Subsidiarity in Regional Policy

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Cohesion is one of only two areas, alongside the Common Agricultural Policy (CAP), in which the EU level of government/public administration plays a substantial role in formulating and delivering policy that requires significant public expenditure. Yet, although it accounts for around a third of the EU budget, cohesion policy expenditure is still a relatively small component of overall public expenditure in the Union at just under 1% of the EU total. Moreover, the term 'cohesion' is open to differing interpretations. Manifestly, the EU level does not have exclusive competence in the policy areas which underlie cohesion, which comprise a combination of those aimed at supporting economic development in regions which are under-performing or less competitive, and mechanisms for the redistribution of income. In fact many of the major spending programmes of the national tier of government (and, depending on the fiscal constitution of the Member State, sub national tiers) are intended to reduce disparities, including regional disparities in access to public services and real incomes.

Formally, EU cohesion policy is not intended to redistribute current incomes, so much as to enhance the long-run competitive position of the regions and social groups it supports. Although the term cohesion encompasses more than regional policy, narrowly defined (for a discussion of the meanings of regional policy, see Armstrong and Taylor, 2000), this paper concentrates on the economic development component of cohesion policy and thus largely equates it with regional policy, understood to be policy interventions designed to raise the level and/or rate of growth of economic activity and employment in regions assisted by the policy. It is important at the outset to recognise that regional policy so defined is a long-term policy and that its function is to create the conditions for improved future economic performance rather than to boost current incomes.

A frequently-articulated argument against EU policy cohesion is that it is ineffective, with the implication that it ought to be re-thought and, conceivably, decentralised or renationalised (Tarschys, 2003). Empirical findings on cohesion policy tend, however, to be inconclusive. Moreover, the ineffectiveness argument is as much (or more) one about whether economic development policies *per se* are worthwhile, than about whether the EU is the appropriate level to offer them. There is, though, a sub-text to this debate, which is that the approach adopted in EU cohesion policy is qualitatively worse than if it were left to national or regional/local levels of government. Here the evaluation literature is of some help.

The paper is structured as follows. The first section explores the rationale for having an EU regional policy, distinguishing between constitutional, economic and political arguments. In the next section, the effectiveness of policy is reviewed, and the wider context of cohesion policy is discussed in section three. Section four considers how to apply a test for susbsidiarity in regional policy, then concluding comments complete the paper.

1 The rationale for EU regional policy

Many standard arguments rooted in fiscal federalism apply to regional policy. Such arguments turn, on the one hand, on matching the geographical scope of the policy with that of the territory in which there are policy demands, taking account of possible spillovers

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between regions within the overall territory, opportunities for economies of scale and scope, and other external effects. On the other hand, fiscal federalism draws attention to the presumed advantages of tailoring policy to local circumstances.

In any economic space, there will be weaker and stronger territorial units in terms of economic performance and dynamism. Even the most prosperous cities typically contain economically weaker neighbourhoods characterised by high levels of social exclusion and deprivation, while other parts of the city thrive. Regions in relative decline or ascendancy are found in all Member States, with the disparities in performance often persisting over decades rather than being temporary aberrations. In the EU as a whole, there have been long-run shifts in the relative positions of Member States, on the one hand, and of classes of region, on the other (see the analyses in successive cohesion reports and periodic reports published by the Commission, as well as the literature on convergence, such as Tondl, 2001). If there is then political agreement that some attempt should be made to limit the consequences of uneven economic performance, the policy will tend to be a top-down one in which the polity as a whole assumes responsibility. Such policy is justified normatively on grounds of solidarity, but may also reflect a search for spatial balance in economic development so as to ensure that the potential of the economy as a whole is realised.

The question then is how to define the encompassing polity and the challenge for subsidiarity is to determine where policy responsibility should ultimately lie for responding to these disparities. In turn, it is important to identify the differing sources of such shifts and to relate them to determinants of the competitive positions of territories[2]. Territorial advantages can be of very diverse sorts. European integration, generally, will affect territorial performance, with gains for certain locations and losses for others occurring for diverse reasons, ranging from the impact of loss of internal borders to the much more profound economic processes flowing from shifting specialisations. The new economic geography approach tries to model these issues by looking at factors such as the economies of agglomeration and the diseconomies of congestion or transport costs.

Top-down influences may be dominant in some cases. If the EU as a whole gains or loses certain sectors of economic activity in global markets (be it textiles and clothing, pharmaceuticals, tourism or financial services) or because of the expansion or attrition of domestic demand (personal services or coal mining), the territories relatively heavily specialised in the activities in question will tend, similarly to gain or lose. Over time, there will be a response, as other territories adjust their economies, but the evidence is strong that such sectoral shifts occur only slowly. How various macroeconomic indicators evolve, such as the interest rate, the exchange rate or the fiscal position may also result in uneven effects on different localities, and with the advent of EMU, such changes are increasingly mediated at EU level.

The level of economic development a region has attained manifestly bears on territorial performance, with some of the effect resulting from the aggregate economy and some from factors specific to the territory. Relative advantage may be attributable to purely geographical features of a territory, such as central location, remoteness or physical separation from trading partners (islands, mountain areas).There may, in this sense be multiple path dependencies that shape economic performance. Finally there are effects on territorial economies from governance, including other policy impacts.

