The emergent European market and economic and social cohesion

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Abstract

There is a growing recognition that even though an acceleration of economic integration in the EC will yield overall gains for the Community economy, there are bound to be losers as well as winners. Regional disparities in income and unemployment are substantial in the EC (and more pronounced than in the US), and may be exacerbated by economic and monetary union. This paper assesses the problems the EC will face in meeting the commitment to promote 'economic and social cohesion' set out as a fundamental principle in Article 2 of the *Treaty on European Union.* It analyses the likely impact of EMU on cohesion and considers the policy implications and options.

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Introduction

Since the *Treaty on European Union* was signed at Maastricht, most of the debate around it has centred on the prospective macroeconomic gains and on the likelihood of the *nominal* convergence criteria - all of which concern the stability of monetary conditions - laid down in the Treaty being attained. Yet it is clear from, first, Article 2 of the Treaty itself and, second, the strength of feeling in the debate at the Edinburgh European Council last December on the future EC Budget that the distribution of the costs and benefits of economic and monetary union (EMU) is a critical part of the political economy of European integration. What ultimately matters for the participants is whether the gains from economic integration exceed the costs. In addition, the social dimension of both the single market and EMU has received comparatively little attention.

In part, this reflects the surprisingly inconsistent use of the term 'social' within the EC. For some countries, the social dimension of the single market mainly concerns the relationships between employers and workers - the social partners. Elsewhere, 'social' issues have to do more with either the less-advantaged members of society - migrants or racial minorities - or with those elements of policy such as health care and education which are deemed not to belong strictly within economic policy. While it would be misleading to claim that the different aspects of 'social' are not dealt with in all Member States in one way or another, there is little doubt that social issues generally have been regarded as of secondary importance in the move towards European union.

Yet they are by no means absent. Many of the measures in the single market programme concern issues such as health and safety which regulate conditions of employment. The much maligned 'Social Chapter' of the Maastricht Treaty, similarly, is about setting adequate standards for workers, and the associated wish to prevent a competitive auction to reduce levels of social protection, captured graphically in Jacques Delors' phrase "social dumping", is seen by many as a necessary concomitant of open markets.

In the EC, existing regional disparities are considerable (Neven, 1990) and success in reducing them has been patchy. These disparities reflect longstanding patterns of economic development as well as more recent structural changes. The probability that the net gains from integration will be greater for some regions than others poses a challenge for the cohesion of the Community. Unless adequate progress is made to increase the relative real incomes of less-favoured regions, the acceptance of continued integration in the European Community could be brought into question. It is also probable that competitive pressures will lead to some labour shedding, especially in the least-competitive regions. Although there is a presumption that the aggregate impact of integration on employment will be positive, unemployment is likely to rise in adversely affected regions, many of which already suffer from high rates. Furthermore, cohesion calls for an adequate distribution of the costs and benefits *within* regions and between social groups.

The weight of evidence suggests that 'market failure' is endemic to the process of regional economic development and it is quite unrealistic to expect a significant narrowing of regional disparities either within Member States or across the Community without public sector intervention of one kind or another. Moreover, adjustment, either through factor migration or relative price changes, tends to be painfully slow and falls a long way short of correcting regional income per head and unemployment disparities (Begg, 1989).

Starting from the presumption that the EC will continue to be faced with severe problems of structural adaptation and persistent spatial disparities, a number of questions must be addressed with respect to public policy. A central question is whether policy should be primarily concerned with tackling the underlying causes of perceived problems or with ameliorating some of the more intractable symptoms of these problems. A second policy question concerns the appropriate tier of government at which policy might best be formulated and in particular whether there is a justification for policy intervention at a European level to complement and support policies designed at a national or regional level. Although views here derive in part from the current debate on the principle of subsidiarity, they also turn critically on the nature and extent of 'market failure' that spills across national or regional boundaries. At issue here is not only the question of what constitutes such market failure, but also whether, empirically, it is of a sufficient order of magnitude to warrant shifts in policy.

Economic and social concerns coalesce in the debate on 'cohesion' which is assuming a more prominent place on the agenda of EMU. In fact, at the Edinburgh summit in December 1992, agreement on altering the terms offered to the Danish people ultimately proved less difficult to attain than a deal on the Budget which ensured a greater transfer of resources to the less-prosperous parts of the Community. Moreover, with unemployment in the EC now at nearly 18 million, social issues such as exclusion from labour markets or the degree to which the EC economy can continue to provide welfare benefits at current levels are the subject of growing concern. This paper reviews some of the issues raised in this context and explores the implications for policy.

