AN AGENDA FOR A REFORMED COHESION POLICY

A place-based approach to meeting European Union challenges and expectations

Independent Report

prepared at the request of Danuta Hübner, Commissioner for Regional Policy

by Fabrizio Barca

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BACKGROUND RESEARCH AND ACKNOWLEDGEMENTS

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The Rapporteur for the study was Eric Von Breska, DG REGIO.

Additional research for sections of the Report was undertaken by Carlos Mendez, European Policies Research Centre, and Gian Paolo Manzella, European Investment Bank.

The Report has greatly benefited from independent research and contributions organised during 2008. In particular:

- *A "**Hearing on growth, institutions and policy - state of the art and territorial dimension**", was prepared and steered by Andrés Rodriguez-Pose (Department of Geography and Environment, London School of Economics, United Kingdom), Michael Storper (Institute d'Etudes Politiques de Paris - Sciences Po, France, and London School of Economics, United Kingdom) and Tom Farole (Regional Director - Kaiser Associates, London) with the participation of Philippe Aghion, (Department of Economics, Harvard University, USA), Philip Keefer (Development Research Group, The World Bank, Washington), Jacques Le Cacheux (UPPA and Observatoire Français des Conjonctures Économique – Sciences Po, France), Philip McCann (Department of Economics, University of Waikato, New Zealand), Ivan Miklos (Former Deputy Prime Minister and Minister of Finance of Slovakia, Member of Slovak Parliament), Alberto Navarro-Gonzales (Former Secretary of State for the European Union of Spain), Tommaso Padoa-Schioppa (Former Italian Economic and Finance Minister), Diego Puga (Department of Economics, Universidad Carlos III de Madrid, Spain), Guido Tabellini (IGIER Bocconi University Milano, Italy), Gert Tinggaard Svendsen, (University of Aarhus, Denmark), David A. Wolfe, (University of Toronto, Canada), Commissioner Danuta Hübner and officials from DG REGIO, DG EMPL, SG and BEPA.*
- *A "**Hearing on cohesion policy and regional innovation**" was prepared and steered by Luc Soete (UNU-MERIT, Maastricht) with the participation of Jan Fagerberg (Centre for Technology, Innovation and Culture, University of Oslo, Norway), Kevin Morgan (Cardiff University, United Kingdom), Andre Sapir (ECARES - Université Libre, Belgium), Gilberto Seravalli (Dipartimento di Economia, Parma University, Italy), Bart Verspagen (Maastricht University, Netherlands) and officials from DG REGIO, DG EMPL and DG ENTR.*
- *A "**Hearing on cohesion policy and social inclusion**" was prepared and steered by Fabrizio Barca with the participation of Sabina Alkire (Department of International Development, University of Oxford, United Kingdom), Tony Atkinson, (Nuffield College, Oxford, United Kingdom), Giuseppe Bertola, (University of Turin, Italy), Marjorie Jouen, (Notre Europe, Paris), Eric Marlier (CEPS/INSTEAD, Luxembourg), Dirk-Jan Omtzigt (Oxford University, Oxford Institute for Global Economic Development, United Kingdom), Saskia Sassen (Columbia University in the City of New York, USA), Commissioner Danuta Hübner and officials from DG REGIO and DG EMPL.*
- ***Five Policy Seminars** were prepared and steered by John Bachtler, Fabrizio Barca and Carlos Mendez with the organisational assistance of Alyson Ross. Invited national and regional officials from all 27 EU Member States took part (see summary).*

The transcripts or summaries of these meetings are available on the web at: ***http://ec.europa.eu/regional_policy/policy/future/barca_en.htm.***

A Workshop on Impact Evaluation was also prepared and steered by Arianna Legovini (The World Bank, Washington), Alberto Martini (Università del Piemonte Orientale, Italy), Matthew H. Morton, (University of Oxford, United Kingdom) and Robert Walker (University of Oxford, United Kingdom), with the participation of officials of the Commission, Member States and Regions.

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Ten Working Papers (also available at the above web address) have been specifically prepared for the Report on the following topics:

- ***Multidimensional Measures of Poverty & Well-being**, Sabina Alkire, Moizza Binat Sarwar, Oxford Poverty & Human Development Initiative (OPHI), Oxford Dept of International Development, Queen Elizabeth House, University of Oxford, United Kingdom*
- ***Towards a Territorial Social Agenda for the European Union**, Fabrizio Barca, Ministry of Economy and Finance, Italy*
- ***Towards better use of Conditionality in Policies for Research and Innovation under Structural Funds - The Intelligent Policy Challenge,** Andrea Bonaccorsi, University of Pisa, Italy*
- ***Operational Rules and Results in Cohesion Policy Programmes: Analysis and Proposals for Conditionalities,** Paola Casavola, Independent expert, Italy*
- ***Cohesion Policy in the European Union: Growth, Geography, Institutions**, Thomas Farole, Andrés Rodríguez-Pose, Michael Storper, London School of Economics, United Kingdom*
- ***The Turning Points of EU Cohesion Policy**, Gian Paolo Manzella, European Investment Bank, Luxembourg and Carlos Mendez, European Policies Research Centre, University of Strathclyde, United Kingdom*
- ***Regional Convergence, Growth and Interpersonal Inequalities across EU**, Philippe Monfort, Directorate General Regional Policy, European Commission*
- ***Applicability of Impact Evaluation to Cohesion Policy**, Matthew H. Morton, Department of Social Policy & Social Work, University of Oxford, United Kingdom*
- ***Survey on Social inclusion: Theory and Policy**, Dirk-Jan Omtzigt, Oxford University, Oxford Institute for Global Economic Development, United Kingdom*
- ***Competitive European Regions Through Research and Innovation - Different Theoretical Approaches to Innovation Policies**, Gilberto Seravalli, Department of Economics, Faculty of Economics, Università degli Studi di Parma, Italy*

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EXECUTIVE SUMMARY

There is a consensus that the European Union should modernise its budget, tackling the new challenges and breaking away from bureaucratic inertia and the *juste retour* logic that hitherto have prevented change. The decision to undertake a budget review has provided the opportunity for doing so. This opportunity is still available. Cohesion policy is part of the review, but there are conflicting views on its rationale, its results, and the need and scope for reform. The risk of wrong changes is high. The risk that no change will take place is also very high.

The purpose of this Report is to help avert these risks by setting an agenda for reform and seeking to initiate a frank, informed and timely debate on conceptual, political and operational aspects. A start has been made with the consultation undertaken for preparing the Report[1]. On the basis of this consultation, and a review of the economic literature, empirical evidence and a comparative and historical perspective, the Report argues that:

- there is a strong case, rooted in economic theory and in a political interpretation of the present state of the European Union, for the Union to allocate a large share of its budget to the provision of European public goods through a place-based development strategy aimed at both core economic and social objectives;

- cohesion policy provides the appropriate basis for implementing this strategy, but a comprehensive reform is needed if present challenges are to be met;

- the reform requires the adoption of a strong policy concept (renewing the original ideas of EU founding fathers), a concentration of priorities, key changes to the governance, a new high-level political compromise and an appropriate adjustment of the negotiation process on the budget;

- current economic and political events have increased the urgency for change: some of the reform proposals can and should be anticipated in the current programme period.

The policy model is the starting point of any change. Indeed, as the Report argues, without such an initial discussion to establish a mutual understanding of the rationale of a place-based development policy, there can be no meaningful debate on reform. A *place-based policy* is a long-term strategy aimed at tackling persistent underutilisation of potential and reducing persistent social exclusion in specific places through external interventions and multilevel governance. It promotes the supply of integrated goods and services tailored to contexts, and it triggers institutional changes.

In a place-based policy, public interventions rely on local knowledge and are verifiable and submitted to scrutiny, while linkages among places are taken into account. The Report argues that this strategy is superior to alternative strategies that do not make explicit and accountable their territorial focus, or even hide it behind a screen of self-proclaimed space-blindness, fail to integrate services, and either assume that the State knows best or rely on the choices and guidance of a few private actors. The lessons of the recent crisis reinforce this argument.

There is a strong case for the EU to allocate a large share of the Community budget to a place-based strategy. It is an essential complement to the unification of markets, the creation of a single currency and the general erosion of national influence over economic developments. It can enable the EU to respond to the expectation of the European citizens that everyone, irrespective of where she/he lives, is able to benefit from the economic gains from unification, to have equal access to

[1] In the course of preparing this Report, 3 Hearings, 1 Workshop, and 5 Policy Seminars were organised involving some 80 academic experts and policy-makers, and a group of Working Papers was commissioned. This material is available at http://ec.europa.eu/regional_policy/policy/future/barca_en.htm.

the opportunities so created as well as an equal possibility of coping with the risks and threats. And it can do so by using a modern governance and by relying on the responsibility of Member States, which retain the power to adapt interventions to contexts.

There is in particular a strong case for building a *territorialised social agenda* as part of cohesion policy, aimed at guaranteeing socially agreed standards for particular aspects of their well-being to which people attach a high priority. This would represent a kind of social contract between the EU and its citizens and a means, in the longer-term, of encouraging mobility by reducing fears about it.

There is also a clear advantage of the EU rather than the Member States running such a policy since it is better able to take account of over-the-border interdependencies, which are of increasing importance for the growth of the EU as a whole as closer integration occurs. Moreover, it is further removed from the pressure of local interest groups which can distort or obstruct the development path pursued.

The review undertaken by the Report shows the severe limits of the quantitative evidence available on policy performance. However, a tentative analysis of strengths and weaknesses leads to two conclusions. First, the current architecture of cohesion policy represents the basis for implementing the place-based strategy needed by the Union. Second, cohesion policy must undergo a comprehensive reform for it to meet the challenges facing the Union.

In short, the Report argues that:

There needs to be a clear and explicit distinction between policy interventions aimed at increasing income and growth ("efficiency" objectives in the terminology of the Report) and those aimed at reducing inequalities ("social inclusion" objectives in the Report), not least in order to be able to monitor and evaluate the results.

There needs to be a greater coherence with the place-based or territorial policy concept. And a true concentration on a few issues of key importance for the EU and its people. This would create a Europe-wide critical mass of interventions on commonly agreed priorities, attract political and public attention to the measures implemented and enable the Commission to better focus its human resources and efforts and play a more strategic role.

There needs to be a reform of governance based on ten "pillars".

Pillar 1: An innovative concentration on core priorities and a conservative territorial allocation

The concentration of 55-65% of funding on 3-4 core priorities, the share varying between Member States and Regions according to needs and strategies, with the criteria for the territorial allocation of funding, and the distribution of funds between lagging and non-lagging Regions and for "territorial cooperation" remaining much as now.

The choice of the core priorities should result from a high-level political debate, but six possible candidates, discussed in some detail in the Report, are: *innovation* and *climate change*, with a largely economic ("efficiency") objective; *migration* and *children*, with a predominantly social ("social inclusion") objective and *skills* and *ageing*, where the two objectives are of similar importance. For most of these, the EU has already developed a body of knowledge and expertise for setting the institutional principles and the indicators for policy implementation.

Pillar 2: A new strategic framework for cohesion policy

An enhanced strategic dialogue between the Commission and Member States (Regions), based on a *European Strategic Development Framework*, setting out the major policy innovations clear-cut principles for the core priorities and a set of indicators for assessing performance.

Pillar 3: A new contractual relationship, implementation and reporting aimed at results

A new type of contractual agreement (a *National Strategic Development Contract*) between the Commission and Member States, based on the above and focused on performance and on the institutional requirements for intervention, covering all cohesion policy resources and specifying verifiable commitments, coupled with the preparation of an *Implementation Assessment* (where required) by the Commission and of a *Strategic Report on Results* by Member States annually after the third year.

Pillar 4: A strengthened governance for the core priorities

The establishment of a set of ex-ante conditionalities on the institutional framework required to be in place in order to pursue each core priority and a system for assessing progress in meeting targets.

Pillar 5: Promoting additional, innovative and flexible spending

The strengthening of the principle of additionality through linkage to the Stability and Growth Pact, plus a contractual commitment and an assessment of how the policy is delivering the value added for which it is justified, and the option of implementing the de-commitment rule over the entire country rather than at programme level.

Pillar 6: Promoting experimentalism and mobilising local actors

The development of a better balance between creating an incentive for local agents to risk and invest and preventing policy from being "captured" by local interest groups, through encouragement for experimentalism and a direct role of the Commission based on the establishment of a small fund for Innovative territorial actions and on the involvement of international expertise at local level.

Pillar 7: Promoting the learning process: a move towards prospective impact evaluation

Encouraging the design and implementation of counterfactual methods for assessing the impact of policy interventions, to improve understanding of what works, especially in a prospective sense, so that evaluation is designed together with the intervention and can have a disciplinary effect by focusing attention on objectives and on the criteria for the selection of beneficiaries.

Pillar 8: Refocusing and strengthening the role of the Commission as a centre of competence

A significant investment in human resources and organisational changes in the Directorates-General of the Commission which have overall responsibility for cohesion policy, together with much-improved coordination among Directorates in charge of cohesion policy.

Pillar 9: Addressing financial management and control

The assumption that recent changes introduced in this area, and further measures that might be taken on the basis of current debate, will allow a greater efficiency to be achieved and space to be made in the Commission for the above additional investment in human resources.

Pillar 10: Reinforcing the high-level political system of checks and balances.

A much improved high-level political debate, fuelled by the new information on performance produced by the previous changes, together with a renewed system of checks and balances among the Commission, the European Parliament and the Council, strengthened by the creation of a formal Council for cohesion policy, assessing decisions and results and issuing recommendations.

The implementation of this reform would require a strong political compromise to take place during 2010. It would also require some changes to be anticipated in the current programme period and the structure of the budget negotiation on cohesion policy to allow for simultaneous agreement on resources, governance and goals.

OVERVIEW OF THE REPORT

Policy concept

1. The policy concept singled out in the Report is the place-based development approach, what the OECD calls the "new paradigm of regional policy", which has been experimented with in various parts of the world in the past two decades. Its objective is to reduce persistent *inefficiency* (underutilisation of resources resulting in income below potential in both the short and long-run) and persistent *social exclusion* (primarily, an excessive number of people below a given standard in terms of income and other features of well-being) in specific places. Places are defined though the policy process from a functional perspective as regions in which a set of conditions conducive to development apply more than they do in larger or smaller areas. This is, in the Report's view, the appropriate and modern way to interpret the task set by the EU Treaty to promote "harmonious development" and to tackle "disparities" of regions and "regional backwardness" by means of cohesion.

2. Economic theory shows that a place might require an intervention from outside in response to two sets of market and government failures. First, a place can be trapped in a vicious circle of inefficiency or social exclusion because the appropriate economic institutions intentionally fail to be chosen by local elites (that being against their interests), or because the less a place has effective institutions, the less likely it is to have them in the future (path dependency). Social exclusion can also be perpetuated because individual circumstances are hereditary and persistent. The intervention needed to tackle these problems should take the form of the provision of integrated bundles of public goods and services aimed at triggering institutional change, improving the well-being of people and the productivity of businesses and promoting innovation. The goods and services concerned need to be tailored to places by eliciting and aggregating local preferences and knowledge and by taking account of linkages with other places. This is where the territorial dimension of cohesion is particularly relevant.

3. Second, agglomerations – one of the driving forces of development – are always the result of public as well as private decisions, the former consisting of the design of institutions (for regulating land use, promoting research and support to firms, providing social services, education, healthcare, water supply and so on) which are tailored to places. Such decisions are invariably made with very limited information on whether the agglomeration process concerned is enhancing or reducing overall efficiency and whether other agglomerations should be encouraged instead or in addition. The pressure of private interests to capture decision-making, moreover, is permanently at work. These features call for a cautious approach under which public interventions with a territorial impact are made visible and verifiable and submitted to scrutiny together with the initiation of a process whereby everyone is given the opportunity and the information to participate and to voice their dissent. A place-based approach has the potential to ensure this.

4. The place-based approach goes beyond the traditional dilemma of fiscal federalism whether to decentralise or centralise any given public function. The responsibility for policy design and implementation is allocated among different levels of government supported by both contractual relations and trust, with a role being played by special-purpose institutions (agencies, public-private partnerships, etc). More specifically, the authority governing the exogenous intervention sets the priorities, rules and general objectives for using the funding provided, leaving it to lower levels of government to implement these principles according to the context as they see fit.

5. Place-based policies are complex and risky. There are serious risks of misallocating resources, creating a dependency culture and favouring rent-seekers over innovators. At the same time, the spatial dimension of public interventions is transparent, verifiable and subject to citizens' scrutiny and there is a clear recognition that "the state does not necessarily know best". The opposite is the case for policy strategies that camouflage strong and intended spatial effects of similar public interventions behind a screen of self-proclaimed spatial blindness. When a

policy for development is explicitly place-based, the risks can be identified and addressed through the effectiveness of the conditionality system, the focus on objectives and results, the discipline imposed by evaluation, the competence and credibility of an external authority and the potential for open public debate over the policy choices made.

A place-based approach to meeting EU challenges and expectations.

6. A placed-based policy approach is particularly suitable for the European Union. The main argument put forward in this Report – the EU sustainability argument - involves two steps. First, all Unions need to accompany sovereignty over markets and money and their responsibility for encouraging internal mobility of labour and capital with a development policy aimed at giving all places the opportunity to make use of their potential (efficiency) and all people the opportunity to be socially included independently of where they live (social inclusion). Whether a Union is "free market" oriented or "social market" oriented – as the examination of the US case shows – money is spent on assisting regions tackle development problems. In the specific case of the European Union, citizens of countries which, after centuries of conflict, have come together under common rules clearly expect it to commit to ensuring equal opportunities for everyone. Tackling the inefficiency and exclusion traps that arise in Europe is a task for the EU because if this task is not successfully performed the EU is blamed.

7. As a result of unification, which has reinforced the effects of globalisation, citizens across Europe have seen their labour markets being opened up, their services being accessed by outsiders and their national and local practices being changed by European rules. They are experiencing an erosion of their national or regional common bonds and their national "feeling of community" (or "identification"). This process is difficult, as memories of conflict and historic division recede, as evidenced in opinion polls and the recent experience of constructing new constitutional arrangements for the EU. For the sustainability of the Union and to avoid a reversion to nationalistic behaviour, two complementary lines of action can be pursued in the short-to-medium term. First, there is a need for less elitism in EU interventions and less invasiveness in interfering with national and local practices in an overly-detailed and bureaucratic way. Second, "common bonds" need to be promoted at the EU level since this is responsible for loosening existing bonds: the expectation of solidarity at the Union level can be a strong cement of this process.

8. It is not a matter of "doing something social" as a "cost to pay" in order to achieve or preserve market and currency unification. This argument has been overused over the years in order to convince the sceptics, and it has backfired. If a policy is a "cost", why should we really care about its quality, its results and its conceptual design? Let's just pay the cost and try to make it as low as possible. Market and currency unification are not objectives in themselves but means for achieving the ultimate objectives which motivated the formation of the Union: increasing growth and well being and preserving peace. Unless inefficiency and social exclusion traps are tackled through a policy for development, the very objectives for which market and currency unification were introduced cannot be achieved. Independently of such unification, the pursuit of these objectives calls for, as the experience of other Unions shows, the Union to take direct responsibility for tackling these traps. It requires, however, that action to do this is successful – which is where problems start.

9. The second step of the argument goes on to claim that a place-based approach, a "cohesion policy", is the best way for the Union to fulfil its development task. This approach, as argued above, can be particularly effective since it responds to the need for tailoring interventions and economic institutions to local conditions; a need that has been forcefully stressed by recent advances in the theory of growth and development. Further, a place-based approach - under which the Union sets the framework for intervention in support of regional development and jurisdictional Regions and Nation-States have responsibility for designing it and for selecting the regions and projects supported - is the only policy model that is compatible with the EU's hybrid form of government and limited democratic legitimacy. The US model of top-down "federal"

interventions would not be suitable for the EU, even if it were superior, which the Report suggests it is not.

10. The rationale for investing a large share of the EU budget in a place-based development policy is further strengthened by two advantages that the Union has over Member States in running such a policy. On the one hand, the EU level is better suited to tackling cross-border interdependencies on which development depends, to reducing the risk of beggar-thy-neighbour policies and taking explicit account of cross-border-externalities. It is also better placed to promote a process of institutional learning and dissemination and, since it is further removed form local interests and regional pressure groups than Member States or Regions, it has more credibility in playing the exogenous role that policy requires.

11. The EU Treaty mission of harmonious development, and the economic rationale for a place-based approach, point to two distinct objectives: increasing efficiency and social inclusion. Greater efficiency is central for the future of the Union: market integration, mobility of capital and labour, fiscal stability change the comparative advantages of regions and call for resource re-allocation and institutional changes that a place-based strategy can promote. Assuming responsibility for social inclusion is a matter of urgency, and not only because of the current economic crisis. The division of labour between an EU level taking care of markets and liberalisation, and Member States taking care of welfare, is under increasing pressure. Scope for action by the latter is increasingly constrained by the constitutional "supremacy of all European rules of economic integration, liberalization and competition law" and by the pressure of tax competition and of EU stability rules on national budgets. Scope for action by the EU is limited by the strength of "national social contracts" and the differences between these.

12. There is a strong case for building a "territorialised social agenda" within the context of cohesion policy It would be a strategy focused on individuals but aware that their well–being and the effectiveness of any intervention depend on the place where they live. By adopting a place-based approach, this agenda should be aimed at guaranteeing socially agreed essential standards for one or two issues of high priority for European citizens. While respecting the diversity of "social contracts" between citizens and their Nation States, it would establish some elements of a social contract between all EU citizens and the EU as a whole. Moreover, while providing a partial solution for the present, it could also help encourage mobility of labour in the longer term, giving an added source of social protection.

Misconceptions and clarifications

13. There is also, however, a different argument to consider which is often used in supporting cohesion policy, namely that it is a means of financial redistribution among Member States and Regions. As the Report demonstrates, this argument is highly misleading. The redistribution of resources among places is not a sufficient condition for pursuing either the efficiency or the equity objectives set out in the Treaty when calling for a reduction of disparities. It might be part of the means of such a pursuit – some places receiving more from interventions than they contribute through taxation – but the main purpose of cohesion policy is not redistribution but to trigger institutional change and to break inefficiencies and social exclusion traps through the provision of public goods and services. It is certainly the case that cohesion policy has been and is still today entrusted, as are other EU policies, with the side task of "transferring resources between Member States as part of grand bargains", but if this were its main purpose it would be inappropriate to pursue it through cohesion policy. A mechanism with much lower transaction costs that does not raise expectations of "development" should be devised instead, a financial equalisation system, an inter-country or an inter-regional "EU fund".

14. Once the financial redistribution argument is dispelled, the inconsistency of the so-called renationalisation critique is revealed. The critique posits that cohesion policy should focus on disparities between countries. Countries with the resources to pay for the redistribution of resources among their regions should do so themselves. Indeed, under the principle of

subsidiarity, these countries would be better equipped to undertake this task than the EU. A system through which the richer countries make large contributions to the EU budget and then receive some of this money back through cohesion policy – but tied to administrative rules and obligations – is regarded as inefficient. If the purpose of cohesion policy were indeed financial redistribution, the system would truly be highly inefficient – so inefficient in fact that it should be substituted by a simple system of "cheques". The reason for not doing so is that the purpose of cohesion policy is not financial redistribution.

15. A more engaging issue is whether cohesion policy should intervene in all regions or only in "poor" ones. A first argument for it being confined to the latter, that "rich" regions already have access to the financial resources to pay for the public goods and services they need, does not apply once it is clear that the policy purpose is not financial redistribution. A second argument, that rich regions tend to have better local institutions and are less in need of an "exogenous intervention", is more pertinent and calls for a concentration of resources and interventions in the poor regions. But, inefficiency and social exclusion traps can arise in all places. Local institutions in all regions find it difficult to adapt to external changes and exogenous interventions can help trigger adaptation.

16. Moreover, excluding citizens of rich regions from cohesion policy would undermine a primary purpose – of giving all EU citizens, independently of where they live, a concrete sign that the Union is taking action to ensure that they have an equal chance of benefiting from the opportunities created by the unification of markets and of avoiding the risks. It is a relevant purpose particularly considering the levels of social exclusion in many otherwise rich urban regions. These arguments are further strengthened since, in the implementation of cohesion policy, eligibility for EU intervention is not decided with reference to places, or functional regions, but to administrative (NUTS 2) Regions – identified by a capital "R" in the Report – which often include inside their borders places at very different stages of development. Whether cohesion policy is actually capable of delivering in rich regions the results that the grounds for intervention assume is a separate issue. It is an issue which has to do with the effectiveness of cohesion policy rather than with its justification.

17. Three further misconceptions regarding cohesion should also be dispelled. The first is the idea that *convergence,* and in particular convergence of per capita income, captures the aim of cohesion policy. It does not. Convergence is neither a necessary nor a sufficient condition for achieving the efficiency and the social inclusion objectives of cohesion policy and should not be used as a policy target. With respect to efficiency, a successful reduction of the capacity under-utilisation of a region can take place while the income gap with other regions increases; equally, a reduction in this gap could well take place with capacity underutilisation worsening in all regions. For social inclusion, a reduction (or widening) in the income gap in a region compared to others can go together with rising (or falling) social exclusion as measured by the number of people with low incomes in the region. Moreover, in any case, changes in the income dimension of social exclusion say little about what is happening to other aspects of well-being.

18. According to another misconception, place-based development policies *restrict mobility* by encouraging people not to move out of places. If this were the case, these policies would be against efficiency and social inclusion, since the option of mobility is an important aspect of both. In fact, it is not the case, since these policies aim at broadening the opportunity of people and giving them more substantial freedom to chose whether to move or not. Similarly, it is not true that place-based development policies act as a *constraint on "natural" agglomeration processes* by inhibiting or distorting market forces, which would otherwise operate freely. Since any agglomeration process is always the combined result of both private and public actions, the alternative to visible, spatially-aware policies is not lack of public action, but seemingly spatially-blind policies, which claim not to have effects which vary arrows places or anyway not to be tailored to contexts. These policies are by definition non-verifiable in their territorial impact, which makes them more likely to be inefficient and inequitable.

19. However, place-based policies are complex and risky. Once the features of the policy model have been investigated and the case for the Union to run this policy has been made, the question remains whether cohesion policy as currently operated in the EU, is achieving its efficiency and equity objectives. Whether it is creating a dependency culture or favouring rent-seekers, or rather it is triggering institutional and economic change and promoting innovators. The success of place-based development policies and their capacity to avoid these risks depend on their governance and implementation. The question, therefore, is whether these aspects of policy have been adequate.

Lessons from cohesion policy performance and the need for a sharp change

20. The state of the empirical evidence on the performance of cohesion policy is very unsatisfactory. The review of existing research, studies, and policy documents undertaken in the process of preparing the Report suggests, first, that econometric studies based on macro-data on growth and transfers, while providing specific suggestions, do not offer any conclusive general answer on the effectiveness of policy. This is due partly to the serious problems faced by any attempt to isolate at macro-level the effects of cohesion policy from those of several confounding factors, and partly to the fact that existing studies have largely analysed the effect on convergence, which is not a good proxy of the policy objectives. The review also shows both the lack of any systematic attempt at EU and national/regional levels to assess whether specific interventions "work" through the use of advanced methods of impact evaluation, and a very poor use of the system of outcome indictors and targets formally built by the policy.

21. Despite these severe limitations, the available quantitative evidence and a large body of qualitative evidence lead to two conclusions on the current architecture of cohesion policy. First, cohesion policy represents the appropriate basis for implementing the place-based development approach needed by the Union. Second, cohesion policy must undergo a comprehensive reform for it to meet the challenges facing the Union.

22. The strengths of cohesion policy, which indicate that it represents the appropriate basis, include, in particular:

- The development of several features of what has come to be called the "new paradigm of regional policy", namely the establishment of a system of multi-level governance and contractual commitments that represents a valuable asset for Europe in any policy effort requiring a distribution of responsibilities.

- A good track record of achieving targets, both when cohesion policy has been implemented as a coherent part of a national development strategy and when local-scale projects have been designed with an active role of the Commission and the input of its expertise.

- A contribution to institution-building, social capital formation and a partnership approach in many, though not all, regions, producing a lasting effect.

- The creation of an EU-wide network for disseminating experience, for cooperation and, for sharing methodological tools in respect of evaluation and capacity building.

23. The most evident weaknesses which indicate the need for reform of cohesion policy are:

- A deficit in strategic planning and in developing the policy concept through the coherent adoption of a place-based, territorial perspective.

- A lack of focus on priorities and a failure to distinguish between the pursuit of efficiency and social inclusion objectives.

- A failure of the contractual arrangements to focus on results and to provide enough leverage for the Commission and Member States to design and promote institutional changes tailored to the features and needs of places.

- Methodological and operational problems that have prevented both the appropriate use of indicators and targets – for which no comparable information is available - and a satisfactory analysis of "what works" in terms of policy impact.

- A remarkable lack of political and policy debate on results in terms of the well-being of people, at both local and EU level, most of the attention being focused on financial absorption and irregularities.

24. An assessment of the evolution of the governance of cohesion policy since the reform in 1988 suggests that some weaknesses are the result of attempts to limit the extent of Commission's discretion over funding. The "conditionalities" governing the provision of finance to Member States and Regions – on monitoring and reporting, evaluation; performance and other institutional requirements – were often turned into "homogeneous prescriptions" liable to be bypassed or downplayed. This is a mistake. Some general principles have to be agreed at EU level, and they should be based on the best available international knowledge on the institutions needed in each area of policy. Member States and Regions should be given freedom to propose how they intend to apply these principles in the implementation of policy. The Commission should be given the discretion to disagree. The conditionality resulting from this "negotiation" should be incorporated in the contract under which Member States and Regions are entitled to use the funds. The present arrangements, by contrast, make applying general prescriptions both cumbersome for Member States and Regions and ineffective in ensuring good performance.

25. The structure of the present budget negotiation, under which the governance and objectives of cohesion policy are decided *after* the amount of funds and their allocation have been agreed, has contributed greatly to this situation. The present sequence of events tends to decouple the discussion on financial balances from the discussion on the use of the funds, while giving Member States and Regions, as well as the European Parliament, little room to debate policy goals. Moreover, once the financial confrontation is over, the interest of the central decision-makers in Member States fades away. Negotiating goals and administrative arrangements is left to the Ministries in charge of implementing the policy, whose mandate is to maximise the room for manoeuvre in the use of funds rather than to maximise the effectiveness with which the funds are used in the other countries. The general interest of the EU in introducing guarantees that funds will be well used is therefore seriously under-represented.

26. It is evident that the diminishing political and cultural consensus on cohesion policy over the past decade has been influenced by the "intellectual complacency" of a majority in the economics profession over what markets can achieve. However, the review carried out during the preparation of the Report makes clear that important internal problems also hamper the conduct of cohesion policy, in the form of a weakened concept of what the policy is about, faults in its governance and a serious failure to focus on results. Re-launching cohesion policy, making it fit to tackle the challenges facing the Union, requires both the adoption of a strong *policy concept* and reform of the *priorities* and *governance*. It also requires building a new *political compromise* capable of giving the European Parliament, the Council and the Commission the determination and strength to approve the reform required, and the Member states the incentive to enact it. By building on the concept of a place-based approach, the Report puts forward a viable agenda for reform that calls for political consideration.

A concentration of resources on a few European public goods

27. The first change proposed is the concentration of resources on a limited number of priorities which has eluded reforms in the past. This would have several positive effects. First, it would create a Europe-wide critical mass of interventions in a few policy areas, capable of having an

impact on issues of European-wide relevance. Second, the effective delivery of the measures concerned should attract both public and high-level political attention, creating an expectation that positive results will be achieved, so encouraging increased involvement. Third, the concentration would require (and enable) the Commission to focus its human resources on a few issues, giving more credibility to its strategic role of governing cohesion policy. This, in turn, would be a condition for the Commission to be entrusted with, and to exercise, greater discretion over the deployment of funds and for designing more effective conditions for their use.

28. The selection of the priorities would be the result of a high-level political debate through a revised strategic process that would also lead to decisions on governance and on resource allocation. The choice of issues would be based on a clear set of criteria: 1) *EU-wide relevance*, in terms of needs and expectations of European citizens and of the advantage of the EU over Member States in addressing the issue; 2) *their place-based nature,* in the sense of the extent to which the inefficiency and/or social exclusion problems relevant for the issue are context-dependent and require interventions which are tailored to the characteristics and needs of different places; and 3) *verifiability*, i.e. the extent to which policy objectives can be clearly identified and measured, and a consensus can be built at EU level on the principles which economic institutions of Member State using the funds must follow.

29. Six candidates for the choice of core priorities are examined as a way of testing the policy concept and for their intrinsic relevance. They are: *Innovation* and *Climate change*, with a predominantly efficiency objective; *Migration* and *Children*, with a predominantly social inclusion objective of efficiency and social exclusion; *Skills* and *Ageing*, where the two objectives are of similar relevance. For most of these issues, the Union has already developed a body of knowledge and expertise that could be put to use in setting the guidelines, the institutional principles and the indicators for policy implementation.

30. A particular case is made for selecting Innovation as a core priority. Place-based interventions, building on the strengths and taking account of the weaknesses of previous experience as regards cohesion policy in this area, could complement policies aimed at developing a European Research Area, by selecting in each region a limited number of sectors in which innovation can most readily occur and a knowledge base built up. Through such an approach – defined in the current policy debate as "smart specialisation" - the most could be made of the present diversity of industrial agglomerations and networks, while their "openness" beyond regional or national boundaries would be promoted. Although in this policy area the risk that local actors, whether public research centres or Universities, firms or innovation "intermediaries", would seek to profit unduly from public intervention is high, due to lack of information on appropriate targets, there are ways, as indicated in the Report, to create incentives to avoid such an outcome. The transfer of funds to Member States and Regions would be made conditional on their committing to using these incentives.

31. A strong case is also made for including Migration among the priority issues. Given the scale of migration, a large number of people in Europe are involved: the people moving to work in some areas of the EU, the people living in the areas where migration inflows take place, and the people experiencing (inside and outside Europe) the outflows from the area where they live. For each of these categories new opportunities go together with new risks. The final balance of advantages and disadvantages depends on how communities adjust and it is affected by the way public goods and services (urban planning, education, public transport, healthcare, social services and so on) are adapted to the change involved. Some places might fail to adjust, as is already apparent from existing tensions, and here place-based interventions are needed to avoid new problems of social exclusion. By building on the creation in 2007 of an Integration Fund, cohesion policy would allow a strategy to be run with a feasible and efficient allocation of responsibilities: the EU would establish the general principles of intervention and ensure the setting of common objectives; Member States and Regions would adapt policies to different social and cultural aspirations; local authorities would design projects to meet the needs of the local communities concerned.

Ten pillars of governance reform

32. The comprehensive reform of the governance of cohesion policy suggested here has ten pillars. They are not intended to provide a blueprint for cohesion policy in the future and take only partial account of the impact – mostly still to be seen – of the changes introduced for 2007-2013. However, together they provide a clear statement of how reformed governance can be constructed as a starting point for debate. They also offer ideas that could be taken up in the current programming period. In some cases this is necessary in order to build the basis and the experience to be put to full use in a new programming period.

Pillar 1: Concentration on core priorities and a conservative territorial allocation

33. In a substantive change from the present arrangements, a share of resources no smaller than 55% and as close as possible to 65% would be concentrated on 3-4 core priorities, the precise threshold being decided together with the choice of priorities, taking into account the financial needs. A *fourchette* would also be established for the share to be allocated to each core priority. The composition of the target allocation between the core priorities would vary between Member States and Regions according to needs and strategies.

34. The criteria for territorial allocation would largely remain unchanged. The unit of intervention of cohesion policy is the place, or functional region, but selecting these units and allocating resources among them is a task for Member States and Regions during the policy process rather than for the Commission or for an *ex-ante* EU-wide decision. NUTS 2 Regions are the closest approximation to places for which homogeneous and reasonably updated economic data are available for an allocation to be made *ex-ante*. Moreover, in line with the policy concept, the proposal is to maintain the present system of intervening in all Regions but with significant concentration on those lagging behind. The choice of 75% of GDP per capita as a threshold to define "lagging" regions is arbitrary and subject to criticism. Similar criticisms, however, could be levelled against any other threshold. Moreover, any proposal to change the existing arrangement would once again focus attention on the financial issue, detracting attention away from the most pressing issue of "how" resources are used. No change is, therefore, suggested. However, an intermediate category of support for Regions above the 75% threshold and below 75+X% (the X being left to negotiation) would be introduced, replacing the present special provisions.

35. Lagging countries (defined as they are today) and Regions and non-lagging Regions would absorb about 96% of all funds, the remainder being allocated to "Territorial cooperation", largely following present guidelines but geared to supporting core priorities. There is a need to achieve greater coherence between the different Funds into which cohesion policy is segmented and, in particular for the rural development actions of the Rural Fund and the territorial actions of the Fisheries Fund to be brought under the umbrella heading of cohesion policy. A proposal is also made to concentrate all the funding for Trans-European Networks (accounting for 11% of cohesion policy funding in the current period) into a single Fund.

Pillar 2: A new strategic framework for cohesion policy

36. The central point of the reform is a new type of contractual agreement between the Commission and Member States (or Regions) focused on performance and on the institutional conditions for intervention. Putting this in place requires an enhanced strategic dialogue between Member States (or Regions) and European institutions leading to the adoption of a strong policy concept and concrete goals. This dialogue needs to start as early as in the second half of 2010 with the Commission's *Fifth Cohesion Report* setting out the policy concept, the lessons to be drawn from ongoing programmes and preliminary proposals on governance and priorities. The subsequent debate would see Member States (or Regions) draw up, in the second half of 2011, a *National strategic assessment* of place-based policies at national level, together with proposals at the EU level. A temporary Place-based Policy Group, comprising senior officials of both

Member States and the Commission and international experts, would lead the debate. For this early debate to take place, and Member States (Regions) to commit themselves, a sufficiently strong political agreement needs to have been reached during 2010, through the budget review, on the broad lines of cohesion policy reform

37. On the basis of this strategic debate, the Commission would draft a *European Strategic Development Framework* by Spring 2012. Along with the policy concept and an outline of the major policy innovations, the Framework would set the 3-4-four core priorities and, in each case, (unlike the present Strategic Guidelines) would lay down clear-cut principles to be followed by Member States and Regions in establishing the institutional framework necessary to tackle those priorities. It would also set out a limited number of core outcome indicators and tentative targets. At the same time, the Commission would draft a *Regulation* with all the key-changes to the governance of policy to be introduced. The debate and subsequent adoption of the Framework and the Regulation by the Parliament and the Council would take place during 2012 simultaneously with the negotiation and approval of the new financial framework.

Pillar 3: A new contractual relationship, implementation and reporting aimed at results

38. On the basis of the agreed Framework and Regulation, and developing the ideas anticipated in the National assessment, the Member States (Regions) would conclude with the Commission by the end of 2013 a *National Strategic Development Contract* (*Contract*) covering all cohesion policy funding. Regions would take part in the preparation of the Contract and would be co-signatories wherever required by national arrangements. Unlike the present equivalent Contract, which is largely a "reference document", burdened by descriptive parts on strategy motivation, the new Contract would concentrate on objectives and the means of achieving these and would specify verifiable commitments. It would cover:

(i) the choice of priorities, objectives and targets (measured through a rigorous system of outcome indicators);

(ii) the allocation of funding to Managing Authorities (regional and national) and the general criteria for the selection of places and the allocation of funding to them;

(iii) the institutional framework in place or which the Member State commits to building in order to pursue each core priority;

(iv) a commitment to have in place the administrative capacity necessary to manage the funds and to implement the conditions specified in the following pillars.

39. In the process of preparing the Contract, the Commission would undertake a strategic consultancy role, availing itself of enhanced human resources and a task force for each core priority (see below). Once a draft text is submitted, the Commission would be able to launch an independent ex ante evaluation of some parts of it. If no agreement were possible on some aspects, the Commission could adopt part or all of the contract "subject to conditions", such as the need for special monitoring and reporting. In the case of the core priorities, Member States (Regions) could be required to shift resources between them. The credibility of the Commission's "threat" not to adopt part of the Contract, at the cost of putting at risk financial absorption – today's primary concern - would be strengthened by a newly created permanent Council for Cohesion Policy assessing the Contract (see below). The Council would also assess any special intervention of the Commission – such as decisions to adopt parts of the Contract subject to conditions. This would provide a check on any arbitrary use of the new Commission discretionary powers.

40. *Operational Programmes* would be retained, describing how the general Contract is to be implemented by particular Managing Authorities, especially by specific Regions, but they would follow the more result-oriented structure of the new Contract. In Member States with federal or

devolved structures, the Programmes would provide the building blocks for the Contract and would be adopted at the same time as the latter.

41. Within a year of the contract being agreed, the Commission could – where required - undertake an *Implementation Assessment* on the adequacy and quality of the implementation structures and processes in each Member State. It would focus on issues such as whether the human resources, skills and administrative system are in place for the various activities involved in managing cohesion policy funds. The extent of the assessment would be proportional to the scale of EU funding and related to the past record of the Managing Authorities. A "contract of confidence" would be agreed between the Commission and Member States when the assessment was satisfactory. Minor deficiencies would result in a provisional contract of confidence, major deficiencies in "action plans" to be implemented by Member States and, possibly, in a shift in the allocation of resources.

42. Every year after the third year, Member States would prepare, in each case, a brief *Strategic Report on Results*, aimed at describing the progress in achieving objectives. The emphasis on indicators and results in relation to targets would mark a difference from current experience. The Commission would prepare an *Opinion* on each country Report as well as a general *Summary Report*. The new Council on Cohesion Policy would assess all these documents and issue recommendations to the Member States and the Commission.

Pillar 4: A strengthened governance for core priorities

43. "Conditionalities" on the institutional framework and a system of performance monitoring to track progress in meeting targets represent the means by which the Contract would be strengthened when dealing with core priorities. Experience shows that the weakness of the institutional framework is often responsible for the failure of interventions. Although it is inappropriate for best-practice institutions to be centrally identified and recommended, international debate and EU methods (such as experience under the Open Method of Coordination) have led to a degree of consensus on the general principles to be applied to institutions implementing specific policies (on innovation, education, urban planning, children care, etc). These principles include the exclusion of arrangements that have repeatedly failed and the focus of policy effort on relevant issues, and they are continuously being renewed through the experience gained from implementation. Member States would turn those principles into specific commitments in the Contract to be agreed with the Commission.

44. Secondly, a large body of experience is available on the use of outcome indicators, and it is evident that they have limitations and need to be interpreted carefully. They do not measure policy impact (see below); they should not be used to criticise those managing interventions since there are many other factors influence outcome and there is a risk that they divert policy action from other relevant (but unquantified) aspects. But, once their limits are taken into account, outcome indicators can act as a powerful tool to focus public debate on objectives and to motivate policy-makers.

45. A system of performance monitoring for core priorities needs to be introduced by: creating a high-standard system of indicators and targets and a database which is accessible; by promoting public debate through the publication of a Commission annual *Indicators and Targets Survey* and a *Scoreboard of Progress*; by encouraging and providing technical assistance for the voluntary introduction of systems of rewards and sanctions linked to targets; and by entrusting the Commission with responsibility for undertaking, together with Member States (or Regions), an in-depth performance assessment when unconvincing justification is provided for a failure to achieve targets. Financial penalties for Member States resisting either the assessment or implementing its recommendations should also be envisaged.

Pillar 5: Promoting additional, innovative and flexible spending

46. The existing financial additionality requirement, under which cohesion policy should not replace domestic expenditure, can help to prevent the improper use of EU funding (e.g. by using it to cut taxes and so compete unfairly with other Member States) and to increase the scope for policy to support target regions. But the present additionality requirement fails to deliver these goals satisfactorily. Several changes are needed, including introducing a formal link with the Stability and Growth Pact, so that the opposing effects that Member State public investment has on the "development pact" (in line with it) and the "stability pact" (contrary to it) come to the fore and lead to more informed policy choices; further improving accountability as regards its measurement; eliminating reference to "past expenditure" as a means of establishing a floor to the level of spending; extending the requirement to all types of regions; and withdrawing automatic sanctions. A discretionary sanction would be foreseen only when Member States failed to show that a persistently negative gap between actual and target expenditure was not the result of an intentional reduction in taxation being compensated in order to comply with the Stability and Growth Pact.

47. A streamlined policy concept and the emphasis on performance increase the importance of "policy additionality" requirement being respected. First of all, there needs to be an explicit commitment in the Contract that cohesion policy is really aimed at delivering the added-value by which it is justified: responding to the expectations of European citizens; exploiting cross-border interdependencies; keeping a distance from local interests. An assessment must also be included in the annual Strategic Reports of how this added-value is actually delivered. Secondly, a commitment should be made to cohesion policy having a high innovation content, such as experimenting with integrated packages of intervention or adopting different geographical borders for certain measures (in the form of urban-rural links, multi-regional action, etc). Innovations should also be assessed in the annual Strategic Report.

48. The present automatic de-commitment rule of funds not spent by a given deadline should be retained, since in a complex multi-level governance system an incentive is needed to bring negotiations to a close. The application of this rule at a detailed level (of single "axes" of single Programmes), however, creates an incentive to give priority to financial absorption over the quality of projects. In order to reduce this risk, Member State would be given the option to apply the rule at the level of the whole country or of macro-areas. Within countries, Managing Authorities, in coordination with each other, would be able to adopt different spending strategies, suitable to their different contexts. A sort of "market for credit" would tend to arise *de facto*, giving flexibility to the system. The present system of national co-financing would also be retained, possibly with changes in the present rates.

Pillar 6: Promoting experimentalism and mobilising local actors

49. A place-based approach ultimately relies on the capacity of external interventions to promote a process for eliciting and aggregating knowledge and preferences in the places targeted. A better balance must be found between, on the one hand, creating an incentive for local actors to reveal information, to risk and to invest, and, on the other, preventing public measures from being captured by these actors. More "experimentalism" is needed, in the sense of giving an opportunity to experiment with different approaches or measures while exercising mutual monitoring. The increased policy debate on objectives and the system of performance monitoring proposed by this Report can help to move things in this direction. This should be complemented by a commitment to promote community-based indicators (on the basis of a growing international experience), especially when pursuing the social inclusion objective.

50. A further contribution should come from direct interventions by the Commission. First, a small share of funding – say 0.1% of the overall budget – should be allocated to *Innovative territorial actions* run by the Commission to develop and experiment with innovative forms of place-based policy interventions, particularly in respect of the core priorities. Funding would be

allocated – without national pre-allocation – on a competitive basis to the "best projects". Secondly, the Commission would be given the opportunity to mobilise local actors directly by organising high-quality workshops and pilot experimental impact evaluation (see below). Thirdly, the opportunity should be increased for sub-regional local actors and interest groups to make their views known, which the new strategic process would to some extent encourage.

Pillar 7: Promoting the learning process: a move towards prospective impact evaluation

51. Cohesion policy has invested significantly in the learning process, in facilitating exchange of experience and promoting evaluation. But in one important area no progress has been made, that of understanding of "what works", of what effects particular interventions produce and "for whom". The very limited information on "effects" which is available after 20 years of cohesion policy underlines how important it is for a reformed policy to make progress in this direction.

52. Different methodologies have been developed in other policy areas to address this challenge, but the most promising results are offered by a family of methods collectively defined as "counterfactual" which are aimed at assessing the impact of an intervention by estimating what the outcome would have been had the intervention not taken place, mainly by analysing what happened in respect of a "similar enough" population which was not targeted by the policy. The information required by this method is demanding. The answers it gives, moreover, are limited. In particular, it does not allow an understanding of "how" an intervention works, nor can it give safe guidance on whether the intervention will have the same effects when it is applied to another group or in a different context. On the issue of what works, however, counterfactual impact evaluation is more effective and accountable than other methods. Moreover, when impact evaluation is prospective, when it is designed together with the intervention, it can have a strong disciplinary effect by creating an incentive for policy-makers to focus on objectives and on the criteria through which beneficiaries are selected.

53. Specific challenges need to be overcome in applying impact evaluation to place-based policies, in particular, the heterogeneity of interventions across places; different services often bundled together, making it difficult to understand what the "active ingredients" are; and so on. These problems suggest that the effort to promote impact evaluation as one of the methodological backbones of cohesion policy must be at the same time visionary and humble –visionary, since it needs to create the technical, administrative and political momentum for the method to be pursued as an important source of information; humble, since building this technical capacity requires time, without any expectation of a "quick fix" able to provide uncontroversial answers on which parts of cohesion policy are working and where. The responsibility for evaluation would be left with Member States, but the Commission, by strengthening its internal structure, would promote its use and create an EU clearing house for collecting, filtering and making accessible studies and their results.

54. The random selection of the beneficiaries of an intervention – a method that allows a more straightforward evaluation of impact – should be experimented with where suitable, as part of greater policy experimentalism. Real uncertainty as to whether interventions are beneficial or harmful would often mean that there is not really a moral problem of confining interventions to some units or groups. The other ethical demand that there should be "respect for persons", requiring individuals to give informed consent to the random assignment, is more likely to be satisfied by a policy characterised by partnership and local actors' mobilisation.

Pillar 8: Refocusing and strengthening the role of the Commission as a centre of competence

55. The reform of cohesion policy put forward in this Report calls for the Commission to play a more ambitious and demanding role than today. This role requires: a fully consistent approach to territorial development issues, embedded in advanced economic and social thinking; the implementation of methods at the frontier of international debate and experience; a stronger engagement with Member States and Regions; specialised human resources and the capacity to

be credible both as a contract partner making discretionary choices and as a think tank. If the Commission were to fail in this role, the effectiveness and feasibility of most of the proposals set out here would be compromised and the architecture proposed by this Report would not hold up. There needs, therefore, to be a strong political agreement to strengthen the role of the Commission, a task that is technically feasible if reform is started in 2010.

56. A significant investment in human resources and organisational changes should take place in the Directorates-General of the Commission which have overall responsibility for cohesion policy and the associated Funds. In the case of DG REGIO, some broad lines of action are outlined by this Report:

(i) establishing high-level, specialist task forces (with officials from different Directorates) for the core priorities – teams of around 20 experts dedicated full-time to activities relating to the core priorities, interacting closely with the geographical units in charge of negotiation;

(ii) training of staff in the conceptual and methodological issues on which policy is refocused and upgrading the knowledge and skills of geographical units;

(iii) upgrading the evaluation department so that it is capable of providing Member States with a think-tank on impact evaluation;

(iv) creating administration support teams capable of carrying out appraisal of implementation;

(v) integrating organisational structures in order to facilitate coordination between "horizontal" teams and geographical units;

(vi) creating a research department, with a close and permanent link with policy research on development.

57. Internal coordination between DG REGIO and DG EMPL will also need to be improved. The two Directorates have different perspectives and competences, one focussed on public goods and services mainly involving material infrastructure, the other focussed on investment in human capital; one focussed on the spatial context and territorial linkages, the other focussed on people. No core priority would be the exclusive realm of either of the two Directorates, nor do their know-how and competences correspond, as is sometimes wrongly assumed, with the two objectives of efficiency and social inclusion. Whatever objective is pursued and whatever core priority is chosen, the perspectives and the competences of the two Directorates should be integrated in their day-to-day activity, both in Brussels and on the ground, unlike the situation now. Closer coordination should also involve DG AGRI and DG MARE, as well as several other Directorates responsible for policy with a significant territorial impact and with areas linked to the core priorities selected. This is what a number of administrators, politicians and experts have long been calling for. It is also what the "territorial" dimension of cohesion policy (made explicit in the new draft Treaty) requires. It is a condition of the reform proposed in this Report.

Pillar 9: Addressing financial management and control.

58. Given the constraints on the size of the Commission, in order for the Directorates responsible for cohesion policy to make the necessary investment in human resources, greater efficiency must be achieved in addressing the task of financial management and control. The information available so far shows that high administrative marginal costs and a high degree of uncertainty in Member States (on whether their choices will be considered acceptable) go together with a high level of error, as assessed by the European Court of Auditors. Two factors contribute to this situation: shared management and the multiplicity of control levels increase the opportunity for uncertainty; the audit of expenditure under cohesion policy works as a "filter" through which general failures of Member States to comply with EU Directives – for example, on

procurement – come to be detected. The errors identified tend to become the main quantitative information available for debate in the European Parliament and among the public. Dealing with this pressure puts a strain on the manpower of Directorates and reduces the time, capacity and incentive they have to deal with strategic tasks and with the monitoring of policy performance.

59. Significant changes have been introduced in this area in the past few years, the first effects of which will become known in 2010. Further changes are being discussed. Some of them seem worth considering, such as increasing the tolerable risk of error, introducing simplifications, like increased use of "flat rates" to measure due expenditure; assessing error rates by Member States annually and withholding transfers if a threshold is passed. It goes beyond the remit of this Report to put forward any further proposals for change. Instead, one or other of the following scenarios can be assumed. These proposals either succeed in reducing the administrative audit costs of the Directorates-General in charge of cohesion policy to the point where they can free human resources to for the reform sketched under pillar 8. Or, if this is not the case, it is agreed that the extra administrative costs borne at Commission level for this task will be considered as "costs to be born by the Commission as a whole" – as a means of monitoring compliance with EU Directives – and additional human resources will be provided for managing cohesion policy.

Pillar 10: Reinforcing the high-level political system of checks and balances

60. The changes proposed by this Report are intended to make policy choices more open to debate and to improve the supply of information. They also give the Commission increased powers of discretion. A complementary change, however, is required on the demand side. A high-level political and policy debate must be organised to make the most of the improved information, accompanied by a stronger system of check and balances between the Commission, the European Parliament and the Council.

61. A formal Council for cohesion policy should be created, possibly under the General Affairs Council. Its main tasks would be: a) to assess the National Strategic Development Contracts, once they have been approved by the Commission; b) to assess the Strategic Reports on Results, produced annually from the third year onwards by Member States and the related Opinions prepared by the Commission; c) to assess the specific situations where a special intervention is needed by the Commission (approval of Contract subject to conditions; deficiencies emerging from the Implementation assessment, results of in-depth performance assessment due to failure to achieve targets, etc.). The Council would issue recommendations. Its activity would be supported by the work of a permanent high-level group composed of senior Member State officials and its organisation into sub-groups would allow the implementation of a peer-review approach. This architecture could be built gradually, starting with this programme period.

62. The new Contracts and Reports would also enable the European Parliament to play a greater role by contributing views through opinions. The Summary Report prepared annually by the Commission would play an important role, in the context of the proviso in the new draft Treaty for the Commission to submit annually to the European Parliament an "evaluation report on the Union's finances based on the results achieved".

Changing the negotiation: a simultaneous agreement on resources, governance, and goals

63. For the negotiation to have a chance of delivering anything approaching a comprehensive reform proposal on cohesion policy, the negotiation on resources, governance and goals must come to a close at the same time. By aligning the negotiations on three relevant documents – the Financial Framework, the Regulation on cohesion policy and the European Strategic Development Framework – a balanced view can emerge from the mix of thematic and general interests: both the need of Member States and Regions to be assured of the freedom to implement the policy as they see fit, and the need to give the Commission the leverage to ensure the quality of spending. It is an obvious requisite for a system of conditional grants to subordinate the allocation of resources to the common acceptance of the rules and goals for using them.

INTRODUCTION

Motivation and scope of the Report

EU cohesion policy is the object of conflicting views at all levels of debate - political, economic and institutional.

Some see the policy as a modern and effective multilevel governance tool for promoting innovation and strengthening the adaptive capacity of European regions. Others take issue with the lack of enforceable commitments in the allocation of funds and the failure to promote tailor-made institution building: they see it as a tool easily captured by rent-seekers that breeds new layers of bureaucracy, protected by the complexity of its rules.

Some see it as an indispensable tool for the European Union to respond to the expectation of equal opportunities that its existence and actions raise among European citizens; and as a way of doing so without impinging on the responsibility and capacity of Member States and Regions to tailor interventions to contexts. Others see it as a highly cumbersome mechanism for redistributing resources between Member States and Regions, which counteracts the efficient agglomeration of economic activity, fails to deliver greater equity and undermines national authorities.

Some point to the available evidence as a sign of policy effectiveness and argue that cohesion policy adds significant value to the policy-making of Member State and Regions. Others use the same evidence to claim that no rationale exists for the EU to run cohesion policy, and to call for the policy to be at least limited to countries or regions lagging behind in economic development.

At times it appears that no common ground exists for a useful debate to take place. The conceptual foundations are blurred and several misconceptions have arisen on cohesion policy objectives. Proposals are being put forward that suggest using the policy as a source of funds either for financial equalisation purposes or for some mix of localised micro-interventions and traditional sectoral public investments. In these conditions, attempts to reform cohesion policy are doomed to failure. Conflicting pressures for change tend to be accommodated by low-key compromises that lack reference to a shared vision and that often result in scattered changes and the imposition of new, and not necessarily coherent, rules. It is no surprise that relevant ideas for a “strategic turn” of cohesion policy were largely neutralised in the last debate on EU financial perspectives.

Except at the time of negotiations, when a strong political EU-wide interest exists, largely concentrated on financial issues, the bridges between the cohesion policy community and the overall debate on the Union are tenuous. No linkage exists with the macroeconomic debate on growth and with the discussion on the Stability and Growth Pact. The conceptual and methodological advances made in the realm of the Open Method of Coordination often fail to be transferred to cohesion policy. The linkage with the Lisbon Agenda established in the current programming period opened up an opportunity that is waiting to be exploited.

In the recent European Economy Recovery Plan drawn up to respond to the financial crisis, cohesion policy plays a role. And it does so also in important debates taking place on sectoral issues such as research, transport infrastructure, employment, climate change, as cohesion policy is the main (sometimes the only) source of EU resources available to provide a spending tool for EU action. However, outside the cohesion policy community the attitude is often one of trying, via appropriate sectoral policies, to make the most of a policy that is considered to be basically about “redistributing funds”. What is lacking is a political debate about whether that particular way of spending public funds adds value compared to sectoral or national approaches. And when and where it is effective. The same failure is visible in the academic debate, where very often a line separates the “cohesion policy experts” and the rest of academia.

The limits are all the more serious if one considers how central to the future and to the very existence of the Union is its direct commitment to development: what does the Union do to ensure all territories and all European citizens have the chances to make the most of the opportunities offered by the Union itself and to cope with the connected risks and threats? The achievement of market integration, the success of the euro, the mobility of people, while creating extraordinary opportunities and winners, have also challenged many regions, created losers, raised concerns, all phenomena that are exacerbated at times of crisis. It could have been predicted. It was predicted. The very purpose for creating cohesion policy was to give European citizens "no cause to doubt the common will" of the Union to take care of their different standards of living[2]. Now, when the division of labour between the EU taking care of markets and liberalisation and Member States taking care of welfare has become very strained, the Union cannot afford to carry on cohesion policy without a large consensus and shared aims.

The general review of the EU budget could still offer the opportunity for common reflection. It could make it possible to step back and to search for common ground in the form of a "policy model" around which a high-level political compromise could be rebuilt. This policy model should fulfil three requirements:

- a clear concept based on a verifiable economic rationale that leads to objectives which are well-defined and open to evaluation;
- an explicit and powerful political justification, rooted in the present condition of Europe and responding to the expectations of European citizens; and
- a system of policy governance that can credibly promise adequate performance, learning and democratic participation.

The purpose of this Report is to develop such a policy model and to use it as a reference point for assessing the effectiveness of cohesion policy and for presenting concrete proposals on how to reform it.

Given that there is a lack of consensus on what cohesion policy should be about and on its objectives, the Report begins with an in-depth analysis of the policy concept. Having set out the "ideal" policy model, the Report addresses the issues whether it is appropriate for the EU to run this policy and to allocate to it a large share of the EU budget. These first two steps are taken in chapter I. They allow chapter II to open up the "black box" of cohesion policy as it actually looks today and to provide an assessment of its successes and failures compared to the model. The subsequent chapters present proposals for change that are drawn from the first two. Their overall structure and their links both to the policy model and to the lessons from the past are outlined in chapter III. Chapter IV puts forward three criteria and some examples for choosing a limited number (3-4) of core priorities on which the majority of cohesion policy funds should be concentrated. Chapter V presents in detail ten "pillars" for the reform of governance.

For those who would agree with the "ideal" policy model and find it appropriate for the EU level, the Report offers a framework for assessing the current policy and a comprehensive set of proposals for reform, coherent with the model. For those who would disagree either with the policy model or with the argument that the EU budget should care about cohesion, or for those who have a different view of what cohesion policy is all about, the Report offers an opportunity for clarifying the nature of the disagreement: an opportunity for a more straightforward discussion in what is today a fuzzy and often uninformed debate and, possibly, for building bridges across different economic, social and political perspectives.

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[2] See the historical overview in section I.1.2.

Guidance for the policy model: the EU Treaty and the "new paradigm of regional policy"

The choice of the policy model adopted in this Report is strongly guided both by the content of the EU Treaty and by the paradigm of development policy that has progressively gained international consensus over the past twenty years.

The overall task assigned by the EU Treaty to cohesion policy (namely to the Structural Funds and to the Cohesion Fund) is "to promote overall harmonious development". This is the expression with which the Treaty summarises, in its "cohesion" Title, the mix of efficiency/growth/economic goals and equity/social goals outlined in its first introductory articles[3]. The task is elaborated ("in particular") as the reduction of "disparities between the levels of development of the various regions and the backwardness of the least favoured regions"[4]. Both the efficiency and the equity dimensions of development are again contained in the objective of reducing disparities and backwardness of regions: all regions must be given the opportunity to achieve their full potential (*efficiency*), and all citizens must be given the opportunity to live a life worth living independently of where they are born (*equity*).

The two missions are interdependent but very different. The Report will argue forcefully that "convergence" of per capita average GDP of regions is a wrong and inappropriate proxy of any of the two missions; and that disentangling the two missions and transparently pursuing them through different interventions as part of a unitary, comprehensive strategy is one of the pre-requisites for improving the effectiveness of cohesion policy.

"Cohesion" is the means through which the Treaty commits the Union to pursue harmonious development and reduction of disparities. It should do so, as a complement to Member States' "conduct" and "coordination" of their economic policies, both by taking those tasks into account when formulating and implementing other policies and the internal market and, directly, through the use of dedicated Funds[5]. The general reference to the action and condition of *fitting together*, embodied in the word "cohesion", is qualified by the Treaty through specific reference to three dimensions: "economic", "social" and (in the draft new Treaty explicitly) "territorial".

Harmonious development and the reduction of disparities must therefore be pursued through an action, and by creating a condition, where: *economic* relations are dense and fluid; *social* relations are open and participatory; and *territorial* effects are taken into account and monitored (for all policies)[6]. As the Report will show, these policy features have been established through a long process started in the early years of the Union that culminated in 1988 with a high-level

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[3] In the current text (article 2): "economic and social progress", "high level of employment", "balanced and sustainable development". In the new text (article 3), in particular: "well-being of [the Union] people", "balanced economic growth", "full employment and social progress", reduction of "social exclusion", etc.

[4] Attention is then given to "islands" and "rural areas" - in the current Treaty, article 158 - and also to "areas affected by industrial transition", or suffering from "severe natural or demographic handicaps"- in the new draft Treaty, article 174.

[5] Articles 159 of the current Treaty and 175 of the new draft Treaty, after mentioning the other two indirect means to pursue harmonious development, state that the Union (Community in the current text) "shall also support the achievement of [the objectives set out in article 159/174] by the action it takes through the Structural Funds", to which the following article 161/177 adds the Cohesion Fund. The instrumental role of "cohesion" is made clear by article 2 of the current Treaty when it mentions "strengthening of … cohesion", together with "the creation of an area without internal frontiers" and "the establishment of economic and monetary union" as the three means "through" which economic and social progress and the other objectives must be pursued. In the new draft Treaty the distinction between ultimate objectives and means to achieve them is blurred.

[6] This interpretation of the three "properties" of cohesion described by the Treaty will become clear through the discussion of the policy model in chapter I. For this interpretation of the "territorial" qualification, emphasizing the need to be aware and to measure the territorial impact of all policies, see also the document adopted in November 2008 by the Ministers responsible for spatial planning and cohesion policy at the meeting in Marseille organised by the French Presidency.

political compromise between different cultural and political conceptions of the policy. Reviving and innovating that compromise is a condition for cohesion policy to become more effective.

The second guideline for the policy model developed and used in this Report is provided by the paradigm of development policy that has gained international consensus over the past twenty years.

The OECD has used the terms "territorial development policy", or "new paradigm of regional policy" to refer to a policy approach whose objectives are "enhancing well-being and living standards" in specific regions and at "generat[ing] and sustain[ing] regional competitive advantages" with a fuller and better use of regions' assets. In this approach, regions are not defined according to administrative boundaries. The strategy "is place-based, multilevel, innovative and geared to different types of regions"[7], and aims at institutional building/strengthening, improving accessibility to goods, services and information, promoting innovation and entrepreneurship.

Essential features of the new paradigm are: tailoring interventions to specific territorial contexts and to their spatial linkages; and eliciting and aggregating the knowledge and preferences of local actors. This new approach compares with an "old approach" to regional policy, whose objective is compensating for regional differences in unit capital costs (due to productivity gaps) and rebalancing labour and capital flows. Its strategy is centred on subsidies to firms or sectoral interventions, often with an exclusive focus on the creation of jobs or on physical connections between places. It is often based on the replication of best-practices through a top-down method.

The new paradigm has gradually come about through independent changes taking place in different contexts and cultures[8]. The design and the implementation of cohesion policy have themselves played a relevant role in this process, although this linkage in itself says nothing about how close cohesion policy is today to the "ideal" model[9].

Some definitions: place, place-basedness and place-based development policy

This Report has opted for referring to the new paradigm as a *place-based development policy*. This stresses its intentional focus on three features: the place-specificity of natural and institutional resources[10] and of individual preferences and knowledge[11]; the role played by the (material and immaterial) linkages between places; and the resulting need for interventions to be tailored to places.

The use of "place-based" avoids any confusion with the political and administrative use of the word "region". The word region, with a small "r", will be used in the Report interchangeably with place: it is clearly the way in which this word (as well as "area") is also used in the EU Treaty. The words "territory" (and "territorial") and "space" (and "spatial"), without entering into

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[7] Excerpts from the Mission statement of the Territorial Development Committee of the OECD. See also OECD (2009b).

[8] This is clearly shown by the large body of evidence gathered by the OECD in the last ten years through its reviews.

[9] On this issue see Bachtler, J. and Mendez, C. (2007). For this assessment see chapter II, section 4.

[10] Most natural resources are immobile, and their utilisation depends on many features which are specific to places. The features and the effectiveness of both informal and formal institutions largely depend on contexts. On this point see below, section I.2.1.

[11] The preferences of individuals are strongly context-dependent, while a relevant part of the knowledge on the comparative advantages of a place is held by individuals living in the place, and their knowledge is often interdependent. See again below, section I.2.1.

the specific meaning attributed to these words in different languages and countries, by different disciplines and in different policy fields[12], will also be used interchangeably with "place-based".

Jurisdictional Regions, with a capital "R", are often the administrative and political entities more suitable for implementing place-based policies, but they are not their unit of intervention. The unit of analysis and interventions of this policy model – the place or region – is endogenous to the policy process.

Alternative options for pre-defining places (often called "functional regions") exist, as many as there are dimensions of human life and activity[13]. In the context of a policy aimed at development, *place* must be defined as a social concept, a contiguous/continuous area within whose boundaries a set of conditions conducive to development apply more than they do across boundaries (i.e. relative to other places): natural and cultural circumstances and the preferences of people are more homogeneous or complementary, the knowledge of people is more synergetic, and positive externalities and formal and informal institutions are more likely to arise. The boundaries of places are thus independent of administrative boundaries, endogenous to the policy process and can change over time.

A *place-based development policy* can therefore be defined as:

- a long-term development strategy whose objective is to reduce persistent *inefficiency* (underutilisation of the full potential) and *inequality* (share of people below a given standard of well-being and/or extent of interpersonal disparities) in specific *places,*
- through the production of bundles of *integrated,* place-tailored *public goods and services*[14], designed and implemented by eliciting and aggregating *local preferences and knowledge* through *participatory political institutions*, and by establishing linkages with other places; and
- promoted from outside the place by a system of *multilevel governance* where grants subject to *conditionalities* on both objectives and institutions are transferred from higher to lower levels of government.

This definition responds to the provisos that the EU Treaty establishes for cohesion policy, in terms of both objectives and means. It addresses both the efficiency and the equity dimensions of the harmonious development mission. It complies with the economic, social and territorial dimensions that the Treaty sets for the means – cohesion – through which the reduction of disparities must be pursued. It actually postulates that the place-based or territorial dimension, as previously defined, is the key feature of the policy model. "Place-based" (or territorial) refers

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[12] For a reference to the very different ways in which "territorial" is interpreted throughout Europe, see for example the Commission staff working document annexed to the Green paper on territorial cohesion prepared by the EU Commission in 2008: "territorial diversity", "territorial competitiveness", accessibility, sustainability, "permanent and cooperative process that encompasses the various stakeholders involved in territorial development", spatial planning, "territorial aspects of sectoral policies", "polycentric territorial development", etc.

[13] In drawing boundaries between places, reference can be made to: concentration of residence and activity, or of both (so as to account for commuting); density of population; absence of land connections (islands); existence of underground, water or other natural linkages; altitude; position relative to outside areas (in whatever way "outside" is defined in geo-political terms); proximity to natural areas; etc.. For many of these perspectives and some solutions on how to take them into account in the context of rather binding administrative constraints, see the Commission staff working document annexed to the Green paper on territorial cohesion prepared by the European Commission in 2008.

[14] This expression includes both "public goods", i.e. goods from whose benefits it is costly to exclude an individual (no-rivalry condition) and it is also undesirable (since there is no marginal cost of an additional individual to enjoy it), like environmental care, contract enforcement, etc., and other goods, like education, health care, transport, etc., which are publicly provided due to other market failures (incomplete information, externalities, etc).

both to the context-dependent nature of the efficiency and equity problems that the policy deals with, and to the fact that the design of integrated interventions must be tailored to places, since it largely depends on the knowledge and preferences of people living in it.

Structure of the Report

But what is the economic rationale for this "ideal" policy model? Does the current state of the economic debate on development and growth lend support to this approach? Why should development policy be spatially-aware? What about the argument that development policy should mostly be a-spatial or "blind" and that any spatially-aware policy deters mobility from efficient agglomeration processes? Why do we anyway need an exogenous intervention by a higher level of government? For, if local knowledge and preferences are so relevant, why should development not be left to places? And why should any exogenous intervention focus on public goods and services?

And, even assuming that a place-based development policy is warranted, why should the European Union budget have a role? Should not such a policy be left to Member States? And, finally, if the EU were given a role, should not the intervention be limited to poor countries or, at least, to poor regions?

These questions need to be addressed before cohesion policy can be assessed and before anything can be said about whether and how it should be reformed. The structure of the Report is thus built around the following sequence.

Chapter I provides the motivations, the economic rationale and the nuts and bolts of the policy model to which cohesion policy will then be compared. After firstly examining the motivations for cohesion policy that emerge from a comparative (EU vs. US) and historical perspective (section I.1), the economic rationale of the ideal model is investigated with reference to the current debate on development and growth, and with separate reference to the two distinct objectives of the policy, efficiency and equity/social inclusion (section I.2.1). This allows some recurring misconceptions of the policy model to be rejected through a set of "corollaries" (section I.2.2). The policy concept is then used to show how a place-based development policy allows the traditional public policy dilemma of centralisation versus decentralisation to be overcome; a methodological framework for implementing the model is sketched (section I.2.3). The analysis can then revert to the question of why the EU should allocate a large share of its own budget to this policy: two rationales are presented which support and shape this choice (section I.3).

Chapter II, by making use of the policy concept developed in the first chapter, assesses how distant cohesion policy is from the ideal model. After sketching the governance and the data of the present arrangement of cohesion policy (section II.1), and providing a brief description of the main features of Member States' regional policies in whose context cohesion policy is being implemented (section II.2), the available empirical evidence on the effects of cohesion policy is reviewed (section II.3). In spite of the very serious limits of the quantitative evidence, a tentative picture is finally outlined of the successes and failures of cohesion policy (II.4).

Chapters III draws a clear-cut message from the previous two chapters: cohesion policy is strongly needed by the Union, it provides an appropriate base for building a response to current challenges, but for those challenges to be met a sharp change of direction must take place. An outline of the necessary reform is then provided, stressing that the chance for success hinges on the synergy of three factors: adopting a strong policy concept; introducing key changes in the priorities and governance of the current policy; and building a new strong political compromise. A revised design of the negotiation process is also necessary.

Chapter IV deals with the issue of core priorities. It proposes three criteria that should be adopted for the choice of a very limited number (3-4) core priorities, on which up to two thirds of all

resources should be concentrated (section IV.1). The case for a strong focus on the social inclusion objective and a move towards a "territorialised social agenda" inside cohesion policy is then made (section IV.2). Six candidates for the core priorities are then assessed as a way to test the criteria: two (innovation and climate change) with a predominant efficiency objective (section IV.3); two (migration and children) with a predominant social inclusion objective (section IV.4); and two (skills and ageing), where the two objectives are of similar relevance (section IV.5).

Chapters V proposes ten pillars for a reform of the governance of cohesion policy: they are not intended to provide a blueprint for cohesion policy since 2014, but do provide clear statements of how a comprehensive reform could be designed. The ten pillars are: an innovative concentration on priorities and a conservative territorial allocation of resources (section V.1), a new EU strategic framework for cohesion policy (section V.2); implementation and reporting aimed at results (section V.3); a strengthened governance for the core priorities (section V.4); promoting additional, flexible, and innovative spending (section V.5); promoting experimentalism and mobilising local actors (section V.6); promoting the learning process: a move towards prospective impact evaluation (section V.7); refocusing and strengthening the role of the Commission as a centre of competence (section 8); addressing financial management and control (section 9); and reinforcing the high-level political system of checks and balances (section 10).

I. THE RATIONALE AND MOTIVATION FOR AN EU PLACE-BASED DEVELOPMENT POLICY

Any assessment of cohesion policy and any proposal for change aimed at building political and cultural consensus require clear answers to the following questions: should the EU devote a significant share of its budget to running a place-based development policy for regions? What is the economic rationale for such a policy? The first question cannot be answered without a preliminary agreement on the other. The European debate on cohesion policy, however, has proceeded for too long on the assumption that it could be. Alternative views on whether and how "cohesion policy" should be reduced in scale, strengthened or modified in same way have confronted each other without any consensus over what "cohesion policy" should be about. This has led to misconceptions and misunderstandings and has prevented a meaningful political debate from taking place as well as substantive changes from being made.

The task of this chapter is to address these questions, to outline a "new paradigm of regional policy" - the place-based model of development policy - and to examine the rationale for the EU running this policy and funding it.

First, the grounds for an EU cohesion policy are set out from both a comparative and an historical perspective (section I.1). The economic rationale for a place-based development policy is then discussed in terms of efficiency and equity objectives, in the process identifying a number of misconceptions about the policy model and showing how the approach enables the traditional dilemma about centralisation or decentralisation to be resolved (section I.2). This, therefore, provides the basis for addressing the central question of why the EU should allocate a large share of its budget to such a policy (section I.3).

I.1. The EU cohesion policy budget: a comparative and historical perspective

Two different perspectives can shed light on the political and economic motivation for cohesion policy. First, in order to obtain a broader view on whether or not a union of States should have a role in economic and social development and if so, what this should be, the EU and the US budgets are compared and differences and similarities are identified. Second, in order to obtain an historical perspective on the political motivation for EU cohesion policy, its origins are revisited, the views of its founding fathers recalled and the main stages in its evolution reviewed.

I.1.1. Alternative ways of tackling economic and social development: the EU and US

In the EU, cohesion policy accounts for most (84%) of the total budget for economic and social development (58.3 billion euro a year in the period 2006-2008). This can be compared with the other large industrialised Union in the world, the US. The marked differences between the two in origin, age, political construct, institutional design and economic and social culture are reason enough for equally marked differences in the two development budgets. The analysis shows that both important differences and similarities are present: they help explaining the motivation for the European Union budgetary choice.

The US Federal Reserve[15] has identified funding for programmes for economic and social development in the Federal budget, namely capital expenditure on infrastructure, financial incentives to firms and spending on training, employment and social services. As in the case of the EU budget, these programmes include only measures aimed at tackling "special" development problems and exclude ordinary welfare provision. They are the result of around 60

[15] See Drabenstott, M. (2005). Its data were updated by reference to the Budget of the United States Government: Detailed Function Tables, Fiscal year 2009, Executive Office of the President of the United States.