1.1 Assigning policy responsibility

There is an unambiguous constitutional case for locating regional policy at the EU level, on the grounds that cohesion is a fundamental EU-wide objective (set out in Art. 2 TEU) that – in constitutional terms - is on a par with the single market and the economic and monetary

[2] The deliberately vague term 'territories' is employed here to cover different ways of delineating the economy in spatial terms. It can, therefore, embrace urban/rural, regional and national boundaries.

union. The mandate for a European policy is fleshed out in Art. 158 TEC which emphasises the need to reduce 'disparities between the levels of development of the various regions and the backwardness of the least favoured regions' and Art. 159-161 which establish the legal base for the Structural and Cohesion Funds. However, it could be argued that this constitutional case is not necessarily sound economics. Given the diversity of influences on territorial advantages or problems, the rationale for higher or lower levels of government to be involved in dealing with the problem areas needs to be carefully explored.

Structural Funds (SF) spending has distinct objectives for different classes of regions and Member States. The bulk of the money is targeted at low GDP regions, conforming to the convergence aim: in previous rounds of the SFs, this was known as Objective 1, and from 2007, it will be explicitly labelled as a convergence objective. But a chunk of the money has consistently been reserved for other spatial aims. What has, for the last three rounds of the SFs been called Objective 2, has been targeted at regeneration of economies that have been afflicted by specific forms of decline, especially consequent on the loss of basic industries such as coal mining, textiles or other 'old' manufacturing. Resources have also been devoted to various kinds of territorial co-operation, most prominently among border regions.

If the locus of problems is an entire (or much of a) Member State, the argument for the wider polity (the EU) to have some responsibility for finding remedies is more persuasive than if it is just a smaller territory. Thus, it can be argued that a city such as London, which is prosperous overall, should be able to deal with the acknowledged problems of deprivation in its worst affected boroughs[3]. France and Germany have the capacity to deal with their different sorts of regional disparities, whereas Portugal or Greece have, over the years, been less well-placed to do so. The argument can be made, first, in terms of fiscal and institutional capacity, as well as in terms of political will and choices. If the Member State chooses not to implement an internal cohesion policy or to articulate its own priorities for such a policy, that is its prerogative, although given the overall EU commitment to cohesion, whether and how a Member State should be obligated to adopt some form of cohesion policy should be open to discussion. In other words, cohesion policy could be subject to some form of co-ordination, using some variant on the open method, instead of being an EU level policy. In this way, Treaty commitments could be respected without calls on the EU budget and without the insistence that the Member State conform to the EU approach.

At the other extreme, fewer fiscal resources are available domestically for economic development in the much lower income Member States that acceded to the Union in 2004. They also tend to have lesser institutional capacity and, while the presumption is that lower income countries may benefit from relatively more rapid growth as they catch-up with richer Member States, this process is often accompanied by a widening of regional inequalities in GDP per head. Insofar as one aim of cohesion policy is to assure territorial balance in economic development, there are grounds for an EU policy that tries to mitigate the widening of disparities. There is however, a dilemma to be confronted. Aggregate Polish or Hungarian growth that achieves the best 'catch-up' trajectory may be best promoted by concentration of activity in the more favoured parts of those countries, with 'trickle-down' relied upon to reach the rest of the country. But such an approach may result in the sort of enduring spatial imbalance that is evident – in extreme form – in Italy and – in possibly more transitional form – in other Member States such as Belgium or Germany.

1.2 Added value from EU interventions

In relation to the mix of policies that bear on regional development, a key question is whether there is added value from EU funding for the policy. There cannot be an unambiguous answer, because in some cases what the SFs offer fills gaps in national policies, while in

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[3] London as a unit of government does not, in fact, command resources that would enable it to fulfil this role, but subsidiarity principles suggest that it should be up to UK electors or interests to make the case for change, rather than relying on the EU level.

others it overlaps. Bachtler and Taylor (2003) argue that added value has both quantitative and qualitative dimensions. They find that in terms of economic development there are tangible gains to be found in Objective 1 regions. An immediate problem in assessing the added value of locating regional policy at EU level is, though, that, *de facto*, the policy has multiple objectives, with the implication that the rationale for the policy is also diffuse. Added value can be envisaged in different facets of the policy process, with ramifications for the discussion of subsidiarity. In this vein, a distinction has to be drawn between the formulation of policy, its financing and its implementation, including the choice of policy instruments. In parallel, it is important to take account of externalities and spillovers: for example, decentralised policy may result in unfair competition between regions or in incompatibilities between aggregate and spatial objectives.

In principle, the purpose of cohesion policy is to promote the real convergence of GDP per head, an aim that implies that is primarily allocative in intent. Yet there is also a redistributive element to the policy in two senses. The first is that it steers resources to lower income regions and thus represents a transfer of income: because public investment in the Member States and regions which benefit is underpinned by the Structural Funds, it is easier for levels of current consumption to be higher. The additionality principle is supposed to prevent this happening, but it is hard to avoid the conclusion that at least some of the transfers indirectly support current consumption rather than investment. The second sense is that cohesion spending has, increasingly, become one of the ways in which net contributions to the EU budget are mediated. Richer Member States that are net contributors to the EU budget, such as Germany and the UK, demand and obtain SF funding that helps them to contain the size of their net contributions, while poorer Member States – as Poland did in the last budget negotiations – hold out for bigger SF allocations for the opposite reason.

