

# **Towards a convergent union? European regional policy between austerity and public investment**

**Manchester 7 November 2012**

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# Summary

- **Why regional policy?**
- **Impact of the crisis**
- **The contribution of Structural Funds and the situation of local authorities' finances**
- **Impact on regional policy making and future of EU regional policy**

**Why regional policy?**

## Why regional policy?

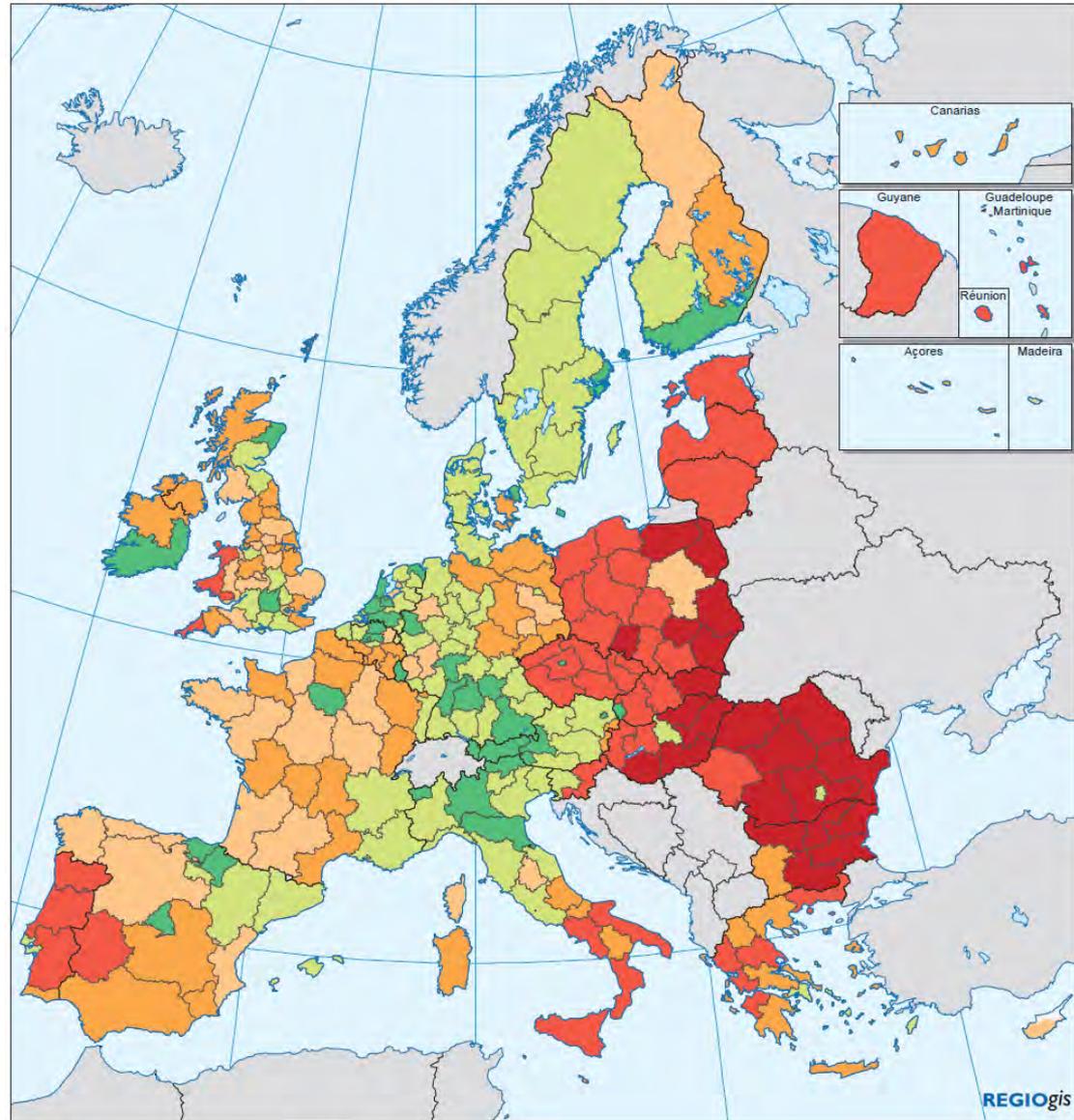
- To reduce economic disparities across Europe. Out of 271 regions, one in four has a GDP per capita under the 75% of the European average.
- To achieve competitiveness. The idea is to enable all regions to achieve their development potential contributing to the overall growth of Europe.
- To meet European EU 2020 challenges: smart, sustainable and inclusive growth.

# Regional disparities

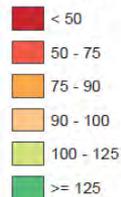
## GDP per capita

- East-West / North-South division
- Top-10: 7 capital regions, 8 in Northern-Western Europe
- EU-15 (110.4) / EU-12 (65.8)
- LU (271.3) / BG (44.3)
- Inner-London (329.9) / Severozapaden (BG, 28.3)

Source: Eurostat code  
tgs00006



### GDP per head (PPS), 2009



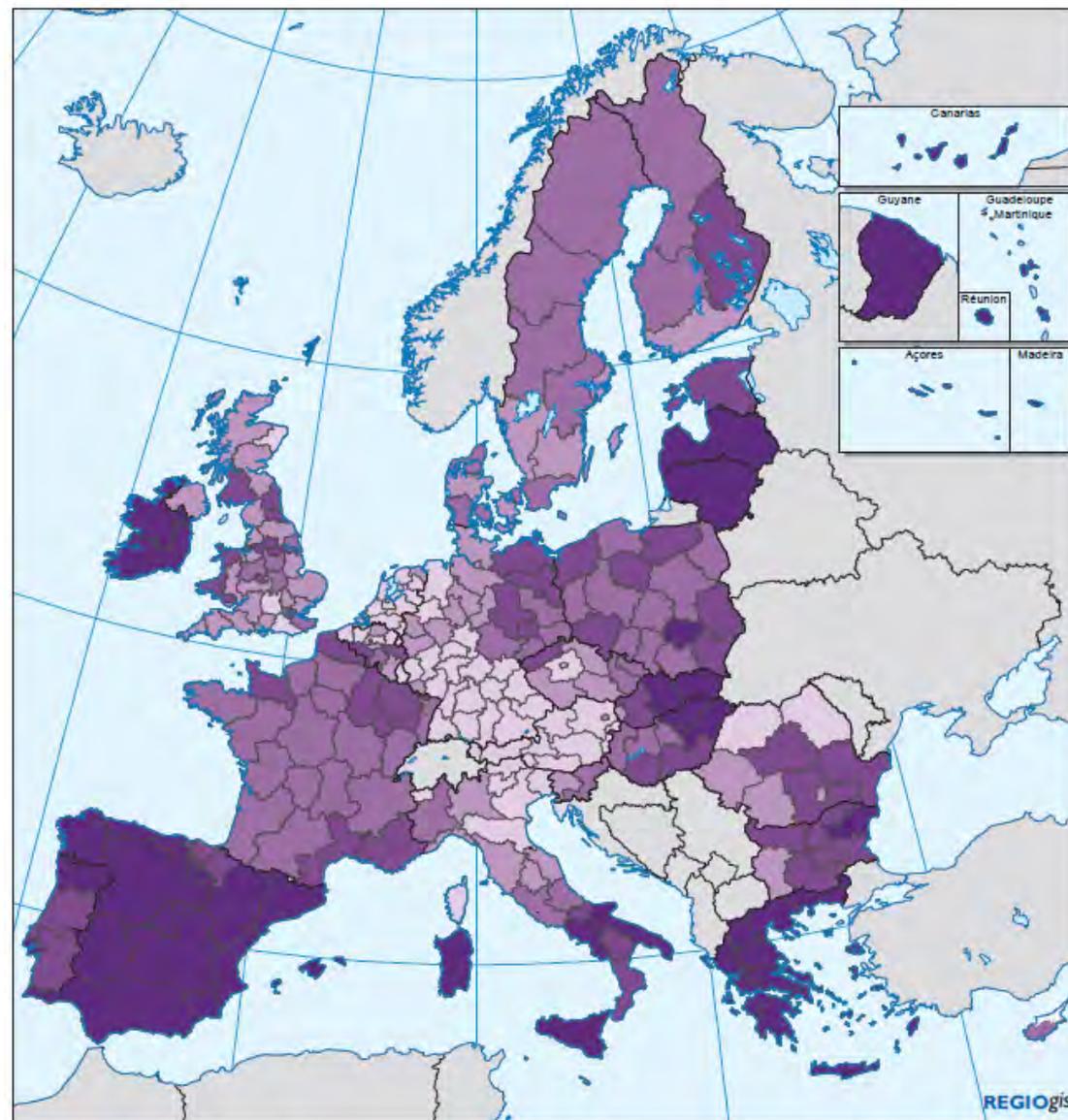
Source: Eurostat

# Regional disparities

## Unemployment

- One region out of 3 above 10%
- Average 9.6%
- Between 2.5% (Salzburg, Tyrol, AT), and 30% (Andalusia).
- Top 30: 28 en ES, EL, FR (outermost regions)

Source: Eurostat code  
tgs00010



### Unemployment rate, 2011



EU-27 = 9.6

Source: Eurostat

# Regional disparities

## Quality of Government

- 34,000 interviewed in 172 NUTS 1 or 2 regions.
- 34 questions focused on three services, education, health care and law enforcement
- Respondents were asked to rate these services with respect to their quality, impartiality and level of corruption.
- In RO, LT, SK and BG more than 20% of respondents were asked to pay a bribe in the previous 12 months
- In BG more than 80% of respondents do not trust the justice system
- Evidence of impact on returns of public expenditure (Rodriguez-Posé 2012)

### Source:

[http://ec.europa.eu/regional\\_policy/newsroom/pdf/20110504\\_shortnote\\_governance.pdf](http://ec.europa.eu/regional_policy/newsroom/pdf/20110504_shortnote_governance.pdf)

### And

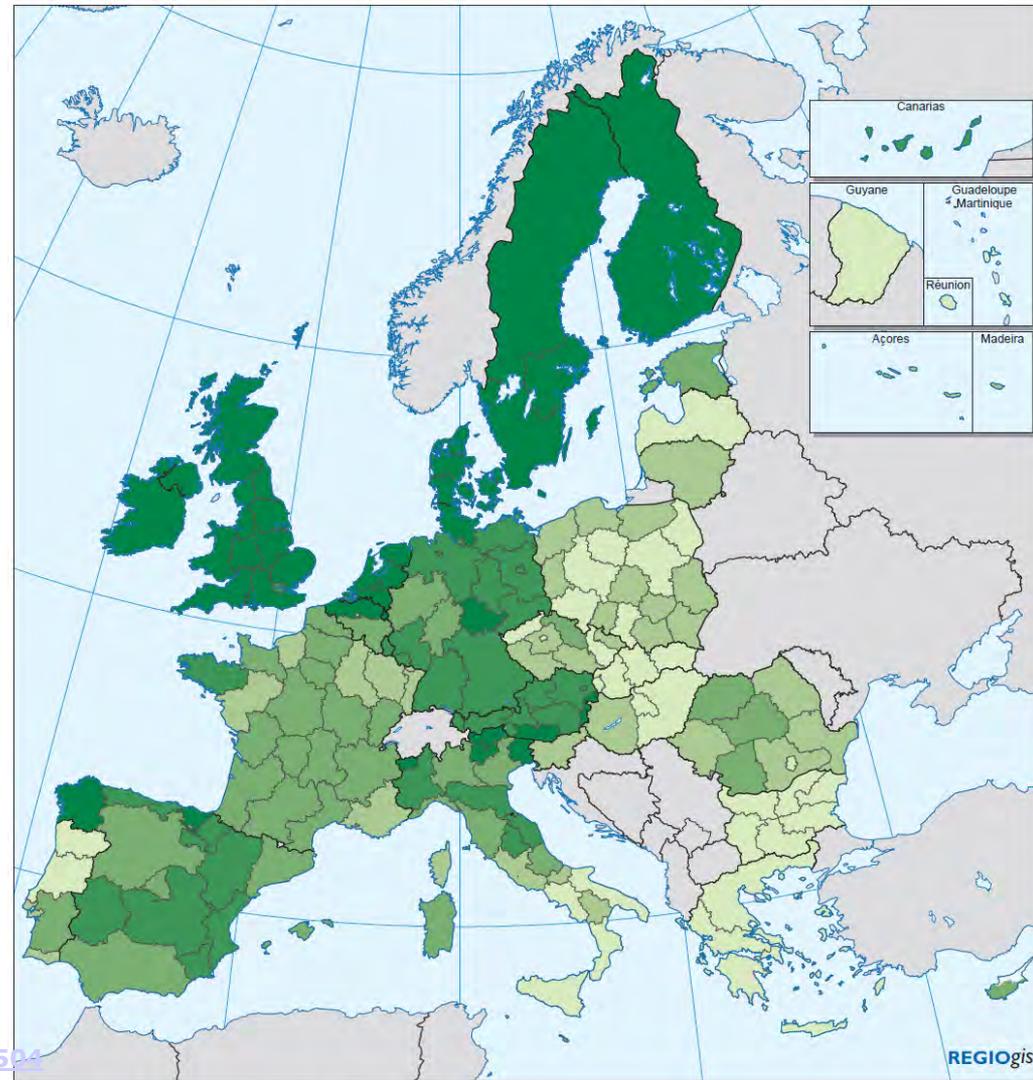
[http://ec.europa.eu/regional\\_policy/sources/docgener/work/2012\\_02\\_governance.pdf](http://ec.europa.eu/regional_policy/sources/docgener/work/2012_02_governance.pdf)

### Full study here (part 1)

[http://ec.europa.eu/regional\\_policy/sources/docgener/studies/pdf/2010\\_government\\_1.pdf](http://ec.europa.eu/regional_policy/sources/docgener/studies/pdf/2010_government_1.pdf)

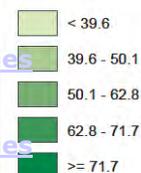
### And here (part 2)

[http://ec.europa.eu/regional\\_policy/sources/docgener/studies/pdf/2010\\_government\\_2.pdf](http://ec.europa.eu/regional_policy/sources/docgener/studies/pdf/2010_government_2.pdf)