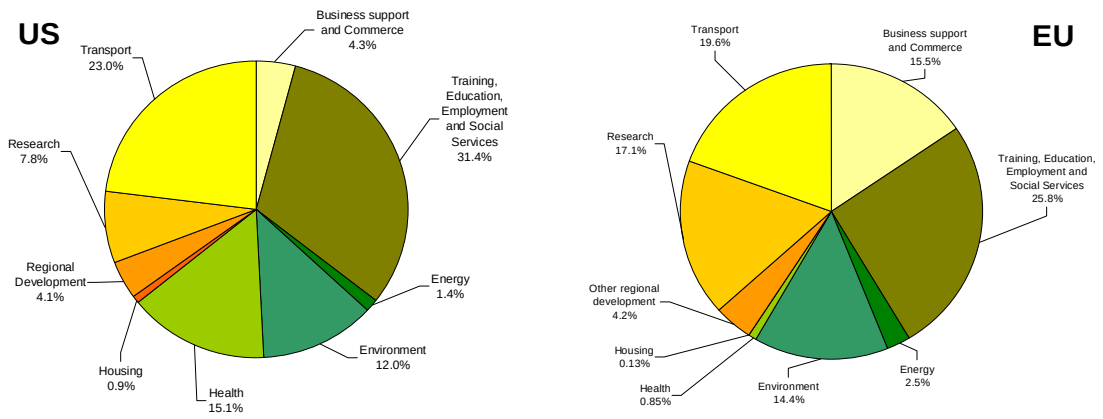
Federal bills dating back to the 1933 Tennessee Valley Authority Act. They include a diverse range of programmes, including those stemming from the 1953 and 1958 acts for "Small Business", the 1977 and 1987 acts to develop old industrial sites; the 1987 act for health, housing, food and other assistance for the homeless, the 1991 act for mass transit, the 1998 act to create employment and business opportunities and provide basic public services in urban and rural areas and the 2002 bill for stimulating economic development and fostering partnership in 13 different States. These programmes are aimed at increasing competitiveness, often in specific areas, compensating for the effects of external shocks, combating deprivation among particular groups of people or in particular areas. Their objectives are to do with increasing both efficiency and equity and often the two together.

The programmes include types of expenditure almost identical to those eligible under EU cohesion policy. Data for planned expenditure[16] on development in the US and the EU for the period 2006-2008 indicate that:

- The *size* of the EU development budget is, as expected given the greater role of Member States in this and other policy areas, smaller than that of the US both in absolute terms (58.3 billion euro as against 252.7 billion euro) and as a share of GDP (0.5% as against 2.5%)[17].

- The *sectoral composition* of the two budgets, however, is similar (Fig. I.1), the share going on infrastructure (transport, environment, energy), training, employment and social services being much the same. The US development budget, on the other hand, includes a larger share of expenditure on housing and a much larger share on health, while in the EU budget, a much larger share goes to both business aid and research.

Fig. I.1: Shares of the Union development budget by sector in the US and EU: 2006-2008
(average %)



Source: Data for US from US Federal budget and data for EU from DG Budget and DG REGIO.

252,7 billion euros per year **58,3 billion euros per year**

[16] "Commitments" in the EU terminology; "outlays" according to the US budget. All information for the US is obtained from the Budget of the US Government website for the fiscal years 2008 and 2009.
[17] Note that the EU development budget accounts for a much bigger share of the overall budget (46%) than that of the US (12%), so that the overall Federal budget is much large still.

The *governance* of the two development budgets is very different. In the US, 89% is spent on some 180 sectoral programmes run by Federal Departments and Agencies (often several being responsible for the same type of expenditure) under a panoply of Federal legislation approved over the years to tackle specific economic or social problems in parts of the country or across the US as a whole[18]. Only 11%, therefore, goes to "community and regional development". In the EU, around 84% of the development budget is spent under cohesion policy – i.e. under a place-based programme under which funds are transferred to Member States and regions without being earmarked for particular sectors (though conditional on general rules being agreed on their use). Only 16% is, therefore, earmarked for sectoral programmes as such[19].

These figures, even after allowing for possible differences in accounting methods and definitions[20], suggest a number of points as regards the role of the two budgets and the particular governance of the EU budget.

First, both the EU and the US, despite strong cultural and institutional differences, allocate sizable resources to economic and social development with largely similar priorities. The differences in the two budgets reflect a different allocation of responsibilities between the Union and the States and, in particular, the choice at present for the EU to play a very limited role in the provision of social services[21]. In neither of the two Unions do the interventions represent an "Equalisation Fund" that States can use as they wish. The purpose is not financial redistribution between States, but rather development according to agreed Union principles – i.e. to increase efficiency and competitiveness and reduce social deprivation, often in specific areas.

The similarities reinforce the idea that a Union of States – whether federal as in the US or hybrid as in the EU – which has legislative responsibility for managing unified markets and a unified currency and which embodies a sense of common citizenship, cannot fail to have some budgetary responsibility for development in its regions and for its citizens. Both the US and the EU have large disparities between both regions and individuals. In the EU, disparities in GDP per head between States are wider than in the US (see Map I.2); in the US, inequality between people within each State is much wider than in the EU[22]. Whether the Union is "free market" oriented or "social market"[23] oriented, therefore, money is spent on assisting regions tackle development problems.

Moreover, given that mobility of people, which also tends to counteract disparities in productivity and standards of living across regions, is higher in the US[24], the size of the EU development budget appears even smaller in comparison.

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[18] See Drabenstott, M. (2005). Many of these acts continued to be financed after the initial expiry date passed.

[19] A greater share might be allocated to sectoral programmes, but as the result of the independent choice of Member States or Regions in their allocation of the resources of cohesion policy. Chapter II will show that this is indeed the case.

[20] Differences in institutional arrangements can also explain some of the differences in the sectoral composition.

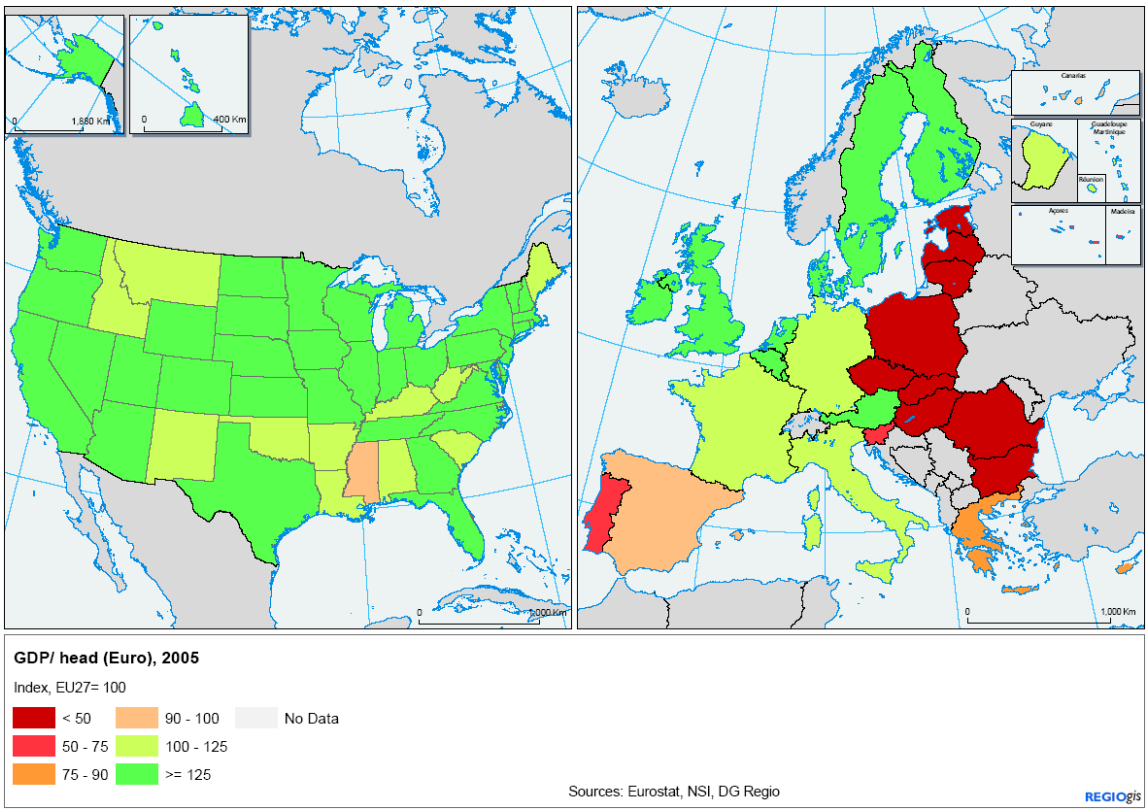
[21] On the instability of this choice see section I.3.

[22] According to Jesuit, D., Rainwater, L. and Smeeding, T. (2002), some 16.5% of people in US States, on average, had income below 50% of the median as against 9% in the EU. In the latter, the highest figure was in Slovakia (16%), much lower than the highest figure in the US 22% in Washington DC).

[23] See the new EU Treaty, article 3.

[24] Data for internal mobility are hard to compare since those for the US refer to mobility from a different State (in 2005, 2% of working-age residents had moved from a different State during the year), while those for the EU refer to mobility from a different (NUTS 2) region (1% on average, in the same year): see European Commission (2008f). These data seem to show that internal migration is very diffused in the US, whereas it is more concentrated in the EU. In the US, the share of working-age residents who moved from one of the "top 10%" States (in terms of mobility and adjusted for population size) was only three times larger than the share who moved from the "bottom 10%" (3.4% as against 1.1%); as compared with 25

Map I.2: Disparities in per capita GDP among States in 2005: US and EU



Source: Eurostat, NSI, DG REGIO.

The fact that the governance of the two development budgets differs is in line with what might be expected in view of the different development stages of the two Unions. The Federal government of the US is the result of a choice made more than two centuries ago by similar-minded communities. Though almost permanently contested, it is strengthened as regards development by the long-term effects of the "New Deal"[25], and it has a high degree of legitimacy to manage directly a large amount of resources for development and to intervene directly in regions. The hybrid government of the EU is the result of a relatively recent choice made by very dissimilar communities which have been in conflict for centuries. It does not have federal powers and very different views coexist on what the limits of its powers should be. It largely relies on lower levels of government to allocate resources for development, establish priorities and manage spending.

It is argued below (section I.2) that the current EU place-based model – that adopted for cohesion policy – has an economic rationale. It is also argued that, if properly designed and implemented by allowing different mixes of sectoral intervention to be truly tailored to places, this approach is a more modern and effective way of pursuing economic and social development than top-down sectoral programmes. But these considerations apart, the comparison with the US suggests a clear conclusion: the policy model currently adopted by the EU can be regarded as the only approach for pursuing a policy of economic and social development that is compatible with the present stage of political development of the EU. Even if top-down sectoral development policies were

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times larger (2.5% as against 0.1%). The higher mobility in the US, linked to a higher degree of cultural standardisation provides people with a form of social protection not present to the same extent in the EU. This is used to explain the lower level of social protection expenditure than in Europe (see D'Antoni, M. and Pagano, U. (2008)).

[25] As Dorf, M.C. and Sabel, C.F. (1998) put it, the present situation is still the result of "a New Deal synthesis in which an all-powerful Congress delegates much of its authority to expert Agencies that are checked by the courts when they infringe individual rights", though as they also discuss, there are weaknesses and ongoing changes in this arrangement.

considered preferable to place-based development policies, the EU could not adopt them as they would impinge on the policy space of Member States.

I.1.2. "No Community could maintain itself so long as some have cause to doubt the common will": guidance from history

The founding fathers of the European Economic Community (EEC, later the European Union) had mixed feelings about the creation of a Community regional policy. In the preamble to the Treaty of Rome, they declared themselves "*anxious to strengthen the unity of their economies and to ensure their harmonious development by reducing the differences existing among the various regions and the backwardness of the less-favoured regions*". However, while their spatial awareness is clear from several Treaty statements, the founders did not provide a firm basis for establishing an autonomous Community regional policy[26].

The choice was intentional for two main reasons. First, there was a general, and arguably over-optimistic, feeling that integration in itself would contribute to reducing regional disparities through the promotion of inter-regional trade[27]. Secondly, the experience with domestic regional policy in a number of the countries –France, Italy and Germany – was relatively recent and it was not felt necessary to duplicate or interfere with this[28]. The choice was made, however, to develop the existing European Coal and Steel Community Treaty fund (operating since 1951) for the retraining and the resettlement of workers into a European Social Fund aimed at increasing job opportunities.

Several factors soon fuelled a growing demand for a Community regional policy, starting with increasing concern about the levels of economic and social disparity between Member States and regions and the worsening problem of declining industrial areas. But despite Commission efforts and a series of resolutions by the European Parliament[29], no action was taken by the Council. The conditions for the creation of a Community regional development policy came in the late 1960s and early 1970s, generated by the plan to deepen the internal market and to launch an Economic and Monetary Union and the expected adverse effects of this on regional disparities.

As the Werner Report put it in 1970[30], "*the realization of global economic equilibrium may be dangerously threatened by differences of structure. Cooperation between the partners in the Community in the matter of structural and regional policies will help to surmount these difficulties, just as it will make it possible to eliminate the distortions of competition. The solution of the big problems in this field will be facilitated by financial measures of compensation. In an economic and monetary union, structural and regional policies will not be exclusively a matter for national budgets*." The first enlargement of the Community in 1972 created a focus for change when both Ireland and the UK supported a new Community policy instrument that could also reduce their net financial contribution to the Community[31]. The Heads of State formally agreed at the Paris Council summit of 1972 to "*give top priority to correcting the structural and*

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[26] These references can be grouped under three categories: a proviso to take account of regions when applying Community sectoral policies (especially in agriculture and the common market, as well as specific provisions for the *Mezzogiorno* in the Italian Protocol attached to the Treaty); derogations from the general rules for certain regions (notably under the state aid rules, with a specific reference to the German *Länder* bordering the (then) Germany Democratic Republic and Czechoslovakia; and EU financial instruments with regional effects (the European Social Fund, the European Agricultural Guidance and Guarantee Fund and, with a more explicit regional dimension, the European Investment Bank which could prioritise the financing of projects in less developed regions).
[27] See Vanhove, N. and Klassen, L.H. (1987), pag. 258.
[28] See Wallace, H. (1977), p. 140.
[29] Resolution Van Campen in 1959; Resolution Motte, in 1960; Resolution Birkelbach, in 1964.
[30] Report on the realisation by stages of economic and monetary union (8 October 1970), in Bulletin of the European Communities (1970). See also a year earlier: Commission of the European Communities (1969).
[31] Wallace, H. (1977).

regional imbalances in the Community which could hinder the achievement of the Economic and Monetary Union….[and]…ask the Community Institutions to set up a Regional Development Fund …".

However EU regional policy came about, its motivation went far beyond that of a mere compensatory tool for correcting the effects of market integration. The Treaty commitment to reducing Community regional disparities was regarded as "*a human and moral requirement of the first importance*". To this end, the Report by Commissioner George Thomson adopted in 1973[32] initiated the legislative process for the creation of the Regional Development Fund, making two key lasting points (italics added):

- "no Community could maintain itself nor have a meaning for the people which belong to it so long as some have very different *standards of living* and have cause to doubt the common will of all to help each Member State to better the condition of its people…The long history and diversity of the European people, the historical and cultural values which are the moral wealth of each region, make the maintenance of establishment in each region of the groundwork of an up-to-date economy a matter of capital importance".

- "The purpose of a Community regional policy is to give areas suffering from regional imbalances the means to correct them and enable them to put themselves on a footing of more equal *competitiveness*. If this can be achieved, then it will be possible for the various factors of production of the community to be *more fully utilised* and the idle human resources and under-used social capital and infrastructure to be more fully employed".

The new policy and its visibility (no one should "*have cause to doubt the common will*") was clearly seen as a necessary way of not just guaranteeing the sustainability of the integration process but, much more importantly, of ensuring the sustainability of the Community itself, particularly given the "*long history and diversity of the European people*". Moreover, the two distinct, though complementary, goals of the new policy - efficiency and equity - were very clearly identified. European citizens demanded a Community effort, on the one hand, to give all regions (or places) the opportunity to fully utilise their potential and achieve competitiveness (efficiency), on the other, to pursue more similar standards of living for all individuals "*in each region*" (equity).

At the outset, the role of the Community level of government in the new policy was not actually very relevant. The old social fund and the new regional fund – collectively called "Structural Funds" – were kept separate, the first being to support people to gain new skills, the second to provide infrastructure. Their overall size was rather small (5% of the total Community Budget). They were to be distributed on the basis of national quotas to finance projects, with no clear-cut strategy agreed between the Commission and Member States and the latter having the final say on project approval.

A greater Community orientation developed under the 1979 and 1984 reforms, reflecting an attempt to improve the effectiveness of policy and to develop an "integrated approach", under which EU measures and national policies could converge[33]. Together with the abandonment of the quota system for allocating resources to them (replaced with a system of indicative ranges), Member States were requested to submit regional development programmes that allowed the Commission to identify and discuss common Community priorities. Ex-post assessment was also introduced with the publication of periodic Commission reports on regional development trends.

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[32] Commission of the European Communities, Report on Enlarged Europe (Thomson Report), COM (73) 550 def, 3rd May 1973. The Report also argued that regional imbalances comprised those that arose from the "*absence of modern economic activity or the over-dependence… on agriculture or declining industrial activities*" which could logically be found in specific geographical areas with a "*preponderance of agriculture, in areas of industrial change and of structural under-employment*".

[33] See the account of Lowe, P. in Inforegio Panorama, European Commission (2008e).

In addition, more scope was given to the Commission to pursue Community priorities (through Community initiatives and programmes). The size of the regional funds rose to around 13% of the Community Budget by 1985. At the same time, a "higher degree of convergence"[34] between countries and regions came to summarise the policy objectives, aimed at capturing at once the equity and the efficiency dimensions, a controversial step as discussed below[35].

These steps, together with the agreement on Integrated Mediterranean Programmes in 1985, represented the basis for the landmark reform under the presidency of Jacques Delors. The starting point was the Single European Act, which dedicated a Treaty title to "cohesion" as a way to "promote … overall harmonious development", along with a requirement to alter the rules governing the operation of the Structural Funds, the main instrument for the pursuit of cohesion. The Treaty revision at Maastricht in 1992 gave added priority to "strengthening … cohesion" by including it in article 2 as one of the means for achieving the Union's goals, on a par with "the establishment of economic and monetary union". This was accompanied by the creation in the Treaty of a Cohesion Fund for countries that were lagging behind in economic terms, aimed at improving their environmental and transport infrastructure. Successive increases in the resources allocated to cohesion meant that it exceeded 32% of the EU Budget in 1993. These developments were followed by a substantial change in the way policy was governed.

Community objectives and priorities were defined as the reference framework for resource allocation. Member States for the most part were required to formulate programmes in line with this and obtain Commission approval for their implementation. The change from annual to multi-annual budgeting underpinned this new strategic approach, which increasingly reflected the idea that economic and social development was not so much to do with building infrastructure and giving subsidies to firms but more to do with encouraging the provision of extensive bundles of integrated services. The Commission invested human resources in designing and developing this framework.

This strategic development was helped in the social sphere by the adoption in 1994 of a European Employment Strategy, which became a point of reference for designing programmes. The importance of involving local actors in development policy if it is to be successful was reflected in the introduction of a "partnership principle" under which regional and local authorities were to be involved in programme formulation and implementation. A Committee of the Regions was created, emphasising the growing role of the regional level of government in all Member States[36], while an "additionality principle" was also introduced to ensure that Community-funded expenditure did not simply replace nationally-funded expenditure. At the same time, the share of resources allocated to initiatives directly managed by the Commission grew to 9 % of total funding.

The reform was pushed by concerns about the different effects on regions of technological change and the Community's policy of market integration and liberalisation[37]. As stated in the Padoa-Schioppa Report[38], "*there are serious risks of aggravated regional imbalance in the course of market liberalisation … and adequate accompanying measures are required to speed adjustment in structurally weak regions and countries … reforms and development of Community structural funds are needed for this purpose*". It was also prompted by the accession of Spain and Portugal in 1986, which substantially widened regional disparities across the Community.

However; a wider political concern motivated the reform and created the necessary political compromise for it to be launched. If progress was to be made in integrating markets and in

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[34] See European Commission (1984).
[35] See section I.2.
[36] According to Marks et al (2008), the 1990s represent the period of maximum concentration of reforms designed to increase "regional authority": See below, section I.4.
[37] See for example Delors, J. (1989), p. 82.
[38] See Padoa-Schioppa et al (1987). See also Cecchini, P., Catinat, M. and Jacquemin, A. (1988).

ensuring free movement of people, if protectionist barriers were to be removed, if national autonomy over management of exchange rates and interest rates was to progressively disappear, there was likely to be increasing expectation that the same authority responsible for these moves should also be responsible for giving all places and all European citizens the same opportunity to gain from the changes and avoid the risks. The new Union would need a development policy giving legitimacy to a voluntary Community of Member States capable of ensuring that all its citizens benefited when new opportunities were opened up by market integration and currency unification and were able to protect themselves against the risks. Indeed, the very existence of the Union would require it. As Delors put it, "…*a Community on the brink of being transformed into a Union consciously accepted by the men and women of Europe … not merely uniting nations but developing a blueprint for society*"[39].

Other political goals can be detected at the end of the 1980s among those who advocated reform, starting with Delors. The concept of cohesion was seized upon and pushed as a "State-building strategy"[40] to further a federalist vision of Europe and to complement and balance the market philosophy underpinning economic integration[41]. Cohesion policy was also seen by some as an opportunity to shift authority from Nation States to administrative Regions, a vision inspired by the conviction that the former potentially promoted nationalistic conflict, while the latter could better represent community values[42].

However, as in the case of all robust compromises, the different cultural and political visions – popular, socialist and liberal – converged on a common denominator. All agreed that for the Union to exist, especially when unified markets and currency were being created, there was a need for clear and strong development objectives. Cohesion policy, as it was designed, was seen as the best option given the historical stage of development of the Union, the role of nation States and the limited power accorded to the EU level. The strong partnership of Francois Mitterrand and Helmut Kohl, the economic and political interests of Spain and the role that Felipe Gonzalez came to play in the new dynamics of decision-making created by Spain's accession and Margaret Thatcher's willingness to compromise all contributed to making the reform possible and to giving it ultimately remarkable stability[43].

Since then, the architecture of cohesion policy has been revised as a result of a continuous search for a balance between conditionality and subsidiarity, as described in Chapter II below (Box II.A). The enlargement of the Union to 27 very diverse countries has provided further arguments for a policy aimed at enabling all people, independently of where they live, to benefit from the opportunities created by the Union. The financial success of monetary union and the euro and the more recent international financial crisis have highlighted once again the unavoidability of the EU having development objectives. The relevance of spatial awareness has been emphasised by the explicit introduction in the Nice Treaty of the territorial dimension of cohesion policy alongside the economic and social dimensions. Nevertheless, no significant progress has been made in giving cohesion policy stronger conceptual foundations or in rejuvenating the cultural and political compromise that occurred at the end of the 1980s.

The progress of the theoretical debate has not adequately found its way into the rather close cohesion policy community. Efficiency and equity have been highlighted as policy objectives, combined as they have been from the start. Even when during the past 10 years, "competitiveness" has become the prevailing catch-word in policy documents, the social and

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[39] Programme of the Commission for 1989, address by Jacques Delors to the European Parliament and reply to the debate, Strasbourg, 16 February and 15 March 1989, p. 8. On this interpretation see also the account of Meadows, G. in Inforegio Panorama, European Commission (2008e).
[40] See Ross, G. (1995).
[41] See Grant, C. (1994); Ross (1995); Hooghe, L. (1996); Hooghe, L. (1998).
[42] On this vision and its risks, see Caracciolo, L. and Maronta, F. (2009).
[43] On the negotiation and the convergence of both economic and political interests that made it possible, see: Moravcsik, A. (1991); Marks, G. (1992, 1993); Pollack, M. (1995); Ross, G. (1995), p. 230-1.

economic dimensions have remained entangled, as if any cohesion policy intervention could achieve both. The design of an overall "development" strategy – the Lisbon Agenda - in 2000 provided a potential opportunity for cohesion policy to be rethought. But, lacking a shared concept of the policy around which to rebuild a strong political compromise, and with several Member States focusing on the financial features of the policy, the linkage with "Lisbon" failed to be used as a way of focusing cohesion policy on a limited number of priorities and on areas of intervention where its original place-based approach could be most effective.

In this situation, the consensus on the value added by the cohesion approach has been progressively eroding over the years. The misconception that cohesion policy is either an equalisation fund for countries or regions or a source of finance for EU sectoral policies has gained ground. Conflicting and incoherent views have emerged and there is a need to re-establish common ground for debate. Understanding the economic rationale for place-based policies is an essential starting-point for this.

I.2. The place-based paradigm: economic rationale and governance

The comparison between the EU and US and the historical overview have emphasised the coexistence of both efficiency and equity dimensions in development policy. One objective, efficiency, is about realising the full utilisation of the potential of every place or region; the other (equity) is about ensuring equal opportunities for individuals irrespective of where they live. This Report argues strongly that, in the context of a place-based integrated strategy, there is a need for clear-cut distinction between these two objectives and a need to pursue them through distinct interventions. As will be argued, progress in pursuing the efficiency objective might help the pursuit of the equity objective, but this need not be the case. Nor, in general, is it the case that a policy which is appropriate for pursuing one objective is also appropriate for pursuing the other. Moreover, confusing the two objectives can lead to fuzziness in both implementing and debating policy[44].

Moving on from this, the chapter examines the economic rationale of the place-based paradigm, considering efficiency and equity objectives separately (sub-sections I.2.1 and I.2.2), enabling some common misconceptions to be exposed (sub-section I.2.3) and the governance required by the place-based approach to be outlined (sub-section I.2.4).

I.2.1. The efficiency objective

In recent years, the varied, and variable, performance of industrialised and developing countries, as well as progress in economic theory and empirical analysis, have made most scholars and policy-makers more cautious as regards both the explanations for growth and for disparities between places and what governments can and should do to stimulate growth[45]. There is, however, a strong consensus on one aspect, namely, that "agglomeration" is one of the key drivers of growth and development.

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[44] One example is the controversy over the weight that should be placed on increasing the growth of a country (or Union) as a whole as opposed to improving the internal balance of growth between regions. If efficiency is the objective, no trade-off by definition exists and the task of "tapping into unused regional capacities" should be pursued insofar as it contributes to overall efficiency. If equity is the objective, one should refer to disparities among individuals and increasing the growth of lagging regions is not the ultimate goal but it can be a possible means of achieving this: accordingly, there can be potential trade-offs with overall growth or efficiency.

[45] See the collection of papers edited by Aghion, P. and Durlauf, S.N. (2005). In particular Rodrik, D. (2005) writes that "the experience of the last two decades has frustrated the expectations of policy advisers who thought we had a good fix on the policies that promote growth". See also the 2008 Growth Report. The same caution is not to be found in World Bank (2008): see below.

Thick agglomerations, networks, growth and the role of public action

The concentration of consumers, workers and businesses in a place or area, together with the formal and informal institutions that make an agglomeration "thick" and cohesive, has the potential to produce externalities and increasing returns to scale. These include: the greater possibilities of matching firms and workers, of inputs and capital goods being more specialised, of a virtuous circle being created between supply and growth of demand, of labour pooling; and of economies of scale in research and in the provision of public goods and services[46]. In both developing and industrialised countries, the concentration of economic activity and people tends to be high and often coincides with a concentration of innovation. In OECD countries, there are wide variations in GDP per head within countries, accompanied by similar variations in innovative activity, productivity and employment rates, the top 10% of regions producing around 40% of GDP[47]. In Europe, which is highly polycentric, the growth of metropolitan regions around the capital city has often exceeded growth elsewhere, as in the case of Athens, Budapest, Dublin, Helsinki, London, Madrid, Paris, Prague and Stockholm[48].

The evidence also shows that agglomeration effects are not limitless and that a concentration of activity is neither a necessary nor a sufficient condition for high growth.

It has long been known that, as the New Economic Geographers have stressed, the traffic congestion, price increases, pollution and other adverse effects on health, the environment and the quality of life, the rising costs of urban infrastructure and of urban sprawl, the social tensions and high crime rate which can all result from agglomeration can offset the benefits and bring the process to a halt[49]. Specialisation can also make agglomerations especially vulnerable to external events in a globalised economy as the current financial crisis is demonstrating. At the same time, opportunities for growth exist in areas where there is less concentration of economic activity. Many rural areas have high rates of growth. In OECD countries, in the period 1995-2005, almost half of the 78 metropolitan regions grew by less than the national average (including Brussels, Copenhagen, and Oslo)[50].

Moreover, although agglomeration is a driver of growth and development, it is not the only one. In particular, for a region to grow often requires strong "network effects" to be at work, i.e. that it is able to benefit from the growth occurring elsewhere because of transport, energy, ICT and other connections. In Europe, where space for large agglomerations to grow is limited and polycentrism is high, economies of scale and growth can be generated by "*networking between major agglomerations and their hinterland*" and by "*dense networks of big or middle sized cities*"[51].

Most importantly, the fact that agglomerations (as well as networks of regions) are never the result purely of market forces needs also to be taken into account. Public action, which invariably has explicit or implicit, direct or indirect spatial effects, is a factor too. This applies to both policies which have an overt spatial dimension – termed "spatially aware" – and those which do not – sometimes termed "spatially blind".

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[46] For a survey of the literature see the Report Working Paper by Farole, T., Rodríguez-Pose, A. and Storper, M. (2009).
[47] See OECD (2009b). "Regions" refer here to the TL3 level adopted by the OECD (over 2300 units in 28 countries) which largely corresponds to the Eurostat NUTS 3 level.
[48] See OECD (2006b).
[49] For example, OECD (2006b) argues that for metro-regions of over 6 million people the relationship between income and population size is negative.
[50] See OECD (2009b). Metropolitan regions are defined by the OECD on the basis of its definition of "predominantly urban regions" (TL3 regions with less than 15% of the population living low density areas) adjusted according to the size of urban centres.
[51] On this issue, see the Report Hearing Paper on Growth, in particular the comments by Ash Amin, Michael Storper and Philip McCann (from which the quotations in the text are taken).

For any *ongoing agglomeration* – i.e. one that is still expanding - it is certainly the case that considerable public policy decisions are responsible for providing the public goods and services that a growing population needs, such as the use of land; transport links and an internal transport network, the provision and servicing of industrial and commercial sites; education and health services, a police force and so on. Some of these decisions will be taken by the local authority, but they often require national legislation, financial intervention at a national scale and coordinated policies across the country as a whole.

In ongoing agglomerations, the "hand of the State" is generally hidden behind seemingly "national" policies and what are claimed to be "natural trends". National policy measures are almost always taken with specific places in mind. An example is the set of policy measures that the recent World Bank Report on "Reshaping Economic Geography" defines as "spatially blind", the institutional measures such as "*regulations affecting the land, labour and international trade and social services as education, health and water and sanitation*"[52]. Even ignoring the strong, context-dependent effects of rules on labour and international trade, all the other institutions defined as "blind" not only have effects which are strongly *dependent on places*[53], but their design is always strongly *tailored to places*.

Political decisions, with an intentional spatial effect, on whether or not to expand or contract services in particular areas, are taken simultaneously with private agents' decisions on whether or not to invest capital and whether or not to move. Public and private decisions, therefore, go together and reinforce each other. Moreover, the design of services (education, public health water supply and so on) tends to be shaped by the preferences and interests of the people and businesses whose influence on public choices is stronger. This is particularly evident in the case of regulation of land use and urban planning. The World Bank (2008) itself argues that "*a city must satisfy the demands of its dominant or growing industries for both real estate and facilities*" (p. 142). High-rise buildings, land for warehouses, pedestrian areas, metro systems – the examples considered in the World Bank Report – relate to choices made as part of public strategies which are designed for specific places and to respond to specific interests.

The spatial concern becomes evident in agglomerations if the negative consequences of further agglomeration can no longer be prevented and national public action is called for to contain it[54]. It is also evident in regions where a process of agglomeration is not at work and public intervention is not disguised by a seemingly "natural" increase in population and GDP.

The strong spatial nature and effects of most public interventions and institutions place great responsibility on governments to decide whether or not to provide public goods and services and, if so, where. In principle, governments should always consider alternatives, assess long-term returns and evaluate both the demands of the "dominant industries" and to what extent they are sustainable. However, the usually limited information on which to base choices, the difficulty of predicting future returns and the existence of strong private interests trying to influence the decision-making process in their favour, makes any full and objective assessment of alternatives both difficult and unlikely. A more modest but feasible approach is to ensure that government decisions are at least transparent, verifiable and actually verified. The screen of spatial blindness tends to prevent this and can lead to painful consequences. It restricts information on, and the public scrutiny of, decisions with strong spatial effects, leads to policy-makers being more easily

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[52] See World Bank (2008), p. 22.

[53] This point is actually acknowledged after 240 pages of the Report when it recognises that the term "institutions (spatially blind policies) … is used here to categorize policies that are not explicitly designed with spatial consideration, but that have effects and outcomes that may vary across locations".

[54] This is for example the case in Japan and Korea, as well as in the Netherlands where national policies have in recent decades switched back and forth between promoting and discouraging the development of the Randstad. See OECD (2005b).

influenced by special interests[55] and can have adverse cumulative effects on both efficiency and equity[56].

The present Report argues that policies which make clear their spatial effects and ensure that these are subject to public scrutiny are superior. This is the case for both urban and rural areas, for agglomerations and lagging regions. A place-based development approach aimed at increasing efficiency should be the reference model for these policies. But what exactly is a place-based approach? What is its economic rationale? What market, and government failures, does it address and how? What are the risks of such an approach?

The rationale for exogenous, spatially-aware public interventions

The present Report defines *efficiency* as the achievement of full capacity or potential[57], meaning the value of output that, given the immobile resources of a place, would be achieved if all the economic and institutional opportunities were exploited and every feasible agglomeration or network effect was at work. It, therefore, encompasses both static and dynamic aspects. Full capacity is, accordingly, the result of private and public action which either increases the utilisation of current capacity at a given point in time (static aspect) or expands capacity itself over time (dynamic aspect)[58]. In consequence, full capacity is determined not by given technological conditions but through the interaction of economic and political decisions and institutions. Secondly, the issue of the long-term sustainability of the potential of a place is embodied in the definition. An exogenous, spatially-aware public intervention aimed at increasing efficiency in a given place/region can be defined as a measure implemented by an external body which has the objective of achieving fuller capacity utilisation of resources (mobile as well as immobile) than otherwise would have occurred.

Exogenous intervention by means of conditional grants, it should be noted, cannot be justified with the simple argument that some places are unable to raise enough revenue locally to promote development. If this is the only purpose, the appropriate solution is financial transfers to such places. Equalisation funds are used all over the world for this purpose and do not require active promotion of development from outside. The spatially-aware conditional grants, which place-

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[55] This is even more the case when spatial-blindness is invoked to call for a purely passive role of the public sector and there is no evaluation before interventions with spatial consequences are implemented. As an example of this,, see World Bank (2008): Box 4.6, which has the inviting title "Hong Kong, China: market forces led the way, government followed", and which explains that "The government contracted out urban redevelopment to a specialist organization dominated by private development interests". In these circumstances, efficiency effects are subordinated to the generally unrealistic assumption of "private development interests" possessing both perfect information and being benevolent, i.e. acting in the collective interest. Note that this "trust" in large concentrations of private interests taking the lead in public decisions and the belief that volatility can be assumed away are two of the main "intellectual errors" made by large parts of the economic profession, as has been pointed out with regard to the current financial crisis: see for example Acemoglou, D. (2009).

[56] See below in the text, in particular note 58.

[57] This definition is an adaptation of the definition of Bourguignon, F., Ferreira, F.H.G. and Walton, M. (2007).

[58] The longer the time-span taken into account in the dynamic perspective, the more difficult it becomes to assess what the potential is and what effect current actions have on it. The more likely also it becomes that a trade-off arises between a short-term increase in capacity utilisation and a long-term sustainable rise in the potential. This trade-off is relevant in terms of public action since the two objectives generally have different distributive effects and are thus supported by different groups of individuals: the irreversible effects often produced by either one or the other choice can make the use of compensatory mechanisms (by which the distributive effects are neutralised and the "best" allocative solution is chosen) hard or impossible (the argument is adapted from Acemoglu, D., Johnson, S. and Robinson, J.A. (2005)). Incompleteness of information and the existence of the trade-off further increase the need for public action to be verifiable and subject to strong public scrutiny.

based development policies are about, are instead motivated by three distinct (though interconnected) types of market or government failure:

- the economic institutions which a place needs are not put in place because they are contrary to the self interest of the local elite;

- the formal and informal economic institutions do not develop because of strong path-dependency;

- there are many potential agglomerations and exogenous public action is an intrinsic part of the process through which some of those agglomerations come about: since the State has very limited information, explicit spatial interventions, which increase verifiability, are likely to be more effective than "spatially blind" policies.

First, *since the required economic institutions may intentionally not be chosen by local elite, exogenous public intervention can make a difference.*

As Douglass North writes, "*institutions are not necessarily or even usually created to be socially efficient; rather they, or at least the formal rules, are created to serve the interests of those with bargaining power to create new rules*"[59]. As has been argued[60], the political power to choose economic institutions depends on the political institutions in place and the *de facto* distribution of power, which in turn depends on the distribution of resources. Elites which hold political power might not choose to put in place more efficient institutions if this is likely to reduce their share of resources[61]. A situation can then arise in which political and economic institutions reinforce each other, a vicious circle which can be broken only by an endogenous shift in the balance of power on which the stability of political institutions rests or by an exogenous intervention aimed at establishing more efficient economic institutions.

This framework, which has been developed to analyse the linkage between growth and national economic institutions, can usefully be applied to "places". Although local elites might not set the rules for representative democracy, they are responsible for how the local democratic process works. Even more, they tend to be responsible for designing and running many of the local economic institutions which influence accessibility from outside, the use of land, internal transport systems and the delivery of basic services, including the way national services (education, health and often security) are implemented locally. These local elites, for the reasons described above, can often choose the economic institutions that best suit their own interests, in doing so, acting as "*rent-seekers*", exploiting their power to extract a return way beyond their contribution to value-added. A "trap" can be created in these cases perpetuating inappropriate institutions (in efficiency terms) and this can occur in any place irrespective of its stage of development.

As compared with the traditional literature on fiscal federalism, the neo-institutional approach enables the (untenable) hypothesis of benevolent local policy-makers to be discarded. Accordingly, it suggests a role for external policy-makers to upset the local economic and political balance and to promote the selection of more efficient economic institutions. External policy-makers do not need to be assumed benevolent. There is justification for them to select the appropriate institutions if their interest is far enough removed from the distributive effects at local level, and if it is linked more to achieving overall growth (as well as more tax revenue, reduced social tension or more legitimacy).

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[59] See North, D. (1993).
[60] See Acemoglu, D., Johnson, S. and Robinson, J.A. (2005).
[61] This is especially the case since they cannot rely on being compensated for their loss. Other agents whose bargaining power is increased by the change cannot credibly commit themselves to later allow for the compensation to take place.

Secondly, the *weakness of both formal and informal institutions can perpetuate itself and, because of strong path-dependency, an exogenous public intervention is called for to bring about institutional change*.

It is widely agreed that both formal and informal institutions are a prerequisite for a place to make full use of its potential. Different concepts can help here: the *agency* of individuals or their capacity to act effectively in the pursuit of goals[62]; the *beliefs* of individuals[63] in other agents or the State to fulfil their commitments; *social capital*, or any aspect "of social structure [which] facilitates certain actions of actors within the structure"[64]; *trust* which is held when "the probability that [someone] will perform an action that is beneficial to us [is attributed a value] high enough for us to consider engaging in some form of cooperation" with them[65]; *institutional capacity,* or the capacity of public and private local institutions to govern and coordinate collective decision-making[66]; *democratic participation in decision making*, as a condition for local choices to be more informed and more in line with people's preferences and to allow citizens and collective bodies the freedom to experiment with solutions while exercising mutual monitoring[67]. All these institutional conditions tend to stimulate development by encouraging the involvement and cooperation of people, creating an incentive for them to pool knowledge and to develop collective projects.

The problem with all these prerequisites is that they do not arise easily and are highly path-dependent. Lack of *agency* tends to be perpetuated from one generation to the next. The same can be true of lack of *trust*, since in order "to protect children from costly mistakes, parents transmit conservative principles to them"[68]. It is also much harder to build effective institutional capacity if the capacity is inadequate to start with. The same is the case for democratic participation in decision- making. All these institutions are "carriers of history"[69]: the less a place has effective institutions, the less likely it is to have them in the future and to be able to exploit its productive potential. Once again, an exogenous intervention might be needed to trigger change. The purpose is obviously not to import institutions from outside, but to provide the pre-requisites for them to develop, to tilt the balance of costs and benefits for local actors to start building up *agency*, *trust* and *social capital*, to change beliefs and to experiment with institutions and democratic participation. As Amartya Sen (1999) puts it, what is called for is "*a contribution to enhancing and guaranteeing the substantive freedoms of individuals, seen as active agents of change, rather than passive recipients of dispensed benefits*".

This second motivation for exogenous intervention applies more especially to places which are lagging-behind in their economic and social development where the "institutional trap" is more likely to occur. But in other places too, changes in the external context or in the place itself (such as those which affect its comparative advantage) can call for specific institutions which were previously not present or for changes in existing institutions. An exogenous intervention might also be required to bring about "institutional thickness" across places or cooperation between them. Fuller utilisation of potential often requires cooperation between different places and these might not have the institutional conditions necessary for this to occur.

Thirdly, *there are many potential spatial distributions of economic activity (many potential agglomerations). Exogenous public action – whether visible and intentional or not –is an intrinsic part of the cumulative causation process through which a particular spatial distribution*

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[62] See Sen, A. (1992).
[63] See North, D. (1990).
[64] See Coleman, J.S. (1988).
[65] See Gambetta, D. (1988).
[66] See Pyke, F., Becattini, G. and Segenberger, W. (1990), in particular the paper by Brusco, S.
[67] See Dorf, M.C. and Sabel C.F. (1998). See also Cohen, J. (1996).
[68] See Guiso, L., Sapienza, P. and Zingales, L. (2008). They test and prove empirically this intergenerational transmission of miss-trust.
[69] See David, P.A. (1994).

comes about. As the State has very limited information on whether one agglomeration pattern is better than another, it should follow a visible and verifiable approach to intervention wherever it takes place.

Agglomerations are initiated by chance and by natural events or by supra-local public action (geo-political decisions or wars) or inaction (failure to address poverty, social or ethnic tension or serious economic problems elsewhere). They represent one of the many possible spatial distributions of economic activity that could come about. The prevailing distribution is not necessarily superior to other possible distributions in terms of efficiency. As has been shown, the existence of an agglomeration does not necessarily mean that it is efficient[70]. Furthermore, "*whether there is too much or too little agglomeration in the absence of regional policy interventions is not clear*"[71]. This means, given the lack of relevant information, that any public action with spatial effects needs to be cautious, whether promoting, mitigating or forestalling an agglomeration process.

There is, therefore a need for public action to establish a process through which the knowledge and preferences of all those living in a place are elicited and aggregated and the decisions made and their effects submitted to scrutiny and public debate. This is what place-based developments policies are about and spatially-blind policies do not offer.

Transparency and verifiability are also required of any public action with intended spatial effects because of the strong interdependencies between places. In particular:

- the movement of labour and capital away from places with untapped resources (often rural areas on the periphery) to thriving agglomerations (the "centre") can reduce the potential output of the former by more than they raise the potential output of the latter, in which case centripetal forces are compromising potential long-term objectives. This is especially true when the skills of those migrating are tied closely to the immobile resources of the area left behind or when the centre has already reached, or is approaching, the point of diminishing returns;

- mass movement away from rural areas can have negative consequences for the sustainability of overall growth, by depriving the land of the people taking care of it;

- the resulting impoverishment of rural areas can reduce the capacity of the overall development process to react to changes and shocks by depriving migrant labour of a place to return to and of alternative sources of income. The current financial crisis is providing worrying examples of what happens when the mantra of spatial blindness obscures open and democratic debate over effects of this kind[72].

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[70] See Ottaviano, G. and Thisse, J.F. (2004).

[71] See Puga, D. (2002). "The fact that firms and workers move without taking into account the possible losses for those left behind implies – the argument goes - there may be too much agglomeration." The failure to take into account the long term losses that might arise from agglomeration – due to either incomplete information or a choice not to do so – and the volatility of comparative advantages are other factors going in the same direction. "On the other hand" - as the quotation continues – "since when firms and workers move they do not fully take into account the benefits they bring for other firms and their impact on aggregate growth, there may be too little agglomeration".

[72] A vivid example of this phenomenon is the mass movement of people in China from rural to urban areas. As the World Bank (2008) reports (p. 22 and 154-155), China, having gone back and forth in the last 50 years "from facilitating to restricting labour mobility", in the past few years has followed the 'Reshaping Geography' mantra: "encouraging mobility of people is the priority" (p. xxii). The effect of this choice can be appreciated in the light of the current financial crisis. As The Economist (2009) stated (in an article entitled 'A great migration into the unknown'), a large number of "Chinese workers from the countryside who are employed beyond their home areas will be out of a job this year" - a figure put in the article 15 million (10% of the total concerned) and at 20 million the following week. "Many, [the officials] hope,

The uncertainty about whether a particular pattern of agglomeration or spatial distribution of economic activity is better or worse than any other must also be taken into account when supra-local public action is advocated by, or for, peripheral areas. There are risks in any attempt to "balance" the spatial distribution of economic activity by investing in the *periphery*. The supposed "untapped potential" of the periphery might well turn out not to exist, as is often the case. Policy-makers might fail to design or implement the means of unlocking this potential, which is not unlikely given how little is known about what works and does not work as regards public intervention. The intervention could end up constraining an efficient agglomeration process while failing to achieve results in the periphery[73]. There are also risks to public decisions concerning regions hit by exogenous shocks. In the absence of viable opportunities, or because of policy failure, public intervention might end up "prolonging the agony" of a region and delaying its recovery by hampering the process of creative destruction, which involves abandoning old technologies and opening the way for new ones.

Inaction is, of course, not a solution either for agglomerations or other regions. A failure to intervene could well lead to declining efficiency. The centre might be constrained in its development, the potential of the periphery might be wasted and a region falling behind might lose its knowledge base and even see the erosion of its formal and informal institutions.

In sum, exogenous intervention (or non-intervention) is, therefore, part of the process through which agglomerations come about and the other places develop. As policy-makers have limited knowledge on how and where to intervene, the spatial effects of all national and supranational policies should be made explicit. Because there are strong interdependencies between places, the spatial consequences of exogenous intervention need to be assessed and compared in the context of a comprehensive place-based policy covering all areas. An explicit and visible spatial awareness of exogenous policy intervention can then become a guarantee of accountability, an incentive for more care to be taken in the design of policy and for initiating a learning process for improving the information on which public action is based.

The three economic grounds together provide a strong case for efficiency-enhancing, spatially-aware, pro-active exogenous intervention. They apply to all types of area, both urban and rural. They are particularly relevant for lagging regions which are especially prone to be stuck in "underutilisation traps" (or "poverty traps"[74]), since all three can be at work: institutions are often lacking, the power of elites tends to be greater (due to weaker democratic participation) and there is in many cases an outflow of capital and labour.

There is, however, a special case, a particular type of area for which an efficiency-enhancing exogenous intervention can make economic sense but which is not aimed at increasing the capacity utilisation of the region: *depopulating regions of collective interest*.

There are two features which characterise this type of area. First, they have *no unused potential*, because there are either no comparative advantages or because a deliberate choice has been made

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will scatter across the countryside", but "in recent years … millions of farmers have lost their land to relentless urban expansion (local governments have profited massively from selling appropriated rural land to developers)", while rural healthcare schemes were being "rolled out across the country"; therefore, "millions of jobless migrants may well remain in cities, if not protesting then at least pushing up crime rates". What will actually happen is hard to predict, but one thing is already sure: "President Hu Jintao has ... announced big increases this year in agricultural subsidies". Failure to acknowledge in time the spatial effects of intervention and the screen of spatial-blindness can not only have negative social consequences, but they can reduce flexibility and ultimately give rise to anti-market policies.

[73] See for example the case of French spatial planning policies of the 1960s and 1970s: the OECD Territorial Review of France argues that the relocation of public research centres outside the Paris metro-region, pursued in the name of balanced development, is partly responsible for the region falling behind its main EU competitors in innovative capacity.

[74] For a survey, see Azariadis, C. and Stachurski, J. (2005).

not to exploit the potential advantages which exist in order to preserve "irreplaceable resources" or diversity. This might be the case, for example, for remote islands or mountainous areas or those with extreme natural conditions. Second, there is *national or international interest in ensuring the economic and social viability of the local community there* as a way of preserving the environment. In such special cases, it is justifiable for the national or international community as a whole to compensate people for living in the area through paying them subsidies. This can be efficiency-enhancing when it increases overall well-being.

Intervention focussed on integrated bundles of public goods and services

The rationale for exogenous intervention suggests that it should not focus on financial transfers to firms and individuals but rather on the provision through conditional grants of integrated bundles of public goods and services. These comprise goods and services traditionally provided by the public sector due to market failure, such as law and order, education, training, basic research, water supply and waste disposal, business support, transport and healthcare. The peculiarity of the place-based approach is that they are provided in (integrated) bundles as a result of an exogenous intervention. There are three justifications for this.

First, raising the quality of the services concerned can directly affect the productivity of business investment and the quality of life of those living in an area, which can influence inflows and outflows of skilled labour and innovators. To be most effective, however, the provision of different kinds of goods and services needs to integrated since there are strong externalities, in the sense that the effects of one service depends on other services being provided. The effectiveness of an improvement in the business environment, for example, depends on the education and training programmes available as well as the health and social services; the effectiveness of an urban renewal project depends on the transport system, business support services and so on. Exogenous intervention should, therefore, be aimed at providing bundles of public goods and services.

Secondly, in lagging regions especially, an essential part of the exogenous intervention consists of building or strengthening both formal and informal institutions, which has more chance of involving local actors and of changing expectations if it is clearly being undertaken with a view to improving general well-being. The process of improving public goods and services in a place creates the context for changing institutions and encourages the commitment of people necessary to do this. The provision of public goods and services reduces uncertainty and helps to provide a focal point around which coordination and cooperation are more likely to take place[75].

Thirdly, public goods and services can promote entrepreneurship and innovation by providing "real services" to small firms – by improving the business environment through facilitating access to external markets, managerial training, ensuring technical standards and access to credit and so on. Promoting research in places where it is already close to the technological frontier and adapting the knowledge base to new technologies in other places can also be a strategy with high returns.

These justifications lead on to the last question, which is why these interventions should be place-based.

The rationale for place-based interventions

In the international debate on growth strategies and public governance, there has been a growing recognition that "one size does not fit all". Economic institutions need to be designed and shaped, on the basis of general principles, to suit the local context and to embody local knowledge.

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[75] See Seravalli, G. (2006).

Given the main functions that institutions need to perform, it has been observed that the "first order economic principles do not map onto unique institutional arrangements", that each objective "can be achieved in a large number of different ways" and that "the art of reform consists in selecting appropriately from a potentially infinite menu of institutional designs"[76]. Local knowledge is necessary to determine the institutions for a particular place. Since institutions capable of supporting a "healthy, sustainable market-based system" are "highly specific to local conditions" and "contain a high degree of tacitness" (i.e. much of the knowledge they require cannot be transferred as a blueprint), local knowledge needs to be exploited and "participatory political institutions [can be thought of] as meta-institutions that elicit and aggregate local knowledge and thereby help build better institutions"[77].

A similar point was made by the Growth Report prepared in 2008 by a Commission of policy-makers and academics, which reviewed the role of government in 13 post-war, fast-growing developing economies. Among a range of prescriptions[78], the Report warned not to "resist the market forces that pulled people into the urban areas", and stressed the need for local capacity to promote "a process of self-discovery" to allow local economies to make the most of their comparative advantages.

In practice, the previous references use the term "local" to mean "national". The same reasoning, however, applies to sub-national economic institutions. Institutions need to be tailored to the context where they are providing largely local services (water, waste disposal, local transport and so on) or higher level services (such as education, research and innovation, law and order) the effectiveness of which, it is now understood, strongly depends on them being adapted to places. This applies still more to those formal and informal institutions that are a prerequisite for development: there is no general recommendation for building trust or social capital, which needs to be designed place by place. But the information which is necessary for such adaptation is not held by the public authorities exogenously intervening, whose know-how concerns general principles and the design of system for extracting local knowledge. Instead it is local actors who have the information needed for this and on the preferences that should guide the development of institutions.

This is where the place-based concept allows a step forward to be taken from traditional development policies. It does not assume that the exogenous State knows better. Instead, it allows for information being incomplete and designs a method for reducing the degree of incompleteness. It requires local knowledge to be "elicited and aggregated" and then combined with global knowledge (the routines and engineering know-how embodied in the provision of any public good or service).

However, in order to get local actors to reveal information and their preferences (regardless of whether they are members of the elite or not), the exogenous intervention must encourage their active involvement. This means making it convenient and rewarding for them to make the effort, to take the risks associated with revealing their views; to cooperate among themselves; to develop new beliefs, build trust and to encourage participation in the democratic process. If this is successful, it can facilitate a positive combination of public and private investment. For supra-local policy-makers, the challenge is to achieve this outcome while retaining a role of guidance, assistance and monitoring. By following a common approach in different places, they can make it possible to compare experiences and initiate a process of institutional learning.

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[76] See Rodrik, D. (2005).
[77] See Rodrik, D. (1999).
[78] In particular: communicating a "vision of the future and a strategy for getting there"; making long-time commitments; facing up to the "economic upheaval that growth can entail"; "be inclusive, leaving citizens confident that they and their children will share in the benefits"; implementing impressive rates of public investments in infrastructure, education and health. See Growth Report (2008).

A further reason for a place-based approach is that the strong interdependencies which exist between different public goods and services can only be fully exploited at a local level through the active involvement of local actors and their knowledge. The integration of public goods and services is a task for to be attempted place by place.

Policy risks

In sum, it is evident that there is a strong case for place-based development policies aimed at increasing efficiency. Of course, as noted above, such policies are difficult and risky, but they are less risky than policies whose spatial effects are not made explicit – than "spatially-blind" policies generally advocated by elites who do not have to account for their efficiency effects. Place-based policies are also less risky than policies simply involving the financial redistribution of resources from richer to poorer regions which often end up benefiting existing "*rentiers*".

Nevertheless, place-based policies tend to involve higher management costs than other policies. These can be justified only if they deliver better results, which may not occur if interventions are not accompanied by effective means for mobilising local actors, eliciting knowledge and preferences, and obtaining more complete information. Moreover, they too can end up being captured by local elites.

In this case, several negative effects can result[79]:

- investment being favoured in activities which are inappropriate and are not in line with either actual or potential comparative advantage[80];

- regions being sheltered from markets, creating a dependency culture, where in the name of generating "structural change", regions come to rely on transfers, which in the medium-to-long-term can mean disparities bring widened;

- responsibility for guiding and monitoring being abdicated in the name of subsidiarity, entrenching existing elites by propping up ineffective institutions and fuelling rent-extracting machines;

- a failure to develop, at local level, the right balance between promoting "openness to new ideas and agents" and giving enough certainty to businesses and individuals who commit to investing in the process;

- a failure of coordination, with under-provision of some public goods and services and over-provision of others[81];

- labour mobility being impeded, agglomerations being prevented and overall efficiency being reduced.

Note that some of these negative effects are the same as those underlined in current criticisms of cohesion policy[82] and brought to light by the World Bank (2008). The difference is that in the

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[79] For some of these risks, see the Report Working Paper by Farole, T., Rodríguez-Pose, A. and Storper, M. (2009).

[80] "This is particularly likely where regions adopt policies that are not based on localised sources of comparative advantages and/or where they attempt to replicate wholesale that which has been successful in other regions (e.g. the plethora of would-be "Silicon Valleys")", as Farole, T., Rodríguez-Pose, A. and Storper, M. (2009) put it.

[81] Lack of coordination across places will cause an under-provision of public goods and services with strong externalities outside the place, while it will cause over-provision if each place does not take into account the effects of other places providing similar services (e.g. multiplication of projects for the promotion of amenities for a limited tourist market, etc.).

World Bank report these effects are seen as the consequence of spatially-aware policies, while the present report regards them as the consequence of the bad implementation of any policy with spatial effects (which, as argued here, includes most policies, whether they are labelled as spatially aware or not).

This highlights how relevant implementation is for an efficiency-enhancing place-based policy. The issue of governance, therefore, comes to the fore and this is considered in section I.2.3 below, which sets out the means for assessing the implementation of cohesion policy.

I.2.2. The equity (social inclusion) objective

It is uncontested that achieving an equitable distribution of well-being is one of the objectives of governments. There is also increasing agreement that development is about both efficiency and equity, and that public action, at whatever stage of development of an economy, should address social problems[83].

In Europe, pressure has mounted for greater attention to be given to social issues at EU level[84]. A concern is that high and rising inequality, and increasing fear of globalisation, could jeopardise economic integration (*market-compensating motivation*). Another is that national welfare systems are increasingly constrained by EU budgetary rules (*political-economy motivation*). A third is that the EU's existence is based on the expectation that citizens should enjoy equal rights (*federal motivation*). The failure to reduce inequality in several European countries, and its rise in others, are signs of the extent of the problem[85].

The question relevant for this Report is not "whether" but rather "how" governments should pursue equity objectives. In particular, the issue is whether there is a rationale for inequality to be tackled by a place-based development policy rather than by financial transfers to people independently of where they live. Before addressing this question, it is first necessary to clarify the concept of inequality and to define the policy objective[86].

Multidimensionality and social inclusion

There is widespread agreement that no single dimension can capture a person's well-being and the degree of inequality.

A life worth living, including the opportunity both to achieve what an individual considers relevant and to widen her or his set of options, embraces labour skills, health, education, housing, security, income, working conditions, self-respect, a role in decision-making and so on. Income is a relevant component of these dimensions but it does not reflect them all, as empirical data confirm[87]. Income is one factor in achieving well-being, though it cannot achieve many aspects

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[82] See for example Guido Tabellini's comments in the Report Hearing Paper on Growth.

[83] As the 2008 Growth Report put it: "the economy's progress maybe jeopardised by divisive politics, protests, and even violent conflict. Again if the ethical case [for a commitment to equality of opportunity] does not persuade, the pragmatic one should". A similar concern for the US has been repeatedly expressed in recent years by The Economist with reference to the extraordinary increase in the inequality of income in the upper tail of the distribution. It will be argued below that an efficiency motivation can, however, a policy for equity.

[84] See the Report Hearing Paper on Social Inclusion.

[85] See Atkinson, A.B. (2008a), Brandolini, A. and Smeeding, T.M. (2009).

[86] For the following, see also the Report Working Paper by Barca, F. (2009a).

[87] The relevance of looking at multidimensional features rather than only at income in measuring inequality can be appreciated by examining the results of the First European Quality of Life Survey. Income deprivation turns out to predict quite well the ranking of people according to a composite index of several forms of deprivation, at least if EU countries are grouped by income and individuals are grouped into quartiles. But it turns out that the countries would be grouped differently if income is ignored and other dimensions are used: in particular, Spain, Malta and Cyprus would be included in a higher group, Greece

of well-being and, accordingly, cannot be seen as an end in itself. Amartya Sen's capability approach makes clear that the capacity of any individual to convert a given amount of any "commodity", including money, into achievements that are relevant for their life depends on a combination of (social and physical) circumstances and on access to other "commodities" often produced by policy. Indeed, several dimensions of well-being strongly depend on public institutions performing essential tasks and provide public goods and services. These different dimensions are also interdependent in terms of their effect on well being[88].

This multidimensional perspective is gaining increasing acceptance, as documented by the findings of the OECD mind-opening "Global project to measure the progress of societies"[89]. It has long been adopted by the European Union in promoting, through the Social Protection and Social Inclusion Process, the commitment and cooperation of Member States to reducing inequality[90]. This political and methodological debate has utilised the concept of "social inclusion", which includes access for all citizens to basic resources, social services, the labour market and the rights needed "to participate fully in economic, social and cultural life and to enjoy a standard of living and well-being that is considered normal in the society in which they live"[91]. Together with the multidimensional approach, this concept also embodies both a threshold and an interpersonal notion of inequality and focuses strongly on the process through which greater equality is pursued.

Building on this perspective, the academic debate[92] and various international policy Reports[93], it is possible to develop an operational definition of *social inclusion*. This can be defined as *the*

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and Portugal in a lower one, closer to Romania. Moreover, for some dimensions (particularly those affected by the provision of public services), the ranking of countries would be radically different from that suggested by income.

[88] As an example, it is worth considering three dimensions which are relevant, say, for a migrant worker: services or rules for access to the labour market; level of competence; and social norms affecting worker "acceptance". Concentration on any one of these dimension could be misleading. Observing or guaranteeing fair labour rules might not avoid the other two factors bringing about serious inequalities. The provision of income transfers as a compensation for lack of work might, on the other hand, produce very different results, even increasing inequalities, if the other two factors strongly influence the capacity to use those financial resources appropriately.

[89] See the website www.OECD.org/progress. See also Giovannini, E., Hall, J. and Mira d'Ercole, M. (2007). In June 2007, at the Istanbul World Forum, the European Commission, the OECD, the Organisation of the Islamic Conference, the United Nations, the United Nation Development Programme, and the World Bank signed an "Istanbul declaration" observing that "an emerging consensus on the need to undertake the measurement of societal progress in every country going beyond conventional measures" and urging "statistical offices, public and private organisations and academic experts to work alongside representatives of their communities to produce high quality facts-based information that can be used in all of society to form a shared view of societal well-being and its evolution over time". See also the documents presented at the conference co-organised with the EU Commission and Parliament, in November 2007, "Measuring Progress, True Wealth, and the Well-being of Nations". The Commission President Manuel Barroso remarked how unsuited GDP is to account for climate change and the environment, while Commissioner Joacquìn Almunia observed that "… [GDP] should not be considered as a benchmark of the overall progress of a society. … There is a clear need to find measures that go beyond GDP."

[90] On this, see Marlier, E., Atkinson, A.B., Cantillon, B. and Nolan, B. (2007).

[91] See in particular the definition of social inclusion provided in the 2004 Joint Report on Social Inclusion (p. 10).

[92] See the Report Working Paper by Omtzigt, D.J. (2009).

[93] Together with the definitions suggested in the 2004 Joint Report on social inclusion, see in particular: Marlier et al (2007), the policy-oriented volume developed out of the 2005 Report on social inclusion; a Report on "social cohesion" prepared for the Council of Europe (2007); a model developed in the context of the World Bank reporting activity in order to define the concepts of "equity" and of "equitable development policy"; an independent Review (Fairness and Freedom: the Final Report of the Equalities Review, 2007), commissioned by the UK Government into the causes of persistent inequality in British society, which draws on Amartya Sen's capability approach.

extent to which, with reference to multidimensional outcomes, all individuals (and groups) can enjoy essential standards and the disparities between individuals (and groups) are socially acceptable, the process through which these results are achieved being participatory and fair.

This definition captures both a threshold and an interpersonal concept of inequality: a *threshold concept*, where the achievement of society consists of guaranteeing everyone some *essential standards*, which depend on (evolving) social preferences and attitudes[94]; an *interpersonal concept*, where the achievement of society consists of ensuring that *disparities* between individuals (or groups) are socially acceptable. The two concepts are complementary but distinct. When disparities are reduced, the proportion of people falling under the threshold could increase and, conversely; when the essential standard is achieved by a growing proportion of people, disparities could increase.

The reference to *"a participatory and fair process"* captures the idea that both the dimensions and the thresholds used in defining social inclusion must be established through a democratic process, in which everyone is given a chance to form an expectation and to voice it, information is exchanged, public scrutiny and criticism take place; and a consensus emerges on which dimensions are relevant and what is "essential"[95]. This is the condition for making local choices more informed and in line with people's preferences and for allowing citizens and collective local actors the freedom to experiment with solutions while exercising mutual monitoring[96]. *Multidimensional outcomes* should identify *people's substantive opportunity to live according to their values and choices and to overcome their circumstances*. The reference to circumstances underlines that social inclusion policies should focus so far as possible on those factors that are outside the control of the individual[97]. These include both personal characteristics inherited or acquired through life (gender, physical traits, social background, etc) as well as contextual factors, including the functioning of public institutions, which can affect everyone, or particular *groups*, sharing certain features (religion, culture, outlook, etc).

On this basis, a "place-based policy aimed at social inclusion" can be defined as[98]: a territorial strategy for improving social inclusion, in its various dimensions, through the provision of public goods and services, by guaranteeing socially agreed essential standards to all and by improving the well-being of the least advantaged.

What is the economic rationale for such a strategy? Why is an exogenous intervention in a place needed in order to promote social inclusion? Why, if an exogenous intervention occurs, should it be centred on public goods and services? And why should the adaption and implementation of the policy be left to the local area?

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[94] The idea that individual deprivation should be defined with reference to a threshold determined on the basis of what is "customary or at least encouraged and approved in the societies in which [individuals] belong" dates back to the 1960s and later to Townsend (see Townsend, P. (1979)). See also Omtzigt, D.J. (2009).

[95] See Sen, A. (1999).

[96] See Cohen, J. (1996); Dorf, M.C. and Sabel, C.F. (1998); Rawls, J. (1999).

[97] See Bourguignon et al (2007). This emphasis corresponds to the idea that those differences in outcome and opportunities among people that depend on their effort should not be a primary public concern. It also springs from awareness of the negative effect that addressing differences due to efforts could have on the efforts that people make themselves, since their incentive to address their condition through personal effort might be reduced if they know that a collective/public effort would be made anyway to achieve the same result. Policy-making must be aware of this tension and address it, but it should not expect to solve it easily. The features of a person's life which are "independent of choice" at any given moment include not only those which they inherited from the previous generation but also those which were the result of irreversible choices and efforts the person made during their life, while the same effort can produce very different circumstances according to external, non-controllable factors.

[98] On the ordering of the threshold and interpersonal objectives and on the focus on the well-being of the "least advantaged", see again Bourguignon et al (2007).

The rationale for exogenous spatially-aware public interventions …

In general, as for efficiency, an exogenous intervention aimed at improving social inclusion is warranted if a situation of "inadequate"[99] social inclusion (either in terms of the number of people below a threshold or in terms of interpersonal disparities) is persistent because economic and social forces are not able to change it. In other words, there is a "social exclusion trap"[100], where social exclusion is defined as the converse of social inclusion[101]. There four main reasons why such a trap might arise.

- The first is the same as for an under-utilisation trap: the strong path-dependency that characterises formal and informal institutions, which can explain why *a whole place* or region fails to develop, socially excluding most of its citizens:

The other three can produce persistent inequalities *within a place* while the place as a whole might be thriving:

- *Circumstances are transmitted inter-temporally* from one generation to the next and they tend to reproduce the same distribution of opportunities or lack of them.

- *Outcomes depend on past outcomes*, so that individual efforts are not independent of what happened in the past and, therefore, past outcomes tend to be perpetuated[102]. This effect is particularly strong when the repeated failure to achieve results by a group leads it to develop a self-deprecating belief.

- Third, *policy and institutions can themselves depend on past outcomes*. As noted above, the political power to choose economic institutions depends on the political institutions in place and the allocation of "*de facto* power", which, in turn, depends on the distribution of resources. Elites which hold political power tend not to select institutions appropriate for economic efficiency when this would reduce their share of resources. Instead, they tend to make policy choices which maintain or increase their share. By so doing, they initiate a process through which political and economic institutions reinforce each other and inequalities are perpetuated (and which, as noted above, might also produce inefficiency). It is equally likely to lead to the provision of public goods and services being distorted[103].

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[99] "Inadequate" is obviously a social concept depending on the social preferences and attitudes of the society which change over time.

[100] This definition and some of the motivations again closely follow those suggested by Bourguignon, F., Ferreira, F.H.G. and Walton, M. (2007), for the one-dimensional concept of equity.

[101] On the conditions for this to be appropriate, see the Report Working Paper by Barca, F. (2009a).

[102] For example, being born the daughter or son of the manager of a particular firm enables them to acquire knowledge of how to manage the firm; all other things being equal, which will make them more "indispensable" (in the sense of Oliver Hart's theory of the firm) than others, make it efficient for the them to be in control of the firm, which will create an incentive for more effort, which in turn will produce a higher outcome.

[103] A particularly revealing example is offered by the development of Istanbul. As clearly set out by Caglar, K. (2005), in the first phase of the very rapid development of the city and of the large inflows of migrants, social inclusion came about as the result of a very high demand for labour, the accumulation of capital that immigrants could achieve by appropriating land and *de facto* becoming owners of their dwellings, and the influence they exerted through their networks on the decisions made by the political elite concerning the provision of public goods and services (populist developmentalism). Since the mid-1980s, there has been a change in the composition of migrants, from those coming from areas with which Istanbul had traditionally traded to those from eastern and south-eastern provinces hit by a severe crisis, where often there was "no place to go back". In this context, three changes took place: demand for labour became more volatile; massive inflows of capital shifted the behaviour of the elites from allowing "illegal appropriation" and the ex-post provision of services to planning in partnership with the land-owners, and putting a halt to the accumulation of capital by immigrants; the informal networks did not survive the rapid

These three factors tend to complement and compound each other. In particular, reversing the influence of intergenerational transmission and of past outcomes would require a strong political willingness to do so that the third factor tends to makes unlikely.

Whatever the reasons for the social exclusion trap, overcoming it requires a move away from endogenously determined choices. This change can sometimes take place because "political equilibria shift sufficiently to bring in governments – or reform groups within governments – that want to pursue"[104] change. Alternatively, change requires an "exogenous intervention" by an external institution with enough power, capacity and credibility to promote internal action.

Interventions focussed on integrated bundles of public goods and services

There are two main reasons why a spatially focused social inclusion policy should concentrate on the provision of integrated bundles of public goods and services.

First, several dimensions of well-being are largely determined by the success or failure of public institutions to provide public goods and services. Accordingly, exogenous effort should be concentrated on the goods and services concerned: healthcare, education, housing, law and order, working conditions, transport services and so on. It should also be aimed not only at making these services available but at ensuring that people are able to access them and so can benefit from their provision: learning from education, availing themselves from the public transport; etc. In order to achieve this result, the active participation of the potential beneficiaries is necessary. By aiming at bringing all individuals above a given threshold, this approach also avoids the limitations of policies targeted at the "really needy", and the recreation of a section of society labelled "poor". But it leaves open the question of how to choose the relevant dimensions and how to set thresholds (see below).

The second reason is that, as in the case of exogenous efficiency-oriented interventions, informal and formal institutions – the deficiencies of which might give rise to a social exclusion trap - have more chance of being built or strengthened if tangible results in terms of public good and services are being delivered. These results become the means through which the ultimate goal of institution building is achieved.

The rationale for a place-based policy

An exogenous social inclusion policy must be place-based because the nature of social exclusion and the effectiveness of any intervention to combat this are influenced by the "place" in which a person happens to leave. In the inequality literature, this fact is generally recognised only as regards the immediate group within which an individual lives - the household. However, the circumstances and well-being of individuals are also influenced by the wider territorial community with which they interact, including its natural and cultural resources and public institutions.

In the first place, the measurement of social inclusion needs to take "place" into account. Although the well-being of individuals is influenced by a range of factors – their social background, the tacit or formal knowledge they have acquired, their gender and the socio-cultural group to which they belong – the nature of this influence will depend on the place they live and the community with which they interact. The extent to which individuals are satisfied with their innate or acquired characteristics is also often place-dependent, as are their preferences – indeed, as noted above, they partly define what a "place" is. Equally, account must be taken of the fact that, for most people, the returns they obtain from their efforts depend on their circumstances

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urban development. This has resulted in a very strong increase in social exclusion, captured by an increase in the Gini coefficient between 1984 and 1994 from 0.43 to 0.58.

[104] See Bourguignon et al (2007).

which in turn are related to the place they live. Their skills, therefore, are often closely linked to other people or the resources with which they work

Secondly, the two institutional causes of social inclusion traps are very strongly context-dependent. Decisions on the provision of key public goods and services that influence social inclusion tend to be made by local elites, which means that social deprivation is likely to show a marked spatial pattern, while informal and formal institutions are also strongly context-dependent.

Existing, if limited, data available for Europe confirm that inequality and social exclusion are spatially concentrated. The polarisation of income inequality is not well captured by disparities in per-capita income between regions (defined at the NUTS 2 level), since this occurs at sub-regional level[105]. Spatial concentration of social exclusion occurs in "pockets" both in urban, suburban or rural areas, which are often adjacent to areas with reasonable or even high standards of living[106].

Thirdly, the effectiveness of policy depends on places. The capacity to access services and to make use of social transfers strongly depends on conditions that are context-dependent. The design of interventions needs to take account of the "technological links" between people and places, since the productivity of a person often depends on the context, or environment, in which they work[107]. The effectiveness of any given "sectoral" intervention aimed at a particular aspect of well-being depends on other "sectoral" interventions being made in the same place. The local level is, therefore, where the integration of bundles of services occurs.

Fourthly, on the operational side, the ability of place-based policies to mobilise local actors and to give them the opportunity to experiment with solutions, exercise monitoring and participate in counterfactual impact evaluation can enable three fundamental problems regarding the implementation of social inclusion policy to be tackled.

- *Choice of dimensions and indicators*. Risks of paternalism, of the selection of both dimensions and indicators not reflecting people's preferences, are always prevalent. They can be reduced in the context of place-based policies by an experimental approach where the actors are mobilised and exercise monitoring on the selection made. A guarantee that indicators satisfy a number of prerequisites is also necessary[108].

- *Choice of thresholds*. The opposite risks exist on the choice of thresholds, the issue being to rely only on the subjective judgements of individuals on whether and how much they are deprived (since subjective measures reflect a "gap between expectations and realities" and "expectations may adapt … in response to the realities of one's life situation"[109]) or on standards established in an elitist way from outside, based on academic, or policy-maker, analysis. A "participatory and fair process" can take the best of both, by drawing on external assessments as well as eliciting individual preferences, and by giving people the opportunity to develop views on their rights and to revise their expectations.

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[105] See Förster, M., Jesuit, D. and Smeeding, T. (2005).

[106] For example, the most prosperous Polish Region – Mazowieckie – is also the one with the third largest internal disparities in GDP per head across OECD Regions: see the OECD Territorial Review of Poland.

[107] If a person's abilities are highly embedded in the place where they live, any intervention promoting exit can be costly in terms of their productivity and so of their capacity to live well. On the other hand, if for some aspects of well-being their abilities are particularly suitable to a different location, promoting exit can improve their well-being.

[108] As has been made clear in the EU Process of Social Inclusion, indicators that are used to focus public debate must satisfy a set of pre-requisites: presenting a "clear and accepted normative interpretation", being "responsive to policy intervention", being statistically validated, etc. See Marlier et al (2007), pp. 40-42.

[109] See Marlier et al (2007).

- *Dealing with information incompleteness*. The information needed for policy-making is very incomplete – on individual opportunities and outcomes (which tend to be approximated by indicators that capture only some of the relevant features), on whether the conditions exist for a social exclusion trap and on how to bring about change. A cautious, participatory and experimental approach, with appropriate use of impact evaluation, can improve the "revelation process" (as regards both knowledge and preferences) and gradually reduce the information gap.

In short, a place-based approach can make the promotion of social inclusion and any social agenda much more operationally effective.

The linkages with efficiency

How should a place-based policy for social inclusion deal with efficiency? Should the two objectives be tackled together through the same interventions? Or should separate interventions be designed, as part of the same strategy, to pursue efficiency and social inclusion objectives? The issue is particularly relevant considering how often, both in general and in the European public debate, it is assumed that equity and efficiency can be pursued together.

There is a fallacy which needs to be addressed first, namely that the social inclusion objective is integrated in the efficiency objective. This is often claimed, or assumed, in the debate on EU cohesion policy by interpreting a reduction in the disparity in GDP per head between lagging regions and others as signifying both increased efficiency and reduced inequality. In fact, a reduction in disparities need imply neither of the two. In the case of efficiency, a reduction in regional disparities can occur in a context in which growth in all regions is falling below its potential and inefficiency is increasing. As regards inequality, even setting aside the issue of differences between GDP per head and income per head as a result of commuting or transfer effects[110], a reduction in disparities can go together with increased income inequality, if inequality within lagging regions is increasing – something which can occur with increased growth. In any case, a reduction in income inequality says nothing about what is happening to other aspects of well-being.

