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Fifth progress report on economic and social cohesion
Growing regions, growing Europe

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1. INTRODUCTION

In September 2007, the Commission launched a public consultation on the challenges with which cohesion policy will be confronted in the coming years to collect ideas on the priorities, organisation and governance of the policy.

Cohesion policy is anchored in Article 158 of the EC Treaty, which states that the Community aims to promote harmonious development and that with this purpose it shall develop and pursue its actions leading to the strengthening of economic and social cohesion. The Lisbon Treaty, which is at present in the ratification process, adapts this text in referring to economic, social *and territorial* cohesion.

The consultation has to be seen in the larger framework of the ongoing budget review, to which it contributes. It has been complemented by other important events such as the informal meeting of the Ministers responsible for regional development which took place in the Azores on 23-24 November 2007; the high level conference organised by the Slovenian presidency in Maribor on 7-8 April 2008; and the opinions which the European Parliament[1], the Committee of the Regions[2], and the European Economic and Social Committee[3] have adopted on the Fourth Cohesion Report.

A further important milestone in 2008 will be the adoption by the Commission of a Green paper on territorial cohesion, whose main purpose is to launch a wide, public debate on the implications of the introduction of the notion of territorial cohesion in the Treaty, particularly in the context of cohesion policy.

In 2008, the Commission will also adopt a Communication on the renewed social agenda. Building on the results of a wide public consultation on Europe's "social reality", it will outline ways in which Europe can respond to changing social realities, in particular how the Union's policies can be harnessed to promote opportunities, access and solidarity.

The first part of this report provides a synthesis of the contributions received between September 2007 and February 2008. This first phase of the debate helps to identify issues for discussion and direction for reflection, which the Commission will take into serious consideration in the context of the budget review.

The second part of the report provides a more in-depth analysis of major regional trends. The theme of this progress report is European growth sectors, whose performance in the regions will, to a large degree, determine the level of regional economic development in the years to come.

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1 A6-9999/2008 [REF] adopted on 21 February 2008.
2 COTER IV-011 [REF] adopted on 29 November 2007.
3 ECO/209 [REF] adopted on 13 December 2007.

2. COHESION POLICY: THE STATE OF THE DEBATE

The Commission received more than one hundred contributions[4], mainly from stakeholders close to the management of the policy, representing more than half the Member States (accounting for almost 80% of the EU population); a large number of regional authorities; a majority of regional and local associations; economic and social partners; civil society organisations; academic and research institutions; and some citizens.

Most of the responses, and particularly those of national governments, do not represent final positions. This is normal given the early stage in the debate and the wider discussion on the EU budget review.

The public consultation confirms that interest in cohesion policy remains pronounced. Indeed, the first general conclusion which can be drawn from the discussion is the recognition by stakeholders of the important role cohesion policy plays in the construction of the European Union and the support for continuation of that policy. Any attempt to re-nationalise the policy is almost unanimously rejected.

Many contributions confirm that cohesion policy guides and fosters growth across Europe; promotes investments that would not have been undertaken otherwise; supports competitiveness in the most vulnerable regions; enhances social progress and solidarity; upgrades physical, social and human capital as drivers of growth, innovation potential, administrative capacity and modernisation of the administration; encourages multi-annual strategic and financial management; promotes transfers of know-how and best practices between regions and Member States; and fosters an evaluation and monitoring culture. Similarly, most contributions value the partnership culture that the policy promotes. In line with the results of a recent Eurobarometer[5] survey, the consultation confirms the role of cohesion policy in increasing the visibility of the EU to European citizens.

2.1. Objectives and priorities

All contributions agree that the main objective of cohesion policy is the reduction of economic and social disparities between the levels of development of European regions. Lagging regions must thus remain the focus of the policy. Yet, a majority of contributions – along with the European Parliament – argues that the policy should cover the whole territory of the EU, considering that cohesion policy is not a simple mechanism of solidarity, but also aims at fostering the endogenous development potential of European regions.