## Quality of Government, 2009

Index - Values range between 0 (low) and 100 (high)



EU27 = 55

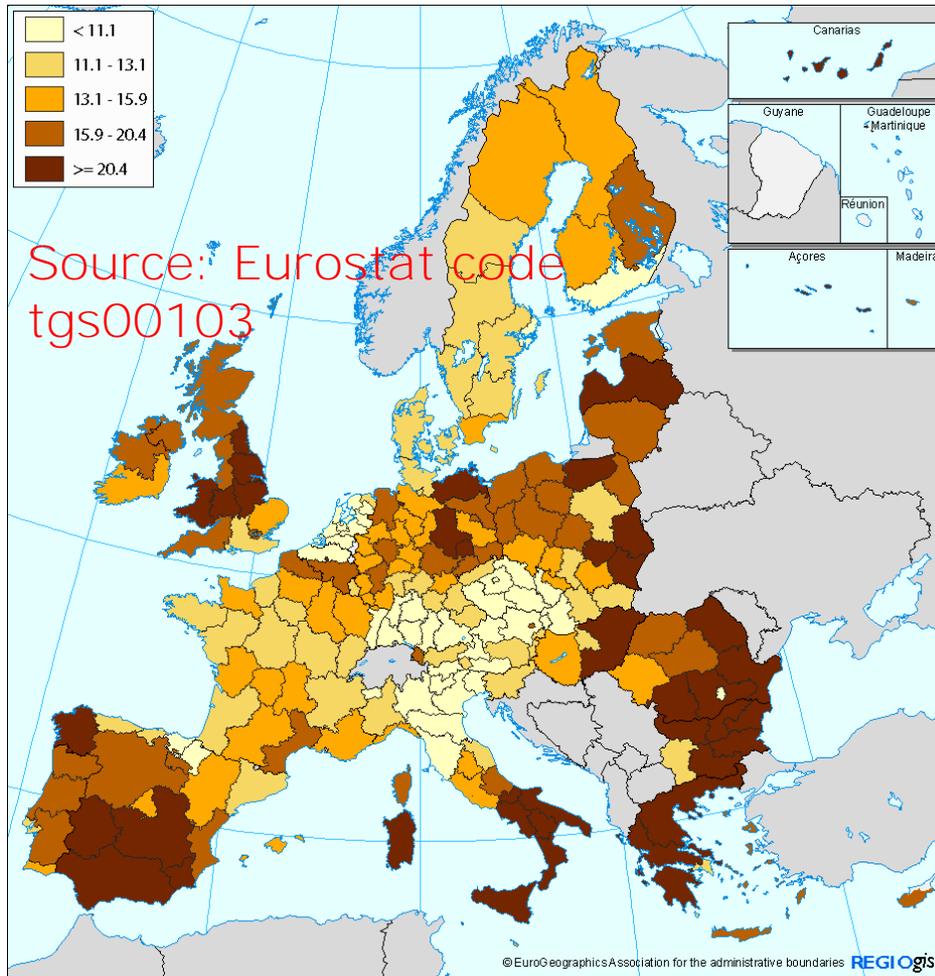
Source: Study on Sub-national variation in Quality of Government (2010) by the Gothenburg Quality of Government Institute. Data is based on World Bank data and a large scale survey carried out in 2009

0 500 Km

# Regional disparities

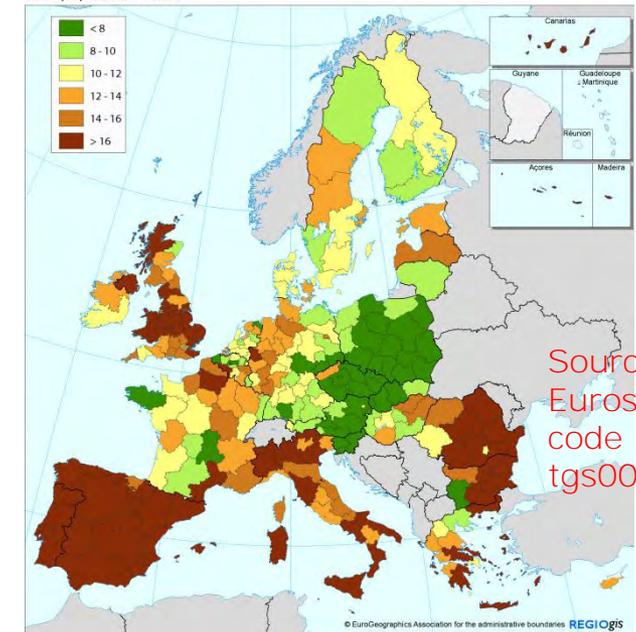
## At-risk-of-poverty rate after social transfers (below 60% of national median), 2008

in % of total population



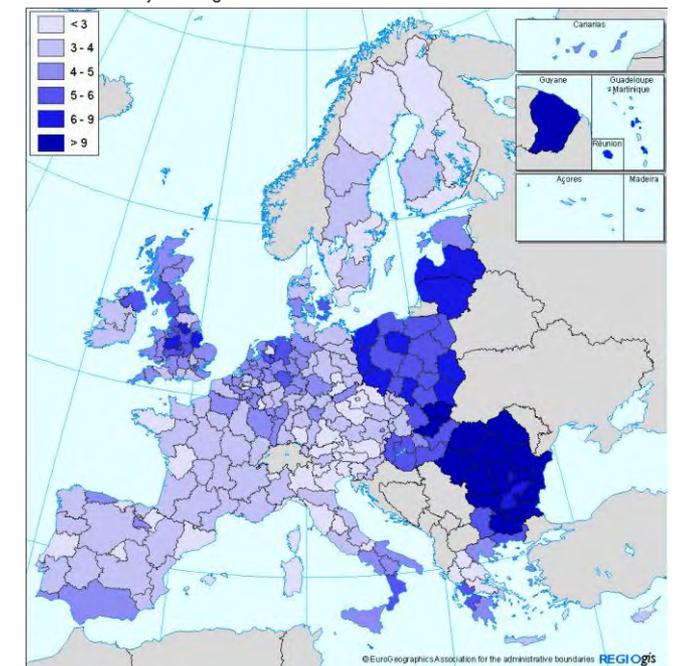
## Early school leavers, Average 2008-10

% of population 18-24



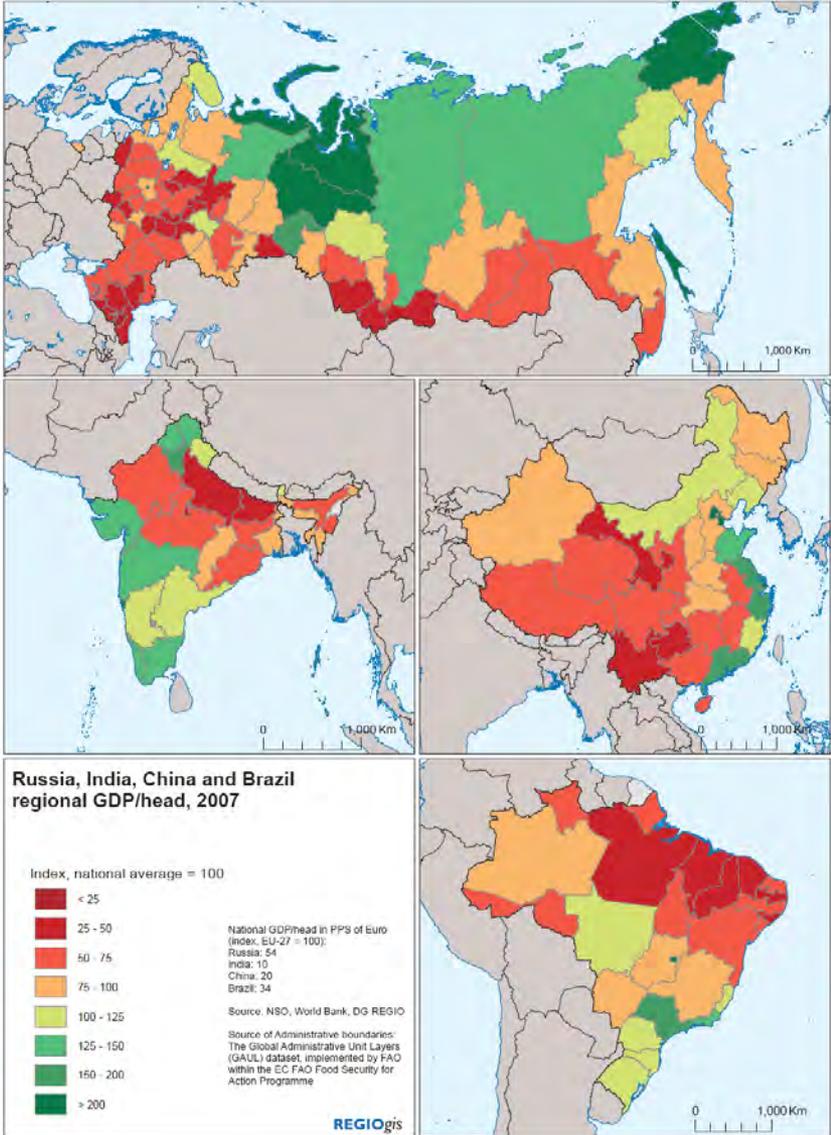
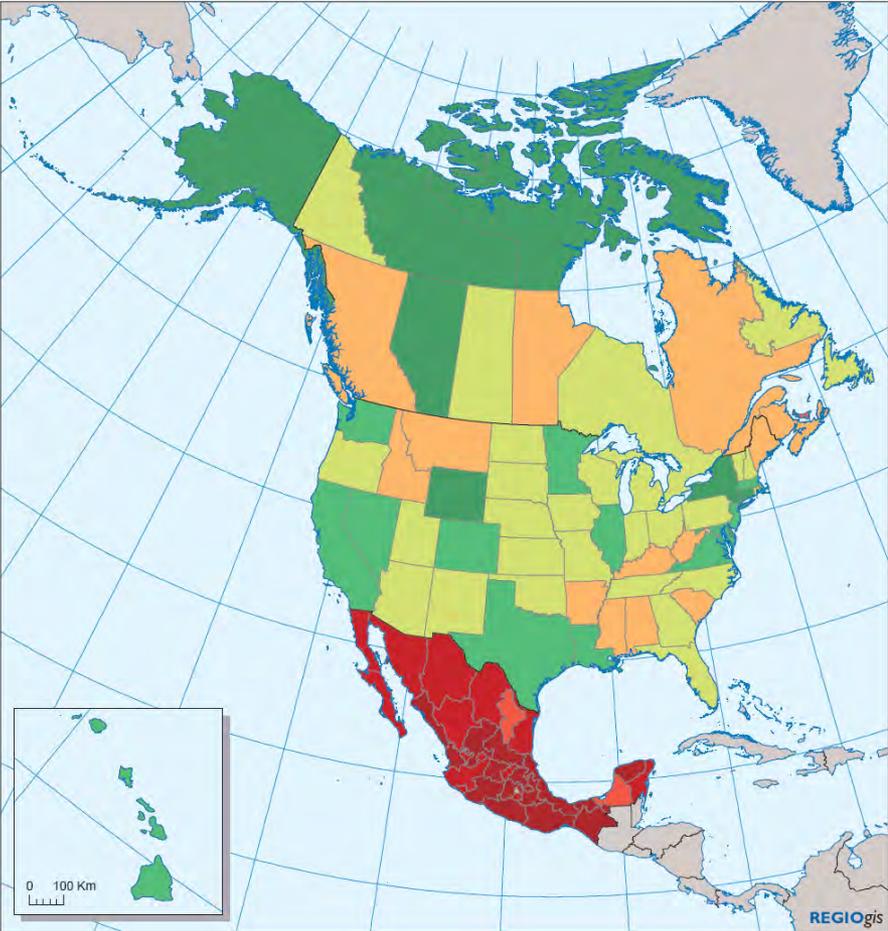
## Infant mortality rate, 2006-2007

Deaths under 1 year of age / 1000 live births



# Regional disparities outside the EU

Source: page 6  
[http://ec.europa.eu/regional\\_policy/sources/doc\\_offic/official/reports/cohesion5/pdf/5cr\\_en.pdf](http://ec.europa.eu/regional_policy/sources/doc_offic/official/reports/cohesion5/pdf/5cr_en.pdf)



# Why do we bother?



- **Because of the treaty**

*“to promote economic and social cohesion by reducing disparities between the regions”*

- **Leaving disparities in place is not an option**

*that would wreck two of the policies on which Europe’s growth has been based: the single market and the European Monetary Union*



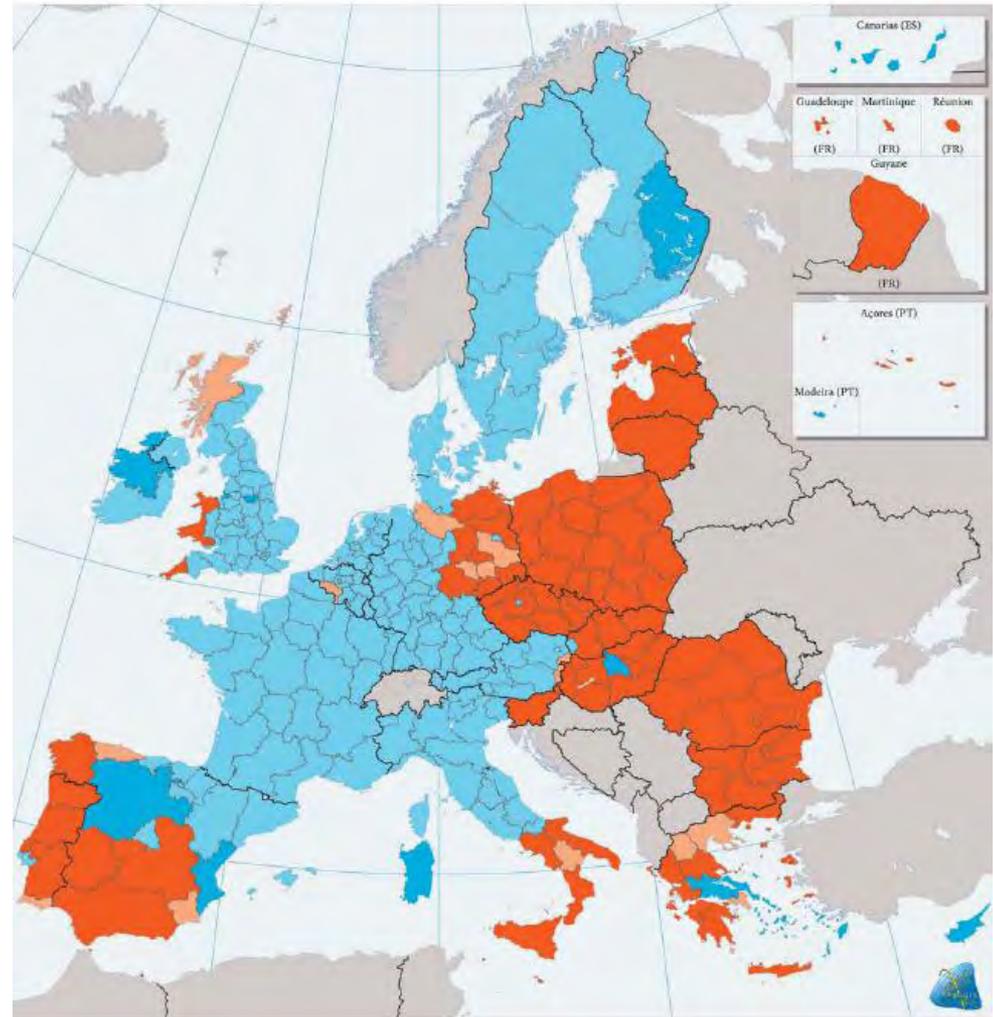
## How does it work?