At the same time, it is clear that synergies can exist between the two objectives. These arise, first, from the common underlying causes of under-utilised potential and social exclusion traps. Building formal and informal institutions for promoting development - more agency, more social capital and more democratic participation in decision making - can boost both efficiency and social inclusion. In particular, social inclusion policy interventions aimed at strengthening the awareness or capacity of local communities can also give rise to a shift of political balance towards reform groups that are interested and willing to promote agglomeration effects which increase the incentive of local individuals to increase their own efforts. At the same time, reversing a policy of public goods and services provision chosen by a local elite in its own interests can enable economic institutions to be selected which are more suitable for growth. A classic example is education, where more investment in those in the lower tail of the distribution can increase "human capital" and growth. (A positive link of this kind between social inclusion and efficiency is often referred to in the European debate as a "market-strengthening linkage"[111].)

Synergies can also arise as a result of the negative effect of social exclusion on efficiency and growth. A high level of inequality is seen as a cause of social and political instability that can disrupt economic and labour relations and raise uncertainty[112]. It is also seen as a cause of

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[110] For an assessment of these effects see Applica (2008), chapter 4, table 4.1.

[111] See for example the March 2008 EU Joint Report on social protection and social inclusion process, where it is argued that "well … designed social inclusion policies are productive factors" and that addressing the social inclusion of children "helps the future generations develop their full potential hence enabling them to contribute more to society and the economy".

[112] See for example Alesina, A. and Perotti, R. (1996).

disruptive redistribution policies which can reduce incentives to invest[113]. In a similar fashion, rising inequality, brought about by a rapid innovation-driven shift of resources between sectors and firms, can produce resistance to innovation itself. Reducing social exclusion can then be beneficial for efficiency. This "market-compensating" view of social policy is widely deployed in the EU debate, while a stronger EU social agenda is also advocated in order to avoid jeopardising economic integration and monetary unification, or as a condition for accelerating Schumpeterian creative destruction.

However, whether the conditions hold for these synergies to operate depends on specific situations – on how institution building develops, on the new public goods and services provided and on the kind of policy actually implemented. It also depends on whether the trade-offs between social inclusion and efficiency, which also exist, are more or less relevant.

A trade-off can arise, first, because greater social inclusion changes the balance of negotiating power among parties. It is, therefore, likely to make some people worse off and reduce their effort; if the resulting losses are greater than the gains from the higher effort of others, then a trade-off arises. Secondly, it can result from the separation of circumstances and effort, in the sense that policy measures which address the circumstances that cause disparities or social exclusion can end up reducing the incentive for effort, so reducing efficiency. Thirdly, when there is limited labour mobility, attempting to reduce inter-regional inequality of income can have negative effects on agglomerations and reduce overall efficiency[114]. In all these cases, whether the effect concerned is important or not is again an empirical matter.

In a place-based strategy, no general presumption can be made, therefore, on whether an intervention intended to pursue one objective will have a positive, or negative, effect on the other. Instead, for any intervention, there is a need to state the primary objective – either efficiency or equity – and then to assess the likely effect on the other objective.

Such a strategy is supported by a further consideration. Even if a given intervention for social inclusion in a given place has a net positive effect on efficiency, it might not be the intervention that would be adopted if efficiency were the aim, at least in the short and medium term. It could well be the case, for example, that from an efficiency perspective, the best intervention for a backward area suffering from both under-utilisation of potential and social exclusion is to strengthen the business environment, through, for example, supporting a productive group of innovators, with limited (or even negative) effects on inequality. From a social inclusion perspective, the best intervention for the same area could be the provision of public goods and service to bring as many people as possible above a given threshold for some dimensions of well-being, with limited effects on efficiency. There could obviously be synergies between the two in the long-term, but the longer the time horizon, the greater the lack of solid information on final effects and of the possibility of measuring results.

Three lessons can be drawn from this cursory review of the linkages between social inclusion and efficiency.

- First, no general relationship can be taken for granted and empirical investigation must always be conducted to monitor the relationship place by place.

- Second, even if a social inclusion agenda were to be adopted with an efficiency justification – according to a market-strengthening or a market-compensating perspective - policy choices should be made by referring to the social inclusion objective alone.

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[113] See for example Benabou, R. (1996).
[114] See Martin, P. (1999).

- Third, the two objectives should generally be pursued through the same strategy but through separate interventions.

Two opposite policy risks and how to move ahead

From the above it can be concluded that there is a strong case for a place-based development policy aimed at social inclusion. Such a policy, however, is difficult and it entails all the risks of a policy of this kind aimed at efficiency. A further risk can arise.

Traditional social policies often focus on individuals without taking account of the fact that their well-being and the effectiveness of policy strongly depend on the place where they live. Accordingly, there is tendency to follow what might be described as a *de-contextualised individual approach*, often with a strong non-egalitarian bias. At the same time, place-based policies can make the serious mistake of referring to places almost as if they had a "preference function", a well-being of their own with the consequences for individuals getting lost. The gap between the average well-being of a place and other places is then taken to represent the "inequality" of the people living there; and the policy for reducing the gap is termed "social". A policy which focuses on places without adequately taking account of the individuals who live there can be described as a *depersonalised place-based approach.*

The failure of the social and territorial agenda to be linked with each other is reflected by the lack of data and of studies that combine and compare information on the interpersonal distribution of income (or specific features of well-being) with information on regional disparities (either in terms of income or other features)[115].

A new combination of the social and the territorial agenda is therefore required. The social agenda needs to be "territorialised", the territorial agenda "socialised". The place-based approach to social inclusion should be the result of these two shifts.

I.2.3. Corollaries: avoiding common misconceptions

The clarifications on the "new paradigm of regional policy" in the previous two sections enable some common misconceptions on spatially-aware development policies to be addressed. They can be reviewed under seven corollaries which will then form the basis for assessing how close cohesion policy is to the new paradigm.

<u>The first misconception</u> is that, as efficiency and social inclusion objectives require a similar approach and synergies exist between the two, a place-based development policy can pursue both through the same intervention. While the policy can address both, in general they should be pursued through separate interventions.

A place-based development approach is suitable for tackling both objectives as under-utilisation of potential and social exclusion have many similar causes. Since strong synergies can be exploited in tackling the two objectives and since, as Joseph Stiglitz puts it, "there is not a neat separation between efficiency and distributive issues"[116] and each policy intervention often has both an allocative and a distributive effect, a comprehensive, place-based development strategy can appropriately pursue both objectives at once. There are three arguments, however, for the two objectives to be pursued through dedicated and visibly distinct measures.

- Information is too incomplete to assess the extent of synergies and trade-offs between objectives in advance and, accordingly, to design catch-all interventions.

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[115] On this issue, see the Report Working Paper by Monfort, P. (2009). See also section II.3.1.
[116] Stiglitz, J. (1989).

- The best option for achieving one objective is often not the best option for achieving the other.

- Mixing the two objectives reduces the accountability of both and the opportunity for public debate. It also increases the scope for local rent-seekers to pursue their own agenda. When policy-makers are fuzzy about objectives and claim that both efficiency and equity can be pursued, rent-seekers have an easier task of justifying interventions that suit them but which have no real effects on either efficiency or social inclusion.

The second misconception is that place-based development policies restrict mobility by encouraging people not to move out of places. On the contrary, the virtue of the policy is that it broadens people's opportunities and gives them more substantive freedom of choosing whether to move or not.

If place-based development policies were about reducing mobility, they would be against efficiency and equity, since the option of moving is an important ingredient of both. On the contrary, place-based policies are, in fact, intended to enhance individuals' substantive freedom of deciding whether to stay (and to make the most of staying) or to move (and to make the most of moving). By promoting public goods and services which are tailored to places, as well as enhancing agency, democratic participation and the formal and informal institutions necessary for development, the policies should enable people to make a real assessment of the alternatives open to them and to translate them into action.

The movement of people out of a place can indeed boost both efficiency and equity, but it only does so if migrants improve their productive potential and the scope they have for exploiting it. This is more likely to be the case when outward migration is not the result of strong deprivation pressures and when it offers migrants the opportunity of making a significant step forward in terms of using their personal skills[117]. Encouraging mobility as a "priority" – as the World Bank Report "Reshaping Economic Geography" does (see in particular p. xxii) – is based on the mistaken assumption that "the state knows better". Choices must always be made case-by-case and the information which informs these choices tends to be very incomplete. Accordingly, the appropriate general principle is to give individuals the capacity freely to assess whether to move or to stay and to adopt policy measures in line with this – which implies a place-based approach based on conditional grants.

There is one special case when place-based development policies should aim at enabling people to remain in a place, that of "depopulating regions of collective interest" (see section I.2.1 above). If there is a wider interest in maintaining population in a region and/or in preventing its resources from being fully exploited, then there is an efficiency rationale for compensating people for not moving out (and encouraging others to move in).

The third misconception is that place-based development policies act as a constraint on "natural" agglomeration processes by inhibiting or distorting market forces which would otherwise operate freely. This is not the case, since the alternative to visible spatially-aware policies is not free market forces but spatially-blind policies which are more likely to underuse information and to be captured by private interests.

Any agglomeration process, networking between places or episode in the development of a place is invariably the combined result of both public and private actions. Some public actions are the

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[117] When skills are closely tied to local immobile resources or to other local skills, their return in other places (although greater than their return in the place of origin if no improvement there were to take place) could be lower than their return in the place of origin if local conditions were to change. The same loss of productive potential and opportunities can arise when people, pushed by deprivation at home, have "no choice", but to leave and they then perhaps contribute to conditions of social unrest in the urban areas to which they move.

result of decisions taken elsewhere in the form of region-specific public investment or particular forms of country-wide institutions, public services and regulations (relating to land use, education, healthcare, water supply, infrastructure and so on). Even in growing agglomerations, what might appear to be a natural, non-State phenomenon is often being fuelled by State intervention. By contrast, under place-based policies, the spatial dimensions of policy objectives and forms of intervention are made visible and open to debate. The alternative to these policies is not the absence of State intervention, since public investment, law-making, regulatory action and so on will still go on, but the lack of visibility, analysis and debate as regards the spatial effects of such policies.

This might not be so important if the State operated with perfect knowledge and was wholly benevolent, neither of which is obviously the case in reality. An explicitly spatially-aware policy is, therefore, preferable. It is likely to elicit local knowledge, so reducing the lack of information, while the greater visibility of policy action, through allowing public scrutiny, makes it more likely that those responsible for exogenous State intervention are not captured by local elites to the detriment of overall efficiency.

The fourth misconception is that place-based development policies entail an in-built trade-off between local objectives and global efficiency. While such a trade-off can arise, it need not do so and the opposite should be the case when efficiency objectives are pursued.

Here, the two objectives of efficiency and social inclusion need to be considered separately. With respect to social inclusion, a trade-off may arise, though not necessarily. As argued above, it depends on whether the various potential synergies are larger or smaller than the various potential trade-offs, which can only be assessed on a case by case basis.

For the efficiency objective (i.e. fuller capacity utilisation), a trade-off would not, by definition, arise if the policy-makers had complete information on the returns to interventions. A place-based intervention would be made only if exploiting unused potential contributed to overall growth of the wider economy more than it hindered it (by, for example, reducing the inflows of people into an agglomeration). If interventions were pursued despite having a negative effect on overall efficiency, it would imply by definition that the equity objective was being accorded priority – in which case the policy decision should be assessed differently, in terms of individual (not average) well-being[118]. In reality, information is always incomplete, and place-based policies can *de facto* end up unintentionally reducing global efficiency, though, for the same reason, failure to intervene could have the same effect. Again, no general claim can be made. This underlines the need for policy intervention to be undertaken with declared, verifiable spatial-awareness and for a cautious approach which is aimed at learning from experience in order to improve the information available.

The fifth misconception is that place-based development policies should focus only on "poor" places or regions. While such regions may be a priority, policy should apply to all regions.

Once again, efficiency and equity objectives need to be considered separately. As regards social exclusion, policies for combating this should be implemented in all places, since it is a problem in rich as well as poor areas. This is evident in the high levels of deprivation, criminality and social tension in many prosperous cities and in the pockets of high unemployment in regions with high productivity[119].

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[118] The intervention would have to be justified in term of its effects on disparities and/or the share of people above relevant thresholds in the place targeted by the policy. This rules out any intervention which is justified in equity terms but is *de facto* aimed at enhancing the returns of very few individuals. This emphasises, once again, the need for a clear-cut distinction between the two objectives.

[119] The data-base of OECD (2008a) shows for example that in half of all metropolitan regions a higher than country-average productivity is coupled with a higher than country-average unemployment rate.

The economic rationale for pursuing the efficiency objective applies most especially to lagging regions, but it can be extended to all regions. Agglomerations tend already to benefit from "the hand of the State" and may have much less need for additional resources. However, there are four reasons for them to be included in a place-based policy. First, as claimed above, this approach increases accountability and can reduce policy risks. Secondly, interdependencies exist which argue for keeping all places in the policy network: Thirdly, policy learning and dissemination effects point in the same direction. Fourthly, comparative advantages can change with remarkable speed and a place which is successful today might well fall behind tomorrow. It, therefore, makes no sense to draw rigid boundaries[120].

The sixth misconception is that "financial redistribution" of resources between places is a necessary and sufficient condition for place-based development policies and that it is a good way of summarising the policy objective. This is not the case: financial redistribution is not sufficient, sometimes not even necessary and the "redistribution" label is misleading.

The redistribution of resources between places is not a sufficient condition for pursuing either the efficiency or the equity objective. The task of place-based development policies is not to compensate for the failure of some places to raise enough revenue from their own sources to finance their development. If this were the purpose, an EU-level regional equalisation fund could be set up, as is common practice in many countries. Instead, the task of such policies is to trigger a change in the behaviour of private actors in regions where either an efficiency or a social exclusion trap exists. The simple transfer of funds cannot get close to doing this and might even worsen problems by creating a dependency culture. Moreover, the persistence of unused potential or social exclusion can occur in regions which do have the capacity to raise sufficient revenue. In this case, a region might receive less in financial transfers from a place-based policy than the funds its citizens contribute (through whatever fiscal mechanism is at work) and financial redistribution is not necessary. For these regions, the return from the policy – if there is one – is its capacity to bring about change through an exogenous intervention.

The term "redistribution" misses what a place-based development policy is actually about for three reasons. First, it evokes "financial redistribution", which, as seen above, is only one part of the policy. Secondly, it highlights a redistributive function when the policy also has an allocative function. Thirdly, once it is coupled with "regional", it hints at the idea of raising the average income of some regions by reducing that of others. This, as noted above, is the objective of equalisation funds and has nothing to do with either the efficiency or the equity objective of place-based policies, which are aimed at fuller capacity utilisation and a reduction of inequalities between individuals rather than between regions.

The seventh misconception is that "convergence" of per-capita income or per capita GDP among places and regions is an objective of place-based development policies which captures their ultimate aim well. This is not the case. "Convergence" is neither a necessary nor a sufficient condition for policy success in pursuing either the efficiency or social inclusion objective, and is a misleading label.

Convergence is not a necessary condition for increasing efficiency. A successful reduction of capacity under-utilisation in lagging regions can take place at the same time as prosperous agglomerations grow faster and disparities between the centre and periphery widen. On the other hand, convergence might occur as a result of a "race to the bottom", with policy failing to have any positive effect in lagging regions and GDP declining in the more prosperous ones. However, the difficulty of measuring the productive potential of an area might mean using the gap in GDP per head as a rough indicator of the magnitude of the underutilisation gap[121], assuming arbitrarily

[120] This issue is further examined, with reference to the EU in section I.5.

[121] The allocation of resources of regional policy often refers, for the lack of alternatives, to this indicator. This is also largely the case with EU cohesion policy.

that all places have the same potential in the long run[122]. But there is a need to be aware that this should never lead to adopting convergence as a target against which to measure policy success.

As regards the social inclusion objective, convergence is only one of several relevant factors. First of all, income per capita needs to be distinguished from GDP per capita: convergence of the latter does not necessarily imply convergence of the former, due to commuting or transfers. Secondly, convergence of regional per-capita income might occur, but because of rising interpersonal inequalities within regions, overall inequality might increase. Indeed, empirical evidence shows, as noted above, that overall inequality is dominated by inequalities within regions rather than between them[123]. Third, income is only one of several dimensions against which social inclusion needs to be assessed and convergence of income need not entail convergence of these other aspects.

I.2.4. Governance: beyond the traditional dilemma of fiscal federalism

Place-based integrated development policies have a strong economic rationale – this is clear from the arguments set out in previous sections. But can they really work? They are complex policies involving different levels of government and private actors which are subject to several serious risks. Their chances of success depend on *how* they are implemented, how risk is reduced and what form of governance is adopted. These are important issues for cohesion policy. Even where the case for it might be accepted on theoretical grounds, it can be rejected, or at least, criticised, because of its implementation and design failures. Outlining a model of governance is necessary for assessing any concrete model of cohesion policy, including the present EU one.

Two points have long been clear in the traditional analysis of public policy and fiscal federalism. First, failure in the provision of public goods and services – "*public failures*" as opposed to market failures – can be important because of incomplete information on the preferences and knowledge of individuals and because of the constraints in establishing adequate incentives for policy-makers and public officials to act in the general interest. Secondly, *decentralisation* of public decision-making is the primary means of dealing with these failures, by allowing closer control by citizens and pressure on policy-makers and public officials, and by encouraging the performance of different places in the provision of public goods and services to be compared. While the strong effect of decentralisation originally claimed – that through the mobility of people, it would ensure an efficient provision of public goods at local level – has proved mistaken[124], it can still exert pressure on authorities and tends to mean that the decisions they make accord better with the preferences of people, as well as accommodating diversity.

The analysis of institutions and path-dependency in agglomerations presented above adds a further dimension. Local governments can consistently fail to build the appropriate economic institutions, either because they are not benevolent or because they do not have the capacity or the means to do so, given how strongly formal and informal institutions depend on past institutions (hysteresis). This failure may be so severe that it leads to underutilisation or social exclusion traps. Only an exogenous public intervention can improve things by upsetting the existing balance. But for this intervention to be effective, it needs to be accompanied by increased local involvement. This is the condition for eliciting the information on preferences and the local knowledge needed to tailor interventions to places and to reap the advantages of closer citizen control.

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[122] See on this Monfort, P. (2009).
[123] See Förster et al (2005).
[124] As Stiglitz, J.E. (1989) argues with reference to public goods, the restrictive conditions under which the exit mechanism (people "punishing" bad local administrators of a place by moving out of the place) originally claimed by Tiebout, C.M. (1956) produces a Pareto-efficient outcome are even stronger "than those required for private goods".

This perspective takes us beyond the traditional dilemma of fiscal federalism, of decentralisation versus centralisation.

The traditional question, therefore, has been how to allocate responsibility for each type of public good and service to either the local or the central level – how to balance, on the one hand, the advantages of taking account of local preferences and allowing greater citizen control and, on the other, the advantages of scale economies and cross-border externalities which stem from centralisation. Under place-based development policies, by contrast, the issue is how to design governance arrangements under which the two levels of government share responsibility for each public good and service. Instead of allocating to each of them a certain number of services, each of them can be allocated a certain number of *tasks* in the provision of services of all kinds.

Subsidiarity of tasks and multilevel governance

The shift from a separation of responsibilities in terms of types of services to one in terms of tasks in their provision can be appreciated by reference to the concept of subsidiarity, the general principle according to which authorities should perform only those activities which cannot be performed effectively at a more local level. In the context of place-based policies, subsidiarity needs to be interpreted with reference to responsibility not for whole *sectors*, but for whole *tasks*. The subsidiarity criterion, therefore, needs to govern the allocation of tasks.

The architecture of policy-making which implements this more modern arrangement has come to be called *multi-level governance*, a system by which the responsibility for policy design and implementation is distributed between different *levels of government* and *special-purpose local institutions* (private associations, joint local authority bodies, cooperation across national borders, public-private partnerships and so on)[125]. In this architecture, it is up to the top levels of government to set general goals and performance standards and to establish and enforce the "rules of the game". It is up to the lower levels to have "the freedom to advance the ends as they see fit"[126]. Special-purpose local institutions, comprising both public and private actors with responsibility for delivering specific services, or bundles of services, play a decisive role in eliciting the knowledge and preferences of citizens of specific places;. Since they are formed through the policy process, they often define what a "place" is. In their absence, multi-level governance can degenerate into a system of negotiation between bureaucracies representing different elites, with an authority defined by purely jurisdictional boundaries.

EU cohesion policy is where multi-level governance has flourished[127], responding both to a strong cultural tradition supporting an active role of local governments and communities and to the awareness of the limits of the Commission in directly managing interventions. In order to assess below how far cohesion policy has lived up to the model that it helped establish, four key aspects can be singled out which together determine how successful multi-level governance is:

- the allocation of tasks among levels of government and the role of jurisdictional Regions;
- contracts between levels of governments;
- decision processes at local level;

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[125] See Hooghe, L. and Marks, G. (2003) for a survey and analysis of how the two distinct types of multilevel governance which are combined in this definition (general-purpose jurisdictions and task-specific jurisdictions) suit different objectives, raise different problems and "coexist because they are complementary". The definition of multilevel governance developed in the remainder of the section also draws heavily on the theory of "democratic experimentalism" by Dorf, M.C. and Sabel, C.F. (1998) and applied to EU policy making by Sabel, C.F. and Zeitlin, J. (2008). See also Molle, W. (2006) and Begg, I. (2008b).
[126] See again Sabel, C.F. and Zeitlin, J. (2008).
[127] See Marks, G. (1993) and Hooghe, L. (1996).

- public debate being focused on objectives, learning and counterfactual impact evaluation.

The allocation of tasks among levels of government and the role of jurisdictional Regions

In the allocation of tasks, two levels can be identified: a *lower level* corresponding to the unit of intervention of a place-based policy and a *higher level*, corresponding to the authority (or authorities) responsible for the exogenous intervention. While the latter level is identified by jurisdictional entities (an administrative Region, a Nation State, a supra-national body), the former is defined by the policy process, its boundaries being those within which a set of conditions conducive to development apply more than they do outside (i.e. in other places). It will then embrace those local public authorities and private agents which, through shared features, are best placed to respond to exogenous interventions[128].

According to the policy concept and to practice, this *lower level* should have the responsibility for designing and implementing interventions, namely: a) eliciting and aggregating the knowledge and preferences of citizens; b) designing projects and appraising them for financing; and c) implementing projects and managing a learning process. Conversely, the *higher level(s)* should have responsibility for: a) setting priorities and general objectives and the contractual framework for the lower levels; b) selecting projects and/or allocating funds to places and providing linkages between them; c) promoting institution-building and learning and monitoring results; and d) providing, when necessary, technical support and expertise. The allocation of tasks must obviously be adapted to the specific areas of action[129].

The question arises, however, as to where the responsibility for the exogenous intervention should lie, whether a supra-national authority should be responsible as well as national authorities. This goes to the core of the EU role and the very existence of EU cohesion policy. The question is addressed in the next section. The further issue is whether there should be an additional level of government between the "place " level and the national level, namely the Region, with a capital "R", i.e. "a coherent territorial entity situated between the local and national levels which has a capacity for authoritative decision making"[130].

A number of factors are relevant in this regard, including the size of the country, the nature of policy priorities and the existence of sub-national cultural traditions. These and other factors can make it difficult – if still feasible – for national authorities to implement policy, such as selecting projects and promoting institution building, and make it desirable for Regions to have a strong role. Constitutional arrangements and the *de facto* allocation of power, i.e. the number of different levels of government and the power of each, are also relevant in this regard[131]. In particular, the trend towards regionalisation which has taken place all over the world since the end of the Second World War[132], but which has been especially strong in Europe, has created a

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[128] Given the definition of a place, which is endogenous to the area of human activity and public services at stake (see Introduction), "local" could refer to a very small or a rather broad sub-national or cross-border territory according to natural and cultural circumstances, the homogeneity or complementarity of people's preferences, synergies as regards the knowledge of people and the opportunity for common informal institutions to emerge.

[129] For example, in the area of innovation and research, the responsibility needs to be taken at the higher level in order to identify, *ex-ante*, places that can be on the technological frontier and places that should concentrate in adapting their knowledge base to existing technologies.

[130] See Marks, G., Hooghe, L. and Schakel, A.H. (2008). More than one jurisdictional layer can exist in practice between the local and the national levels. The authors identify functional and non-functional reasons for explaining both the number and the power of intermediate governmental layers.

[131] See Alesina, A. and Spolaore, E. (2003).

[132] See again Marks et al (2008). By analysing data for 42 countries and capturing in an indicator the tax, expenditure, legislative and constitutional power of Regional governments over their own territory and over the nation as a whole, they identify 384 reforms during these 56 years, 90% of which increased regional authority. They also show that the last wave of power-shifting to Regions, started in 1992, ended in 2001 and that there are signs of a move in the opposite direction since then.

strong pressure for increasing the role of Regions. Whatever their role, however, jurisdictional Regions cannot be the unit of intervention of place-based development policy, or the "lower level" of multilevel governance described above, since neither their boundaries nor their internal governance are coherent (unless by accident) with the specific and changing objective of the policy.

Contracts between and within levels of government

The nature of exogenous intervention by higher levels of government and the distribution of tasks between levels of government require commitments between them. Equally, the multi-sectoral nature of place-based development policy requires horizontal coordination and reciprocal commitment at every level of government. "Contracts", both vertical and horizontal, and "conditionalities" – the conditions set – for the granting of funds are a defining feature of multilevel governance. A central problem arises here for place-development policies because – as in a growing number of other policy areas – a web of reciprocal commitments must be made in a context of very incomplete information.

For contracts to be effective requires the ex-post verifiability of commitments. However, both parties to the contract lack complete information on how to specify commitments *ex ante* in a clear-cut and verifiable way. Accordingly, this makes for difficulty in defining the targets that could reasonably be achieved, the means of pursuing them and the institutional conditions for these means to be effective. It is *not* a matter in this regard of *information being asymmetric*, in the sense of a lower level of government (the agent) being in possession of information not available to the higher level (the principal) and of the latter being able to design contractual incentives to extract this information or make the agent behave efficiently. Generally, the agent does not have the information either. It is a matter instead of *information being incomplete*, which cannot be overcome through contractual incentives. The information on how a commitment should be formulated, therefore, becomes complete only in the course of the policy process, if knowledge is elicited and aggregated during this process.

Faced with this problem, policy-makers can take two opposite approaches, both of which are risky. They can take a *hyper-rationalist approach* under which targets and commitments to targets and institutional requirements are established as if complete information were available. Or they can resort to a *pure relational approach* under which "parties commit to co-operating *ex-post* … and design a governance mechanism for that purpose"[133], making only a commitment to negotiate later and disregarding other commitments as being ineffective.

In the first case, the premise of policy being place-based – subsidiarity of tasks - is violated. In particular, the setting of firm commitments for the design of institutions or specifying "best practices" tends to lose sight of the fact that institutions are highly specific to context. Commitments distort public action. Moreover, they are unlikely to be considered credible and the unravelling of the policy process will tend to create a common incentive to renegotiate. By discounting this in advance, it is likely that both parties will agree *ex-ante* on commitments which are merely formal and which can be followed by formal (and useless) compliance. As indicated below, the "performance reserve" system implemented by cohesion policy in the years 2000-2006 is an example of this approach (section II.4).

In the second case, two facts tend to be overlooked. The first is that policy experience, public debate and evaluation very often provide a body of knowledge on both causal relations between means and ends and on institutions, which can be used as guidance for future action. This can encompass the order of magnitude of the effects of particular interventions, the institutional problems that cannot be left unanswered and alternative approaches that seem to have worked in different contexts. The second is that the policy process itself can gradually improve knowledge

[133] See OECD (2007b). The survey of country cases shows the two radical cases and attempts of combining them.

on what to do and how to do it. By overlooking these two aspects, incomplete information can become an alibi, for not contractualising commitments at all. Except for special circumstances where the parties have a strong additional motivation to cooperate, the lack of any clear target or commitment to institutions is likely to prevent a convergence of policy effort, encourage opportunistic behaviour and discourage people from revealing knowledge and committing to the process. The way that "regional innovation strategies" were often implemented in practice provides an example in this regard (section IV.3.1).

Experience shows that favourable results can come from combining the two approaches. Conditionality and subsidiarity can be combined by making the most of accumulated experience and by conceiving contracts as a means of learning[134]:

- All the aspects for which commitments can be codified in a verifiable way can be stipulated (i.e. included in "hard" clauses in the contract) – the funds to be spent by a given date, the data to be produced, the way that beneficiaries are selected and so on.

- For all other commitments, there can be open-ended – "soft" – clauses, which describe the commitments by means of principles or indicative quantitative conditions. These open-ended "conditionalities" can apply to two aspects in particular: a) *economic institutions* in policy areas (education, research, environmental and transport infrastructure and so on), for which a set of *principles* can be established, the authority in charge of the exogenous intervention being responsible for approving *ex-ante* the actual implementation of these principles by the lower level of government; b) the *objectives* for each priority area for which *targets* can be set, appropriate *ex-post* incentive mechanisms (peer pressure, sanctions for repeated unexplained failure to achieve targets and so on) being implemented through monitoring and the dissemination of information.

In the case of open-ended clauses, mechanisms should also be activated to aggregate and put to use the knowledge elicited and produced during the policy process in order progressively to firm up the open-ended clauses. In particular, targets can be progressively revised and sharpened. In this case, "reputational" mechanisms, linked to the prospect of further contracts or to the external role of an "expert mediator" should be in place to ensure fair and agreed interpretation of the original open-ended targets[135].

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[134] A move towards a combination of two radical approaches has been detected in the US by Sabel, C.F. and Simon, W.H. (2004) for a range of public goods and services (education, mental health, prisons, public housing). In particular, in the case of the attempt to enforce equal rights to education, a "top-down movement for standards" based on "high stakes testing" has come together with an opposite "bottom-up movement" based on "localism" and agent empowerment, in a new approach which mixes "local initiative and diagnostic standard". For some practical examples in the difficult case of policies for innovation, see the Report Working Paper by Bonaccorsi, A. (2009).

[135] Actors with different interests and knowledge will have the opportunity to learn from policy implementation what open-ended commitment should or could have meant. Cooperation is then promoted around the focal points provided by the contracts and given the aim of progressively "closing" the contract by specifying the nature of the commitments. In particular cases, this combination can even allow a financial incentive to be attached to the open-ended commitments included in the contract. See for example Barca, F., Brezzi, M., Terribile, F. and Utili, F. (2004), for an "experiment" implemented in the context of cohesion policy, of open-ended clauses with incentives attached, where the mechanism of "closing the contract" was entrusted to a third party, a Committee composed of members of the evaluation unit of the principal (the national government), two representatives of the Regions (with very different chances of complying with the commitments) and two independent experts (appointed by the Commission). By periodically assessing the implementation of the clauses in each Region, the Committee brought together both an understanding and a consensus of what their right interpretation was in each different context. See also Bonaccorsi, A. (2009).

Decision processes at local level

The ultimate purpose of exogenous intervention is to induce private agents, individually and through "voluntary institutions", and local governments to do what they fail to do by themselves, which is investing time and effort in revealing knowledge and preferences and aggregating them so as to provide public goods and services. For this to happen, both private and public actors need to have an incentive to participate, which, in turn, requires a change in expectations and a degree of certainty about the return from such effort[136].

Local institutions – networks, associations, districts, pacts, agencies, etc - created by private and public actors for specific purposes represent the means through which a change in expectations and certainties comes about. They provide the framework in which coordination takes place, reciprocal guarantees are provided, information is elicited, projects are developed and commitments are made through "contracts" with the different levels of government. Their purpose can be focussed on one service only (transport, healthcare, education, waste disposal, research, etc.) or cover bundles of services. They can embrace different administrative levels, from local to international, which are relevant for the purpose[137]. These local, special-purpose institutions can have negative effects. Since they influence the use of public money, and become the means through which the exogenous intervention is linked to the place, pursues its goal and disburses funds, they can be used simply to make money. This would discourage new ideas and new people becoming involved, reduce the incentive to innovate, lead to a choice of economic institutions which are neither in the interests of overall efficiency nor of equity and undermine the purpose of the exogenous intervention[138]. Even when a degeneration of this kind is avoided at the start of the process, it might occur once an elite (possibly replacing the old local elite) comes to govern the process and makes itself "indispensable" to those running the exogenous intervention.

The antidote to this is the verifiability, openness and experimental nature of the local decision-making process. The creation of local institutions and their activities needs to be inspired by these principles, by the idea of substantial democratic participation in decision-making. Three ingredients have emerged from the previous sections:

- a clear identification of *objectives* and *standards*, measured by validated *indicators*, which can be compared with what happens elsewhere, are open to monitoring, and capable of providing a focal point for public debate and action;

- a permanent *mobilisation of all those interested*, stimulated by the exogenous intervention, by the injection of information on actions and results and by having opportunities for expressing more informed proposals and for voicing disagreement;

- an *experimental approach* through which collective local actors are given an opportunity to experiment with solutions while exercising mutual monitoring, and alternative measures are tried and compared through a systematic learning process, in which prospective impact evaluation plays a relevant role and the results of previous interventions are used to design new ones.

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[136] An example of these incentives is represented by the choice in the regional innovation programmes of strongly limiting the number of selected clusters or poles or to label them to signal the ranking: see OECD (2007c).
[137] See again Hooghe, L. and Marks, G. (2003).
[138] On these risks, see also Farole, T., Rodríguez-Pose, S. and Storper, M. (2009).

Focusing public debate on progress towards objectives, learning and prospective counterfactual impact evaluation

Focusing public debate on objectives and learning about what works in practice are, therefore, two fundamental components of place-based development policies. Their successful implementation requires them to be distinguished methodologically. In particular, there are four distinct functions, which are often at risk of overlapping and hampering each other in policy design and implementation:

- *Ensuring efficient and regular policy implementation* (the narrow "accountability function"). Here, the purpose is to create an incentive for policy-makers responsible for implementation to work conscientiously, to comply with regulations, to spend the resources that were allocated to them cautiously, and to deliver the "physical" output (the public works, the number of training hours) to which they committed themselves. Tasks should be clear-cut and described in a verifiable way with audit and incentive mechanisms to encourage policy-makers to perform them diligently and with care.

- *Encouraging focus on objectives and on the progress towards achieving them.* The ultimate goal of the policy is to achieve objectives – given outcomes or effects as regards the well-being of people (reduction in travel time or in pollution, increasing skill levels and so on). The achievement of these depends, once the physical output is produced, on the appropriateness of the policy intervention as a whole (and of the theory on which it is based) and on factors influencing the context. The policy process can be enhanced by requiring policy-makers to establish *targets* in terms of verifiable indicators of the objectives concerned, to document how closely results are to them and to focus public debate on this information. This process can encourage people to participate and increase policy effort, though results and the extent to which they are in line with targets should never be interpreted as a measure of policy effectiveness.

- *Learning about what works.* The purpose here is to understand how effective policy is, whether observed outcomes are due to the policy and to what extent, the ultimate aim being to increase understanding of the link between policy and outcomes. This requires a means of estimating what would have happened if the intervention had not been undertaken.

- *Learning about the implementation process.* Here the task is to learn how policy was enacted – the sequence of actions, the allocation of responsibilities, the coordination of those involved and so on. Together with learning about what works, this can lead to recommendations for policy change and enable interventions to be better designed.

The task of ensuring that the focus is on the progress towards achieving objectives requires contracts to put a strong emphasis on these and to set targets. It also requires a clear methodological framework, a rigorous distinction between outcome and output indicators and between indicators and tools for impact evaluation, indicators which are statistically robust, comparability across places, public access to data and regular monitoring reports. The task of learning about what works – or impact evaluation – is even more demanding and needs to play a central role in these policies. If it is carried out in a *prospective* way, i.e. by designing it in tandem with policy design, it can not only facilitate checking of whether public money delivers results but focus attention on objectives, on their definition and on the selection of beneficiaries. By doing so, it can have a disciplinary effect on policy-makers.

Impact evaluation is complex since the effects of policy need to be disentangled from the underlying trends and from the effects of other events and policies. Outcome indicators can never do this job since they show how things evolve *while* the policy is being carried out but are silent on the underlying causes. Various methodologies have been developed to respond to this

challenge[139]. Among them, the so-called "realist evaluation" can be of help, since its aim is to learn which mechanisms and which contexts cause an intervention to be successful – i.e. what makes individuals act in the way postulated by the theory of change on which the intervention is based.

The most promising results, however, come from a family of methods developed in recent years, collectively defined as "counterfactual", which are aimed at assessing the impact of interventions by estimating what the outcome would have been had the intervention not taken place. This is mainly done by analysing what happened as regards "similar enough" individuals, organisations or areas not targeted by the policy. Place-based development policies represent a challenge for the implementation of counterfactual impact evaluation, but they also offer an environment in which the disciplinary effect of using the method can be particularly strong, especially when it is used *prospectively* (see Box I.A).

Box I.A Counterfactual impact evaluation and its prospective use by place-based development policy

Counterfactual impact evaluation (here termed simply impact evaluation) allows the assessment of policy effects without the use of complex econometric models, in which strong hypotheses need to be made which are often hard to appreciate by the layman, and to act as a leverage for policy improvement. It focuses on using data of good quality and on the robustness of the method through which a population "similar" to the target population is identified[140].

This second requisite is demanding, since the selection (or self-selection) of the beneficiaries of the intervention might well produce a group with features that differ markedly from those of non beneficiaries (those which, according to the selection criteria, are the most suitable firms, the most deprived individuals, the least capable local administrations, etc). In this case, a comparison between the beneficiaries and non beneficiaries does not produce a valid estimate of the effect of the policy. Methods have been developed, which must be adapted and tested case by case, to deal with this problem by measuring the differences between the two populations taking observable variables into account in the comparison[141]. These methods cannot be used when there is reason to believe (as can often happen) that some "unobservable variables" also exist which influence the selection of those targeted by the policy. One way to solve this problem is to adopt randomised assignment, that is an experimental design by which the beneficiaries of an intervention are randomly selected so that non beneficiaries can be used as the counterfactual.

Ethical issues that apply to "all social experiments (and, indeed, to any unproven social policy implemented on a large scale)"[142] become more visible with randomised assignment. This has created pressure openly to discuss and deal with these issues, a step which is often overlooked when the selection of participants is based on different methods. Building on the experience established in medicine, a set of principles of conduct has developed in the social field so that random assignment can be considered ethically acceptable[143]. One of them, "equipoise", requires policy-makers to be truly uncertain whether the intervention concerned is beneficial or not: in this case, being excluded from the intervention in not necessarily a disadvantage. Other principles are that use of the results of the experiment is guaranteed; and that, in order to run the experiment, the normal level of service will not be reduced[144]. Respect for people is a further relevant principle requiring individuals to give "informed consent" to their participation in the experiment: they must "not feel under undue pressure to

[139] On this and what follows (in the text and in Box I.A), see the Report Working Paper by Morton, M.H. (2009). This paper and this Report also draw on the results of a two-day workshop which was organised by the DG REGIO evaluation unit in March 2008 and which benefited from the contributions of Arianna Legovini (sharing the results of the experience of the Africa Impact Evaluation Initiative at the World Bank), and Professors Alberto Martini and Robert Walker. For a critical assessment see, for example, Ravallon, M. (2009).
[140] See in particular Heckman, J.J., LaLonde, R.J. and Smith, J.A. (1999).
[141] See again Morton, M.H. (2009) for a survey.
[142] See Walker, R., Hoggart, L. and Hamilton, G. (2008).
[143] See Bluestein, J. (2005).
[144] See Stafford, B., Greenberg, D. and Davis, A. (2002).

participate" and must have a full understanding of the purpose and consequences of participating[145].

Several ethical conditions for randomisation can be better dealt with in the context of a place-based policy:

- Unlike the ordinary provision of services, place-based exogenous interventions are by definition *additional* and can be truthfully treated as "demonstration projects", avoiding the risk that the normal level of service for some people is reduced.
- In the participatory process which should characterise place-based interventions, both the expression of consent and the information on which consent is based can be better guaranteed.
- The choice of using randomised assignment as a way of testing the effects of an intervention where these are doubtful has more chance to emerge through the policy process.
- In this case, the principle of equipoise can be consensually extended to cover a situation (which often arises) where the benefits for the whole community are truly uncertain, although the those targeted are likely to fare better than the non-targeted because, for example, they receive a monetary transfer.
- It is part of the logic of place-based interventions to be carried out in some places and not in others; if the selection of the target places is random (which in some cases would be advisable and commonly agreed), the ethical problem is reduced, since no individual would be "disadvantaged" relative to any other living in the same area[146].

Whatever the method adopted, if the conditions exist for its implementation, impact evaluation can potentially answer the question of "what works" and "for whom": whether an intervention has effects – on average and for specific groups – on the people at which it is aimed, and how close these effects are to the objective ("internal validity"). It does not provide an answer to the question of "how" the intervention worked. Nor does it give safe guidance on whether the intervention will have the same effect once it is applied to another group or extended in scale ("external validity"). This is because effects vary across individuals; context matters; the commitment of service providers and of policy-makers might be greater in a demonstration setting; and there can be general equilibrium effects which do not manifest themselves until an intervention is taken to full scale[147].

The contribution of impact evaluation goes beyond learning about "what works" and "for whom". When it is *prospective*, i.e. it is designed together with the intervention, impact evaluation can have a strong disciplinary effect. First, it can help focus the attention of both policy-makers and beneficiaries on objectives. Secondly, it creates an incentive to assemble the information necessary to assess results. Thirdly, it brings to light the criteria by which beneficiaries are selected, which is a delicate problem in all development policies since there is a risk of policy being captured by pressure groups; prospective impact evaluation can, accordingly help to give transparency to the selection procedure. The place-based development approach offers a policy space in which prospective impact evaluation can take place and the relevant information extracted through cooperation between evaluators, policy-makers and beneficiaries.

In applying counterfactual methods to place-based policies, there are a number of specific challenges which need to be addressed. Three are of particular relevance.

- By definition place-based policies give rise to heterogeneous interventions in the different places, so that implementation analysis is necessary in order to identify different "types" of intervention and to make them the subject of separate impact evaluations[148].
- Place-development policies are often aimed at all the individuals living in a selected set of places. In comparing the performance of these places with that of others, the criteria that led to the selection of

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[145] See Walker, R. et al (2008) for an evaluation of whether this condition was satisfied in the "largest random assignment test of a social policy's effectiveness in the United Kingdom to date" (p.162). Notice that the study represents an evaluation of the random assignment evaluation and was conducted under the auspices of the UK Department for Work and Pensions which launched the social experiment.

[146] For example, as Walker, R. et al (2008) point out, "consent for programme involvement is not sought … in the UK when a trial programme is run in one area and not in another".

[147] See Duflo, E., Glennerster, R. and Kremer, M. (2006).

[148] On this and other challenges see Diez, M.A. (2002).

the target set should be expressed in terms of observable variables so that they can be used to select a "similar" group for counterfactual purposes.

- It is part of the rationale of place-based policies that changes can be achieved if public goods and services are provided in bundles, i.e. if multi-component projects are undertaken. This presents a challenge since it is difficult to assess what the "active components" are and which ones are beneficial, neutral or damaging. Different strategies can be adopted in this respect – singling out *ex-post* projects that have all the same components except one and assessing them separately, designing *ex-ante* packages that differ in only one component or resorting to qualitative methods in order to derive from the subjective perception of participants some hypotheses about the relevance of the different components and then testing them.

A strategy for prospective counterfactual impact evaluation, capable of tackling and testing different approaches to these challenges is, therefore, a key component of the governance of place-based development policies. It is one of the main responsibilities of the higher levels of government responsible for the exogenous interventions to design and implement this strategy.

I.3. The case for the EU cohesion policy budget reconsidered: why should the EU care?

Now that a clear-cut policy concept – the place-based development model – has been identified, its rationale and governance have been investigated and misconceptions have been removed, it is possible to return to the central issue of this chapter, namely, what is the rationale for the EU to have a place-based development policy and to devote a significant share of the Budget to financing this? What, in other words, is the rationale for cohesion policy?

Economic and social conditions indicate that the European Union is no exception to the rest of the world, in the sense that place-based development policies are greatly needed. As regards efficiency, Europe is not exploiting its resources to the full in all types of region. Many large regions are lagging behind their potential and failing to exploit their comparative advantages. Several regions are finding it difficult to adapt to external changes and risk falling behind. The successful agglomerations are hampered, as elsewhere in the world, by development constraints and by the negative consequences of concentration. Furthermore, current technological, demographic and climatic trends and changes in global competition are having different effects on different regions[149]. On the equity side, income inequality is marked and is increasing or at best stable in most countries, while the average risk of (income) poverty across the EU has remained at 15-16% for a decade. There are concentrations of deprivation, on various measures of well-being, in most countries[150]. In the case of NUTS 2 regions, large intra-regional inequalities exist and even prosperous regions have a significant polarisation of living standards. Moreover, independently of the global financial crisis, fears of falling behind are widespread among large sections of the population. The demand for a new paradigm of development policy has been growing[151].

The financial crisis has further underlined the need for a new approach to development, for two reasons. First, it has increased uncertainty and fear right across society and has inflicted losses (current and anticipated) which will create new inefficiency and social exclusion traps and aggravate existing ones. The crisis, beyond the necessary short-term boost to demand, calls for

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[149] See European Commission (2008d).
[150] See section II.3.1.
[151] See the analysis and the data for what is by now an extensive review of regional problems and territorial policies assembled on the by the OECD Territorial Committee in its broader world-wide activity: the Reviews of territorial policies of Italy, Czech Republic, France, Poland Portugal and Finland; the case studies of rural and so-called "intermediate regions" , Teruel and Comarca Central Valenciana in Spain, Tzumerka in Greece, Champagne-Ardenne in France, Marevska Trebova in Czech Republic, Siena and Bergamo in Italy; the case studies of metropolitan regions of Athens, Helsinki, Øresund, Vienna/Bratislava, Randstad (conurbation of Amsterdam/Rotterdam/The Hague/Utrecht), Milan, Madrid, Stockholm, Copenhagen and (looking forward) Istanbul.

exogenous interventions which are highly tailored to places. Secondly, there is a crisis of trust between lenders and borrowers. It is not possible to anticipate how it will be overcome and what lasting changes will come about. But it can be anticipated that rebuilding will require investing in institutions that are capable of restoring the trust of lenders and providing better flows of information on borrowers. Indeed, promoting local projects that elicit and aggregate the knowledge of actors and initiate a learning process across places is an appropriate way for governments to act in the present circumstances.

But why should the EU operate this kind of policy and devote a large share of the Budget to it? Does not subsidiarity suggest that place-based development policies should be a matter for Member States? What is the rationale of the Treaty *proviso* that the Community supports "the achievement [of harmonious development] by the action" of dedicated Funds? Would it not be more appropriate for the Union to promote Member State place-based policies by means of moral suasion through an "open method of coordination"?

There two economic grounds for a large share of the EU budget to be allocated to a place-based development policy. First, such an approach is the only feasible and effective way to pursue a development strategy which is indispensable for the existence of the Union (*sustainability* argument). Second, the Union has a comparative advantage over Member States in running the place-based approach (*policy effectiveness* argument).

The sustainability argument: a feasible and effective way to respond to rising expectations …

The sustainability argument for the EU to run a place-based development policy has two elements.

- First, the existence of the EU and its (actual and perceived) impact on people's lives compel it to pursue a development policy which addresses the expectations of European citizens, wherever they live, to be given the chance of benefiting from the opportunities and avoiding the risks created by globalisation and by the Union itself.

- Second, the place-based model – one targeted at regions defined by the policy process, in which the EU sets the framework, the priorities and the "conditionalities" (on which grants to lower levels depend) and jurisdictional Regions and Nation States have responsibility for selecting places and projects - is the only development policy compatible with the limited democratic legitimacy of the Union; though it is also a highly effective tool for addressing the task.

This is a reformulation, made under even more compelling circumstances and on the basis of more advanced economic thinking, of the main reason that led, following the Thomson Report in 1973, to the progressive creation of cohesion policy and to the 1988 high-level political compromise (see section I.1.2).

Globalisation, a "state of economic, political and culture in world affairs" where distance between places and between individuals is reduced, markets become more integrated, branded products are widely spread and "closer interconnectedness" exists between countries[152], is at work everywhere. In Europe, the political choice of unifying markets and currencies has deepened the effects of globalisation, creating new opportunities for many European regions where the knowledge base is significant. But exploiting these opportunities is challenging and difficult and the creative destruction brought about by market pressure involves losers as well as winners. In places where local economic institutions are weak or slow to adjust, market integration does not automatically encourage capital and labour inflows and can actually facilitate

[152] This definition of the "elusive concept" of globalisation is derived from an extensive inquiry conducted by the UK House of Lords in 2002. See House of Lords (2002).

outflows[153]. In this context, and with large inflows of migrants attracted by the relative openness and freedom of societies, a threat to local or national cultural identities is also being felt (strongly in some places), particularly by those lacking the means to "connect" economically and culturally[154]. New under-utilisation and social exclusion traps are likely to arise and existing ones might become more resilient. There are many possible scenarios open and the one that emerges will depend, *inter alia*, on public action.

Once the choice has been made to pursue market and currency unification, to make markets more flexible and to open internal borders, the sustainability of the Union depends on people being convinced that a similar kind of policy effort is being made to give all of them the same opportunity to benefit from these changes independently of where they live. The important progress achieved in market unification and the remarkable success of the single currency created ten years ago underlines what was argued back in 1973: that "*no Community could maintain itself nor have a meaning for the people which belong to it so long as some have very different standards of living and have cause to doubt the common will of all to help each Member State to better the condition of its people*". The European Union has been vested with sovereignty over economic, market and monetary issues which deeply affect the well-being of European citizens. This authority is often exercised through Member States, but EU citizens tend to perceive – by and large rightly – that the lawmaker in these areas is the EU[155]. This calls for the EU to use its budget to overcome the perceived disadvantages of European integration and the obstacles that prevent European citizens from benefiting from integration, wherever they live.

One important clarification is needed, however. It is not a matter of "doing something social" as a "cost to pay" in order to achieve and preserve market and currency unification. This argument has been over-used through the years in order to convince the sceptics and has backfired. If a policy is a "cost", why should anyone care too much about its quality, results, evaluation or conceptual design? Let's just pay the cost and try to make it as low as possible.

The reductionist argument is wrong for three reasons. First, market and currency unification are not objectives but means to achieving the objectives which motivated the formation of the Union, namely increased growth and well-being and helping to preserve peace. Secondly, unless inefficiency and social inclusion traps are tackled through a policy for development, the very objectives for which market and monetary unification were introduced cannot be achieved. Thirdly, independently of market and monetary unification, these objectives require, as indicated by the experience of other Unions, the EU to take direct responsibility for tackling these traps.

That the EU should commit to equal opportunities is clearly expected by citizens of countries which, after centuries of conflict, have voluntarily chosen to come together under common rules. In doing so, they have experienced their labour markets being opened up, their services being accessed by outsiders and their national and local practices being changed by European rules. They have also experienced an erosion of their traditional bonds and their national identities. The process of unification is difficult as evidenced in opinion polls and the recent experience of attempting to construct new constitutional arrangements. For the Union to be sustained and a reversion to nationalistic behaviour to be avoided, two complementary lines of action seem to be called for in the short-to-medium term. First, there should be less elitism in EU interventions and

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[153] See Ekinci, M.F., Kalemli-Ozcan, S. and Sorensen, B.E. (2007) for evidence of the fact that the capacity to benefit from capital market integration depends, within the same EU country, on "social capital" measured by subjective indicators of trust (in people) and confidence (in institutions).

[154] The empirical study conducted by Kriesi, H., Grande, E., Lachat, R., Dolezal, M., Bornschier, S. and Frey, T. (2006) analysed a quality newspaper and a tabloid in Austria, France, Germany, Switzerland, the Netherlands and the UK in pre-electoral periods and showed that "the cultural dimension has been gaining in importance as it has become the primary basis on which new parties or transformed established parties seek to mobilise their electorate". This in turn has often coincided with rising opposition to European integration and growing support for restrictive immigration policies.

[155] See the note above.

less invasiveness in interfering with national and local practices in an overly-detailed and bureaucratic way. Secondly, "common bonds" need to be promoted at the EU level since this is responsible for loosening existing bonds.

Tackling the inefficiency and exclusion traps that arise around Europe is a task for the Union because it will be blamed if the task is not performed successfully. Moreover, if it successfully performs the task, then the loosening of existing national, or regional, bonds is likely to be accompanied by a strengthening of European bonds, extending beyond national or regional borders. Borrowing an expression from a letter written in 1932 by Sigmund Freud to Albert Einstein, it could be argued that a process of building a "new identification" as European citizens is needed for the Union to hold under the present strain. An expectation of solidarity at EU level, of a "common will" to give opportunities to all citizens, can, therefore, be seen as the necessary cement for this process[156]. If this expectation were not to be fulfilled, not only would the EU's pursuit of a market-based policy of liberalisation be eroded, but the existence of the Union as a meaningful institution would be put in strong doubt, so putting growth, well-being and peace at risk.

But what kind of EU development policy is warranted today by present political circumstances? Here is where the second part of the motivation comes in.

The EU is a transitional hybrid form of government and enjoys only limited democratic legitimacy. Member States have strong social contracts with their citizens which would not permit a top-down development policy like that in the US (see section I.1.1). Full sovereignty over development policies would not be allowed. Nor would a place-based development policy be accepted if the Union, by overriding Nation-States and regions, were to select regions and directly finance their projects. A place-based development policy under which Nation-States and Regions are responsible for these two tasks and the Union is responsible for the framework, the priorities and the conditions set for receipt of grants is a way of dealing with the expectations of European citizens, without impinging on national aspirations and by making the most of jurisdictional Regions. This is the political economy reason that explains the 1988 European-wide high-key political compromise that brought together different but converging visions of the Union (see section I.1.2).

At the same time, as the previous section has shown, this policy model is also particularly suitable, unlike a top-down approach, for tackling both inefficiency and social exclusion traps because it combines an exogenous strategic intervention with a reliance on local preferences and

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[156] In September 1932 Sigmund Freud answers a letter by Albert Einstein, encouraged by the International Institute of Intellectual Cooperation created by the League of Nations, asking his views on how to prevent "wars between nations" (as "the most typical, most cruel and extravagant form of conflict between man and man"). Among other observations, Freud argues that "there are two factors of cohesion in a community: violent compulsion and ties of sentiments ("identification" in technical terminology) between the members of the group. If one of these factors becomes inoperative, the other may still suffice to hold the group together". With reference to the League of Nations, which in his words was attempting to acquire authority "by calling into play certain idealistic attitudes of mind", he argues that "it would seem that any effort to replace brute force by the might of an ideal is, under present conditions, doomed to fail". But he argues that two ways exist to "divert [man's aggressive tendencies] into a channel other than that of warfare" between nations. One is love. "The other bond of sentiment is by way of identification. All that brings out the significant resemblance between man call into play this feeling of community, identification, whereon is founded, in large measure, the whole edifice of human society". This "feeling of community", this "identification", no longer at national or sub-national level, but among the citizens of different nations is what can help prevent wars. See the letters published in Einstein on Peace (1960), pp. 186-203.
In 1941, after the failure of the League of Nations predicted by Freud and in the middle of the war, a very similar concept was expressed by Altiero Spinelli and Ernesto Rossi in the Manifesto "For a Free and United Europe" written while being confined on the island of Ventotene. They advocated European unification, basing it on a set of policies aimed at freedom and at the equality of opportunities that would create "on the new order the consensus of very large masses of citizens".

knowledge. Its participatory approach also serves to counteract the elitism that often characterises EU interventions.

A place-based development approach is, at once, the only model politically available to the EU to fulfil an unavoidable task and the approach potentially most effective in performing it.

This motivation is strengthened by the present financial crisis, which, by threatening the economies of whole regions and the well-being of many people, imposes pressure on national governments to act defensively. It also forces the EU to reconsider some of its fundamental economic principles concerning market integration, mobility of labour, currency unification and fiscal stability, as well as restraining countries from tackling their problems at the expense of others [157]. Going back on these principles would undermine the whole political construction of the Union. Responding to the crisis through major public investment – whatever is thought about the likely effectiveness – is an option open to Member States but not to the Union as such, due to its hybrid political nature. The supply-side policy model embodied by cohesion policy – a long-term strategy aimed at the provision of public goods and services with a determining role for "local" actors – appears to be a more feasible, appropriate and effective answer.

... with an overtone of urgency for the social inclusion objective

This strong justification for an EU place-based development policy applies to both the efficiency and the equity objectives. On the efficiency side, citizens of all regions need to know that the same authority – the European Union – which is promoting the conditions for greater capital flows and preventing the use of traditional defence mechanisms (subsidies and protectionist barriers) is also engaged in a serious and accountable effort to enable their local, regional and national authorities to strengthen the economic institutions which are necessary for taking advantage of these capital flows. On the social inclusion side, the need for EU responsibility is assuming some urgency.

The division of labour between the EU taking care of markets and liberalisation and Member States taking care of welfare is under increasing pressure[158]. On the one hand, the scope for action of Member States is increasingly constrained by the constitutional "*supremacy of all European rules of economic integration, liberalisation and competition law*" and by the pressure of tax competition and EU stability rules on national budgets. On the other hand, "*Europeanising social policies ... [is] politically constrained by the diversity of national welfare states, differing ... in their ability to pay, [and] .... in their normative aspirations and institutional structures*". This is occurring in a Union which, "*because of the great cultural and linguistic diversity*" of its Member States, "*cannot count on a high liquidity of resources*", namely on high labour mobility,

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[157] This pressure is visible in the text of the Commission Communication on "Temporary Community framework for State aids measures to support access to finance in the current financial and economic crisis" (2009/C 16/01). By significantly widening the framework originally proposed by the Commission in November 2008, it introduces, together with guarantees, subsidised loans and risk capital measures, aid schemes and a provision on the cumulation of different measures, as well as extending eligibility to companies "in difficulties". On the delicate issue of the "free movement of workers", where problems are increasingly perceived by the European Trade Union Confederation on the implementation of the posted workers Directive, a Communication was prepared for Council adoption in February 2009 (6480/09) which concludes that "the post-enlargement free movement of workers has not led to serious disturbances on the labour markets", and "invites those Member States that continue to apply restrictions under the transitional arrangements, with the full involvement of the social partners … to lift all restrictions in the third phase if serious disturbances to the labour markets … cannot be established". But the issue of how compatible a situation of free movement of workers is with the absence of common requirements on wage levels and working conditions is coming to the fore.

[158] See among others Scharpf, F.W. (2002), from which the two following quotes in the text are taken, Cramme, O. (2008), Bertola, G. (2007), D'Antoni, M. and Pagano, U. (2008).

which can act as a source of social protection and accordingly requires more protection to be provided through public intervention[159].

It has been argued that Europe is "in the paradoxical situation where forms of European protection are extremely difficult for the same reason that they are necessary. The absence of cultural homogeneity hampers the introduction of social protection policies … that are necessary precisely because of cultural diversity"[160]. The soft route of the Open Method of Coordination, while creating an innovative framework for policy learning and policy guidance and giving the EU a way to encourage policy action by Member States[161], does not resolve the paradox, since it ultimately relies on the willingness of Member States to make use of it. Nor is there a solution in the European Court exercising some kind of radical pressure to balance the rights and duties emerging from liberalisation and common citizenship, since people will not be satisfied with the EU playing only the *pars destruens* – ruling against national laws that go against these rights and duties – and leaving the *pars costruens* to Member States[162].

An EU place-based development policy can be a way of experimenting with a move ahead while mobility of people and labour is very gradually promoted. It can reconcile the diversity of "social contracts" between national groups of EU citizens and their Nation States by establishing an overall social contract between all EU citizens and the EU as a whole. The content of this contract would be a commitment of the EU to pursue a number of clear-cut objectives – or to guarantee certain socially agreed essential standards – through a *territorialised social agenda*. These objective would include issues of high priority for European citizens, such as migration, child poverty or ageing (see chapter IV below). The amount of available resources and the very nature of cohesion policy - which is not geared to providing services for everyone but rather at providing additional support in specific places – would obviously not enable whatever priority is chosen to be fully achieved. But it could enable the issue to be tackled in many regions all over Europe and a European methodology to be established. It would be up to each Member State and/or Region to implement the policy in a way that was in line with social aspirations.

While providing a partial solution for the present, a territorialised social agenda could help build future solutions. On the one hand, it could help promote mobility (if, say, it reduces the risks of migration) with positive effects on social protection. On the other, it could provide lessons on building a comprehensive and permanent European social policy.

A comparative advantage over Member States: exploiting interdependencies and enhancing credibility

The second economic rationale for the EU running a place-based development policy and devoting a large share of its budget to this has to do with the comparative advantage that it has over Member States in running such a policy. This advantage depends on two factors: the capacity to exploit interdependencies and to avoid a zero-sum game among Member States and the credibility not to be captured by local interests.

In the first place, the EU level is better suited to tackling strong, cross- border interdependencies on which development depends. The capacity of a place to come closer to its potential and to reduce social exclusion depends on what happens in other places. A prominent example is the often strong interdependency resulting from the dynamics of agglomerations and networks, which creates links between places which can be in different countries. In general, as compared with the national level, the EU can achieve three additional results.

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[159] See D'Antoni, M. and Pagano, U. (2008).
[160] The quote is taken from D'Antoni, M. and Pagano, U. (2008).
[161] See again Sabel, C.F. and Zeitlin, J. (2008).
[162] See Scharpf, F.W. (2008).

- *Reducing the opportunity for beggar-thy-neighbour policies* by restraining Member States from favouring their national champions or reacting to regional problems by intervening through subsidies and the like which are damaging to other Member States. Existing EU Regulations create the framework for avoiding these zero-sum (often inefficiency-enhancing) actions, but having a direct influence through controlling a significant share of total European capital expenditure could give much greater guarantees.

- *Taking account of the cross- border externalities* of the public goods and services provided in any given place. For several important services (environmental protection a, research and high education, energy, etc), the benefits produced by public intervention are only partly enjoyed by those living in the place concerned and so they tend to be under-produced. By contrast, an EU-level policy can lead to *cooperation* between Member States and Regions around the achievement of common goals – through a common strategy with contractual commitments that assure participants that others are making similar investments, rather than through common projects (the transaction costs of which can be very high). Such cooperation can enable all of them collectively to achieve a level of provision of these services that is beneficial to all.

- *Promoting a process of institutional learning and dissemination* that allows each place to benefit from the experiments, results and mistakes of policies carried out in other Member States. This can have the additional positive effect of developing a common culture in national bureaucracies that for centuries have been working against each other.

Secondly, the EU level of government can improve the credibility of exogenous intervention.

For place-based development policies to work, the exogenous policy-makers running them must be motivated by interests that are not specific to the places in which policy is implemented, such as by the prospect of increased tax revenue from more prosperous regions, a wider political consensus or reduced social tension. These interests tend to give them an incentive to reduce capacity underutilisation in areas or to increase social inclusion there. The greatest risk for these policies is perhaps when the exogenous policy-makers become diverted away from their general interests because they are captured by local elites. If this happens, these places will be favoured over others with no reference to efficiency considerations, though this is even more likely to occur if there is no place-based policy and the spatial-awareness of public interventions is hidden. Moreover, policies will tend to favour elites in the places concerned, with no reference to either efficiency or equity considerations. Because of this risk, the more distant the policy-makers are from places, the less chance there is for them to be 'captured' in this way.

The peculiar way in which the authority of the EU has come about, and the mixed loyalty to national and European interests which its political and bureaucratic elites tend to have, can ensure a distance from local interests and regional pressures which is much greater than in the case of national government. Administrative Regions and Municipalities do lobby "Brussels" strongly and experience shows that they are sometimes effective as a group in tilting policy in a way that is favourable to the level of government they represent. However, their individual influence manifests itself only occasionally in affecting the allocation of very limited "special" resources. The EU, therefore, has the potential to be very credible in playing such a role.

Obviously, credibility cannot be attributed to an institution by *fiat* alone. An institution like the EU which has the scope to acquire it, must build it up and renew it continuously. This is equally true, however, of the other grounds which make the EU an appropriate level of government to run place-based development policies, namely, sustainability and the capacity to deal with interdependencies. Entrusting the EU with partial authority over development, as in the case of cohesion policy, requires it not just to manage funds but to have a strong political vision, to base this on a development model and to choose clear objectives.

Before coming on to how this sovereignty is exercised in practice and how far cohesion policy has been in line with the conceptual model that it has helped to shape, two different critiques directed at the geography of EU cohesion policy first need to be considered. They both dispute EU-wide coverage of the policy and advocate more concentration. One argues that policy should focus on disparities between countries, the other that it should be limited to the "poorer" Regions[163].

Renationalisation and the issue of "rich" regions

According to the first critique, cohesion policy should leave the issue of disparities within countries to the Member States themselves and confine funding to lagging or "poor" countries only. The argument is that countries with the resources to pay for regional development should do so without support from the EU and, in any case, under the principle of subsidiarity, they are better equipped to undertake this task than the Union. In addition, a system by which the richer countries make large contributions to the EU Budget and then receive some of this money back through cohesion policy, and tied, moreover, to administrative rules and obligations, is regarded as inefficient.

The approach of allocating cohesion policy resources only to poorer countries – variously termed a "cohesion model" or "renationalisation" – would have potentially significant implications for the net balances of Member States depending on the version adopted (e.g. whether allocations to Member States are based on national or regional disparities). Although this is often the main concern in the debate, this issue is not of interest for this Report. What matters here is the thesis that there is an economic rationale for the EU to intervene in disparities between Member States but not in disparities between regions.

This thesis essentially assumes that cohesion policy is a mechanism for financial redistribution, transferring funds from richer to poorer areas to compensate for their lower levels of prosperity and revenue-raising capacity. The EU – the argument goes – should be concerned with redistribution among jurisdictional entities which are the next level down – i.e. the Member States – which should then, according to the principle of subsidiarity, decide how to deal with internal regional disparities given their national constitutional and institutional arrangements.

If the assumption that cohesion policy is a financial redistribution mechanism were correct, the thesis that the policy should be concerned only with poor countries would, in fact, be wrong. A complex, multi-level governance system with conditions on the use of resources would be an overly cumbersome way of redistributing funds between Member States. A mechanism with much lower transaction costs should be devised: a financial equalisation system – an inter-country "EU fund" – which compensated for the different levels of national income per head across the EU. It is not relevant, as has been argued in this regard, that the scale and format of cohesion policy may have been influenced by the demand of some Member States to rebalance their net payments to the EU or to compensate them States for the effects of other policies[164]. This is not a good reason why policy should be preserved in its present form when redistribution could be delivered more efficiently by other means.

However, as the Report has argued, cohesion policy is not about financial redistribution. It is a policy for the exogenous promotion of development through public goods and services in all places where inefficiency or social exclusion traps exist. This explains its complex architecture. If the arguments put forward to justify the policy concept and the Union responsibility for it are agreed, then it should be accepted that the policy should not be about compensating for disparities between countries and the issue of "poor" countries does not arise. If the actual

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[163] See, for example, Sapir, A. (2003). In order to appreciate current views on these two issues, see the contributions of Member States to the public consultation on the budget review launched by the European Commission: http://ec.europa.eu/budget/reform/issues/read_en.htm.
[164] See Molle, W. (2006).

governance and implementation of the policy are considered ineffective, they should be reformed everywhere. And if no improvements can be made or if the conceptual arguments in favour of place-based policies are rejected, then the policy should be discontinued everywhere. It would certainly not be appropriate to "inflict" it on poor Member States only.

The second critique of the geographical scope of cohesion policy intervention accepts that regions and not countries should be the territorial reference for determining eligibility for EU support but argues, first, that Regions should be defined at the NUTS 2 level and, secondly, that the policy should be limited to the poorest of these Regions (whether in poorer or richer Member States). In essence, in terms of the present system, this would mean discontinuing support for regions under the "Competitiveness and employment" objective (formerly Objective 2).

The main feature of this critique is that non-lagging Regions do not need EU financial support. They already have access to the resources to pay for the public goods and services they need and they tend to have local institutions which can take care of their development needs and implement region-specific solutions. The costs of "recycling" national contributions via the EU are seen as particularly high in these Regions. This argument is buttressed by referring to the questionable performance of EU support for them in the past, with a lack of clear evidence of quantified impacts from relatively small allocations of funding, disputed "added value" and high administrative costs. Moreover, it is argued that support for innovation, entrepreneurship and so on could equally well be delivered by targeted interventions under other EU policies.

These criticisms raise important issues concerning the performance of cohesion policy especially in non-lagging Regions, issues that are considered in the next chapter. The criticism, however, is not convincing on conceptual grounds.

First, while cohesion policy determines eligibility and resource allocation on the basis of NUTS 2 regions – the authorities in which are also in some cases responsible for managing the funds (see section II.1 below) – these should not be mistaken as the unit of reference for interventions, which is rather the place or region endogenously identified through the policy process. A "rich" NUTS 2 region can include both "rich" and "poor" places, so that even if it were agreed to exclude rich places because of their stronger local institutions, it does not seem reasonable to exclude poor places too. But even if this important point is set aside and it is assumed that rich NUTS 2 regions include only rich places (or functional regions), their exclusion from the policy seems unwarranted for several other reasons.

In the case of the "renationalisation thesis", references to financial capacity and "recycling" indicate that cohesion policy is largely (or even solely) perceived as a redistribution mechanism. But, as argued extensively above, the function of the policy is quite different, namely, to address inefficiency and social exclusion traps, problems extending well beyond the adequacy of "own" financial resources to fund required expenditure. Comparing the maps of "problem Regions" from the 1950s and 1960s, when regional policies were launched in the more developed EU countries, with spatial patterns of regional disadvantage today demonstrates both the remarkable persistence of some problems, despite large transfers of financial resources over the year, as well as the emergence of new problems. For both kinds of problem, institutional failures, path dependency and/or agglomeration effects are at work which calls for exogenous, active interventions, not just financial transfers.

In non-lagging Regions, the institutional structure is more often in place to tackle inefficiency and social exclusion problems autonomously. Increasingly, however, Regions have to adapt to economic, social and environmental challenges to their comparative advantage. For political, institutional or cultural reasons, the local institutions often find it difficult to adjust to external changes – because, for example, of the inability or unwillingness of local elites to understand the nature of change, to detect problems, to change established policies, to shift away from declining sectors or activities, to try fresh ideas or generally to act in a timely way. Such constraints are particularly pertinent for the EU in addressing, as an intrinsic part of its role, the challenges to

economic and social development and in trying to ensure strategic and coordinated action in areas like innovation, migration, climate change or demographic ageing.

Moreover, excluding all the citizens of rich Regions from interventions would undermine a primary reason for the policy, namely, to give everyone in the EU, irrespective of where they live, a concrete sign that the EU is addressing their problems. This is particularly so for the equity objective once the extent of social exclusion which is a feature even of rich Regions is taken into account, but it is also true for the efficiency objective whenever adjustments are resisted by local elites.

In particular, rich Regions no less than other Regions can gain from both an EU-wide perspective and the capacity of cohesion policy at EU level to reduce the extent of beggar-my-neighbour policies and to reap the benefits of cross-border externalities and institutional learning.

It is sometimes argued that the added value of Community involvement in non-lagging Regions could be achieved by alternative methods such as the Open Method of Coordination or other exchanges of experience. The reality, however, is that the multi-level governance approach of cohesion policy is central to its effects. Put simply, it is the combination of financial resources, "conditionalities", partnership, multi-annual planning – cutting across national and regional electoral cycles – and mutual learning over successive programme periods which underlies its potential effectiveness. Passive or "softer" mechanisms would not have the same influence. This leaves open, of course, the important question of whether these effects materialise in the actual implementation of policy – a point which is considered in the next chapter.

A final conceptual issue is whether cohesion policy is best placed to deliver the place-based, or territorial, dimension of EU objectives in rich Regions or whether this should be undertaken by sectoral policies. In the Report's view, this distinction is irrelevant. Of course, the same objectives could be delivered under other policy headings. However, if place-based, territorially differentiated policy intervention is needed at EU level – as many believe and as this Report argues – then some form of multi-level governance will need to be (re)invented to deliver these policies in partnership with Member States and Regions. Cohesion policy already has an established system of multi-level governance. If changes are needed, this should be the starting-point.

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Having discussed the rationale for an EU place-based development policy and its potential role as an exogenous driver of change, the question arises of how close cohesion policy is to this policy model and how far is living up to its potential. This dual question, which relates to the effectiveness of EU cohesion policy, is considered in the next chapter.

II. INSIDE THE BLACK BOX OF COHESION POLICY

Having singled out and discussed a policy model - the new paradigm of regional policy or place-based (territorial) development approach - and having argued that a strong rationale exists for the European Union to allocate to this approach a large share of its budget, the Report can now move on to question whether cohesion policy, with its current architecture, lives up to the challenge. How close is cohesion policy to the policy model?

The place-based approach is a very powerful and innovative method of public action to support development, but it is not an easy one and it runs several risks (section I.2). It is important to understand how far its actual implementation is from these risks and what results it seems to have delivered. This is the second indispensable step in order to develop a consensus on whether, compared to an agreed model, cohesion policy is so far from its mission that an appropriate place-based approach must be built anew from different premises, whether it is so close to its mission that only minor adjustments are needed, or whether it is the appropriate basis for implementing the model but it requires major changes in order to meet the challenge.

This chapter, after presenting a sketch of today's cohesion policy and of the regional policy context of Member States where cohesion policy takes place, surveys the available quantitative evidence and presents a tentative assessment of successes and failures of this EU policy.

II.1. Cohesion policy today: resources, governance and goals

The present framework of cohesion policy for the period 2007-2013 is the result of several changes which have taken place since the far-reaching 1988 reform. Box II.A briefly reviews this evolution, while this section describes the present system in terms that are accessible to readers outside the rather closed cohesion policy community.

Resources, governance and goals of cohesion policy for the seven year period 2007-13 were set by three *separate* policy decisions that were made *at different times* between December 2005 and October 2006:

- *Resources* and their allocation to Member States and Regions, after a *de facto* negotiation with the Commission started in 2003, were first agreed by the Heads of State at the European Council summit of *December 2005*, and then finalised (with relatively minor changes) by an Inter-Institutional Agreement between the European Parliament, the Council and the Commission (2006/C 139/01) on May 2006.

- *Governance* was agreed in *July 2006* through a set of Regulations by the European Parliament and the Council, on Commission's proposal (Regulations 1080 and 1081, and Council Regulation 1083).

- *Goals* were set in *October 2006* when the Council adopted the Community Strategic Guidelines (with "assent" by the European Parliament), a document that the Commission had drawn up by moving from an original draft prepared in July 2005 (following, in turn, the communication in May 2005 of the Third Progress Report on Cohesion).

- The overall amount of expenditure allocated to cohesion policy for seven years is 346 billion euro (308 billion at 2004 prices, which was the basis for the negotiations), accounting for 35.7 percent of the EU budget. The budget is divided into three distinct funds. The two "Structural Funds" are: the European Regional Development Fund (ERDF, or Regional fund), 58 percent

of the total; and the European Social Fund (ESF, or Social fund), 22 percent[165]. The "Cohesion Fund" accounts for the remaining 20.0 per cent. In the Commission, the responsibility for the ERDF and Cohesion Fund is entrusted to the Directorate for Regional Policy (DG REGIO), which also has an overall responsibility for cohesion policy, while the responsibility for the ESF is entrusted to the Directorate for Employment, Social Affairs and Equal Opportunity (DG EMPL).

The European Agriculture Rural Development Fund (EARDF or Rural fund) and the European Fisheries Fund (EFF or Fisheries fund), which financed interventions for these two fields of action, were moved out of the realm of cohesion policy and included under "agricultural policy" and "fisheries policy" respectively, although most of their interventions are inspired by principles similar to those of cohesion policy.

Territorial allocation to Regions and countries

Resources are allocated to three types of eligible territory, using as a geographic unit of reference either jurisdictional Regions ("level 2" of a pre-defined normative nomenclature – Nomenclature of Territorial Units for Statistics, NUTS, approved through EU Regulation - largely based on administrative units)[166] or nation-states: 1) the *lagging Regions* and the *lagging countries*, 2) the other (*non-lagging*) *Regions*, and 3) all areas entitled to run interventions of *territorial cooperation.* It is long-established practice to call the three types of eligible territory "objectives". The first eligible territory has been recently identified as "convergence", in order to underline the existence of a development gap to be reduced; the second one is termed "regional competitiveness and employment". As chapter I made clear, "convergence" does not capture either efficiency or equity – the two general objectives of cohesion policy – while the term "competitiveness and employment" somehow captures both. For these reasons, and since in both cases the same broad range of interventions can be financed, this Report will refer to the first two categories for what they are: types of eligible territory, called lagging and non-lagging.

