ESF, ERDF.

Moreover, 10% of the structural funds were reserved for Community Initiatives Programmes (CIP).

1989-1993: A More Genuine EU Cohesion Policy

- 2. PROGRAMMING: The Structural Funds were implemented within the framework of **multiannual programmes** with a first programming period of five years (1989-1993). Their content was drawn by the national or regional partners and negotiated with the European Commission on the basis of the beneficiary areas.
- 3. ADDITIONALITY: The Structural Funds were not intended to be utilized as a substitute for national funding, but rather to provide **additional assistance**. The Member States were thus under the obligation to *maintain their public expenditure* at the level of the beginning of the programming period; the Community assistance were subject to the following limits: maximum 75% of total cost and as a general rule; minimum 50% of public expenditure for measures applied in the regions defined for action under Objective 1; or, minimum 25% of public expenditure for measures applied in other regions.
- 4. PARTNERSHIP: close **consultation** between the different partners (i.e., European Commission, Member States, regional or local authorities concerned) at all the steps in a programme: preparation, negotiation, implementation, monitoring and evaluation.

1994-1999: Doubling the Effort and a New Instrument

- The Treaty of the European Union,² which came into force in 1993, states as one of main goal of the Union the “promotion of **balanced and harmonious development** of activities in the whole of the Community, of durable growth [...] of **economic and social cohesion** and solidarity between the member states” (Art. 2), alongside economic and *monetary union* and the single market (Art. 3).
- It also established a new instrument, the **Cohesion Fund** to be set up before 31 December 1993, and a new institution, the **Committee of the Regions**, as well as the introduction of the **subsidiarity principle**.
- Overall ECU 168 billion (at 1994 prices) were allocated.

²Treaty on European Union, Maastricht 7 February 1992

1994-1999: Doubling the Effort and a New Instrument

- The method of allocation of Structural Funds is partially revised. In particular:
 - **Objectives 1, 2 and 5** remain unchanged, **Objectives 3 and 4** are slightly redefined and the entry of Austria, Finland and Sweden in the European Union leads to the creation of Objective 6, to favour regions with very low population densities;
 - **CIP** are slightly redefined;
 - a **Cohesion Fund** of over 15 billions ecus is introduced to aid less-developed Member **states**, i. e. states with a **per capita GDP below 90%** of EU average, in their effort to attain the convergence criteria that were defined for the introduction of the Monetary Union (only countries in line with the program of convergence to the Monetary Union are indeed eligible). The specific purpose of the Cohesion Fund is to provide financial support for environmental investment projects and for transport infrastructure projects within the *Trans-European Transport Network*.

2000-2006: Enlarging the European Union

A step towards the simplification of the Cohesion Policy and the preparation for enlargement were the two major themes of the period 2000-2006.

In particular, the 1999 reform:

- merged the previous Objective 2 and 5, as well as 3 and 4 and reduced the number of Structural Funds objectives **from six to three**, that is:
 - **Objective 1:** promoting the development and structural adjustment of regions whose development was lagging behind (i.e. GDP per capita lower than 75% of Community average);
 - **Objective 2:** supporting the economic and social conversion of areas facing structural difficulties;
 - **Objective 3:** supporting the adaptation and modernisation of policies and systems of education, training and employment;
- reduced the number of CIP to four;
- established that the participation in the area of each initiative has to be financed by a single Fund.

2000-2006: Enlarging the European Union

Overall EUR 213 billion (at 1999 prices) were allocated over the period 2000-2006, and EUR 21.7 billion (at 1999 price) for the 10 New Member States between 2004-2006.

Administration of the Structural Funds between 2000 and 2006 was governed by the so called “ $n+2$ ” rule. According to this rule, failure to provide proof of payment within two years meant that the allocation was lost.

In November 2002 a new financial instrument, the **European Union Solidarity Fund** (EUSF), which is not part of Cohesion Policy, was set up to provide urgent aid to regions suffering major catastrophes.

2007-2013: Focus on growth and jobs

In February 2004, the European Commission published a document on the future of the enlarged Union, including a budget proposal for the years 2007-2013.

Of the total budget of 1.025 billion euro, 336 billion euro were earmarked for the Structural and Cohesion Funds, while another 70 billion euro were allocated for rural development under a different heading than cohesion.