- Three funds, three objectives
- 50bn EUR / year, around 36% of EU budget
- Focus on less developed regions
- National co-financing
- Functioning and main strategic lines at EU level, implementation at national and/or regional level

## How does it work?

The available resources amount to EUR 350 billion

- 81.5 % for the convergence objective (including phasing-out);
- 16 % for the Regional competitiveness and employment objective (including phasing-in);
- 2.5 % for European territorial cooperation objective.

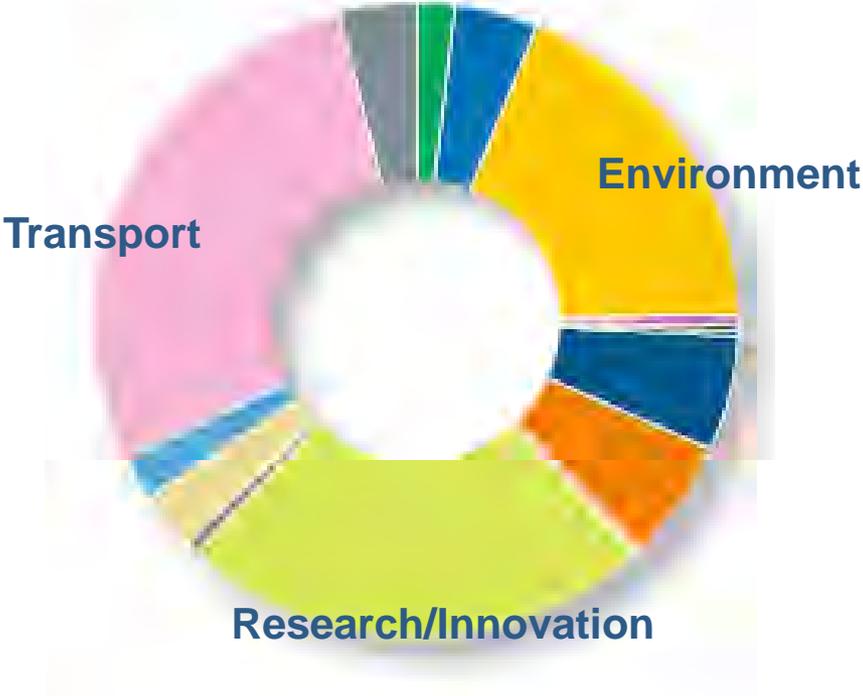


From 2007 to 2013



# How is the money spent?

European Regional Development Fund and Cohesion Fund (€271 billion)



- Information society
- Social infrastructure
- Energy
- Tourism
- Culture
- Institutional capacity

European Social Fund (€76 billion)



- Adaptability of workers and firms
- Social inclusion
- Capacity building
- Technical assistance

## Does it work?

- Leverage effect of additional resources
- Multi-annual planning, partnership, monitoring and evaluation
- Support for other EU objectives such as internal market, sustainable development
- Ring-fencing public resources, added value in public services
- Interregional cooperation and sharing of good practices

### But....

- *Management and control structures are complex*
- *Reality on ground can be very variable*
- *In some countries it is unclear if effects are consistent or attributable to policy*
- *Effectiveness of monitoring and evaluation undermined by poor data*
- *Evidence of facts: some areas are not converging although received consistent and significant support (Mezzogiorno)*

## Does it work?

- It's the only real EU investment policy
- When conditions are in place, the impact is significant
- A lot has to do with strategic approach, policy-mix and quality of local institutions and partnerships
- And a lot with the design of each programme



# Regional Disparities 1995-2007

- Since 1995, Convergence took place across European regions (see Fifth Cohesion report and Barca Report)
- ...but the differences are still very wide
- And some disparities increased within countries, e.g. Romania (as already Rodriguez-Posé has shown in 2001 in the case of Portugal and Spain)
- The crisis will probably slow the catching-up process (?)

Source: page 15

[http://ec.europa.eu/regional\\_policy/sources/doc\\_offic/official/reports/cohesion5/pdf/5cr\\_en.pdf](http://ec.europa.eu/regional_policy/sources/doc_offic/official/reports/cohesion5/pdf/5cr_en.pdf)



Evolution of regional GDP/head (PPS), 1995-2007

Index, EU27 = 100

		2007				
		< 50	50 - 75	75 - 100	100 - 150	> 150
1995	< 50					
	50 - 75					
	75 - 100					
	100 - 150					
	> 150					

Source: Eurostat

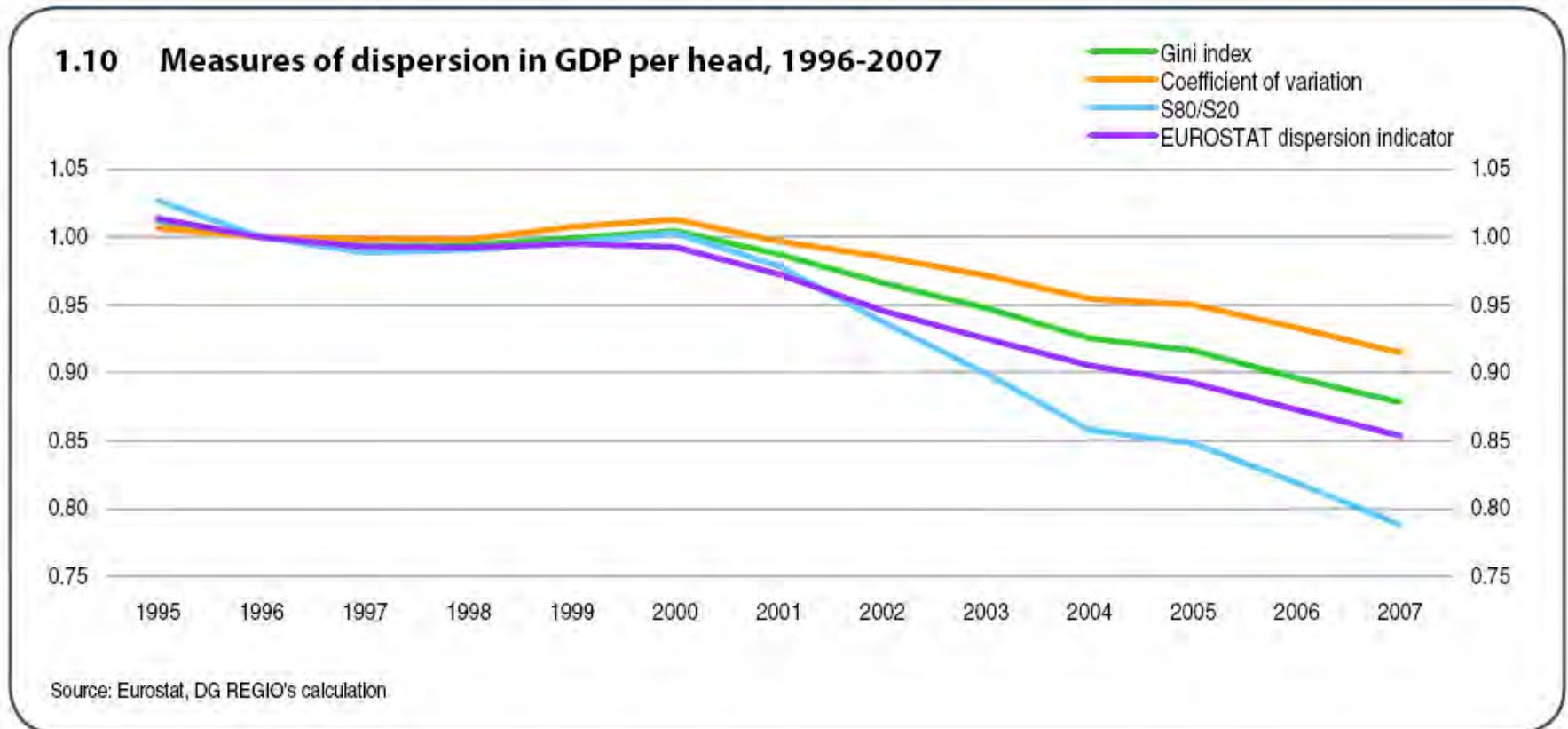
0 500 Km

© EuroGeographics Association for the administrative boundaries

# Regional Disparities 1995-2007

Source: page 11

[http://ec.europa.eu/regional\\_policy/sources/doc\\_offic/official/reports/cohesion5/pdf/5cr\\_en.pdf](http://ec.europa.eu/regional_policy/sources/doc_offic/official/reports/cohesion5/pdf/5cr_en.pdf)



# Is convergence the only way to measure success?

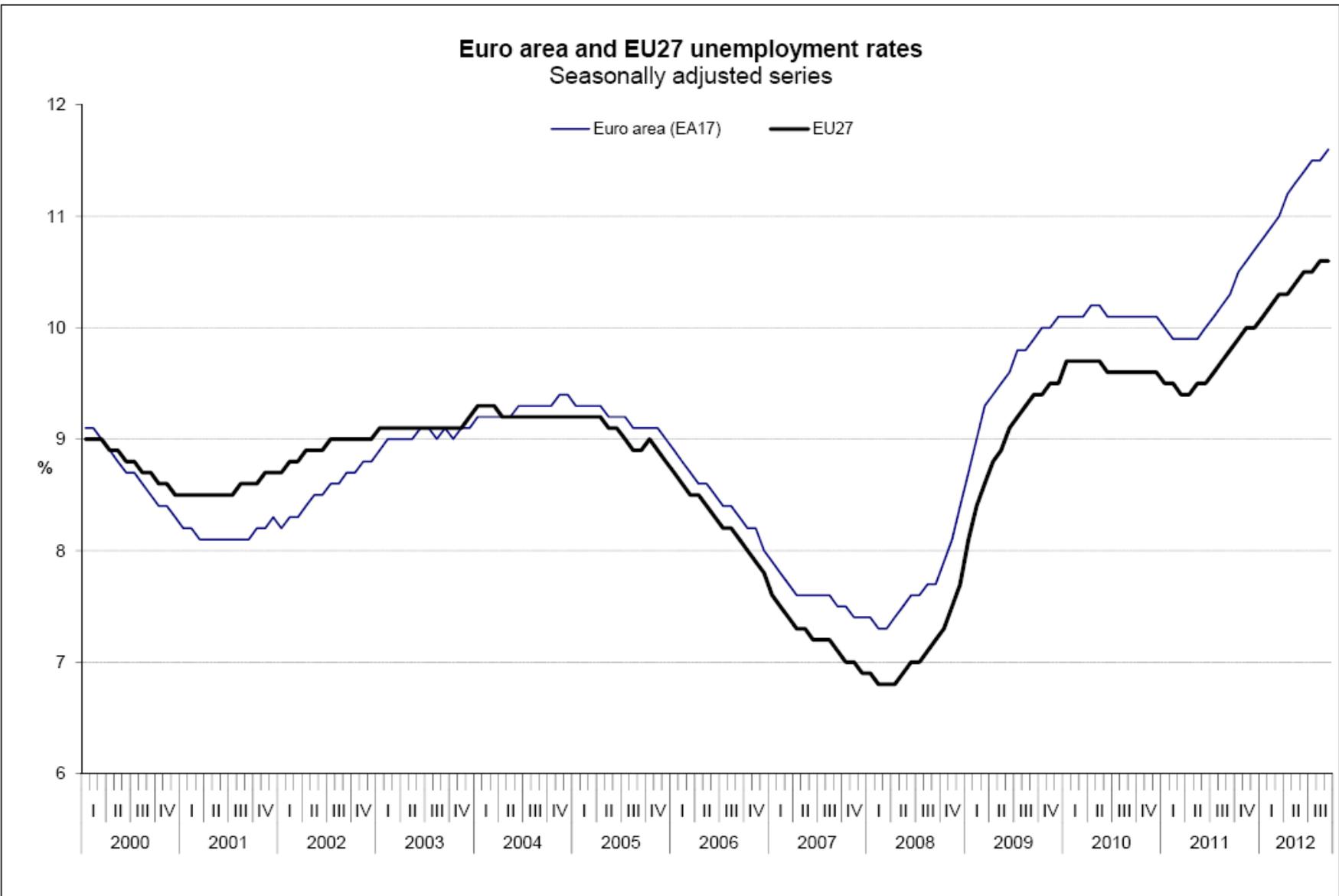
- Limitations in econometric analysis (...data, geographical unit of analysis, timeframes)
- Counterfactual analyses are quite complex and have many limitations and assumptions
- New models under development (RHOMOLO)
- Budget is relatively limited (0.3%-0.4% of EU27 GDP )
- Disparities in employment, R&D, productivity, health indicators, are large and even wider than disparities in GDP
- The impact of Cohesion policy is heterogeneous in purpose (e.g. quality of life, public services, social policies)

# **Impact of the crisis**

# Consequences of the crisis

## Unemployment rate

Source: Eurostat  
Code: lfsq\_urban



# Consequences of the crisis

## Public debt (% of GDP)

Sorry –cannot show you the chart with the increases between 2007 and 2012 in gov. debt.