The large majority of stakeholders recognises territorial cooperation as an essential part of cohesion policy and appreciate that it is now a "fully-fledged" objective. They underline that territorial cooperation is one of the best examples of the added value of this policy and, for this reason, should be strengthened.

The Fourth cohesion report identified a series of challenges with which regions and Member States are and will increasingly be confronted: globalisation, demographic change and social tensions, climate change, and increased energy prices. While it is widely admitted that cohesion policy should also address such challenges, most of the contributions point out that cohesion policy cannot be the only instrument, not even the principal one. Some consider that

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4 See http://ec.europa.eu/regional_policy/conferences/4thcohesionforum/all_contrib_en.cfm?nmenu=6

5 http://ec.europa.eu/public_opinion/flash/fl_234_en.pdf

these challenges are already being addressed through the delivery of the Lisbon and Gothenburg Agendas. Others recall that tackling these challenges should not overshadow the main objectives of cohesion policy as enshrined in the Treaty.

Some contributions urge the Commission to complement GDP per head in PPS with other measures of well-being and standards of living.

Concerning the content of cohesion policy, a consensus seems to emerge at this stage on the following cross cutting themes:

- Competitiveness is at the heart of cohesion policy. The requirement of "earmarking" a significant share of the financial resources for the key investments linked to the renewed Agenda for growth and jobs is clearly supported. In particular, research, innovation and upgrading skills to promote the knowledge economy, development of human capital through education and training, adaptability, support for business activities (especially, small and medium enterprises), strengthening of institutional capacity and development of an entrepreneurship culture are deemed as key areas in which investments should be concentrated.

- Active labour market policies are also at the heart of the actions proposed to boost employment, strengthen social cohesion and reduce the risk of poverty. A significant number of participants consider that cohesion policy should contribute to Europe's social dimension by improving employment prospects of the most vulnerable groups such as youth, elderly, disabled, immigrants and minorities.

  Social and economic partners and civil society organisations stress the important role of the social economy in producing quality jobs, enhancing innovation, contributing to the development of rural areas and providing a number of services of general interest. They also point out the contribution of capacity building to the enforcement of principles of good governance and partnership. Finally, some voices representing civil society argue that cohesion policy should support groups that have special difficulties entering the labour market.

- The third cross cutting theme is sustainable development. Many contributions consider that cohesion policy should strengthen its orientation towards the delivery of the objective of the Gothenburg Agenda. In particular, the policy could contribute to reducing greenhouse gases emissions through mitigation policies aimed at improving energy efficiency and promoting the development of renewable energies.

In addition to the above themes a number of other issues received considerable attention.

The inclusion of territorial cohesion in the Lisbon Treaty is generally welcomed. Some contributions however urge the Commission to develop a definition of territorial cohesion and indicators for better understanding this concept. At the same time, several national governments consider that territorial cohesion is already integrated within cohesion policy, and that the economic, social and territorial dimensions of cohesion cannot be separated.

Territorial cohesion is seen, notably by regional and local actors, as an opportunity to strengthen the role of regional and local authorities and other actors in the implementation of the policy. Several contributions stress the role of urban areas and their interdependence with rural areas as important dimensions of economic, social and territorial cohesion. Cities are often identified as places characterised by significant social exclusion, poverty and unbalanced development. Existing mechanisms in favour of some specific areas such as the outermost regions or the northern sparsely populated areas are not questioned.

Many are also confident that the notion of territorial cohesion will help to better integrate a territorial dimension in the design and implementation of European sectoral policies.

A consensus seems to emerge in favour of more flexibility under territorial cooperation so that regions can cooperate with regions other than neighbour regions or regions belonging to the same geographical area. Cooperation with regions and countries neighbouring the EU is also considered essential.

2.2. The governance of cohesion policy

The reform of cohesion policy towards a more strategic approach is supported by the majority of the contributions.

Many mention that programme implementation has just started and a comprehensive assessment cannot be made until the results of evaluations become available.