Lagging Regions and countries have been assigned the majority of resources: 81.6 per cent (see Table II.1). *Lagging Regions* (61.6 per cent of the total funds) qualified for the assistance when their GDP per capita in the years 2000-2002 was below the threshold of 75 per cent of the EU25 average: this criterion led to the selection of 84 Regions (in 18 Member States), with a total population of around 154 million (or 31 percent of the EU27 population). A further 13 EU15

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[165] The internal proportion of ERDF and ESF is the result of Member States' choices and their negotiation with the Commission.

[166] The Nomenclature of Territorial Units for Statistics (NUTS), established by Eurostat since the 1970s, was turned into Community legislation in 1988, when the reform of cohesion policy took place whereby the units were used for the allocation of large amount of resources. It is now ruled by EU Regulation 1059/2003 and subsequent amendments. The nomenclature is a hierarchical classification, whereby each Member State is subdivided into NUTS (level) 1 territories, each of which is subdivided into NUTS 2 territories, and so forth. Criteria for classification are the following: 1) administrative units within the Member State (defined as "a geographical area with an administrative authority that has the power to take administrative or policy decisions for that area"); 2) thresholds of population (level 1: 3-7 million; level 2: 800 thousand – 3 million; level 3: 150-800 thousand); 3) if no administrative units exist for that level (population interval), this NUTS level shall be constituted (as a non-administrative unit) "by aggregating an appropriate number of existing smaller continuous administrative units" taking into consideration "geographic, socio-economic, historical, environmental circumstances" (thresholds will not be binding). The 2003 Regulation established a list of units at each level: for level 2, the largest Regions are Île de France and Lombardia-Italy (11 and 9 million inhabitants respectively), the smallest (with less than 300 thousand inhabitants) are 14 units, mostly in peripheral areas or islands. Changes can be proposed by the Commission (at Member State request) not more often than every three years: they follow automatically from changes in administrative units; for non-administrative units, a limit exists according to which changes should "reduce the deviation of the size in terms of population of all EU territorial units". This proviso can help in curbing proposals by Member States which have a mere financial scope of widening the territories entitled to higher EU transfers (see below).

Regions (accounting for 3.4 per cent of the total EU population) were eligible as transitional "phasing-out Regions", in recognition of the "statistical effect" (on the threshold) of enlargement. *Lagging countries* (20.0 per cent of the total funds, corresponding to the whole of the Cohesion Fund) qualified for EU support when they had a GNI per capita in the years 2001-2003 below 90 percent of the EU25 average. They included all of the new Member States, Portugal and Greece (plus Spain on a transitional basis), with a total population (partly overlapping with the previous one) of around 166 million euro.

Table II.1: Allocation of the cohesion policy budget for 2007-2013 and eligibility criteria
(2004 prices)

Territorial allocation		Criteria for Regions' and States' Eligibility	Criteria for allocating resources among Regions and States	Eligible population (Millions)	Financial resources		Annual euros (per capita)
					(%)	(Billion euros)	
Lagging Regions and Countries	Countries	GNI p.c. below 90% of GNI p.c. of EU25	Surface, population and GNI	166.0	20.0	61.6	53.0
	Regions	GDP p.c. below 75% of GDP p.c. of EU25	For groups of eligible Regions of each MS: GDP per capita, population, unemployment rate and GNI of the Region's country[1]	153.7	57.5	177.1	164.6
	Phasing out Regions	GDP p.c. below 75% of GDP p.c. of EU15 (and not selected by the previous criterium)	Linear reduction from the 2006 level, unemployment rate[2]	16.4	4.1	12.5	109.1
	Total	-	-	206.4[3]	81.6	251.2	173.9
Non-lagging Regions	Phasing in Regions	Not included in the previous categories but eligible as lagging Region in 2000-2006	Linear reduction from the 2006 level, unemployment rate	19.0	3.4	10.4	78.1
	Regions	All Regions different from the other categories	For groups of eligible Regions of each MS: suggested distribution[4]	295.3	12.5	38.7	18.7
	Total	-	-	314.3	15.9	49.1	22.3
Territorial Cooperation	Cross-border	NUTS 3 areas along all internal and certain external land borders and along maritime borders separated by a maximum of 150 km.	Share of population of eligible NUTS 3 Regions	190.0	2.5	7.7	2.3
	Transnational	All areas	Share of national population	484.4			
Total	-	-	-	484.4	100.0	308.0	90.9

Source: DG REGIO.

(1) The rather complex criteria are such that the weights of the three variables "correcting" the population are approximately as follows: 85% regional GDP, 12% GNI, and 3% to unemployment.

(2) The allocation for the statistical phasing out region in 2007 corresponds to 80% of their per capita aid intensity level in 2006 and a linear reduction to reach the national average per capita aid intensity level for the Regional competitiveness objective in 2013 (i.e. between EUR 18 and EUR 25 per capita). To the allocation thus obtained is added, if applicable, a premium of EUR 600 per unemployed person exceeding the number that would be unemployed if the unemployment rate of the EU convergence Regions applied (see point 6(a) of Annex II to Council regulation 1083/2006).

(3) It includes 166 millions of people in lagging countries, 31.2 millions in lagging Regions not included in lagging countries and 9.2 millions in phasing-out Regions not included in lagging countries.

(4) For the distribution of the resources within any group a formula was suggested by the Commission: weighted average of population, unemployed people at NUTS 3, number of jobs needed to reach an employment rate of 70%, number of employed people with low educational level, population density.

The major part of the remaining resources (15.9 per cent of the total) has been assigned to the *non-lagging Regions*, a greater intensity of assistance being provided for those "phasing-in Regions" which in the previous programming period qualified as "lagging" but which exceeded the eligibility threshold because of their own growth.

The third component of the cohesion policy budget (2.5 per cent) is assigned to *European territorial cooperation*. The main beneficiaries (two thirds of the amount) are all the "level 3" NUTS territorial units that are considered to be entitled to cross-border projects: those along internal and certain external land borders and along maritime borders separated by a maximum of 150 km (and including overall almost 40 percent of the EU27 population). The other beneficiaries under this part of the budget – for trans-national and inter-regional cooperation - are all areas of the EU.

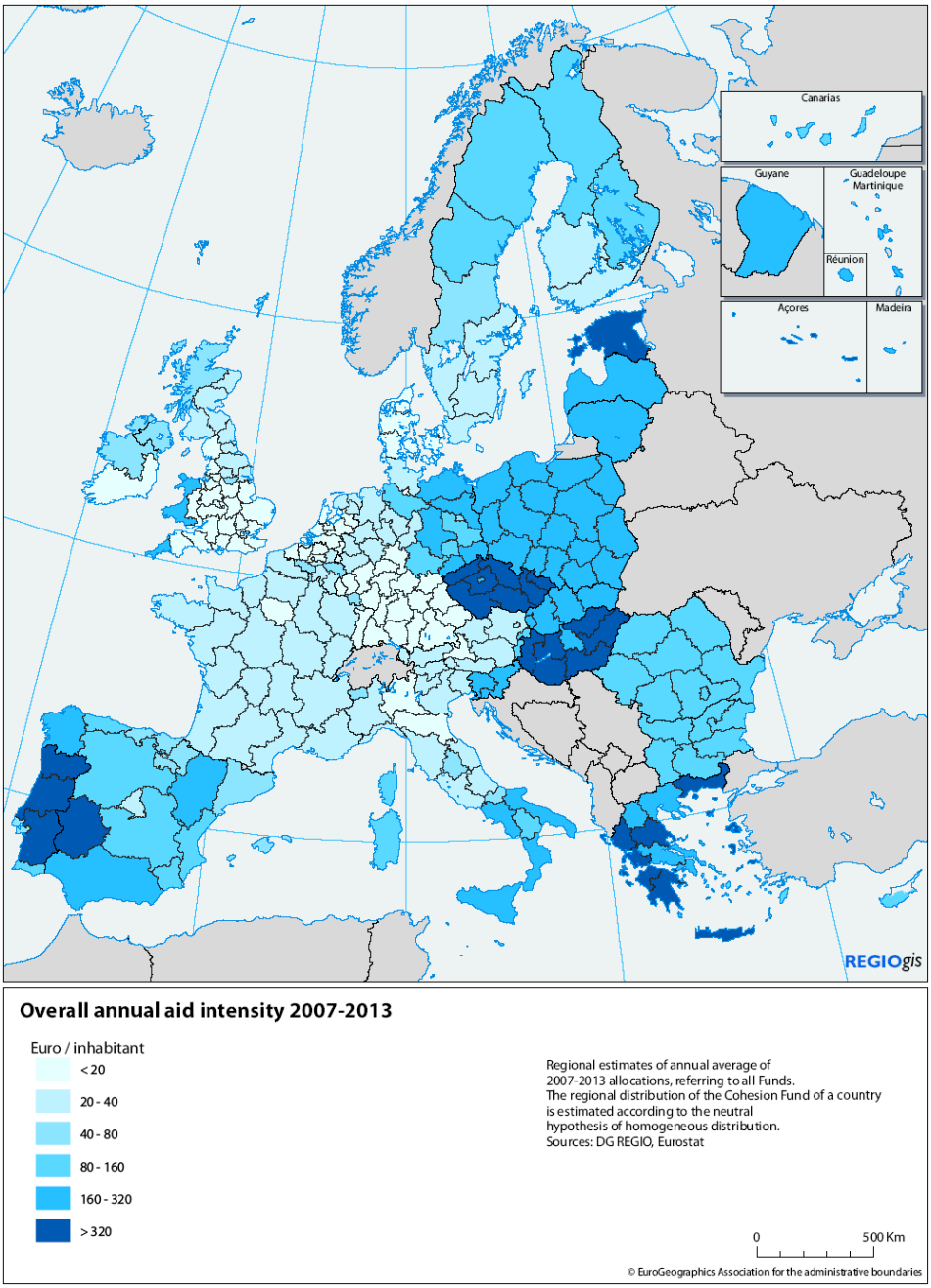
For each eligible territory, the distribution of resources across Regions and countries followed some general criteria (see Table II.1). For a lagging Region, the per-capita allocation was inversely related to the per capita GDP of the Region and the per capita GNI of the country of which it is part, while the region's unemployment rate had only a very small influence (about 3 per cent). A series of *ad hoc* provisions also had to be introduced during the negotiations in order to take care of specific national interests. The resulting overall distribution among Member States is presented in Table II.2, while Map II.3 shows an estimate of the final "aid intensity" for each Region of the EU and Map II.4 shows the corresponding gaps in per capita GDP across Regions.

Table II.2: Allocation of cohesion policy budget to Member States for 2007-2013
(million euros, 2004 prices)

Member States	Lagging Regions and States		Non-lagging Regions	Territorial Cooperation	Total
	Countries	Regions			
Austria	-	159	914	228	1 301
Belgium	-	579	1 268	173	2 020
Bulgaria	2 015	3 873	-	159	6 047
Cyprus	193	-	363	24	580
Czech Republic	7 830	15 149	373	346	23 698
Denmark	-	-	453	92	545
Estonia	1 019	1 992	-	47	3 058
Finland	-	-	1 426	107	1 533
France	-	2 838	9 123	775	12 736
Germany	-	14 323	8 370	756	23 449
Greece	3 289	14 158	584	186	18 217
Hungary	7 589	12 654	1 865	343	22 451
Ireland	-	-	681	134	815
Italy	-	19 255	5 640	752	25 647
Latvia	1 363	2 647	-	80	4 090
Lithuania	2 034	3 965	-	97	6 096
Luxembourg	-	-	45	13	58
Malta	252	495	-	14	761
Netherlands	-	-	1 477	220	1 697
Poland	19 562	39 486	-	650	59 698
Portugal	2 722	15 494	843	88	19 147
Romania	5 769	11 143	-	404	17 316
Slovakia	3 433	6 230	399	202	10 264
Slovenia	1 239	2 407	-	93	3 739
Spain	3 250	20 161	7 628	497	31 536
Sweden	-	-	1 446	236	1 682
United Kingdom	-	2 594	6 232	642	9 468
Not allocated	-	-	-	392	392
Total	61 558	189 604	49 127	7 750	308 041

Source: Fourth progress report on economic and social cohesion, COM (2006)281, Brussels, Annex, p. 12.

Map II.3: Overall annual aid intensity 2007-2013

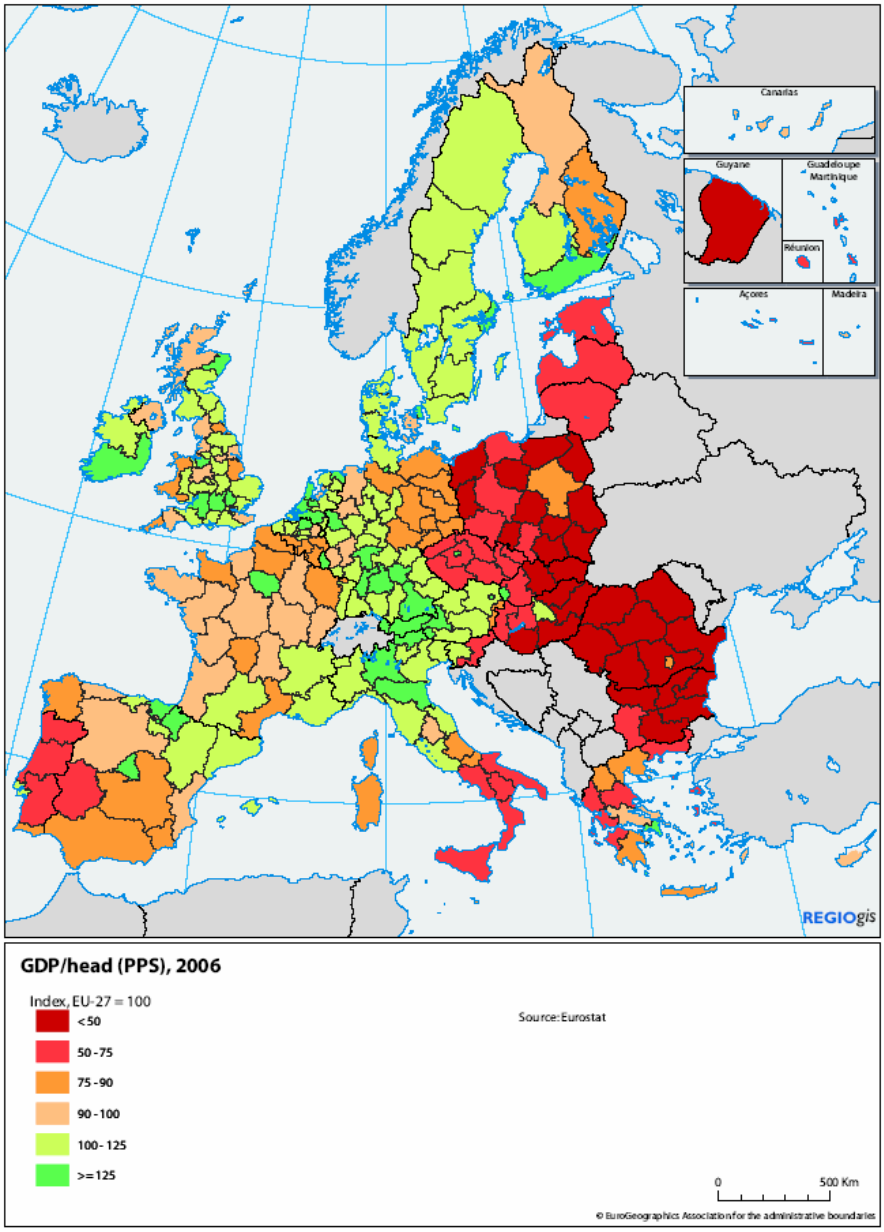


Source: Eurostat.

Allocation to national and regional authorities

The allocation of resources to a Region says nothing about the authority that manages those resources, which might well be the central State. It only establishes that the beneficiaries have to be citizens of that Region.

Map II.4: Disparities in GDP per capita among NUTS 2 Regions in 2006



Source: Eurostat

By looking at the decisions actually undertaken by the Member States on the management of resources allocated to Regions, it appears that only 36.9 per cent[167] of these resources are managed by the Regional authorities, the rest being managed by the central government. Taking account of the resources allocated to the national level through the Cohesion Fund, the administrative Regions are now managing only 30.5 per cent of the whole cohesion policy budget (excluding territorial cooperation) (see Table II.5). As expected in a place-based approach, the role of the administrative Regions strongly depends on the constitutional and political arrangements in each country. Among the ten countries benefiting most from support for lagging Regions, only Germany, Italy and Spain - where Regions enjoy considerable autonomy - have a greater share of cohesion policy resources managed at regional level than at national level (see Figures II.6 and II.7).

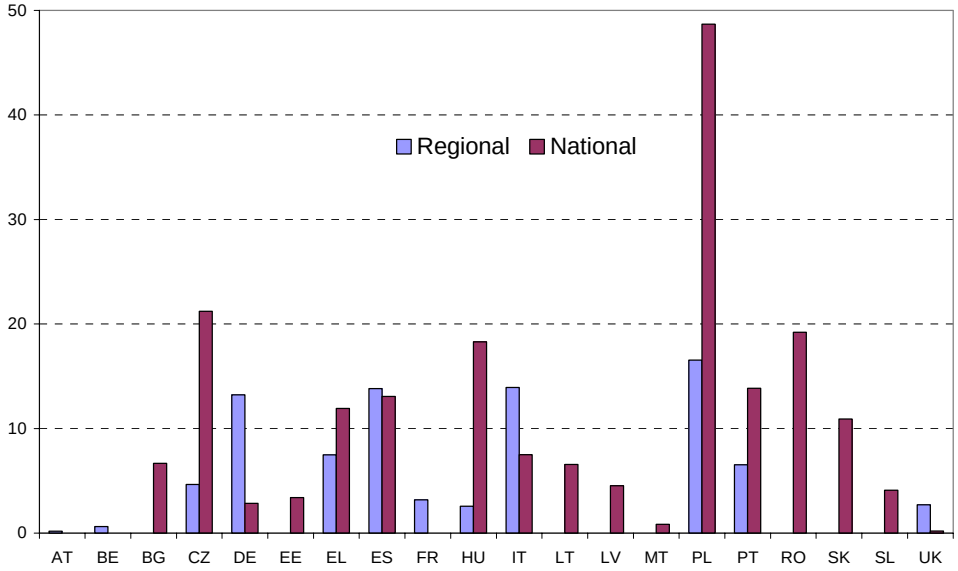
[167] The data have been elaborated by DG REGIO.

Table II.5: Share of resources managed by Regional and National authorities (%)

Managing authorities	Lagging countries	Regions			Total
		Lagging	Non-lagging	Total	
National	100.0	69.4	31.5	63.1	69.5
Regional	-	30.6	68.5	36.9	30.5
Total	100.0	100.0	100.0	100.0	100.0

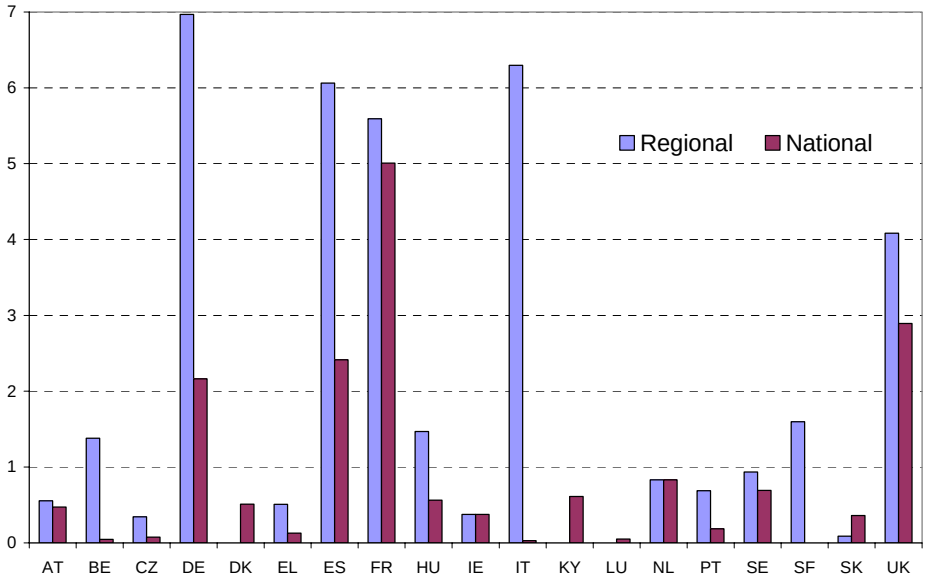
Source: DG REGIO.

Fig. II.6: Share of resources managed by Regional and National authorities in lagging Regions by Member State: 2007-2013 (%)



Source: DG REGIO.

Fig. II.7: Share of resources managed by Regional and National authorities in non-lagging Regions by Member State: 2007-2013 (%)



Source: DG REGIO.

Typologies of interventions

The cohesion policy budget can finance a broad range of expenditure, under the different typologies, or "priorities", in which the development strategy is categorised[168]. The 16 expenditure categories (plus "technical assistance" and "special interventions in the outermost regions"[169]) currently in use are presented in Table II.5, where the distribution of tasks between the ESF and ERDF is also reported. The Cohesion Fund, targeted on the lagging countries, has a more limited scope of action defined by the Treaty: transport, energy and environment.

In the current period, Member States and Regions were also asked to "earmark" resources for those expenditure categories that are considered to fit mostly the EU's Lisbon agenda. These are equivalent to nine of the 16 categories. Lagging Regions were required to concentrate 60 percent of expenditure on those categories, with the requirement increased to 75 percent in other Regions. Earmarking was voluntary for the Regions of the so-called EU12 newer Member States.

Table II.8: Categories of policy interventions and scope of the specific Funds(*): 2007-2013

Categories	Regional Fund (ERDF)	Social Fund (ESF)	Cohesion Fund
Research and technological development (R&TD) and innovation(1)	X		
Support to firms' investments	X		
Information Society	X		
Transport	X		X
Energy	X		X
Environmental protection and risk prevention	X		X
Tourism	X		
Culture	X		
Urban and rural regeneration	X		
Adaptability of workers and firms, enterprises and entrepreneurs		X	
Access to employment and active and preventive labour market measures		X	
Social inclusion of less-favoured persons(2)		X	
Human capital (education, life-long training, high-level studies in R&TD)		X	
Social infrastructure(3)	X		
Partnership and networking		X	
Institutional capacity at national, regional and local level		X	
Reduction of additional costs of outermost Regions	X		
Technical assistance	X	X	X

Source: DG REGIO.

(*) The flexibility of the eligibility criteria of each Fund is such that both of regional and the social ones do also finance a few interventions falling in the categories which are not marked in the table.

(1) R&TD activities, technology transfers, assistance to R&TD, advanced support services to firms, assistance to SMS for environmentally-friendly products, support to firms' investments directly linked to research and innovation.

(2) Integration and re-entry into employment for disadvantaged people.

(3) It also includes: education, health, childcare, housing.

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[168] The Regulation explicitly excludes only: interest on debt, recoverable value added tax, decommissioning of nuclear power plants, purchase of land for an amount exceeding 10% of the total eligible expenditure for the operation concerned (and, for the social Fund, purchase of furniture, equipment, vehicles, infrastructure).

[169] Compensation of costs due to accessibility deficits, territorial fragmentation, size of market factors and climate conditions are accepted for the "outermost regions" listed by article 299 of the Treaty (349 of the new Treaty): it includes freight transportation services, operations linked to storage constraints, operating aids, etc.

General conditionalities

The funding provided by the EU must be matched by national financing. Matched funding does not need to be provided at the level of single projects or intervention, but rather at the level of all the expenditure made in any given category of each Operational Programme (see below). This system of co-financing promotes coherence between cohesion policy and national policies and it extends the amount of expenditure on which EU cohesion policy rules have an influence beyond the limits of the EU budget. Since co-financing does not apply to single projects, it does not reduce the moral hazard of national authorities in choosing projects for EU financing.

Together with this co-financing principle and with the coherence principle (earmarking of expenditure to support the Lisbon strategy), five other general pre-requisites are established as "principles of assistance"[170]:

- *Additionality*: dating back to the origins of the Regional fund, the aim of this principle is to ensure that Community expenditure does not merely substitute for planned national expenditure. In 2007-2013, its verification has been restricted to lagging Regions and a new sanctioning mechanism for non-compliance has been introduced, which could allow the Commission to withhold a percentage of the Member States' funding allocation at the stage of ex-post verification of additionality.

- *Complementarity, sustainable development and gender equality*: the implementation of cohesion policy must complement national actions and other EU policies, must take into account, and actively promote, sustainable development and gender equality/non-discrimination in the planning and implementation of assistance.

- *Partnership*: Member States are required to organise the design and implementation of EU-funded regional development programmes in partnership with "competent regional, local, urban" authorities, with economic and social partners, and with "appropriate bodies representing civil society, environmental partners, non-governmental organisations, and bodies responsible for promoting equality between men and women".

- *Shared management*: the implementation of cohesion policy operates through a mode of shared management, whereby tasks are delegated to Member States but which are required to cooperate with the Commission to ensure sound financial management.

- *Proportionality*: newly introduced for the 2007-13 period, this principle stipulates that the financial and administrative resources employed by the Member States and Commission should be proportional to the total amount of expenditure of a programme in relation to indicators, evaluation, management, control and reporting.

Responsibilities for programming and "contracts" among the Commission and States/Regions

Member States are responsible for implementation, but they must comply with the previous principles and with the commitments that are agreed ex-ante in "contracts" with the Commission. The Commission is responsible for this contracting process, for ensuring the compliance of contracts with the regulations, as well as for offering advice, technical support and guidance.

[170] As set out in Chapter IV of Regulation 1083/2006 (Articles 9-17).

The contracting process works as follows. First, on the basis of Commission proposals, the Council adopts a set of *Community Strategic Guidelines* which specify an indicative framework for intervention linked to the *Integrated Guidelines for Growth and Jobs*. Then, by building on these guidelines (with which "consistency" is required by the Regulation), every Member State prepares "in dialogue with the Commission" a *National Strategic Reference Framework* which sets out the strategy for the use of the funds in that country. The Framework is required to contain the following information: 1) the analysis of existing weaknesses and potentials; 2) an outline of the strategy, including its priorities, and its justification; 3) a description of how it will contribute to the EU priorities; 4) a list of the specific "operational programmes" through which the strategy would be implemented; 5) the indicative allocation of funds among the programmes; and, only for lagging Regions, 6) information on the Additionality commitment; and 7) on the actions planned for improving administrative efficiency[171]. The Commission is given the power formally to approve points 4-5-6-7, while it takes note of the other points.

Finally, each authority of the Member States (either central administrations or Regions, or other bodies) to which the National Framework has assigned a role for managing a programme, draws up an *Operational Programme* (separately for the Social and Regional funds). About 430 Operational Programmes exist in the current programming period. Each Programme is required to contain: a socio-economic analysis; a strategy with priority axes (justified on the basis of the previous two strategic documents) and quantified targets; an indicative breakdown of categories of expenditure; a financing plan; and implementing provisions for a monitoring and evaluation system; and an indicative list of major projects. The Commission is given the power to "appraise" – here the Regulation uses a more straightforward language than it does for the National Framework – the propose operational programmes "to determine whether it contributes to the goals and priorities of the National Strategic Reference Framework and the Community Strategic Guidelines", and to approve the Programme or ask the Member States to revise it.

It must be noted that no information or commitment is required, either in the National Framework or in the Operational Programmes, on the institutional requisites which must be satisfied in each sector where interventions take place in order to spend resources effectively – the institutional focus is limited to the requisite for financial implementation and administrative efficiency by the authorities managing the funds - or on the chain of events (the "theory of change") through which the planned expenditure should bring about results. Quantification of targets is required only in the Operational Programmes.

The allocation of the cohesion budget across the different categories of interventions which, for the current programming period, has resulted from this process is presented in Table II.9 for the threefold typology of eligible territories. Table II.10 presents the breakdown of expenditure (giving both the shares and the actual amounts in millions of euro) for the whole of the Union among the 86 sub-categories into which the 16 expenditure categories have been subdivided.

[171] A "national contingency reserve" could also be set up, providing a mechanism for responding to unforeseen crises.

Table II.9: Allocation of cohesion policy budget by categories and territorial destination, 2007-2013[(*)] (% shares)

	Lagging Regions and countries	Non-lagging Regions	Territorial cooperation	Total
Research and technological development (R&TD) and innovation[(1)]	13.0	21.9	16.3	14.5
Support to firms' investments	4.0	4.5	0.4	4.0
Information Society	4.4	4.2	7.1	4.4
Transport	25.7	4.5	13.2	22.0
Energy	3.1	3.3	4.3	3.1
Environmental protection and risk prevention	16.0	6.3	16.1	14.6
Tourism	1.8	1.5	7.4	1.8
Culture	1.7	1.5	6.0	1.7
Urban and rural regeneration	2.9	3.5	2.2	3.0
Adaptability of workers and firms, enterprises and entrepreneurs	3.0	10.4	1.8	4.2
Access to employment and active and preventive labour market measures	5.0	15.3	2.5	6.6
Social inclusion of less-favoured persons[(2)]	1.8	9.1	0.8	2.9
Human capital (education, life-long training, high-level studies in R&TD)	7.6	8.0	3.9	7.6
Social infrastructure[(3)]	5.5	1.5	5.7	4.9
Partnership and networking	0.2	0.7	2.8	0.4
Institutional capacity at national, regional and local level	1.1	0.2	3.5	1.0
Reduction of additional costs of outermost Regions	0.1	0.5	0.1	0.2
Technical assistance	3.1	3.1	5.9	3.1
Total	100.0	100.0	100.0	100.0

Source: DG REGIO.

(*) In some cases the description of the categories differs from the established one. General subsidies to firms (not linked to innovation) are kept separate from the general category of RT&D and innovation.

(1) R&TD activities, technology transfers, assistance to R&TD, advanced support services to firms, assistance to SMS for environmentally-friendly products, support to firms' investments directly linked to research and innovation.

(2) Integration and re-entry into employment for disadvantaged people.

(3) It also includes: education, health, childcare, housing.

Table II.10: Allocation of cohesion policy budget by categories and sub-categories, 2007-2013 (million euros at current prices; % shares)

Categories		Million euros	Overall share (%)	Share within category (%)
Research and technological development (R&TD) and innovation		**50 046.5**	**14.5**	**100.0**
Code	***Sub-categories***			
01	R&TD activities in research centres	5 783.3	1.7	11.6
02	R&TD infrastructure and centres of competence in a specific technology	9 899.4	2.9	19.8
03	Technology transfer and improvement of cooperation networks ...	5 578.0	1.6	11.1
04	Assistance to R&TD, particularly in SMEs (including access to R&TD services in research centres)	5 574.0	1.6	11.1
05	Advanced support services for firms and groups of firms	5 150.9	1.5	10.3
06	Assistance to SMEs for the promotion of environmentally-friendly products and production processes (...)	2 504.6	0.7	5.0
07	Investment in firms directly linked to research and innovation (...)	9 029.6	2.6	18.0
08	Other measures to stimulate research and innovation and entrepreneurship in SMEs	6 526.7	1.9	13.0
Support to firms' investment		**13 605.4**	**3.9**	**100.0**
Code	***Sub-categories***			
09	Support to firms' investment	13 605.4	3.9	100.0
Information society		**15 284.7**	**4.4**	**100.0**
Code	***Sub-categories***			
10	Telephone infrastructures (including broadband networks)	2 256.5	0.7	14.8
11	Information and communication technologies (...)	3 597.8	1.0	23.5
12	Information and communication technologies (TEN-ICT)	523.8	0.2	3.4
13	Services and applications for citizens (e-health, e-government, e-learning, e-inclusion, etc.)	5 225.1	1.5	34.2
14	Services and applications for SMEs (e-commerce, education and training, networking, etc.)	2 144.4	0.6	14.0
15	Other measures for improving access to and efficient use of ICT by SMEs	1 537.2	0.4	10.1
Transport		**75 774.0**	**22.0**	**100.0**
Code	***Sub-categories***			
16	Railways	4 105.3	1.2	5.4
17	Railways (TEN-T)	18 518.6	5.4	24.4
18	Mobile rail assets	558.8	0.2	0.7
19	Mobile rail assets (TEN-T)	695.6	0.2	0.9
20	Motorways	5 133.1	1.5	6.8
21	Motorways (TEN-T)	17 482.2	5.1	23.1
22	National roads	7 659.3	2.2	10.1
23	Regional/local roads	9 775.8	2.8	12.9
24	Cycle tracks	634.4	0.2	0.8
25	Urban transport	1 793.9	0.5	2.4
26	Multimodal transport	1 635.4	0.5	2.2
27	Multimodal transport (TEN-T)	446.8	0.1	0.6
28	Intelligent transport systems	1 089.8	0.3	1.4
29	Airports	1 851.1	0.5	2.4
30	Ports	3 532.5	1.0	4.7
31	Inland waterways (regional and local)	265.8	0.1	0.4
32	Inland waterways (TEN-T)	595.6	0.2	0.8
Energy		**10 756.2**	**3.1**	**100.0**
Code	***Sub-categories***			
33	Electricity	272.8	0.1	2.5
34	Electricity (TEN-E)	313.2	0.1	2.9
35	Natural gas	658.6	0.2	6.1
36	Natural gas (TEN-E)	361.9	0.1	3.4
37	Petroleum products	171.6	0.0	1.6
38	Petroleum products (TEN-E)	0.0	0.0	0.0
39	Renewable energy: wind	787.6	0.2	7.3
40	Renewable energy: solar	1 071.6	0.3	10.0
41	Renewable energy: biomass	1 796.9	0.5	16.7
42	Renewable energy: hydroelectric, geothermal and other	1 129.8	0.3	10.5
43	Energy efficiency, co-generation, energy management	4 192.3	1.2	39.0

Categories		Million euros	Overall share (%)	Share within (%)
Environmental protection and risk prevention		**50 120.2**	**14.5**	**100.0**
Code	***Sub-categories***			
44	Management of household and industrial waste	6 234.3	1.8	12.4
45	Management and distribution of water (drink water)	8 087.7	2.3	16.1
46	Water treatment (waste water)	13 906.6	4.0	27.7
47	Air quality	1 020.4	0.3	2.0
48	Integrated prevention and pollution control	738.9	0.2	1.5
49	Mitigation and adaption to climate change	304.7	0.1	0.6
50	Rehabilitation of industrial sites and contaminated land	3 450.6	1.0	6.9
51	Promotion of biodiversity and nature protection (including Natura 2000)	2 705.1	0.8	5.4
52	Promotion of clean urban transport	6 166.7	1.8	12.3
53	Risk prevention (...)	5 829.0	1.7	11.6
54	Other measures to preserve the environment and prevent risks	1 676.2	0.5	3.3
Tourism		**6 355.3**	**1.8**	**100.0**
Code	***Sub-categories***			
55	Promotion of natural assets	1 142.4	0.3	18.0
56	Protection and development of natural heritage	1 427.6	0.4	22.5
57	Other assistance to improve tourist services	3 785.3	1.1	59.6
Culture		**5 962.9**	**1.7**	**100.0**
Code	***Sub-categories***			
58	Protection and preservation of the cultural heritage	2 917.5	0.8	48.9
59	Development of cultural infrastructure	2 245.4	0.7	37.7
60	Other assistance to improve cultural services	800.0	0.2	13.4
Urban and rural regeneration		**10 188.2**	**3.0**	**100.0**
Code	***Sub-categories***			
61	Integrated projects for urban and rural regeneration	10 188.2	3.0	100.0
Adaptability of workers and firms, enterprises and entrepreneurs		**14 427.9**	**4.2**	**100.0**
Code	***Sub-categories***			
62	Development of life-long learning systems and strategies in firms; training and services for employees ...	9 752.9	2.8	67.6
63	Design and dissemination of innovative and more productive ways of organising work	1 898.0	0.6	13.2
64	Development of special services for employment, training and support in connection with restructuring of sectors ...	2 777.0	0.8	19.2
Access to employment and active and preventive labour market measures		**22 638.5**	**6.6**	**100.0**
Code	***Sub-categories***			
65	Modernisation and strengthening labour market institutions	2 375.5	0.7	10.5
66	Implementing active and preventive measures on the labour market	12 075.2	3.5	53.3
67	Measures encouraging active ageing and prolonging working lives	1 043.6	0.3	4.6
68	Support for self-employment and business start-up	3 247.2	0.9	14.3
69	Measures to improve access to employment and increase sustainable participation and progress of women ...	2 651.2	0.8	11.7
70	Specific action to increase migrants' participation in employment ...	1 245.9	0.4	5.5
Social inclusion of less-favoured persons		**10 156.0**	**2.9**	**100.0**
Code	***Sub-categories***			
71	Pathways to integration and re-entry into employment for disadvantaged people ...	10 156.0	2.9	100.0
Human capital		**26 030.8**	**7.6**	**100.0**
Code	***Sub-categories***			
72	Design, introduction and implementing of reforms in education and training systems ...	8 612.9	2.5	33.1
73	Measures to increase participation in education and training throughut the life-cycle ...	12 500.6	3.6	48.0
74	Developing human potential in the field of research and innovation, in particular through post-graduate studies ...	4 917.3	1.4	18.9
Social infrastructure		**16 864.3**	**4.9**	**100.0**
Code	***Sub-categories***			
75	Education infrastructure	7 356.2	2.1	43.6
76	Health infrastructure	5 211.0	1.5	30.9
77	Childcare infrastructure	555.7	0.2	3.3
78	Housing infrastructure	802.9	0.2	4.8
79	Other social infrastructure	2 938.5	0.9	17.4

Categories		Million euros	Overall share (%)	Share within category (%)
Partnership and networking		**1 274.5**	**0.4**	**100.0**
Code	***Sub-categories***			
80	Promoting the partnerships, pacts and initiatives through the networking of relevant stakeholders	1 274.5	0.4	100.0
Institutional capacity at national, regional and local level		**3 562.2**	**1.0**	**100.0**
Code	***Sub-categories***			
81	Mechanisms for improving good policy and programme design, monitoring and evaluation ...	3 562.2	1.0	100.0
Reducing additional costs of outermost regions		**647.5**	**0.2**	**100.0**
Code	***Sub-categories***			
82	Compensation of any additional costs due to accessibility deficit and territorial fragmentation	474.8	0.1	73.3
83	Specific action addressed to compensate additional costs due to size market factors	129.0	0.0	19.9
84	Support to compensate additional costs due to climate conditions and relief difficulties	43.7	0.0	6.7
Technical assistance		**10 838.6**	**3.1**	**100.0**
Code	***Sub-categories***			
85	Preparation, implementation, monitoring and inspection	7 894.7	2.3	72.8
86	Evaluation and studies; information and communication	2 943.9	0.9	27.2
Total		**344 533.7**	**100.0**	**-**

Source: DG REGIO

A significant difference can be detected between the allocation programmed for lagging Regions and countries and the allocation for non-lagging Regions. In the first group, about 45 per cent of resources is assigned to transport, environmental and energy infrastructures, while this share goes down to about 15 per cent for the second group. The main differences concern transport infrastructure, which represent more than one quarter of all the expenditure of lagging Regions and countries (less than 5 per cent in the other group). Human capital receives about 8 per cent in both groups. In Regions with a GDP per capita lower than 50 per cent of the EU average, the share of infrastructure goes up to 52 per cent, with human capital falling to less than 5 per cent.

Interventions related to research and innovation receive 13 per cent of the funds in the lagging Regions and countries and about 22 per cent in the non-lagging Regions. Generic subsidies for business investment (not connected to innovation or environment) are down to about 4 per cent in both groups. Pro-active and preventive labour market measures, access to employment (and self-employment) and adaptability of workers and entrepreneurs absorb 8 per cent of funds in the first group and about 26 per cent in the second. Social services (mostly education and health) and measures aimed at social inclusion in the labour market account for about 7 per cent in the first group, and over 10 per cent (mostly aimed at the labour market) in the second.

Management and control

Once the programmes have been approved, Member States have the responsibility for management. The responsibilities for programme management, audit and control are assigned to three key bodies: a Managing Authority with overall responsibility for the main programme-level management and implementation tasks (some of which can be delegated to a technical secretariat or intermediary body); a Certifying Authority, responsible for certifying statements of expenditure and payments applications; and an Audit Authority.

Project generation, appraisal and selection are the responsibility of the Managing Authority, providing that they are in line with programme objectives. Also, a Monitoring Committee, created by the Member State for each programme, is required to approve project selection criteria

within six months of programme approval. An exception concerns major projects, which require prior approval by the Commission[172].

The *financial management* of programmes is undertaken on the basis of commitments and payments. Financial commitments are made by the Commission on an annual basis, in line with the agreed profile of spending under the EU budget and, at Member State level, the aggregation of approved or planned expenditure. Payments to Member States are made by the Commission at three stages: a first interim payment, conditional on receipt of assurance on management and control systems; interim payments, three to five times a year on the basis of certified expenditure incurred; and the final payment of the balance, once the programme closure requirements have been fulfilled and the necessary documentation has been sent to the Commission.

Finally, coming to *control*, the overall system is intended to ensure that the expenditure reimbursed from the EU budget meets all the required national and Community conditions (relating to public procurement, State aids, environment, eligibility) and demonstrate a low error rate. The control system has several levels. One is the control system of the Member States themselves, which aims to prevent, detect and correct irregularities. A second level is the Commission's supervision, which aims to ensure that Member State control systems are established, operate as required and mitigate the risk of control failures, with provisions for financial corrections to be made when irregularities are detected. A third level involves controls by the European Court of Auditors. In the current period, as a result of successive tightening and adjustments of controls, Member States are required to certify, for each Programme, the compliance of its management and control system: the Commission's approval is needed before interim payments can start. An annual audit opinion on the effectiveness of the system must also be issued by Member States.

Monitoring, evaluation, deadlines for spending, other sanctions

Monitoring is linked to the financial and physical targets set in the operational programmes. Progress in achieving these targets is reported by the Managing Authority to the Commission through an Annual Implementation Report, which must be examined and approved by a Monitoring Committee, whose composition is fully up to the Member States to decide and where a representative of the Commission might take part - much looser provisos than in the past). A review meeting is also held annually between the Commission and Member State authorities to examine, for the whole country, programme implementation progress and results over the previous year. A computerized monitoring and information system has the task of allowing a timely exchange of data with the Commission.

Evaluation focuses on the overall programme and is segmented in three distinct phases: ex-ante, on-going and ex-post. The first two stages are primarily the responsibility of Member State authorities, although the Commission offers support through the publication of guidance documents, networking activities and participation in evaluation steering groups, while ex-post evaluation is formally required to be undertaken by the Commission. The scope of ex-ante evaluation is broad, covering the appraisal of needs, goals, expected results, quantified targets, strategic coherence, lessons from the previous period, as well as the quality of the procedures for implementation, monitoring, evaluation and financial management. The "on-going" evaluation is left to Member State choice, in connection with changes in the external environment, difficulties revealed by the monitoring system, and proposals for programme modification.

The only compulsory *incentive mechanism* used by cohesion policy is the automatic de-commitment rule which requires committed funding to be spent within two years (three years for the EU10, Greece, Portugal, Romania and Bulgaria, but only for 2007-10 commitments) or be lost to the programme: the so called n+2 system. Member States are allowed to set aside, at the

[172] Major projects are defined as those whose total cost exceeds €50 million (€25 million in the domain of the environment).

start of the programme period, a "national performance reserve" equal to three percent of programme allocations, whose allocation is linked to the achievement of performance goals and targets. Most Member States have not set up a performance reserve.

The *suspension* of payments is foreseen only for "serious deficiencies" in the managing and control system, for "serious breaches" of the control procedure, for "serious irregularities". No discretional tool is given to the Commission, other than moral suasion, if no or inadequate move seems to be made in the direction of the announced results. The pressure to produce results is left to possible mechanisms operating at country level, or to the possibility of public debate taking place at EU level on the basis of Member States' reporting.

Reporting

With the aim of enhancing accountability and transparency, Member States are required to elaborate two S*trategic reports* in 2009 and 2011 for all Programmes, analysing their "contribution" to cohesion policy objectives, tasks of the Regional and Social Funds, priorities set out in the Community Guidelines, and the Lisbon goals (beyond this reference to these very general goals, no mention is made in the Regulation of comparing results to objectives or targets). A summary of the Member State strategic reports will be prepared by the Commission in 2010 and 2013 and will be subject to examination and debate by the Council, the European Parliament, the Economic and Social Committee and the Committee of Regions.

Finally, the annual implementation Reports prepared by Member States for the National Reform Programmes of the Lisbon strategy must include a concise section analysing the contribution of each cohesion policy Programme, beginning in 2007. An annual progress report summarising the Member State reports is submitted by the Commission to the Spring European Council from 2008 onwards.

BOX II.A The evolution of governance: 1988-2008

Empowering the Commission: 1989-93 and 1994-99.

The 1988 reform (see section I.1.2) led to a radical change in the balance of decision-making authority in the governance of cohesion policy, providing the Commission with much stronger leverage and influence. In the programme periods 1989-93 and 1994-99, considerable emphasis was placed on the programme design stage, where the Commission was able to exercise a powerful role in influencing programme priorities, measures and the balance of funding. This applied particularly to the planning for the 1994-99 period, where ex ante evaluation of programme outputs was actively used as part of a strategic policy discussion between the Commission and Member States.

Several important conditionalities on the use of funds were introduced: stricter regulatory provisions on programme content, requiring quantified objectives; an evaluation of environmental impact; more detailed financial tables and specific information to allow additionality to be verified; increased emphasis on compatibility with other Community policies, most notably in the areas of State aid, public procurement, gender equality and the environment; and strengthened evaluation obligations. Lastly, as a member of Monitoring Committees with veto power, the Commission services were given the opportunity of an important oversight and a decision-making role in the implementation of programmes. Outside the mainstream programmes, the role of the Commission was also reinforced through the increased importance given to Community Initiatives, where it had greater scope for proposing priorities for targeted EU support and stronger managerial responsibilities (prominent examples include Interreg for cross-border cooperation, RECHAR for the conversion of coal-mining areas, URBAN for urban development, and LEADER for rural development). The political role acquired by cohesion policy and its difficult task attracted many professionals to the Directorates-General responsible for the policy, enabling it to cope with the challenge.

Reducing Commission discretion and designing a compliance-oriented system: 2000-2006

During the mid to late 1990s the power of the Commission was increasingly perceived as excessive. The approach was criticised for being too top-down, with insufficient flexibility for the Member States and Regions to adapt the policy requirements to different domestic contexts. At the same time, national and regional authorities (the latter strengthened by decentralisation trends across the EU), had gained experience in preparing development strategies, and were less ready to accept the Commission's role, sometimes perceived as intrusive advice. In response to these pressures, the regulatory framework adopted in 1999 led to a new balance in the respective roles of the Commission and the Member States. On the one hand, the Commission's discretion was curtailed by decentralising responsibility for programme content and management to Member States and Regions. Detailed information on the interventions (i.e. listing the final beneficiaries, monitoring indicators and financial plans for so-called "measures" or groups of projects) was transferred to a Programme Complement adopted by Member States and Regions. The Commission's role in the Monitoring Committees receded to that of an observer, and its role in the programming phase took a step back. A drastic reduction took place in the number of Community Initiatives (from 13 to 4), with a corresponding fall in their share of the Cohesion policy budget (from 10 percent to 5 percent).

On the other hand, in return for this loss of discretion, and with the idea of better supervising the effectiveness of expenditure, new requirements were introduced that would not supposedly require the Commission's discretion, and would rather be as much as possible "automatic". So the obligations for monitoring and reporting became more prescriptive; a formal distinction was introduced between ex-ante, interim and ex-post evaluations, eroding the unitary nature of the evaluation process; a "performance reserve" was introduced where the performance was supposed to be captured by fully-defined and rigid targets and their achievement was rewarded. Financial absorption was also incentivised through a further automatic rule (the n+2 rule). Finally, stronger audit and control requirements were introduced and applied with increasing rigour throughout the latter half of the 2000-2006 period, partly in response to the financial management crisis which led to the resignation of the Santer Commission in 1999.

Attempting a strategic turn: 2007-2013

It soon became clear during the 2000-2006 programme period that the shift away from discretion to more automatic rules had not achieved the desired results. The conditionalities were very often considered by Member States as a "compliance exercise", and they failed to give the Commission substantial information or an opportunity chance to exert adequate influence on performance. The performance reserve, in most cases, placed emphasis on financial absorption rather than on other dimensions of performance (i.e. effectiveness or management), and the difficulty of determining meaningful targets in advance was very often tackled by setting them at unchallenging levels (see below, section II.4). At the same time, programme authorities found themselves burdened with a very complex web of procedural tasks with high regulatory uncertainty, in spite of the simplification exercise undertaken during 2003. This reinforced existing doubts on the effectiveness of cohesion policy. Amid increasing criticisms and growing proposals to restrict the policy to disparities among countries (see section I.5), a widespread conviction arose that a strategic turn was needed in which the Commission could step back from some of the procedural issues and play again a more substantial role regarding the content of policy.

Whether the governance (described in this section) that has resulted from the attempt of a strategic turn, is a satisfactory one is an issue dealt with in section II.4. But it can be anticipated that the changes to the Regulation produced by the long 2003-2006 negotiation, while representing a step in the right direction, especially in introducing a National Strategic Reference Framework for each Member State, have fallen short of expectations. Having been substantially weakened by Member States pressure, they have not provided the Commission with the opportunity or the information adequately to press Member States and Regions on matters of substance and results, and they have further deprived it of discretion by integrating all Community initiatives, except for Territorial cooperation, into the mainstream programmes. The potentially interesting decision to earmark expenditure for Lisbon-related priorities offers such room for manoeuvre that it was treated as yet another compliance exercise. While some procedural requirements were loosened, others have been strengthened or newly introduced. A strengthening of audit and control obligations has also taken place.

II.2. The policy context: a very brief outline of Member States regional policies

EU cohesion policy operates in contexts where development policies are also run at national level. The effectiveness of the former in each country partly depends on how it is strategically integrated with the latter. In particular, all Member States have, together with sectoral policies, some kind of place-based/territorial/regional/spatial development policy, with varying degrees of correspondence with old or new paradigms developed through the culture, the politics and the practice of the country[173]. These domestic development policies – which can be termed "regional" – shape the policy space existing for cohesion policy.

The definition of what constitutes regional policy in the EU Member States has developed significantly over time. From the immediate post-war period up until the early 1990s, the reduction of disparities and the guarantee of equal opportunities to all citizens through the national territory - sometimes linked to constitutional commitments - was implemented, together with welfare policies, through a regional policy mostly aimed at reducing the inter-regional gaps in per capita income. Its main tools were infrastructure support (for transport, water, energy, land improvements) and business aids, largely targeted on backward areas. Examples of such policies includes British regional policy, with regional development grants and regional selective assistance at its core, support in Germany under the regional policy GA (*Gemeinschaftsaufgabe*) established in 1969 and special intervention in the Italian *Mezzogiorno* up to 1992. Governance was rather straightforward, with a strong responsibility of the central governments both for designing and managing policy interventions (except in federal states).

A partial move towards the new paradigm

Following and fomenting an international trend, and influenced both by the strengthening of EU cohesion policy and by the process of decentralisation of authority to jurisdictional Regions, the regional policy of Member States has gradually shifted away from this paradigm, and it is now often closer to the model of place-based policies sketched in chapter I, with an emphasis on the efficiency objective. Competitiveness and growth have taken relevance as policy objectives, the use of business aids has been reduced[174] while the set of instruments has been focussed on public goods and services to citizens and firms, interventions have often broadened to cover all regions, and multilevel governance systems have been designed[175].

The general awareness and attention to the spatial effects of all policy action has increased. In those countries, particularly the Nordic ones, where there has historically been a distinction between narrow regional policy, targeted at designated problem regions, and broad regional policy, focusing on the spatial impact of sectoral policies, the latter has grown in importance, with an effort to coordinate the different policies aimed at social and economic development[176].

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[173] The typology of Ministries (sometimes more than one) in charge for regional policy varies greatly between countries, reflecting different conceptual approaches, the amount of available resources and sometimes the influence of cohesion policy.

[174] This has taken place in the context of a general reduction of the use of State aids, discouraged and progressively limited by the European Union as a policy instrument very prone to be used in an anti-competitive way and as a beggar-my-neighbour tool. Total State aids (for industry and services), of which today regional State aids represent about one sixth, have decreased in the EU15 as a share of GDP from 0.9 percent in 1992 to 0.4 percent in 2007. The reduction has been particularly strong in countries with relevant regional policies, where the use of State aids was particularly intense, like Italy (from 1.4 to 0.3 percent) and Germany (from 1.4 to 0.6 percent). In the EU12 countries the share in 2007 was equal to 0.4 percent, down from 1.2 in 2000.

[175] See Yuill, D., Ferry, M., Vironen, H., McMaster, I. and Mirwaldt, K. (2008), from which many of the following information are extracted.

[176] In Denmark, the new institutional set-up centred on regional growth partnerships integrates local, regional, national and EU economic development activities within a single, programme-based policy structure. In similar vein, the renamed regional growth policy in Sweden aims to improve local and regional competitiveness in all regions via regional programmes and enhanced regional and sectoral

In other countries where EU cohesion policy funding is of major importance and covers a large share of total spending for capital expenditure and for development, particularly those which are beneficiaries of the cohesion fund but also Italy, the strategic framework created by cohesion policy has provided the ground for coordinating "regional interventions" with spatially relevant sectoral interventions. In other countries too regional policy has broadened its scope[177].

On the other hand, the change of perspective has often failed to break into the policy segmentation that prevents truly integrated place-based interventions. The need to define the boundaries of "places" according to the scope of feasible and useful development projects, rather than the other way round, has often run into the bureaucratic, top-down limit of administrative Regions. The need to bring together all spatially-aware interventions, whether aimed at urban, rural or other areas, has often run into the vested interests that have grown up around these fields of action. The need for national spatial planning and the strategy of regional policy to be designed together has run into conceptual, academic and bureaucratic barriers, although some countries are moving successfully in this direction[178].

Efficiency and equity

In its shift towards the new paradigm, the regional policies of Member States have predominantly focused on the efficiency objective. The generic task of "reducing disparities" has been often substituted by the objective of ensuring that the capacity and the potential of all places are exploited and utilised to the full. Regional competitiveness and the extraction of the region's comparative advantages have often become the mantra of regional policy. In the move away from generic business aids, interventions have therefore concentrated on infrastructure support (both broad infrastructure and measures specifically targeted at the business sector), innovation-related assistance, training and retraining, and more in general services aimed at improving the business environment. Measures aimed at improving the capacity of local administrations have also acquired a growing role.

The emphasis on the task of promoting capacity utilisation has broadened the policy from areas lagging behind in economic development, to all areas that need an exogenous support in order to keep up with ever-evolving external challenges. On the other hand, the majority of domestic regional policy funding very often still flows to the backward or peripheral areas[179]. A significant

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coordination. In Finland, the policy focus has shifted towards the development of all regions. In most of these countries, regional interventions in the lagging areas still play a relevant role.

[177] In Germany, where regional policy has long been a Land responsibility, an important instrument for assisting areas facing structural weaknesses, the coordination framework has been used in recent years also to finance R&D institutes, regional strategy-building and cluster initiatives. In the United Kingdom, the focus of regional policy has moved from regional aid and infrastructure-based measures to a wider set of initiatives designed to target the key productivity drivers in the regions (competition, enterprise, innovation, skills and investment).

[178] A good example is Ireland where, following its introduction in 2002, the National Spatial Strategy has become central to developments in the regions, with spatially-oriented support increasingly concentrated on the nine regional gateways and related hubs designated under the Strategy. In the Netherlands, the Peaks in the Delta White Paper is closely aligned with the longer-term National Spatial Strategy, while, in the United Kingdom, economic and spatial development strategies in the English regions are being brought together within integrated regional strategies. Portugal is another country where spatial planning priorities are having a growing impact, not least through the development of a more integrated and coherent approach to the role of urban areas in economic development.

[179] In Germany, six-sevenths of regional funding is allocated to the new Länder which contain under one-fifth of the population; in Italy 85 per cent of the funding goes to the Italian Mezzogiorno which has one third of the population; in Denmark, at least 35 percent of programme-based expenditure must benefit the designated peripheral areas, which hold 10 percent of the population; in the Netherlands, the all-region "Peaks in the Delta approach" has transitional provisions until 2010 under which 27 percent of the budget will flow to the north compared with a population share of 10 percent.; in Sweden, the four northernmost regions received some 44 percent of programme-based funding in 2007 compared to their 11 percent

role is increasingly played in some countries by places and regions at risk of depopulation that the country as a whole wants to maintain viable[180]. As it was pointed out (see section I.2.3), this target – the only one for which the new paradigm of regional policy calls for discouraging labour mobility – can actually be efficiency-enhancing when it truly responds to the demand of people living outside the place to preserve those places through the presence and care of their communities and/or to preserve diversity.

In the policy shift, EU Member States have often not given a similar attention to equity considerations. Neither the freedom of individuals to enjoy an essential standard of services independently of where they live, or their opportunity not to differ "excessively" from the others for reasons linked to external circumstances have generally been the central focus of domestic regional policies. This was already often the case with the old paradigm, but the move away from the vague concept of "reducing disparities" has brought this policy bias to light. Relevant exceptions exist, mostly in the Nordic countries, where the focus on social inclusion is often reflected in the commitment to equitable service provision across the country[181]. In Sweden, the achievement of "a good level of services in all parts of the country", which was the overarching objective of regional policy under the 2001 Government Bill[182], remains an underlying policy theme; one of the three objectives of Finnish regional policy over the 2003-07 period was to safeguard the service structure throughout the country; a shift in a similar direction took place in 2003 in Denmark[183].

In some countries the lack of focus of domestic regional policy on equity and social inclusion is due to the fact that this task and the whole social agenda are tackled through welfare systems not dependent on contexts, and/or through a system of un-conditional block grants paid by an equalisation fund, whereby jurisdictional Regions are fully responsible for spending. This is the case in Austria, where issues of interpersonal equity are addressed through fiscal equalisation mechanisms which aim to provide equal public services all over the territory, and regional policy has a strong growth and innovation orientation. It is also the case of Germany, whose constitutional guarantee of uniformity of living standards throughout the territory (Article 106(3)2) is also fulfilled through a strong fiscal equalisation system.

Governance and evaluation

The greater place-basedness of domestic regional policies and the growing authority of NUTS 2 Regions all over Europe through a process of decentralisation have involved a change of regional policy governance. A system of multilevel governance has come about, partly favoured by the similar mechanisms that were being implemented by EU cohesion policy, and partly influencing them.

The shift to a system where the responsibilities for different tasks of the same policy action are assigned to different levels of government and where at each level of government different sectoral authorities are asked to interact has called for an increased degree of policy coordination,

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population coverage. In Poland too, domestic regional policy support is allocated according to a formula which favours sub-regions with low GDP per head and high unemployment.

[180] In Finland, one of the three broad regional policy goals involves supporting a multi-centred regional structure. In Sweden, the aim of regional development policy over the 2001-07 period was to provide a good level of services in all parts of the country. In Slovenia, one of the objectives under the 2005 Law on Balanced Regional Development is to promote the polycentric development of settlement and polycentric economic development.

[181] See Neubauer, J et al (2007). Italy has made an initial step in this direction in its 2007-2013 comprehensive domestic and European regional programming, by setting standards for services (in education, child care, assistance to the elderly, etc), gearing policy interventions to them and linking financial incentives to their achievement (see http://www.dps.mef.gov.it/obiettivi_servizio/)

[182] Government Bill 2001/02:4, En politik för tillväxt och livskraft i hela landet, 27 September 2001.

[183] See Regeringen (2003) and Halkier, H. (2001).

both horizontal and vertical. National-level coordination involves both the authority in charge of domestic (and sometimes European) regional policy and other national ministries which act as partners in regional development[184]. Regional-level coordination brings together the growing number of local actors to set goals, plan initiatives and allocate resources; regional programmes often play an important role in this coordination. Finally, national-regional coordination is pursued through joint structures with national and regional representation, through the application of national-level guidelines or targets and through the use of contracts or agreements[185].

Whether domestic regional policies have moved in the direction of the place-based model also in the focus on places and in the capacity to mobilise local actors and to truly engineer a process for eliciting and aggregating local knowledge and preferences is very hard to say. The lack of information on this central issue is linked to a more general poverty of information on those aspects of the policies that concern their implementation place by place. In general, the progress in policy tasks, content and governance design has not been matched by adequate progress in the capacity to evaluate policy performance. An increased amount of resources and time is now dedicated to this task, but results are not yet satisfactory.

In the early days of regional policy, relatively little stress was placed on policy evaluation, although a pressure for improving evaluation in the realm of regional policy came in the 1970s both in the UK and in Germany[186]. More recently, evaluation has become more broadly grounded across the Member States, driven by a variety of factors including demands for accountability in public expenditure, an increasing need to demonstrate value-for-money and a growing emphasis on policy learning. A relevant contribution has also come from the evaluation culture of EU cohesion policy, which has certainly influenced changes in countries like Austria, Finland, Ireland and Italy, and more recently in the new Member States.

Results in terms of assessing - through rigorous methods - whether some regional interventions actually have an effect on the policy objectives have come in the area of business aids, where counterfactual impact evaluations are now carried on in several countries[187]. But in general results have fallen very short of needs, and short of the progress which was in the meantime made in other policy areas, especially in social policies. This is partly explained by the peculiar difficulties that impact evaluation encounters in regional policy (see section I.2.4). But the very limited number of academic evaluation studies in this policy area does probably signal also a lack of administrative and political commitment that deprives domestic regional policy of a powerful tool to learn and improve.

II.3. Empirical evidence

II.3.1. Macro

The starting point of any empirical macro analysis of regional performance is convergence, generally limited to average GDP per capita or to productivity. With specific reference to EU

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[184] Together with France, changes in this direction have for example taken place in Greece, Portugal, UK, Finland and in most new Member States.
[185] See OECD (1996).
[186] In the United Kingdom, a 1973 report by a parliamentary sub-committee challenged academics to fill what it considered to be a serious policy vacuum (see House of Commons, Expenditure Committee (Trade and Industry Sub-Committee) 1973). In Germany there has been a long-standing interest in policy evaluation, with "success controls" (Erfolgskontrollen) applied to all public intervention measures from 1970 (see Bachtler, J. 2008). Both the Netherlands and Sweden have also had a long-term interest in regional policy evaluation, in particular when developing new regional policy proposals and related legislation.
[187] In the UK context, see for instance Wren, C. (2005).

cohesion policy, it is often assumed that this is a good measure of the "disparities between levels of development" referred to in the EU Treaty as a proxy of economic and social cohesion.

On the limits and the numbers of convergence

In fact, as this Report has argued (sections I.2.1 and I.2.3), convergence is not a good measure of development. It does not give information on the capacity of a region to escape either inefficiency or social exclusion traps. As for social inclusion, even putting aside the commuting and social transfer issues which make per capita income gaps different from GDP per capita gaps, convergence refers to only one dimension of well-being that cannot be taken as a summary measure of all the others. Furthermore, even on the income dimension, it refers only to an average measure that is silent on individuals' well-being: average convergence (divergence) of a region could well coincide with an increase (decrease) of the share of people below essential standards or of interpersonal disparities, because of counteracting changes within the region. As for efficiency, convergence is not informative on the capacity of a region to make use of its own potential, unless one makes the empirically unproven assumption that this potential is adequately approximated by the average output of all the other regions.

All these limits are even greater since in practical terms convergence is generally measured with reference to administrative Regions which have little to do with the regions or places relevant from the point of view of development.

Furthermore, convergence is even less useful as a measure of the effectiveness of a place-based development policy. When this policy is at work in a region, the reduction of its GDP/income gap with other regions (even setting aside the commuting issue) says by itself nothing on whether, without the policy, the performance would have been worse, the same or better. Convergence of EU regions is then of no help in assessing whether cohesion policy is effective and whether it should be continued, discontinued or reformed.

Still, convergence of average regional per capita GDP can be of use as a "context indicator". It can provide information on the following features: whether, as the result of all market and public forces at work (including cohesion policy), the centripetal forces have been prevalent or not; whether and at what pace a convergence process is taking place; and, if so case, with what features it has occurred. A failure of a region to converge can raise questions – though not give answers – on whether this is due to the potential of that region falling short of the potential of other regions (possibly due to permanent under-utilisation) or to the repeated failure of that region adequately to utilise its potential.

Regional dispersion in per capita GDP is high in all industrial countries[188]. It is high in Europe too. Its change in recent decades is the object of a wide empirical literature. The results can be summarised as follows[189].

First, *a strong overall regional convergence has taken place in the EU in the last 25 years*, in the EU15 only until the end of the 1990s, with a change of trend since then, in the EU27 between 2001 and 2005(see Figure II.11)[190]. In the current decade employment rates have been slowly converging in both areas, while productivity of labour has converged only in the EU12 area. *Overall convergence is largely associated with convergence between countries* with the countries newly joining the Union often growing at a pace much greater than the others (Map II.12): since the mid-1990s *within-country gaps have actually widened* (Figure II.13). The internal widening has been particularly significant in some of the new members of the Union. These results should

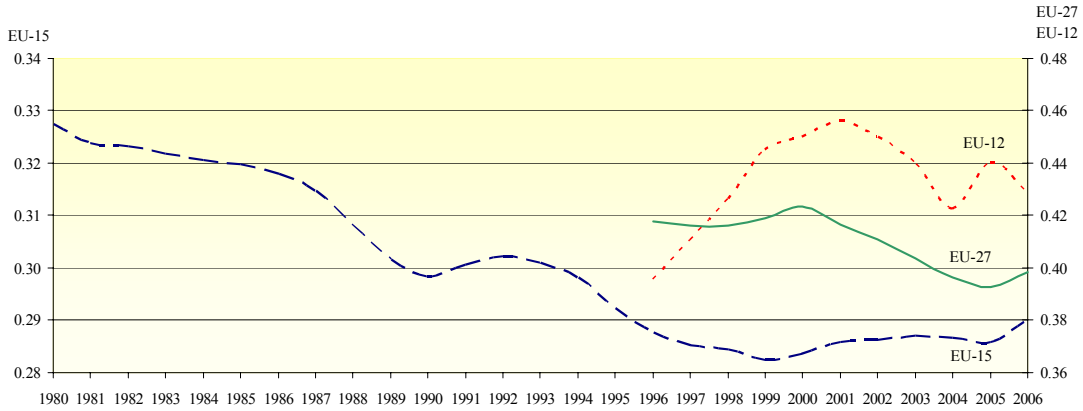
[188] See OECD (2009a).

[189] For a survey of recent results and new empirical evidence from which the figures and maps of this section are taken, see the Report Working Paper by Monfort, P. (2009).

[190] Caution is required in the analysis of long-term trends since the series for the years 1980-1995 are estimates based on data of the previous national accounting system.

be used with caution since the size of regional dispersion, and possibly its within-country increase, are biased upwards due to commuting effects which tend to overestimate GDP in big cities where many people work but do not live, and they tend to underestimate it for "commuter belts"[191].

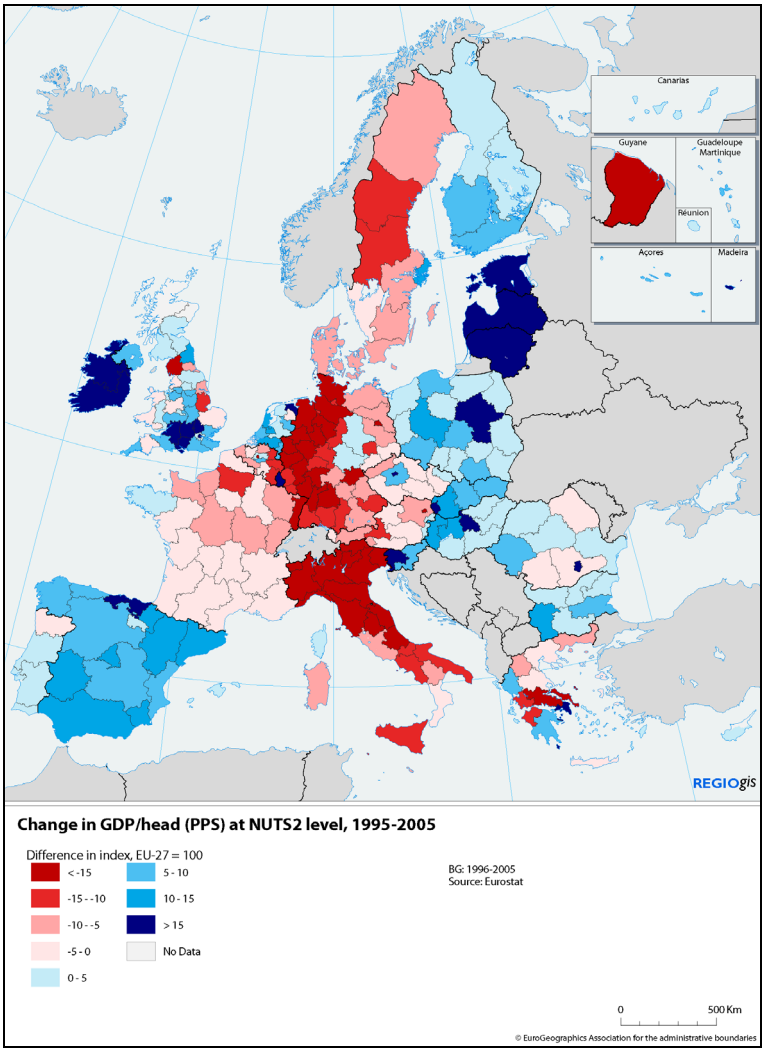
Fig. II.11: Regional per capita GDP dispersion (coefficient of variation) across groups of EU Member States: 1980-2006[(1)]



Source: Cambridge Econometrics and Eurostat database. DG REGIO calculation.
(1) Coefficient of variation measured on NUTS 2 Regions.

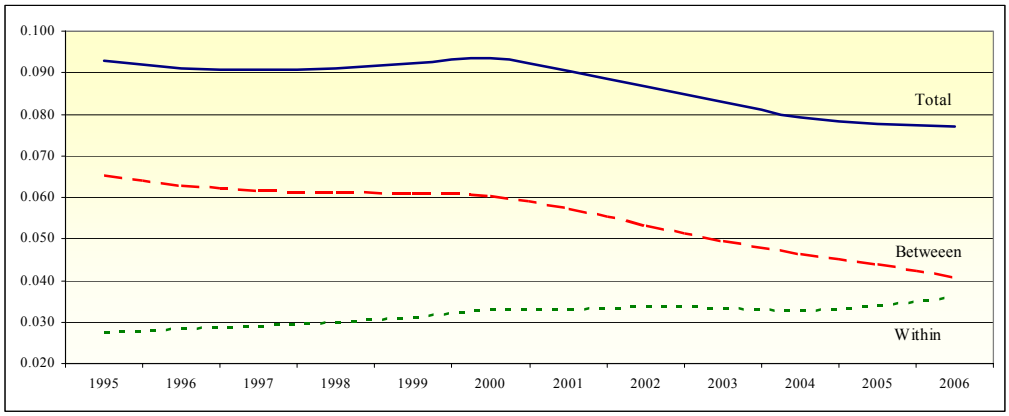
[191] Correction for the commuting effect can lead to significant reductions in the extent of measured regional disparities. A recent study finds that the mean log deviation index is reduced by 15% across the EU-25 as a whole in 2005 and by around 30% in the EU-15 when adjusting for the commuting effect. The effect is even greater in some countries like Belgium, the UK, Slovakia and the Czech Republic. See Applica, Ismeri and Wiiw (2008). This effect might contribute to the observed increase of within-country regional disparities.

Map II.12: Relative income performance of EU Regions, 1995-2005 (per capita GDP - PPS)



Source: Monfort, P. (2009).

Fig. II.13: Regional per capita GDP dispersion for the whole EU in 1995-2006[(1)] between-countries and within-country components (Theil index)[(2)]



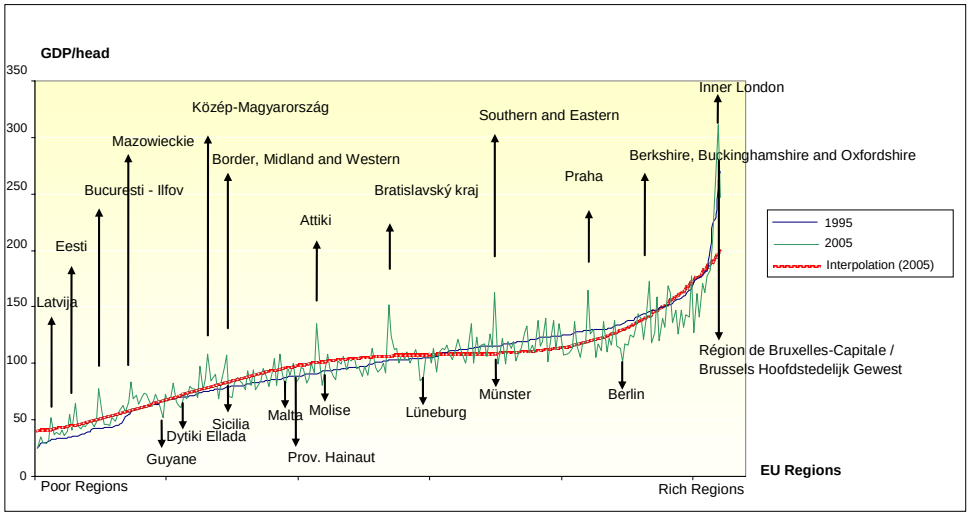
Source: Eurostat database. DG REGIO calculation.

(1) Theil index measured on NUTS 2 Regions.

(2) The Theil index is derived from a measure of information entropy. It measures how far the actual distribution of income is from the distribution that would prevail (at the limit) if each person had the same probability to earn any unit of income (which is equivalent to perfect equality). A property of the Theil index compared to other disparity measures is that it can be expressed as the sum of the average disparity within subgroups and the disparity among those subgroups, a property which is referred as "decomposability".

Second, *the poorest regions have in general been converging towards the average during the last decade*. This can first be appreciated by observing that the regions which ranked as the poorest in 1995 have generally moved up in their relative level of per capita GDP, as have many medium-ranked ones, while most top-ranked regions have moved down: as Figure II.14 shows, movements are of course not uniform among poor and rich regions, the exceptions often belonging to countries with very slow growth (like Italy and Germany). This general feature is confirmed by building transition matrices that express the frequency with which, in the same period, regions of any given class of income stay in the same class or move to other classes. In the EU-15 Member States, and with different choices of classes, the frequency of upward movements of regions in the lower classes is high, is higher than the frequency of downward movements, and is higher than downward movements of regions in upper classes[192]. The typology of regions according to their position in the transition matrix is presented in Map II.15.