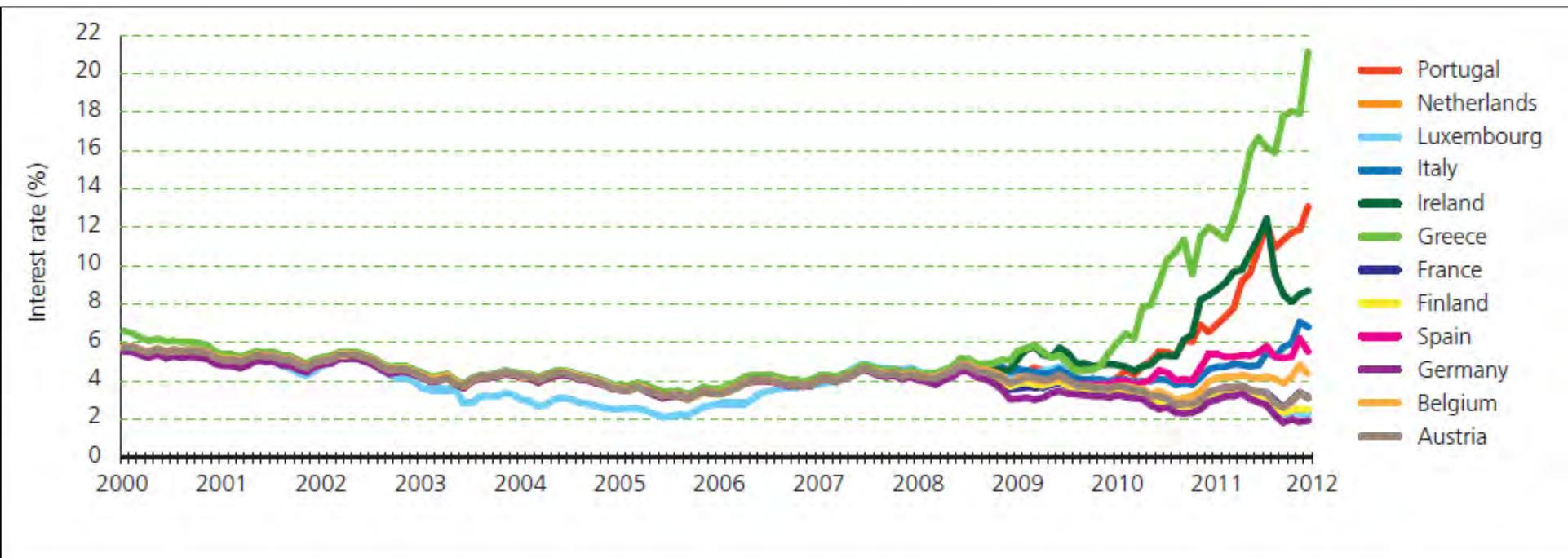
Data up to 2012 is on Eurostat

Government debt in % of GDP - quarterly data

Code: tipsgo20

# Consequences of the crisis

## Interest rates on 10y Government bonds



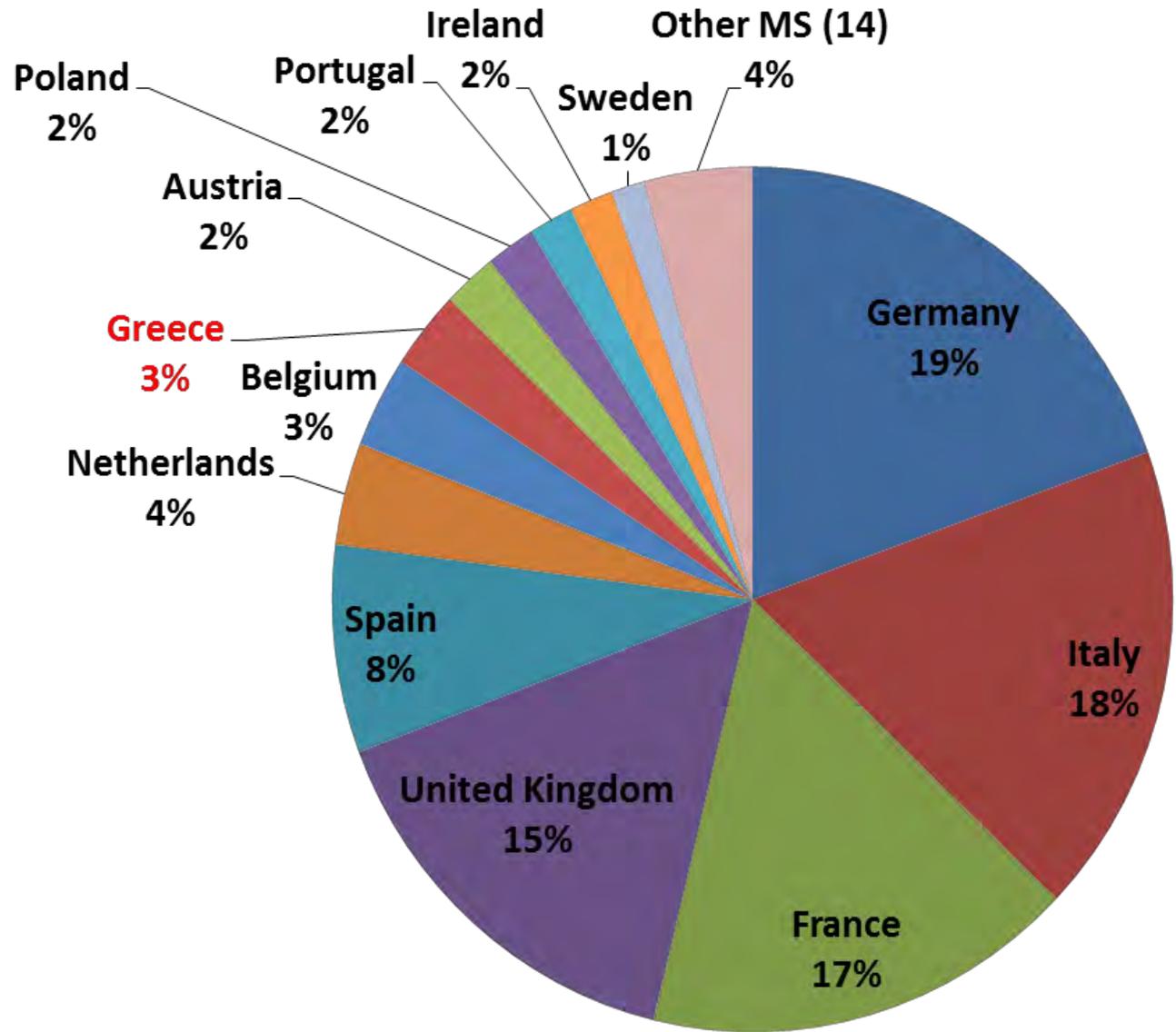
Source: Dexia 2012

[http://www.ccre.org/docs/Note\\_CCRCRE\\_Dexia\\_EN.pdf](http://www.ccre.org/docs/Note_CCRCRE_Dexia_EN.pdf)

# Consequences of the crisis

## Public debt (% of total)

Source: Eurostat  
Code: teina225



# **Drama for everybody?**

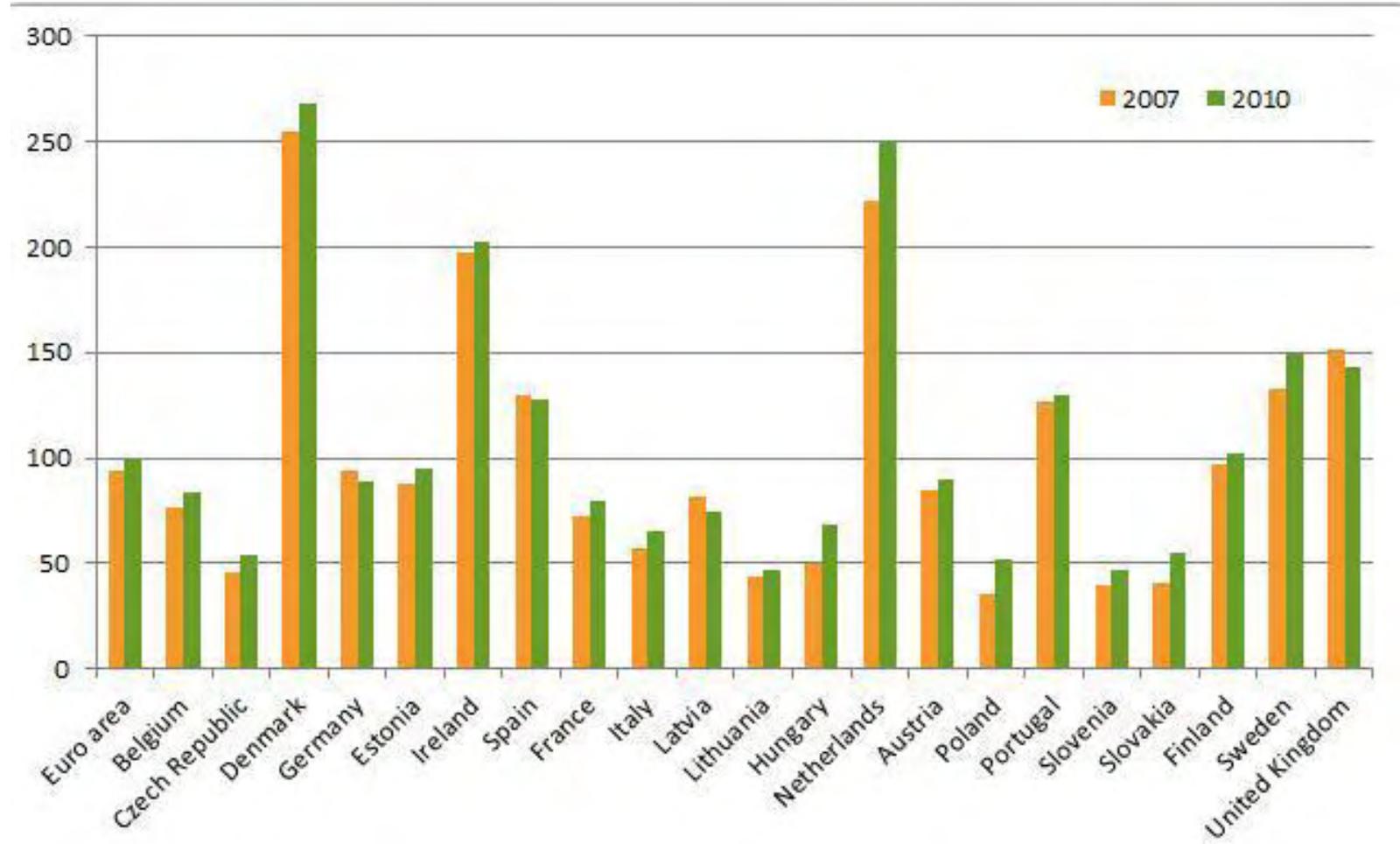
## **Quarterly growth rates**

Sorry – cannot show you the table with quarterly growth rates and the trend by sector.