Interpreting cohesion

Cohesion is a difficult concept to define, making it hard to determine the weight it deserves in the priorities for economic integration. In part, this is because much of the economic theory which underpins economic integration assumes distributional issues to be of secondary importance. Yet the reality of the EC is that the division of costs and benefits is central to the political agreements needed to proceed with integration. It is also confused by emphasis on the further concept of 'convergence' as a precondition for EMU, in which *nominal* criteria relating to monetary variables are apt to be confused with *real* convergence which concerns comparative welfare.

Although cohesion is associated both in the *Single European Act* and the *Treaty on European Union* with disparities between regions (Article 130a), there is no objective way of ascertaining how narrow disparities need to be for cohesion to be assured. It is also important to note that the rates of change of target variables as well as comparisons of levels (for example, of GDP per head in PPS) matter. If the richer regions grow more rapidly than the less-favoured, this could be detrimental to cohesion, even if the absolute level of income rises in the latter regions.

Other dimensions of cohesion also have to be considered. In many regions, structural change can give rise to acute social pressures either because of indigenous unemployment or because emigration from regions with surplus labour creates tensions in more favoured regions between immigrant and indigenous populations. It is important, too, to recognise that cohesion is an issue within regions or Member States as well as between them. As Kennedy (1992) has pointed out, the relatively low level of employment in Ireland means that for every ten workers there are twenty-two dependents. This is partly because of a traditionally low participation rate and a large youth population, but is mainly caused by 'poor labour market conditions, manifest particularly in the high unemployment rate'. The corresponding ratio for Denmark is just nine dependents for every ten workers.

Labour market trends are especially significant in the dynamics of cohesion. The data reported in *Employment in Europe* (Commission of the European Communities, 1991a) demonstrate that most of the *Objective 1* regions (the regions 'lagging' behind in their economic development - the Southern and Western periphery of the EC) have above average natural rates of population growth. These mean that they would need to create employment at a markedly higher rate than elsewhere in order to absorb labour market entrants or to make inroads into very high rates of long-term unemployment. The need for faster employment creation is also a problem in *Objective 2* (declining industrial) regions to address their high incidence of structural unemployment. With the single market likely to accentuate pressure to cut costs in order to enhance competitiveness, job creation on a sufficient scale would require a disproportionate level of investment in these regions. This requirement, however, is not easy to fulfil because the regime of 'state aids' and the fiscal capacity of richer regions does not favour the less-favoured regions (Lehner and Meiklejohn, 1991), highlighting a further obstacle to cohesion.

Alternatively, a higher rate of emigration has to be accepted. This, however, can lead to different cohesion-related difficulties. First, it is workers with the most marketable skills who find it easiest to migrate, giving rise to the risk that less competitive regions will be denuded of the sorts of skills needed to attract inward investors or to encourage entrepreneurship and innovation. A second concern is that where such migration occurs, richer regions benefit from the education and training provided by the regions of origin of the emigrants, implying a (perverse) net subsidy to human capital in richer regions. The combination of these effects would be to add to the barriers facing regions seeking to break out of vicious cycles of low growth or underdevelopment

As was argued in Begg and Mayes (1991), cohesion is, in the final analysis, a political rather than an economic concept. It is one, moreover, that fluctuates through time: it may be tolerable, if undesirable, today that income-per-head in the ten least-favoured regions is only a third of that of the ten most favoured regions, but if such a gap were to persist, it might threaten the survival of the EC as an economic union.

Factors affecting the regional impact of the single market

The eventual impact of the single market on any individual region will be influenced by a wide range of factors. If economic integration follows the standard neo-classical analysis[1], it predicts (as Barro and Sala-i-Martin, 1992, demonstrate), that convergence in GDP per capita will occur. This is because diminishing returns to capital set in as an economy develops, so that lower income economies have higher returns to capital. This attracts capital and thus has an equilibrating effect. Convergence is accelerated if there is strong inter-regional labour mobility and rapid diffusion of technology between regions. This analysis depends critically on the familiar restrictive assumptions of the model, such as perfectly competitive markets and homogeneity of factors of production, for its prediction that specialisation according to comparative advantage will occur, enabling gains in welfare.

Recent theorising on models of 'endogenous growth' and the impact of trade[2] has led to some reappraisal of the welfare effects of integration, suggesting that the outcome may not be easy to predict, because the dynamic consequences of existing disparities in, for example, human capital endowments or technology are uncertain. Moreover, the reality of the EC is that even if the '1992' programme is successfully implemented, there will still be significant market segmentation and barriers inhibiting genuine free trade. In the light of these considerations an appraisal of the effects of the single market on a region has to look at both macroeconomic and microeconomic costs and benefits.