While merging the previous Objectives 2 and 3, the 2006 reform transformed the Interreg initiative within a third objective while integrating other CIP into the main stream programmes.

2007-2013: Focus on growth and jobs

The priority objectives are defined as follows:

- **Convergence:** aims at speeding up the convergence of the least-developed Member States and regions defined by GDP per capital of less than 75% of the EU average;
- **Regional Competitiveness and Employment:** covers all other EU regions with the aim of strengthening regions' competitiveness and attractiveness as well as employment; and
- **European Territorial Cooperation:** based on the Interreg initiative, support is available for cross-border, transnational and interregional cooperation as well as for networks

Total of Structural and Cohesion Funds available:

- 347 billion euro representing 35.7% of the EU budget and 0.38% of the total GDP of the EU:
 - of which for Objective 1 regions: 81.5%;
 - population in Objective 1 regions: 170 million (35% of the total, including phasing-out regions).
- Main beneficiary countries: Poland (67.3 billion), Spain (35.2 billion), Italy (28.8 billion), Czech Republic (26.7 billion), Germany (26.3 billion), Hungary (25.3 billion), Portugal (21.5 billion), and Greece (20.4 billion)

http://ec.europa.eu/regional_policy/sources/docgener/panorama/pdf/mag26/mag26_en.pdf

http://ec.europa.eu/regional_policy/en/policy/what/history/

2014-2020: Ongoing

Investing to meet the goals of the *Europe 2020 Strategy* for **smart, sustainable** and **inclusive growth** in the European Union.

Whats **new** for 2014-2020?

- **Stronger focus on results:** clearer and measurable targets for better accountability.
- **Simplification:** one set of rules for five Funds.
- **Conditions:** introduction of specific preconditions before funds can be channelled.
- **Strengthened urban dimension and fight for social inclusion:** a minimum amount of ERDF earmarked for integrated projects in cities and of ESF to support marginalised communities.
- **Link to economic reform:** the Commission may suspend funding for a Member State which does not comply with EU economic rules

What are the **priorities**?

- Cohesion Policy has set **11 thematic objectives** supporting growth.
- **Investment from the ERDF** will support all 11 objectives, but **1-4** are the main priorities.
- **Main priorities for the ESF** are **8-11**, but also 1-4.
- The **Cohesion Fund** supports objectives 4-7 and 11.



A comparable dataset for Period I, Period II and Period III

Programming Period	Share of funds on EU GDP	Average <i>SCF</i>	St. Dev. of <i>SCF</i>
Period I (1989-1993)	0.1568	0.0044	0.0081
Period II (1994-1999)	0.3767	0.0039	0.0066
Period III (2000-2006)	0.2541	0.0039	0.0069

Tabella: Descriptive statistics on Structural and Cohesion Funds in the three programming periods

Objective	Period I (1989-1993)	Period II (1994-1999)	Period III (2000-2006)
1	67.7	64.6	64.4
2	8.74	5.11	13.5
3	-	6.87	-
4	-	1.25	-
3 & 4	10.55	-	-
5	5.60	2.96	-
5a Agr.	-	5.37	2.88
5a Fish.	-	0.88	0.40
5b	-	3.30	3.57
6	-	0.40	-
NL	0	-	-
PIM	0.41	-	-
2 Init.	-	3.12	0.41
Other Init.	-	1.87	2.57
Cohesion	2.62	9.85	19.17
Total	100	100	100

Tabella: Percentage of commitments of funds according to Objectives. "NL": New Länder in Germany in Period I; "PIM": regional program in Period I for regions outside Objective 1; "2 Init.": regional initiatives similar to Objective 2 for period III "Other Init."

	Period I (1989-1993)	Period II (1994-1999)	Period III (2000-2006)
All.Obj	35.67	43.35	45.48
Ob. 1	49.90	57.15	55.66
Ob. 2	0	0	1.52
Ob. 3 & 4 & 5	3.26	1.62	-
Ob. 6 & Other	0	23.06	40.95
Cohesion	55.86	81.21	60.74

Tabella: Percentage of total funds given to regions with GDP per worker below 75% of sample mean