Data for quarterly growth rates up to 2012 is on Eurostat

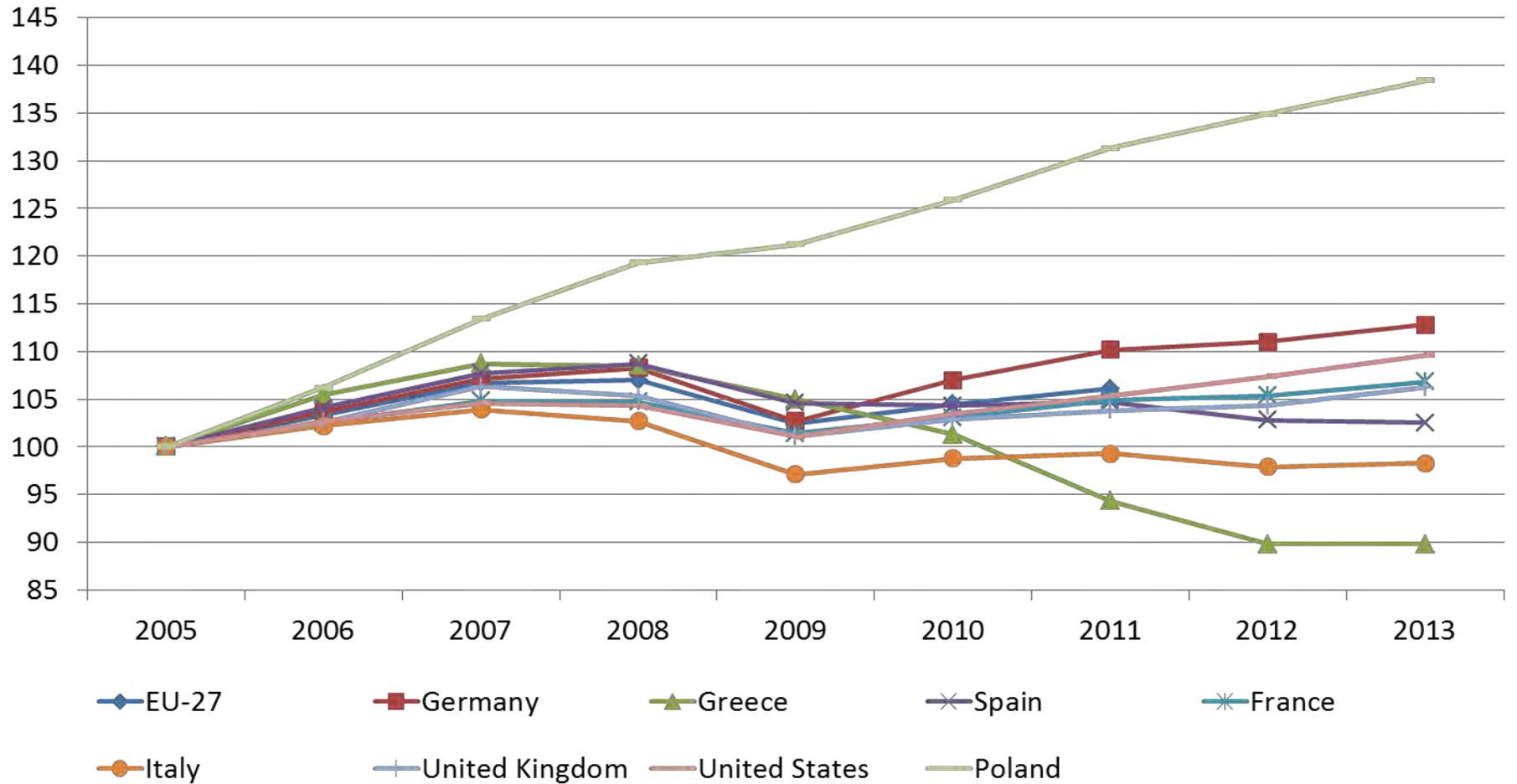
Code: teina011

# Consequences households debt



# The same crisis for everybody?

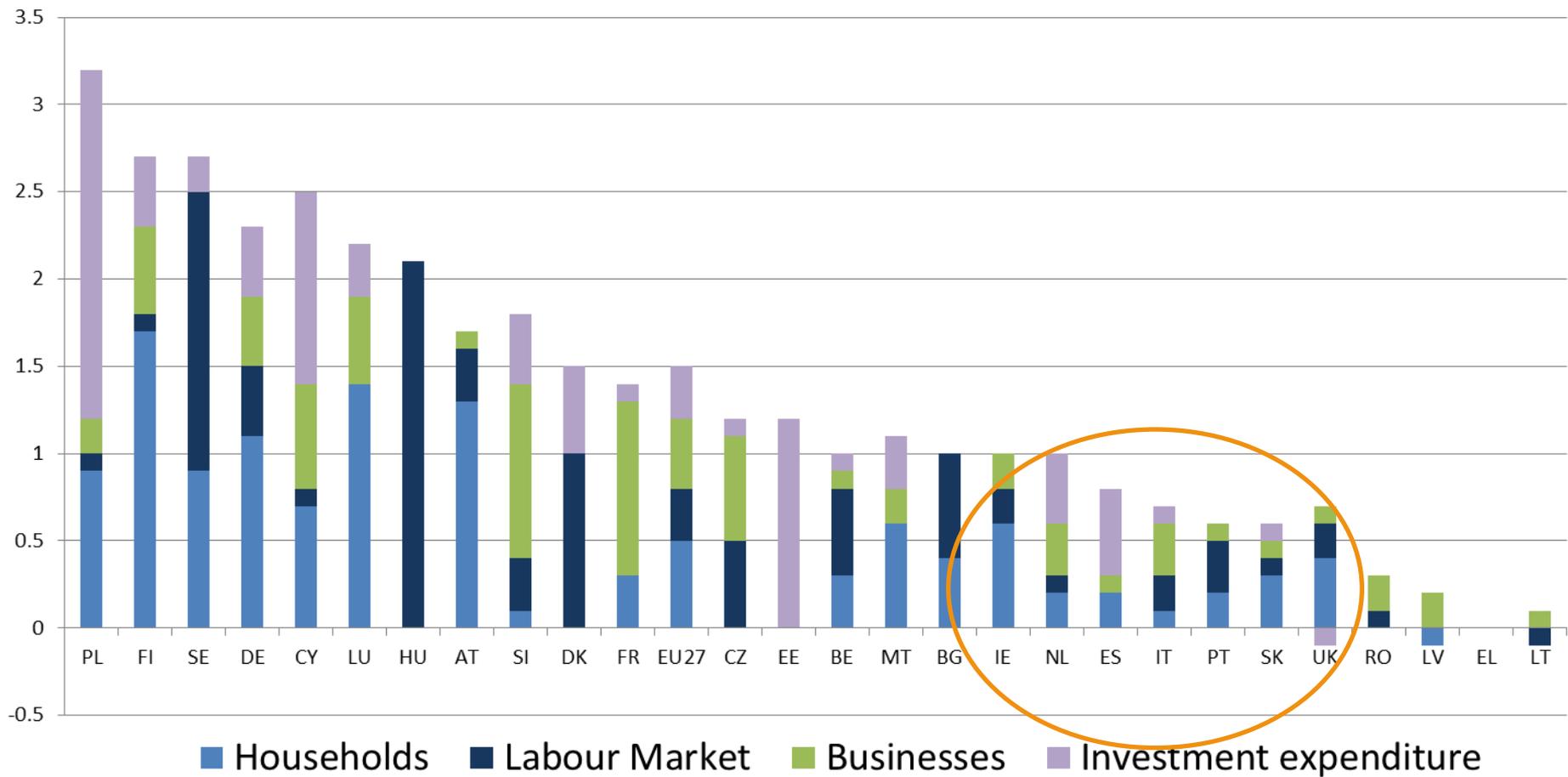
## GDP



# National responses

- Income and value-added tax reforms
- Social welfare support
- Labour market support (part-time)
- Business aid (automotive, environmental projects, tourism, access to finance)
- Increased public investments
- Rationalisation of unproductive public spending

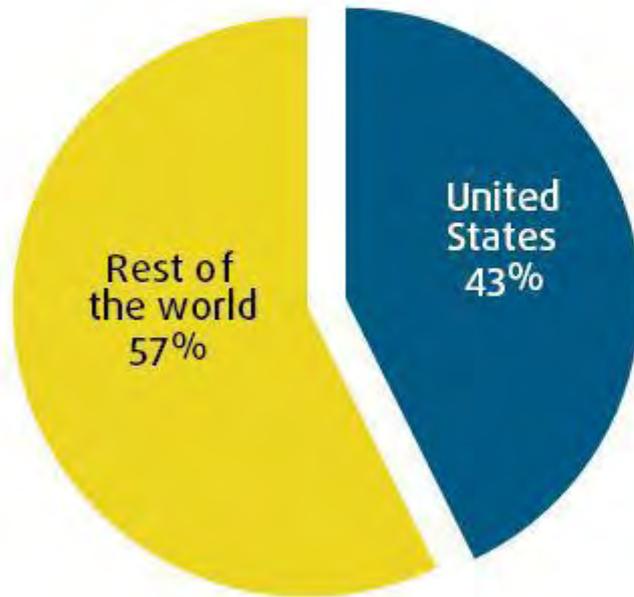
# National policy responses - Fiscal stimulus and increased social protection (2010, % of GDP)



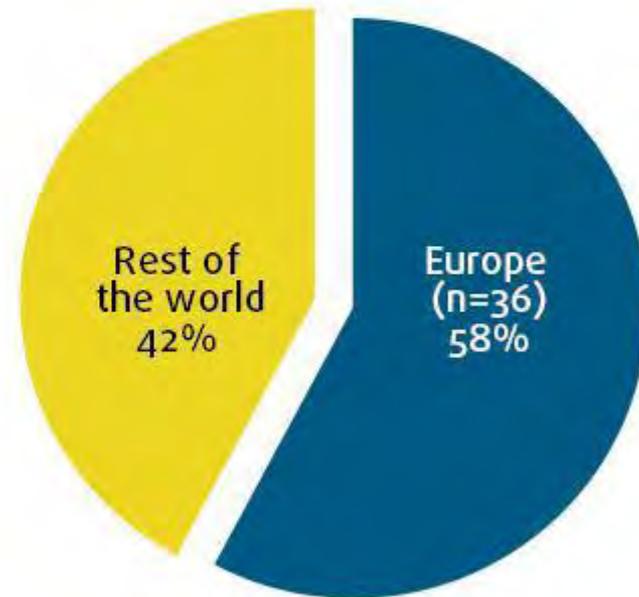
# Europe: lifestyle superpower (World Bank 2012)

Government expenditure,  
percentage of world total

Military (n=124)  
2010



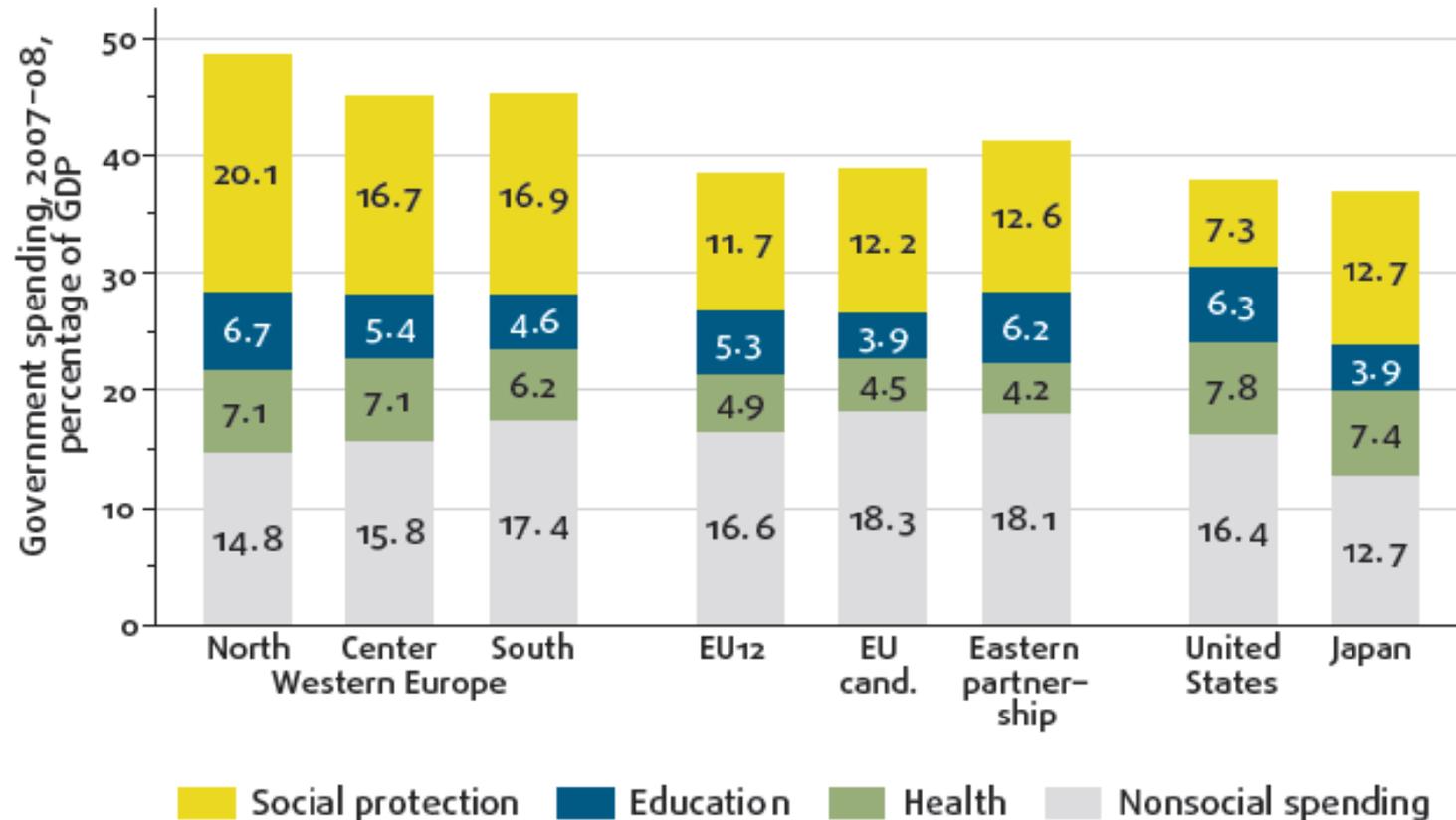
Social protection (n=96)  
2004-09



Source: World bank golden growth report

<http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/0,,contentMDK:23069550~pagePK:146736~piPK:146830~theSitePK:258599,00.html>

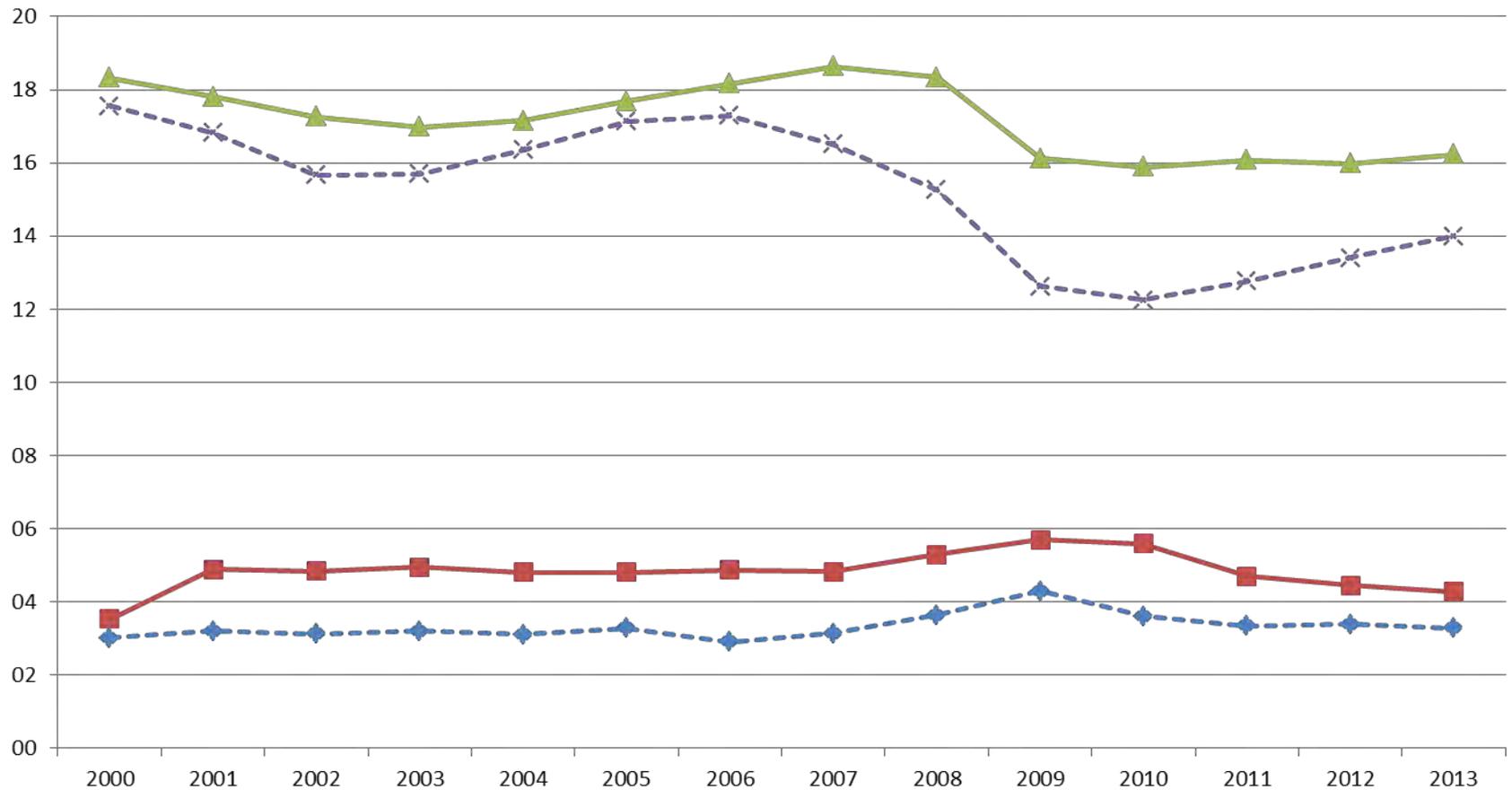
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Source: World bank golden growth report

<http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/0,,contentMDK:23069550~pagePK:146736~piPK:146830~theSitePK:258599,00.html>

# Business and public investment in fixed assets (% of GDP)



- EU-27 - Public investment, capital transfers and subsidies
- ▲ EU-27 - Business Investment
- ◆ US - Public investment, capital transfers and subsidies
- ✕ US - Business Investment

# Regional impact of the crisis – unemployment

- Up in 3 out of 4 regions
- Positive trend in Germany and Austria
- Resilient regions in Belgium, France, Finland
- Average: +2.4 p.p.