For any region, the macroeconomic consequences of integration will be of two main types. The first is the extent to which gains in aggregate growth in GDP in the Community 'trickle down' to regional economies. The second is how restrictions on macroeconomic policy that follow from integration affect policy choices. In the larger Member States, these macroeconomic restrictions may be more noticeable in less-favoured regions, since these regions generally have net fiscal inflows. Overall, much of the impact on a single region will depend on the macroeconomic performance of the respective Member States: even a cursory analysis of regional accounts shows that relative movements in national

[1] For a summary of the development of this model, see Jacquemin and Sapir (1989)

[2] For a survey of trade questions, see Baldwin (1992) and for a review of endogenous growth, see the Winter 1992 issue of the *Oxford Review of Economic Policy*

GDP play a considerable part in determining regional income growth. In addition, it is at the level of the Member State that many of the policy constraints will bite, especially with the obligation to adapt in order to meet the criteria for nominal convergence in preparation for economic and monetary union (EMU).

However, the relative competitiveness of regions is bound to have an effect, especially in the more competitive economic environment that '1992' will usher in. This will reflect microeconomic as well as region-specific factors, and will manifest itself in location decisions by companies, in the attractiveness of different labour markets both to employers and labour and in the scale of new firm development (Mayes, 1991). In practice, it is the *absolute*, rather than the *comparative* advantage of regions that will determine whether or not a region is well-placed to gain from market integration. To elucidate this, one approach is to extend the analysis by Porter (1990) of factors affecting competitive advantage to the level of the region. An alternative outlook is that adopted by IFO (1990), which measures a region's competitiveness by looking at national, regional and company-specific factors.

An attempt to synthesise the various approaches can be made by bringing together four categories of factors which feed into regional competitiveness (summarised in figure 1). These are:

- *Macroeconomic variables* which determine how the region's circumstances compare with competitors in other countries. These have a direct effect on operating costs, such as relative unit labour costs, as well as indirect effects stemming from the path the economy takes. It may also happen that the macroeconomic conditions suit some regions better than others. Camagni (1992), as an illustration, argues that in an integrated economy, the weaker region has to contend with too high an exchange rate. This makes it more difficult to compete in high-tech sectors, pushing it back towards low productivity activities with poor growth prospects.

- *The regional business environment* which includes the quality and costs of the assorted factors of production (labour, property etc.), various characteristics of the region's location and endowments (peripherality, transport and communications infrastructure) and the effects of local administrative and fiscal arrangements. Some of these factors will be unchanged by completion of the internal market (peripherality being the most obvious), but others may be subject to change. It is likely, for instance, that low-wage regions will face upward pressure on wage costs (and indirect labour costs, if the Social Chapter is implemented) in a more open market, while the reverse applies in high-wage areas. In addition, the competitive position of regions will be affected by less tangible factors such as the local business culture, the character of local and regional institutions or the industrial relations climate.

- *Attributes of industrial and commercial companies* in the region, such as their organisation, success in external markets, size structure or financial strength. Few dominant large companies are located in less-favoured regions, and it is often the case that the leading exporters are subsidiaries or branches of externally owned multinationals, engendering a vulnerability to decisions to relocate. This is exemplified in Ireland, where it is the branches of foreign owned multinationals which are judged to be the most competitive in the industries most affected by the single market (Bradley et al, 1992). Amin et al (1992) maintain that corporate restructuring will generally work against the less-favoured regions where there tend to be fewer opportunities for attaining economies of scale and not many large 'anchor' companies to act as the cores of networks.

- *The ability to innovate and to learn.* This fourth category is perhaps the most difficult aspect of competitiveness to pin down, yet in many ways the most critical. In the business world of the 1990s, it is widely believed that the ability of companies to learn, to adapt and to react quickly will be the key to success[3].

[3] Such issues are highlighted in Best (1990), Scott Morton (1990) and Shimada (1991)

It is important, too, to recognise that in an age of rapidly evolving technologies, diffusion of new technologies and mastery of their use is as much a problem of organisation and management as it is one of invention or basic scientific discovery. Networking is increasingly being recognised as an important factor affecting innovation, and the very uneven distribution of research activity in the EC (Hingel, 1992) is considered a problem for cohesion.

The outlook for different sorts of regions

Figures on GDP per head by Member State, adjusted for purchasing power, show a range in 1990 from 47.1% of the EC average in Greece to 123.7% in Luxembourg. The relative position of three of the least-favoured Member States, Spain, Ireland and Portugal, has improved over the last five years, although Greece has slipped further behind. Taking a longer perspective the picture is rather less encouraging. During periods when the overall growth of the EC has been less buoyant than in the second half of the 1980s, disparities have tended to widen (Commission of the European Communities, 1991a). In part, this reflects a diminution of migration from weaker regions. Evidence from the US (Barro and Sala-i-Martin, 1992) suggests that convergence does tend to occur in the long-run, implying that disparities will tend to diminish in the EC as integration proceeds (although a large part of the shift in the US occurred in the brief period 1940-1945, indicating that it was due to the distortionary effects of war).