It is easy to construct a scenario in which the need to obtain support for the economic development of a region through the Structural Funds diminishes the impact because of the inevitable transactions costs of going through different tiers of bureaucracy, with ‘Brussels’ imposing conditions inappropriate for the region. An alternative scenario is that having an external body such as the Commission improves the quality of policy and obliges national or regional governments that might be susceptible to ‘capture’ by domestic interests to adopt more enlightened policies.

The question of the time span over which regional policy is applied has a number of ramifications. Development is acknowledged to be a long-term aim which will result in dislocations along the way, with the implication that it has to be appraised in differing ways, but also that consistent policy is required. Equally, policy interventions need to occur in the right sequence and have cumulative effects. In considering subsidiarity, it may be that different steps in the sequence should be undertaken by different levels of government, but there is also an argument that the EU level will be better able to engage in long-term coherent policies than national governemnets which are subject to shorter-term pressures. Endogeneities and learning-by-doing also have to be taken into account. Part of the rationale put forward by the UK Government (2003) for repatriating regional policy is that while the approach adopted in the 1988 reform of the SFs did improve national policy-making in the Member States that receive the bulk of Objective 2 funding, they have now have assimilated the lessons and no longer need the external impetus. Tarschys (2003), too, argues that one option for reform is to return power over regional policy to Member States, although he also canvasses the idea of changing the content of policy away from a narrow focus on local economic development.

1.3 Political economy

From a political economy perspective there are various arguments behind an EU role in regional policy, starting with inertia. Although at least some of what is now EU regional policy might not be justified if policy were being assigned afresh, it is difficult to shift policy assignments because there is path dependency reinforced by the presence of bureaucratic and other structures that take on a life of their own. As Alesina et al. (2002: 40) put it: ‘policy agendas are the result of bargaining processes, typically delegated to elected representatives or bureaucracies. Competing bureaucracies may not be willing to easily give up responsibilities, from which they derive prestige and influence.

It has often been asserted that one of the grand bargains of European integration is that Germany would shoulder a sizeable proportion of the budgetary burden in return for market access. A similar logic can be applied as an economic integration argument for regional policy, which is that because integration creates adjustment problems, it is at least partly incumbent on the EU level to assist regions which lose (relatively, if not absolutely) from integration. The irony in this position is that the most potent adjustment mechanisms in an economic space (labour and capital mobility, or induced fiscal flows) are much weaker in the EU than in most Member States or in comparable economies such as the US. In other words, because the economies of the EU are not that well integrated a regional policy may well be justified to counter the effects of integration. Put this way, the proposition seems almost contradictory, but if normative considerations such as a preference to curb intra-EU migration or a reluctance to countenance cross-border fiscal flows are taken into account, regional policy as a means of facilitating adjustment could be seen as a plausible second-best policy.

Political economy factors are also evident in the machinations around the EU budget within which regional policy has become one of the bargaining chips, as described above, with the net contribution becoming of greater concern than whether or not there is a compelling case for EU policy being applied in each Member State. Even if purely budgetary reasons were absent, there is a similar political economy argument which is that the visibility of cohesion policy plays a valuable role in fostering support for EU regional policy and, indeed, the EU generally. If, say, Austrians are to be expected to support a policy that transfers sizeable resources to poorer neighbouring Member States, the fact that some resources flow to regions such as Burgenland can help to sell the policy in Austria, even though an ability to pay test might suggest that the policy should be funded domestically.

Poll data also lend some support to the idea that a regional policy should exist at EU level, although there is plainly a risk that such polls will find support for what is already in place. Alesina et al (2002) report a Eurobarometer study which shows that in all Member States, there is a balance of opinion in favour of EU involvement in regional policy. The figure quoted shows the difference between the number of respondents, broken down by Member State, who believe that a policy area should be a ‘shared’ competence between the Union and the Member States and those who believe it should remain a national competence. For most policy areas, there are diverse views, with respondents in some Member States strongly in favour of national competence, while in others ‘shared’ is preferred. Only for ‘global crime’ and ‘regional policy’ is there a unanimous preference for ‘shared’ though the balance of opinion is much stronger in some Member States (such as Belgium or Spain) than in others (such as France or, surprisingly given how much it benefits from the Structural Funds, Portugal).

2 Regional policy effectiveness

A different perspective on whether or not there should be a regional policy comes from posing the simple question of whether it works. EU cohesion policy has been assessed from diverse standpoints and the range of theoretical approaches and empirical techniques used in work on evaluating cohesion policy is extensive, as is clear from the scope of the special issue of *Regional Studies*, published in April 2006, which contains contributions from leading exponents of such evaluations.

Not surprisingly, the Commission (or at least parts of it) argues that cohesion policy has been a success, for example in the 3rd Cohesion report (Commission, 2004) which notes that growth per capita in the cohesion countries (even excluding Ireland, an extreme outlier) exceeded the Community average by one percentage point over the period 1994-2001. The OECD (2004: 153) observes, however, that ‘it is difficult to assess empirically the impact of the EU regional funds, and the evidence that the Union's regional policy succeeds in its aims is mixed'.