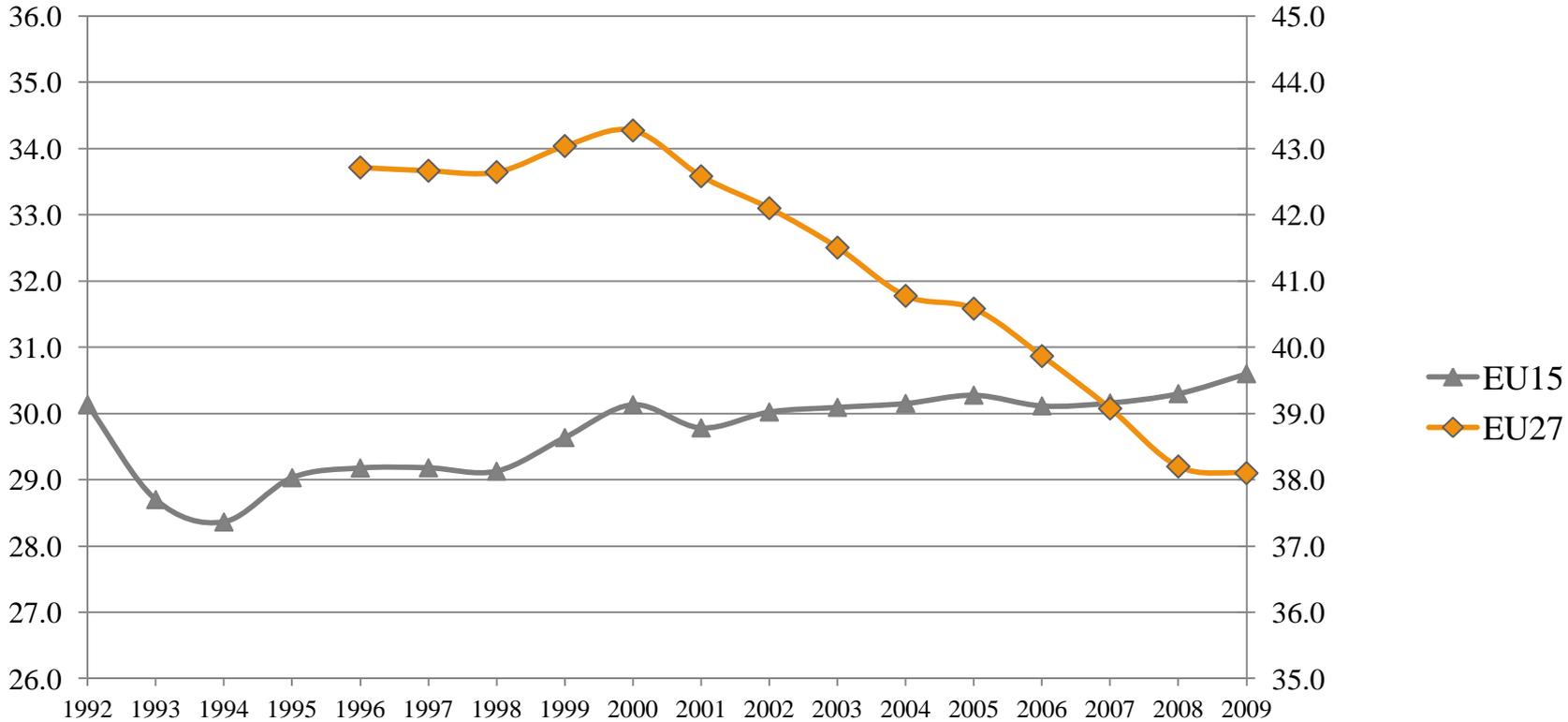
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# Regional impact of the crisis - GDP

- Regions where GDP has decreased the most are mainly located in Ireland, the UK and Sweden.
- Out of the top-50 regions where the GDP per head has increased the most, 38 have a GDP per capita below the EU average.

**Cannot show you the map, for the data:  
Eurostat  
Code: tgs00006**

# Regional impact of the crisis – variation coefficient –GDP/head, NUTS 2



Source: Monfort 2012

[http://ec.europa.eu/regional\\_policy/sources/docgener/work/2012\\_02\\_intern\\_transfert.pdf](http://ec.europa.eu/regional_policy/sources/docgener/work/2012_02_intern_transfert.pdf)

# Regional impact of the crisis

- Export-driven regions hit first, including dynamic and traditional industrial areas
- SMEs hit first, employment did not go down immediately
- Downturn in externally-oriented services such as international trade (e.g. harbours) and tourism
- Regions with high shares of more cyclical sectors were more affected by the crisis (EC 2012; Groot et al. 2011)
- However, in the medium-run, while stronger regions can bounce back, weaker regions face the risk of a permanent reduction of competitiveness and productive capacity

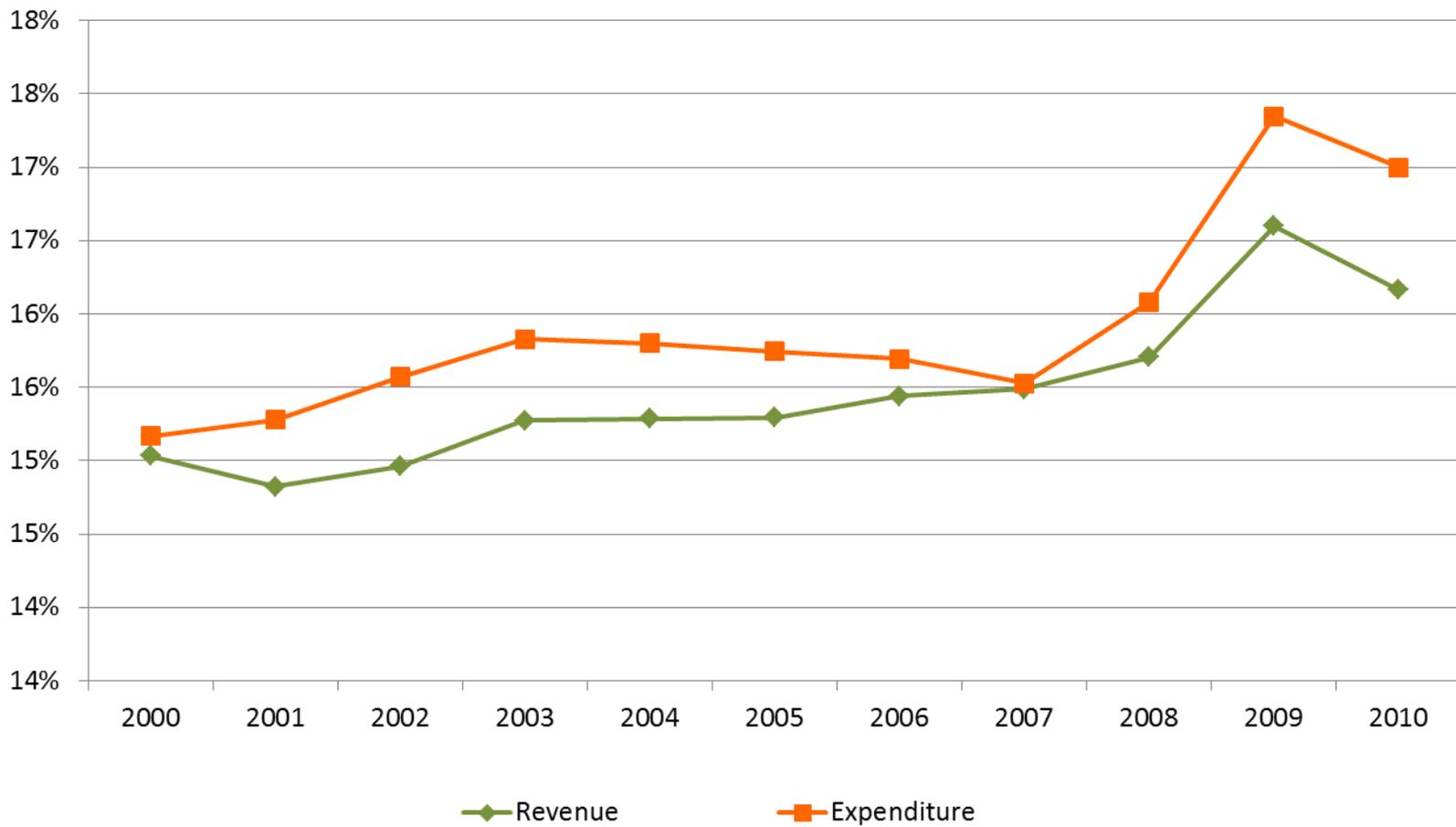
# Regional impact of the crisis

- Disruption of the convergence trend (??)
- Diverging innovation performance, -> diverging capabilities and growth potential (Archibugi and Filippetti 2011)
- Ongoing restructuring and changes of industrial base
- The heterogeneity of regions with respect to their sectoral composition implies a different response to recessions or crises

# Regional responses

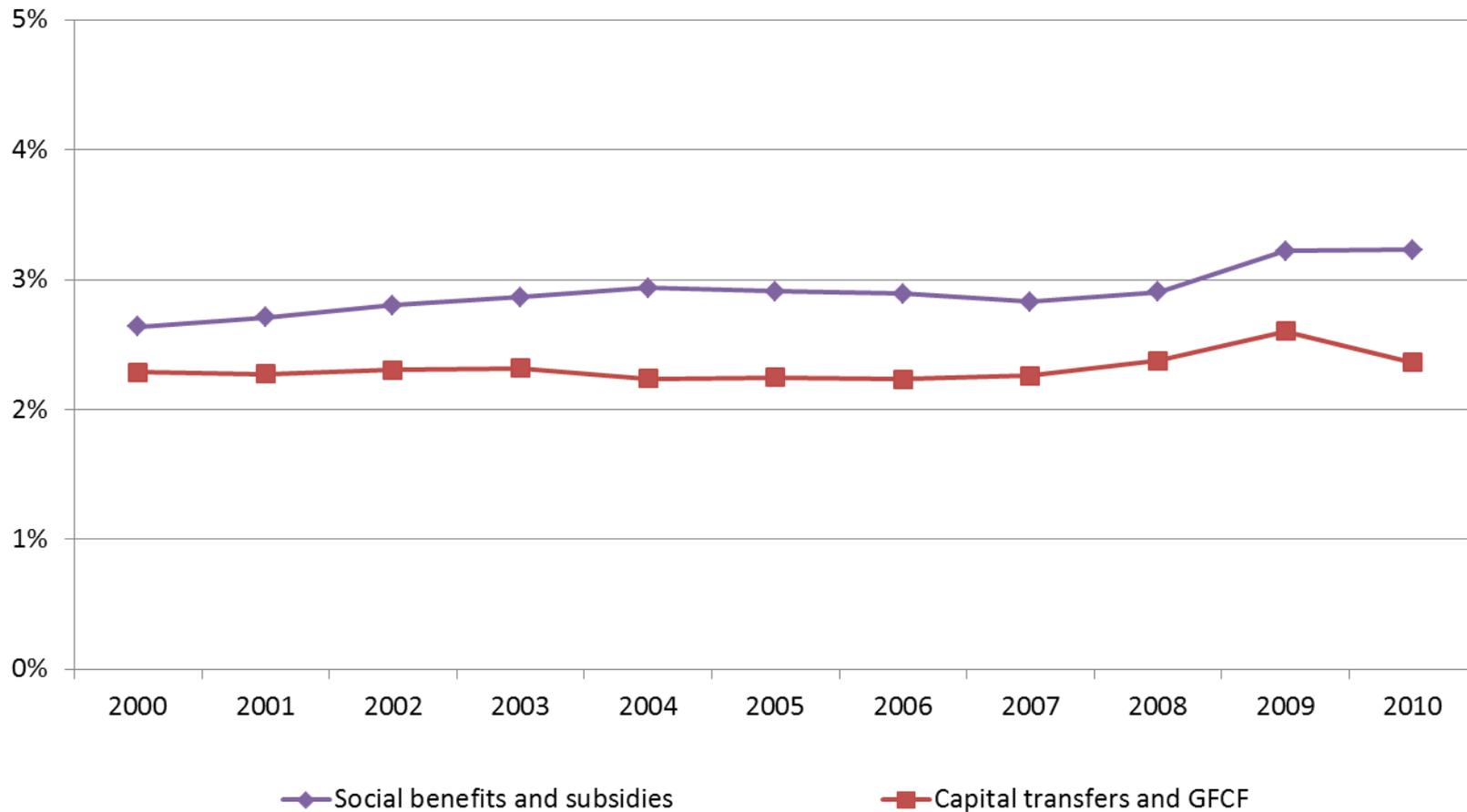
- The involvement of regions has been overall marginal compared to national governments
- Most of the national interventions are spatially blind (and in case, sectoral interventions driven by regional pressures, e.g. automotive in Sweden)
- However, some regions had their own stimulus package
  - Italian regions' total stimulus was higher than the one of the central government (Fabbris and Michielin 2011)
  - Other examples are Scotland, Wales, Flanders, with a variety of measures in easing economic activity and improving social protection