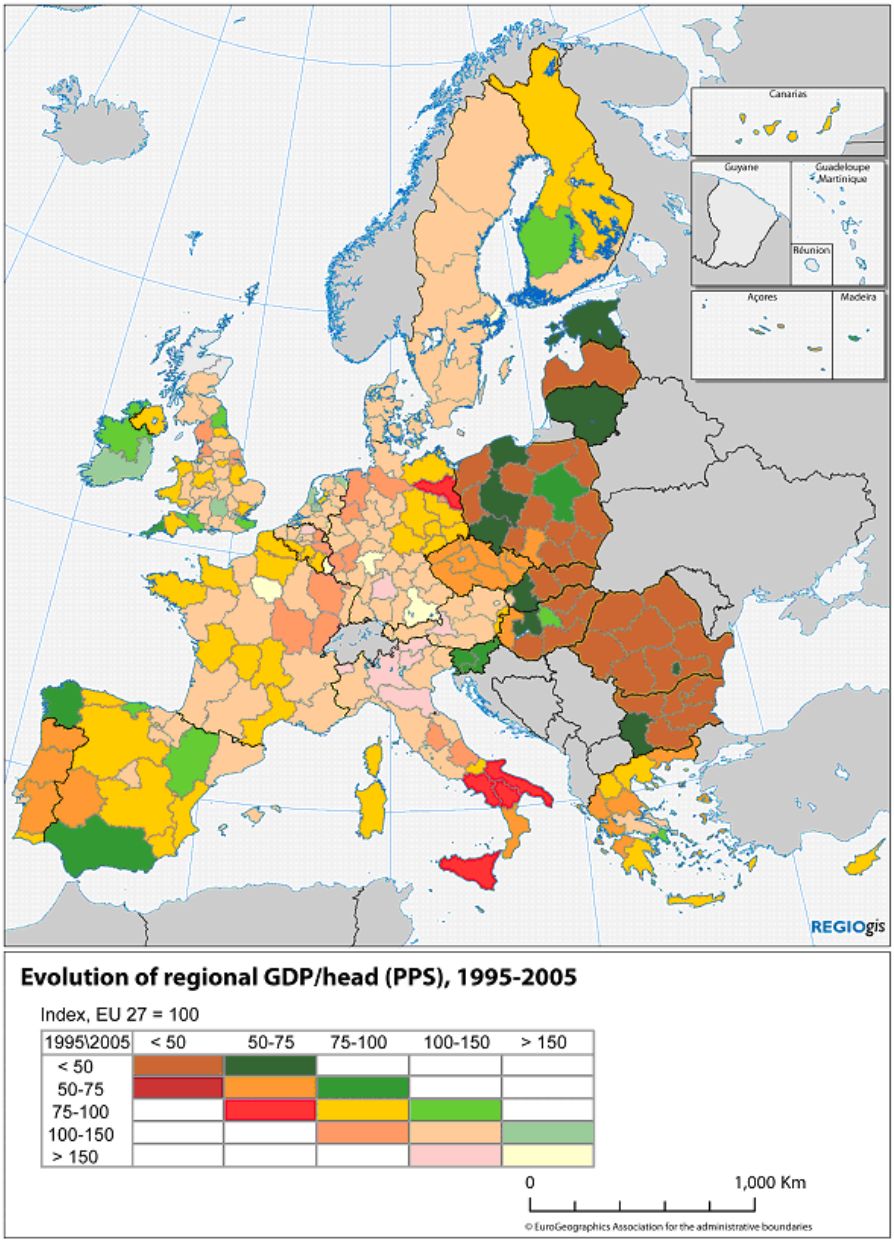
Fig. II.14: 1995-2005 change of per capita GDP of EU Regions ranked according to their 1995 per capita GDP[(1)] (EU=100)



Source: Eurostat database. DG REGIO calculation.
(1) Measured for NUTS 2 Regions.

[192] See again Monfort, P. (2009).

Map II.15: Transition of EU Regions from one income class to an other: 1995-2005
(per capita GDP - PPS)



Source: Monfort, P. (2009).1995 classes by horizontal axis; 2005 classes by vertical axis.

Third, *the convergence process of the last decade is slow*. This is clearly shown by using the information of the transition matrices as a way of estimating the stationary distribution of regional income that would prevail, and the time that it would take to come about if the past relative growth trends were to persist in the future (Markov chain analysis). With different choices of classes, the existence of a process of reduced divergence is confirmed, but the present distribution appears quite persistent, and the time estimated to achieve the new stationary distribution is long (between 40 and 50 years)[193]. The result of a "high persistence … in the regional distribution" is confirmed for a slightly longer period (1991-2005) with reference to labour productivity by a recent study that employs an alternative methodology[194].

[193] See again Monfort, P. (2009).
[194] See Maza, A., Villaverde, J. and Hierro, M. (2009).

It is no surprise that with changes in inter-regional disparities so much depending on idiosyncratic factors, and with a strong persistence of the current distribution, no general "natural linkages" or "path" can be detected between convergence and growth.

It has sometimes been argued that: (i) development will inevitably create regional disparities in GDP per capita; and (ii) these regional disparities will "naturally" vanish as economies develop. An inverse-U curve[195] has therefore been postulated between the level of per capita GDP and the regional gaps in GDP per capita. Recent work seems to confirm the existence of such a correlation across EU countries at a given moment in time[196]. But when time is considered, it becomes clear that many different economic growth paths exist and that no general "rule" is warranted[197]. The application to Europe of the vast empirical literature which tests the existence of a negative correlation between growth rates and the level of growth, shows very different results, depending on the specification adopted (absolute or conditional convergence, set of control variables, spatial effects, change of convergence rate over time, etc.)[198].

Impact of cohesion policy

The strong focus on regional disparities and convergence has influenced the empirical macro-analysis of the impacts of cohesion policy. Both simulation models and econometric analysis have paid much attention to this profile, while being also concerned with the impact of cohesion policy on growth, productivity and employment, or on specific targets, like innovation and accessibility. On the whole, although specific studies have allowed light to be shed on some policy aspects in specific countries and to offer some insights on how policy works, this large body of analysis has led to contrasting results and has not created a consensus on policy effectiveness.

The analysis based on simulation models has made clear the relevance of capital expenditure mobilised by cohesion policy, some of its macro-outputs (such as the number of people trained or those employed by subsidised firms), and the extent of some changes which have taken place while cohesion policy was being implemented (in productivity, employment rate, etc). It has also allowed the construction of accounting frameworks which are relevant for policy debate. However, conclusions on the policy effectiveness of cohesion policy, which are often positive, tend to be strongly influenced by the assumptions built into the models[199].

Econometric analysis has built on the growth theory and on the analysis of absolute and conditional convergence. Existing studies tend to suggest an excessive policy focus on infrastructure investment, while the impact of investments on education and human capital is generally estimated as positive[200]. The estimated success or failure of EU support is also often region/programme-specific due to factors such the quality of strategic planning, the policy and institutional context, and administrative capacity[201]. Beyond specific suggestions, these studies do not offer, though, a conclusive general answer on the effectiveness of cohesion policy. The use of

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[195] The inverse-U is sometimes referred to as "Williamson curve" from the name of the US economist who, by following work by Kutznets on individual incomes, estimated a similar curve for a given moment in time between the level of GDP per capita of US States and the extent of regional disparities internal to each State.
[196] See Barrios, S. and Strobl, E. (2005); Ezcurra, R. and Pascual, P. (2007).
[197] See Monfort, P. (2009).
[198] See the survey by Eckey, H.-F. and Türck, M. (2006).
[199] See among many others: Bradley, J. (2006); Ecotec (2003); ESRI and GEFRA (2002); in't Veld, J. (2007).
[200] See among recent works: Puga, D. (2002); Rodríguez-Pose, A. and Fratesi, U. (2004); Ecorys (2006); De la Fuente, A., Doménech, R. and Jimeno, J.F. (2003).
[201] See among others: Bailey, D. and De Propris, L. (2002); Ederveen, S., Gorter, J., de Mooij, R. and Nahuis, R. (2003); Milio, S. (2007); Ederveen, S., de Grot, H.L.F. and Nahuis, R. (2006); (but on the latter paper, see the criticism of Bradley, J. and Untiedt, G. (2008)).

similar data sets has produced positive, statistically insignificant and negative effects of cohesion policy[202].

These inconclusive results can be attributed to the complexity of the growth and convergence process and to the failure to model it over time and over different countries and regions which are characterised by very different institutional, economic and social conditions. Furthermore, cohesion policy should, by definition, be targeted on specific places and specific populations which represent only a subset of the "regions" and of the population investigated by macro-analysis. Finally, serious problems come from the great difficulty of isolating at macro-level the effects of cohesion policy from those of several external confounding factors, including the effects of seemingly spatially-blind policies, i.e. of building an acceptable counterfactual[203].

An understanding of whether cohesion policy makes a difference to the capacity of specific populations in specific places to increase their unused potential or to reduce social exclusion can be better derived through direct micro-analysis of the specific interventions that were aimed at them. The macro-analysis can then follow, by aggregating the micro-evidence. Before coming, then, to the micro-dimension of evaluation, a final reference must be made to the very limited macro-level information available on what should be the other general objective of cohesion policy: inequality and social inclusion.

Interpersonal income inequality, growth and the regional dimension

The empirical literature on cohesion policy has never paid much attention to interpersonal inequality: neither to the linkage between regional convergence and changes in interpersonal inequality within countries and across the whole EU, nor to intra-regional interpersonal inequality, and not to the impact of cohesion policy on income inequality. This should be surprising considering the proclaimed relevance of the social dimension of cohesion policy. But it can probably be explained by the tendency to overlap the efficiency and the equity goal and to assume implicitly that a reduction of regional disparities in GDP per capita is a good proxy - which it is not - of a reduction in interpersonal inequality.

Existing data show, however, that no given, natural correlation exists between interpersonal inequality and growth in GDP per capita. We know today that the other inverse-U curve – suggested by Kuznets - that was supposed to link the level of development (measured by GDP per head) with inequalities in the distribution of personal income – by which at the first stage of development, inequalities would tend to grow with GDP per head, while at a later stage they would tend to decrease - does not hold. In the last twenty years, the rebound in income inequalities in some industrial countries and its resilience in others show that "if there was an inverse-U, the pattern has now become a U", or more precisely that "it is misleading to talk of 'trends' when describing the evaluation of income inequality…it is better to think in terms of 'episodes' when inequality rose or fell"[204]. In the more recent period, and with the caution required by problems with data homogeneity and availability, a measure of personal income inequality provided by the Eurostat database shows increases in three-quarters of the new

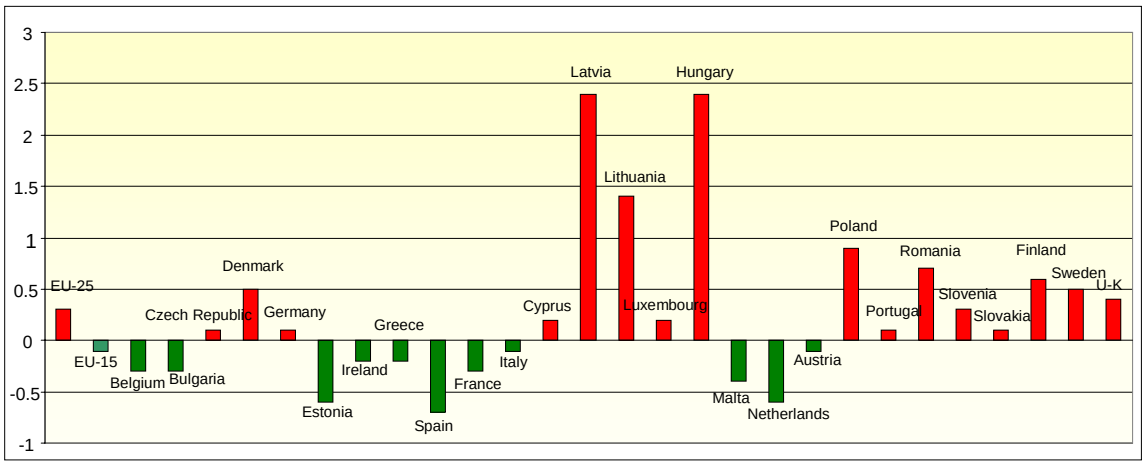
[202] Among recent works, for positive effects, see for example, Cappelen, A., Castellacci, F., Fagerberg, J. and Verspagen, B. (2003), Beugelsdijk, M. and Eijffinger, S.C.W. (2005), and Hagen, T. and Mohl, P. (2008); for absence of results or even negative ones, see for example Dall'Erba, S. and Le Gallo, J. (2008), and Hagen, T. and Mohl, P. (2008). Conditionally-positive effects (depending on the existence of adequate institutions) are estimated by Ederveen, S., de Grot, H.L.F. and Nahuis, R. (2006) (but see on this the criticism of Bradley, J. and Untiedt, G. (2008)).

[203] For an attempt to move in this direction, see Busillo, F., Muccigrosso, T., Pellegrini, G., Tarola, O. and Terribile, F. (2009).

[204] Atkinson, A.B. (2008a).

Member States and in half of the old ones (Figure II.14)[205]. Similar high levels of inequality are shown by an examination of non-income dimensions of well-being (see section IV.2).

Fig. II.16: Changes in interpersonal income inequality in 1995-2005[(1)]
(absolute difference of ratios)



Source: Eurostat database.

(1) Changes in the "income quintile share ratio" (S80/S20), i.e. the ratio of total equivalent disposable income received by the top richest 20% of the population to that received by the bottom 20% of the population. Changes are computed for the period 1995-2005 for EU-15 countries and 2000-2005 for the EU12, except for Cyprus (2002-2005), Latvia (1999-2005), Malta (1999-2005) and Slovakia (2004-2005).

Coming to intra-regional inequality, very little information is available, due to limited policy demand. But what is known is quite revealing. A study conducted on 1990s data shows a very high variance of poverty rates (measured relative to 50% of national median income) within each European country[206]. This high variance persists even when, for each region, rather than a unique national median income, the regional median income is adopted as a standard: even relatively rich areas show high "poverty": Greater London showed a 20.1% variance against 10.1% in Wales or 4.7% in Lorraine.

As a result of very high interpersonal inequality within each region, overall interpersonal inequality is not well captured by inter-regional disparities in income per-capita. A recent study of central and eastern European countries shows that "the contribution of intra-regional inequalities to overall inequality largely outweighs the inter-regional contribution"[207].

The reduction in inter-regional disparities – convergence – obviously tends, *ceteris paribus*, to reduce overall interpersonal inequality[208], but the latter can be strongly influenced by changes in intra-regional inequalities, which can move in the opposite direction. As was argued above, an improvement in a region's efficiency can well take place together with a rise in its internal inequality. Once again, this calls for an analysis to be carried out at micro level, place by place, on the separate effects of cohesion policy on efficiency and social inclusion.

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[205] See also Förster et al (2005) who analyse the evolution of personal income inequalities during the 1990s in the Czech Republic, Hungary, Poland and Russia.
[206] See Jesuit, D.K., Rainwater, L. and Smeeding, T. (2002). Reference is to NUTS 2 Regions.
[207] See Förster, M., Jesuit, D. and Smeeding, T. (2005).
[208] A correlation between the convergence of regions within a country and the degree of income inequality in the same country is shown by an examination of both cross-section and time series by Monfort, P. (2009).

II.3.2. Micro

Since its reform in 1988, cohesion policy has been one of the most extensively reported and evaluated policies in Europe, certainly more than any other EU policy. The evaluation framework, as the analysis of Member States practice shows, has certainly increased the propensity to question results, and to investigate the implementation process. It has created strong incentives for investing human resources in this field, even in countries whose culture was more alien to an evaluation approach. However, if we search for the evidence produced by this effort, the results appear to be poor. This is particularly true for two of the most relevant dimensions of any evaluation effort in the field of place-based policies: an understanding of which interventions work and which do not; and the mobilisation and concentration of public debate, both at the level of the elites and the general public, on a few clear-cut objectives measured by indicators and targets.

The first of these two tasks – learning about what works (and for whom) – should have been entrusted to impact evaluation, i.e. to a micro-evaluation, intervention by intervention, of whether the action aimed at a given set of citizens or firms changed their behaviour and produced the desired effect or any other effect (see section I.2.4). Impact evaluation, as with the rest of the evaluation process, is the responsibility of Member States. A valuable effort undertaken recently by DG REGIO, whereby all the information and evaluation studies conducted by individual Member States for the 2000-2006 programmes were surveyed and analysed, has shown that very little and fragmented results have been achieved by Member States in this area of evaluation, their effort being concentrated on process evaluation and on the qualitative evaluation of all programmes[209]. A limited amount of available empirical studies making use of counterfactual impact evaluation concerns the effects of business aids on the levels of investments and employment[210]. No systematic use can be made of these results. The possible reasons for this failure in making impact evaluation a central tenet of cohesion policy are discussed in the next section.

The picture for indicators and targets is equally worrying.

Member States are and were formally required to quantify targets in the operational programmes. This was both in terms of financial and physical outputs – such as the kilometres of road or of training hours - and in terms of outcome relevant for people's well-being – such as accessibility times or competence levels) and with reference to measurable indicators. Member States were also required to update the Commission, via a dedicated database, on the progress made against these indicators. The questions are then: Have meaningful target values been chosen? Do the indicators (whose selection is left to Member States and is supposed to reveal preferences and policy choices specific to places) comply with minimal requisites of statistical validation, clarity of interpretation and responsiveness to policy intervention? Can some of the indicators (at least those referring to output) be aggregated across countries? Has there been ex-ante or ex-post a European public debate on the targets chosen by different Member States? Or on whether targets were achieved and why? The answer to all these questions is not affirmative.

The survey of ex-post evaluations confirms what the absence of any EU-wide database available to the public on indicators and targets was already signalling: the quality of the indicators is doubtful and so is the meaningfulness of the targets. Indicators mix variables that are quite close to policy interventions (like the share of goods transported by train or the connection to sewage networks) with variables that describe the general context (rate of employment, share of direct investments). They mix (without clarification) objective and subjective typologies, they often

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[209] See Ex-post evaluation of Cohesion Policy Programmes 2000-2006. The few exceptions are mostly represented by the impact evaluation of business aids.

[210] See for example: Bondonio, D. and Greenbaum, T. (2006); Bronzini, R. and de Blasio, G. (2006); Duch Brown, N., Montolio Estivill, N. and Mediavilla, M. (2007); Adorno, V., Bernini, C. and Pellegrini, G. (2007).

refer to different years, they are often expressed in absolute terms with no clue to how they are to be standardised, and they do not exhibit statistical validation. Targets are often overly ambitious, often just above the baseline, without justification being provided for these choices.

For two countries – Italy and Spain - where information was available which allowed the survey of evaluations to construct some tables, the targets and actual values for some of the indicators are reported in Table II.17[211]. The choice of indicators is limited to those for which the above problems seemed less serious. The table draws attention to several issues: the scattered and unstructured way in which the information is provided; the problems that should be tackled in order to make it really useful; but also the potential that these figures could have if they were to become the object of public debate. This is ultimately the real problem with this information. In general, it is provided by Member States as a compliance exercise, knowing in advance that it will not be discussed. No-one will ask, for example, Italy why the reduction of water distribution irregularities, to which many resources were assigned, fell so much short of the target, or which local achievements are behind the reasonable results in differentiated waste collection, considering what is publicly known about *Naples mondezza* (garbage). No public discussion, no circulation of information, poor quality of information: this is the inferior equilibrium that prevents indicators from being of use.

Table II.17: Targets for lagging Regions eligible for cohesion policy: a selection for Italy and Spain

Indicators	ITALY			SPAIN		
	Baseline (2000)	Targets (2006)	Final values (2006)	Baseline (1998)	Targets (2006)	Final values (2005)
Transport						
Length of road network of high capacity (kms/1000 km^2)	-	-	-	14.5	24.3	20.9
Length of TEN (kms)	-	-	-	5 096	8 186	6 144
Length of high speed rail (kms)	-	-	-	623	1 565	687
Goods transported by train as share of all transported goods (%)	1.9	2.7-2.8	1.8	-	-	-
Air traffic (passengers per 100 inhabitants)	90.4	120-140	119.5	-	-	-
Telecommunication						
Internet diffusion among families (%)	10.8	40.0	29.1	-	-	-
Internet diffusion among population over 14 years old (%)	-	-	-	5.4	25.4	23.5(1)
Environment						
Water distribution interruptions (% of families with irreg.)	29.7	12.0-15.0	23.3	-	-	-
Connection to sewage water network (% population)	-	-	-	79.0	98 .0(2)	100.0
Differentiated waste collection (% of waste)	2.2	7.0-13.0	9.7	-	-	-
Protected land (% of surface)	-	-	-	12.9(3)	28.0	13.4
Polluted coasts (% of total)	5.9	4.0-5.0	6.6	-	-	-
Other services to citizens						
Medical doctors (per 1.000 inhabitants)	-	-	-	3.9	4.5	4.1
Thefts (per 1.000 inhabitants)	19.3	14-16	18.7	-	-	-
Violent crimes (per 10.000 inhabitants)	15.2	12-14	23.8	-	-	-
Participation in sport (% total population)	21.8	25-30	23.1	-	-	-

Source: Ex-post Evaluation of Cohesion Policy Programmes 2000-2006.
(1) 2003.
(2) 2006.
(3) 2000.

The quality of indicators and the lack of any legal requirement to establish core indicators common to all Member States are also the reasons why data can only be aggregated internationally for some countries and for limited information. The above survey and other sources allow, for example, DG REGIO to estimate that, in the period 2000-2006, and with reference to different subsets of Member States, 44.4 thousand kilometres of new (or reconstructed) roads, 11.7 thousand km of new (reconstructed) railways and 17.2 thousand km of

[211] The failure of the evaluators to construct summary tables for other countries is not a good signal on their quality.

water supply network have been built[212]. But, for example, in terms of the time saved by transport improvements (a meaningful measure of outcome in this field), information is only available for certain countries, expressed in non-comparable units of measurement[213].

Although no changes have been made in the Regulation for the current programming period 2007-2013 that are likely to change this situation, improvements might come from the Commission's recommendation to apply a limited set of indicators across all programmes and from the recent DG REGIO initiative to establish, through a survey of countries' choices, indicative common definitions of core indicators and then to check the actual availability and quality of data for these indicators in the information system. But a sharp change in the demand side, in the expected public use of this information, and in the role these data play in Member States' strategy and reporting is clearly necessary to make indicators and targets a useful policy tool.

II.4. A tentative general assessment of successes and failures of cohesion policy

The limits of both macro and micro quantitative systematic evidence weaken any attempt to produce a definitive assessment of cohesion policy. However, the availability of a large body of qualitative analysis and studies, the existing research, as well as a review of an extensive set of policy documents and reports allow us tentatively to assess how close/far cohesion policy is from/to the place-based model sketched in chapter I.

"Successes" and "failures" are summarised in a list of 15 statements presented in Box II.B. The following sections provide explanations and references for those statements. The list is defined as "provisional", since some of its content represents an informed assessment, and in the hope that the discussion promoted by this Report, together with new results on the effects of the more recent programme periods and improved quantitative analysis of results will lead to refinement, revision or rejection of some or parts of these statements.

On the whole, on the basis of all the reviewed evidence, the Report has come to believe that cohesion policy offers the appropriate framework for implementing a place-based approach to development in the European Union. But it has also come to believe that its present strategy and architecture cannot meet the challenge. Significant and visible major changes need to be made in its priorities and governance. The weaknesses analysed in what follows can help in identifying these changes.

Strategy and objectives

Cohesion policy has certainly contributed to the development of a common strategic approach to regional policy across the EU which has many features of a place-based development approach[214].

A multi-level governance system has been developed, where an agreed set of policy principles and criteria for allocating funds and a common regulatory framework are combined with flexibility for Member States to implement the funding according to their own institutional structures. Within this governance system, the Commission has played a central role. It has been the architect of reform proposals and has influenced area designation and financial allocation methodologies. Its role in ensuring regulatory compliance has been used to modify programme

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[212] The aggregation refers to different group of countries: for roads to 15 Member States (CY, CZ, DE, EE, EL, ES, FR, HU, IRL, IT, LV, MT, PL, PT, SK), for railway to 8 (CZ, DE, EL, ES, IT, LT, SK, UK), for water to 9 (CZ, DE, EL, ES, IT, MT, PL, PT, SK).

[213] Spain, for example, saved nearly 1.2 million hours of travel time; Czech Republic reduced road time by 23% in the areas of intervention.

[214] Bachtler, J. and Yuill, D. (2007).

strategies and to influence, monitor and control the operational allocation of expenditure[215]. Research has indicated that the principles and methods of cohesion policy have influenced the design and/or implementation of regional development policies in almost every Member State. In particular, they have contributed to a broadening of the agenda of regional development (beyond business support and infrastructure, and with an increasing focus on EU-defined objectives), and to new forms of governance, to include regional and local actors as well as non-governmental groups in developing region-specific development responses.

These policy and institutional effects are most prominent in the lagging regions and countries of southern, central and eastern Europe – where significant spillovers into national policies and administrative practices and effects on institutional capacity are evident – but also apply (to a lesser extent) in the non-lagging regions[216].

However, the paradigm shift is still a "work in progress". The traditional approach to regional policy, focusing on financial transfers to firms to compensate for their higher unit capital costs, and on public works retains a high profile in some Member States, where a place-based approach – aimed at providing bundles of public goods and services tailor-made to contexts – is still in the making. In these situations, although cohesion policy funds are not earmarked to sectors, a large part of the resources ends up being allocated to sectoral programmes that lack place-basedness: this is particularly the case for the resources – about two thirds of the whole budget – which are managed by the central administrations.

Efficient (and possibly effective) management and implementation of the policy is particularly evident in Member States where there has been a high level of integration between EU and national development strategies, built on strong analytical foundations, with institutionalised partnership, clear definitions of roles, wide consensus and a strong commitment from political elites[217]. This integration has also sometimes enabled the Commission services to play a supportive role in strategy development (especially in the 1990s) and in the management of programmes[218].

Where this shared strategic approach is lacking, the implementation of cohesion policy has been subject to major tensions and conflicts. This is evident in some Member States which have a long-standing domestic regional policy, and which have been unable or unwilling to integrate fully the objectives or (more commonly) the management processes of cohesion policy. This has led to the implementation of "parallel" regional policies (EU and national), each with its own administrative requirements. The result is inadequate internal policy coherence between cohesion policy and domestic regional development policies/strategies and limited exploitation of the scope for strategic synergies. A further consequence is problematic relations between national and European administrators[219].

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[215] Bachtler, J. and Méndez, C. (2007).
[216] Ibid. See also: Dąbrowski, M. (2008); ÖIR (2007); Mairate, A. (2006).
[217] See for example: Hartwig, I. (1999); ÖIR, LRDP and IDOM (2003); Bradley, J. (2005).
[218] Bachtler, J. and Méndez, C. (2007).
[219] National administrators chafe at the imposition of administrative obligations which are variously seen as more prescriptive, complex and bureaucratic than existing national processes – especially where EU funding is relatively small-scale – and they may resent or even obstruct the influence of the Commission services. For their part, Commission officials are frustrated at their limited ability to influence the way that cohesion policy funds are managed and implemented. Over successive programme periods, some of these conflicts have been ameliorated by a convergence of EU and national policy goals and the adaptation of administrative systems, but the friction between different EU and national processes – and associated strategic deficits - remains a problem in several countries. See EPRC and Metis (2009).

The territorial or place-based dimension

In general, the effectiveness of the strategic approach has been negatively influenced by the failure to develop over time the policy model, to debate and refine the place-based development model – that cohesion policy itself helped to shape after 1988 – in the light of lessons and of the advancement of economic theory.

Existing research has underlined insufficient understanding in cohesion policy strategy development and debate of what is driving or hindering regional economic change, and the lack of a development model behind the adopted strategies[220]. This weakness has made cohesion policy open to several inappropriate interpretations (for example, of being a tool for financial redistribution among regions, or for regional convergence – see sections I.2.3 and I.5); it has led to growing criticisms – that it acts against labour mobility or against efficient agglomeration processes; and it has diluted its territorial or place-based nature. The reference to places, to a place-based approach, has been progressively left to a "niche" of the policy arena. The place-based dimension has been somehow constrained into a corner – the "spatial" corner – and has been progressively treated as a perspective which is separate from the "economic" and "social" perspectives, rather than as a way of approaching both these dimensions; the perspective has been used for some limited programmes (territorial cooperation, Leader – in rural areas – and Urban, while they existed, and a few others), but does not characterise all interventions.

The failure to develop the conceptual foundations and the scope of the territorial dimension is evident in the tendency to treat jurisdictional NUTS 2 Regions as the unit of reference for policy intervention, i.e. to confuse them with the places or regions that the policy should target (according to the economic rationale discussed in section I.2). NUTS 2 Regions very often are, in the context of a place-based policy, the most suitable entity to be entrusted with programme management, i.e. with the responsibility to select places and projects (section I.2.4). Due to the availability of robust data, they might also be the appropriate unit of reference for allocating EU funds (see below, section V.1). But they almost never are the appropriate unit of intervention. They are not the places/regions for which a place-based intervention should be designed. Mistaking one thing for the other has led to the unfounded idea that the purpose of cohesion policy was the convergence of NUTS 2 Regions.

The conceptual limits, the inadequate emphasis on the territorial perspective, have limited, in the current programming period, the positive impact of the decisions to link a relevant share of cohesion policy to the Lisbon Strategy and to introduce the Community strategic guidelines and a National Strategic Reference Framework for each Member State. While the Community strategic guidelines, especially their first draft, reflected several important territorial themes, the opportunity was missed for cohesion policy to add - to the sectoral approach of the Lisbon strategies - the place-based dimension. Cohesion policy was rather seen by many as a "fund with a redistributive tilt" to be used as a means of financing sectoral policies. Furthermore, the final scope of "priorities" was so broad and their number was so high that a very unfocussed policy design was allowed[221]: Member State pressure on the regulations during the negotiations

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[220] Bachtler, J. and Gorzelak, G. (2007).

[221] This lack of focus is well represented by the juxtaposition of several "sets of priorities" whose reconciliation take place at the cost of taking away any focus from the word priority. The Community strategic guidelines for 2007-13 contain three "priorities": (a) improving the attractiveness of Member States, regions and cities by improving accessibility, ensuring adequate quality and level of services, and preserving the environment; (b) encouraging innovation, entrepreneurship and the growth of the knowledge economy by research and innovation capacities, including new information and communication technologies; and (c) creating more and better jobs by attracting more people into employment or entrepreneurial activity, improving adaptability of workers and enterprises and increasing investment in human capital. These priorities are sub-divided into a number of specific guidelines, mostly related to cohesion policy but some relating to legal, regulatory or investment policies of the Member States such as land-use planning, accessibility of services and wage bargaining. Partly corresponding with the guidelines,

worsened this situation by inserting "catch-all" categories of eligible expenditure – such as "other investment in firms" – and ensuring that the Fund-specific priorities needed only be "primarily" rather than exclusively targeted.

Finally, the lack of clarity and consensus on the policy model has limited the coordination, both at Member States and EU level, between the territorial approach of cohesion policy and sectoral strategies.

At EU level, although sometimes presented as an organisational problem - different funds administered by different Directorates-General – the insufficient policy integration has often concerned the goals and the priorities of policy. This is most obvious in the relationship between cohesion policy and rural development, where there is no coherence between the two sets of community strategic guidelines. But it also applies to social priorities, which should be tackled through a fully coherent territorial strategy embracing public goods and services financed by both the Regional and the Social funds. Or to specific policy goals like innovation or cluster development, where the Directorates for Regional policy, Research and Enterprise (and indeed for Competition) each have their own, poorly coordinated objectives. The debate and analysis originated by the explicit reference in the draft of the new Treaty to the "territorial" dimension of cohesion have recently brought attention to these limits: "Experience shows – it is argued in the document adopted in November 2008 by the Ministers responsible for spatial planning and cohesion policy[222] - that the European Union's sector-based policies often have effects which can run counter to the cohesion goals", not taking into account their "likely territorial impact".

Efficiency and social inclusion objectives

The conceptual fuzziness has been increased by the failure to distinguish between efficiency and social inclusion (equity). The Treaty reference to "reducing disparities between the levels of development of the various regions" has progressively come to be interpreted as "convergence" between regions, and convergence has been interpreted as implying both efficiency and equity. Social goals have progressively been pursued by "camouflaging" them as efficiency goals, while efficiency goals have often been "justified" with reference to their social synergies. One objective has been pursued in the name of the other. As has been noted: "much of the language of EU cohesion policy eschews trade off"[223], as if the two objectives would necessarily and always reinforce each other.

This is unfortunate, since, as this Report has shown (sections I.2.2 and I.3): first, from the outset cohesion policy has embodied a vocation to pursue both equity and efficiency objectives; second, the place-based approach, which characterises cohesion policy, is a very effective way to pursue both these objectives; third, none of the two objectives is captured by convergence; fourth, both trade-offs and synergies exist between the two objectives, whose balance can only be empirically determined with reference to specific contexts; therefore and finally, policy effectiveness demands that the two objectives are pursued by dedicated interventions, in both cases through a territorial/spatial/place-based perspective.

This fuzziness of meta-objectives and the dichotomization of the economic-social perspective from the territorial one have hampered strategic design. This is particularly the case for social interventions: as the Report argues (section I.2.2), the very causes of social inclusion are context-dependent and policy effects depend on places; the effectiveness of a social agenda, the pursuance of greater social inclusion, could be strongly enhanced by its territorialisation. At the same time, the ambiguity between efficiency and equity and the emphasis on convergence have

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the Fund-specific regulations identify 16 priority themes on which assistance should be 'primarily' focused (see Section II.1). Under the earmarking requirements, 9 of these priorities are "prioritised".

[222] The document was approved at the meeting in Marseille organised by the French Presidency. It was a step in the process initiated by the presentation of the Commission "Green Paper on Territorial Cohesion".

[223] See the Report Working Paper by Farole, T., Rodríguez-Pose, A. and Storper, M. (2009).

negatively influenced the policy process - by depriving it of a more meaningful and focussed public debate – and the capacity to assess results. And they have fuelled some of the misconceptions mentioned above.

Contracts and conditionalities

As the Report has shown (section I.2.4), the multilevel governance that runs place-based development policies must appropriately combine conditionality and subsidiarity[224]. In particular, it must allow the level of government responsible for the exogenous action to set priorities and to shape criteria for interventions (*conditionalities*), while at the same time allowing and promoting the freedom of the private and public actors at lower level of government to "advance ends as they see fit" on the basis of their knowledge and preferences (*subsidiarity*). In EU cohesion policy the compromise between conditionality and subsidiarity is unsatisfactory.

On the one hand, the combination of the National Strategic Reference Framework and the Operational Programmes of each country fails *de facto* to provide the Commission with an adequate commitment by the Member State (and its Regions) about its strategy and its coherence with EU criteria. On the other hand, the ex-ante conditions on the use of funds give rise to great concern among Member States and Regions about their interpretation and about being second-guessed by the Commission[225]. Overall, the perception of cohesion policy as a mere redistributive tool in the form of block grants has been reinforced.

As pointed out earlier (section II.1), the Regulation does not require, either for the National Framework or for the Operational Programmes, any commitment on the institutional requisites to be satisfied in the sectors of intervention and any explanation of how the national or regional authorities expect to achieve the announced results and about the timing of this process. As for objectives and targets, they do not need to be specified in the National Framework, while a review of Operational Programmes for the 2007-2013 period, as well as the experience of previous periods, show that the section on indicators and targets, generally relegated to the latter stages of the programme approval process, often appears as an appendix[226]. Furthermore, as noted above (section II.3.2), although a large amount of resources is invested by the Commission and Member States in the collection of data on physical outputs and outcomes, indicators lack the minimal requisites of statistical validation, clarity of interpretation, responsiveness to policy intervention, comparability over time and across countries. Targets are often overly ambitious, or set just above the baseline, signalling either that the strategy and its goals are not appropriately defined, or that Member States have a propensity not to reveal their goals. On the whole, even after several programme periods, monitoring is still often seen as a "regulatory requirement" and subject to systemic failings[227].

Given this situation, how could cohesion policy be more results oriented? How could one expect a lively debate to take place in the Council or in the European Parliament on whether targets are being achieved in country X or Y? But the questions also go in the other direction. How could one expect Member States to take the commitment to specify objectives more seriously if there is no strong requirement, opportunity or demand at EU level (as for the Open Method of Coordination) for a periodic debate on these commitments?

Four concurring reasons explain these serious limits.

First, owing to the lack of a renewed high-key political compromise, limited consensus on a policy concept and Member State pressures, the choice has gradually prevailed of curtailing any conditionality that would require the Commission to exercise discretionality, an indispensable

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[224] See OECD (2007a), chapter 7.
[225] See Blom-Hansen, J. (2006). See also OECD (2007a).
[226] See the Report Working Paper by Casavola, P. (2009).
[227] Polverari, L., Mendez, C., Gross, F. and Bachtler, J. (2007).

requisite for policy success[228]. This is clear if one considers how broad and un-binding the Community Strategic Guidelines are. The Report will argue that design of the negotiation process, by which resources are agreed and allocated to Member States and Regions before agreeing on the rules and setting the goals, is an important concurrent cause of this weakness.

Second, a methodological failure has prevented dealing appropriately with the issue of incomplete information. It is not only the case that the Commission has less information than Member States and Regions on what should be done to achieve results (as in the traditional paradigm of asymmetric information). It is also generally the case that, at the moment of drawing Programmes, Member States and Regions themselves have only a very partial understanding of what their targets should be and how to achieve them; therefore, even if they wanted to, they could not commit themselves in a complete and verifiable way. The "degree of completeness" varies across policy fields, being quite high, say for major infrastructure – the managing authority presumably has a clear idea of which projects will be implemented during the programme period – but very low in other fields, like innovation.

In this context, any attempt to set very high-stake requisites in a homogeneous way across all fields (as if contracts could be largely complete and verifiable) is bound to fail: contracts will either set very low targets or targets will knowingly be unrealistic, while unevenness in the implementation of the rules is bound to arise - sometimes perceived by Member States as arbitrariness. An example of this methodological failure is the performance reserve in the period 2000-2006. Introduced in response to concerns about the effectiveness of spending, it initially pursued a very homogeneous approach across countries and it finally had to succumb to a selection of targets which could be easily achieved and which did not put regions/programmes in competition with each other[229].

Third, a perverse incentive mechanism is at work due to the spending deadlines and the decommitment system, by which the Commission is under a strong pressure to let Member States move on with spending, rather than checking on its quality. The emphasis on financial targets, while motivated by efficiency reasons, has both reduced the credibility/ability of the Commission to reject ex-ante programmes on the grounds of "quality" and reduced the incentive for Member States to promote the quality of spending. The de-commitment (n+2) rule was introduced to improve the financial absorption of EU funding and avoid the programme closure delays experienced in the 1990s. By incentivising programmes to ensure timely commitment of resources, the n+2 rule has had a powerful effect on programme management. At the end of 2007, de-commitments amounted to around 1.9 billion euro, or around 1 per cent of total allocated funding allocated (1.1 per cent for lagging regions, and 0.4 per cent for non-lagging regions)[230], although with major differences between countries (up to almost 3 per cent) and within countries (five programmes in three different countries ranging between 13 and 26 per cent). However, there is considerable evidence that the de-commitment rule has negatively affected project quality, encouraging programme managers to focus on "safe" types of intervention projects and applicant groups and discouraging innovative or risky projects[231] .

Fourth, setting more binding conditionalities and monitoring their implementation would require a quantity of human resources that cannot today be made available by the Commission. The present breadth of policy priorities and the amount of procedural tasks to be executed (especially relating to control activity, see below) prevent the Directorates-General in charge of the policy from having the human resources that would be necessary to be fully competent, tough and

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[228] On the need for clear-cut conditionalities and Commission discretionality, see the Report Hearing Paper on Growth, particularly the comments by Philip Keefer and Michael Storper.
[229] See: European Commission (2000); European Commission (2004d). For an exception, see Anselmo, I. and Raimondo, L. (2003). For an example of the very polarised debate on the issue, see BKA (2003).
[230] See Applica, Ismeri, Wiiw (2008).
[231] See also the Report Seminar paper summarising the views of Member States' and Regions' policy-makers.

trusted (as a provider of value added), both in negotiating the programme strategies and later in supervising commitments and assisting Member States. The positive experience of the role that the Directorates-General and their geographic units in charge of these tailor-made activities played in some policy areas and in some Member States confirms that the issue of human resources is a central one. The discretion required for an appropriate implementation of cohesion policy and by the open-ended nature of the commitments undertaken in its multi-level governance demands very high skills.

A particularly serious conditionality failure concerns additionality: the commitment of Member States that EU assistance will not substitute for a reduced domestic policy effort, which is one of the main "principles of assistance" of cohesion policy. Here, the complexity and the lack of transparency of the methods used by every Member State, the lack of comparability across countries, and the failure to circulate information have so far prevented any satisfactory public debate both on the way additionality targets are set, and on the compliance with those targets. They have also created high risks of arbitrariness in checking compliance. On the whole, they have not guaranteed adequate pressure on Member States to avoid using EU assistance to reduce both domestic expenditure and taxation and to cause unchecked, inappropriate competition with other Member States. Under the current Regulation and practice, the publication of results and methodologies has been introduced. But the failure to link (formally and statistically) the additionality requirement to the information requirements of the Stability and Growth Pact prevents a frank public debate from taking place on the trade-off that several countries face between respecting additionality (or establishing an ambitious additionality targets) and complying with budget constraints. This is a particularly relevant issue at a time when financial instability demands truly concerted efforts and no free-riding.

The specific task of territorial cooperation

The assessment of results is still more difficult in the case of the three strands of territorial cooperation – cross-border, transnational, interregional – due to their complexity, to the particular fuzziness of their objectives, and to shortcomings in monitoring systems and data collection[232]. Indeed, one study concluded that some of its programmes had "hardly any tangible outputs"[233]. As a generalisation, this is excessive, and there is certainly evidence of territorial cooperation encouraging partners to proceed with projects that would otherwise have not taken place[234]. However, much of the research evidence focuses on the qualitative effects of territorial cooperation.

On the whole, the available evidence seems to suggest the following tentative conclusion[235]. First, cross-border and transnational programmes have often helped to overcome institutional inertia, mobilising financial resources, stimulating economic, social and cultural exchanges and new relationships[236]. Second, they have facilitated policy transfer and institutional adaptation through networks[237]. Third, the intensity and effectiveness of territorial cooperation vary greatly, with the greatest impact occurring in regions where integration and cooperation are already well

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[232] See: Interact (2006) and Taylor, S., Olejniczak, K. and Bachtler, J. (2004).
[233] See: Böhme, K. (2005).
[234] See: BMBau (2008); European Commission (2007b); Colomb, C. (2007), p. 347.
[235] See: BMBau (2009); Mirwaldt, K., McMaster, I. and Bachtler, J. (2008); Ferry, M. and Gross, F. (2005).
[236] See: Lähteenmäki-Smith, K. and Dubois, A. (2006); Taylor et al (2004); Böhme et al (2003); Marchante, A., Ortega, B. and López, J. (2002); Perkmann, M. (1999); Church, A. and Reid, P. (1999).
[237] See: Dühr, S., Stead, D. and Zonneveld, W. (2007). In the more advanced cases, the effects transcend "simple learning" to promote systematic learning processes and organisational learning: see BMBau (2008); Farthing, S. and Carrière, J.P. (2007); Böhme, K. (2005); Böhme, K., Josserand, F., Haraldsson, P.I., Bachtler, J. and Polverari, L. (2003); Giannakourou, G. (2005).

developed (e.g. Baltic Sea, Benelux area) within a pre-existing political or strategic framework[238]. On the other hand, it has been suggested that territorial cooperation has encouraged new public conceptions of regions, and the creation of new "regional identities", institutions and cross-border governance systems: in some cases, local authorities have entered a field previously reserved for central state actors[239]. Whether this has positive or negative effects on economic efficiency and on geo-political stability is obviously an open issue[240].

Whatever view is taken of the networking and new regional identities promoted by territorial cooperation, their translation into verifiable results has been limited in the past by several factors. First, a lack of fit between EU and national policies and rules together with insufficient (or absent) Member State commitment to exploiting the programmes – which is also evident in their poor integration with mainstream cohesion policy programmes – has prevented the use of their experimental results[241]. Second, the policy objectives have often lacked clarity: most programmes are broad, leaving room for the pursuit of more vested interests[242]. Finally, the territorial programmes themselves have lacked adequate organisational commitment to translate learning into practical results. Territorial cooperation is inherently complex; projects are commonly characterised by interdisciplinarity, multiple languages, cultural diversity and the challenge of communicating across sectoral boundaries[243], and there may be difficulty in translating individual learning into organisational learning and change[244]. No information is yet available on whether the changes introduced for the 2007-13 period can actually improve some of these factors.

The role of Regions

As part of the paradigm shift, the new method of running public investments has been associated with a process of decentralization to Regions that has occurred in many European countries, as well as other parts of the developed world over the past decades.

A progressive regionalisation of Structural Funds management and implementation has taken place over successive programme periods since 1988[245]. Responsibility for managing programmes, specific programme elements (priorities, tranches of funding) or certain implementation functions (e.g. project selection) have been devolved to lower levels of government (e.g. Italy, United Kingdom) or to deconcentrated offices of the state (France, Sweden). In many Member States, there have been spillovers into domestic policy through the creation of new Region-level institutional frameworks or a strengthening of the ability of Regions to steer their own economic development, as in Finland, Ireland, Italy, the Netherlands and Sweden[246]. But, the regionalisation of management has not been universal, as shown by parts of southern and central-eastern Europe[247].

This process has largely followed a trend towards an increase in the authority of Regions that has taken place all over the world (see section I.2.4). However, the shift to Regions taking

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[238] See: Böhme, K., Haarich, S., Lähteenmäki-Smith, K., Polverari, L., Turró Bassols, L. and Ulied, A. (2003); Nadin, V. and Shaw, D. (1998).
[239] See: Böhme, K. (2005); Taylor et al (2004); Perkmann, M. (1999).
[240] For example Caracciolo, L. and Maronta, F. (2009) argue that the creation of these new identities, failing a truly federal design of Europe, might well produces fragmentation of political decision making, undermine the legitimacy of national States and create the premise for future geo-political instability.
[241] See: Dühr et al (2007); Wilson, T.M. (2000).
[242] See: Scharpf, F.W. (1991).
[243] See Böhme, K. (2005).
[244] Ibid.
[245] Some commentators argue that there has been little substantial redistribution of political power for deciding regional policy planning and spending. See: Elias, A. (2008); Keating, M. (2008). John, P. (2000).
[246] See: Kunnunen, J. (2004); Fabbrini, S. and Brunazzo, M. (2003); Gren, J. (2002); Coyle, C. (1997); Kleyn, W.H. and Bekker, M. (1997).
[247] See: Bruszt, L. (2008); Bachtler, J. and McMaster, I. (2008).

responsibility should not be overstated. Only 30 per cent of the cohesion budget (37 per cent of structural funds) is managed today by Regions. These figures partly reflect the fact that, with the wave of decentralisation coming progressively to a halt and a new pressure for centralisation appearing at the beginning of this century[248], there has been a certain re-centralisation of management responsibility: from regional to national authorities (as in the Netherlands and Sweden) or from the local level to the regional level (as in Flanders and Scotland)[249]. For some countries, the reduction of EU funding (in 2007-13) might have contributed to this reversal. On the other hand, for the new Member States the low level of regionalisation might reflect the early stage in the implementation of a new policy.

To what extent, cohesion policy has actually played a part in this process of variable regionalisation, and the effect in terms of policy effectiveness, is hard to establish. Undoubtedly, since 1988, the regulations governing cohesion policy have consistently emphasised the importance of involving Regions in the design and delivery and strengthening their capacity. The EU - and particularly EU cohesion policy – has been credited with exercising a strong influence on the evolution of Region-level structures and systems, as part of the governance of regional development policies in the Member States[250]. The Commission has often acted as an ally of Regions in pushing for their stronger involvement in programme formulation, management and implementation[251]. This involvement was a necessity for those Regions which have almost (or even formally) the status of a State or which, for their degree of authority, cultural identity and/or geopolitical role, have acquired the strength and the capacity to play a central role in economic and social development. In other circumstances, the degree to which regionalisation has improved policy effectiveness depends on the balance between two factors: Regions' proximity to places/regions, and the effect of cohesion policy on Regions' capacity, allowing more tailored-made strategies and a better promotion and selection of projects (as it can be appreciated by the superior quality of many Regional Operational Programmes); a misconception arising by which jurisdictional Regions become a proxy for places/regions and *de facto* constrain or fail to enhance the role of local governments and municipalities.

Significant differences exist between Regions in their capacity to manage, programme, monitor and evaluate cohesion policy interventions, and similarly strong differences existing also between Member States[252]. Cohesion policy might have sometimes represented the leverage through which endogenous change in institutional capacity and in human resources has taken place[253]. At the same time, the EU decision to require every Member State to create NUTS 2 entities for cohesion policy, when they previously did not exist, and with programmes needing to be planned and implemented through some kind of relationship between national and local governments, is likely to have been an important governance device for facilitating cooperation and coordination between the two levels. However, design of the policy has often failed to be sufficiently adaptable to different national context, and its implementation might have not acted as a device to promote a greater role and participation of local actors. Furthermore, the pro-regional attitude of cohesion policy might in some cases have been used by the Regions to promote their geo-political ambitions (and the vested interests of particular organisations), well beyond the purpose of cohesion policy[254].

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[248] See Marks et al (2008).
[249] See Ferry, M., Gross, F., Bachtler, J. and McMaster, I. (2007).
[250] See: Hooghe, L. and Marks, G. (2001); Hooghe, L. (1996); Marks, G., Nielsen, F., Ray, L. and Salk, J. (1996); Marks, G. (1992); Marks, G. (1993).
[251] See the Report Seminar paper summarising the views of Member States' and Regions' policy-makers.
[252] See Milio, S. (2007).
[253] See for example Barca, F. (2009b).
[254] See Caracciolo, L. and Maronta, F. (2009).

Capacity of local governments and mobilisation of actors

The mobilisation of public and private actors at local level with the aim of eliciting and aggregating their knowledge and preferences and of promoting their freedom and capacity to develop projects is the ultimate purpose of the place-based approach (section I.2). Cohesion policy addresses it through one its "principles of assistance": the principle of partnership.

At local level, the improvement of public capacity and the involvement of private actors and their associations often go together. There is evidence that cohesion policy has actually contributed to – and in some cases initiated – processes of institution-building and social capital formation. It has been argued that the planning and implementation requirements for spending cohesion policy funds have challenged the power balances, interests and behaviours of established actors, providing opportunities for new organisations and views to have an influence on economic development[255].

Research on the application of the partnership principle reveals clear changes in the territorial relations between organisations and across levels of government, both in the implementation of cohesion policy as well as domestic policies[256]. This concerns the way in which sub-national authorities have become involved in the planning and implementation of cohesion policy programmes through various forms of consultation or cooperation, although with major differences between Member States. Cohesion policy has often played a key role in supporting local development institutions and networks, which has helped them to lead and co-ordinate bottom-up, integrated responses to economic development challenges. It has also extended the number and type of organisations involved in economic development, and increased the resource base for their local bodies. It has more recently (since 2006) strengthened the exchange of experiences (through the web-based availability of material prepared in a given format) and promoted linkages across networks and local projects through the "Regions for Economic Change initiative"[257].

How often the creation of networks and the promotion of local institutions in the targeted places have allowed knowledge and preferences to be elicited from local actors and opportunities for innovators to be opened up, rather than the funding being captured by the same elites responsible for the unsatisfactory development of those same places, is hard to say.

Systematic evidence is not available on an issue that would require more concerted evaluation and analysis. Implementation reports, a large amount of evidence reported by European bodies which organise private and public local actors, and anecdotal evidence suggest, as one would expect, that both situations have occurred. There are situations where cohesion policy seems definitely to have elicited and aggregated local knowledge, promoted innovators, and represented leverage for change. Situations also exist where the failure to mobilise local actors, the incentive to spend the funds rapidly, and a top-down attitude of regional governments have favoured the creation of a rather static system of public clients endowed with the competence to spend cohesion policy funds. As has been stated, in these situations, "unorganised actors in the region will often be unable to come onto the scene"[258]. Even when special-purpose institutions – networks, associations, districts, pacts, agencies, etc. – have emerged at local level and have acquired a central role in developing projects for the "place" whose boundaries they have created, the risk of these institutions rapidly evolving from a tool for innovators and change to a tool for rent-seeking has often not been identified and addressed.

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[255] See: Paraskevopoulos, C.J. (2003); Paraskevopoulos, C.J. (2001); Hibbitt, K., Jones, P. and Meegan, R. (2001).
[256] See: Dąbrowski, M. (2008); Roberts, P. (2003); Jones, M. (2001); Östhol, A. and Svensson, B. (2001); Kelleher, J., Batterbury, S. and Stern, E. (1999).
[257] See http://ec.europa.eu/regional_policy/cooperation/interregional/ecochange/index_en.cfm?nmenu=1.
[258] See De Rynck, S. and McAleavey, P. (2001), p. 545-546.

On the whole, the mobilisation of local actors, the opening up of opportunities for innovators and the limitation of rent-seeking have not been helped by a lack of reference to, and debate on, the policy concept. In the social domain, there has been a tendency to "de-personalise" the territorial approach, to refer to places or territories as if they had a preference function of their own and not to give due importance to the ultimate effects on individuals' well-being.(see section I.2.2). Compared to the policy concept, the failure to take an experimental approach, guided by the use of impact evaluation (see below), and to focus public debate on objectives and targets have also taken a toll.

A more positive performance in this respect is apparent in the implementation of local-level initiatives directly managed by the Commission services and characterised by the intensive provision of expertise in relation to financial resources. These local initiatives have shown that they can be successful in developing new ideas, promoting policy integration and institutional cooperation, engaging with new stakeholders and encouraging the dissemination and transfer of knowledge. The drawback is that these initiatives have generally operated separately from mainstream programmes, and their results have not always been considered or integrated in the development of either EU or domestic regional policies.

One example is the regional innovation actions. Since the early 1990s, the Commission has actively sponsored various initiatives to develop local innovative activities. Building on the experience of previous pilot projects[259], the Regional innovation strategies and other initiatives were launched since 1994. A key objective was the promotion of regional and local activities and capacity in the policy domains of innovation and the information society. The positive contribution of the initiatives in these respects has been demonstrated in several evaluation studies, notably in terms of the creation of new partnerships[260], although the effectiveness and impact of the actions has also attracted criticisms[261].

A second example is provided by the URBAN initiative which promoted an integrated approach to urban development through cross-sectoral coordination, local responsibility and concentration of funding on selected areas. Evaluation (of URBAN 1) found the initiative to be successful in building local capacity and targeting disadvantaged groups, although it was considered limited in the scope of interventions[262]. Similar observations can be made about the Leader initiative under the EU's rural development policy which again emphasised locally-based, bottom-up approaches for rural development with a strong focus on multi-sectorality. Central to the participative, partnership-working method is the requirement to set up Local Action Groups of public and private stakeholders to identify development needs within their rural communities and to develop and test small-scale, innovative projects to tackle the identified needs. These distinctive features, commonly referred to as the "Leader method", are often singled out as generating significant added value[263], notwithstanding several non-trivial challenges[264].

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[259] In particular, the launch of a Regional Technology Plan (RTP) pilot action under article 10 of the ERDF regulation by DG REGIO to initiate the development of Regional Technology Strategies, subsequently developed in eight European regions between 1994 and 1996.

[260] See: Boekholt, P., Arnold, E. and Tsipouri, L. (1998); Ecotec (2000); Charles, D., Nauwelaers, C., Mouton, B. and Bradley, D. (2000); Socintec and Inno (2005). See also: European Commission (2006a).

[261] Such as lack of involvement of target beneficiaries in strategy formulation; difficulties in generating private sector funding; non-implementation of actions identified in the strategy; unsystematic monitoring and evaluation. See Cocintec and Inno (2005).

[262] See GHK (2003).

[263] The ex-post evaluation of the 1994-1999 period, for instance, argued that more effective use of endogenous resources has been promoted through the area-based approach; while the scope of local actor involvement has been broadened as a result of the bottom-up approach, particularly by drawing in the voluntary sector. See ÖIR – Managementdienste GmbH (2003).

[264] The main problems identified in the 2000-2006 mid-term evaluation include: a lack of competition in the selection of the Groups; restricted abilities by Groups to design tailor-made strategies due to time constraints. A more important fundamental criticism, given that much of the success of Leader depends on

The mainstreaming of Community initiatives in 2007-2013 has led to increase financial allocation for urban development but with a stronger sectoral focus and loss of local targeting and community involvement[265].

Financial management and control

The success of a system of financial management and control is greater, the lower are its costs, in terms of its administrative burden and the uncertainty produced by its rules, and the lower the resulting error rates. The system used for EU cohesion policy seems to fare quite badly on both these counts.

The most comprehensive available information on financial management errors is the estimate of ("at least") 11 per cent produced by the European Court of Auditors' in the 2007 Report published at the end of 2008. The errors mainly consist of breaches of public procurement rules, declaration of expenditure not complying with the eligibility rules and other conditions of funding, failure to deduct revenues from project costs or expenditure declared, and lack of supporting documents as evidence of correct expenditure. Fraud is not common. Most errors seem to stem from a lack of knowledge, training or management capacity, but also from the complexity of funding conditions.

The above error figure could turn out to be an overestimate, since for each programme period the final selection of the expenditure actually entitled to be reimbursed by the EU budget is done at closure, both within Member States, through the winding-up declaration exercise, and at Commission level, through the evaluation of that declaration. A definitive assessment of the effectiveness of the control system enacted in the years 2000-2006 will therefore be available in one or two years time. At the moment; no information is available that might suggest an error rate lower than the 2 per cent level which is currently the "acceptable" EU threshold. It is also not clear - and will take a long time to become clear given that the new programmes have just started to "generate expenditure" – whether the new, more preventive control system introduced for 2007-2013, which increased the responsibility of Member States to verify and ensure that the control system is working properly, can produce better results.

As for the costs of the control system, the direct administrative costs of running the system would increase rapidly, according to Commission estimates, if an attempt were made under the present rules to reduce the error rate[266]. The existence of several layers of control, partly linked to the shared management that characterises cohesion policy, and the overlap at any given moment of regulations relating to different programme periods create differences of interpretation and uncertainty. A significant share of human resources and time is spent both by the Commission Directorates-General and by Member States in dealing with the control system. In particular, the responsibility entrusted to the Commission for the system of financial management and control has required the allocation to these tasks of a sizeable share of the human resources and time of the geographic units in the Directorates-General. All this activity takes away human resources from the strategic tasks of negotiating ex ante and monitoring ex-post the substance of Member States' programmes; and it threatens the credibility of the Commission carrying out these tasks.

To these costs one must add the political cost for the Commission, and for its role in governing cohesion policy, which arises from the estimates of a high error rate and from the ensuing debate. This effect is particularly strong, since, as we saw earlier (section II.3.2), no other results of cohesion policy are so well analysed in quantitative terms and debated at EU level, namely in the European Parliament and in the media.

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learning, is that there is a lack of systematic knowledge accumulation and transfer from one programme period to the next. See ÖIR (2006).

[265] See European Commission (2008h).

[266] See Commission of the European Communities (2008g). See below, section V.8.

The publication of the Court's estimate in 2007 (of an error rate of 12 per cent for 2006) triggered a crisis in the discharge procedure, which is not yet over. The Commission addressed the crisis by adopting an Action Plan to improve its supervisory role and by accelerating suspension and financial correction decisions: in 2008, the Commission adopted 10 decisions formally to suspend payments (as against one in 2007), because Member States failed to take action on weaknesses of their control systems; 26 decisions involving financial corrections were taken, as against 16 in 2007, and for much larger amounts. In its 2007 Annual Report; the Court upgraded the rating of Commission and Member State systems to "partially effective" (yellow instead of red, in the EU Court's coding system) as a result of finding 3 of the 16 audited systems to be ineffective, as against 13 out of 19 in the previous assessment. But the debate is still open on how to improve the system while reducing its costs, and proposals for change are being put forward which will be discussed in Chapter V.

Evaluation

Research shows that the evaluation system established for cohesion policy has produced three positive effects[267]. First, national and regional authorities responsible for managing cohesion policy have invested time and resources in planning and commissioning evaluation studies – in many cases for the first time. The requirements have also stimulated the supply of evaluation services from consultants, universities and research centres. Second, although many authorities may have a "compliance approach" towards evaluation, there is evidence that the value of evaluation for the effective design and management of programmes has been increasingly recognised. Third, there have been certain spillover effects on the evaluation of domestic regional policy, with the adoption of some EU evaluation procedures in non-EU funded areas of government intervention.

Nevertheless, in spite of the progress in the evaluation culture, a learning system, based on impact evaluation of projects and the systematic diffusion of information that would allow the policy to improve over time, has not been created. As we have noticed (section II.3.2), very little is known about which interventions did or did not work. This is largely due to the failure to develop a strategy of impact evaluation.

Compared to the policy concept (section I.2.4), a clear distinction has not been made between the function of promoting the focus on objectives through outcome indicators and targets and the function of learning about what works. In particular, it has been assumed that indicators can contribute to measuring the impact of cohesion policy on outcomes. An ambiguous definition of "impact indicators" has been introduced: they are considered to be those indicators of outcome that "refer to the consequences of the programme". It has been argued that "the ultimate objective of structural funds and cohesion fund assistance is a certain impact, *measured as far as possible by impact indicators*"[268]. This can obviously never be the case, since outcome variables and indicators are influenced both by the policy and by any other event that has in the meantime taken place. Disentangling the first effect from the latter is precisely the purpose of impact evaluation. Indicators measure what happened *while* the policy was being implemented: it can be very relevant for focusing public debate and policy-maker action on a few, clear-cut objectives, but is says nothing about effects. Mixing the two functions – as is currently done – has taken credibility away from the task of truly evaluating impacts.

Some further factors have also prevented impact evaluation from developing. First, the fuzziness about objectives noted above has discouraged evaluation questions on the purpose of interventions: in order to address the issue of "what works", one needs to have clear idea on what "works" mean, which outcome an intervention should produce for it to "work". Second, an excessive emphasis has also been placed on the evaluation of whole programmes that are

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[267] See: Bachtler, J. (2008); Bachtler, J. and Wren, C. (2006); Derlien, H.-U. and Rist, R.C. (2002).

[268] See European Commission (2006d), pp. 6, 10 (italics added). See Martini, A. (2008) for an examination of this misconception.

composed of heterogeneous interventions, to which impact evaluation methods cannot be applied. Third, the evaluation process has been fragmented into stages of the programme cycle (*ex-ante, in itinere, ex-post*), logically placing the evaluation of effects at the end of the cycle, and making it conceptually more difficult to design the sort of "prospective impact evaluations" envisaged in section I.2.4.

Political and policy debate

One final feature emerges from the review carried out for this Report, a noticeable paradox: although cohesion policy is undoubtedly the most important EU policy for economic and social development, an EU-level, continuous political and policy debate on cohesion policy and its progress has been lacking.

Outside the boundaries of the "cohesion policy community", the representatives of EU citizens in the European Parliament and the politicians and policy-makers of Member States do not have the opportunity to discuss the successes and failures of cohesion policy in different countries and regions and to make informed decisions on this basis. The Commission and Member State policy-makers in charge of cohesion policy are not questioned in national or European fora about the substantive performance of their policy choices, their accountability being limited to financial irregularities. This deprives them of the incentive and the stimulus to focus on substantive issues, rather than on financial absorption. Cohesion policy has failed to become an arena for lively and mature debate on "development" or for competition in the use of alternative, advanced policy models and methodologies.

The failure to create a robust system of *outcome indicators and targets* (section II.3.2) is at the same time a cause and an effect of this absence of high-level political debate. The lack of a qualified and regular flow of information on outcomes, the failure of the proviso on the 2009 and 2011 strategic reports by each Member State to require any precise comparison of targets and results, has clearly prevented a results-oriented debate. At the same time, the lack of a strong political demand for information, the absence of any linkage at EU level between the debate on cohesion policy and the debate on growth and stability, in spite of cohesion policy financing a large share of European total fixed capital formation, have not created any strong motivation for those indicators and targets to be dealt with rigorously. This applies both to Member State programming documents and reporting and to the Commission pressure on Member States.

The lack of high-level strategic debate must also be linked, once again, to the lack of progress since the 1988 reform in focussing the objectives of the policy and in providing the strategy with more advanced conceptual foundations. The justifications for the EU to run cohesion policy, to be entrusted with a direct responsibility for development (see section I.3) – the very sustainability of the Union, and its comparative advantages – are strong, but they rely on the EU exerting this responsibility on the basis of a politically agreed vision. The strong substantial compromise of political and cultural views that made the 1988 reform possible has failed to be moved forward and rejuvenated. The conceptual model which cohesion policy itself has partly shaped has not evolved. Cohesion policy has often sealed itself from advance in mainstream debate, although, as chapter I showed, these advances often brought increasing support to its very existence.

This deficit in the strategic debate has prevented the European Parliament, the Commission and the Council from making progress with this vision. "The idea of integrated development has lost ground in the Member States and progressively in the Commission as well, and hence confidence has diminished in what should be managed at the level of the Union"[269]. Conflicting and incommunicable views on cohesion policy have emerged, fuelled by the scarcity of solid evidence on results, by the inadequacy of the debate on the policy conceptual framework and ultimately by ambiguities in the policy objectives.

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[269] See the account of Jean-Charles Leygues in European Commission (2008e).

The structure of the negotiations in the seven-year cycle of cohesion policy: resources, governance, goals

This Report believes that the structure and sequence of the complex negotiation that every seven years sets the framework of cohesion policy bears a responsibility for some of its failures, namely the weakness of the policy debate and the fact that no adequate tools exist to pursue performance.

The present negotiation, whereby resources, governance and goals are not decided simultaneously but in a sequence starting with the allocation of funds and finishing with the goals, has a rationale. First – with reference to the last negotiation, and referring to the first year of the new programming period as "t" – in the year t-4, debate on the budget starts both inside the Commission and between Member States. Then in Spring-Summer of the year t-2, while negotiation on resources enters its final phase, the Commission focuses its attention on goals by issuing the Cohesion Report and its draft Guidelines. In the meantime, by the end of year t-2, Member States agree on a budget, which is later discussed and approved (with minor changes) by the European Parliament. Once this is done, the discussion on governance and goals can enter its final phase and come to a close with a decision by Council, European Parliament and Commission by Summer-Autumn of year t-1. Governance and goals, it can be claimed, can be discussed in detail only once the quantity and allocation of resources is decided: with the great uncertainty that characterises to the last minute financial issues, there would be no point in trying to discuss goals and governance any earlier.

But this sequence presents several serious weaknesses:

- First, Member States and Regions, social and economic actors and experts, European Parliament and citizens have very little time to discuss goals and priorities: the debate is dominated for 3-4 years by financial issues, often with no reference to objectives and priorities; while no more than a year is dedicated (after the Spring-Summer of year t-2) to debating these central issues. There is no time for strategic ideas to emerge which are alternative to those advanced by the Commission. The pressure of all actors can be accommodated only by diluting ideas, a phenomenon visible in the changes of the Guidelines, from the original Commission communication to the approved document.

- Second, the European Parliament has no major say on the budget: once the agreement has been reached by the European Council, the threat of upsetting the fragile equilibrium that has been reached prevents any effective discussion and significant change.

- Third, the separation of the three decisions on resources, governance and goals is particularly damaging. Resources are set and allocated without a clear mandate on how and to what ends the resources should be spent. Once the financial confrontation is over, the interest of the political and economic decision-making centres of each Member State fades away. Negotiation with the Commission on goals and governance is largely entrusted to specific Ministries that, in each Member State, are in charge for implementing the policy: their main preoccupation is, by mandate, to maximise the flexibility and room for manoeuvre in using the funds in their own country, whereas they have no interest in maximising the effectiveness of the use of funds in the other n-1 countries. A strong bias is thus introduced in the final negotiation on goals and governance, whereby the rules of the game and the goals are loosened and the general EU interest fails to be pursued.

- Fourth, as the result of the delay in esrablishing goals and governance – only a few months or weeks before the new cycle starts – Member States and Regions set the basis for the programming cycle when these features are not yet decided: This makes Member States and Regions particularly averse to any new binding rule, which would upset their programmes.

All these factors make it extremely difficult to introduce any comprehensive reform of the governance and goals of cohesion policy that tackles the weakness reviewed in the previous

pages. And helps explaining the failure to introduce a "strategic turn" in the last negotiation (see Box II.A).

Box II.B Successes and failures: a provisional list

The available information from evaluations, studies, qualitative assessments suggest that cohesion policy has achieved the following successes.

1) Cohesion policy has played a major part in the "paradigm shift" in regional development policies across the EU, towards a more place-based/territorial, knowledge-oriented, integrated and participatory approach to public investment based on multilevel governance. It offers the appropriate base for the Union to build a rejuvenated place-based approach to tackle economic and social development.

2) A very relevant contribution has been made to public investment in the lagging areas of the EU: policy effectiveness has been achieved when cohesion policy has been implemented as a coherent part of a national development strategy.

3) In some lagging regions, cohesion policy has contributed significantly to institution-building and social capital formation, producing a lasting effect. However, this has not been universal: sometimes the lack of initial institutional capacity has prevented policy from being effective and institution building has not succeeded.

4) Cohesion policy has provided a common framework for policy management, allowing for institutional diversity while facilitating cooperation and exchange of information across countries, regions and places. This approach is at the centre of deserved international interest.

5) Cohesion policy has often played a key role in promoting and enhancing the knowledge base of local development institutions and networks, and in strengthening the exchange of experiences and the linkages across networks. Local-scale projects designed with an active role of the Commission, and intensive input of expertise, often have a good track record of success.

6) There is evidence of cohesion policy strengthening the role of administrative Regions, as part of the regionalisation process taking place in some parts of the EU. However, the picture is mixed: the enforcement of a given template of NUTS 2 Regions is not effective when regions lack political legitimacy.

7) An evaluation culture has been promoted across the EU, encouraging awareness, capacity-building and methods for assessing regional development in countries and regions where this was previously limited or non-existent. (But see point 13).

Notwithstanding these successes, the policy has also been characterised by important weaknesses and failures, which are partly to be attributed to the negotiation process settling the governance and goals issues after the resource issue.

8) In the absence of a high-level cultural and political compromise on a policy model, strategies, both at EU and Member States (Regions) level, often lack clear-cut objectives and a justification of how planned interventions should achieve them. Priorities are very broad, covering all possible areas of public action and cannot by identified with any European public good.

9) The territorial or place-based perspective (that cohesion policy has helped bring about) is often blurred: insufficient attention is paid to its central tenet according to which public goods and services and institutions must be tailored to specific contexts by eliciting and aggregating local knowledge and preferences; administrative Regions (decisive players in the implementation process) are erroneously treated as the unit of reference for policy interventions; outdated concepts of regional policy, involving financial transfers and sectoral public works, still play a strong role.

10) The meta-objectives of efficiency and equity are generally mixed, reducing the room for performance accountability. Specific objectives and targets, relevant for EU citizens well-being, are often mentioned only as part of a compliance exercise.

11) The conditionality system is not sufficiently results-oriented and insufficiently effective. A high level of uncertainty in Member States, concerned about being second-guessed by the Commission, often goes together

with the failure of the Commission to receive adequate guarantees on the effective use of funds: a) ex-ante commitments on the national institutional requirements for the use of funds look inadequate; b) the bad quality and very limited role played by outcome indicators and targets prevents this tool from providing focus and incentives for good performance; c) significant costs are incurred to prevent irregularities with unsatisfactory results.

12) The mobilisation of local actors and experimental approach are inadequate. The prevalence of a top-down approach to programme management, with limited local public debate, too often betrays the very nature of place-based policies and increases the chances for the interventions to be captured by vested interests (rent seekers) rather than promoting innovation.

13) Despite the progress made in developing an evaluation culture, a European "policy learning system" has not been created on the crucial issue of "what works and for whom", limiting the scope for policy to improve over time. At the same time, methodological problems and an insufficient public debate, both at local (point 12) and European (point 14) levels, have failed to create a demand for a systematic diffusion of information on outcomes.

14) Outside the "cohesion-policy community" there is no high-level, continuous policy and political debate on cohesion policy and on its results, whether in the European Parliament, in the Council, or in the Commission, or in society at large, and there is no linkage with the debate on Growth and Stability.

III. THE NEED FOR A SHARP CHANGE OF DIRECTION

The results of the previous chapters send a very clear message: cohesion policy is strongly needed by the Union, but a sharp change of direction is needed to make it fit for the challenge.

The place-based approach pursued by cohesion policy is a much-needed tool for the Union today …

The place-based (territorial) development policy model, the paradigm that cohesion policy aims to implement, is a modern way to promote development and it is the only model available at this stage to the European Union to fulfil the development mission required by its own existence.

The unit of intervention of this policy model is the place or region defined endogenously by the policy process. Its objective is to reduce *inefficiency traps* and/or *social exclusion traps* in specific places - backward or advanced, urban or rural, central or peripheral – due to the failure of appropriate economic institutions to be chosen, to path dependency, to the conditions of uncertainty in which private and public agents make their choices. This is the interpretation proposed by this Report of the overall task set by the EU Treaty to promote "harmonious development" and to tackle "disparities" of regions and "regional backwardness".

The model operates by financing and promoting the supply of bundles of place-tailored public goods and services aimed at:

- strengthening/building institutions and challenging inefficiency and social exclusion traps,
- improving access of citizens and firms to goods, services, information,
- promoting innovation and entrepreneurship.

Place-based policies are run by a system of multilevel governance where grants subject to conditionalities on objectives and on institutions are transferred from one level to the lower ones, and where the latter has the freedom to enact the mandate in the way it sees fit. For the design and implementation of interventions, these policies elicit and aggregate the knowledge and preferences of people living and working in the places.

Place-based policies are complex. Serious risks exist of misallocating resources, creating a dependency culture, or favouring rent-seekers instead of innovators. But in this paradigm, the spatial awareness of public interventions is transparent, verifiable and submitted to scrutiny and there is a strong recognition that "the state does not necessarily know best". The opposite is the case for those interventions that camouflage strong spatial effects or intentions behind the screen of self-proclaimed spatial blindness[270]. Policy risks can then be detected by the very process of writing contracts, by monitoring the achievement of targets, by evaluating impacts, by comparing results across places: if public debate and political mobilization are high, the risks can be addressed and partly overcome.

A strong case exists for this policy paradigm to be directly run by the European Union and to be entrusted with a large share of its limited budget:

- it is a modern and effective model for promoting development (for the reasons just recalled);
- it is the only policy model through which the Union, given its limited democratic legitimacy, can address the expectations of European citizens, wherever they live, to be given the chance to benefit from the opportunities and to escape the risks created by globalisation and by the

[270] See World Bank (2008) and the critique of this approach in chapter I.

Union itself, without impinging onto national sovereignties and regional and national aspirations;

- the Union has a comparative advantage over Member States in running this policy: preventing or mitigating degenerative defensive actions; exploiting and promoting cross-border interdependencies; benefiting from a greater credibility to act independently of the pressure of local rent-seekers.

The present state of the Union makes cohesion policy even more important than in the past. Since the early 1990s, the issue of European integration has increasingly engaged the general public, opening up room for innovators and creating opportunities, but also raising widespread fears of falling behind and eroding national or sub-national common bonds. It has become an important theme in national party politics and the object of social movement protests[271]. The views of national public opinion – traditionally less supportive of European integration than those of the national elites[272] - which have for a long time not been given much relevance by national or supra-national elites, cannot any longer be ignored[273].

The Report has made clear that the answer to this discontent and pressure is not "doing something social" in order to achieve and preserve market and currency unification, a reductionist view that has promoted disengagement from the way EU resources were being spent. Inefficiency and social exclusion traps need to be tackled by the Union both because market and currency unification by themselves cannot deliver what they promised, and because tackling those issues is what citizens of a Union expect from the very entity that is opening "their" national labour markets, letting other people access "their" services, asking them to change "their" national or local practices. The loosening of existing national bonds needs to be accompanied by the strengthening of bonds at a higher level, if rising tensions are to be avoided. Tackling the inefficiency and exclusion traps that arise around Europe is a task for the Union because the Union will be blamed if this task is not successfully performed.

If cohesion policy lived up to the challenge, it could represent an opportunity to strengthen the Union and to democratise its decision process. If it did not, it would leave the Union exposed to strong threats and to a reversion to nationalistic behaviour. These arguments – the Report has stressed – are further underlined by the current financial crisis.

The Report has sketched some features of the policy model that take particular relevance in the EU context and has singled out some common misconceptions. In particular:

- The policy model does not aim either to discourage the mobility of people or to "encourage the mobility of people" - the latter option being advocated by seemingly-blind policies which attribute to the state the capacity to know best (just by observing the latest moves of capital and labour) - but more modestly aims at *giving people a more substantive freedom to choose* whether to move or not, and the opportunity for learning about policy choices, expressing more informed proposals and voicing disagreement.

- The two objectives of efficiency and social inclusion should be pursued through distinct interventions. Social inclusion should be addressed with a clear-cut reference to both places

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[271] As shown by Imig, D. (2004), from the first half of the 1980s and the second half of the 1990s, the proportion of social movement protests which have Europe as the central topic of the protest has risen from 5-10 to 20-30 per cent. Benoit, K. and Laver, M. (2006) show through an expert survey that in 2003 European integration was the third most important issue in national party political contests. For these and other results see Hooghe, L. and Marks, G. (2008b).

[272] See Hooghe, L. (2003).

[273] See Hooghe, L. and Marks, G. (2008a, 2008b). The second paper stresses that "in the 25 years prior to the Maastricht Treaty Accord" only seven national referenda were held on European issues, while 27 have been held since, in 6 cases with the Government being defeated.

and people so as to avoid the opposite risks of "depersonalisation" and "decontextualisation". The social and the territorial agenda should come together in a *"territorialised social agenda"*. The division of labour between the EU level taking care of markets and liberalisation and Member States taking care of welfare is increasingly unsustainable: this agenda is sensible and a pragmatical way to move forward.