Yet, a significant majority of stakeholders calls for further clarification in the allocation of responsibilities between the different institutional levels (Commission, Member State, regions and other players). Many stakeholders, particularly at the regional and local level, would appreciate further decentralisation of responsibilities. They also underlined, especially for the European Social Fund (ESF), the importance of delivery at the local level. Similar statements came from the economic and social partners and the civil society. These stakeholders also insist on a more inclusive definition of the partnership principle.

Simplification is another demand that emerges from a majority of contributions. Many contributions expressed concern as regards the newly introduced "one programme-one fund" principle, which may not facilitate the implementation of the policy.

There are many complaints about "red-tape" and auditing requirements related to the implementation of the policy. These are perceived as discouraging many potential beneficiaries and hindering the implementation at local level of important projects. The Commission is urged to simplify the existing procedures at least for small programmes.

Another important matter frequently mentioned concerns the coordination between the ERDF, the ESF and the Cohesion Fund. Some contributions call for their integration into a single Fund for the sake of a more coherent strategic development.

Opinions seem to be divided regarding the opportunity to use cohesion policy as an instrument to react immediately to asymmetric shocks or important crises triggered by processes of restructuring: while some advocate more flexibility, others point out that cohesion policy is first and foremost a structural policy characterised by strategic planning with a medium and long-term perspective.

A number of contributions insist on further exploring the use of means of financing other than grants such as bank loans, micro-credits, risk capital instruments or public-private partnership instruments.

A final, important issue raised by the consultation concerns coordination between cohesion policy, other Community policies, and national policies. Many contributions consider that Community sectoral policies should take better account of regional aspects. In addition, many stakeholders consider important to develop coherent, integrated approaches, particularly between cohesion policy and rural development.

Coordination with national policies is also considered critical. Some stakeholders, for example, consider that the principle of additionality should be strengthened. Moreover, some economic and social partners believe that cohesion policy should be driven by the Integrated Guidelines for Growth and Jobs and the National Reform Programmes.

2.3. Next steps

The debate on the future of cohesion policy has just started and will continue in the coming years. Among the many important events which will mark this debate, it is worth mentioning the ongoing public consultation on the budget review, the public consultation on the Green Paper on territorial cohesion which the Commission will launch in autumn 2008, and the ministerial and high-level events which will be organised under the different Presidencies.

The Commission will report on the progress of this reflection in the Sixth progress report on economic and social cohesion in spring 2009.

In due course, the Commission will present its report on the 2008/2009 budget review setting out its overall vision for the structure and direction of the EU's future spending priorities.

3. CONVERGENCE, GROWTH AND ECONOMIC RESTRUCTURING AMONG EU REGIONS

Convergence among European regions has remained strong in recent years, leading to a marked narrowing of disparities in GDP per head, employment and especially unemployment rates. This trend is largely driven by improvements in the least prosperous regions (See Figure 1).

For the purpose of the analysis which follows, regions have been grouped into three categories: Convergence, Transition[6], and Regional Competitiveness and Employment (RCE) regions, each with a distinct socio-economic profile.

Convergence regions still have a considerably lower GDP per head, at 58% of the EU average while Transition regions are getting closer to the EU average. Between 2000 and 2005, both groups of regions reduced the gap with the EU average by around 5 percentage points (see Table 1 and fiche on GDP).

Employment rates are low at 58% in Convergence regions, compared to 68% in RCE regions. Since 2000, Convergence regions have not been able to reduce this gap. Transition regions, however, did reduce the gap and now have a 63% employment rate, but remain well below the RCE regions (see Table 1). Unemployment rates are still four percentage points higher in Convergence than in RCE regions, but this gap was almost twice as big in 2000.

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6 Phasing in and Phasing out regions were grouped together as Transition regions since both receive transitional support.

3.1. Regional distribution of European high growth sectors

This section discusses the sectoral structure of regional economies focussing on the EU growth sectors (see annex). At the regional level, three growth sectors are analysed: (1) Financial and business services, (2) Trade, transport and communication and (3) Construction. The growth sector, high and medium-high tech manufacturing, is part of the industry sector and thus can not be readily identified at the regional level.