Molle (2006) points out that EU policy can be adjudged, on the whole, to have been appropriate, insofar as it has focused on infrastructure and human resources, the two elements of backward regions that he consider do, indeed, need attention. He is more dubious about whether policy has been effective: on the one hand, it has tried to do what it intended to do; but on the other, the evidence on convergence is unclear. As regards efficiency (that is whether the policy has used its resources well), Molle is more negative, arguing that because political imperatives have meant that specific grants are used and because the eligibility criteria may have distorted project choice, sub-optimal investments have been made. In addition, the fact that other policy aims are loaded on to cohesion policy creates a risk that just evaluating the contribution to cohesion may miss part of the effects of policy. Given that cohesion policy is increasingly expected to contribute to Lisbon objectives, the risk of over-load in policy objectives may now be accentuated.

2.1 Empirical assessments

Many of the empirical assessments of the SFs focus on the degree to which cohesion policy alters trajectories of convergence in the sense pioneered by Barro and Sala-I-Martin (1991, 1992). A distinct, but related approach is growth regressions: econometric work which, essentially, take some measure of economic development (usually either the level or the growth of GDP) as the dependent variable and include SF expenditure among the explanatory variables. A third class of studies uses simulation models to try to capture the full range of effects of the SFs, recognising that spillover effects of policies can be crucial. By contrast, much of the evaluation effort – including large-scale studies of SF programmes - has concerned how cohesion policy has been implemented and whether or not policies have been well-conceived. Although some evaluation studies arrive at tolerably favourable conclusions about the SFs, they interpret effectiveness in different terms from more narrowly based econometric studies.

Econometric studies

Efforts to appraise the SFs using econometrics have emanated from a number of different theoretical perspectives. In the convergence literature, the concepts of beta convergence (the pace at which a backward economy catches-up) and sigma convergence (the change in the variance – or some other measure of dispersion - of GDP per head) are used to monitor changes over time. The original work by Barro and Sala-I-Martin demonstrated that convergence was the norm in the US and Europe, though subsequent work by many others has either sought to refine their approach or to apply it in different contexts and, not surprisingly, has arrived at different empirical results (see, for example, Tondl, 2001; Beugelsdijk, 2002; and Magrini, 2003).

A second strand of work draws on new economic geography (NEG) and several recent studies have sought to appraise the effectiveness of the SFs from this perspective. The question posed tends to be not just whether there has been an effect, but also whether the changes induced by the policy support help to steer the recipient economy in an appropriate direction and whether the effects on the Member State and EU economy as a whole are positive. Here, too, an implicit link to Lisbon aims can be identified. Some authors have argued that EU policy should concentrate on convergence at the national level, leaving domestic cohesion policies to deal with intra Member State disparities; thus, de la Fuente (2004) finds that Spain would have had greater overall welfare gains if SF investment had been targeted at dynamic regions, rather than the least prosperous ones.

Midelfart-Knarvik and Overman (2002), in a study of the effects of structural support for less-advantaged regions, find that the regions that have adapted most successfully have increased their specialization within manufacturing. They find, however, that policy 'is encouraging relocation counter to comparative advantage', but also that 'regional comparative advantage…is severely restricted by the fact that factor price returns tend to be equalized within nation-states due to the centralized nature of wage-setting' (Midelfart-Knarvik and Overman, 2002: 351). This raises a central issue about what the SFs are intended to do that also bears on subsidarity. If it is accepted that an aim of policy is to facilitate specialisation along NEG lines, these findings could be interpreted as evidence that the SFs are misconceived and would be better as national policy. The trouble with this conclusion is that it offers no concessions to the ambition of structural policy to transform the *competitive* (as opposed to *comparative*) advantage of assisted regions.

Boldrin and Canova (2001, 2003) assess the impact of transfers under the Structural and Cohesion Funds and find hardly any effects. Indeed, speculating on the likely trajectories of the recently acceded member states, they conclude (Boldrin and Canova, 2003:1) that such transfers 'may increase income in the receiving countries by an amount equal to the one transferred, but there is no evidence they will have an impact on long-run growth rates'. Instead, they argue for a Washington consensus kind of mix of sound macroeconomic policies, supply-side reforms and trade integration. An obvious problem with any econometric approach, though, is that the lags involved in economic development are uncertain and it may even be the case that some initial impacts are perverse.

Simulation models

Modelling exercises have been extensively used to assess the impact of the SFs, notably in work undertaken by John Bradley and his various collaborators, often using the Hermin model. Although applied economists have had a long experience of modelling the impact of public spending on demand, quantifying supply-side effects requires very different techniques. What is at issue is modelling the response of the economy – especially private investment - to strategic public investments, a research question that macroeconomic models based on estimations using long time-series are ill-equipped to answer. Because the purpose of the public investment is to change the economy, success will mean a structural break, rendering models which assume consistent behavioural relationships over time inappropriate

By focusing on the supply-side, the SFs work in a different manner from more conventional income transfers that simply boost demand and need to be analysed as such. This is a point which is stressed by Bradley and Morgenroth (2004) and which they argue bears on how the SFs are assessed., because the implication is that it is not just demand-side elasticities that matter, but also the induced increases in stocks of human and physical capital.