- *"Convergence"* in per capita income (or GDP) of either countries or regions - however the latter are defined - is not the purpose of the policy paradigm, nor is it a good proxy of its objectives, nor is it an appropriate interpretation of what the EU Treaty calls for. Both the increase in the capacity utilisation of places and the increase in social inclusion of people living in those places can take place independently of convergence, while convergence does not necessarily ensure either of the two.

- *"Financial redistribution"* between territories (however defined) is not what the policy paradigm is about – equalisation funds would do this job with much lower transaction costs. Its purpose is to use financial resources as a means of exogenously promoting pro-active interventions in places/regions where inefficiency or social exclusion traps arise.

... but sharp changes must be introduced to make it fit for the challenge

Cohesion policy, with its current architecture, offers the appropriate framework to implement the place-based policy model and tackle the challenges facing the Union, but for these challenges to be met a sharp change of direction is needed and several key-components of the policy must be reformed. This is the result of the review conducted by the Report by comparing the actual implementation to the policy model.

On the one hand, cohesion policy:

- has nurtured several features of what has come to be called the new paradigm;

- has produced a good track record of result, both when it was implemented as a coherent part of a national development strategy, and when local scale projects have been designed with an active role of the Commission and intensive expertise;

- has set in place a system of multilevel governance and contractual commitments, both vertically, between Commission, national and regional levels, and horizontally, that represent a very valuable asset for Europe;

- has contributed to institution-building, social capital formation and a partnership approach in many regions, producing lasting effects;

- has created a network across the whole Union for the diffusion of experiences and of methodological tools in the area of evaluation and capacity building.

On the other hand, these weaknesses have come to the fore:

- a deficit in strategic planning and in developing the policy concept through the coherent implementation of a place-based, territorial perspective;

- a lack of focus on priorities and a failure to distinguish efficiency from social inclusion;

- a failure of the contractual arrangements to focus on results and to provide enough leverage for the Commission and Member States to design and promote institutional changes tailored to contexts;

- methodological and operational problems that have prevented both the appropriate use of indicators and targets, and an adequate analysis of "what works" in terms of policy impact; and

- a remarkable lack of political and policy debate on results, both at local level – insufficient experimentalism – and at EU level, most of the attention being focussed on financial absorption and irregularities.

The diminishing political and cultural consensus on cohesion policy during the last decade has certainly been influenced by the "intellectual complaisance" of the majority of the economic profession to what markets can achieve[274]. But to this – the review conducted by this Report has made clear - must also be added the failure to develop a conceptual framework, the weaknesses of the governance and a serious failure to focus on results.

Re-launching cohesion policy requires three steps: adopting a strong *policy concept*; reforming the *priorities and governance* of current policy; and building a new strong *political compromise.*

This Report has put forward the proposal for a strong policy concept. It needs to be accompanied by sharp changes in the priorities and governance of cohesion policy aimed at removing the weaknesses that have been identified: this is the purpose of the next two chapters. If this second step were to be agreed, the opportunity would arise for a new high-level political compromise to be constructed. Cohesion policy could be re-launched as a primary tool for the Union.

Reforming priorities and governance: from general principles to operational proposals

The proposals for change are inspired by the following principles, which reflect the policy concept, the rationale for the EU to implement a place-based policy and the lessons learnt from the last twenty years:

(1) *Concentrating resources.*

(2) *Orienting grants to results*.

(3) *Mobilising and learning*.

(4) *Strengthening the Commission.*

(5) *Reinforcing political checks and balances.*

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[274] The expression is borrowed from Acemoglou, D. (2009). He argues that the financial crisis offers large parts of the economic profession the opportunity to reflect on its "intellectual errors" and to move forward on those economic principles that are "still valid". Three errors are mentioned: the notion "too-quickly accepted … that the capitalist economy lives in an institution-less vacuum, where markets miraculously monitor opportunistic behaviour"; "the idea "that the era of aggregate volatility had come to an end"; and the "trust [in] the long-lived large firms to monitor themselves and their own because they had accumulated sufficient reputation capital". Notice that all these three "errors" still hamper the argument of World Bank (2008) when it calls for public decisions to follow the decisions of large concentrations of private interests and the market signals coming from labour flows ("encouraging mobility of people is the priority", p.xxii). The three still-valid principles are described by Acemoglou as: the central role of innovation and reallocation for economic growth, and the risk of them being prevented by local elites, by the resistance of losers which lack safety-nets, and, today, by a crisis-induced backlash against markets. Notice that the new paradigm of development policy discussed in this Report is strongly in tune with these principles: when appropriately implemented, as the significant and visible changes advocated here should allow cohesion policy to do, it can be a powerful tool to promote innovation and reallocation and to prevent a backlash against market integration.

These principles are implemented by the proposal of a new, narrowly defined set of core priorities, in chapter IV, and of revised governance articulated in ten "pillars", in chapter V. Each principle maps onto several operational proposals.

The first principle – *Concentrating resources*- calls for a concentration of the majority (as close as possible to two thirds) of cohesion policy resources on a very few (three-four) narrowly-defined core priorities. This would allow: achievement of a critical mass that can make an effective and visible difference; the focusing of public debate both at local and EU-wide level; and making it feasible for the Commission to play the substantial role called for by the policy model. The criteria according to which the political process could choose these core priorities are presented in chapter IV, where six candidates for this choice are also analysed, *innovation*, *migration*, *climate change*, *children*, *skills* and *ageing*. In particular, pursuing the issue of migration and/or children would allow a *territorialised social agenda* to be launched by the Union.

The second principle – *Orienting grants to results* – calls for both the EU-wide strategy and national and regional strategies to move towards the clear identification of objectives, and for contracts where Member States (Regions) take a commitment to results and to a strategy to achieve them. A system of annual reporting on results and on indicators is needed, to be submitted to the discussion of high-level political institutions. The system of indicators and targets must be highly verifiable. For the core priorities, a commitment to the economic institutions governing the sectors of intervention (whether education or environmental infrastructures or research) must be foreseen.

The third principle - M*obilising and learning* – calls for a strengthening of some essential and interconnected features of the policy paradigm which are necessary for it to be effective in truly eliciting and aggregating knowledge and preferences at place level and discouraging rent-seeking: (i) the use of an experimental approach by which collective local actors also exercise mutual monitoring; (ii) the provision of information and the creation of a policy space giving an incentive to people to voice their views and dissent; and (iii) the implementation of methodologies that allow a prospective search for "what works", with its strong disciplinary effect.

The fourth principle – *Strengthening the Commission* – is the complement of all the others. Little of what is envisaged by the other principles can be implemented unless the Commission's Directorates-General in charge of cohesion policy, and their links with relevant sectoral Directorates-General, are reformed in line with the challenging role that the revised design assigns to the Commission. The enhanced function of think-tank that it is foreseen by the proposals on core priorities, on impact evaluation and on a more direct role as a mobiliser at place level, and the enhanced function of negotiator that is linked to the redesign of contracts, demand a move in this direction. In particular, a significant investment in human resources and a far-reaching internal reorganisation are needed.

The fifth principle – *Reinforcing political checks and balances* – calls for both the European Parliament and the Council to be given the opportunity to debate on a well-documented ground the implementation and the results of cohesion policy and to assess the choices of Member States and the Commission. The present situation, where the political and policy debate focuses on financial absorption and the estimated share of irregular payments must be overcome. Together with the drastic improvement of the system of indicators and reporting, this objective calls for the creation of a dedicated Council for cohesion policy and for a formal linkage, through financial additionality, with the Stability and Growth Pact.

The proposals advanced in the next chapters along these principles build both on the conceptual model discussed in chapter I and on the experience of the place-based approach, within and outside cohesion policy. The experience suggests that these proposals are feasible, but it also suggests that they are demanding. They call for a substantial effort, both by the Commission and

by each Member States, in improving the organisation, investing in human resources, improving methodologies, overcoming current habits. A high-level political compromise is an indispensable requirement for this to happen. However, adequate time is also necessary for the implementation to take place. If changes were going to be agreed for the next programming period, reform should start "now", since 2010, by intervening, in the true spirit of the budget review, on the implementation of the current programming period.

Three further general questions needs to be addressed before presenting the proposals in details.

- What is the Report proposing in terms of territorial allocation of resources?
- How dependent on each other are the proposals made on the core priorities and on the ten pillars of governance?
- Should any change take place in the budget negotiation (on the cohesion policy issue) whose structure was argued to be partly responsible for the failure to innovate cohesion policy?

A conservative view on territorial allocation

The principles for territorial allocation suggested by the policy model are straightforward: a) the appropriate unit of intervention for a place-based development policy is a place/region defined as a contiguous/continuous area within whose boundaries a set of conditions conducive to development apply more than they do across boundaries (see Introduction), an area that can be identified only through the policy process, independently of administrative boundaries; b) interventions should potentially extend to all regions of the Union and should concentrate on the lagging regions, where inefficiency and social inclusion traps are generally more likely and pressing; c) the selection of places/regions suitable for intervention should be up to jurisdictional Regions or Member States, i.e. (except for pilot programmes) it is not up to the EU level of government to discretionally map places.

The present arrangement by which resources are pre-allocated to NUTS 2 Regions (and, for the cohesion fund, to Member States), leaving the lower level of government to allocate it internally, is thus coherent with the policy model.

As for the use of parameters – mostly GDP per capita – referring to NUTS 2 Regions, for defining what territories are "lagging" and in allocating funds, the Report will argue (chapter I, pillar 1) that this choice is dictated by the availability of robust, homogeneous and adequately updated economic data. The Report will also argue that there are no credible alternative methodologies on offer which are clearly superior to the present approach and which have a chance of gaining consensus. And that embarking on a complex revision of parameters would once again focus the policy debate on financial issues, distracting from the pressing issue of how the funds are used.

As it has been argued, the "EU budget still has a role to play in smoothing the (bumpy) road towards European integration by transferring resources between Member states as part of grand bargains. These may be parcelled up inside policies that have worthy objectives (cohesion as a public good), but are inevitably susceptible to the pork-barrel politics of *juste retour* thinking"[275]. The more the financial compromise is preserved, the more room there will be for a high-level political compromise over "worthy objectives".

What really matters is that, once resources are (conservatively) allocated to Regions and Member States, no assumption should be made – as in the past has sometimes been made – that resources will be provided to every place/region. Under the contracting system proposed below in chapter

[275] See Begg, I. (2009b), p.10.

V, Member States (Regions) will be required to concentrate resources where economic inefficiency or social inclusion traps are more pressing.

A set of comprehensive proposals: "tout se tient"

The reform proposals made in the next two chapters are strongly inter-dependent. Some of the ideas (a stronger indicator system, the sharpness and quality of reporting, experimenting with impact evaluation, strengthening the Directorates responsible for the policy), assuming that any consensus builds up around them, could have a life of their own and could be of use in the current programming period. Implementing them as soon as possible would actually be necessary to build the basis and the experience for a full use in the next programming period. But the major proposals (the new contractual arrangements, the concentration on a few priorities, the discretional role of the Commission, the high-level debate, the linkage with the Stability Pact, etc) can fly and can even be implemented only as part of a comprehensive package. The change of direction that this Report calls for in order to tackle the existing challenges cannot be achieved though gradualism, it requires a cold-turkey approach that adjusts all at once the incentives for all the actors engaged in this policy. One example can make this strong interdependence clear.

Let's consider the proposal to foresee for each core priority the establishment at EU-wide level of a set of general principles on the institutional framework that is suitable for pursuing the priority: each Member State (Regions) would have the freedom to implement those principles as it sees fit, while the Commission would have the responsibility for expressing or not expressing (after negotiation) confidence in that choice.

A minimum requirement for this proposal to be accepted is that the principles regarding the institutional framework concerning each core priority are agreed through a policy process where Member States play an active and effective role. Even in this case it could be argued that too much discretionality is being entrusted to the Commission in assessing, case by case, whether the general principles have been appropriately tailored to the circumstances; and that a strong risk exists of falling back on a "best practice syndrome", by which the Commission would arbitrarily have a template in mind and would try to apply it to all cases. The very competence of the Commission in exercising this role on some specialised issues could be challenged. Alternatively, it could be argued that the Commission would not have the incentive to exercise the discretionality and to block, if deemed necessary, the allocation of resources to a priority, since the political pressure of EU institutions is focused only on financial absorption and irregularities, rather than on the capacity to achieve objectives.

These objections make it clear that the above change can fly only if it is accompanied by a set of other changes. In particular, in order to overcome the reasonable concern on the "best practice syndrome" – reasonable in the light of past and current experience – a strong, clear consensus must exist at political level both on the need for Commission discretionality, as a requisite for the very existence of a conditional grants system, and on the context-dependent nature of economic institutions: a strengthened high-level political debate both in the Council and in the EU Parliament are indispensable. This change, together with the drastic improvement in the quality of indicators, with the production of annual reports focused on results and with a linkage with the Stability and Growth Pact, would also create the right pressure and incentive for the Commission not to express confidence when confidence is unwarranted. Furthermore, since Member States (Regions) will generally have a better knowledge on the institutions that are most appropriate for their territories, the Commission can credibly challenge their proposals only if it demonstrably has, on its "side of the table", highly qualified in-house experts who, together with a good understanding of the national and regional contexts, have an in-depth expertise on the core priority of high international standard.

Comprehensiveness is where previous attempts to reform cohesion policy have failed. They have been trimmed during the negotiation and have lost much of their effectiveness. This is where the reform attempt advocated by this Report should seek to succeed. If a strong political compromise

were built on the basis of the policy concept and on a coherent proposal for changing the priorities and the governance, it could possibly withstand the turmoil of the financial negotiation phase.

A simultaneous agreement on resources, governance and goals

This leads to the last preliminary question, regarding the structure and sequence of the negotiation. The course of cohesion policy for each programming cycle is ruled by three documents establishing:

- the strategic principles on the policy concept, priorities and goals;
- the financial framework on the amount and allocation of resources;
- the regulation designing the governance.

The analysis carried in chapter II suggests that for the negotiation to have a chance to deliver anything similar to a comprehensive reform proposal of cohesion policy, the negotiation on resources, governance and goals must come to a close at the same time.

Experience shows that, once the financial framework is signed, the general economic and political interest of each Member State fades away and with it the interest in the quality and effectiveness of the policy in all the other Member States. The regulation and the strategic principles become then the realm of the "regional/territorial/spatial/place-based authorities" of each Member State that, by mandate, are not supposed to be interested in the effectiveness of policy anywhere except in their own country: While indispensable for their competence and experience, they are also generally moved by the goal of keeping the hands of national or regional authorities as free as possible, and the regulation and the strategic principles are modified likewise. Only by aligning the negotiation of the three documents can a balanced view emerge from the mix of general and thematic interests and contributions. It is, on the other hand, an obvious requisite for a system of conditional grants that the amount and allocation of resources are subordinated to the common acceptance of the priorities and the rules for using them.

A policy concept *plus* a sharp reform of priorities and governance *plus* a strong political compromise, *together with* an appropriate design of the negotiation process could deliver the much improved cohesion policy that the Union so much needs.

IV. A CONCENTRATION ON A FEW EUROPEAN PUBLIC GOODS

The concentration of the majority of funds (possibly up to two thirds) on a few (3-4) narrowly-defined core priorities in all regions is one of the main features of the proposed reform of cohesion policy[276].

Such a concentration of resources would have several positive effects. First, it would create a European-wide critical mass of interventions on a few priorities, capable of having an effect on issues of importance across the EU and of creating a set of well defined "European public goods"[277]. Secondly, the effective delivery of these European public goods could attract both public and high-level political attention and accordingly give more of an incentive for all those involved to produce effective results. It would also create more favourable conditions for an EU-wide learning process. Thirdly, such concentration of funding would enable the Commission to focus its expertise in a limited number of policy areas and give it more credibility in playing a greater strategic role in governing cohesion policy. This is a condition for the Commission to exercise greater discretion over the deployment of funds and to put in place more effective conditions over their use.

The concentration of resources would not only apply to the selection of the priorities but also to the nature of the measures undertaken in each priority area. With the choice of core priorities across the EU being decided after a high-level debate, involving Member States and Regions and the implementation of the changes in governance proposed in the next chapter, there would be a stronger incentive to use the resources effectively as well as in places where they can best contribute to pursuit of efficiency or social inclusion objectives.

The high-level political debate leading to the choice of core priorities would be part of a revised negotiation process over strategy which would lead to the simultaneous approval of the financial framework, the strategic principles and the regulation. This process is described in the next chapter together with proposals for the share of resources to be allocated to core priorities and the arrangements for their governance. In this chapter, three criteria are put forward to be used for selecting the core priorities (section IV.1), a case made for a strong focus on the social inclusion objective through the launch of a "territorialised social agenda" (section IV.2), and some candidates for the choice of core priorities suggested – "Innovation" and "Climate Change", with a predominantly efficiency objective (section IV.3), "Migration" and "Children", with a predominantly social inclusion objective (section IV.4) and "Skills" and "Ageing", where the two objectives are of similar relevance (section IV.5).

The options put forward should be regarded as *examples* of how the three selection criteria could be applied in practice. They also demonstrate the way that the conceptual framework discussed in Chapter I can be applied and how the ideas and methodological advances already made can be deployed. The maturity of the analysis set out differs markedly between the potential priorities examined, reflecting existing knowledge and experience. In particular, the lessons learnt from regional policy intervention in support of Innovation over the past two decades enable a more in-depth assessment to be made of this option.

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[276] For the other resources, Member States and Regions would be free to choose without constraint the priorities that they consider most appropriate to focus on from the broad range of existing options. See chapter V, pillar 1.

[277] A "European public good" refers to a strategic action undertaken by the EU with the following two features: a) the action has a general effect – making the Union and its policies sustainable – which benefits all European citizens in addition to those affected by the projects supported under the action concerned; and b) it is neither possible nor desirable to exclude anyone from the general effect.

IV.1. Criteria for the choice of core priorities

Ranking the priorities

Three criteria are of particular importance to apply when selecting the core priorities:

- Its EU-wide relevance;
- Its place-based nature;
- Its verifiability.

EU-wide relevance refers to both the relevance of the issue for European citizens and the rationale for EU involvement in a policy response. It includes five distinct but interdependent sub-criteria, linked to the justification for the EU to manage a place-based development policy and to Member States interests.

A first group of three sub-criteria are linked to the sustainability rationale for cohesion policy – that the policy is the most feasible and effective way for the EU to fulfil the development task which is inherent in its existence.

- First, the issue must be *highly relevant to the well-being of EU citizens*, from an efficiency and/or a social inclusion perspective based on existing information and projected future developments.
- Secondly, there must be a *strong and unsatisfied political expectation from EU citizens* that the issue needs to be addressed by policy.
- Thirdly, EU citizens should expect *this issue to be wholly or partly addressed by the EU*; the more this is the case, the greater is the need for and the potential value added of EU direct development intervention.

The fourth sub-criterion is linked to the other rationale for cohesion policy – that the EU has a comparative advantage over Member States in running a place-based development approach.

- In comparing alternative options for cohesion policy action, choices should be guided by the potential effectiveness that EU budgetary intervention could have. For example, higher added-value would be expected if EU supra-national exogenous interventions involve: addressing: cross-border interdependencies, reducing the possibility of beggar-thy-neighbour actions, exploiting externalities and promoting cooperation and exchange of information. The added-value is also likely to be greater, the more the Commission is able to act as a "centre of expertise" capable of commanding credibility in negotiations on the use of resources.

- Fifth and finally, an assessment of EU-level relevance needs to take account of the political legitimacy of choosing the option in question, in the sense of ensuring that there is sufficient Member State support for the priority to be selected.

Member States interest can be of two kinds. For some, it could lie in the advantage of externalising some responsibility for the design of intervention rules (for reasons of externalities and coordination, competence, credibility, etc) or in the perception of gains associated with EU cohesion policy intervention. For other countries, the benefit could be indirect, such as ensuring that deficiencies or gaps in the priority area are properly addressed in other countries, or reinforcing the sustainability of the EU as a whole and its capacity to deliver in other areas of interest such as market integration or currency unification. Whatever the basis for Member State interest, the existence of a genuine compromise among Member States on selecting a few core priorities is also a condition for achieving EU-level agreement on the strategic principles for each core priority – both in terms of goals and institutional requirements – and coherence between cohesion policy and the actions undertaken under other Community policies.

The second general criterion, that the adoption of a *place-based* approach is important, is also of great importance. In spite of the recent formal acknowledgment of a "territorial" dimension in the Treaty, this perspective is often neglected in debates on the choice of priorities for cohesion policy. The risk is to conceive this policy as a "pot of funds" available for whatever EU strategy, and to make choices on the basis of traditional sectoral perspectives. Attention should instead be paid to how far the particular tools of a place-based approach – allowing interventions to be tailored to places – are needed in practice in tackling the issue concerned. In most cases, the knowledge and preferences of local actors are of relevance for policy success, since most institutions and the measures applied need to be tailored to places. But the importance of adopting a place-based approach differs between issues and the core priorities should, therefore, be chosen where it is particularly important.

In this context, it should be emphasised that for an issue to require a place-based approach it is not enough that the scale of the problem differs across regions. For example, employment rates could differ markedly between regions, but it might be that the main cause was the regulation of the labour market and so tackling low employment rates would not be a priority for cohesion policy. Two features should be considered when assessing the place-based nature of an issue, which are linked to the definition of the term (see Introduction and sections I.2.1 and I.2.2): first, whether and to what extent the inefficiency or social exclusion problems relating to the issue are strongly context-dependent; secondly, whether the measures for tackling the problems need to be tailored to places. As shown in Chapter I, the place-based nature of problems tends to be particularly high where changes to local, informal, institutions are required, which in turn entails the direct and active involvement of the people in the place concerned. The same is true when a number of sectoral interventions need to be integrated, which can only occur at place level through the bundling of particular public goods and services to match local needs. Lastly, the place-based nature of policies matters greatly if there are strong interdependencies between places and there is a need for a comprehensive territorial strategy.

The third and last criterion for choosing core priorities is *verifiability,* defined as the capacity for identifying, and committing, to concrete *objectives* and to the development of *economic institutions* whose achievement and implementation can be confirmed *ex-post*. This is an important criterion given that the major change advocated for cohesion policy is largely centred on assigning a greater role to performance and results in policy design and implementation and on the construction of institutions which are necessary to achieve results.

So far as objectives are concerned, a core priority should, first, be unambiguously about what the EU is seeking to achieve. The high-level political compromise that leads to their selection must, therefore, make clear the nature of the goals which are being commonly agreed at EU level. Second, it should be possible to track the pursuit of these goals through indicators which are adequately measured and regularly reported and the limitations of which can be monitored and adjusted over time. This requirement would be more easily satisfied (and agreement on a set of EU-wide core indicators facilitated) if the EU had already developed, a body of knowledge and expertise in the selection and measurement of indicators. Finally, verifiability would be greatly enhanced if the goals concerned lent themselves to prospective impact evaluation, which is proposed as an integral part of future cohesion policy.

As regards economic institutions, an issue can become a core priority when sufficient consensus exists at EU level on a set of principles which institutions at Member State level need to comply with for cohesion policy funds to be allocated to tackling the issue concerned. These principles need to be incorporated in a European Strategic Development Framework and their specific implementation described in a verifiable way in the National Strategic Development Contract which each Member States needs to agree with the Commission (see Chapter V). The more agreement there is at European level on such a set of principles, the more effective cohesion policy can be. These features are reflected in the proposals described in Chapter V below.

Having explained the three general criteria of EU relevance, the next task is to clarify how they might be applied in practice by examining possible candidates for the choice of core priorities. Before this, however, two further questions need to be addressed:

- whether the choice should be from among "policies" corresponding to different kinds of public goods and services or from among "issues" corresponding to economic and social challenges;
- whether a core priority should be concerned with only one of the two main objectives of cohesion policy, efficiency and social inclusion, or both.

Defining the priorities

There are different ways to define the priorities. One approach would be *policy-based,* under which, in line with the current categorisation used for cohesion policy (see tables II.8-9-10), the priorities are selected from among the different kinds of public goods and services (those relating to research, transport, energy, education, social infrastructure and so on). An alternative would be *issues-based,* deriving the priorities from global trends or specific challenges faced by the EU (demographic change, technological advance, environmental degradation, and so on).

In the first case, cohesion policy would finance a limited set of public goods and services included in the chosen category; in the second, it would finance public goods and services relevant for addressing the issue chosen. Opting for the first approach would have the advantage of the EU specialising in some clearly defined services. Its sectoral nature, however would betray, as has often been the case, the premise on which a place-based approach is founded: that bundles of different public goods and services tailored to places are the way to address inefficiency and social exclusion traps. It would also have a greater chance of conflicting with national sectoral policies. Choosing the priorities on the basis of issues (challenges), on the contrary, has a much greater chance of satisfying the EU-relevance criterion and responding to the expectations of EU citizens. This is the option suggested here.

With regard to the distinction between the efficiency and the social inclusion objectives, it has been argued that both should be pursued through cohesion policy, but that this should be done through distinct and separate interventions (sections I.2.2 and I.2.3). To repeat, this is, first, because the relationship between the two objectives is complex, context-dependent and uncertain; secondly, because the most appropriate intervention for one objective is not necessarily the most suitable for the other; and, thirdly, because verifiability is improved and profiteering made more difficult if the focus is limited to one objective only[278]. In the light of this principle, should any core priority address only one of the two objectives?

Whatever priority is chosen, both dimensions - efficiency and social inclusion - are bound to be relevant. For any priority, synergies and trade-offs, which need to be recognised in policy-making, are almost certain to exist. For any priority, the increased emphasis on results calls for an impact assessment in terms of both objectives. For any priority, consensus on the policy will also depend on its capacity to make progress on both fronts. At the same time, for the reasons set out above, for any priority, each intervention needs to be expressly aimed at either efficiency or social inclusion objectives. It is, accordingly, not necessary, and likely to be unfeasible, to limit the aim of a whole core priority to one objective alone.

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[278] As argued in section I.2.2, relevant synergies often exist inefficiency traps and social exclusion traps often coincide and might even require similar interventions (especially in building local institutions, both formal and informal). But this is not always the case, since in many cases the pursuit of fuller capacity utilisation calls for interventions that are sub-optimal for social inclusion. In addition, in the short and medium term, which is relevant for the mobilisation of public opinion and debate, synergies are much less important, while experience shows that if objectives are fuzzy, people's expectations tend also to be and the behaviour of policy-makers is, accordingly, allowed to be so.

Nevertheless, there is a strong case for at least one or two of the core priorities to focus primarily on one objective only. It would assist policy verifiability and the focus of political and policy debate if at least some of the European public goods produced by cohesion policy could be easily identified as being aimed at increasing either efficiency or social inclusion. Moreover, the need to choose at least one core priority that is primarily and visibly aimed at social inclusion is essential if the reform of cohesion policy is also to be used as an occasion to launch a territorialised social agenda. This choice requires a strong political and policy focus, which a "dedicated" core priority can offer.

It should be noted that the focus of a core priority on one of the two objectives does not mean assigning it exclusively to one of the two distinct Funds, regional (ERDF) and social (ESF), that currently make up most of the cohesion policy budget. If the present configuration of Funds were to be maintained - as the Report suggests doing (see chapter V, pillar 2) – the two Funds would specialise (with many overlaps) on two types of intervention: "hard", comprising largely investment in infrastructure under the regional Fund, and "soft", aimed at strengthening human resources under the social Fund. Both types are needed in any comprehensive action aimed at a core priority, whether the objective is efficiency or social inclusion.

Given these considerations, two core priorities for which the main objective is efficiency – Innovation and Climate Change - two for which it is social inclusion - Migration and Children - and two for which the two objectives are both relevant – Skills and Ageing – have been chosen as relevant examples. These priorities are assessed against the general criteria set out above. First, however, there is a need to justify why there should be a strong focus on social inclusion and a move towards a territorialised social agenda.

IV.2. The case for a strong focus on the social inclusion objective: towards a territorialised social agenda

The Report has set out the conceptual principles (sections I.2.2 and I.5) and some of the evidence (section II.3.1) that suggest cohesion policy being given a more focused social task (section I.3). These threads are brought together below in the proposal for a territorialised social agenda.

Europeanising and territorialising the social agenda

The argument in favour of a territorialised social agenda aimed at social inclusion can be set out in four steps.

First, over the past decade, the EU has seen some reduction in regional disparities in average GDP per capita, but for individuals there appears to have been little or no improvement in any measure of social inclusion at national level. The limited data available (section I.2.3) suggest that in the EU Member States income inequality, after some decline up to 2000, has risen since then in many countries. The risk of poverty has averaged 15-16% across the EU over the past decade[279], with marked differences between Member States (see table IV.1). No automatic correlation between growth and income inequality has materialised, challenging the assumption that, after rising with GDP per head in the early stages of development, income inequality would tend to decline as development proceeded.

[279] Risk of poverty refers to disposable income adjusted for household composition below 60% of the national median: "risk" refers to the fact that whether or not "poverty" materialises depends on other features of any individual's life (see below for the concept of multidimensionality). See Eurostat, "At-risk-of-poverty rate after social transfers – total" available at: http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996,45323734&_dad=portal&_schema=PORTAL&screen=welcomeref&open=/&product=REF_SD_SC&root=REF_SD_SC&depth=3.

Table IV.1: Multidimensional measures of social inclusion: selected indicators in 2007(*)

Table IV.A - Multidimensional measures of social inclusion: selected indicators in 2007(*)

Country	Income		Education		Health	Employment
	At risk of poverty national rate (1) (% share)	National threshold(2) (PPS euros)	Early school leavers among 18-24(3) (% share)	Low achievement in literacy by 15 years old students(4) (% share)	Disparity in access to care(5) (ratio)	Regional disparity in employment rate(6) (% share)
Austria	13	22 296	10.9	21.5	3.3	3.4
Belgium	15	20 822	12.3	19.4	18.0	8.7
Bulgaria	14	n.a.	16.6	51.1	n.a.	7.3
Cyprus	16	20 300	12.6	n.a.	13.2	n.a.
Czech Republic	10	10 505	5.5	24.8	7.0	5.2
Denmark	12	20 592	12.4	16.0	1.0	n.a.
Estonia	18	7 205	14.3	13.6	4.6	n.a.
Finland	13	18 879	7.9	4.8	5.2	5.4
France	13	19 147	12.7	21.7	7.2	7.5
Germany	13	19 155	12.7	20.0	n.a.	5.2
Greece	21	14 201	14.7	27.7	4.0	3.7
Hungary	16	7 751	10.9	20.6	4.9	9.1
Ireland	18	20 025	11.5	12.1	3.9	n.a.
Italy	20	17 714	19.3	26.4	4.4	16.0
Latvia	23	5 734	16.0	21.2	4.9	n.a.
Lithuania	20	5 904	8.7	25.7	3.5	n.a.
Luxembourg	14	36 136	15.1	22.9	2.0	n.a.
Malta	14	14 798	37.6	n.a.	4.3	n.a.
Netherlands	10	21 012	12.0	15.1	3.0	2.2
Poland	19	6 416	5.0	16.2	2.1	5.1
Portugal	18	10 954	36.3	24.9	8.7	3.1
Romania	19	n.a.	19.2	53.5	n.a.	3.6
Slovakia	12	7 563	7.2	27.8	8.0	8.6
Slovenia	12	15 753	4.3	16.5	1.5	n.a.
Spain	20	15 819	31.0	25.7	4.5	7.8
Sweden	12	19 045	12.0	15,3	3.7	2,9
United Kingdom	19	22 520	13.0	19,9	1.7	5,5

Source: http://ec.europa.eu/employment_social/spsi/common_indicators_en.htm .

(*) The indicators are selected from those adopted at EU level to monitor the objectives of the social inclusion strand of the Social Protection and Social Inclusion Strategy. All data refer to 2007, except for low achievement in literacy (2006).

(1) Share of population below the national threshold (60% of the equivalised median income).

(2) 60% of the median income for two adults with two dependent children, at purchasing power parity.

(3) Share of total population aged 18-24 who have at most lower secondary education and not in further education on training.

(4) Share of students assessed at level 1 (of 6) or below by the international OECD Pisa survey.

(5) Access to care is measured by self-reported umet need for medical care for the following reasons: financial barriers, waiting times, too far for travel. Disparity in access to care is measured as the ratio of the access to care for the first quintile of income to the access to care for the last quintile of income.

(6) Coefficient of variations of employment rates across Regions at NUTS 2 level.

There are other dimensions of well-being, which this Report has argued are necessary in order to assess and address social inclusion satisfactorily. Here, too, inequalities are significant. table IV.1 shows, for example, with reference to EU-wide thresholds, that in 2007 the share of early school leavers (with at most lower secondary education) among 18-24 years old was over 10% (in some cases, well over) 21 out of 27 Member States. In over half of the Member States, more than one in five 15 year-old students has literacy levels at the lowest end of the scale. Disparities within countries are also important, as the same table shows for access to health care measured by self-reported unmet needs. In addition, available information indicates large proportions of individuals feeling stressed as regards more than one relevant aspect of their well-being[280].

[280] See Marlier, E., Atkinson, A.B., Cantillon, B. and Nolan, B. (2007) and the First European Quality of Life Survey.

At regional level, there are wide disparities in employment rates (table IV.1) as well as in risk of poverty rates, with high values in some relatively prosperous regions. Intra-regional inequalities in income tend to dominate over disparities between regions (section II.3.1).

Secondly, this persistence of inequality is mirrored by a series of factors which give rise to increased concern among European citizens: the challenge of globalisation and of market and currency unification (and now of the financial crisis and its repercussions) to both regions and to particular sections of the population; fears about not reaping the opportunities offered by these global changes but instead falling behind; pressure of migration flows; perceptions of a threat to cultural identity; and the growing limits of national budgets to deliver on welfare commitments. All these factors place growing pressure on the EU to strengthen its social agenda and to address the issue of social exclusion, as symbolised by the explicit reference to its reduction in the new Treaty as one of the goals of the Union.

Third, the EU has been addressing the social agenda primarily with reference to employment and labour market issues. This is a central aspect and deserves the attention that it receives (including the launching of initiatives through cohesion policy), especially at times of crisis. But it is only one of the several dimensions of the social agenda. In particular, the issue of social inclusion has been tackled through the Social Protection and Social Inclusion Process, the open method of coordination based on the voluntary commitment of Member States. This process has achieved important results in methodological terms, setting measurable indicators and guidelines, alerting some countries to the issue and promoting a debate based on facts and figures. A serious gap exists, however, between "the objectives and aspirations of Member States and the actual implementation of policies"[281]. Despite its aim, the process has failed to mobilise a wide range of actors and to raise widespread political interest. It has often remained elitist and its important methodological advances not fully exploited.

Equally, the social inclusion framework has had only a limited impact on the use of cohesion policy resources. In the 2007-2013 period, under 3% of these are being spent, through the social Fund, on "improving the social inclusion of less favoured persons" (mostly on their integration into employment) (see table II.8). Significant other resources are being spent, through the regional Fund, on "social infrastructure" (4.9%) – the majority on education and health, but also on childcare and housing – and on other infrastructure that can be of great relevance for addressing deprivation and inequalities (6.3% on the management, distribution and treatment of water, and 1.8% on the management of household and industrial waste) (Table II.9). But they are not necessarily directed at the objective of social inclusion, nor are they necessarily integrated at local level with the provision of other services aimed at extricating places from social exclusion traps.

Fourthly, as argued in section I.3, the current situation, where the EU has sovereignty over markets and liberalisation and Member States have sovereignty over welfare, is becoming increasingly unsustainable. Member State social policies are increasingly constrained by common budgetary commitments and rules. Cultural and linguistic diversity limits internal mobility as a means of effectively providing an additional source social protection. At the same time, European citizens attribute to the direct action of the EU – and are sometimes encouraged to do so by national politicians, eager to turn necessary institutional changes into external constraints - the adverse effects of increased competition, pressure on national budgets, migration and so on. For the sustainability of the EU and its policies, European citizens in whatever region they live also need to see the EU running effective policies to address their fears; all of them need to be reasonably convinced that a policy effort on the same scale as devoted to unification is being

[281] See the 2006 Joint Report on Social Protection and Social Inclusion. Similar conclusions are to be found in the Commission's 2008 Communication on "A renewed commitment to social Europe": "In spite of the European Council's commitment in 2000 << to make a decisive impact on the eradication of poverty>>, there are no signs of an overall reduction in poverty rates in the EU… and health inequalities (shorter lives, worse health status in disadvantaged groups) persist" (p. 4).

made by the EU to ensure that they have equal access to the opportunities created by unification, independently of where they live. The EU cannot allow social inclusion not to be improved.

A territorialised social agenda offers the Union a chance to respond to the challenge sketched out above. The open method of coordination, while providing a strong methodological base (see below), falls short of being able to meet this challenge. The action of the EU Court of Justice can undo national rules that produce perverse social results, but cannot positively build new rules which address the issue. The option of transferring sovereignty for welfare intervention to the EU, as in economic areas, is not feasible owing to cultural diversity and differing national aspirations and social models as well as to the lack of political legitimacy of the EU level of government. The place-based approach is a feasible and effective means of tackling this situation. It is an advanced approach for delivering public goods and services addressing multiple dimensions of social inclusion. And it is a means which is compatible with the current architecture of the Union. It can combine action across three levels of government: the EU, setting the general strategy, priorities and objectives, supervising, promoting measures aimed at results and learning and mobilising actors; the national and Regional levels, adapting the strategy and objectives to specific aspirations and institutional contexts and selecting projects; and the local level, designing the projects to the particular needs, knowledge and preferences of places.

Cohesion policy can simultaneously Europeanise (in a feasible and cautious way) and territorialise the social agenda. It can enable the EU to respond to the growing demand for a stronger commitment to the social agenda, while, at the same time, experimenting with a modern way of promoting multi-dimensional social inclusion. It can also have another positive effect. By creating new solidarity and new "identifications"[282] between citizens at an EU-wide level and by progressively reducing their fears about the effects of integration (especially if aimed at issues such as migration, see below), it can help lay the foundation for greater mobility of citizens and labour, which can itself represent, in the long term, an additional source of social protection[283].

Building on the existing knowledge base

In building a territorialised social agenda, cohesion policy would not start from scratch. It could first of all build on its own experience, bringing together the lessons from those Member States which, in implementing cohesion policy or their own regional policies, have experimented with a place-based approach aimed at social inclusion. It can then build on the measurement, the methods and the ideas developed in the Social Inclusion Process.

Five lessons can be extracted from this Process[284].

- The *multi-dimensional* nature of social inclusion calls for a measurement of both standards and inequalities in relation not only to income but to a wide range of indicators representing the multiple aspects of well-being. A *system of comparable indicators* across Member State has been developed (the now-revised Laeken indicators[285], from which the figures in Table IV.1 are taken) which is aimed at being "comprehensive" and "balanced" and covers income, labour, education, material deprivation, housing and health. These indicators are mostly "objective", but others on "subjective measures" also exist[286].

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[282] Identifications stay for "ties of sentiments between the members of the group": see section I.3, and in particular note 155.
[283] On this issue see D'Antoni, M. and Pagano, U. (2008).
[284] See in particular Marlier et al (2007).
[285] The revised set of Laeken indicators which are currently used in the open method of coordination include: 11 primary indicators at national level (poverty risk, labour conditions, education, housing, health and material deprivation), 3 secondary indicators (a breakdown of poverty risk by personal characteristics and education level) and 11 context indicators (mostly measures of income and labour inequality).
[286] See the European Quality of Life Survey.

- The selection of *indicators* complies with the *requirements* previously outlined (section I.2.2), and ideas have been developed on how to move forward; the data for these indicators are provided by Eurostat (in the form largely of the EU Statistics on Income and Living Conditions – EU-SILC but also the EU Labour Force Survey) mostly on the basis of household sample surveys. The choice of indicators strongly reflects the main purpose of the exercise which is cross-country comparability.

- The view has been established that, in assessing disadvantage, reference must be made not only to *national standards* but also in relation to the *standards of the EU as a whole* (EU-wide thresholds), at least as background contextual information of which policy action must take notice. Although EU citizens set their expectations and perceive their rights primarily with reference to their own national societies, but they increasingly take account of the "European society". This will be increasingly the case the more and the longer that markets and currencies are unified. The variation in living standards across EU countries is substantial, with "the rich in the poorest countries [being] objectively as badly off, or worse off, than low or middle income groups in the richer countries and [feeling] accordingly"[287]. This situation is likely to produce mounting tension.

- The importance of the *sub-national dimension* is clearly recognised, i.e. that disadvantages should not only be measured for Member States as a whole but also for regions within these, given the pronounced territorial concentration of inequality that exists in Europe. Due to the lack of data at present, however, the revised Laeken indicators include only regional disparities for employment rates.

- On more strategic grounds, *impact evaluation*, *mobilisation of actors* and *mainstreaming* are strongly advocated. It is argued that, by developing an appropriate system of measuring and reporting, social inclusion considerations should influence public interventions in all policy areas. For this to happen, a systematic practice of impact evaluation must first be developed, so that beneficiaries of policy measures and the public at large can be mobilised. If this happens, systematic knowledge on how different interventions affect social inclusion can be built up and by feeding this into the policy-making process, there is scope for achieving permanent effects.

For cohesion policy to be able to draw extensively from these lessons and to respond appropriately to the task outlined in this Report, there is for major reform in its governance, as proposed in Chapter V. To pursue the objective of social inclusion, three mutually reinforcing features are particularly important to include in the policy-making process: a *system of robust indicators and targets*; a *mobilisation of the relevant actors at place level;* and a *prospective impact evaluation.* Given their role as regards social inclusion,, it is useful to develop further in each case the general ideas sketched in section I.2.4.

A system of robust indicators and targets

A *system of indicators* represents the "hardest" component of the triangle to put in place, but it is indispensable for improving verifiability.

The use of indicators for a policy the main goal of which is to reduce the share of people "falling below essential standards" in multi-dimensional terms[288] is clearly central. It is only through indicators and setting standards that the policy can be designed, implemented and monitored. Three limitations of indicators are particularly relevant in this context. First, because measurability is difficult, there is the risk of only partially capturing the dimensions of well-being being considered, so creating a bias in the policy implemented. Secondly, there is a risk of

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[287] These are the results brought to light by the First European Quality of Life Survey, p. 36.
[288] The interpersonal goal must be defined in relation to indicators too.

choosing indicators in a top-down way, without incorporating local information and taking account of what is considered to be most relevant in the place concerned. Thirdly, there is a risk of interpreting changes in the indicators which have occurred while policy was being implemented, as signs of policy impact, ignoring all the other factors potentially responsible. As has been argued, all these risks are commonly incurred by cohesion policy.

Similar problems arise in setting essential *standards* for the different dimensions of well-being[289]. First, when standards are set with reference to given indicators and are turned into policy targets, policy bias, as noted above, can become important, which also creates scope for political manipulation. Secondly, the standards should reflect, as emphasised by the definition of social inclusion, a social agreement reached through a "participatory and fair process". This requirement is hard to respect, and standards might well be set top-down and not reflect actual local preferences or needs. Thirdly, standards can be context-dependent (as, for example, in the case of housing requirements which vary according to climate), so that they might need to be adjusted for this.

These issues are being resolved by a rapidly growing body of international experience (including that documented by the Union itself), to which cohesion policy can turn for guidance[290].

In particular, the experience of the social inclusion process suggests that a set of core indicators should be established first, in a similar way as in the case of the Laeken indicators. Given the unsatisfactory nature of the present system of indicators of cohesion policy, account needs to be taken of requirements such as[291]:

- having the capacity to "capture the essence of the problem";
- having a "clear and accepted normative interpretation" (i.e. that "a movement in a particular direction … is a positive outcome");
- being robust and capable of statistically validation;
- being responsive "to policy intervention but not subject to manipulation";
- being "timely and susceptible to revision".

Improvements to the Laeken indicator system have also been proposed[292], which can be useful in the context of cohesion policy: a) introducing a regional – and sub-regional - breakdown for as many indicators as possible, through greater recourse to administrative data; b) upgrading the comprehensiveness of the indicators; c) increasing the coverage of dimensions of social inclusion and d) encouraging the use of indicators by "independent researchers" and the public at large.

There is also much scope for Member States to develop additional national indicators. Unlike what happens today, in doing so, they should be required to respond to a set of requirements such as those sketched above, with the Commission providing technical assistance and supervision. Scope is also required for particular places and communities to choose their own indicators. In the case of social inclusion, the scope for bottom-up design is obviously greater. International experience shows that this approach is feasible, that it can be integrated with the use of a few indicators applied on a broader spatial scale. Equally, there is a need for a "policy space" at national and at local level to contribute to the development of both national and European standards. The latter should be a priority in policy implementation. Feedback from the local level

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[289] Once again, a similar problem exists in addressing the inter-personal goal, since targets must also be set.
[290] See the website www.OECD.org/progress of the OECD Global Project to measure the progress of societies: the section on "knowledge base" provides a link to hundreds of documents and experiences of a very different nature on the development, analysis and policy use of indicators of well-being. See also Marlier et al (2007) and the Report Working Paper by Alkire, S. and Sarwar, M.A. (2009).
[291] See Marlier et al (2007), pp. 40-42.
[292] Ibid.

to the EU level, and a debate on core and community-based indicators, would encourage and facilitate a comparison of opportunities and outcomes in respect of the different dimensions and would form part of the process of determining socially agreed essential standards.

The effectiveness of a system of indicators and targets can be enhanced through impact evaluation and the mobilisation of local actors. Impact evaluation, is the only way properly to investigate effects and to avoid misinterpreting indicators as measures of impact, while mobilisation of beneficiaries is the only way to ensure both a demand for, and usage of, impact evaluation. At the same time, the latter is also the way through which local knowledge and preferences can be taken into account in choosing indicators and standards, new place-specific indicators can be developed and standards set and pressure can be exerted to change established indicators and standards. Mobilisation and impact evaluation can together keep a check on the potentially damaging effect of indicators not being truly comprehensive by highlighting the problems, pressing for changes in indicators and complementing these with qualitative assessment of "what really happens to deprivation in a given dimension".

Mobilisation of actors at local and European level

The design of a reliable but flexible and mixed system of indicators is strongly linked to the successful mobilisation of relevant actors. On this issue, some lessons can again be derived from the experience of the open method of coordination, but, as has been said, the learning process should enter "the political bloodstream of national and European debate, rather than [being] locked away in the processes of the Open Method of Coordination"[293].

It has been observed that, in spite of the annual Round Tables on Poverty and Social Inclusion and other steps, the EU strategic approach "still often appears far removed from what is happening on the ground"[294]. More involvement of the bodies representing social interests at EU and national levels, including NGOs in particular, is clearly required, in line with the mandate of the 2002 European Council "to mobilise all relevant bodies". But this should be only an intermediate step towards the ultimate goal of mobilising the potential beneficiaries of policy and the local branches of those bodies in every place in which intervention occurs. Conditions should be created for them to participate actively in the policy process, in identifying the most relevant dimensions to address in each place and the way to measure them, in designing interventions and in assessing their effects. In order to move in this direction, account should be taken of the experience of a number of pilot and demonstration projects implemented in the 1970s and 1980s Poverty Programmes, which were small scale and very place-based and which succeeded in involving local actors[295].

The requirements for mobilisation should be identified and Member States asked to commit to them in their "contracts" with the Commission. But the Commission should also undertake the task of directly raising public awareness and encouraging involvement, by organising workshops and "conventions" across the EU in places where the priorities are particularly relevant. Information and data should be analysed and debated, and policy options and results should be presented and compared. Such actions would be greatly assisted by the participation of representatives of policy-makers and beneficiaries from other countries where similar problems are being addressed. This methodology is already part of the toolbox of cohesion policy, but it is underused and it has not so far relied on substantial Commission expertise on the priority issue concerned. In addition, the design and implementation of impact evaluation of as many local projects as possible would increase local involvement and make it more pragmatic.

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[293] See Liddle, R. (2007a).
[294] See again Marlier et al (2007), p. 231.
[295] See again Marlier et al (2007).

Prospective impact evaluation

Prospective impact evaluation is the third methodological pillar to be developed and applied whenever feasible. This method is more frequently implemented in the social policy area, where a body of experience has been accumulated, which should be put to use in cohesion policy. The idea is to submit social inclusion projects financed by cohesion policy to impact evaluation, using, so far possible, counterfactual methods. As the Report argues (see Box I.A and Chapter V, pillar 7), this evaluation should not be designed and implemented *after* the interventions have been initiated, but it should instead be prospective, i.e. it should be designed while the objectives are being identified and the policy designed.

By being prospective, impact evaluation can not only improve the chances of coming up with clear results, but it can also have a useful disciplinary effect. It can focus attention on objectives (which often tend to "get lost" in the complex process of local partnership) and on the criteria for the selection of beneficiaries and can improve data collection. It is a way of making better use of the knowledge of independent experts. The learning process established by the design of prospective impact evaluation and fuelled by its results can improve policy and provide a good basis for mobilising local actors. Member States need to commit to its use and be responsible, with regions, for designing and implementing it. The Commission, however, should have the opportunity, the in-house skills and the resources to launch impact evaluations of specific projects, whenever required, and to promote an EU-wide public debate on the results (see chapter V, pillar 7).

IV.3. Addressing the efficiency objective

IV.3.1. A case for "Innovation"

Innovation is a major source of productivity growth and economic efficiency. In its broad definition it embraces any discontinuity - of technologies, organisations and institutions[296] – in the workings of the economy and society[297]. A narrower definition, the one used here, includes those changes that have the (direct) effect of inventing general purpose technologies or bringing about their application in a specific domain (business activities, healthcare, the environment, culture and so on)[298]. Innovation, and the research that can lead to it, tends to be under-produced by society due to well-recognised market failures, to radical or Hayekian uncertainty or to asymmetries of information. These require public intervention, which in turn is prone to failure[299].

In what follows, the case is made for Innovation (using the narrower definition) to be a core priority of cohesion policy, providing that its objectives are focused and that, in the context of the governance reform proposed in Chapter V, key changes are introduced.

The need for an overall European strategy

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[296] See OECD (1996).

[297] From this point of view, place-based development policies as a whole are policies for innovation. On this issue, see Seravalli, G. (2008).

[298] On this issue, see Foray, D. (2008). This narrower definition is the one generally used in the vast literature that examines the impact of the effort to innovate and the expenditure on innovation (and the research that innovation initially requires). On the level and growth of GDP: see for example Sala-i-Martin, X. (1996); Aghion, P. and Howitt, P. (1992, 1998); Roemer, J.E. (1986).

[299] See the Report Working Papers by Seravalli, G. (2009) and Bonaccorsi, A. (2009). The "Hayekian uncertainty", referred to by the latter author, follows the notion proposed by von Hayek (1945) relating to the component of knowledge which is relational, time-dependent and space-dependent and requires trusted relationships between individuals to be elicited and aggregated.

There is already a powerful case for support of innovation to be an item in the EU budget. Taking a global perspective, the innovation gap between the EU and two of its main competitors, the US and Japan, is significant, although diminishing, and is reflected in productivity growth. Over the 2005-2007, the US kept its lead as regards 12 out of 17 indicators for which comparable data are available (the main exceptions being science and technology graduates and employment in medium-high and high-tech manufacturing). The same is true of Japan[300]. A comparison over a longer period indicates that the EU has been closing the gap with the US in all of the indicators except business R&D and European Patent Office and Patent Cooperation Treaty patents.

Major disparities in innovation capacity persist within the EU, both at Member State and regional levels. A summary innovation index constructed with reference to the years 2002-2003 by aggregating a much more limited group of indicators (7)[301], gives some indication of the relative performance at NUTS 2 level (Map IV.1). It highlights a strong innovation "polarisation": the presence of technological "hotspots" is accompanied by a high number of regions with low or very low performance[302]. Leaving aside the Finnish and Swedish northern regions (which are large in terms of land area but sparsely populated, for which the relevant disaggregated data do not exist), Europe's innovation "polarisation" is strongly marked by a form a centre-periphery pattern. Many of the regions located physically on the outskirts of Europe or farthest from the European centre, appear to lag behind in research and innovation.

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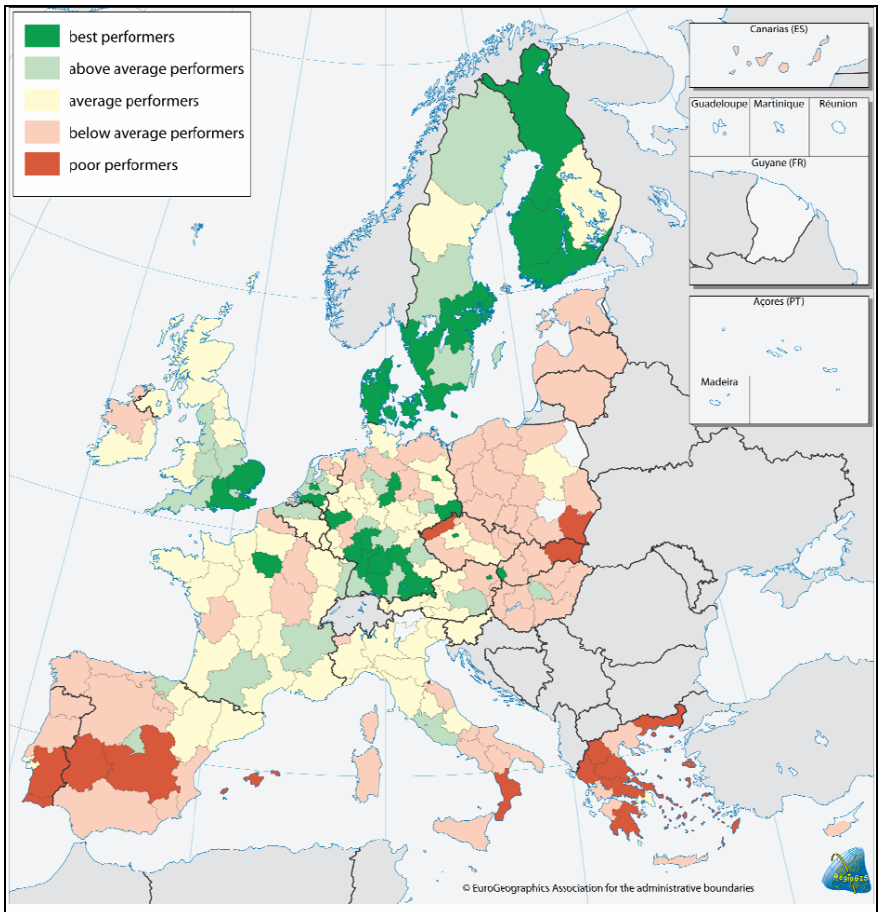
[300] See MERIT (2009), where 29 innovation scoreboard indicators are reviewed, with reference to three broad categories: enablers (human resources, finance and support), firm activities (firm investments, linkages and entrepreneurship, throughput) and outputs (innovators, economic effects). A role is attributed to non-R&D innovation. Comparison with US and Japan concerns 17 indicators.

[301] See MERIT, Joint Research Centre (2006). The summary indicator is built for 25 EU Member States with reference to the following indicators: participation in life-long learning per 100 population aged 25-64; public R&D expenditure (% of GDP); business R&D expenditure (% of GDP); employment in high-tech manufacturing (% of total employment); employment in high-tech services (% of total employment); number of patents applied for at the European Patent Office (per million population); human resources in science and technology (% of population). Two indices are calculated for each NUTS 2 Region, one relative to the EU-wide mean value, the other relative to the national mean; the weighted mean of the two is then obtained by attributing a weight of 0.75 to the first and 0.25 to the second.

[302] It should be noted, following MERIT (2009), that at country level a convergence of innovation performance (measured on the broader set of indicators) has been taking place over a five -ear period (up to 2005-2007), countries with below average performance having faster growth rates of the innovation indicator than those with above average performance. (The main exceptions are Italy, Spain, Norway, Lithuania and Croatia, which combine below average levels of performance with below average growth rates, and Switzerland which combines a high level of innovation performance and an above average rate of improvement.)

Map IV.2: Regional disparities in innovation, 2002-2003



*** The Index for this map has been build on the basis of the following 7 regional innovation scoreboard indicators**

- Human Resources in Science and Technology – Core (% of population)
- Participation in life-long learning per 100 population aged 25-64)
- Public R&D expenditures (% of GDP)
- Business R&D expenditures (% of GDP)
- Employment in medium-high and high-tech manufacturing (% of total workforce)
- Employment in high-tech services (% of total workforce)
- EPO patents per million population

Further information: ***EUROPEAN INNOVATION SCOREBOARD 2006,*** *Maastricht Economic Research Institute on Innovation and Technology (MERIT) and the Joint Research Centre of the European Commission*

Source DG REGIO.

The causes of this innovation gap have been identified and discussed in the growing debate on the EU innovation deficit, prompted by the Report on "Creating an Innovative Europe" (the Aho Report)[303]. The conclusions have influenced EU decision-making[304] and underlie the choice to concentrate a large share of cohesion policy resources for 2007-2013 on the innovation priority (see Tables II.9-10 in section II.1)[305]. Among the causes of the innovation gap, one is of particular relevance: the nationally fragmented nature of the public research system. The result is that: a) scale effects cannot be exploited; b) flows of human resources and the establishment of networks between research centres and with the private sector are limited; c) the advantages of Europe's high diversity (of culture, science, business attitudes and so on), which could enable

[303] The Report was prepared in January 2006 by an independent expert group appointed following the Hampton Court Summit and chaired by Esko Aho.

[304] In December 2006, the EU adopted a number of strategic priorities for stimulating innovation at EU level which were aimed at improving access to finance in support of innovation, at creating an innovation-friendly regulatory environment and demand for innovation and at reinforcing the activities of institutions relevant for innovation. See Council Conclusions on a broad-based innovation strategy: strategic priorities for innovation action at EU level, Competitiveness Council meeting, Brussels, 4 December 2006.

[305] See Commission of the European Communities (2007b).

general purpose technologies to be applied in numerous areas, or spill-over effects to take place across areas, are not being exploited; and d) over-production of research is taking place, with several regions investing in the same ways. This situation affects regions which are on the technological frontier or close to it as well as regions which have an important knowledge base to exploit in adapting technologies[306].

The acceleration of the formation of a European Research Area (ERA) is, therefore, a key need, as is the strengthening of the Framework programmes and of all the initiatives aimed at organising and financing high-level research at EU level. But these steps must be part of a more general strategy that allows the full potential of all places to be exploited. If, in the polarisation process, places not on the technological frontier but with a strong knowledge base were to fall behind, the opportunity would be wasted to apply new general purpose technologies in the activities in which they are specialised. Diversity would be squandered and growth opportunities would be lost. Inefficiency traps would multiply. The overall effect on Europe innovation and productivity growth would be negative. Moreover, the persistent failure to adapt the new technologies to regions away from the frontier, by progressively eroding the comparative advantages of those regions, would increase the fears of the people living there about the effect of innovation and their opposition to it, as well as to the institutions which are working to increase the pace of innovation. Such opposition, too, would have negative effects on overall growth.

These arguments provide a background to the political decision taken for the current programme period to shift some of the focus of cohesion policy to investment in research and innovation. The intrinsic uncertainty that characterises innovation, however, and the long time it takes for policy effects to materialise make the general policy risks of a place-based approach (see section I.2.1) particularly relevant and call for them to be tackled through the implementation of strong "conditionalities".

A place-based approach: rationale, policy risks and solutions

In the case of innovation, the general rationale for EU-level funding for development through a place-based approach (see section I.2.3) has special importance[307].

First, any policy for innovation needs to be place-based. By definition, the knowledge base on which interventions need to be built is local, and the nature of the economic institutions that must be enhanced are also strongly linked to places. In tackling unused innovative potential, the first step to make is capacity building, both through the training of people and through the promotion of new institutions. Capacity building must be geared to places and it must be given adequate time to produce results, as well as being continuously monitored. A place-based approach is the appropriate way of doing this.

Secondly, the EU level is the most appropriate one. As US experience shows, *diversity and openness* can be best be combined at this level. On the one hand, it can promote the diversity of agglomerations, knowledge bases and networks that fuel innovation. On the other, it can facilitate the opening up of research and innovation areas across national boundaries which is needed for diverse places to interact with each other in a mutually productive way. In this respect, the distance of the EU level away from the place concerned, if coupled with high-level expertise, can give it greater *credibility* in exercising a brokerage function and resisting the pressure for every area to "play a world-wide role", a pressure to which national and regional governments often succumb. The EU level can also reap the benefits of *transnational externalities* and can encourage the circulation of information on policy results and practices. Finally, by assigning an important strategic role to the EU level, place-based interventions can be *coordinated with the*

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306 See in particular Foray, D. (2008).

307 See the Report hearing summary on Innovation (2009), in particular the introductory note by Luc Soete. On the need to tailor interventions to contexts, see also the Report hearing summary on Growth, in particular the presentation by Philippe Aghion.

EU policy aimed at supporting "areas of excellence", turning it into a comprehensive European policy for innovation.

Innovation, therefore, satisfies the first two criteria that a core priority must meet – policy needs to be place-based and the issue has EU-level relevance. It is less easily satisfies the third criterion of verifiability, however.

A place-based policy for Innovation is anything but easy. Policy which set out to close the gap in innovation between regions can make three different mistakes: it can encourage "policy imitation", when the institutions and measures established in places with a history of successful innovation are taken as a model to be imitated, without appreciating the particular conditions under which they operate; it can suffer "local capture", when the policy agenda is taken over by local actors, whose interest does not coincide with the general interest of tapping into the unused innovation potential; and it can pursue "financial redistribution", when regional interventions are interpreted as a means of ensuring: that all regions (or NUTS 2 Regions) in the EU achieve a given target level of R&D expenditure, or that finance is provided to all private projects that appear "innovative" according to some pre-defined parameters, or that "collaborative networks" with Universities are developed.. To pursue this objective, the massive injection of EU funds in regional knowledge economies not nearly enough by itself, but it could even be detrimental.

In line with the idea of "smart specialisation"[308], what is needed is a policy that matches the effort to establish a European Research Area (ERA) and promotes the use of the knowledge base of regions by tailoring intervention in line with innovative potential; a policy that concentrates funding by selecting for each region the limited number of areas where innovation can usefully take place and by defining in these terms the boundaries of the "region" itself. It is a difficult task because, whenever a region is away from the technological frontier, the classic problem of incomplete information and asymmetrical information is increased by a lack of reference to recognised international standards of excellence. There is, however, no alternative to trying to do this if an EU strategy is to be pursued. The task is difficult but not impossible[309], since selection and incentive mechanisms can be designed to help concentrate interventions. This is why verifiability must be ensured and adequate "conditionalities" set to link the transfer of resources to.

Cohesion policy has built up a stock of experience on methodologies, successes and failures that can help to deal with the risks of public failure and to design "conditionalities". In particular, important lessons can be drawn from the experience of the European innovation strategies launched as a Community initiative in 1994. The interventions under this strategy marked a radical departure from concentrating funding on the creation of public research centres and other purely supply-side interventions, often juxtaposed with developing local networks, the creation of participative, demand-oriented, local and cross-country linkages and an experimental approach of trial and error. The Commission played an active role, bringing its expertise to bear and gaining credibility as a result, often close supervising implementation of the strategy. Results are mixed and possibly not fully appreciated[310] (partly because of the general failure to invest adequately in the evaluation of impacts), but they gave rise to the development of both capacity and methodology which could now be put to use.

The steps that have followed have not made enough use of the lessons of this exercise. This can be attributed to the strong demand for a European policy, by the rush "to do something visible about innovation" and by the rhetoric that accompanied it. The decision to reduce the role of the Commission and to mainstream interventions in national and regional programmes was accompanied by the allocation of resources to innovation and research which seem to have been

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[308] See Foray, D. and Van Ark, B. (2007).
[309] This slogan is taken from the title of Seravalli, G. (2006).
[310] See Morgan, K. (2004).

greater than the capacity to use them. For whatever reason, the interventions in this area in the 2000-2006 programming period have not lived up the expectations. The capacity to build, place by place, a policy tailored to regional innovative potential was often inadequate. Efforts to improve policy-making, strategy development and evaluation, including coordination between national and regional policy-making, were limited. Financial allocations to innovation planned in 2000 had to be reduced at the mid-term point in several Member States due to implementation difficulties arising from the design of the new measures and the weak demand from enterprises[311]. Four main bottlenecks to the efficient absorption of funds and the effective outcome of innovation measures were identified in the evaluation of these[312]: a) a lack of expertise at national and regional levels; b) an administrative rather than strategic management of the interventions leading to a lack of synergies with other initiatives; c) a dominance of supply-side measures with poor linkages to regional innovation systems; and d) limited interest in many "softer demand side" measures aimed directly at enterprises.

Strong risks exist that, despite the guidelines drawn up by the Commission in its Community strategic guidelines, these limitations may persist in the current programme period. No change has in fact taken place to some key aspects factors on which greater success of the strategy depends. No unified conceptual framework has been developed at EU level, in spite of the first steps made to give strategic coherence to the interventions of the Framework programmes and cohesion policy[313]. Competing pressures and the extremely broad range of priorities for intervention dealt with by the Directorate for Regional Policy mean that no further investment in human resources has been made in this specialised area. Nor have improvements been introduced in the design of "conditionalities" applying to this policy area. In short, the conditions are not yet in place to avoid regional innovation policies serving purely as a mechanism for redistribution and/or being heavily "de-financed" half way through the programme period.

The proposal made here to make Innovation one of the core priorities - on which to concentrate the concerted effort of the Commission, Member States and Regions – is, therefore, very much conditional on a decisive shift in the way that policy deals with the above factors. The key changes are the same as the general ones advanced by this Report for the whole of cohesion policy and described in the next Chapter. In particular, a set of principles needs to be included in the European Strategic Development Framework (see Chapter V, pillar 2) and Member States need to describe in their National Strategic Development Contract with the Commission how they plan to tailor these principles to their particular context (Chapter V, pillars 3 and 4). This would ensure the requirement of "verifiability"[314].

Principles

At strategic level, the general policy guidelines of the Innovation priority should follow the conceptual framework outlined above:

- Regional policy would effectively complement ERA policy by focusing on the application of innovation at local level and being aimed at the promotion of a specific (and unique) knowledge base in each region (smart specialisation). Each place would be competing with a small number of other territories to attract and capture specialised knowledge resources in its own area. This would enable it more easily to reach a "tipping point" for gaining increasing returns. Innovation systems associated with these knowledge bases need to be developed in conjunction with the application domains essential to the economy of the place concerned. Close relationships need also to be maintained with other (central) regions which are the source of generic technologies.

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311 See European Commission (2006a).
312 See Technopolis (2006) and Musyck, B. and Reid, A. (2007).
313 See Commission of the European Community (2007a).
314 For what follows, see the Report hearing summary on innovation. See also Foray, D. (2008), Report Working Papers by Seravalli, G. (2009) and Bonaccorsi, A. (2009).

- Investment in diverse systems would then go together with openness to other research and innovation areas, facilitating both cooperation and competition. Often, obsession with making sure that policies have local impacts has meant that they have been designed as closed in "geographically", further exacerbating the locational "tournament effects"[315]. It is, therefore, important to open up those local networks as part of the regional innovation policy.
- Pursuing this approach offers a way of reconciling polarisation and polycentrism and of enabling policy to escape from the trap of regional administrative barriers. If carried out by a large number of regions, it would add a new dimension to the ERA by creating numerous sub-areas of competition and regional polarisation. These areas would not necessarily correspond to state borders, nor to the administrative boundaries of administrative Regions. Instead; they would be based on the existence of specific areas of specialisation, delineated by the aggregation of public and private interests.

Any national strategy for the implementation of a regional innovation policy should also include a clear linkage with education policies (possibly co-financed by cohesion policy also). In particular, in the regions on the technological frontier, an appropriate strategy for tertiary education is essential[316].

This place-based strategy largely depends on a fine balance being maintained between cooperation and competition and between exogenous push and endogenous choice that is achieved in the process of designing and implementing projects. Five principles assume particular importance in this process[317].

(1) In every candidate area (the boundaries of which should not be pre-defined *ex-ante* but drawn according to the responsiveness of local actors), a *preliminary ex-ante search* would seek to identify comparative advantages in terms of innovation potential.

(2) As the information on the knowledge base is largely held by local actors (businesses, researchers, specialised workers and so on), these need to be given a stake in the process with a scale of intervention which encourages them to *reveal information* and to invest.

(3) On the basis of the *ex-ante* search, a bundle of interventions should be designed, combining the supply and demand side, and setting an appropriate *system of incentives* in order to reduce the risks of adverse selection and of moral hazard.

(4) A context of *competition* must be maintained, with promotion of the mobility of researchers.

(5) Lastly, since much uncertainty by definition hampers any *ex-ante* decision, and learning is the essence of the policy, an *experimental and cautious* attitude should be adopted, and room should be preserved for replacing projects when the first steps do not look promising.

These principles partly conflict with each other - for example, mobility increases the "innovate here, benefit elsewhere syndrome" - and only a dynamic process governed by an external actor can reconcile them.

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[315] See the Report hearing summary on innovation, in particular the introductory note by Soete, L.
[316] See Aghion, P. (2006)
[317] See again Foray, D. (2008) and the Report hearing summary on Innovation.

Incentives

By far the toughest task, on which policy success hinges, is the creation of adequate incentives for public and private actors. The problem arises because of the uncertainty that is inherent in the process of innovation and which prevents complete contracts between actors being written. It can be summarised by adapting the image of the Triple Helix[318], often used to describe the strategic collaboration that is necessary for an innovation system to succeed. Together with private firms and the public sector (encompassing here the government, public research centres and universities), it is useful to think of the third corner of the Helix as made up of "intermediaries", i.e. those individuals and institutions that other institutions use in order to communicate and transact between themselves, and which (in order to play this role) acquire idiosyncratic knowledge and often separate interests and a specific agenda.

It is evident that, due to public failures, this "*Triple Helix may fail to materialise, particularly in less developed regions. In most cases, the three actors do not align their goals … They constitute separate corners of a triangle, not strains in a dynamically active helix. Actors stay at their own corner and pull forces in their direction*"[319]. Rent-seeking can take several forms: public research centres and universities tend to define the agenda of cooperation solely from a research perspective and overestimate its application potential; less developed regions might be biased by having additional social aims, such as supporting support; large firms might try to use interventions as a form of leverage for maintaining a plant production against competition from lower cost locations; smaller firms may be reluctant to take long-term risks and might try to use innovation support to fund short-term activities; intermediaries might exploit their special knowledge to charge all the other institutions unreasonable fees.

In order to extract rents, all the corners of the Helix can turn the lack of information, which prevents perfect incentives from being designed, into a way of avoiding any link between public transfers and results at all. The way out of the problem is to challenge these positions and to explore, replicate, adapt and experiment in respect of the various ways that exist to write contracts even under conditions of strong uncertainty.

This step requires the systematic use of the extensive experience that has been accumulated through years of policy operation, in order to extract, generalise and make usable information on results-based mechanisms for adaptation in other circumstances. These mechanisms could include:

- identifying elements and functions of the innovation process (like the provision of certain services) which are sufficiently standardised and for which there is enough experience of what constitutes good practice or fair price, and designing for these elements complete contracts linking public funding to results;

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[318] See Bonaccorsi, A. (2009).

[319] Ibidem. On the introduction of "intermediaries" as a separate corner, Bonaccorsi, A. (2009) writes: "The assumption that intermediaries simply represent one of the other actors is wrong. Public intermediaries are assumed to act on behalf of the government, but in practice they have large autonomy and behave for their own survival and growth. Intermediaries created by universities and public research centres, on the other hand, are assumed to represent the research activity of their organizations, but often develop their own strategy. Finally, intermediaries created by business firms, or acting on behalf of them, end up creating permanent structures, whose goal is procuring resources. In all these cases, the actors are the principal, and intermediaries are assumed to be the agent. However, over time intermediaries combine the role of agent for principals with an autonomous strategy, usually generated by internal resources following processes of learning in the field. They are no longer agents of a principal in the Triple Helix but are themselves relatively independent actors."

- linking the financing of one phase of the innovation process to verifiable results of an other phase (possibly leaving the actors the opportunity to select the relevant indicators themselves), whenever this distinction in phases is appropriate;

- designing incomplete contracts with open-ended clauses, where the re-negotiation of the contract is planned by defining *ex ante* a third party in charge of observing the results and defining *bona fide* the conditions for the interpretation of the open-ended clauses;

- using public procurement, as emphasised by the Aho Report[320].

The transfer of cohesion policy funds to Member States and Regions would be made conditional on them committing to using these and other results-oriented methodologies that are deemed to be suitable to particular contexts. The "conditionalities" introduced in the contracts (see pillars 2-3 in Chapter V) would also include an outline of the institutions and in-house capacity which are required. Contracts would also identify objectives and valid indicators to monitor them and commit Member States and Regions to the adoption of prospective impact evaluation.

The Commission would supervise the implementation of those "conditionalities" according to the rules described in the next chapter. The Commission would provide guidance and assistance to countries and on the ground, transfer information, create a clearing house for results and encourage dissemination of information. It would also be given the opportunity to build a one-to-one relationship with the areas and the actors running the projects where required. In order to perform these tasks, to be credible in doing so and to acquire a recognised status throughout the EU, the Commission would invest in the creation of a specialised task force on Innovation (see chapter V, pillar 8).

IV.3.2. Exploring other options: "Adapting to climate change"

The well-being of most current and all future generations will be strongly influenced by climate change (whatever estimates of impact are used) and by the public response to it.

The evidence presented by successive Assessment Reports of the Intergovernmental Panel on Climate Change and other bodies on the detrimental effects of increased concentration of atmospheric greenhouse gas resulting from human-induced CO2 emissions has gained growing acceptance. These effects concern many features of human life and economic activity, stemming from changes in temperature, sea levels, water and food availability, land yields, the risk of disasters, energy supply and demand, the functioning of transport systems and so on. There is agreement on the fact that this is an extraordinary example of market failure and, despite controversy and persistent uncertainty about the exact magnitude of the potential effects, a broad consensus has emerged about the need for public action, though there is disagreement about what the nature and size of this should be[321].

In terms of the definition of the objectives of cohesion policy adopted by this Report, addressing climate change is an issue which definitely falls under the efficiency objective. It is part of a forward-looking approach aimed at preventing a possible permanent reduction of the capacity to

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[320] For example of these mechanisms and for an attempt of generalising them, see again Bonaccorsi, A. (2009).

[321] The economic case and the debate were catalysed by the Report on "The Economics of Climate Change" entrusted by the UK Treasury in 2006 to a Commission headed by Lord Nicholas Stern, which produced estimates of the likely value of future economic losses and of the costs of mitigating them. The discussion that followed concentrated on the emission scenarios adopted by the Report, on the possible bias towards pessimistic assumptions on expected damages and towards optimistic ones on mitigation costs, and on the "almost zero" discount rate that was adopted to measure time preference. It was also pointed out that standard discounting procedures are not suited to dealing with extremely low probability events.

use the planet's potential. Trade-offs obviously exist between the short-to-medium term use of resources and their long-term use, which is what the disagreements are largely about. But, as Kenneth Arrow put it, given the size of risks, "*the case for intervention to keep CO2 within bounds ... is sufficiently strong to be insensitive to this dispute*" and that, whatever the assumed discount rate, "*we are much better off reducing CO2 emissions substantially than risking the consequences of failing to act*"[322].

The European Union (both the Council and Parliament) has addressed the issue of climate change by developing a strategy for its mitigation. In December 2008, it approved a climate and energy package with legally binding targets for 2020 on greenhouse gas emissions, share of renewable energy and energy efficiency and on a revised Emissions trading system[323]. Other legislation on climate change, such as reducing CO2 emissions from motor vehicles, increasing the energy efficiency of buildings and a framework for Carbon Capture and Storage are also being considered or have already been adopted. In June 2007, the Commission published a Green Paper, *Adapting to climate change in Europe – options for EU action*, drawing up a framework to tackle climate change from an "adaptation" perspective or, as the document put it, of "*reducing the risk and damage from current and future harmful impacts cost-effectively or exploiting potential benefits*". A White Paper is expected to be adopted in 2009.

In this context, on one point there is no doubt: cohesion policy, as any policy aimed at delivering public goods and services, must take account of the impact on climate change when designing measures. More specifically, all programmes supported by cohesion policy must contribute to the targets set by the Union – by taking account of the price of carbon in the analysis of their net benefits; by actively contributing to the rebalancing of energy sources; by considering the possible effects of climate change on the return from infrastructure and the feasibility of constructing it, and so on. A move in this direction is partly included in the current allocation of cohesion policy funds for the 2007-2013 period, where 1.3% of all resources (EUR 4.8 billion) are allocated to renewable energy, 1.2% cent (EUR 4.4 billion) to increasing energy efficiency and other uses directly impacting on climate and an additional 9.2% (EUR 31.7 billion) to "clean" modes of transport (such as railways and cycle paths) (see Table II.9-10). At the same time, however, a similar share in aggregate (11.6%) is allocated to investment in motorways and other roads. There is little doubt that a greater effort of integrating climate change fully into the decision-making process needs to be made, starting from now.