The three types of regions differ in terms of economic structure, growth trends and productivity. For example, productivity in Convergence regions is half that in RCE regions or less (see Table 3) and employment shrank in Convergence regions while it grew in the other two types of regions.

3.1.1. Convergence regions

The three growth sectors are less important in Convergence regions, where they account for only 40% of employment compared to 50% in the other regions. The share of **Financial and business services** is especially low. Growth of GVA and especially of employment in this sector, however, is much higher than in other sectors. **Trade, transport and communication** also experienced a strong increase in both employment and GVA, while the growth rates in **Construction** are similar to the EU averages.

Industry is more important in Convergence regions than in the others and recorded the highest GVA growth rate. Employment in industry declined but less than in the other regions. Nevertheless, industrial productivity is still a third of that in RCE regions. Employment in high and medium-high tech manufacturing, however, grew by 1% between 2000 and 2005.

Agriculture remains an important sector in Convergence regions accounting for more than 15% of employment, five times the share in RCE regions. This happens in a context of falling employment in this sector accompanied by productivity increases[7]. This means that despite strong employment increases in the growth sectors, total employment declined in the Convergence regions.

3.1.2. Transition regions

Transition regions have the same share of employment and GVA in the three growth sectors as RCE regions, but their share of **Financial and business services** is much smaller. With annual growth rates of 4% this sector has grown faster than any other, but the difference remains large.

The two other growth sectors, **Trade, transport and communication** and **Construction,** also grew above average. In Transition regions, especially the share of the Construction sector is much higher than in the other regions. This can be partly explained by the strong economic growth, rising incomes and continuing need to upgrade some of the physical infrastructure. In some regions, the growth of construction is also partially due to demand for second homes and tourist

[7] See Commission Communication: Employment in rural areas, SEC(2006)1772.

accommodation. The highly cyclical nature of this sector, however, leaves these economies vulnerable.

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

3.1.3. Regional competitiveness and employment regions

In RCE regions, **Financial and business services** experienced the highest growth in employment and GVA showing a growing specialisation. The two other growth sectors have a lower share of GVA and employment than in the other two regions and experienced growth rates close to the EU average.

The GVA share of **Industry** in RCE regions is comparable to that of Convergence regions but employment in this sector is significantly lower in RCE regions, reflecting the results of a successful shift towards higher value added activities in this sector. Employment in this sector and in high and medium high-tech manufacturing declined.

R&D expenditure as a share of GDP is almost three times higher in RCE regions than in Convergence. However, competition in innovation is becoming global which means that the EU has to compete globally. RCE regions spend 2.1% of their GDP on R&D, but the US spends 2.5%. Also the share of GDP going to R&D in the top 10% US States is a quarter higher than in the equivalent EU regions.

RCE is the largest of the three groups and as a result also more diverse. The economic structure varies considerably. Some are specialised in Financial and business services, such as Luxembourg and Île de France with at least 40% of their GVA in this sector. Other regions rely heavily on Trade, transport and communication such as for example Tirol, Praha and Illes Balears with at least 30% of their GVA in this sector. Economic performance also varies. Between 2000 and 2005, 17 RCE regions experienced a decline in employment and 22 had a GDP growth rate below 0.5%.

3.2. The contribution of high growth sectors to convergence

The analysis above shows that the growth sectors have made an important contribution to convergence both in Convergence and Transition regions, but the pattern varies.

In Convergence regions, the three growth sectors have contributed to substantial employment creation, but not enough to offset the significant employment reductions in agriculture. GVA growth was also strong in the growth sectors especially in Financial and business services and Trade, transport and communication.

GVA growth, however, was higher in Industry, leading to a high and growing share in this sector. Combined with a high share of employment, this trend may present a risk as several industrial sectors have been in decline at the EU level (see figure 2). Within industry, the share of employment in high and medium-high tech manufacturing, the sector where the EU has the strongest competitive advantage, is only 24% in Convergence regions as compared to almost 40% in RCE. Since 2000, Convergence regions have only reduced this gap by 1 percentage point.