Among the studies which have focused on individual Member States or regions, some feel for the orders of magnitude of the effect of the SFs can be ascertained. Thus, Honohan et al. (1997) conducted a model based assessment of the effectiveness of the Irish CSF in a study which stands out as a comprehensive one. They show that the CSF did contribute significantly to Irish growth, but that the contribution has to be placed in perspective, since the growth also reflects several other factors. Depending on assumptions made, the study finds that one percentage point of the growth (which attained nine to ten percent per annum at its peak during the 1990s) can be attributed directly to the CSF. Sosvilla-Rivero et al. (2006), using a Hermin modelling approach, find that the SFs increased the growth of a case study region (Castilla La Mancha) by 0.64 percentage points over the period 1988-99.

Evaluations

In a sea-change from the practice of earlier rounds of the SFs, they are now very extensively evaluated, and often receive quite positive appraisals. A comprehensive evaluation of the Objective 1 programmes (ECOTEC, 2003) finds much to applaud in the functioning of the SFs and identifies several quantitative gains in terms of jobs created, business supported and so on. The study has an extended discussion of the effectiveness of policy, although it emphasises the difficulty of arriving at a convincing assessment because of the diversity of qualitative and quantitative targets adopted by programmes. Commenting on gross and net job creation, the study concludes [p. 130] that 'overall effectiveness in terms of net [employment] effects is unknowable'.

Similarly, an ex-post evaluation of the 1994-99 Objective 2 programmes by Centre for Strategy and Evaluation Services (2003) reached an overall conclusion that the 'programmes made a significant contribution to regional developments'. While there might be some temptation to say that a study for DG Regio is bound to reach such a conclusion, the report does provide more detailed justifications for the assertion, although it is noteworthy that the report finds that many of the Objective 2 (O2) regions recorded a fall in GDP per head relative to the EU average. On the other hand, the O2 regions are reported to have seen a bigger drop in unemployment than the EU average. Estimates of cost-per-job, a well tried metric for assessing regional policy interventions, are provided, showing reasonably good results. However, in a passage that sums up the dilemma of how to assess the effectiveness of the SFs, the report states that '

> *'because target-setting practices remained poor, it is not possible to fully assess the extent to which specific Objective 2 aims were achieved ('effectiveness'). Likewise, methodological techniques and data sources are not sufficiently developed for Objective 2 impacts to be fully quantified.'*

The report notes that a higher share of investment than in the 1989-93 round of the SFs went on business-related projects, rather than infrastructure, and an increasing use of interventions to promote research and innovation. The latter did, however, raise some problems, one of which is complications in networking with centres of excellence outside the assisted region.

Over the years, much of the SF spending has gone on infrastructure and, as Stierle (2005) notes, how it affects a recipient economy needs to be appraised with care. He makes the obvious, though often over-looked, observation that it is likely to be most effective when there is an infrastructure deficit. Some commentators have argued that too much of the SF spending has gone on infrastructure in preference to other policies that might have been more effective in promoting economic development (Rodriguez-Pose and Fratesi, 2004) if a more decentralised approach had been followed. Equally, it should be recognised that some infrastructure spending that has goals other than contributing directly to growth, notably environmental aims, though energy security might be another such goal in today's context.

Failure to spend money allocated has been another problem that has beset the SFs, especially in areas of weak institutional capacity. One argument might be that the sheer bureaucracy of the Funds is an obstacle and that this is a predictable effect of having too many tiers of government involved, with the implication that decentralisation would improve matters. The other side of the coin is, that the controls serve the purpose of avoiding poor choices and that the failure to spend may even show that quality of spending is enhanced by EU oversight. As in so much of the subsidiarity debate it is hard to arrive at firm conclusions.

Where cohesion policy correlates with improved performance, there may be problems in attributing observed results to the policy itself. Moreover, even if there is a plausible case that policy intervention has had positive effects, the added value from carrying out the policy at EU level may not be proven. Consequently, it is difficult to judge whether EU cohesion policy is optimal or a distantly second-best or whether the same resources would have achieved more if deployed at another level f government. In addition, if the underlying question about the effectiveness of the SFs is linked to subjecting cohesion policy to accountability, it poses a different question from evaluations designed to improve the implementation of policy. The first motive is about outcomes, while the second partly concerns policy learning, but also legitimacy. In a long enough run, it can be argued that *only* outcomes matter, but it can also be argued that premature assessment may damage the implementation of policies which have progressive effects. Cumulative effects, especially, are hard to capture and may be one explanation for the generally ambivalent econometric results about whether or not the SFs have been effective.

3 The Structural Funds in economic governance

Any assessment of the SFs has to take account, in addition, of the effectiveness of other adjustment mechanisms, and these considerations, too, bear on subsidiarity in that what the SFs do may be distinctive from what goes on within Member States. Low labour mobility in the EU has long been a characteristic, although the 2004 enlargement may have altered the pattern. The OECD (2004) also places a strong emphasis on the wider policy context in promoting growth in lower income regions, citing not just other supply-side measures, such as a pro-business environment and efficient public administration), but also stable macroeconomic policies (see also, Barry and Begg, 2003). This leads the OECD (2004) to argue that a high level of educational attainment education may help to compensate as a means of attracting investment. Analyses of the Irish experience suggest that while the SFs have made a difference, a long-term strategy of investing in education may, indeed, have been pivotal (Barry et al., 1999).