# Expenditure and revenues of local authorities



% of EU-27 GDP

# Stimulus and social protection of local authorities

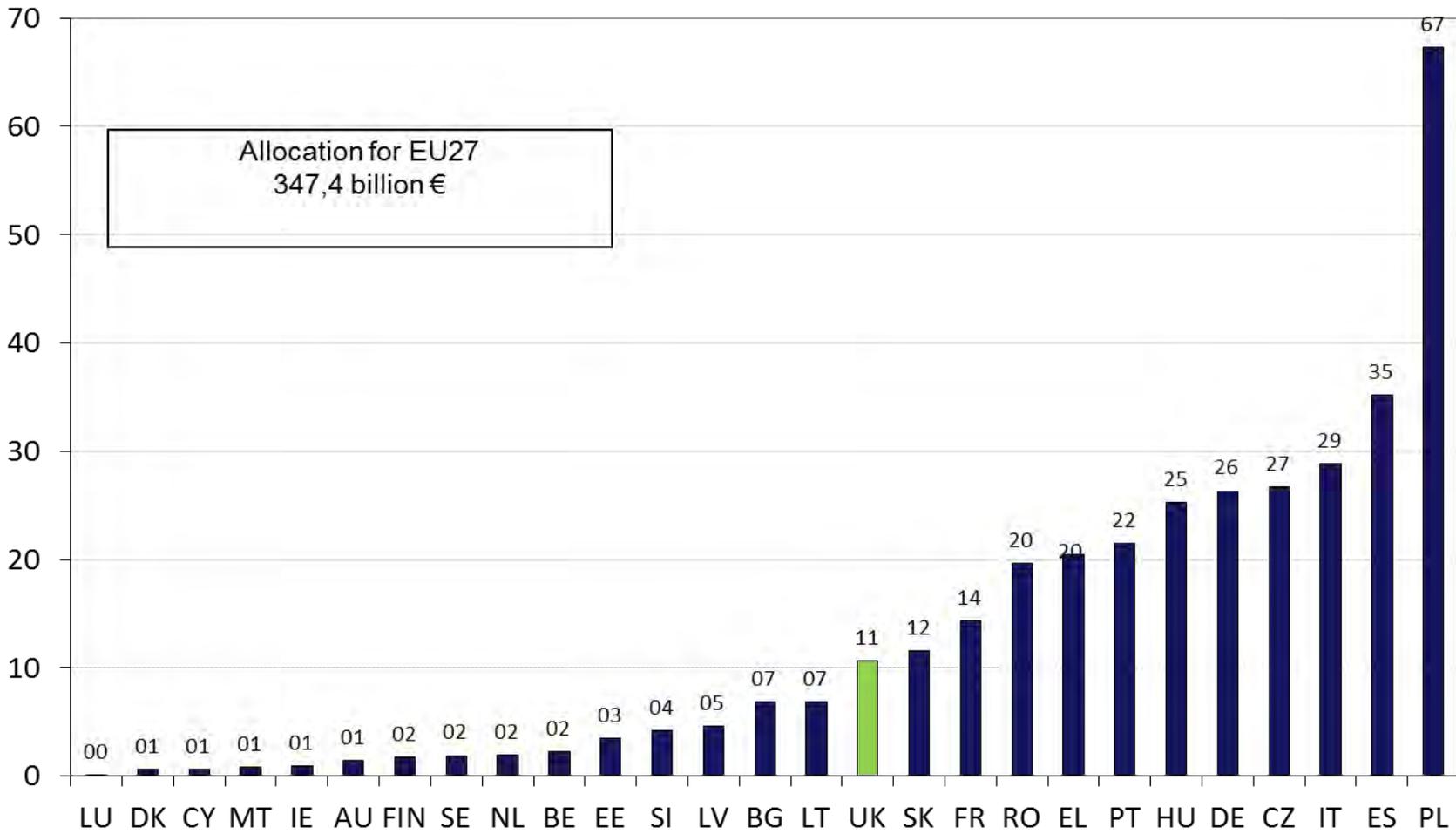


% of EU-27 GDP

# **The contribution of Structural Funds and the situation of local authorities' finances**

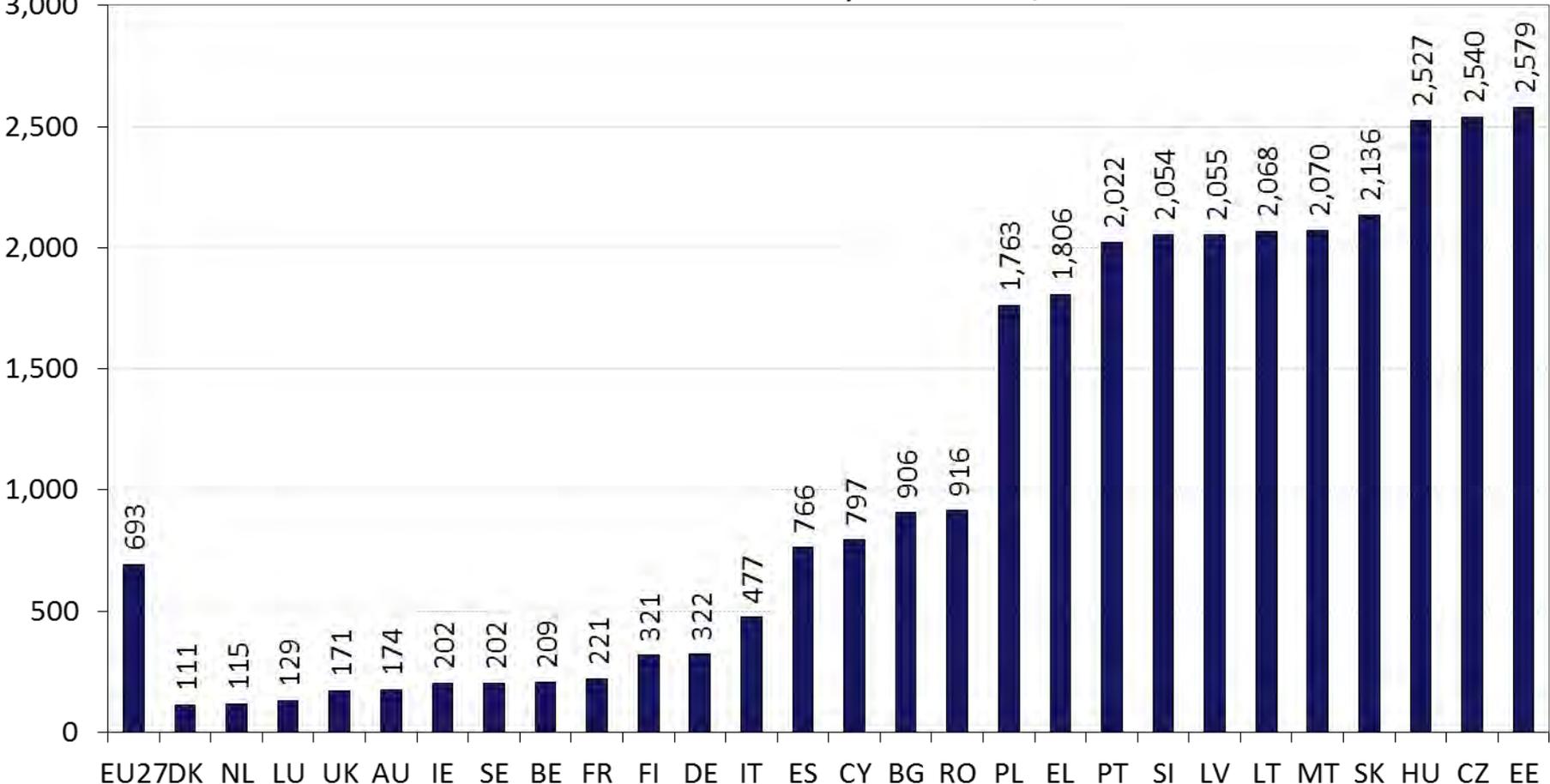
# Contribution of Structural Funds

Allocation by Member State in billion €



# Contribution of Structural Funds per capita

Allocation by Member €/head



# Additionality

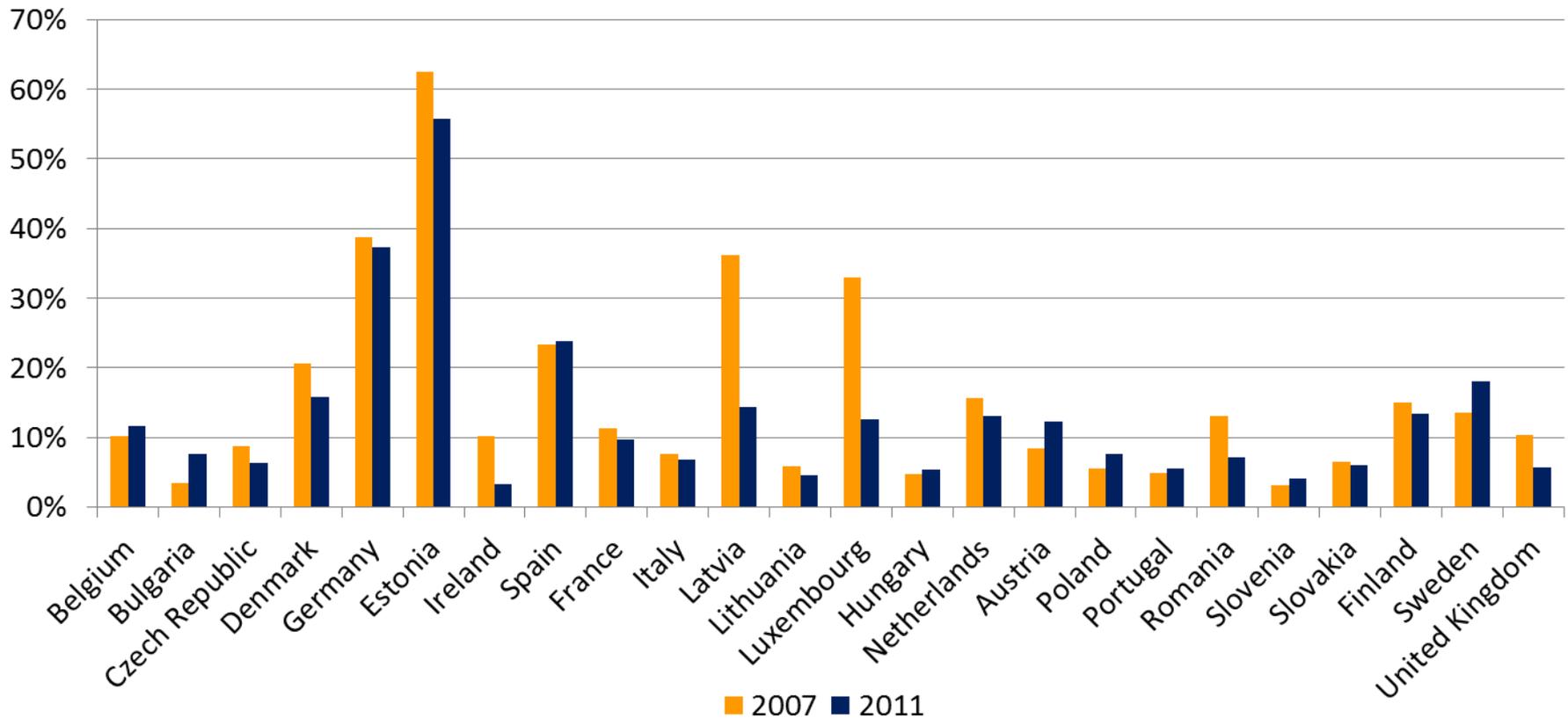
- Additionality is the principle that avoids replacements of national investments (in less developed regions) with investments financed by the EU
- But...in times of crisis public investments are at risk
- The mid-term verification demonstrates that the principle has been verified in 2007-2010
- This is due mainly to stimulus packages and the relatively positive investment trends of some countries, especially Poland and Spain (where infrastructural investments have been very high until 2009).
- But...need to link the principle with macroeconomic situation. Dichotomy between higher expenditure needed to respect additionality (in some MS) and lower spending for fiscal consolidation until 2013 (in most MS)

## **Regional impact of the crisis: a debt crisis for local authorities?**

- In OECD countries, sub-national governments had a debt of 13% of GDP on average in 2010, vs. 10% in 2007
- Deficit, from 0.75% of revenue (2007) to 9.5% (2010).
- Debt-to-revenue ratio from 58% to 69%.