National data shows that GVA is growing faster in high and medium-high tech than other manufacturing sectors in most Member States. Yet some still have a low share of manufacturing GVA in high and medium-high tech, in particular in Romania, Bulgaria, the Baltic States, Greece and Portugal. This and their low productivity in the sector may leave them vulnerable to increased global competition.

Transition regions are catching up rapidly with RCE regions thanks to the strong performance of the three growth sectors and high and medium-high tech manufacturing. As a result, the economic structure of Transition regions is becoming more and more like that of RCE regions.

3.3. Education, skills and knowledge workers

Skills and qualifications are an important determinant of individual income and employability and a substantial contributor to labour productivity. They also indicate to what degree regional economies have shifted towards a more intensive use of knowledge. Yet, the EU invests only 1.2% of GDP in higher education where the US invests almost 2.9%.

The share of highly educated people aged 25-64 is considerably lower in Convergence regions than in RCE regions, 17% and 25% respectively. Still, the share has increased equally between 2000 and 2006, with a slightly higher increase in Transition regions, which have now almost reached the same share as RCE regions.

The share of human resources in Science and Technology (HRST core)[8] also lags in Convergence regions as compared to RCE regions, 12% compared to 17%. But Convergence regions have been able to reduce that gap since 2000 by one percentage point. The use of HRST core is particularly high in knowledge intensive services such as health and education and high and medium-high tech manufacturing.

The overall share in the Convergence regions in 2006 was still 10 percentage points lower than in the RCE regions. Growth in the share of knowledge workers is nevertheless high. It increased by 3.4 percentage points between 2000 and 2006 and the increase was the same in Convergence and RCE regions.

The share of knowledge workers[9] is particularly high in capital regions and other major metropolitan regions which host major headquarters and specialised services. The share of knowledge workers tends to be low in Portugal, Spain, Greece and Bulgaria even in their capital region. The share increased particularly in many regions in Spain, France, Greece, Austria and Slovenia, indicating that the shift to the knowledge economy is not an exclusive affaire of large metropolitan regions.

3.4. Conclusions

This brief analysis has shown that European growth sectors have largely contributed to convergence. However, important differences in the economic structure of the three groups of regions remain and the pattern of catching-up differs between

8 See SEC(2008) […] for definition.

9 Idem.

Convergence and Transition regions. This has several implications from a policy point of view.

Efforts to foster European high growth sectors, i.e. those with above average employment or GVA growth, seem justified. Not only are these sectors the ones in which the European economy has its clearest global growth perspective, they can also be powerful motors for the EU convergence process.

Moreover, the analysis shows that Convergence regions are undergoing a major economic restructuring. Substantial employment is being created in the service sector, while agriculture is shedding even more employment. GVA growth is high especially in industry and services and productivity growth is three times higher than in RCE regions. Such restructuring requires a tailored policy response.

Convergence regions should facilitate the shift of employment to services, especially to sectors which do not require high education levels, and continue to modernise their agriculture sector. As industry is and will remain an important sector in Convergence regions, policy should facilitate a progressive reorientation of the industry towards high productivity and high value added activities to avoid specialisation in industrial sectors particularly exposed to international competition and offering poor growth prospects.

Convergence regions should also aim to improve the education level of the labour force as shifting to higher value added activities will increase the demand for such labour. This will also influence the speed at which they adopt new technologies and help to reduce the productivity gap.

Finally, the high productivity levels in RCE regions give these regions an edge not only in Europe but also in the world. In part, this high productivity is due to strong investments in R&D, which are much higher than in Convergence regions. Yet to maintain a global edge, these regions have to be able to compete with other world competitors, which invest even higher shares in R&D and higher education. This clearly underlines the benefit of the increasing orientation of cohesion policy in RCE towards more investments in innovation and human capital.