If cohesion policy is not integrated with, or at least consistent with, wider national structural policies, the policies can pull in opposite directions (Midelfart-Knarvik and Overman, 2002). In practice, EU cohesion policies are complemented by a wide range of other policies, mainly at Member State or sub-national level, that also bear on economic development and/or living standards. Quantitatively the most important is the net fiscal transfer that arises from the spatially unbalanced incidence of national tax and public expenditure flows. In many Member States, various public services (notably health and education) are organised so as to ensure comparable per capita entitlements, irrespective of the capacity of the spatial unit to raise taxes. Where there are well-developed national pension systems, too, the net flows across spatial boundaries are often huge for the simple reason that pensioners tend to locate in specific parts of the country in preference to others. Similarly, social assistance and unemployment benefits flow to regions with higher than average numbers of people affected by poverty or unemployment.

The financing of these net flows varies according to national traditions, with some countries having explicit inter-regional equalisation mechanisms to redistribute taxes[4], while in others it is central government that picks up the bill and redistributes via block grants or the direct financing of public services. While the magnitudes of such flows are never easy to calibrate (and are often, perhaps deliberately for political reasons, kept quiet), they can be surprisingly large. In a study for DG Regio, for example, Begg et al. (2004) showed that the regions that benefit most can receive net fiscal transfers as high as a third of the region's GDP.

Regional economic development is also affected by a range of supply-side policies, some of which have an explicit spatial component, while for others any spatial bias in their incidence is the less direct result of the focus of the policy. The policies with explicit spatial objectives include domestic regional policy, urban policy and various forms of spatial planning. Some countries, such as France, Italy and the UK, have a long tradition of territorial development policies administered by central government, albeit employing very different approaches which have, in addition, fluctuated over time. Policy instruments have included land and property development, regional labour subsidies, grants for capital investment, and technology initiatives. Typically the budgets for such policies are comparatively small and the impact is difficult to measure. Although the designated regions are often aligned with those eligible for SF support, there are also noteworthy exceptions. For example, urban policies that provide assistance for deprived neighbourhoods in the cities of richer regions (Ile de France or Greater London, for instance) may pull in the opposite direction to regional development policies that try to attract economic activity away from congested regions.

[4] Germany and Austria also have systems which transfer between sub-national units of government via the *Finanzausgleich*.

Active labour market policies (ALMP) have substantial budgets in some countries, reaching 1.52% of GDP in Denmark where they are most intensively used and averaging 0.64% (Eurostat, 2006), approximately double what is spent on the SFs. Because these policies support unemployed persons, their spatial incidence will reflect – but not exactly follow - disparities in unemployment rates. Such policies may dovetail with the support to Member States under what is now Objective 3 of the Structural Funds via the European Social Fund (ESF) and it is certainly true that many local providers of training and related schemes rely on ESF support. Equally, there is no guarantee that the sorts of project that obtain ESF funding are necessarily those that the Member State would choose.

Policies that promote new technologies, investment in R&D and innovation have been highlighted as part of the Lisbon strategy. In the EU today, the data show that expenditure on R&D is regionally very concentrated, as is patenting activity. A policy response has been to try to diffuse this activity more widely, but the danger with such an approach is twofold: first, it risks dissipating research efforts when concentration may be a more effective strategy; and, second, there may be little advantage for relatively backward economies in trying to stimulate research activity. On the other hand, it could be argued that unless more effort is put in to transforming an economy's underlying characteristics, it will be unable to make a leap forward. Midelfart (2004) argues that that intra-industry knowledge spillovers in the EU are probably more significant than inter-industry ones and that this tends to militate against policies which seek to allocate activity against comparative advantage. She argues that rather than trying to lean against the wind in this way, it would be more efficient to deal with inequalities by direct income transfers, thereby allowing (efficient) spatial concentrations - that increase intra-industry spillover - in favoured areas. This reasoning is bound to be controversial since it invites a dependency culture in the less-favoured areas, implies the possible wasting of assets in such regions, and can also result in spatial imbalances that have damaging macroeconomic consequences

3.1 State aids

One of the more awkward issues in decentralising regional policy is how to regulate competition between regions. Such competition arises in a variety of ways, with regions vying with each other to attract different investment flows, to retain tax-payers or to stimulate enhancement of factors of production. There is an evident danger that if many regions adopt similar approaches to public intervention that there will be a zero-sum (or possibly negative-sum) game, but political economy arguments often over-ride pure market logic. State aids offer a good illustration. They are widely criticised for their distortionary effect on markets and for acting as a brake on restructuring and regeneration. Yet any government (local, regional or national) that is confronted with a possible loss of a major employer or the prospect of luring one will be sorely tempted to offer such aids. Davies and Hallet (2001) draw attention to a contrast in effectiveness between the SFs and indigenous regional policy. They argue that, despite relatively small budgets, the former can have a significant impact on income and employment, but that state aids (especially) are subject to very high levels of deadweight that render them relatively ineffective.