The question open for debate is a different one. Is there a role, beyond being "coherent", that cohesion policy could or should play in supporting public action in relation to climate change? Is there a case for "climate change", or more accurately "adaptation to climate change", becoming one of the 3-4 core priorities advocated by this Report? These questions need to be addressed in two stages, applying the criteria set out in section IV.1. First, is there a place-based dimension to climate change, and the mitigating actions required, which justifies intervention through a place-based policy? Secondly, if answer is positive: is there a rationale for the EU to have some responsibility for such a policy?

There is no doubt that, although climate change is a global phenomenon, its effects are place-specific. The map presented in the 2007 Commission Green paper (see Map IV.3) illustrates the varied nature and extent of problems that might affect different regions in Europe in terms of rainfall and temperature change by the end of the current century. Other consequences, such as a rise in sea level or desertification, are even more space-specific. Some places will suffer more, or many more, negative effects than others. According to the projections, the most extreme direct effects are likely to occur in the peripheral parts, so exacerbating existing disparities. That climate change has asymmetrical territorial effects is powerfully underscored by the

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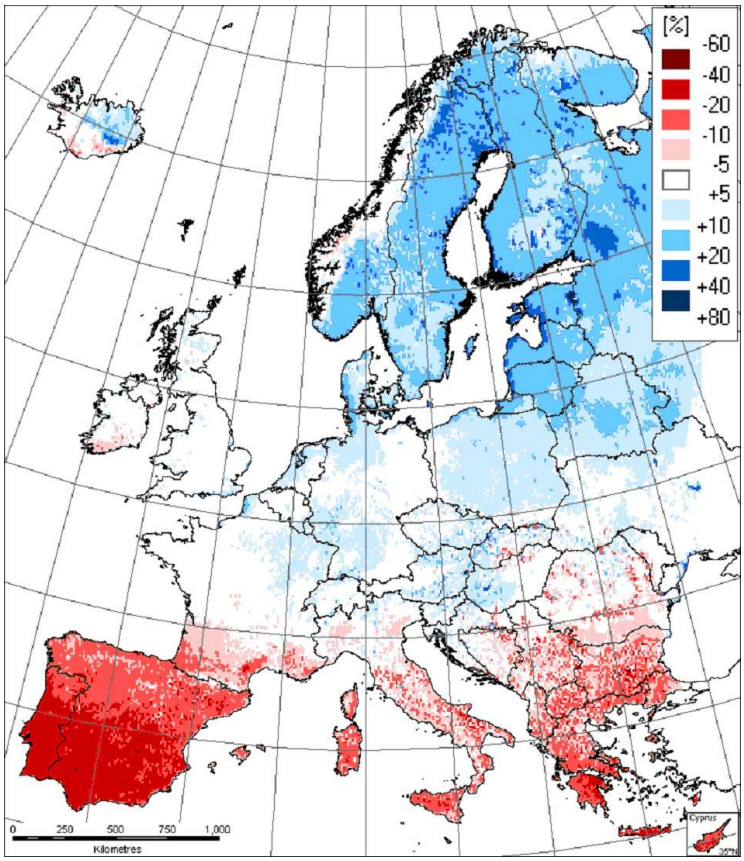
[322] See Arrow, K. (2007).
[323] See Council of the European Union (2008c).

Commission's working Document "Regions 2020"[324]. Mitigation of climate change, too, tends to have differential effects of regions, as emission intensity varies between industries, and some places will be affected more than others.

But regional differentiation is not sufficient to justify a place-based policy. For this, local knowledge and preferences must also be necessary both to understand the full extent of climate change effects (on the basis of externally developed scenarios) and to design effective public action to adapt to it. The Commission Green Paper on climate change argues that: "*Many decisions influencing directly or indirectly climate change adaptation are taken at the local level. This is also where detailed knowledge on the local natural and human conditions is available*." It can be argued that, faced with the exogenous shock of climate changes or with the impact of mitigation, each place is challenged to respond with innovative action that is out of the ordinary, such as, changing land use and management, conserving and managing water supplies, reassessing infrastructure provision, investing in new sectors, reviewing risk prevention and relocating settlements. The capacity to innovate, which gives opportunities for improvement as well as for managing negative effects, is specific to places and depends on the capacity of local actors to pool their knowledge and reach agreement on their preferences.

Map IV.3: Change in mean annual precipitation by 2100(*)



Source: EU Commission, Green paper on "Adapting to climate change in Europe".

(*) The figure is based on IPCC SRES scenario A2. The projected climate impacts are estimated for 2071-2100 relative to 1961-1990. The map is based on DMI/PRUDENCE data (http://prudence.dmi.dk), and processed by JRC within the JRC funded PESETA study (http://peseta.jrc.es).

[324] See Commission of the European Communities (2008e).

We are then in a situation where some places might fail to develop adequate responses. New inefficiency traps could arise. For the same reason, some people will be affected more than others, due to factors such where they live, their income level and their capacity to adapt. Existing social exclusion traps could worsen and new ones could emerge, while inequalities might result from mitigation policies. There is, therefore, a rationale for place-based intervention. This would have the purpose of alerting communities to risks independently of vested interests, promoting early and innovative adaptation to both climate change and the effects of mitigation, triggering public debate, by bringing to light problems and alternative solutions, taking account of the experience elsewhere, and building capacity and links with global centres of competence as well as with other places, the response in which influences the effectiveness of the measures taken.

If this is agreed, it is possible to move on to the second question: how important is it for the EU to adopt this priority as part of cohesion policy? The point here is not to do with *mitigation* – with whether or not mitigating climate change is a reasonable task for the EU budget. A strong case can be made, and has already been made[325], for the EU spending some of its budget on mitigation, by pointing to the common benefits of action – once it is undertaken, it is neither possible nor useful to limit the gains achieved to particular individuals or countries – and to the disincentive, therefore, for Member States to act independently. Nor is the issue here whether the cost of mitigation should be partly paid for by a reduction in the present budget for cohesion policy[326], which to answer would require a comparative assessment of alternative budget options, which goes beyond the scope of this Report. The issue is instead to do with *adaptation*, whether adapting to climate change (and/or to the effects of its mitigation) through a place-based approach is a task for the EU or should be left to Member States.

A first point to consider is how far choosing climate change as a core priority of cohesion policy would add to the sustainability of the Union, since this is one of the two justifications for the EU directly to run a place-based development policy. It can be argued that the active role of the Union in a policy of mitigation, with potentially negative short- and medium-term effects on some sectors and jobs, requires it to take an active role in adaptation. The EU cannot be left once again - the argument would go - to shoulder the burden of actions with negative effects on large sections of the population, without being given the chance to have some responsibility for the more positive, "well-being-improving", part of the strategy. This is even more the case once account is taken of the attitude of some countries which tend to off-load the more unpleasant decisions on mitigation on to the Union. The experience of market and currency unification suggests that the political sustainability of the EU requires it to have a direct policy responsibility for public investment in the areas affected by the decisions it makes. This case would be further strengthened if the Union were to decide to pursue mitigation directly through its own budget.

A second point relates to policy effectiveness, i.e. whether the EU has a strong comparative advantage over Member States in having responsibility for policy intervention in this area. It could be argued that, although interventions for adaptation are very place-specific, they are also interdependent and interdependencies extend across national borders. The effectiveness or the feasibility of some interventions depends on trans-European territorial cooperation, as with coastal defences or for protection from river flooding. In addition, benefits can result from information flows and exchange of practices that only a common policy framework can ensure. Benefits can also come through a coordinated commitment to avoiding beggar-my-neighbour interventions in adaptation to exogenous change.

These arguments seem to suggest that adapting to climate change and a low-carbon economy is potentially a relevant issue for EU cohesion policy. More analysis is needed to assess whether it

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[325] See Begg, I. (2009).

[326] Begg, I. (2009) argues that this could be the case, possibly by "embedding" the mitigation task inside the policy.

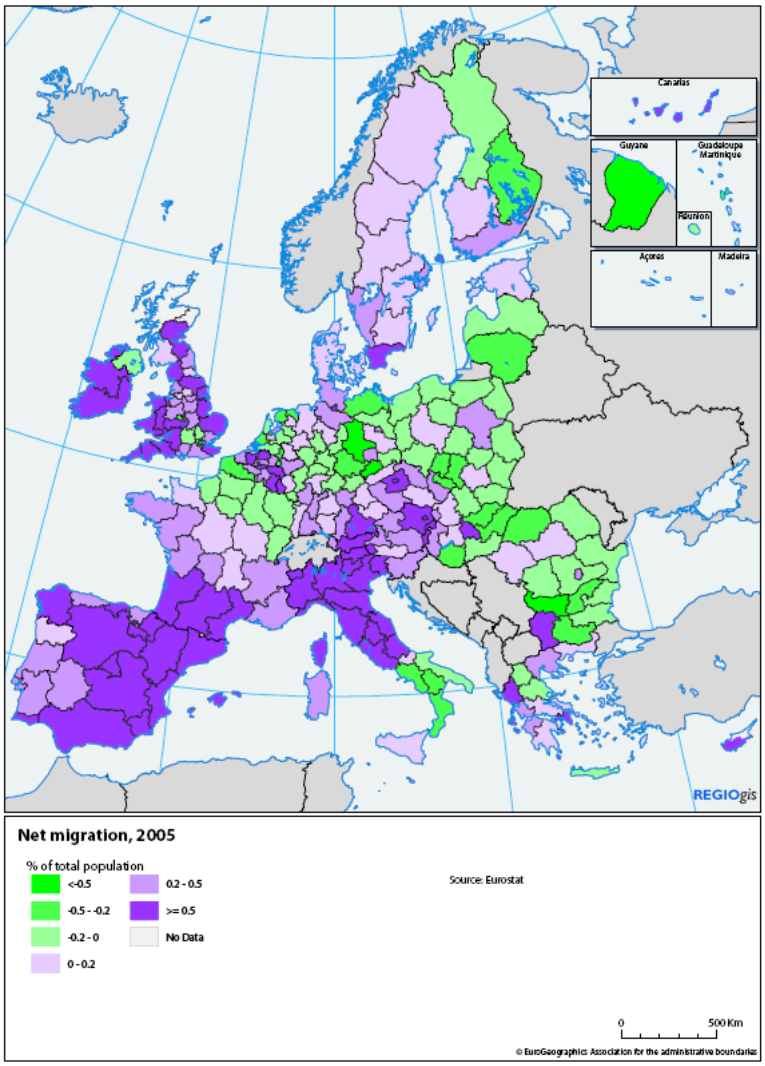
should also become one of the core priorities of this policy. This decision should be taken by investigating the verifiability criteria as well as, which is not done here. However, should this issue be chosen as a core priority, there would need to be a significant effort to create a Commission task force capable (as it argued in relation to innovation) of playing a role in providing guidance and assistance, negotiating "conditionalities" with Member States, promoting the circulation of information, mobilising local actors and carrying out impact evaluations of interventions.

IV.4. Addressing the social inclusion objective

IV.4.1. A case for "Migration"

Migration represents one of the principal challenges facing the European Union in the coming years.

Map IV.4: Net migration by NUTS 2 Regions in 2005
(% share of total population)



Source: Estimates on Eurostat data on NUTS 2 population, deaths and births.

Trends, effects and the role of public action

Migration flows both from outside and within the Union are important. In 2005, there was an estimated net inward migration to the EU of some 1.6 million, adding just over 0.3% to the EU's population, only slightly lower than for the US in the same year (0.4%)[327]. Marked regional differences exist, however, with the inflows being very much concentrated in certain parts.

Estimates of net inter-regional and international flows at NUTS 2 level suggest that in 2005 about 180 Regions experienced a net inflow of migrants (a total of some 1.8 million people) and about 80 experienced a net outflow (a total of 0.2 million people).Some 70 Regions experienced an inflow totalling 1.4 million and an addition to population of over 0.5%. These include large parts of Spain and south-west France, the centre-north of Italy, south-eastern Germany, western Austria; Ireland, the western and eastern areas of the UK, the capital city regions of the Czech Republic, Hungary and Bulgaria and some areas in Belgium and Greece (see Map IV.4). Together these regions account for around a quarter of total EU population and had a net inflow of migrants amounting on average to 1% of population. Regions with net outflows were concentrated in the eastern parts of the new Member States, northern Germany, the Netherlands and north-eastern France, southern Italy and the northern-most parts of Finland, though, on average, net outflows amounted to only around 0.2% of population.

Data on the composition of active working-age population by country of origin show that the share of people born in other countries has grown significantly in recent years: from 10.6% in 2000 to 12.9% in 2006 in the EU15 Member States, taken together, where comparisons can be made (see Table IV.5). The increase has affected all the countries except France and the Netherlands. In the new Member States, the average share in 2006 was 5.8%. With internal mobility of people within Europe still limited[328], these net inflows are largely due to immigration from outside the Union.

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[327] See European Commission (2008f).

[328] The share of working-age residents who moved from a different Region or Member State of the European Union "within the previous year" is estimated in 2006 at 1%, while the corresponding share of working-age population who moved from a different State is estimated at 2% in the United States. See European Commission (2008f).

Table IV.5: Share of population which is born outside the country of residence: total and by macro-area of origin(*)

Country	Share of active working age population from any other country		By country of origin in 2006(1)		
			Share of active population	Share of total population	
	2000	2006	From an EU-15 countries	From an EU-12 countries	From outside EU
Austria	12.1	15.4	3.1	3.6	8.7
Belgium	11.5	13.5	6.2	0.6	6.7
Denmark	5.8	6.8	1.6	0.4	4.6
Finland	0.5	3.3	1.1	0.3	1.8
France	12.1	11.5	3.1	0.3	7.8
Germany	-	-	-	-	-
Greece	5.3	7.5	0.6	1.1	5.9
Ireland	7.5	-	-	-	-
Italy	-	7.6	1.1	1.1	5.3
Luxembourg	38.5	40.4	36.0	1.9	8.6
Netherlands	13.2	12.8	2.3	0.5	9.1
Portugal	5.3	7.4	1.6	0.2	5.7
Spain	4.2	13.6	2.1	2.4	10.0
Sweden	12.5	14.9	4.1	1.4	10.0
United Kingdom	9.1	11.8	2.3	1.2	8.8
EU-15 (2)	*10.6*	*12.9*	-	-	-
Bulgaria	-	-	-	-	-
Cyprus	11.2	17.3	6.0	2.1	11.0
Czech Republic	-	1.9	0.1	1.2	0.6
Estonia	19.7	14.3	-	0.6	13.6
Hungary	-	1.7	0.2	1.1	0.4
Latvia	-	10.6	-	1.1	9.6
Lithuania	6.0	4.1	-	(0.3)	3.8
Malta	-	4.6	1.7	-	3.0
Poland	-	0.5	0.1	0.1	0.3
Romania	-	(0.1)	-	-	-
Slovakia	-	0.7	-	0.6	(0.1)
Slovenia	-	7.5	(0.7)	-	4.6
EU-12 (3)	-	*5.8*	-	-	-
EU-27 avail.	**-**	**9.3**	-	-	-

Source: IZA, AMS, NIRAS (2008).

(*) Data in brackets lack reliability due to small sample size. The symbol "-" is used when data are either not available or extremely unreliable.

(1) The three shares do not generally add up to the total share since one refers to the active working age population and the other two refer to total population.

(2) Data for Germany are not available.

(3) Data for Bulgaria are not available.

Projections for the years up to 2020, made before the outbreak of the global financial crisis[329], show significant flows continuing and high concentration persisting[330]. The majority of migrants are expected to go to regions in Western and Southern Europe, with Eastern European regions experiencing significant outward migration. Interregional migration flows within countries are also expected to be substantial, with Regions in Southern Italy, Greece, Eastern Germany and Central and Eastern Europe experiencing significant outward migration (the expected net outcome for each NUTS 2 Region is shown in Map IV.6).

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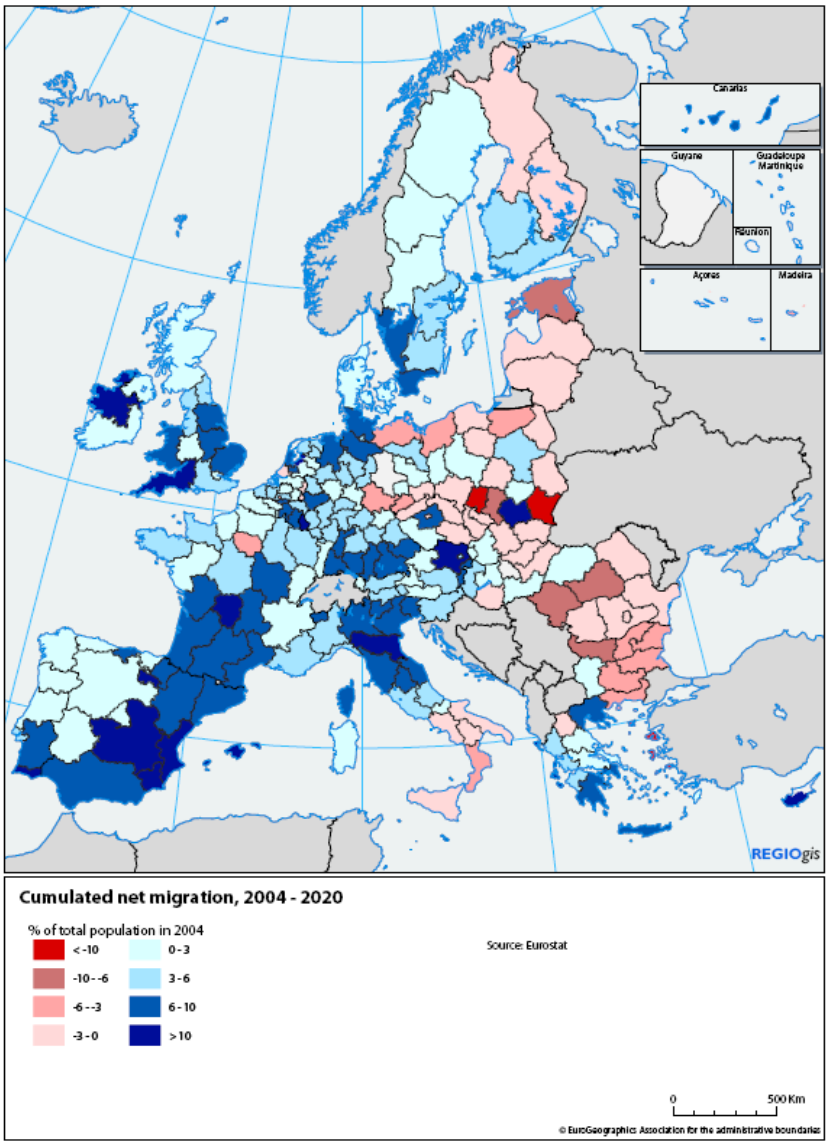
329 The effects of the crisis on migration flows are hard to predict. On the one hand, the pull effect will obviously diminish for a while. On the other, the global nature of the crisis might well strengthen the push factor, while the severity of the crisis in some of the eastern Member States might also increase flows.

330 See Lanzieri, G. (2006, 2007). Projections are based on the 2004 EUROPOP national and regional population projections produced by Eurostat, the latest available on a regional scale. The national population projections released by Eurostat in August 2008 are based on a so-called Convergence scenario (based on the assumption that the socio-economic and cultural differences between Member States of the European Union will fade away in the very long run – in 2150 – with fertility and mortality rates converging to the same values and net migration converging to zero), in contrast to the trend scenario applied for 2004.

Migration into Europe and between Member States is driven both by push and pull factors. The push comes from differences in economic possibilities, income and quality of life between Europe and other world regions. High population growth in Europe's immediate neighbouring regions (the Middle East and North Africa) coupled with poor economic performance, scarcity of natural resources and human rights abuses constitute a strong driving force for many migrants, reinforced by the very wide disparities in earning possibilities. On the pull side, together with a need for specific skills, two additional factors are at work: a generalised and increasing shortage of labour, linked to demographic trends (which is likely to reassert itself once the present crisis is over) and the policy of many local producers in the agriculture and other traditional sectors to withstand global competition by offering low wages and poor working conditions, often illegally, to people from abroad.

Map IV.6: Forecast of cumulated net migration 2004-2020
(% share of total population)



Source: Lanzieri, G. (2006, 2007).

Migration represents both an opportunity, sometimes a once-in-a-lifetime one, and a risk for the three groups of people involved.

Those who migrate can enjoy, in addition to higher income, increased learning possibilities, more freedom and more life chances, while their children (second generation migrants) might have greater, or much greater, opportunity to be educated. On the other hand – leaving aside the two

extremes of highly skilled professionals and those involved in criminal activities - migrants can find themselves in a very weak position in the labour market, live in disadvantaged areas, have problems in accessing public and private services based on trust relations (like bank credit) and face fear from their neighbours. All these factors amount to less freedom, while second generation migrants might see their disadvantage perpetuated by the school system.

For people living in areas where migration inflows are concentrated, there may be benefits from the labour migrants have to offer (their skills, their availability to do jobs that residents would not do, the pay they accept, and so on) as well as from exposure to a different culture. On the other hand, social and public services (such as schools) might be strained, infrastructure become inadequate, the general wage level pushed down and local identity and "values" come under threat. Moreover, when the demand for labour attracts immigrants to illegal activities or the integration process fails, domestic residents might also feel a threat to their security.

For the people living in areas most affected by migration outflows[331], there is a benefit from the remittances sent from abroad and there can be advantages coming from the increased competence and the cultural broadening of those who have left. On the other hand, social services might be discontinued or curtailed because of the reduction in population and the economic potential of the area might decline, especially when a large share of those migrating are young, well-educated people.

The net outcome for these three groups depends on both the capacity of the communities involved to react to change and other developments which occur as a result of the migration. Public action can make a significant difference to the outcome: by adjusting urban planning, education, public transport, health services, security and social services; by adapting the support given to businesses and easing access to the labour market; by investing in cultural facilities; by encouraging a reconsideration of comparative advantage, and so o. These are all interventions which, while inspired by common principles and experience, need to be very much place-based, since both the effects of migration and the way to tackle these depend on the specific context. As repeatedly noted in this Report, however, some places might fail to react for a variety of reasons. New social exclusion traps might emerge, giving rise to a clear demand for exogenous place-based intervention.

The pressure on the EU and the scope for cohesion policy

Faced with this situation, pressure has been mounting on the EU since the late 1990s to play a role in tackling the issue of migration. There are three main reasons for this[332]. First, it has been clearly recognised that, with a unified labour market and free movement of people across most internal national borders, the effectiveness of internal and external migration policies in one Member State will be strongly affected by the policies adopted in others. Secondly, some Member States are particularly willing to externalise some national decisions on migration. Thirdly, whatever the actual state of affairs, the EU is considered by many European citizens as having a responsibility for the inflows[333], once again, the sustainability argument strongly implying that the EU should take direct responsibility.

At the same time, there are strong pressures for dealing with this issue in a country-specific way, especially in regulating flows and coping with integration. This is because the economic needs

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[331] This last issue is often overlooked. On the need to take it into account, see for example The Region Council of Päijät-Häme (2008).

[332] For this point and the following ones, see Papademetriou, D. and Zincone, G. in UniCredit Venice Forum 2008 "Migration from a national, European and global perspective". See also Niessen, J. (2001).

[333] As noted above, Kriesi et al (2006), by analysing Austria, France, Germany, Switzerland, The Netherlands and UK in pre-electoral periods, show a strong linkage in the shift of position of several parties towards increased opposition to European integration and growing support for restrictive immigration policies.

and preferences of countries and Regions differ markedly in terms of required competences, while radically different country- or Region-specific cultural heritages imply different approaches, especially to integration. The challenges that migration represents for national identity are perceived and dealt with in many different ways.

This situation, which is unlikely to change in the foreseeable future, explains why the EU-wide debate and effort have had only limited results on: legal immigration and relations with third countries; a common broad denominator (in the 2003 Directive); and, through the European Pact on Immigration and Asylum (adopted by the European Council in October 2008), controlling illegal immigration, making border controls more effective, regulating asylum and creating a partnership with countries of origin and transit. "*There is no consensus in Europe about migrants' entitlements or their integration into society*"[334], and on the difficult issue of whether the equal enjoyment of rights by all might legally require differentiated treatment[335].

Immigration represents a particularly significant example of the general paradox – that the EU is expected to play an active social role but is at the same time prevented from so doing by the existence of national social contracts and different aspirations. Failure to deal with the immigration issue not only erodes consensus in favour of the EU and its policies, but, by fuelling concerns and fears, it deters mobility of labour within the Union, depriving people of an additional potential source of social protection

One EU decision, however, indicates that the opportunity exists to move forward, namely that establishing for 2007-2013 a small but significant (EUR 4 billion) Framework programme for Solidarity and the Management of Migration Flows, including four Funds: for External Borders (EUR 1.8 billion), for Return (EUR 0.7 billion), for Refugees (0.7 billion) and for the Integration of Third-country Nationals (EUR 0.8 billion). In the Commission Communication which, by building on the already established Refugee Fund, started the process that established the Framework[336], it was argued that the different features of the migration issue had different effects in different Member States and that the need existed for a "fair share of responsibilities between Member States". In particular, in June 2007[337], the Integration Fund was designed with the aim of supporting the efforts of the Member States in "*enabling third-country nationals of different economic, social, cultural, religious, linguistic and ethnic backgrounds to fulfil the conditions of residence and to facilitate their integration into European societies*", in particular "*taking into account the principle that integration is a two-way dynamic process of mutual accommodation by both immigrants and citizens of Member States*." Some 93% of this Fund is distributed among Member States on the basis of the number of legally resident third country nationals; the rest being available for Community actions.

Cohesion policy, by combining EU principles and the freedom of Member States and Regions as well as local institutions to apply them to specific needs, could serve as the appropriate framework to take one step further and to address the social problems concerning all the three groups of people discussed above.

An EU place-based approach can respond to the highly differentiated way in which migration inflows and outflows affect different places. It can do so by helping to provide the public goods and services that these effects demand. Moreover, while many different cultural and normative aspirations exist in the EU, there is one common feature, that citizenship is *de facto* defined in part by the accessibility of people to services (education, healthcare, public transport, security, etc). The arrival of "outsiders" in some areas and the departure of people from others put this under stress and gives rise to a fear among those who have not moved that this might threaten

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[334] See Report for the Council of Europe, p. 23.
[335] See the ruling of the European Court of Human Rights as quoted by the Report for the Council of Europe, p. 48.
[336] COM(2005) 123 final.
[337] Council decision n. 2007/435/EC.

their quality of life and among those who have moved, a fear of being excluded from a better standard of life. Dealing with the pressures placed on public goods and services as a result of migration, adjusting these to change, in order to promote the inclusion of newcomers (allowing for their diversity) and preventing exclusion is a task common to all EU regions, and one which . could also extend outside the EU's borders.

Cohesion policy would give ample room to local authorities in both urban and rural areas to design projects according to the context, combining the bundles of services that are required: strengthening or adjusting education, healthcare, transport, childcare, etc; extending skills; supporting businesses and access to credit; upgrading urban areas; addressing special needs of migrants and minority groups – of residents threatened by migration inflows, of people in areas depopulated by migration outflows – strengthening action against illegal work and organised crime and so on. External border regions would also benefit in particular from the extension of interventions to transnational cooperation projects.

National and local government would promote these actions in the context of the general principles and guidelines which would be agreed for the whole of the EU (see chapter V, pillar 2). On the basis of these principles, each Member State (or Region) would design a strategy for implementing the core priority and would agree with the Commission the institutional framework which the policy requires in each local context as well as the means for ensuring its successful implementation (see chapter V, pillar 3). As for any other core priority, this would require the creation in the Commission of a specific, inter-service, high-level task force. Member States and Regions would have the opportunity to shape their strategies in line with their aspirations and integration policies, but they would do so by continuously confronting other approaches and other standards, as their citizens increasingly require (see chapter V, pillar 8).

Mobility is bound to increase the awareness of European citizens of the quality of services enjoyed in other areas of the Union; to strengthen progressively their tendency to use not only national but also "European" standards as a reference for their aspirations, however defined. Cohesion policy, by defining its overall objectives with reference (as argued in section IV.2) to both national and European standards, is suited to this (long) phase of transition. In addressing migration and reducing fears, cohesion policy would also be likely to have a positive effect on labour mobility, providing a further source of social protection.

In terms of its effectiveness, cohesion policy would also benefit from two general advantages that it has over national policies: the capacity to take account of cross-border interdependencies and the greater distance it has from local problems and pressures. So far as the verifiability condition is concerned, the choice of migration as a core priority would require a concerted effort by the Commission and by all levels of government, in consultation with national and European bodies representing citizen interests, to develop the methodological tools proposed in chapter V that are necessary for the policy objectives to be clearly identified (at all territorial levels) and for results to be evaluated[338]. In particular, in setting objectives and building a robust system of indicators, care would be needed to represent the multi-dimensional nature of social inclusion satisfactorily. Experimental methods and the use of prospective impact evaluation in the implementation of local projects have particular relevance in this regard.

If all these conditions were satisfied, choosing this "Managing the social consequences of migration" as one of the core priorities of cohesion policy would enable the EU to tackle the issue in an effective way, but without setting a role for itself that cannot be achieved.

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[338] Some lessons could be drawn both from the current experience of the European Fund for the Integration of Third Country Nationals (see above) and from the limited experience of addressing migration issues through cohesion policy in the area of labour market integration and through specific assistance to regions particularly affected by migration issues, such as outermost and external border regions.

IV.4.2. Exploring other options: "Children"

Ensuring the social inclusion of "Children" is another option to be considered as a core priority.

The conditions of children represent a particularly striking aspect of the permanence of social exclusion in Europe. According to 2005 estimates[339], 19 out of 98 million children (aged 0-17) live in households with income under the risk of poverty threshold (60% of the median equivalent household income). Both their share and the intensity of their risk of poverty[340] are higher than those of the total population. The information available suggests that, on average, the risk of poverty has not changed much over time. Taking account of deprivation as regards other dimensions of well-being, the proportion of children below the threshold for more than one of the dimensions covered by the Laeken indicators ranges from around 10% in some Nordic countries – where the risk of poverty is lower than for the rest of the population - up to about 40% in 10 Member States.

Family circumstances matter for childhood deprivation. Children in large families (with 3 children or more) have a risk of poverty rate of 25% (as opposed to 19% for all children) and those in lone parent households, a rate of 34%, an alarming figure, given that the share of children not living with both their parents increased from 14% to 19% during the 1990s. In these households too, as in others, the risk of poverty of children is strongly affected by the education level of parents and their labour market situation. On average across the EU, for over 30% of children at risk of poverty, neither of their parents had an upper secondary level of education as opposed to 16% in the case of all children.

Faced with this situation, several Member States do not have a policy specifically aimed at children but seek to reduce their risk of social exclusion through policies on education, housing, childcare, health, etc. As has been pointed out: "*a significant number (though not all) of the Member States with an average or high level of child poverty have yet to develop an adequate response to combat it*"[341]. Policies in this area, on the other hand, are bound to be strongly influenced by "value" considerations. The way of educating, raising and caring for children reflects strong issues of identity, linked to what individuals and communities consider desirable. On the other hand, the effects of these intended choices on observable outcomes are hard to disentangle from the effects of collective failure to act.

The European Union, in the context of the social inclusion process, has given growing attention to the social inclusion of children and it has influenced the social agenda of countries which had not identified this as an objective[342]. It has explicitly mentioned the "protection of the rights of the child" in the proposal for a new Treaty as one of the Union's aims in article 3 alongside "economic growth and price stability". In the Presidency conclusion of March 2006, the European Council asked Member States "*to take necessary measures to rapidly and significantly reduce child poverty*", since they are "*less likely than their better-off peers to do well in school, enjoy good health and stay out of dealing with the criminal justice system*" and "*have damaging effects on the future life opportunities of children*". The report on *Child poverty and well-being*, from which the quoted figures are taken, originated from this conclusion[343]. The social inclusion of children is an issue where the demand and the momentum exist for the European Union to take some direct responsibility.

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339 See European Commission (2008a).

340 Measured by the distance of the median equivalised income of those living below the line and the value of the threshold.

341 See again European Commission (2008a), p. 126.

342 See Atkinson, A.B. (2008b).

343 A strong focus on the social exclusion of children ("prioritise early intervention for disadvantaged children, tackle early school leaving, overcome declining social mobility") is suggested also by Liddle, R. (2007a) in the context of a proposal for "A new Social Europe".

In bringing increased and explicit attention to bear on the objective of social inclusion, as this Report advocates, cohesion policy should consider childhood deprivation as a serious option for one of the core priorities. The issue is certainly important and addresses widespread concerns. Of the three requirements set out in this Report for choosing a core priority, the place-based aspect is clearly satisfied. The circumstances which influence the social exclusion of children are strongly linked to the territorial context – not just to the family in which children happen to grow up, but also to the schools they attend, the environment in which they spend their time and its degree of openness. Most public interventions that matter for increasing the social inclusion of children – education, housing, urban planning, social services, security, cultural activities, etc – need to be tailored to places in a way that place-based policies are well positioned to ensure. As for the verifiability requirement, this is complicated to ensure, but no more so than for other social issues. Experience exists in the Commission, in some Member States, in international bodies in measuring outcomes and assessing effects which can be built on.

On the question of EU-level relevance, several aspects need to be considered. The social inclusion of children is unquestionably an issue of importance for all EU citizens. The issue, however, does not present the EU with a problem of sustainability, since the Union is not commonly held responsible for deprivation among children, as is the case for, say, migration. Moreover, the "value" aspect linked to the issue raises strong identity problems that demand national approaches and invite caution in setting EU-wide targets for services.

On the other hand, the choice by the EU of children as a core priority would have some clear advantages. First, the synergies between equity and efficiency are particularly relevant: improving opportunities for the most deprived children can also increase their future productivity, while taking care of some of their needs through public services can increase their parents' possibility of working and earning more[344]. Although there should be no confusion between the two tasks, this is *ceteris paribus* an advantage for the effectiveness of the policy. Secondly, with several Member States not having a specific strategy to deal with this issue, there are less risks of impinging on national policies and political spaces. Thirdly, the issue would unquestionably have high visibility and potential for being perceived as a European public good.

One example helps to clarify the different aspects that need to be weighed up in deciding whether or not to make children a core priority. It concerns childcare, a service at the centre of EU attention. At the EU Council in March 2002, targets were established for the provision childcare (which includes childcare at day-care centres and pre-school education, but not the informal care provided by relatives, friends or neighbours), facilities needing to be provided for 33% of children under 3 and 90% of those between 3 and compulsory school age. Eurostat figures for 2006 show an average figure of 26% for the first age range and 84% for the second. The country variance around these proportions is extremely high, in the first age group, the share ranging from over 70% in Denmark and over 40% in Sweden, the Netherlands, Spain and Belgium, down to less than 20% in Greece and Germany and less than 5% in most new Member States.

The issue is strongly supported by all social partners who have also drawn attention to the wide disparities which exist within countries. In July 2008, the main EU organisations representing workers and entrepreneurs (European Trades Union Organisation, Businesseurope, European Centre of Employers and Enterprises, and European Association of Craft and Small and Medium Size Enterprises) wrote in a letter to the Commissioner for Employment, Social Affairs and Equal Opportunities that "*despite significant improvements in a number of [Member States], the situation remains unsatisfactory in the majority of EU countries*" , that a "wide variety of situations" exist within countries, and that also "*regional disparities exist in terms of quality, accessibility and affordability. For example the provision of childcare is particularly challenging in bigger cities and remote areas*". They then underline the "disincentive to work" for parents

[344] The trade-off between equity and efficiency is also smaller, if it is assumed that a greater separation is possible, especially for younger children, between circumstances (at which interventions would be aimed) and effort: in other words, the improvement of circumstances would not have a negative effect on effort.

that derives from this situation, Member State responsibility for the issue, and the need for the EU to promote action and for the European Social Fund to be used for this purpose.

The figures, the demand for the EU to act and the emphasis on national responsibilities raise two separate issues. First, the figures reflect both the degree of political awareness as well as different national conceptions of the desirable way to care for children in the early stages of life, which is a reminder of the risk of pushing common uniform targets too far. Secondly, from the perspective of social inclusion, the provision of childcare should be considered along with its quality – as the social partners remark - its linkage to education, and the other rules and conditions relevant for both children and parents (including leave facilities at work, the opportunity for the elderly to play a role in childcare, the conditions for community support, and the quality of housing). Only an integrated, place-based approach can deliver results.

If the EU were to decide to prioritise the social inclusion of children in cohesion policy, it should be wary about recommending general best practices on the issue of childcare. Rather, it should encourage, through the strategies of Member States (and Regions), the production of validated community-based indicators capable of focusing action and public debate on the features relevant for specific contexts. It should also encourage tailor-made projects that respond both to a set of EU-wide agreed principles and to different national aspirations. How effectively the Commission could play this role in such a sensitive area through the strengthening of its in-house capacity is one of the issues that should be considered in making the choice.

IV.5. Tackling both objectives with the same core priority: the options of "Skills" and "Ageing"

Two further options for the choice of core priorities, where the objectives of efficiency and social inclusion are equally relevant, skills and ageing, will be briefly considered.

Skills

Possessing adequate skills is necessary for the capacity to enjoy life, for self-esteem, for increasing income and for finding a job[345]. Map IV.7 shows how important the effect of education – a major source of skills – is on employment rates. It also shows that this effect differs markedly between regions, even within the same country. Possessing adequate skills is even more important in a situation where rapid technological change, global challenges and external shocks are likely to make existing skills obsolete or in need of updating.

Employment and unemployment rates, strongly influenced by education and the availability of skills, have been converging in the EU, but the variation in these, even within countries, remains very high, and there is a persistent tendency of some Regions to under-perform. The relative position of 80% of Regions in the EU with "very high unemployment" in 1993 remained the same in 2003, as against 65% in the US and Canada[346].

A substantial effort to upgrade skills at all levels (and in particular of the low-skilled and disadvantaged) will be essential to enable all European citizens to adjust to a changing environment, to maintain and improve their long-term job prospects and to avoid falling behind. It will require investment to improve the quality of education and training[347]. But it will also require more informative and timely ways of matching the supply of skills with labour market demand, and new strategies to make the most of the skills of older people with their much extended life span. The effects of the public action taken to deal with the skill issue will be important for efficiency and growth. But the effects on social inclusion will also be important.

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[345] See for example Overman, H.G. and Puga, D. (2002).

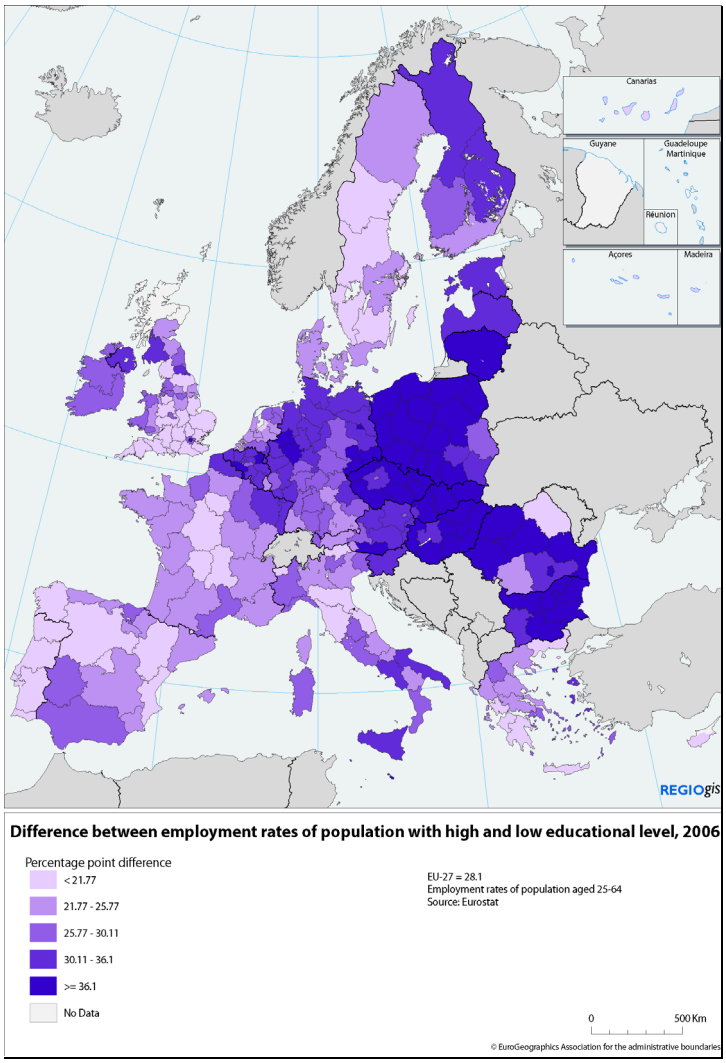
[346] See OECD (2005a). High unemployment is defined as the unemployment rates which belong to the upper quintile of the unemployment distribution.

[347] See Commission of the European Communities (2008d).

Public action aimed at improving skills undoubtedly requires nation-wide institutions. But in order to be effective, it must also take account of the specific circumstances and needs of places, in order to address the causes that make some nation-wide services (education, training, labour market policies) more effective in some contexts than in others. This is particularly true for education, the effectiveness of which strongly depends, not only on the social and cultural upbringing of the students, but also on the context in which they live and on the other students with whom they interact[348]. In the case of public action aimed at upgrading the skills of people already active in the labour market, a successful approach needs to take account of, and adjust to, the knowledge and preferences of those that it is directed at, especially the unemployed and marginalised groups. For this reason, in several EU countries, local and/or regional authorities have responsibility for upgrading skills. As in other areas, however, the local capacity or willingness to act can vary greatly between places. Exogenous intervention is needed to avoid both inefficiency and social exclusion traps and to support action, diffuse information and ensure standards.

[348] According to the data collected and analysed by PISA – see OECD (2006a) – for 11 of the 17 EU countries surveyed by the assessment, the variance in student performance in mathematics between schools represented more than 30 per cent (for 7 countries more than 50 per cent) of the total variance in student performance, with a large majority of it being explained by the economic and social status of students and schools. Partly due to structural features of those education systems, this show how "territorial" the education challenge often is.

MAP IV.7: Differences between employment rates of population with high and low education level in 2006(*)



Source: Eurostat.

(*) High education is defined as qualifications at tertiary (ISCED 5 or 6) level; low education as only basic schooling or qualifications no higher than lower secondary (ISCED 2) level.

EU cohesion policy already operates in this field. In the current period 2007-2013, EUR 25 billion have been allocated to improve human capital and EUR 13.5 billion for supporting the adaptability of workers, enterprises and entrepreneurs, which also includes the development of systems for anticipating economic change and future requirements in terms of jobs and skills. The equity and efficiency objectives, therefore, coexist[349]. The question is whether there are sufficient conditions and opportunities for redirecting some of these funds and/or other funds to a less fragmented strategy, inspired by a general EU vision and more clear-cut objectives, centred on both equity and efficiency.

In terms of social inclusion, the general objective would be to raise the education, competences and basic skills of as many European citizens as possible above certain minimum levels. In terms of efficiency, the general objective would be to support in all places the upgrading of individual skills which are needed in the EU in order to strengthen competitiveness. An analysis needs to be carried out of the extent to which a policy space for the EU level of government exists for it to

[349] Equity is likely to be the main objective for the additional EUR 10 billions which are aimed at improving the active inclusion in the labour market of less favoured persons (but here the emphasis is not necessarily on skills).

acquire more sovereignty on this issue, as well as how far there is knowledge base in the Commission from which to start playing this new role .

Ageing

Population ageing, driven by low levels of fertility and mortality, represents a global "demographic revolution"[350]. For the EU, it is a challenge in terms of both efficiency and social inclusion, calling for interventions on the organisation of labour and on the structure of public goods and services.

In the world as a whole, the share of older people in the population will reach 21% in 2050 against around 11% today and by then the number of older people is expected to exceed the number of young people under 15 for the first time[351]. The EU displays a combination of high and increasing life expectancy and an extremely low fertility rate[352]. As a result of the accession of the new Member States, the average age of EU population has fallen slightly. However, enlargement has not significantly changed the demographic map of the Union and the recent reductions in fertility rates in the new Member States have given them the same demographic pattern as the rest of the Union.

Projections for the EU[353] for 2050 anticipate about 60 million more people of 65 and over – the official age of retirement in most Member States – and about 50 million fewer 15-64 year olds. The share of population aged 65 and over will rise all across Europe, but a wide variation between regions is expected. Map IV.8 shows that in the 2020 the largest shares of older people are projected to be in Eastern Germany, Central France, Italy, North-West Spain, parts of Bulgaria, Finland and Sweden[354]. In some of these areas – in Eastern Germany, North-West Spain, Bulgaria and some Regions of South-Italy – this would be coupled with marked population decline, (Map IV.9). Recent research suggests that demographic ageing in virtually all European countries will increase income inequality and poverty rates in Europe in the coming decades[355].

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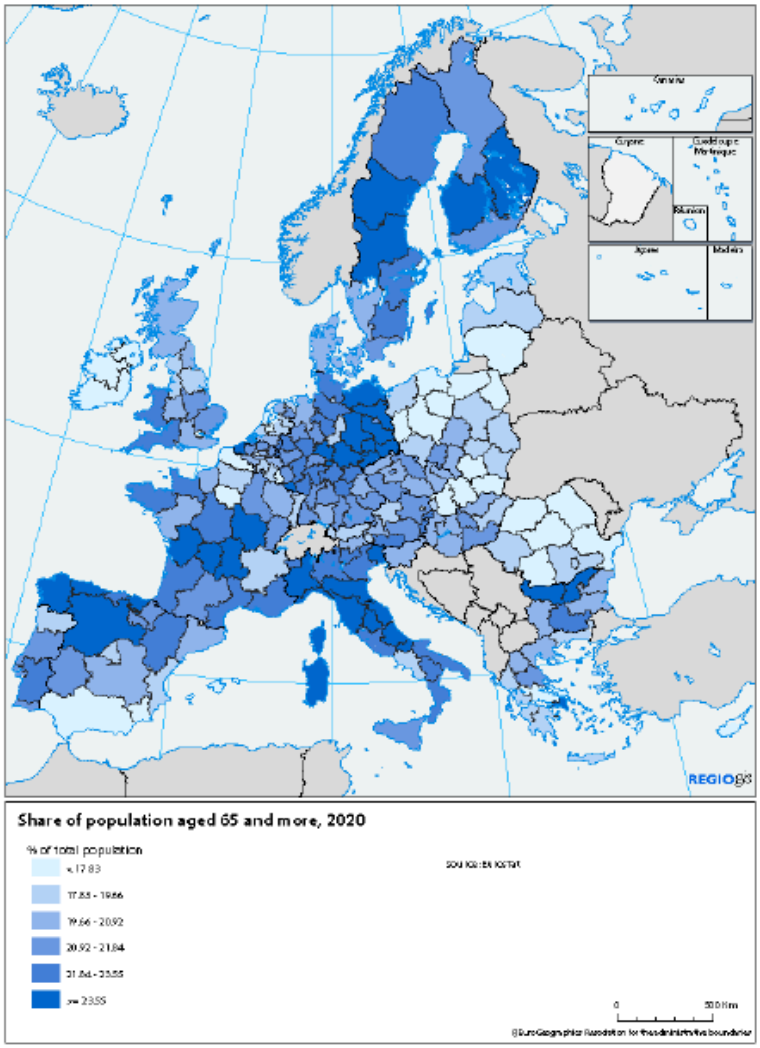
350 See World Health Organisation (2004), p. 6.
351 See United Nations (2001). "Old" in the UN definition is 60 and above.
352 See Eurostat (2004), p. 37; European Commission (2004a). The fertility rate is defined as the average number of babies born to women during their reproductive years.
353 Projections were made by Eurostat in 2004 at national and regional level by applying a trend scenario. National projections were then produced in 2008 only at national level and with a convergence scenario. See Commission of the European Communities (2008e).
354 See Commission of European Communities (2008e), using the Eurostat 2004 projections.
355 See SCP (2004).

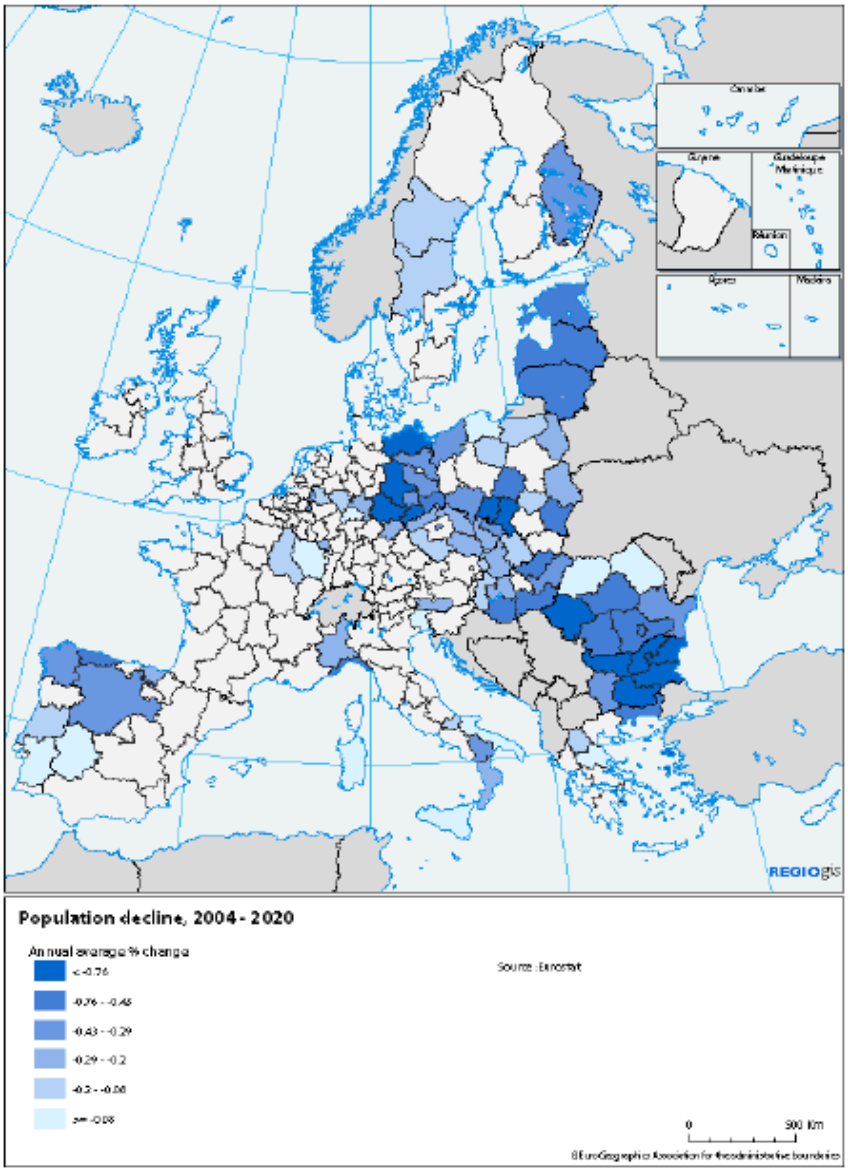
Map IV.8: Share of population aged 65 and above in 2020
(% shares)



Source: Commission of the European Communities (2008e).

These widespread and profound changes will not only differ in intensity across regions but will also be experienced very differently from place to place according to factors such as ethnicity, the structure of occupations and migration flows. The different rates at which different ethnic groups age, and their different family and intergenerational relations, will also influence the effects, making them very dependent on the local context. Moreover, the regional policy response will be conditioned by the administrative context, the regional policy framework and the broader socio-economic profile of the region. Demographic ageing, therefore, has significant territorial consequences.

Map IV.9: Population decline between 2004 and 2020
(annual average % change)



Source: Eurostat.

The challenges for each region are likely to relate to all aspects of life.

- *Organisation of labour*. Ageing contributes *prima facie* to a shrinking population of working age, and the regions most affected might see their income prospect worsen. On the other hand, the older sections of the population represent an often underutilised source of labour, ideas, guidance and information. If they are properly used, which is likely to require changes in the present organisation of work and labour, they could represent an asset rather than a liability for many regions.

- *Consumption*. The different pattern of consumption of retired people calls for adjustments in the composition of goods and services provided.

- *Welfare system*. A growing number of older people requires changes in the type and scale of social services.

- *Spatial planning and infrastructures*. Outward migration of younger people can leave older people isolated in deprived urban centres or in rural areas and this has implications for spatial planning, welfare provision, housing and transport systems.

- *Voluntary activities*. The elderly, through their participation in the provision of local services and voluntary and caring work, can be among the most active contributors to social cohesion and to the reduction of social exclusion, including that resulting from demographic ageing. This contribution can be facilitated or hindered depending on the degree to which older people have a say on issues such as urban and spatial development, housing, social services and public transport.

In the face of all these various challenges, risks and opportunities, there is a need, from both a cultural and political perspective, for a major adaptation of the policy measures and institutions that have been designed for a population with a very different age composition and for an adjustment of the national pension, welfare, labour market and family law systems in place. At the same time, there is also a need for a response at local level, capable of tackling all the issues mentioned above. Since places will be affected very differently by the demographic changes and since their circumstances differ, there will be considerable variation in their capacity and innovativeness to respond. New inefficiency traps will arise, as some places fail to adapt their institutions and services, and comparative advantages will be lost. New social exclusion traps will also emerge as sections of the population fall below socially acceptable levels of income and suffer deprivation in other aspects of well-being.

There is, therefore, a clear case for a place-based development policy to combat the effects of demographic ageing. Intervention can help to increase participation rates and labour productivity through support for active labour market policies, training of older people and improvements in education and life-long learning. It can also raise awareness of the potential of older workers and promote changes in the organisation of labour which enable their potential to be realised and support improvements in accessibility and mobility. In addition, it can help to reduce physical and social isolation in rural areas as well as that caused by a decline in family support, ensure that housing stock meets new needs, improve service delivery, access to ICT and public transport, provide suitable health and long-term care and focus interventions on the specific situation of vulnerable groups.

Since the problems that demographic ageing gives rise to require a place-based approach, the next question is whether the verifiability criterion is satisfied. For the social inclusion objective, the methodological issues are similar to those mentioned above with respect to children. For the efficiency objective, verifiability is undoubtedly more complex and calls for carefully defined methods if the criterion is to be satisfied. The final and central question is whether the Union should be involved in running a place-based policy in this area.

The European Union has always recognised the importance of ageing. The issue has featured prominently in both the Lisbon agenda and in the anti-discrimination Directives. It is commonly recognised that population ageing is one of the main challenges that the EU will face in the coming years. Cohesion policy support has already been given to a number of initiatives dealing with ageing[356]. But the question is whether the EU importance is sufficient for the issue to become a full-scale central concern of cohesion policy.

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[356] Cohesion policy is financing projects in private firms, municipal and regional governments and development agencies aimed at developing strategies for retaining older workers: see European Commission (2007a). Community Initiatives are also supporting projects combating age discrimination in the labour market. These include support for business start-ups among those of 50 and over and life-long learning: see Ministerstvo práce a sociálních věcí ČR, *Evropský sociální fond, Program Iniciativy Společenství EQUAL*; and *Shrnutí Programu Iniciativy Společenství EQUAL* (Accessed at: http://www.esfcr.cz/).

As in the case of the social inclusion of children, there is no specific expectation by European citizens that the EU should address the issue, nor is the EU blamed for its existence. But, by tackling this issue as a core priority of cohesion policy, the EU would have an opportunity to anticipate, through a shared strategy, the effects of a demographic revolution that individual countries are not adequately responding to and for which there is, therefore, a policy space to fill. Moreover, due to the innovations that a policy for the elderly requires, there is significant scope for the exchange of experience and mutual learning that a policy governed at EU level is well placed to ensure. The issue would undoubtedly have high visibility and the policy measures put in place to tackle it the potential for being regarded as a European public good.

V. A MORE STRATEGIC AND EFFECTIVE GOVERNANCE

Reforming the governance of cohesion policy is one of the conditions for meeting the challenges for which the policy is needed in the European Union.

More so than two decades ago, cohesion policy can be a primary and effective instrument for addressing issues of inefficiency and social exclusion in Europe and for promoting solidarity and a renewed commitment to the Union and its integration strategy among European citizens. The Report has argued that a clear-cut rationale exists for an integrated, place-based approach to be run at EU level according to the needs of places (chapter I). The task assigned by the Treaty to the Union "to promote overall harmonious development" and to reduce "disparities" and "backwardness" in regional development has strong foundations.

The review of policy results conducted by this Report (chapter II) shows that cohesion policy offers an appropriate basis for addressing the task, but that a set of serious weaknesses exists requiring reform of some key components of the policy. The basis is represented by: a system of multilevel governance with a focus on places/regions; a system of contractual commitments, both vertically, between Commission, national and regional levels, and horizontally, that represent a valuable European asset; an EU-wide network for the diffusion of methodological tools; and an attitude and a capacity for partnership. The weaknesses concern: deficits in strategic planning and policy conception; lack of focus on core priorities and of distinction between efficiency and equity considerations; failure of contractual arrangements to focus on results and to design institutional changes tailored to different contexts; methodological problems hampering the appropriate use of indicators, targets and evaluation; and a lack of debate on results, both at local and EU levels.

The case for change was made in chapter III. Together with a strong concentration of resources on a few core priorities and a territorialised social agenda (chapter IV), the following principles, drawn from the policy concept and from the lessons of the past, have been highlighted to guide the reform of the governance of cohesion policy: orienting grants to results; mobilising and learning; strengthening the Commission; reinforcing political checks and balances. Some steps in these directions have been attempted for the current period[357], but they have fallen short of expectations due to lack of progress on the policy concept, methodological weaknesses, and the absence of a strong political compromise that enabled Member States largely to neutralise the proposals for change.

The "ten pillars" for reform presented in this chapter are based on the principles summarised above. They are not intended to provide a blueprint for cohesion policy in the future and take only partial account of the impact – mostly still to be seen - of the changes introduced for 2007-2013. However, the pillars do provide clear statements of how a reformed system of governance can be constructed as a starting point for debate. They also emphasise, as has been stressed in chapter III, that effectiveness is dependent on a comprehensive reform, with the success of one proposed change strongly depending on the implementation of the others.

Changes such as those proposed here can be made and results can be achieved if the rejuvenated policy concept is accompanied by a strong political compromise and by an appropriate design of

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[357] Particularly relevant is the introduction of the Community Strategic Guidelines and the National Strategic Reference Frameworks: whatever their actual implementation; they do represent a building block on which the proposals of this Report can be built. Earmarking has also been introduced, but the reference to the very broad Lisbon "priorities" and Member State pressure during the negotiation (see Box II.A) have diluted its effect. A strategic reporting process has been launched, but Reports are not asked to describe progress towards quantified objectives, and the persistent lack of a system of robust indicators makes this step unlikely. A more intensive exchange of experience is being promoted through the 'Regions for Economic Change' initiative, which is a basis for further moves in this direction.

the negotiation process, with the strategic principles, the financial framework and the overall regulation being approved simultaneously. The overall regulation, which would embody the rules described and justified in this chapter, would represent a simple and clear general EU framework. This would have important implications at EU level. However, for the framework to succeed would also require Member States and Regions to play their part in making the necessary domestic changes that the reform requires.

The ten pillars also offer ideas that could be of use in the current programme period. In some cases this is both possible and necessary in order to build the base and the experience to be put to full use in the post-2013 period: a stronger indicator system; the sharpness and quality of reporting; experimenting with impact evaluation; and strengthening DG REGIO and DG EMPL. Other proposed changes would also warrant preparatory moves before the end of the current period – most notably the dialogue on new priorities.

V.1. An innovative concentration on core priorities and a conservative territorial allocation

The first question for this chapter is how cohesion policy resources should be deployed: the share of resources for the core priorities; the territorial allocations to regions and countries – geographical coverage, territorial units for resource allocation and eligibility thresholds; and the specific aspects of territorial cooperation and TENS funding. All these issues are discussed under the working assumption that the resources for cohesion policy will be similar to the present amount.

Focusing resources on core priorities: a large share of cohesion policy resources should be concentrated on 3-4 narrowly defined core priorities of EU interest.

One of the substantive changes proposed by this Report is the concentration of a significant proportion of cohesion policy funding on a limited number of core priorities (three or four). They would become the European public goods on which cohesion policy is focused. We propose that the selection of these core priorities should be the subject of a strategic political process (see pillar 2) involving EU and Member State authorities. A key requirement is that the priorities are defined strictly and that they are assessed on the basis of conceptually-founded criteria. The Report suggested three criteria in chapter IV – EU-relevance, place-basedness, and verifiability - which are coherent with the rationale of the EU having a cohesion policy. The Report also examined the arguments for some specific options for the choice of core priorities: innovation, climate change, migration, children, skills, ageing.

Strategic political agreement would also be required for the *share* of cohesion policy resources to be allocated to the agreed priorities. Clearly, they could not account for the whole cohesion policy budget; in many lagging regions, there is a wide range of development needs and challenges to be addressed. Determining the degree of concentration also needs to consider the varied capacity of Member States effectively to absorb funding (absorption capacity) under the various options for core priorities, and this decision needs to go hand-in-hand with the choice of core priorities. However, we propose that the target share at EU level should be no lower than 55 per cent and as close as possible to 65 per cent: this aim should be born in mind in deciding the core priorities and assessing the likely financial absorption of each candidate. The agreement should also establish a *fourchette* (a range with an upper and lower limit) for the share of the cohesion policy budget allocated to each core priority at EU level.

The concentration requirement would apply to every country or region, but the share (allocated to core priorities) should vary according to territory: highest in non-lagging Regions, where the smaller amount of per-capita resources demands strong concentration; and lowest in lagging

countries, where the scope for using the funds is limited by the Treaty to transport, energy and the environment[358].

Each Member State (and Regions) would determine, in dialogue with the Commission, the distribution of its allocated cohesion policy resources among the core priorities, justified with reference to its needs and development strategy. In the context of the strengthened governance concerning the core priorities – described in pillar 4 – the approval of the Commission for these choices would be necessary. The remaining resources would be allocated to other development priorities selected by the Member State (Region), providing that the place-based nature of the interventions is adequately justified with reference to development needs and the overall strategy (see pillar 3). A decision would have to be taken on whether to retain, as a reference, the present 16 expenditure categories, with some clear advantages of comparability over time, or to adjust them in favour of a less sectoral approach.

Territorial allocations to Regions and countries: as currently, cohesion policy should have the scope to address development issues in all parts of the Union, with resources concentrated on lagging countries and regions.

The territorial allocation of resources raises three questions: in which regions should cohesion policy resources be used? What units should be used for the allocation algorithm? And what threshold(s) should be used for determining the territorial concentration of resources? As anticipated in chapter III, on all these issues the Report takes a conservative view.

The first issue concerns geographical coverage. Addressing development problems, namely "development traps" relating to economic inefficiency and social inclusion (see chapter I), is a challenge for all areas of the Union. The main development problems are clearly greatest in the lagging places, where the need for financial support is greatest and where both institutions and fiscal capacity are weakest. It is here that the concentration of resources should be maximised. However, the rationale for a place-based approach by cohesion policy is not restricted to lagging regions; there is a strong justification for the EU to intervene also in non-lagging regions where economic inefficiency and social exclusion traps exist (see section I.3)[359]. This is even more the case when (see below) the territorial unit for resource allocation is a jurisdictional unit – either a Region or a nation-state - which can include regions/places at different stages of development. The Report therefore proposes that the present principle for the territorial allocation of funding should be retained: cohesion policy should apply to all parts of the EU territory, concentrating on lagging regions, and having the scope to intervene in all non-lagging regions in support of EU core priorities also.

An important caveat is that, while cohesion policy should have the scope to intervene everywhere, this does not assume that funding will necessarily be provided to every place/region. Under the contracting system proposed below (pillar 3), Member States will be required to justify the spatial allocation of resources (especially where concentration is required by the core

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[358] Taking, as an example, the present distribution of funds (around 20 per cent to lagging countries, 62 per cent to lagging Regions, 16 per cent to non-lagging Regions and around 2 per cent to territorial cooperation), the overall range allocated to core priorities under the above proposal – no less than 55 per cent, possibly up to 65 per cent - could approximately correspond to the following ranges of resources attributed to each type of territory: 25-30 per cent of the resources attributed to lagging countries (given the Treaty constraints); 55-65 per cent of the resources attributed to lagging Regions; 85-100 per cent of the resources attributed to non-lagging Regions; 55-100 per cent of the resources attributed to territorial cooperation (very much depending on what the chosen priorities are). These specific ranges are coherent with an overall 55-65 range also for other potentially feasible distributions of resources among different territories.

[359] As section I.3 made clear, proposals to restrict cohesion policy to "poor" countries or "poor" Regions are based either on budgetary politics or on a conceptual view of cohesion policy concerned with convergence and financial redistribution, rejected by this Report.

priorities to be effective). Depending on the core priorities selected, the territorial allocation of funding within Member States should be those places/regions where economic inefficiency or social inclusion traps are considered most important.

The second issue relates to the territorial unit for resource allocation at EU level: which unit should be used to distinguish between lagging and non-lagging regions so as to differentiate the intensity of funding? The policy concept would suggest referring to places defined as a contiguous/continuous area within whose boundaries a set of conditions conducive to development apply more than they do across boundaries (see Introduction); an area that can be identified only through the policy process, independently of administrative boundaries. The primary alternative to the present pre-allocation of resources to jurisdictional Regions is then a discretionary process of allocating funds to places/regions according to the geography of needs. But this is not a task that the Commission has the knowledge to perform. It is a task better performed by Member States and Regions. Once the options are restricted to a pre-allocation to jurisdictional units, there are no credible alternative methodologies which are clearly superior to the present approach. The Report considers that the present use of jurisdictional entities - NUTS 2 Regions – for resource allocation should be retained (plus national allocations for the Cohesion Fund as specified by the Treaty).

NUTS 2 Regions are the closest approximation to the relevant territorial units for which robust, homogeneous and adequately updated economic data exist for an allocation to be made ex-ante. The backwardness of a NUTS 2 Region can then be taken, for the sake of allocating funds, as a proxy of the economic backwardness of the regions/places included in its boundaries. However, it must be emphasised that NUTS 2 Regions should not be considered as the relevant unit of intervention by Member States (Regions). Once the overall amount of resources has been decided at EU level for all lagging Regions and for all non-lagging Regions in each Member State, the allocation of resources to places/regions inside each of the two blocks and the territorial scale for intervention – national, regional, sub-regional – should be based on what is most appropriate for the priority being supported and the institutional context. Within Member States, the territorial allocation for lagging and non-lagging Regions, as well as the criteria for the allocations to places and regions within each NUTS 2 Region, would be part of the contract agreed with the Commission.

A possible exception to this approach concerns peripheral or remote regions suffering from depopulation in which there is wider European or global interest (as discussed in chapter I). In such regions, where there is a "Community interest" in maintaining settlement, environmental resources or cultural heritage, a compensatory approach to EU support could be undertaken to address the sustainability/viability of these regions (potentially defined through demographic or territorial criteria) without the requirement to meet the objectives or minimum spending targets of the core priorities.

This leaves one last issue to consider here[360]: the threshold for separating lagging from non-lagging Regions and the associated intensity of funding.

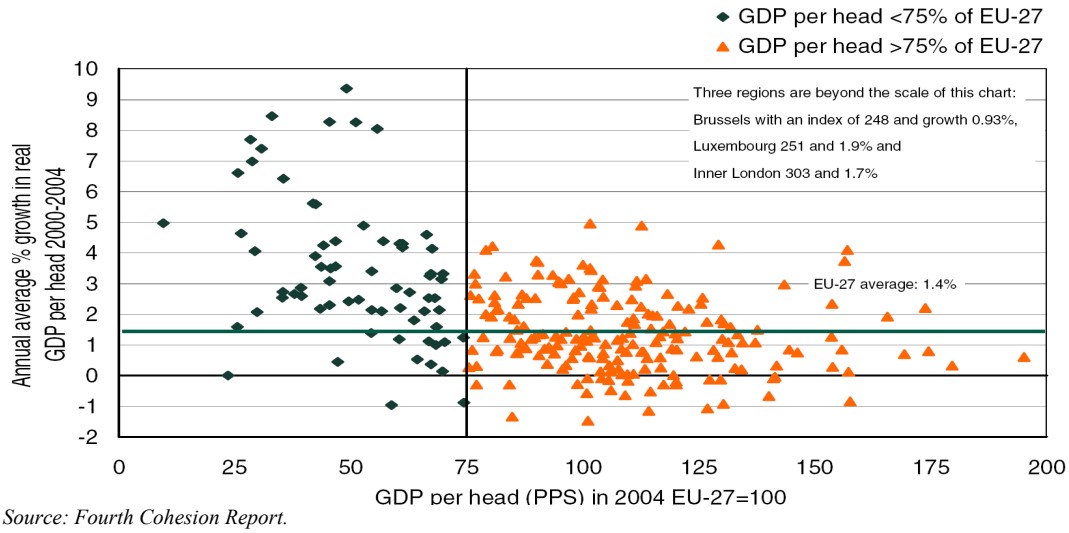
The present 75 percent GDP per capita (at purchasing power parity) threshold, with reference to the EU average of GDP per capita, - as any other similar threshold - does not provide much information on the unused potential of a Region, unless one assumes (on the basis of no evidence) that the long-term potential is the same in all Regions. As for inequality, it provides information on the proxy of one dimension only (income) and says nothing either on the distribution of income or on any other dimension. But similar objections would apply to any other straightforward threshold that might be considered. And the present criterion has the

[360] Other parameters exist: those for deciding the difference in aid intensity between lagging and non-lagging Regions and within lagging Regions (according to their "level of development"). The discussion over them, being largely a matter of negotiation, does not belong to the present stage of budgetary review and to this Report.

considerable advantages of relying on the most accountable of all national statistics (at least for the GDP current-price and constant-price figure) and of having been the established criterion for eligibility since 1988. Furthermore, since decisions on the budget (and net Member States balances) are currently entangled with policy decisions on territorial allocation, any debate on the latter would once again focus attention on the financial issue, distracting from the more pressing issue of "how" resources are used[361].

The arbitrariness of any thresholds and the perverse effects that they can induce suggests, though, considering a new category of transitional support for Regions above the 75 per cent threshold and below another threshold, to be decided. There is large cluster of Regions either side of the 75 per cent threshold. Small upward or downward changes in annual growth rates (or revisions of GDP data) can have a major impact on (in)eligibility for lagging status (see Figure V.A below), an issue aggravated by the volatility of regional economic circumstances in the current economic crisis. Furthermore, as a result of the accession of Bulgaria and Romania by the end of the 2007-13 period, a new, strong "statistical effect" is at work which would exclude several Regions without them necessarily having actually improved in absolute terms. Modulating the impact of the 75 per cent threshold would also permit the current special provisions made for phasing-in and phasing-out Regions to be discontinued.

Fig. V.1: Growth of GDP per head 2000-2004 and GDP per head 2004



Source: Fourth Cohesion Report.

On the basis of the above discussion, the main territorial focus of post-2014 cohesion policy would look as follows.

- *Lagging countries and Regions*. Lagging countries, with less than 90 per cent of EU GDP per head, and lagging Regions with less than 75 per cent of EU GDP per head. A secondary category of "transition Regions" (lagging Regions with between 75 and 75+X per cent of EU GDP per head) would also qualify for lagging status with lower per capita financial allocations. The label – "lagging" - is used for this primary focus of the policy, in order to replace ambiguous terms such as "Objective 1" or "Convergence"[362].

- *All other (non-lagging) Regions*. All Regions with more than 75+X per cent of EU GDP per capita. The label "non-lagging" is used for this secondary focus of the policy.

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[361] Disentangling decisions on policy from decisions on the net balances of Member States, as several commentators have suggested, would possibly create a scope for a debate on indicators and units used for allocating resources.

[362] On the ambiguity of "convergence" and of the term used for non-lagging regions – "regional competitiveness and employment" – see section I.3.

These two categories could absorb a similar proportion of funding to their shares in the current period, and about 96-97 per cent of total resources. The remaining share would be allocated, as in the current period, to a third focus of support: Territorial cooperation (see below). For all the territorial categories, a small reserve would be set aside for Commission-managed Territorial innovative actions, aimed at boosting innovative policy methodologies in different fields of action (see pillar 6).

Territorial cooperation should focus much more strongly on strategic interventions with a verifiable impact.

Territorial cooperation should be maintained as the destination of a small share of Cohesion policy funds; we propose that this should be raised from the current 2.5 per cent to 3-4 per cent. In spite of a lack of quantified evidence on its effects, there is a consensus - shared by this Report - that in this field the EU can add value by dealing with relevant, over-the-border interdependencies and promoting cooperation networks and collaborative learning involving both public and private actors. However, for that to happen, some significant changes are necessary.

- The *overall EU strategy on territorial cooperation* would form part of the EU framework (see pillar 2). On this basis, each Member State would outline its own strategy. In establishing a strategic regional cooperation or cross-border cooperation programme, interventions should be focussed on clear objectives, with verifiable results (taking account of experience with the enhanced obligations in this regard for the current period).

- *Transnational/cross-border programmes* should be conditional on a supportive political/policy framework being established by the participating Member States[363] to demonstrate that the EU programme is part of a wider strategy of cross-border or transnational cooperation (including complementary actions – potentially smaller projects - financed wholly by the Member States) and that it has the political commitment and resources of Member State authorities at national, regional and local levels. The exceptions are where EU-funded programmes are being funded for the first time, and on external borders.

- *Transnational/cross-border programmes* should dedicate a significant share of resources to supporting the core EU priorities, complementing (and adding value to) the priority-based interventions being undertaken by cooperating regions through other EU funds.

- Funding for *inter-regional cooperation* should concentrate on network funding for regional and local organisations (development agencies, local authorities, universities, research centres, associations of social partners, etc.) to create or to strengthen networks with the specific purpose of better pursuing the objectives of one (or more) of the core priorities, conditional on tangible and measurable outcomes and subject to periodic, independent evaluation; the possibility of learning projects should be considered - time-limited partnerships of regional and local organisations, with emphasis on learning about the core priorities and with active involvement of Commission services as knowledge broker[364].

- *Legal and administrative barriers* to more intensive cooperation should be reviewed, with the aim of allocating transnational and cross-border funding to programmes rather than individual Member States. State aid control provisions – which currently require participating Member States to notify aid schemes separately – should also be reviewed in collaboration with DG

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[363] An existing example is the Baltic Sea Strategy.

[364] In order to maximise the scope for policy learning, it would be important that the Commission's role in facilitating knowledge exchange goes beyond conferences and databases. In line with the proposals made for the Commission later in pillar 7, the role should involve a brokerage function whereby the Commission filters and transfers knowledge to individual countries and regions in a form which meets specific circumstances and needs.

Competition with a view to exploring how aid control procedures might be more supportive of territorial cooperation.

- *Monitoring* by the Commission, and *evaluation*, must be strongly improved, including efforts to design of a system of impact evaluation, geared to this complex field of action.

The management of Trans-European Networks should be reviewed to enable a more strategic and coherence approach to TENS planning and investment. Putting all TENS resources in a single fund is a possible solution.

Trans-European Networks (TENS) have a vital role to play in ensuring connectivity and network development in key infrastructures. The Treaty contains a special title (Title XV, Articles 154-156) devoted to TENS, covering the areas of transport, telecommunications and energy. However, progress has been relatively slow and plagued by a range of financial, strategic and operational problems[365]. Cohesion policy provides a major share of the EU funding for TENS: 43 billion euro (about 11 per cent of the whole cohesion policy budget, half of the resources allocated to transport) in the current programming period. On the specific issue of TENS funding through cohesion policy it has been argued[366] that the nature of the programming process, in which individual countries individually define their own priorities, automatically lead to cross-border coordination failures. Moreover, countries tend to place greater priority on investing in a connection to the core of Europe than in a missing link toward more peripheral neighbouring countries, thus exacerbating the accessibility advantage of the core. Lastly, the contribution of infrastructure spending in lagging Regions to the reduction of regional disparities in the EU is disputed.