# Impact of the crisis for local authorities

## debt of local authorities / total public national debt



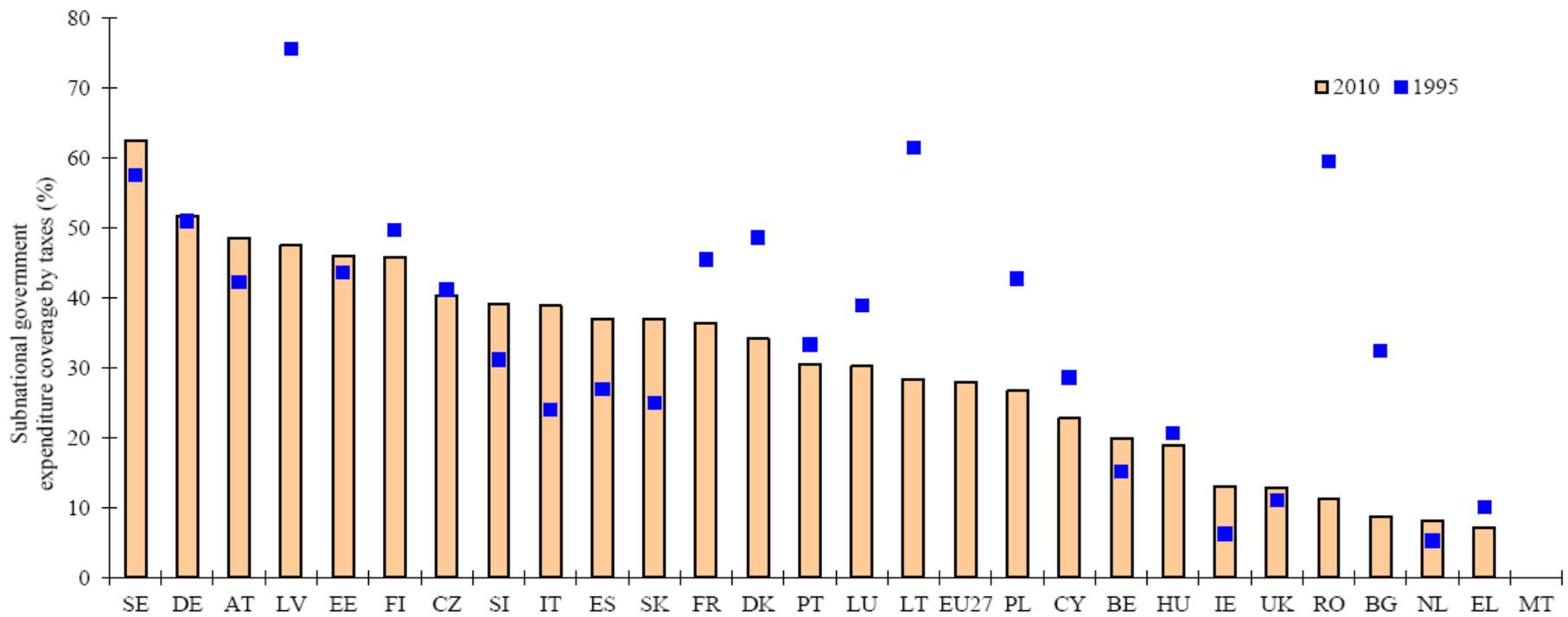
# Impact of the crisis for local authorities' budget

- Fiscal austerity measures play out differently between the European countries and between European regions (Groot et al 2011).
- Scissors effect: decreased revenues and increased demand for social services
- Increased deficit and total debt at local level
- Initial support by national governments, but then fiscal consolidation at central level (=reduction of transfers)
- Possible cascade effects on procuring, public investment, quality of services, and ultimately on the local economy

## Reduction of transfers...

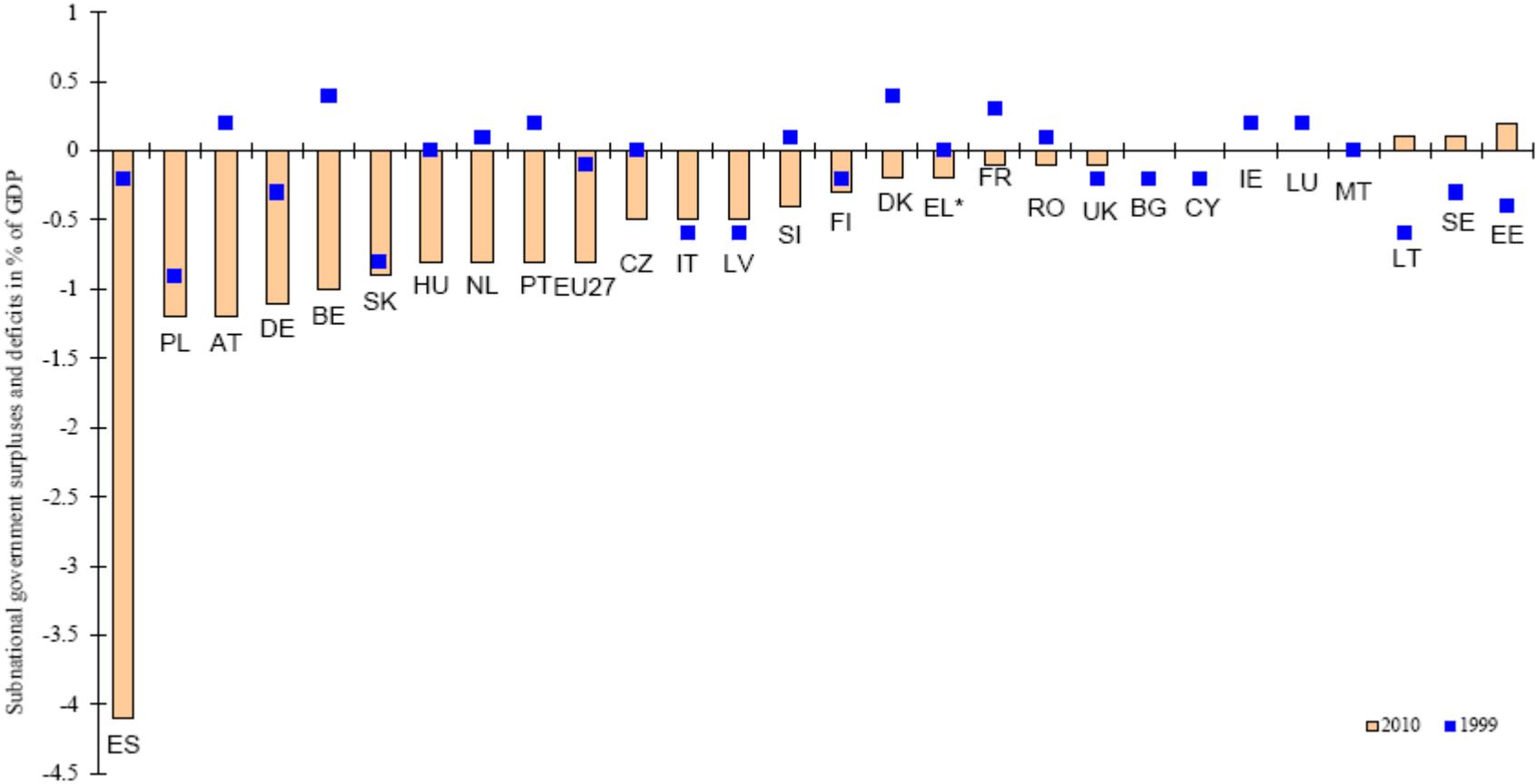
- Ireland: -15% in 2009 and -18% in 2010
- France: transfers frozen from 2010 to 2013
- English local authorities: around -6 bn£ over 2011-2014
- Italy: around -14 bn€ in 2011/2012
- Spain, Belgium, Portugal: automatic adjustment linked to national tax revenues

# Tax and expenditure decentralisation Falling short



Local expenditure covered by local taxes - Source: ECFIN 2012 – Public finances in the EMU

# Subnational governments' deficits



Source: ECFIN 2012 – Public finances in the EMU

## ...limited margin of manouver and difficult access to funding

- A large part of expenditure is non-discretionary (depending on national policies)
- Many public services are in critical sectors (education, health, social protection)
- As most of the expenditure is non-discretionary, even small deficits can create big problems...
- Downgrade of Spanish debt in 2011 due to the situation of local authorities
- Sometimes, co-financing EU regional policy becomes an issue
- Higher difficulties in issuing debt to match the funding requirements
- Difficulties of private partners to access credit to finance their participation in public investment projects (e.g. public private partnerships in transport), which – anyway – now face a weak demand...probably a bigger problem than lack of investments

# **The impact of the crisis on regional policy making and on EU regional policy**

# Risks

- The main adjustment variable left in local budgets is public investment (consequences on key public services?)
- Regional/local governments often own public enterprises whose debt is not accounted in the national accounts
- Central government is often ultimately responsible for the debt, so risk of unsustainable debt policies for regions
- When deciding what to cut, long-run programmes are more at risk (contingency vs. perspective)

# How the crisis (and the macroeconomic governance) has already influenced EU regional policy

## Current period

- Reprogramming where possible
- Co-financing rates reduced to improve absorption
- Priority projects in Greece, increased technical assistance in Bulgaria and Romania
- Reduced additionality requirements until 2013
- Use of macroeconomic conditionalities (Hungary)

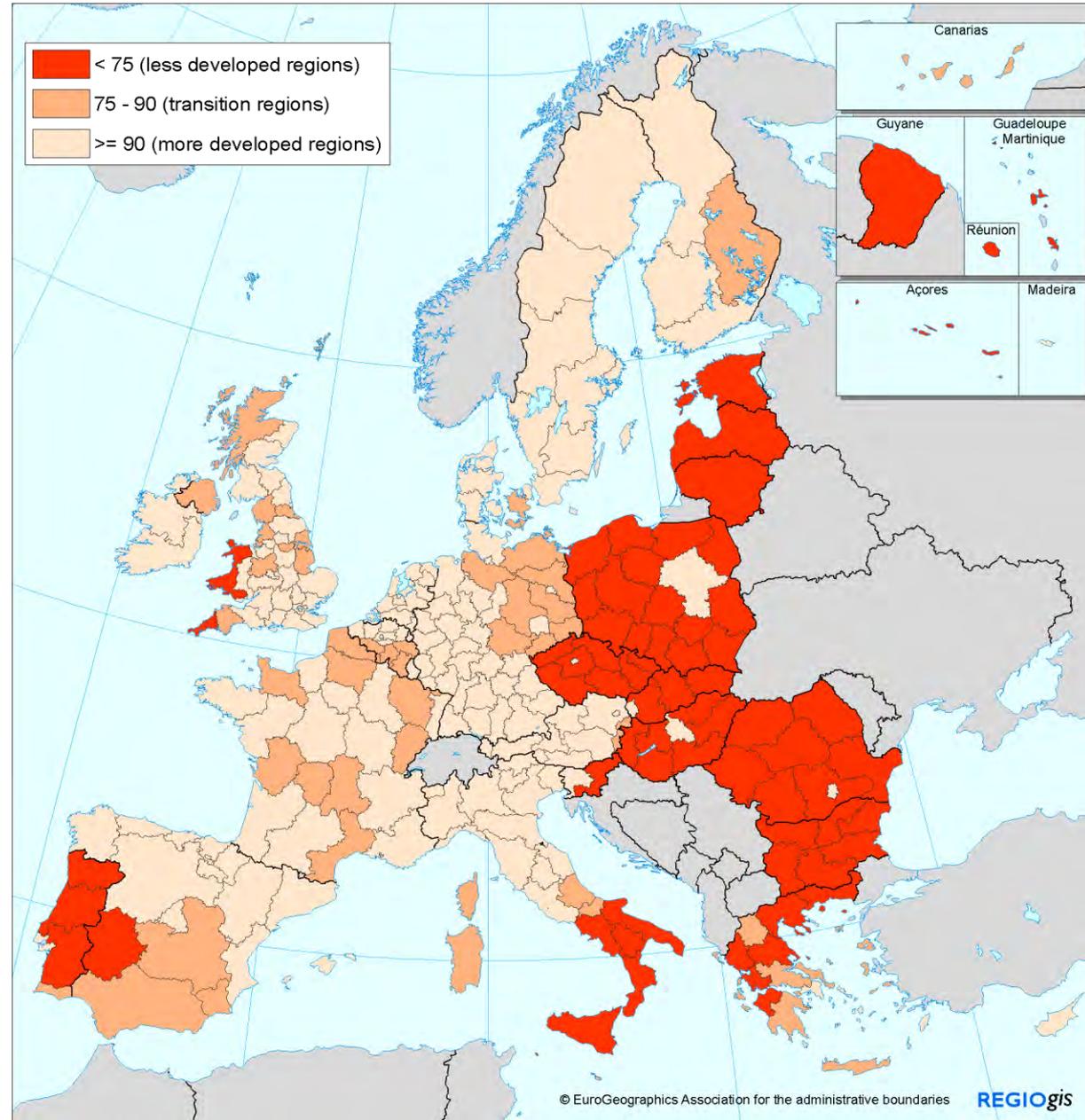
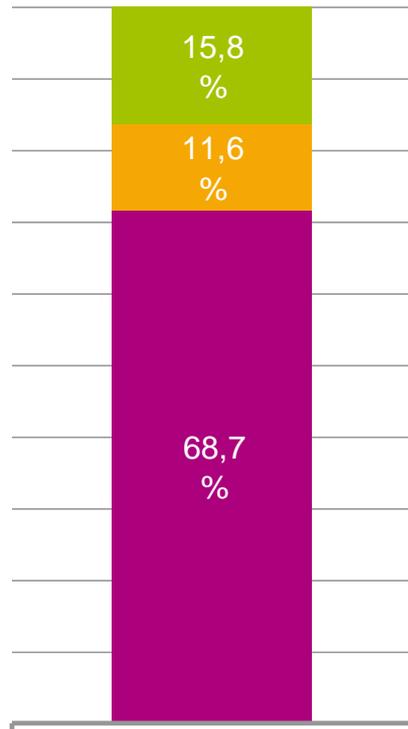
## Future cohesion policy (2014-2020)

- Main EU priorities: macroeconomic stability and recovery
- Impact on total EU budget: same objectives, more difficult context, lower (?) budget
- Macroeconomic conditionalities
- Policy conditionalities
- Thematic concentration
- Impact: more difficult to isolate (-> new performance system for 2014-2020)

# Future cohesion policy (2014-2020)

## Eligibility simulation 2014-2020, March 2012

GDP/head (PPS), index EU27=100



# The way forward in regional development

- Territorial capital, integrated place-based policy strategies, non-material assets (Camagni and Capello, 2012; OECD 2011)
- Differentiated policies rather than a one-size-fits-all approach (Groot et al. 2011).
- Governance: increased integration and co-ordination of public investments (bearing in mind that public investment do not solve all problems)
- Policy conditionalities in multi-level governance systems (OECD 2011; Barca Report 2009) to push regulatory and structural reforms (some basic regulatory requirements are missing....e.g. R&D in Latvia, but also water, electricity, land in several Countries)

# Concluding remarks...and questions

- Highly diversified impact of the crisis - very few countries have zero imbalances
- Responses are diversified and limited by the contingencies and imbalances of each country
- Scissors effect affecting policy effectiveness
- Trade-off between short-run needs and long-run structural actions (including EU co-financed programmes)
- Sector-oriented policies often face high market uncertainty (e.g. automotive) – priority on place-based policy-mix
- Is this re-shaping regional policy objectives?
- Will the debt crisis affect the trend of decentralisation of expenditure?
- Limited margins: making regional policy more strategic or more marginal?

**Thank you very much for your attention !**

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