The usual rationale for regulation of state aids is to ensure that the internal market is not at risk (Wishlade, 2003), but it can also be argued that a cohesion rationale should be adopted. Community policies, by contrast, are specifically geared towards altering the economic development trajectory of eligible regions. The implication is that the approach required by the Structural Funds and the Cohesion Fund has spilled over to shape national policy on cohesion-related matters. For the future, this poses a number of challenges about what should be expected of national policies and, subsidiarity notwithstanding, the degree to which Community policies are needed to reinforce the overall commitment to cohesion. In part this is because some Member State policies – state aids being a good example – may undermine, rather than support cohesion in the Union as a whole.

3.2 Confluence with the Lisbon strategy

With the 2005 re-launch of the Lisbon strategy, there has been a growing expectation that the SFs will contribute to wider economic reform aims. A closer linkage between the SFs and the Lisbon strategy has ramifications for subsidiarity. With such a linkage, the discussion of which level of government should carry out regional policy has to be viewed differently. Spatial balance in economic development is, however, a dimension of economic reform that does not feature strongly in the Lisbon strategy, but arguably should do. In the Strategic Guidelines for cohesion policy issued by the Commission (Commission, 2005a and 2005b), much is made of the degree to which structural actions should be consistent with Lisbon aims, sometimes giving the impression that this ought to be paramount. Consistency in policy is also a pre-condition for effectiveness. Davies and Hallet (2001) find that effectiveness is diminished if regional policy is too diffused and tries to hit too many targets. In addition, poor implementation can often weaken impacts.

The test would then become not just whether the expenditure on the SFs stimulates growth, the employment rate, research potential and other Lisbon targets in *assisted* regions, but also the much stiffer one of whether it adds to the collective *national* and *EU-level* performance. The SFs do plainly have spatial objectives that the Lisbon strategy does not, and their focus is on decentralised operations, while the new National Reform Programmes that are at the centre of the re-launched Lisbon strategy are about integrated strategy. Nevertheless, it is important to recognise, as a Danish Technological Institute (2005) study shows, that there is substantial congruence between Lisbon and cohesion objectives. However, the study shows that the congruence is highest in the relatively more prosperous regions supported by the SFs and much lower in the least well-off regions. The scope for a clash of policy objectives is, therefore, evident, although in its latest update on cohesion, the Commission (2006) is positive about the contribution of the SFs to wider EU economic governance aims, stressing the contribution to the re-launched Lisbon strategy.

4 A regional policy subsidiarity test?

The forgoing discussion leads to a question about whether a subsidiarity test can be devised to determine when regional policy should be at the EU level one and when it should remain a national (or, conceivably, sub-national) competence. Several factors need to be taken into account. A first is that so long as the EU budget remains capped at around 1% of GDP, the resources available for cohesion policy will be sorely limited. Consequently, even if there were a case for a policy that extends to all Member States, financial imperatives might dictate limits to the geographical spread of cohesion policy. The concentration principle for the SFs is supposed to achieve this aim, yet the fact that the Funds are seen as one element in the equation of net contributions to the EU budget means that even the richest Member States obtain some receipts from them.

The criterion used to concentrate spending for Objective 1 (now convergence) of the SFs has long been a threshold for GDP per head of 75% of the EU average, applied at the regional level, while the test for the *Cohesion Fund* is 90% of the *national* GDP per head. A fiscal capacity subsidiarity test would emphasise the latter by making a Member State above a certain level of prosperity responsible for funding its own regional policy, while envisaging transfers from the EU for those below a threshold. However, an abrupt cut-off point would lead to contestation and create the sort of 'poverty-trap' familiar to social policy-makers, so that a tapered or banded support would be more congenial. It has to be stressed that the funding and the design of policy need to be distinguished and that a common policy approach can be consistent with diverse funding streams.

A test for subsidiarity in policy design raises different issues. The approach to regional development espoused by the EU is to promote long-term structural change by altering the productive potential of a region. Indeed, in a background report for the 3rd Cohesion Report on factors of regional competitiveness, Cambridge Econometrics and Ecorys (2004) argue that regions have to avoid the temptation of 'transient' Keynesian transfers, and to focus instead on policies that steer the regional economy in a direction that makes best use of its current and prospective assets. The report is critical of what it characterises as 'spread-betting'[5] or 'shopping-list' strategies which dissipate policy effort. There are however circumstances in which a Keynesian boost may be more suitable and there may be domestic reasons for adopting a specific development trajectory that is at odds with a competitiveness model. The report, in putting forward typologies of regional competitiveness, does acknowledge that part of the art of regional policy is to enable a region to shift to a different competitive position, often implying an attempt to break-out from a structure of activity that is overly constraining or traps the region in its own history The question then is whether subsidiarity allows this to be achieved more easily.

At one level the answer is straightforward and, ostensibly, clear-cut. Policies that are formulated by policy-makers close to the regional problem would, on the whole, be expected to be better attuned to the region's needs. But there are counter-arguments, centring especially on the risks that dominant local interests will 'capture' local policy-makers, leading to policies that serve these dominant interests rather than the wider regional interest. Extreme forms of the latter are where organised crime or systemic corruption results in the resources being diverted to favoured recipients with little discernible impact on regional development. More common is weak institutional capacity, which tends to diminish the effectiveness of any economic development policy, whether because of poor project choices, inadequate implementation and monitoring or shortcomings in complementary policies. This can even lead to the almost paradoxical finding (as suggested, for example, by Ederveen et al, 2006) that regions with stronger institutional capacity make the most effective use of the SFs, even though it could be argued that they need them least.