It has been suggested that the whole of TENS funding could be brought within the Cohesion Fund. However, given the policy and strategic expertise required to plan and manage the TENS, a preferable option would be to create a single fund for TENS. This would represent a significant transfer of budgetary resources, with implications also for the management of TENS in the Member States. It would be important, therefore, for TENS to be managed as a "Structural Fund" under the same European strategic framework as the Regional Fund (ERDF), and with TENS investments coordinated with Member State cohesion policy strategies to ensure a territorially coherent approach to maximising the benefit of new transport networks.

Architecture of the Funds: the current configuration of Funds should be largely retained but with more coherence between EU interventions promoting a place-based/territorial approach to development.

Faced with the present fragmentation of Funds – three within cohesion policy and two outside it – and the need for integrated projects to use more than one of them, with different rules and through different programmes, pressure has been mounting for a merger of the Funds. The most widespread concern is with the separation of the Rural Development component of the Agriculture-Rural Fund (EARDF) from the whole of cohesion policy.

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[365] The following problems have been identified: under-investment by the Member States; long implementation delays, particularly concerning cross-border cooperation projects (which face inherent difficulties due to their intergovernmental nature); insufficient financial and operational coordination between Member States on projects along a single axis; generally inadequate concentration, selectivity and coordination of the projects selected; low financial participation from the private sector. See Van Miert, K. (2003); Commission of the European Communities (2007e); European Commission (2008e).
[366] Ecorys (2006).

While the optimal technical solution might be to have all funding instruments merged or coordinated in a single Fund under one Directorate-General, this would require such a readjustment of human resources and of the organisation of the Commission – in order to make sure that no accumulated knowledge is dispersed – that this hypothesis is hardly feasible, if not potentially disruptive. Therefore, it would be more appropriate to conceive a partial readjustment of the architecture of the Funds along the following lines:

- the operation of cohesion policy within a strategic (place-based) territorial framework (see further details in pillar 2), with common strategic objectives and priorities, consistency of guidelines and a clear division of responsibility for different types of intervention; the systematic use of different Funds for the same core priority, would require and produce a much stronger strategic integration of the different Funds, namely of the social and regional Funds;

- adaptation of the current architecture of cohesion policy:

  – to promote a full integration of the interventions financed by the Regional and Social Funds, and a strategic cooperation of DG REGIO and DG EMPL by combining the social and the territorial agenda;

  – to align fully the objectives and rules of the ERDF and Cohesion Fund;

  – to bring the rural development actions of the EARDF, the territorial actions of the Fisheries Fund (EFF) and any other Commission interventions to support territorial development under the umbrella policy heading of cohesion policy, as Structural Funds;

  – to ensure that each type of intervention is allocated to one Fund only (although not eliminating the current provisions for cross-financing);

- common rules and procedures for all the Funds (building on the harmonisation of the Regional and Social Funds rules) with respect to eligible expenditure, management, monitoring, reporting and financial management obligations which would facilitate the use of different Funds in the same schemes or projects;

- provision of Member States with maximum flexibility to allocate resources between the different Funds in line with the objectives of the strategic framework (see below).

V.2. A new EU strategic framework for cohesion policy

The effectiveness of cohesion policy, as with any place-based development policy, depends on the balance between conditionality and subsidiarity of its multilevel governance system. In this respect, compared to the reference model discussed in chapter I, the governance of cohesion policy presents some key problems that need to be addressed (section II.4).

Both of the present "contracts" agreed by the Commission with Member States and Regions - part of the National Strategic Reference Framework and the Operational Programmes – do not provide the Commission with an adequate commitment by the Member State (Regions), while raising great concerns among Member States about the Commission infringing subsidiarity. Both types of contracts generally fail to specify clear objectives and targets, which tend to be relegated to the latter stages of the programme approval process, and to explain satisfactorily the relationship between planned actions and targets and the institutional conditions necessary for results to be achieved. Both the quality of the indicators and the meaningfulness of the targets are so doubtful that no summary statistics can be derived (section II.3.2). More generally, this Report has identified a methodological failure to deal appropriately with the profoundly incomplete

information available to both the Commission and Member States (Regions) at the time of drawing up the current programmes.

The changes proposed by this Report converge in creating the appropriate conditions for greater effectiveness of the contract between the Commission and Member States, through:

- a *greater focus on objectives*, for both core and non-core priorities, enhanced by the clear-cut distinction between efficiency and social inclusion, and strengthened by an improved learning process (pillar 7);

- the focus of a large share of resources on *a few core priorities* (chapter IV and pillars 1 and 4), allowing the Commission to concentrate and to qualify its effort;

- a greater mobilisation of local actors (pillar 6) and a greater EU-wide political oversight (pillar 10), *raising the pressure on results* and the external assessment of outcomes both at the bottom and at the top level;

- *a stronger Commission*, made more credible by the flexibility of the spending deadlines (pillar 5) and by a shift away from audit (pillar 9), and made more effective by a reorganisation and an investment in human resources (pillar 8) and by adjustments in the architecture of the funds which can allow more internal coordination (pillar 1).

However, for all these improvements to come together and be effective, the present system of "contracts" must be revised. This Report argues that a new type of contractual agreement between the Commission and Member States (Regions) is required, which focuses on performance and, for the core priorities, on the general institutional pre-requisites. It can give both Member States and Regions greater freedom for implementation and more certainty in their choices, allowing for the design of solutions tailored to regions, in return for credible and verifiable commitments on outcomes and on the institutional conditions for those actions to be achieved. These commitments must rely on the design of appropriate ways to deal with incomplete information incompleteness through a tailor-made approach. They must be the result of a genuine strategic debate on priorities and objectives. And they must be embodied in a unified contractual agreement for each Member State (including Territorial cooperation) and a unified reporting/monitoring system.

A new kind of strategic dialogue between the Member States and European institutions is required to mobilise knowledge and political debate, to produce a coherent European Strategic Development Framework, and to identify the core priorities.

One of the cornerstones of the proposals in this Report is a genuine dialogue among the Member States and European institutions on a strategic framework for cohesion policy. The intention is to begin the process earlier – to allow more time for reflection and debate – and also to engage the Member States more fully in the development of EU-level objectives and priorities.

The development of a strategic framework would begin with an EU-level strategic debate in 2010-12[367] in the Parliament and Council on the role of cohesion policy post-2014 with the objective of producing a European Strategic Development Framework document. An indicative outline of how such a debate might be managed is as follows.

- The debate would start with an analytical document – the *Fifth Cohesion Report* – published by Autumn 2010 which would set out: the state of territorial development in the EU, with reference to both capacity underutilisation (inefficiency) and to social exclusion; the main projected challenges to European development which call for a place-based approach; a

[367] The references to specific dates in the following description are indicative.

preliminary proposal for "core priorities" for post-2014 intervention, justified on the basis of EU-wide relevance (the value they can add for the Union and its citizens), place-basedness and verifiability (as defined in chapter IV); an assessment of the performance of cohesion policy in the 2007-13 period (thus far), notably whether it has overcome the limitations discussed in chapter II; and a proposal for key changes in the governance of the policy. An open debate would be organised on the Report.

- As part of the debate, each Member State and its Regions would draw up (by Autumn 2011) a *National strategic assessment of regional/territorial/place-based/spatial development challenges and policies at domestic level.* This would be prepared in partnership with local partners. Where such an assessment has already been done, the document could be based on (or comprise) an existing national/regional strategic assessment. The strategic assessment would include: an analysis of the main territorial development needs and challenges, with distinct reference to situations of underused capacities (inefficiency) and of social exclusion; a description of the priorities, objectives and main interventions of national development policies; an assessment of their effectiveness, with particular reference to the use of impact evaluations; and a description of the most promising progress achieved in the construction and use of outcome indicators and targets. Member States would also propose, with reference to the Fifth Cohesion Report, priorities where the need/scope for cohesion policy to make an impact in their territory is greatest, and methodological innovations that could be introduced in order to increase the focus on results.

  This is a key change: bringing the drafting of a Member State strategic framework forward to earlier in the cycle allows a "bottom up" dimension to be incorporated into the preparation of the EU-level framework. However, the purpose is not to pre-empt decisions on the priorities for allocating funding within a Member State – which would only be decided once the financial perspective had been agreed.

- The debate would be animated by a temporary *Place-based Policy Group* established in the first half of 2010. This would comprise a group of senior officials[368] from Member States, international experts (in topics such as economic development, urban and rural development, inequality, impact evaluation), a senior official appointed by the Committee of the Regions, and senior representatives of the Commission's Directorates-General in charge of cohesion policy or engaged in issues with strong territorial effects (particularly with reference to the proposed core priorities). This composition would allow the Group to "take into account the territorial impact of major strategies and sector-based policies"[369] and to maximise the coherence of Commission policies and intervention. The Group would be chaired by the Secretary-General of the European Commission. Its general task would be to make proposals for the European Strategic Development Framework, especially on the core priorities for cohesion policy, on the territorial dimension of other relevant Community policies, and on key governance issues[370].

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[368] In order to keep the Group manageable, it would be preferable for only a limited number of national officials to participate (although representative of the diverse development situations across the EU). The proposals of this temporary Policy Group would be submitted to the new Council Committee for cohesion policy envisaged in V.10 (via its technical sub-committee) on which all Member States would be represented.

[369] This is the first condition set by the document adopted by Ministers responsible for spatial planning and cohesion policy (at the meeting organised in Marseille by the French Presidency in November 2008) for implementing the territorial agenda. The document notes that "Experience shows that the European Union's sector-based policies often have effects which run counter to the cohesion goals".

[370] Prepared by a sub-group, specific governance issues would include those discussed in the ten pillars of this chapter: design and use of outcome indicators and targets; design of incentive mechanisms linked to targets; criteria and institutional requirements for a successful, place-based development policy for the core priorities; methodologies of impact evaluation for integrated projects; the application of new types of

- On the basis of the strategic debate, by Spring 2012 the Commission would draft the above-mentioned *European Strategic Development Framework* and accompanying set of regulations. The draft regulations would introduce the key changes to policy governance. Taking account of other relevant EU and Member States policies, the Framework would specify the contribution that cohesion policy (and other relevant Community policies) would aim to make during 2014-20 to the territorial development objectives of the Union, with reference to both efficiency and social inclusion.

Based on this process, the Framework would present the conceptual perspective to be adopted by EU cohesion policy. It would set out a limited number (3-4) of core priorities, for both efficiency and social inclusion, providing a clear justification for them, based on the criteria discussed in chapter IV, and their main objectives. For each core priority and for the other main issues relevant for cohesion policy, it would set a limited group of core outcome indicators, benchmarks and targets against which progress could be measured, and a methodological system to ensure their quality, timely updating and broad diffusion. In doing so it would take advantage of the experience accumulated through the Open Method of Coordination, of the proposals made in Member State Strategic Assessments and by the Policy Group[371]. For the core priorities, the Framework would outline the general principles which should inspire the national institutional frameworks with which Member States (Regions) would tackle each core priority (pillar 4). The Framework would also pinpoint the main requisites that interventions must have to be truly place-based and the major policy innovations that would be expected to characterise cohesion policy in the post-2013 period: particular relevance would be given to impact evaluation and local actor mobilisation (pillars 7 and 8).

The debate and adoption of the Framework by the Parliament and the Council would take place during 2012, simultaneously with the negotiation and approval of the new financial framework and of the cohesion policy regulation. The size and territorial allocation of cohesion policy resources, the European Strategic Development Framework and the regulation would need to be agreed simultaneously. As the Report has argued, the experience of previous negotiations has shown that, once the financial agreement is reached, the focus of each Member State on the effectiveness of cohesion policy in the other Member States rapidly evaporates. This tends to create a perverse collusion of all countries on the selection of rules (in the regulation) and of policy content (in the framework) that weakens conditionalities and the pursuit of EU-wide goals.

V.3. A new contractual relationship, implementation and reporting aimed at results

Strategic development contracts: the "strategic development contract" between each Member State (Regions) and the Commission should find a better balance of conditionality and subsidiarity, focus much more on performance and provide room for adapting institutional changes to contexts which greatly differ among Member States (and sometimes Regions).

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instruments (such as the financial instruments introduced in the current period to lever greater involvement of the private sector) etc. The Group would also be endowed with a budget to set an agenda for empirical analysis, for surveys on issues where the scarce availability of information represents a serious impediment to the design of appropriate governance changes, and for workshops.

[371] The Laeken indicators for several variables of social inclusion; the Barcelona targets for child care; the employment and unemployment targets with reference to the European Employment Strategy guidelines: these and other examples illustrate the now-common EU practice to set EU-wide targets for some relevant indicators capturing the political objectives. Compared to this experience, care is necessary on two specific points. First, as section IV.4 made clear, fixing one target can wrongly induce policy-makers to focus on one aspect only of a policy that should be broader. Second, while setting the same target for all EU countries responds to the idea that EU citizens increasingly combine national and EU standards, it can introduce a bias, as EU citizens do still largely look at national standards, and a particular target can be a very limited aim for some, and an excessive one for others. Hence, it is suggested that the EU-wide target should only be indicative, leaving each Member State to set its own.

For each country of the Union, the Member State (Regions) would conclude a *National Strategic Development Contract* (or Contract) with the Commission, a document formally approved by the Commission committing the Member State (Regions) to a strategy and to results for the use of the funds. This builds on the strategic approach used in the current period, by significantly changing its content and turning the strategic contract from a "reference instrument" into an agreement on objectives and means, where Member State and Regions commit themselves to quantified and verifiable objectives, coherent with the goals of the European Strategic Development Framework. It would exploit existing national institutions, where they are adequate for achieving the objectives of the core priorities, and adjust the existing ones or build new ones where institutions are weak. This should give Member States (Regions) flexibility as to how results are achieved and the institutions and instruments that are used. The role of the Commission would be to focus on ensuring the verifiability of the objectives and the adequacy of institutional capacity or institutional changes (when necessary) and on assessing performance.

The process of contract planning would begin in the latter stages of the current period. On release of a draft version of the European Strategic Development Framework, the Member State and Regions in each country would draw up a draft *National Strategic Development Contract* during 2012 and early 2013 (in consultation with relevant partners). This would be based on the strategic assessment previously undertaken (see pillar 2 above) and represent a draft version of the final contract with the Commission, with a similar content. Its key function would be to set out the use of EU funding and targets. In this process, the Commission would undertake a strategic consultancy role in providing: expert assessment of proposals/drafts; contribution of ideas, innovations; and intermediation with all the relevant Directorates-General. The intention would be to maximise the scope for lesson-drawing and reduce problems during the adoption phase. Compared to the current programming period, when a similar role was conceived, the effectiveness of this function would be enhanced both by the different content of the document at stake (see below), much more focused on results and institutional requirements, and by the strengthening of the Commission strategic expertise (pillar 8). The relevance of this phase would be enhanced by the Commission's commitment that issues agreed with Member States (Regions) during this phase would not be re-opened during the approval phase without good cause.

The draft National Strategic Development Contract would be finalised by each Member State once the financial perspective for the post-2013 period had been agreed. It would then be submitted to the Commission to allow the approval (contracting) process to start. The document would be subject to expert assessment by the Commission.

Where the Commission has major doubts, it could launch an independent ex ante evaluation of all or part of the Contract with a view to (re)assessing the proposed deployment of funding. The Strategic Development Contract would then be agreed between the Commission and Member States (Regions), by the end of 2013. If no agreement were possible for some aspects, the Commission could adopt a part of the Contract (e.g. relating to specific Regions) or adopt it "subject to conditions" such as payment in tranches subject to review (e.g. after three years), or special monitoring/reporting conditions. Regarding the implementation capacity and the institutional framework needed to pursue the core priorities, the Commission could ask the Member State to submit an Implementation Report on some or all of the implementation issues (see below). For the core priorities, Member States (Regions) could be required to shift resources to other fields of intervention.

All the commitments of the Member State (Regions) would be embodied in the Contract, including commitments to Territorial Cooperation. The Contract would specify the role of the Regions (as currently), and Regions would be co-signatories of the Contract wherever required by constitutional, administrative or *de-facto* political arrangements. In order to allow flexibility and capacity of adjustment to external shocks, or to take account of the results of endogenous learning, Member States would have the option to request a revision of the Contract from the third year of the funding period onwards.

The Contract would include one or more Operational Programmes, the number and type of Operational Programmes being determined by the objectives and priorities of intervention and the constitutional/institutional arrangements of Member States (see below). The Operational Programmes would also be adopted by the Commission. The sequencing of Contract and Operational Programme preparation could differ, depending on Member State governance arrangements, but adoption of the two would normally take place at the same time. In the case of small Member States, and/or where small national allocations of EU funding are involved, the Programmes would not necessarily be required.

Content of the Contract

The contract would have a logical structure very different from the current National Strategic Reference Framework. It would begin with the core priorities, objectives and the targets established, and then it would describe how these goals are expected to be achieved, in terms of actions, institutions and methods. This could be brief and pertinent; where relevant background and analytical information had already been covered in the strategic assessment this would not need to be repeated. In particular, unlike the present "contract", it would not have lengthy descriptions of existing weaknesses and potentials.

Specifically, the content required on the ***use of funding*** would encompass:

- the *choice of priorities* (both core and non-core) and the *specific objectives* of the funding, separately for efficiency and social inclusion, for each type of territory (lagging and non-lagging) and their contribution to the objectives of the European Strategic Development Framework;

- *the targets* established for each priority (for the end year and for the intermediate years) both for the indicative "core outcome indicators" specified by the European Strategic Development Framework and for a system of indicators selected at national or regional level according to rigorous requirement[372] and with timely measurement, plus the commitment to a wide accessibility and communication of information on indicators and targets and (for relevant social inclusion actions) to the promotion of community-based indicators at local level;

- the *allocation of funding* by priority for each type of territory, justified with reference to the above objectives and targets and to other territorial development criteria; and the corresponding allocation of funding by management authorities (NUTS 2 Regions and other authorities), appropriately justified; and the amount of national co-financing for each priority;

- a *commitment to the strategy* through which the Member State (Regions) is planning to achieve, for each priority (core and non–core) those objectives and targets; this would be in the form of a narrative (supported with reference to the European Strategic Development Framework and to previous interventions and results) describing: (i) the main typologies of interventions that the Member State (Regions) is planning to finance, with reference to their place-basedness[373]; (ii) the methods for selecting the places where

[372] See for example the requirements for indicators of social inclusion in section IV.2.

[373] The level of detail would vary significantly depending on the type of intervention, since the limits of the information that Member States (Regions) themselves have when launching a new strategy strongly differ according to types of interventions. For example, in the case of major infrastructure (e.g. railways, which might be chosen as the appropriate intervention to improve accessibility), it is likely that achieving the objectives during the period would require a Member State (Region) to have already identified a precise list of projects at the time of Contract preparation. The absence of such a list could suggest that the commitment is not credible. In most other cases, it could be appropriate for the Member State to commit to typologies of intervention. For example, in the case of Innovation a Member State could commit to use

interventions will be concentrated; (iii) the institutional framework in place, or that the Member State (Regions) commits itself to build, for pursuing the priority effectively (only for the core priorities, see pillar 4); (iv) the causal factors/relationships through which the objectives/targets are expected to be met and the expected timing of their achievement;

- a commitment to *financial additionality* and to *policy additionality* (see pillar 5).

Other specific requirements on ***implementation and reporting*** would be as follows:

- *Implementation capacity.* As now, decisions on management and implementation would be the responsibility of the Member State (Regions). The Member State (Regions) would provide evidence that the necessary human resources, skills and structure/system are in place, or will be established for the proposed EU interventions, to enable the strategic management, the generation and selection of projects, control, monitoring and evaluation of funding according to sound management principles, norms and standards and to deliver the proposed outcomes[374].

- *Partnership.* The Member State would describe how the partnership principle has been applied in the development of the strategy and decisions on the allocation of EU funding, as well as how will be applied in the implementation of the contract[375]. A particular emphasis would be put on how managing authorities are planning to promote at local level experimentalism and mobilisation (pillar 6), and to create the appropriate balance between encouraging local actors' commitment and discouraging rent-seeking.

- *Reporting and evaluation.* The Member State (Regions) would commit to a single system of reporting to the Commission, based on annual reports to the Commission on progress in meeting the outcomes (see below). The Member State (Regions) would also commit to the design and implementation of a system of evaluation, utilising prospective impact evaluation whenever possible (pillar 7).

This structure allows an appropriate application of the principles of proportionality and diversification. The number and range of targets, the detail of the ex ante assessment, and the amount of information required on implementation capacity, partnership and reporting and evaluation, would be related to the size of the financial allocations. The commitments to institutional changes would take into account the starting conditions of different Member States and Regions.

Operational Programmes

The Operational Programmes would explain how the general strategy is based on, or adapted to, the specific needs and potentials of specific places and regions in line with existing Member State institutional arrangements. For example, in Member States with federal or devolved structures, the Programmes would provide the building blocks for the Contract. As in the current period, therefore, Operational Programmes would be drawn up for the main areas of policy intervention in lagging and non-lagging Regions and adopted as described above.

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typologies of incentive mechanisms such as those outlined in section IV.3.1. On these issues see, for example, the Report Working Papers by Casavola, P. (2009) and Bonaccorsi, A. (2009).

[374] Specific EU management and implementation processes would only need to be in place where national institutional arrangements are weak or undeveloped.

[375] In line with the policy concept of this Report, Member States (Regions) will describe here the methods that they are planning to adopt in order to ensure that their interventions will actually elicit at local level the knowledge and the preferences of local actors, a condition for tailoring them to specific contexts.

As in the case of the Contract, Operational Programmes would move from a clear-cut description of core priorities and objectives and then move to the strategy to achieve them. In particular, they would specify: the objectives/targets of each of the priorities; the allocation of funding to all priorities, and the main criteria for allocating funding to places/regions; the main typologies of interventions, with an emphasis on their place-basedness; a narrative on how the interventions will achieve targets, and the timescales for these to come about. On the issues of implementation, institutional capacity, partnership, reporting, robustness of the indicator system, and on impact evaluation, the Operational Programmes would be simply commit to follow the commitments of the overall Contract. Again, the level of detail required would be proportionate to the scale of EU funding involved.

Operational Programmes could be drawn up at the level of administrative Regions or at national level, as is currently the case. However, reflecting the requirement for "policy additionality" below (pillar 5), it is anticipated that regional Operational Programmes would not necessarily be restricted to the boundaries of administrative Regions. For example, promoting innovation through cluster strategies might warrant a Programme for two or more neighbouring regions to ensure a critical mass of research centres, universities and firms; and addressing environmental hazards could require a new or distinctive geographical approach. In the context of an appropriate definition of places, endogenous to the policy process (as required by the territorial dimension of cohesion policy) – and of the need to think afresh about the development needs of peripheral, mountainous or island areas – and with reference to the spatial strategies that some countries/regions have drawn up, new territorial boundaries as a basis for the Programmes might also be considered.

Administrative and institutional implementation: the Commission's assessment would be proportionate, differentiated and focused on the capacity to produce results.

When the Contract is adopted, the Commission would have the option of asking Member States to submit an Implementation Report demonstrating that the capacity and the institutional framework for the core priorities exist to implement the chosen interventions effectively. This Report would cover those aspects of the implementation capacity where the Commission had concerns which were not resolved during the adoption of the Contract. The Report would certainly be required in cases where the institutional framework for a core priority was not in place and a commitment needed to be given for its future construction. The key feature of the Implementation Report would be a focus on performance, rather than formal compliance with detailed prescriptions, i.e. demonstrating that the human resources, skills and administrative structure/systems are in place for the implementation of the Contract.

In cases where, on the basis of the Report, the Commission still has concerns about implementation capacity – based for example on a lack of Member State experience with implementing certain interventions, previous problems with implementing the Funds, or other known administrative or institutional deficiencies in the Member State – the Commission would undertake its own Implementation Assessment. This assessment would focus on specific areas of intervention (e.g. certain priorities, particular implementing bodies) or on the administrative capacity for a programme or the Funds in the Member State as a whole. In such cases, the Commission would assess the adequacy/quality of Member State implementation structures and processes (the mechanisms implemented for selecting projects; effective financial management, control and audit; reporting; monitoring; evaluation). For the core priorities, the assessment (if required) would extend to the national (or regional) institutional framework to which the Member State had committed itself in the Contract for tackling each priority (point d-iii; see pillar 4). Existing provisions by which the Commission is currently required to give specific approval, in the absence of on-the-ground information, would not be a standard obligation[376].

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[376] A relevant example is the system concerning "major projects" (projects whose total cost exceeds €25 million for environment and €50 million in other fields), which Member States currently have to submit to

The Commission's approach to this task would be differentiated. The content of the Member State's Implementation Report and the extent of the Implementation Assessment (if required) would be proportional to the level of EU resources, the degree to which public management principles and administrative norms/standards are already applied in the Member State for domestic policy interventions, and the experiences with administrative capacity for managing cohesion policy in the current period.

Where the Commission deemed the implementation capacity to be satisfactory – either at the time of adopting the Contract or subsequently following the Implementation Report/Assessment - a "contract of confidence" (applied to assurance of the methodology and quality of audit in the 2000-06 period) would be applied to the whole of the implementation system and agreed between the Commission and a Member State. Minor weaknesses would lead to a provisional contract of confidence subject to deficiencies being addressed within a specified time period. Major deficiencies would require an action plan to be implemented by the Member State (overseen by the Commission), with funding potentially having to be shifted to other priorities, and some or (at worst) all funding delayed/phased until deficiencies are addressed. In certain cases, the Commission could require approval or oversight of major projects or a "special purpose body" (e.g. administrative agency) to be established operating at arm's length from Member State government bodies with responsibility for specified management or implementation tasks.

Reporting: a tool, focussed on results, to promote a high-level political debate.

A periodic review of progress would play a central role, coupled with the other proposals of this Report, in raising the quality of EU-wide public and political debate on the results of cohesion policy.

Every year, after the third year, each Member State would prepare a brief, unified *Strategic report on results*, presenting the results so far achieved compared to the objectives and targets established in the contract. The emphasis on indicators, results and the comparison with targets would mark a difference from previous and current experiences (the "Strategic Reports" for years 2010 and 2013). Variation of outcomes in relation to targets would be explained/justified. A synthesis would be provided (with appropriate accessible references) of the on-going activity of prospective impact evaluation (pillar 7). The report would also include: information on the implementation of financial and policy additionality, including a brief description of the most innovative interventions or methodologies; and a web-site reference for the outcome indicators data-base; brief assessment of the main obstacles and risks of the strategy.

The Commission would ensure the translation of each Report into the working languages of the Union. On each Report the Commission would prepare a brief *Opinion*; it would also prepare a general *Summary Report*. The country Reports, the Opinions and the Summary Report would represent the basis for the high-level political debate both in the European Parliament and in the Council discussed under pillar 10.

V.4. A strengthened governance for the core priorities

The core priorities play a very important role in the revised architecture. They would: absorb a large share of the funds; catalyse much of the focus on results; be supported by Territorial Cooperation; and be a focus for strengthened Commission support. Both in the strategic planning process and in the Contract described in the previous section, core priorities are given privileged attention and are subject to strengthened conditionalities. It is useful to collate and describe these aspects.

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the Commission for approval. This kind of provision would only be required where the Commission has concerns about the quality of management and implementation (see below).

Appropriate institutional framework: a critical factor for the governance of the core priorities is to ensure that the adequate institutional framework is in place for Member States to meet their objectives.

They would also explain how the Member State (Regions) was planning to finance the public goods and services promoted by the EU-funded interventions after the EU funding ends.

The strengthened governance first emphasises the importance of Member States (Regions) having in place (or making a commitment to) the appropriate institutional framework for EU funds to be spent effectively (see point d-iii of the Contract). Apart from the required implementation system (which is the concern of the Implementation Report), support for each core priority would require that each Member State (Region) has in place or develops, where necessary, an institutional framework suitable for pursuing that priority. On the basis of international experience, the Commission would set out principles in the European Strategic Development Framework (pillar 2) in the form of principles on institutional conditions for each of the priorities.

Member States (Regions) would be required to argue ex-ante in the Contract (and/or in the Operational Programmes), for each core priority, how the institutional framework relevant for the implementation of the priority meets these principles. The discussion with a Commission "core priority task-force" (pillar 8) would represent a significant part of the negotiation for the agreement on the Contract. In extreme cases, if no agreement were to be achieved on a given priority, Member States (Regions) might be required to shift the allocation of funds to other priorities. The principles would also be used by the Commission for its implementation assessment within one year of the Contract, analysing the adequacy of Member State institutional frameworks for implementing the core priorities, and for working with Member State authorities eventually to identify the adjustments to be made.

The institutional capacity for implementing the core priorities would be the subject of specific and critical attention as part of the process of agreeing a "contract of confidence". It is particularly with respect to the core priorities that the above-mentioned steps for addressing identified deficiencies would be employed, notably a requirement for them to be rectified within specific time periods, the imposition of conditions on the provision of funding, or – in extreme cases – the requirement for special management arrangements to be put in places or funding to be shifted to other priorities.

Experience and evaluation evidence show that it is weaknesses of the institutional framework which are often responsible for the failure of interventions to be effective. There is, of course, no general de-contextualised recipe on how to design "best practice" institutions: "best-practice institutions are, almost by definition, non-contextual and do not take into account … complications"[377]. It would therefore be highly inappropriate for the EU level to decide what the institutions relevant for each priority should look like in a particular Member State. Nevertheless, international debate and EU methods, such as experience under the Open Method of Coordination, have brought about a degree of consensus in most fields on some general principles to be followed for institutions to implement certain policies. These principles often allow the exclusion of solutions that have failed repeatedly, the comparison of alternative solutions, and the focus of policy effort on relevant issues, and they are continuously renewed through the experience emerging from implementation[378].

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[377] Rodrik, D. (2008b). "Complications" are defined as the effects that any institution has on development constraints other than those they directly addressed: for example, strengthening judicial enforcement – a seemingly uncontroversial and oft-advocated institutional requirement for any policy or for the market to be successful - can undermine relational contracts based on trust and repeated interaction.

[378] As an example, the principles developed by the OECD and progressively updated on "what institutions make schools successful", represent an example of these broad principles. They can still be questioned, and appropriately so, as reflecting one cultural model, one typology of context, more than another, but they

This is the role that the principles agreed in the Strategic Framework would be asked to play, and the Commission would be entrusted with the responsibility of vouching for their operationalisation. In order to play this enhanced role, the Commission would need to undergo the reorganisation and investment in human resources outlined under pillar 8.

Focus on targets and performance: the core priorities should be subject to performance monitoring – separate from evaluation – to track their progress in meeting targets.

A second set of strengthened conditionalities would enhance the ex ante focus on targets and the ex post verification of performance, an area where cohesion policy has proved so far to be particularly weak.

The performance management system proposed here – using outcome indicators and targets - has a central but limited purpose: to ensure more focus on the objectives chosen by policy-makers in their support of the core priorities. A concentration of the policy debate on targets can create a strong motivation for policy-makers (both officials and politicians) to provide a reasonable and accurate narrative on why and how targets were achieved, missed or exceeded.

The proposals should not be confused with the evaluation of impact (addressed under pillar 7). As the review of international and European experience has noted (see section I.4), outcome indicators cannot measure policy impact, as they cannot identify causal factors: they simply measure what happened to the objectives *while* policy was being implemented. Nor can they be used to evaluate/stigmatise those who manage the interventions, as their performance is only one of the many determinants of results. Further, an exclusive, automatic focus on one particular indicator (as a measure of the "success" of an objective) can have distorting effects by diverting public attention or policy action away from other relevant dimensions of the objective.

It is also evident that the use of target-based financial incentives must be used with great care. This high-stake use of targets is suitable in specific contexts when the targets concern outcomes that are the direct result of identifiable cohesion policy interventions. However, even here, they may have unintended consequences or perverse effects. In most other cases, where outcomes are influenced by several factors, largely outwith the control of policy-makers, the incentive can produce considerable bias and/or may induce great prudence on the part of policy-makers in setting targets. Equally, experience shows that in, some cases, the effects can be positive and can induce a better selection of projects – even in the case of innovation, where the incompleteness of information is very high (see section IV.3.1)[379].

Therefore, the solution lies in not imposing any EU-wide financial incentives linked to targets, but in promoting the verification of results for the core priorities in the following ways.

- Creating for the core priorities a *high-standard system of indicators and targets* and an indicator data-base, fully accessible by the public. This would exploit the extensive knowledge accumulated in previous EU policy practices (especially in the context of the Open Method of Coordination) – for the objective of social inclusion, see section IV.2).

- Promoting (starting with the work of the proposed Policy Group) an intensive *exchange of experience* between the cohesion policy community, other policy communities and the

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have a powerful capacity: not to recommend (generally) best practices, but to engineer powerfully an active public debate on alternative ways: to deal with a by-now-agreed set of institutional issues; to promote public action and comparability across seemingly incomparable contexts; and to be continuously enriched by this debate. It should be noted, with reference to the proposals made in Section V.7, that all this is possible thanks to a strong investment in human resources and the high credibility acquired internationally by the task-force which runs it.

[379] See the Report Working Paper by Bonaccorsi, A. annexed to this Report.

academic community on the use of financial incentives. It would include creating a "clearing house" in the Commission for documentation on all the most relevant experiences.

- Encouraging Member States (Regions) to adopt cautiously and voluntarily *systems of sanctions/rewards* linked to targets. This would include the provision of advice and technical assistance on their construction and use, and allowing – as in the present Regulation - the creation of a performance reserve (of three percent of the total allocation) for this purpose as part of the contract[380].

- Promoting a *public debate* at all levels on the targets and progress. This could be through: the publication by the Commission of multi-language annual "*Indicators and targets survey*", clearly presenting the core indicators and those chosen by Member States, as well as baselines and target values; publication of the progress made for the main indicators in the annual reports submitted for discussion to the EU level (see pillar 10); and (from the third year onwards) an annual "*scoreboard of progress"* to allow some basic ranking of Member States (Regions) in meeting targets.

- *Evaluating lack of performance*. When targets for the core priorities are not being met and cannot be justified on the basis of unforeseen external circumstances or of convincing arguments (concerning, as is often the case, an overestimation of policy effectiveness), an in-depth performance assessment/evaluation would be undertaken by the Commission together with the Member State to identify problems and find solutions. Where the Member State resists either the evaluation or implementing recommendations, financial penalties would accrue (up to the suspension of payments). This decision would later be assessed by the permanent Council set according to pillar 10.

V.5. Promoting additional, innovative and flexible spending

The effectiveness of financial additionality: the financial additionality requirement should be strengthened and simplified, by extending it to all funds, linking it to the Stability and Growth pact, making it more accountable, and abolishing automatic sanctions.

The existing requirement that cohesion policy expenditure should not replace domestic expenditure - that it should rather be "additional" - can help in preventing the improper use of the EU intervention and increase the opportunity for the policy to make an identifiable contribution. By committing a Member State to announce publicly the domestic public expenditure that the country would have realised if no EU assistance had taken place, and to monitor the actual implementation of spending net of cohesion policy funds, additionality should have two positive effects. On the one hand, it should help prevent Member States from using the inflows of public funds to reduce domestic public expenditure and taxation, turning the EU intervention into a tool for unchecked tax competition with other Member States. On the other hand, it should increase the scope for the EU budget actually to increase the amount of resources at the disposal of the targeted areas.

This Report supports the additionality requirement, but, in view of the serious limits discussed in section II.4, argues that its effectiveness should be strongly increased through some key changes inspired by the following principles:

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[380] This would exert a moral suasion for the adoption of such systems in cases where the effects on outcomes are relatively traceable (and less distorting). It could be of benefit for those countries or regions where the weakness of the public debate and of the mobilisation of local actors inhibits other, "softer" ways of focusing the efforts of administrators on objectives. The adoption of such systems of incentives could facilitate Commission to agreement on a "contract of confidence" after the implementation assessment.

- more transparency and accountability (by building on the improvements made in the current period);
- exclusion of any automatic sanction, a discretionary sanction being foreseen only in a special circumstance;
- introduction of an explicit linkage with the Stability and Growth Pact;
- extension of the requirement to all funds and foci of cohesion policy;
- annual public information and motivation of any divergence.

The aim of the proposed new system is to ensure high visibility and intense debate both at the moment of fixing the ex-ante targets and during implementation. This would be achieved by making the procedure simpler, giving less room for arbitrary measurements and establishing a strong linkage with macroeconomic issues.

The first step would be to eliminate any reference, even only "as a general rule", to past expenditure – currently, the "average annual expenditure in real terms attained during the previous programming period" (Regulation 1083/2006, art 15/3) – as a way of establishing a floor for the level of expenditure in the programme period. Gross fixed capital formation (which is the major part of the expenditure financed by cohesion policy) changes significantly both with the short-term cycle and with long-term structural cycles, and what is "adequate" or "inadequate" can be decided only case by case. Any automatic threshold can either be too low or too high. Given the complexity of current measurement procedures, the adoption of an automatic threshold creates an incentive to use the discretion of interpretation as a way of adjusting to problems. A better solution is to increase the verifiability of the variable used for the additionality target and to rely on domestic public opinion as a check on its meaningfulness.

Second, through changes of Regulations and/or through the interpretation of existing ones, a clear link should be established between the information provided by Member States in their Stability Programmes according to Council Regulation 1466/97 on the Stability and Growth Pact (section 2) and the information on additionality provided according to the cohesion policy regulation. At the moment, the Stability Programmes must report, together with the medium-term objective for the budgetary position, "variables which are relevant for the stability programme such as government investment expenditure …" (Art. 2, letter b). Public expenditure eligible under cohesion policy includes basically all items which in the current national accounts are part of "gross capital formation", plus some current public expenditure relative to human capital. The first variable refers to the country as a whole; the latter to the macro-area targeted by cohesion policy[381]. By working on both definitions, and possibly extending the proviso of the 1466/97 Regulation (to add a breakdown of gross capital formation) and/or accepting (for the additionality rule) the reference to a subset only of the cohesion policy expenditure, a way can be found to make sure that the commitment to additionality undertaken by the Member State as part of its commitment to stability (for the period in which they overlap)[382].

The proposal is self-evident. Public investments simultaneously play a dual role: they worsen the accounts; and they increase the resources for development policy. Thereby, they influence two distinct "pacts" that Member States have with the Union. The trade-off between the two opposite aims should be accountable and publicly debated. This is the best guarantee for cohesion policy

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[381] A further issue is represented by the definition of "public" used in the two systems: the boundaries of public sector used in the cohesion policy framework are now broader than the concept of "general government" used in the stability framework. But work is now being done at Eurostat for establishing an agreed list of "public entities" and broadening the concept used in the stability context.

[382] Every Member State would also release information on the list of institutional units used to define the "public sector" and on the items used to produce its estimates.

that the targets for additionality are set appropriately and that adequate pressure from all sides is exerted on their achievement. This is also why – in a third step – any automatic sanction for the failure to achieve the targets should be eliminated (see below). The main sanction is the political one that policy-makers risk in the domestic political market.

A further advantage of this revised mode of application is that it can be used regardless of the size of the cohesion policy contribution. Even when this contribution amounts to a very small share of total capital public expenditure per-capita– say around 5 per cent, as is the case in many non-lagging Regions – it is still useful and feasible to make an additionality commitment. Therefore, the Report strongly recommends, as a fourth point, to extend the proviso to all funds and types of territory, i.e. also to lagging countries and non-lagging regions.

Finally, coherent with the annual information for the Stability Pact, Member States would provide annual information on the implementation of the financial additionality commitment in their cohesion policy reporting (see below). In the report, Member States would justify any divergence of the actual additionality from the target level. In particular, if there were to be a persistent (two consecutive years) negative gap, Member States would need to show that the gap was not the result of a country reconciling an intentional reduction in taxation with respecting the Stability and Growth Pact ceilings. If a Member State failed to provide an adequate justification, a procedure for financial sanctions would have to be in place as a last resort, potentially via the Committee proposed under pillar 10.

The present possibility of formally revising the additionality commitment in the fourth year "if the economic situation in the Member State concerned has significantly changed" would be maintained, by making sure that full information is circulated on this decision and on its motivations, so as to exclude the above circumstances from being considered acceptable.

Policy additionality: Member States should be encouraged to use the funds in ways which justify the rationale for the EU to run this policy – adding value - and the need to be innovative.

The degree of "policy additionality" of cohesion policy is not given significant weight under the current approach. The DG REGIO guidance on ex-ante evaluation provides criteria for defining added value, and ex-ante evaluations are required to look at Community added value for all programmes. However, this does not appear to have been accorded much attention in many ex-ante evaluation reports, which restrict themselves to weakly substantiated assertions or a restatement of expected outcomes.

Several of this Report's proposals - the emphasis on objectives, the concentration on core priorities, the strengthening of the conceptual model, the stress placed on the EU contribution to a place-based approach – should provide an opportunity for Member States, Regions and the Commission to focus their attention on whether cohesion policy:

(i) actually embodies the values which justify its existence - sustainability of the Union, additional capacity to deal with interdependencies, additional credibility; and

(ii) is producing the innovations in the policy process as part of the conceptual model discussed in chapter I.

We propose that the National Strategic Development Contract describes how the proposed use of cohesion policy funds will add policy value in these two respects (see pillar 2, proviso e) of the Contract); and that in the annual Strategic Report on results, each Member State (Regions) assesses how the programmes are faring in that respect.

In terms of the rationales for EU cohesion policy (section I.3), examples of policy additionality would be: a measurable change of attitude of EU citizens on the Union's capacity to address their needs (in specific fields or in general) or in the consensus for market integration; addressing

priorities (especially the core ones) that were previously not adequately addressed; avoiding beggar-my-neighbour policies or the exploitation of cross-border interdependencies; and increasing capacity to prevent exogenous interventions in lagging areas from being captured by local rent-seekers.

In terms of place-based policy innovations, examples of policy additionality would be (see also pillars 6 and 7):

- experimentation and piloting of new integrated packages of interventions to respond to inefficiency or social exclusion traps of particular complexity (unused and degrading knowledge base, intense impact of migration, strong climate changes, etc);

- implementing policy interventions using different territorial/place-based approaches, with new or distinctive geographies, such as urban-rural links, city-regions, environmental hazard areas, city networks, inter-region clusters, or other joint/multi-region actions;

- implementing interventions using new or innovative delivery mechanisms (such as financial engineering instruments); or

- the development of innovative or experimental methods for monitoring and evaluation, based on the use of community based indicators and of prospective impact evaluation.

Flexible spending deadlines: the automatic decommitment rule should be retained but at the level of the Member State, to ensure that it does not discourage innovative interventions and projects.

The automatic decommitment rule has a clear advantage. In a multilevel governance system, where decisions often require the agreement of several actors, setting deadlines and linking sanctions to their violation create an incentive for those actors to bring negotiations to a close and/or to be more efficient. But, as noted in section II.4 and as was pointed out in the policy-maker seminars conducted for this Report[383], the rule has led financial absorption being prioritized over project quality, has inhibited innovation and has eroded Commission' credibility in promoting quality.

This Report recommends retention of the decommitment rule but giving Member States the option of applying the rule at the level of the whole Member State (or, alternatively, of macro-areas: the block of lagging regions and the block of non-lagging regions of every country). Within countries, the different authorities managing the funds would be able to adopt different spending strategies, according to (for example) the priorities and capacity of Regions, and the complexity, timescales and innovativeness of projects. This would provide greater flexibility for the system and accommodate different situations and propensity for risk, while retaining the general effect of creating an incentive for efficiency. The Member State would provide an overall coordination function for the financial plans of the different authorities – as in a 'market for credit' where demand and supply must be balanced - so as to ensure both compliance with the overall deadline and an orderly internal system.

National co-financing: the present system of national co-financing should be retained.

The present system of national co-financing, whereby national resources are committed, as a specified proportion of total funding, to the priorities that have been selected for EU assistance (rather than to individual projects), seems appropriate. Although it does not reduce the moral hazard linked to the transfer of funds - as it allows a Member State (Region) to invest its own public resources in projects which are different from those financed with EU funds - it increases

[383] See the Report Seminar Paper.

the coherence of EU and national strategies. Furthermore, co-financing gives adequate flexibility to Member States (Regions). Therefore, we consider that it should be retained in the present form. One of the issues for the proposed Policy Group (see pillar 2) would be to consider, in the light of the selected core priorities, whether the rates of national co-financing should be modified.

V.6. Promoting experimentalism and mobilising local actors

The scope for cohesion policy to promote policy innovation, experimentation and learning should be further exploited.

A place-based approach ultimately relies on the capacity of external interventions to promote (in the target places/regions) a process for eliciting the knowledge and preferences of individuals, facilitating innovative actors and new ideas, and designing projects for the production of public goods and services. As chapter I argued, innovation and overcoming institutional inertia traps are the justifications for a place-based approach. An effort must be made to improve cohesion policy in this direction, where, as chapter II has argued, its potential is under-exploited. More experimentalism is needed, defined as the opportunity to experiment with solutions while exercising mutual monitoring, a greater capacity to promote innovators and to avoid favouring old or new rent-seekers. A better balance must be found between creating an incentive for local actors to reveal information, to risk and to invest, possibly through "special-purpose bodies"[384] (territorial pacts among different local authorities and private partners, networks, local agencies), and being captured by those actors, as the guarantee of a secure flow of resources independent of results can often do[385].

Several proposals made by this Report have the capacity to move in this direction. The focus of a large share of resources on a few core priorities, a sharper definition of objectives with a clear-cut distinction between efficiency and social inclusion, and a strong focus on these objectives consistently pursued by the Commission would facilitate public debate and participation. Of particular use would be an improvement to the system of indicators and targets and the development of modern ways for EU citizens to learn and to be interested about indicators/targets. Additionally, in the contract with the Commission Member States (Regions) would also be asked to commit, whenever feasible, to the promotion, through appropriate financial resources and technical assistance, of community-based indicators selected at local level for specific projects, and usable for monitoring their objectives and results. On the whole, a growing body of international experience shows how effective systems of indicators linked to the policy process can be in focusing administrators and public debate on objectives that actually correspond to people's preferences[386].

A second relevant contribution would come from the commitment of Member States (Regions), in their contract with the Commission, to design appropriate methods for eliciting and aggregating at local level the knowledge and the preferences of local actors, to promote at local level experimentalism and mobilisation and to create the appropriate balance between encouraging local actors' commitment and discouraging rent-seeking. A significant contribution can also come from the improvement of the learning process through prospective impact evaluation described under pillar 7.

An additional factor that can improve the mobilisation of all actors and the emergence of innovators is a greater role and scope of the Commission in pursuing this task. This can be achieved in two ways.

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[384] See section I.4.

[385] On this issue, see also the Report Working Paper by Farole, T., Rodríguez-Pose, A. and Storper, M. (2009).

[386] See the Report Working Paper by Alkire, S. and Sarwar, M. (2009). See also the OECD website OECD.org/progress (section "Knowledge base").

- First, the EU should build on the effectiveness of its previous initiative to reserve a small share of funding to *Innovative territorial actions* under each of the allocations to lagging Region, non-lagging Regions and territorial cooperation. An indicative figure of no less than 0.1 per cent of the overall budget (equivalent to 350 million euro in the current period) should be allocated to this task. These actions would be explicitly designed to develop and experiment with innovative forms of place-based policy intervention which meet the core priorities. The objectives of the innovative actions would be developed collaboratively by the Commission services to promote cross-sectoral thinking (e.g. with the Directorate General for Research, Environment or Education) on issues such as regional innovation systems, integrated regional adaptation to climate change, or methodologies for adult education. Funding would be allocated – without national allocations - on a competitive basis to the "best projects", a key criterion being that practical lessons are generated.

- Second, the opportunity would be given to the Commission (and formally recognised) to exert a more active and direct role in raising public awareness at local level, by organising high-quality workshops and bringing international expertise to places of particular relevance for the core priorities; and by directly organising, in selected places, pilot experimental impact evaluations. The *Regions for Economic Change* initiative could be further developed for the core priorities, by focusing attention also on quantitative results, on their comparability, on a systematic comparison of methodologies for intervention and for assessing impact.

The actual achievement of these changes relies, once again, on a strengthened capacity of the Commission (pillar 8).

Finally, the promotion of experimentalism and of a greater mobilisation of local actors depend on how much both sub-national public institutions and private actors can make their views, assessments and contributions known in an effective way at EU level. Regions already have the opportunity to do so, either as direct interlocutors with the Commission on the Operational Programmes, or through the Committee of Regions, which would play an enhanced role both in the process leading to the European Strategic Development Framework (pillar 2) and in the high-level political process (pillar 10). The opening up of debate on the progress and achievements of the policy should also allow the views of sub-regional public actors and interest groups – such as economic and social partners, NGOs, environmental, voluntary and equality bodies, other representatives of civil society – to be made known.

V.7. Promoting the learning process: a move towards prospective impact evaluation

Prospective impact evaluation should be promoted at Commission and Member State levels as a distinctive tool of cohesion policy, to be designed in tandem with policy design; while improving in the long-term the knowledge on "what works" and "for whom", it can have a relevant disciplinary effect in the short-term.

Cohesion policy has invested significantly in the learning process: in creating networks, facilitating exchange of experience, and promoting evaluation. As chapter II showed, the policy has produced relevant results, but improvements are much-needed in two directions: the capacity to apply lessons must be strengthened; and the failure to develop knowledge on "what works", i.e. on whether interventions are producing effects, and "for whom" must be remedied.

The first of the two steps forward is strongly linked to the key changes discussed in the previous sections. A greater policy focus on core priorities, a streamlined reporting system centred on results, and a strengthened political debate (at local and EU levels), would increase the opportunity for using what has been learnt in policy-making. Through the initiatives discussed in the previous section, the Commission could contribute to this result by promoting the systematic and thorough analysis of experience and their careful use in different contexts. An important contribution would also come from a stronger investment by the Commission in the conceptual

issues relating to the place-based approach and in general to the theories of economic development, on the methodologies for an effective governance and on the empirical analysis of results (see section V.8).

The second step, aimed at understanding the effects produced by specific interventions, requires a dedicated effort. Several improvements can be made in the area of evaluation. The Report has chosen to focus on this one, where a change is particularly needed and significant disciplinary effects can be obtained.

The complex methodological issues which characterise the use of a counterfactual approach in the context of cohesion policy (see section I.4)[387], suggest that the effort to promote impact evaluation as one of the methodological backbones of cohesion policy must at the same time be visionary and humble. Visionary, since it must create the technical, administrative and political momentum for impact evaluation to be actually pursued as an important source of information. Humble, since building this technical capacity requires time, without expectation of a "quick fix" able to provide uncontroversial answers on which parts of cohesion policy are working and where.

Cohesion policy is often about large programmes comprising a mix of interventions; these interventions are often (and should be more often) made up of bundles of different public goods and services; interventions are by definition (or should be) tailored to places. These are difficult conditions for impact evaluation to be performed. It will take several years of trial-and-error in systematically using impact evaluation techniques for a large enough body of results to exist to draw some general conclusions. But, the timescale of cohesion policy is precisely the long term. And, in the meantime, the process of designing and implementing impact evaluation, more than its actual results, can become, place-by-place, an instrument helping, in the context of agents' mobilisation (section V.6), to make policy more focused and knowledge based; i.e. it can have a relevant disciplinary effect.

The experience of several countries and the assessment conducted in preparing the Report (involving international experts, the Evaluation Unit of DG REGIO and evaluators of some Member States)[388] suggests that the promotion of impact evaluation as a central tool of cohesion policy should be centred on the following guidelines.

- *Rigorous separation from the use of indicators.* As we have seen (section I.4), outcome indicators and impact evaluation respond to two radically different tasks: the first represents a tool to focus policymaker and public attention on objectives and to monitor what happened to objective-indicators *while* interventions are being implemented; the latter represents a tool to learn about whether specific interventions have had an effect on a given dimension. Unlike what has happened so far (section II.4), these two functions must not be confused.

- *A focus on counterfactual methods.* Several methodologies exist to estimate impacts. It should be a first task of the cohesion policy evaluation framework not only to ensure room for all appropriate methodologies, but to promote high-level, cross-country, public debate on the conceptual foundations, limits and advantages and applicability of different methodologies. Whenever the conditions exist, "*counterfactual"* methods should be used where the impact of

[387] See also the Report Working Paper by Morton, M.H. (2009).
[388] See the Report Working Paper by Morton, M. (2009), which partly draws on the contributions of Arianna Legovini, Alberto Martini and Robert Walker at the work-shop held on impact evaluation. Proposals also benefit from the hearings conducted by the Commission on "The evaluation of the effects of public policies" (chaired by Alberto Martini and Ugo Trivellato) appointed by the "Consiglio italiano per le Scienze Sociali".

interventions is assessed by comparing what happened to the beneficiaries to what happened to a "sufficiently comparable" group not exposed to the policy (the counterfactual)[389].

- *Prospective impact evaluation.* To facilitate and to make more effective the counterfactual approach, it must be used *prospectively* (designing impact evaluation in tandem with policy design), not retrospectively (designing and conducting it after policy has been designed and implemented). By making explicit the expected results and the linkages between means and ends on which the intervention is based, and by building a strategy for learning about policy effects, impact evaluation can contribute to the extraction of knowledge at local level and to the clear identification of objectives in policy design. Relevant disciplinary effects can in this case be expected in the short term, before the interventions are implemented and the effects are assessed.

- *Experimenting with randomisation.* If the beneficiaries of the intervention are chosen at random among those eligible, impact evaluation is facilitated because what happens to those not exposed credibly approximates to the counterfactual. Although randomisation is not always appropriate or possible, it should not be rejected as an option for cohesion policy interventions and then for their evaluation. Once we take into account how little we know about policy effects, two things become clear. First, true uncertainty exists on whether interventions are beneficial or harmful: being excluded from a (tested) intervention could be an advantage, and no moral problem is involved in limiting interventions to some units or groups randomly selected (see chapter I, Box I.A). Second, cohesion policy, with its long-term perspective and contractual/partnership framework, is a good policy space where randomisation can be experimented, since the requirement of "respect for persons" has more room for being satisfied (see again chapter I, Box I.A). The simultaneous adoption, in different and comparable places, of distinct alternatives is also a practice suitable to the cohesion policy environment.

- *Commission role: clearing house and think tank.* The Commission is needed to play a central role in making impact evaluation a backbone of cohesion policy. While keeping the present arrangements, by which the evaluation responsibility is largely entrusted to Member States (Regions) – which would have to make significant investments in competences to cope with the new task - the Commission would: (a) adjust its guidelines clearly identifying the functions of indicators separately from impact evaluation; (b) promote methodological debate and analytical innovations; (c) promote the use of counterfactual impact evaluation along the lines outlined above and provide technical assistance; (d) conduct pilot studies, possibly with Member States (Regions); and (e) create an EU "clearing house" for collecting, filtering and making accessible the studies performed according to some criteria. These functions could already be tested in the current programming period, developing some preliminary moves made in recent months by DG REGIO (see Box V.A). In order to perform this new role, the Commission would invest in strengthening its in-house evaluation units.

- *Data availability.* The availability of data is often a constraint in the use of impact evaluation. Many of the necessary data could (or can only) be collected in the process of implementing the interventions which they should help evaluating, but they fail to be collected because their need is not identified in time. The prospective use of impact evaluation and the involvement of beneficiaries in its design should help in addressing this limit. But the possibility should also be considered of introducing in the Regulation a proviso that further facilitates this timely decision to collect information. This proviso would not make impact evaluation into a "requirement", to avoid the risk of turning it into a procedural compliance, but it could open up a "window of opportunity" for policy-makers and partners to decide whether to include

[389] As we have seen in section I.4, place-based policies present counterfactual methods with particular challenges that call for a strong analytical effort, a close-knit relationship between policy-makers and experts, and an experimental approach.

into the requirements of the intervention the collection of data for impact evaluation (and which data), or formally to decide not to do it.

V.8. Refocusing and strengthening the role of the Commission as a centre of competence

The specialist knowledge resources and skills of the Commission should be strengthened to allow it to provide more effective support to Member States in policy development and implementation.

Most of the proposals in this Report have major implications for the Commission, and particularly for those Directorates-General with a direct or indirect role in cohesion policy. Some of the functions outlined in the previous sections are (at least in part) similar to present functions; others are new. Overall, the Commission is being called on to play a more ambitious and difficult role than today. This role requires a more coordinated and coherent approach to territorial development issues, a reorganisation of its engagement with Member States, as well as the specialised human resources and the capacity to be highly credible both as a tough contract partner and as a think tank. If the Commission were to fail in this role, the effectiveness and feasibility of most proposals would be compromised. The architecture proposed by this Report would not hold. A strong political compromise is required to strengthen the role of the Commission, a task which is technically feasible.

First, as part of the strategic planning process for the proposed European Strategic Development Framework (pillar 2), it is important for the Commission to strengthen its internal coordination in establishing priorities and ensuring the coherence of relevant policies and interventions. There are two Directorates that already have responsibility for cohesion policy (DG REGIO and DG EMPL), two others whose territorial development support should be brought within the cohesion policy framework (DG AGRI – with respect to the rural development support, and DG MARE – for the territorial actions of the Fisheries Fund) and several other Directorates whose intervention have a strong territorial impact. The Report proposes that a strong, high-level inter-services group, chaired by the Secretary-General, should ensure tighter coordination in both the strategic design and implementation of territorial development policies run by different Directorates. This is a pre-requisite for an appropriate implementation of the enhanced territorial dimension of cohesion.

Second, at operational level, the Commission needs to consider how best to address the concerns of Member States regarding "administrative compartmentalisation" on issues which require an integrated (or at least coordinated) approach: this is a condition for the Commission to deal appropriately with Member States own tendency to compartmentalise. Core priorities relating to issues such as innovation or migration cut across the responsibilities of several Directorates; there are also "horizontal" policies in areas like State aids or environmental regulation which are influential for the operation of cohesion policy. Although inter-services cooperation already takes place, the Commission needs to review its organisational structure to facilitate better integrated or cooperative working. A related challenge is how to ensure more coordination and cooperation between the geographical units of different Directorates, not only for the purposes of information sharing but also to enable a more coherent administrative approach to working with Member State authorities.

Third, and most important, the complex skills required by the more strategic and enhanced role proposed for the Commission in this Report, including some highly specialised ones (relating to the core priorities, indicators and targets, impact evaluation, etc) can be appreciated by briefly reviewing some of the key functions entrusted to the Commission:

- first mover in the strategic debate, development of a conceptual framework, open dialogue with academia and Member States experts;

- preparation of the European Strategic Development Framework, including an outline of the institutional principles and the choice of EU-wide core targets;

- provision of strategic advice to Member States in drafting the Strategic Development Contracts, and Operational Programmes, especially on the core priorities;

- negotiation of the Strategic Development Contracts, especially on the core priorities (indicators, targets, institutional requirements);

- implementation assessments; agreement on contracts of confidence; oversight of special management conditions; advice and support for administration capacity- building, especially in the creation/development of management and implementation processes;

- evaluation – especially development of impact evaluation;

- selection of the core indicators, advice and monitoring on the quality of the overall indicator system, preparation of the indicators and targets survey; progress scoreboard; assessment of Member States results;

- knowledge brokerage – facilitating policy learning between countries/regions;

- promoter of experimental approach and innovative methodologies for the mobilisation of actors at local level; and

- direct management of Innovative territorial actions.

It is beyond the task of this Report to assess what changes should be implemented in the relevant Directorates-General of the Commission in order to meet these challenges. However, with reference to DG REGIO, which has an overall responsibility for the policy, some broad lines of action are outlined for future discussion in Box V.B. Particular stress is placed on the establishment of high-level, specialist task forces (with officials belonging to different Directorates) for the core priorities: teams of about 20 experts dedicated full-time to activities related to the core priorities, strongly interacting with the geographical units in charge of negotiation. For this purpose and for the others a major investment in human resources is required, accompanied by changes in the internal organisation of the Directorate. If the course of action envisaged by the Report were to be adopted, these changes should be launched in 2010, since their effects require time to materialise.

Box V.B: Indicative developments in the human resources and the organisation of DG REGIO to play the role of a 'centre of competence'

- *Establishment of specialist task-forces for the core priorities* – highly qualified experts in the core priorities (for example in innovation, or migration).with expertise on policy, measurement, institutions, etc, and a capacity to tailor the analysis to specific contexts: due to the different thematic issues involved in every core priority (for example, in the case of migration, together with regional and social affairs relations with countries outside the EU, education, health, etc.), the experts should belong to different directorates (for example, in the case of migration, together with the Directorate for Regional policy and for Employment and Social Services, also those for External Relations, Education and Culture, Health).

- *Induction training of staff* in the concepts of place-based development, the specialist themes/priorities of the policy, the different regional policy systems/contexts in Member States and regions, the theory and use of indicators/targets/incentives.

- *Upgrading of the evaluation department* to enable a more intensive programme of evaluation, especially with respect to the core priorities, to build the clearing-house for impact evaluation studies, and to put at the disposal of Member States a think-tank on impact evaluation.

- *Creation of administration support teams* – with expertise in public administration (management/implementation processes of the policy) to undertake implementation appraisals and provide support to Member State administrations, if necessary through the co-management of interventions targeting the core priorities.

- *Upgrading of the knowledge/skills of geographical units* – 'country executives' with in-depth knowledge of the countries/regions, policies, institutional structures i.e. capable of being highly informed interlocutors and as well as intermediation with Member States.

- *Integrated organisational structure/mechanisms* – to ensure that the task-forces for core priorities and the administration support teams work closely together with geographical units, both within the Directorate-General and with other Directorates-General.

- *Creation of a research department* with the remit of establishing a permanent bridge with academics and policy researchers internationally, especially in the themes of economic and social development, regional/spatial/urban/rural/place-based policies, being updated on theoretical and empirical advances, producing original research and commissioning some, investing in gaps of relevance to the Directorate, providing continuous briefing to Directorate staff and disseminating information.

Significant systemic changes of the kind envisaged in this Report, will require a similar commitment from the Member States and Regions. The organisation of policy responsibilities in the Commission often mirrors the institutional arrangements (and associated coordination barriers) at Member State level. Similarly, the deficits in knowledge and skills identified here – especially with respect to complex policy challenges and integrated development - are also evident at Member State level. The investments in skills to be made at Member State and Region level represent a further reason why the reform presented in this Report can succeed only if it is a result of a high political compromise where Member States and Regions play a committed and substantive role.

V.9. Addressing financial management and control

Greater effectiveness and lower costs of the regulatory, control system is a critical component of a more effective governance of the policy.

Regularity in the disbursement of EU financial resources represents one of the requisites of cohesion policy performance. This involves reducing financial errors to a "minimum", including both errors directly affecting the amount to be paid and those that could lead to this result.

As shown by Section II.4, the costs borne by the Commission and by Member States (in terms of administrative burden and uncertainty) do not seem to prevent today a high intensity of errors, as assessed by the European Court of Auditors (Court). Furthermore, the estimates of high errors tend to become, in the absence of adequate analysis of performance and results, the main quantitative information available for debate in the European Parliament and among the public. They raise doubts about the effectiveness of cohesion policy, and they put at risk the budgetary discharge procedure. The Commission, holding ultimate responsibility for the correct use of the funds, comes under recurring and increasing pressure. Dealing with this pressure, the enhanced supervisory role, and the need to assess Member State compliance with the rules, puts a strain on the available human resources and crowds out the time, the capacity and the incentive for the Commission's Directorates to deal with strategic tasks and with the monitoring of policy performance.

Improvements might come from the new rules on the regulatory control system introduced for the current programme period, whereby Member States are entrusted with further responsibility to

ensure its proper operation by delivering a formal annual audit assurance[390]. The issue of how to further improve the present arrangements is also the subject of several proposals by Member States and the object of analysis by Commission services on the basis of the work of an ad hoc group of the Commission and Member States.

It goes beyond the remit of this Report to present proposals on this issue. However, it is important to emphasise that the key changes proposed by this Report assume a solution of the problem. In particular, they assume that the administrative audit costs of the Directorates-General in charge of cohesion policy will be either reduced enough, or will be considered as extra costs to be borne by the Commission as a whole, so as to allow adequate resources to be freed up in those Directorates to create room for the core priority task-forces and the other important investments in human resources. In this context, it is appropriate to review briefly the main proposals being put forward.

Some proposals refer to what are probably the two main causes of the combination of high marginal costs of control and high errors. First, cohesion policy, due to the Commission's ultimate responsibility, represents the most important case in which the Commission (and the Court) have the opportunity systematically to audit expenditure by Member States: cohesion policy ends up being the "filter" through which a general failure of Member States to comply with EU Directives – for example, on procurement or the environment – comes to light. Second, multilevel governance, due to the multiplicity of rules and "contracts", and to shared management, and, in the case of cohesion policy, to the multiplicity of control levels, is bound to increase the opportunity for uncertainty on the appropriate interpretation of rules and thereby for errors.

The first problem explains the request by some Member States for the control system of cohesion policy not to become the occasion for addressing failures which have to do with other, horizontal policies of the Commission. However, one cannot expect the Commission to "look away" when encountering breaches of Directives. As for the second problem - shared management – it is currently being addressed at EU level through an Inter-institutional debate with the Council, Parliament and the Court of Auditors, initiated in December 2008 by the Commission proposal to *raise the tolerable risk of error* (now at 2 per cent)[391]. The proposal builds on the Court of Auditors 2004 Opinion that "Any control System is a trade-off between the cost of operating the defined intensity of checks on the one hand, and the benefit these procedures bring on the other. In the Community context, the benefit involves reducing the risk that funds are wasted and containing the risk of error to a tolerable level. It is likely that the level of tolerable error or irregularity would vary between different budgetary areas, depending on both the cost of controls as well as the inherent risk of transactions containing errors or irregularities". A methodology is then proposed to choose the "tolerable risk of error" as a value lying between "the current error rate, as adjusted to take into account of possible improvements [at limited or no significant additional cost] in existing controls" and the "theoretical tolerable risk point", an estimate based on Member States data of the point at which the marginal cost of control equals the marginal benefit.

An example is presented in the Commission proposal for the Regional fund (ERDF). The adjusted current error rate is estimated at 9 per cent (down from 11 per cent), while the theoretical tolerable risk point is estimated at 4 per cent: the latter would require an annual cost of control of about 1 billion euro, or 3.5 per cent of total cohesion policy expenditure (compared to the current 0.7 per cent figure). In order to account for this very high (theoretical) increase in control costs, the intermediate value for the actual yearly "tolerable risk" is suggested at "around 5 per cent". An additional option, specific to the multi-annual nature of cohesion policy expenditure, would be to put the yearly tolerable value at a higher level: annual interim payments

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[390] First data on the effects of these changes will become available in 2010.
[391] See Commission of the European Communities (2008g).

are in effect provisional and become definite at closure when the final amount of the Community contribution to the policy is determined and when all control processes for the detection and removal of errors have had a chance to operate, thus reducing the residual error rate. The tolerable risk of error might therefore be higher for the interim payments than for final payment.

Other proposals are also being made to address the control issue. One proposal begins with the observation that the emphasis on financial irregularities distracts attention from the issue of performance, and it suggests a radically new system whereby reimbursement would take place on the basis of the achievement of agreed *outputs*, rather than of the proof of some costs. Once the delivery of the output had been confirmed, the agreed amount of public funding would be paid out without the need to audit the actual costs of the project. In fact, no improvements could be expected from this proposal, which shifts the control function to a far more complex requirement for evidence: that the 'agreed output' has actually been delivered[392]. This would also leave open the need to audit compliance with Directives (procurement, etc.). The objective of making cohesion policy more results-oriented must not overlap (as section I.4 made clear) with the problem of ensuring efficient and regular policy implementation. The first of these two objectives must be dealt with by improvements to the indicator and target system and by a strong investment in impact evaluation (see pillars 3, 4 and 7).

Some room for improvement could come from various proposals on *simplification*. In particular, a limited effect, for small projects and relative to certain types of costs (overheads etc.), can come from a greater use of *flat rates* or lump sums for particular types or items of expenditure[393]. Improvement could also come, according to some proposals, by avoiding the tendency of "reinterpreting" past rules in the light of clarifications which have been brought about by new rules: this is relevant since several programme periods, with different rules, always overlap at any point in time. More doubtful is that any significant contribution could come from a further decentralisation of eligibility rules. The other hypothesis, to replace national and regional rules with a limited set of eligibility rules at EU level (advanced for Territorial Cooperation) needs to be considered from a legal point of view. Room for further application of proportionality has also been suggested.

Two further proposals are directly aimed at creating an *incentive* for Member States to make the control system more efficient and at *reducing their audit costs*. Currently, payment claims are normally settled at the end of the seven-year period. Therefore, in the early years of a programme period, Member States do not have an incentive to be concerned about the effectiveness of their control system. It is suggested that an annual system of error rates could be introduced, exactly matching the Court's approach, by which transfers to Member States are withheld if a threshold is passed. This would require the annual error rate to be broken down by Member States and the threshold to be agreed. The second proposal has to do with the fact that currently, due to various provisions, a share of cohesion policy projects is compulsory audited by Member States that exceeds the share for national projects. A cap could be put on the share of funds or projects audited.

If, as could be the case, it became clear that a coherent combination of the above proposals (considered to be feasible and effective) were not to produce the desired effect on both the administrative costs of auditing and its effectiveness, some further, more general solution should be considered. In particular, if the EU maintains the position that – as the Court observed in its 2006 Annual Report – "national declarations that systems are functioning as required by EU regulations may not in itself provide assurance about the legality and regularity of the transactions concerned", and if the consolidated interpretation of the new Treaty did not make it possible for Member States to have an enhanced responsibility for control, a way would need to

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[392] Standard costs of output would have to be defined, running into problems of price differences across places, and, even more so (for the majority of public investments), of defining quality-equivalent "output".
[393] This is included in the current proposal for modifying the 2007-2013 ERDF and ESF regulations.

be found to reduce or to account appropriately for[394] the administrative audit costs of the Directorates responsible for cohesion policy.

V.10. Reinforcing the high-level political system of checks and balances

A high-level political and policy debate on cohesion policy, through an appropriate Council configuration, is required to drive the strategic direction and performance of the policy.

Cohesion policy is by far the largest development policy of the EU. It is also of great financial and strategic relevance by international standards. As the Report has shown, the development policy of the United States pursues similar efficiency and equity objectives although with a different approach and larger scale than the EU policy approach, but it is not governed by a distinctive strategic framework and its management in Washington is not as concentrated as in Brussels. By comparison, the EU-wide political debate on cohesion policy appears absolutely inadequate and largely limited to the policy community that deals with it: administrators, beneficiaries, Ministers, and numerous experts.

Except at the time of budget negotiations, when a strong, political EU-wide interest arises, largely concentrated on financial issues, the bridges between the cohesion policy community and "the rest of the world" are tenuous. The linkage with the Lisbon Agenda tends to be mostly formal, while no linkage exists (except for the Cohesion Fund) with the Stability and Growth Pact. Similarly, the conceptual and methodological advances made in the realm of the Open Method of Coordination are often not transferred to cohesion policy. The policy does play a role in the recent European Economy Recovery Plan; it also plays a part in important debates taking place on sectoral issues, but exclusively as a source of funding, as cohesion policy is the main (sometimes the only) EU financing available. What is lacking is a debate about whether a particular way of "spending public funds", the place-based approach employed by cohesion policy, adds value compared to sectoral or national approaches. And when and where it is effective. The same failure is visible in academic debates, where a line often separates the 'cohesion policy experts' from the rest of academia engaged with issues of growth and development.

The serious limitations, illustrated by this Report, in the availability of evidence on cohesion policy results have certainly played a relevant role in discouraging public debate, as have the limitations of the reporting system. They hamper the possibility of: Member States reviewing each other's progress; the European Parliament and the Council discussing results; and the Commissioners in charge of cohesion policy debating policy with their fellow Commissioners. It has a negative effect on the dialogue within the cohesion policy community. But the lack of appropriate Council configurations to ensure a continuous, high-level debate has also played a role, by failing to create a political demand for timely information on objectives, targets and results and for good reporting.

The architecture of the changes proposed by this Report is intended to make policy choices more open for debate and to improve the supply of information: the concentration on core priorities; the clarification between efficiency and social inclusion; the focus of contracts between Member States (Regions) and the Commission on objectives, indicators and targets; the commitment to a system of impact evaluation; the streamlining of the reporting system; and the linkage with the Stability and Growth Pact via additionality. These changes need to be complemented by changes on the demand side. A high-level political and policy debate has to be organised. A stronger system of checks and balances between the Commission, the European Parliament and the Council has to be put in place.

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[394] Those costs could be considered, not as costs of cohesion policy, but as costs of the EU as a whole (because of the "filter" role they play for all EU policies and Directives, see Section II.4), and additional human resources could be required by the Directorates in charge of cohesion policy.

The turning point for ensuring a continuous high-level debate would be the creation of a formal Council for Cohesion Policy, possibly under the General Affairs Council. This would be composed of those national Ministers with responsibility for cohesion policy (potentially more than one Minister in some Member States). As is currently the case in the informal meetings of Ministers, the right of representation could be extended to Regions from federal Member States and those with devolved administrations[395].

The Cohesion policy Council could meet between two and four times a year, and it would substitute for the present bi-annual informal meetings of regional policy Ministers. Its main tasks would be: (a) to give a political assessment of the National Strategic Development Contracts, once they have been approved by the Commission, of their choices and of the way they implement the European Strategic Development Framework; (b) to examine and debate the progress shown by the Indicators and targets survey, prepared annually by the Commission, and (from the third year onwards) by the Scoreboard of progress for the core priorities); (c) to assess the content of the Strategic report on results, produced annually (from the third year onwards) by Member States and of the related Opinions and Summary report prepared by the Commission; (d) to assess the specific situations where a special intervention is needed by the Commission[396]; and (e) to give a general political assessment of policy implementation and of the coordination with other EU and national policies, with particular attention to their territorial impact[397].

The permanent Council formation would issue recommendations on the choices and lack of choices, and on the results and lack of results of both the Commission and the Member States (Regions). Its activity would be supported by the work of a permanent high-level technical group or committee composed of senior Member State officials (directors of regional/territorial/spatial/place-based policies). This group could organise its activity in sub-groups of relevant countries that could allow the implementation of a peer review methodology.

The streamlining of the contracts between Members States (Regions) and the Commission and the new system of reporting would enable the European Parliament (through its own committees) to play an enhanced role. In particular, the Parliament would contribute views through opinions, notably on the National Strategic Development Contracts and the annual reports. In the context of the proviso of the new draft Treaty according to which the "Commission shall also submit to the European Parliament and to the Council an evaluation report on the Union's finances based on the results achieved" (amended art. 275), the Summary report prepared annually by the Commission on the results of cohesion policy should play a central role. As in other policy areas, the Parliament would build close links with the Cohesion policy Committee.

Meetings of the Council formation should be preceded by meetings of both the Committee of Regions and of the Economic and Social Committee, which could issue opinions on the annual Reports prepared by Member States.

The architecture suggested here needs to be built gradually, starting with this programme period. A possibility would be to create an Informal high-level group, assigning to it the strategic assessment and the review of results of current policy on the basis of the more limited flow of

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[395] Participation of the Committee of the Regions could also be considered, potentially with the responsibility of representing – and facilitating a dialogue with – regional and local authorities and urban, rural and other networks.

[396] In particular: actions taken for deficiencies emerged from the Implementation assessment; approval of contracts subject to conditions due to inadequate institutional setting; results of in-depth performance assessments due to the unmotivated failure to achieve targets; financial sanctions for those Member States which, in the case of a persistent (two consecutive years) negative gap between the targets for spending set for financial additionality and actual spending, fail to show that the gap was not the result of the country reconciling an intentional reduction in taxation with respecting the Stability and Growth Pact ceilings.

[397] On this issue, see again the document adopted by Ministers responsible for spatial planning and cohesion policy (at the meeting organised in Marseille by the French Presidency in November 2008).

information now available. This would, in itself, represent a move forward, as currently only two regular opportunities exist for Member State administrators to meet: the Structural Actions Working Group; and the Coordination Committee of the Funds, which is primarily concerned with regulatory issues, implementing rules and programming decisions. New methodologies could be tested and the group could be involved, after the Fifth Cohesion Report, and by making use of the results of the Place-based Policy Group described in section V.2, in the debate on the design of the new strategy.

Finally, strengthening the strategic debate obviously needs to involve each Member State. In this respect, a difficulty is that responsibility for development and for cohesion policy in EU countries is often divided between different government departments and policy areas, and between national and sub-national levels, with weak or inconsistent coordination. Monitoring committees of cohesion policy – originally intended to provide a strategic oversight of the programmes – are generally pre-occupied with administrative and technical issues. Consideration should therefore be given to each Member State establishing a high-level national strategic forum (where this does not already exist) – at both political and administrator levels – to ensure strategic oversight of cohesion policy, notably the development of strategic assessment of national territorial development policies, the development of national/regional strategic programmes, performance assessment and coordination of contributions to the EU-level debates.

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