5 Concluding comments

Cohesion in the EU is advanced by policies implemented both by the Member States and the Community. While what Member State policies do has a large and positive impact on aspects of cohesion, Community policies plainly contribute to promoting convergence, especially for the least competitive regions and the poorer Member States. There is, however, a qualitative difference between the main instruments of national policy, which have explicit re-distributive aims, and the much more specific interventions from the SFs aimed at economic development. This sort of regional policy is best organised in a top-down manner for three main reasons. First, to the extent that it is intended to alter development trajectories, the inevitable competition between regions needs to be recognised and mediated. If lower tiers of government are the principal actors, this will be much harder to achieve since their state aids or other forms of support may undermine the efforts in competitor regions. Second, the net transfer of resources has to be orchestrated by a higher tier of government. Third, in transferring resources, the higher tier is able to impose governance conditions that ensure that the support is used appropriately.

On this basis, for the Objective1/convergence element of current EU regional policy, the fact that there is a net transfer of resources does warrant retention of the policy at the Community level. It is also noteworthy that in the Member States that receive substantial resources from Community cohesion policy, Community and national policies towards economic development have become quite closely inter-twined. While the evaluation evidence is far from conclusive, there are at least signs that the SF model for fostering economic development has facilitated a more strategic approach than past national models.

Whether the EU regional policy should continue to be offered in other regions or in richer Member States is more problematic. Unless *juste retour* arguments are adduced, there is no resource transfer argument to justify EU spending in richer areas, since the recipients are

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[5] Though betraying a mis-understanding of how a spread bet functions; 'hedging bets' would actually be a more accurate metaphor!

generally net contributors to the EU budget. However, there may still be a case for the EU level to oversee the orientation of policy and there may also be advantages in being obliged to follow the EU policy model, despite the reservations expressed by the likes of the UK Government (2003). For Leonardi (2005: 1), one of the distinguishing features of the EU's cohesion policy is the 'extensive involvement of different administrative levels and socio-economic groups in the formulation and implementation of policy'. Leonardi asserts that cohesion policy has had a major influence in the governance of economic development policy by broadening the participation of a wider range of actors, including the empowerment of sub-national levels of government. He notes that evaluation evidence suggests that an outcome has been economic development policies better attuned to local circumstances and also that cohesion policy has encouraged institutional innovation and reform.

This does not mean that the SFs, as presently constituted, should be a permanent feature of EU policy, although the political economy arguments cited above suggest that policies are hard to shift once established. Indeed, the history of the Common Agricultural Policy – set up in an era when security of food supply was a prime concern, but now much more a social policy for farming communities – demonstrates the power of inertia in EU policy: as we approach the 50th anniversary of the Treaty of Rome, the CAP is still the most costly EU policy. For constitutional and political economy reasons, EU cohesion policy is also likely to prove its resilience, even if some of the more theoretical economic arguments for subsidiarity are more persuasive, at least in relation to some Member States. At the same time, cohesion could be retained as an aim while adopting different methods of co-ordinating policy (Begg, 2003).

In looking at work that attempts to assess the effectiveness of the SFs, it rapidly becomes clear that different techniques produce diverse conclusions and that none in isolation offers a wholly convincing answer. Therefore, despite the very substantial effort that has gone into evaluating and assessing the SFs, the debates between those who disparage the SFs and supporters of cohesion policy remain surprisingly inconclusive. What can be read into this finding? One answer is that there are methodological challenges to be solved in assessing regional development, not the least of which is matching techniques to questions. Distinguishing between the three broad classes of assessments, an (admittedly crude) characterisation is that econometric studies – broadly – offer little support for the contention that cohesion policy is effective. Modelling exercises tend to be more positive, but it is the survey based assessments that seem to be most sanguine.

There is thus a paradox that it is hard to draw firm conclusions about the effectiveness of a policy domain subject to so much evaluation effort. A number of factors behind this paradox can be identified. First, as Bachtler and Wren (2006: 143) note 'evaluation has to serve the objectives of many different organizations…each with its own motives and interests in the results and implementation of EU spending'. They also highlight the fact that the SFs function in very diverse national and regional settings, with heterogeneous institutions and priorities. A second consideration is that the absence of firm evidence of improved economic performance does not preclude the possibility that the underlying potential of a region has been improved.

Questions also arise about the purpose of assessment and evaluation of policies such as cohesion. Many of the econometric studies and modelling exercises have the comparatively simple aim of testing the hypothesis that the SFs do (or do not) promote economic growth. Yet the evaluation studies tend to take a wider view of effectiveness by looking also at whether the policy interventions provide a basis for economic reform.

In short: SFs, properly supported can be effective, but they may often appear to have a disappointing effect, above all in the short-term. For policy purposes, this is a message that is difficult to interpret, the more so when associated with the issue of subsidiarity. It is tempting to reduce subsidiarity to a simple, even simplistic cost-benefit calculation, based on fiscal federalism principles, of whether the benefits of tailoring policy to local circumstances outweigh the gains from internalising externalities through situating the policy at the EU level. But the issues raised in this paper suggest that a more nuanced approach is needed.

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