Unemployment rates are particularly high in the whole of Ireland and the *Objective 1* regions of Spain and Italy. A number of the *Objective 2* regions also have very high and persistent rates of unemployment, reflecting the enduring problems of decline of staple industries. The unemployment rate in 1990 ranged from 23% in the South of Spain and 17% in Ireland and the South of Italy to 3% in Baden-Württemberg and 1.5% in Luxembourg, with a standard deviation of 5.0 percentage points for the Community's 'Level 1' disaggregation of regions. By contrast, in the US in 1989, the spread was from 2.6% in Hawaii to 8.6% in West Virginia, with a standard deviation of just 1.33 percentage points[4]. Figure 2 shows graphically how much greater unemployment disparities were in the EC than in the US and reveals, in particular, that unlike the US, the EC has a long 'tail' of regions with very high rates of unemployment. Because of social and institutional differences between regions, however, comparisons of unemployment rates, even using supposedly harmonised data, are neither wholly reliable, nor a convincing proxy for regional prosperity. Greece and Portugal, for example, do not register high rates of unemployment, even though they manifestly lag behind the rest of the Community in terms of prosperity. Future labour market problems can be gauged from the fact that youth unemployment is very high in many less-favoured regions. In Campania, Sicilia, Basilicata and Calabria in the South of Italy, as an illustration, the youth unemployment rate is in excess of 50%.

Although it has become customary to refer to regions allocated to broad categories, (especially according to the *Objectives* of the Structural Funds) some caution needs to be exercised in generalising about either the less-favoured regions overall or large clusters of them. Despite the strong growth in Spain in the late 1980s, weaker regions such as Asturias lost ground. Similar relative losses affected regions such as Calabria and Basilicata in Italy. Much of the analysis of the expected sectoral impact of the single market has been based on assessments of the forty sensitive sectors identified by Pierre Buigues and Fabienne Ilzkovitz (see Buigues et al, 1990). For many of the less-favoured regions, these sectors only account for a small proportion of value-added and employment, so that an appraisal of regional prospects based only on these industries would be misleading. Instead, the critical importance of completion of the internal market in services (as well as reforms of the CAP) has to be recognised. In addition, the responses of labour markets and capital markets to the changes will play a large part in determining how a region is affected. These latter considerations have received relatively little attention in empirical work.

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[4] In the US, 1989 was the peak of the economic cycle and is when the unemployment rate reached its low point. The same point was reached in the EC in 1990.

Quévit (1992) notes that there are three broad descriptions of the less-favoured regions: those in which intra-industry trade dominates; those for which inter-industry trade is the pattern; and those which are in-between. He argues that with the single market, the tendency will be for a shift away from inter- to intra-industry exchanges between regions and that this will affect the structures of economies. Although a few regions may have the opportunity to benefit from specialisation in specific industries which reflect comparative advantages and are characterised by inter-industry trade, the real battleground in the single market will be elsewhere.

Objective 1 regions

Under the most favourable scenarios, benefits from completion of the internal market for the lagging regions would be substantial. These would arise because of the opportunity to penetrate hitherto protected markets and to attract capital investment to exploit comparative advantages. It is also argued that technology diffusion would be accelerated, enabling the lagging regions to jump a step up the development ladder. These arguments are open to various criticisms. To begin with, there is a danger in locking regions in to existing comparative advantages that they would fail to make the transition to new, more dynamic specialisations. The analysis in Buigues et al (1990) suggests that it is the outcome in *intra-* rather than *inter-*industry trade that will be most critical in deciding the degree to which the single market produces net benefits. A further doubt is whether some of the lagging regions have attained a sufficient threshold of development (infrastructure, labour skills etc.) to be attractive to potentially mobile investment.

Camagni (1992) maintains that 'Objective 1 regions will not only benefit less from the creation of the single market, due to their weaker economic structure, but they will also suffer directly from some of the harmonization regulations implied by the 1992 programme'. Inevitably, there are significant variations between regions. The study by Nam and Reuter (1991) explores the inherent competitiveness of the lagging regions through a survey of business and concludes that only four such regions - Valencia, Murcia, Abruzzi and Molise - have potentially good development prospects. Seven further regions have 'open' prospects - national centres in Greece and Portugal, Puglia, Andalucia, Canary Islands, Northern Ireland, Eire - while the other Objective 1 regions have problems which are likely to worsen. It is immediately apparent that there is a strong correlation between the extent of existing disparities and the expectation that problems will worsen; all the regions in the bottom 10% of the EC in terms of income per head are in this 'tending to worsen' category. Similar conclusions are drawn in the GREMI (1991) report which is reasonably sanguine about the prospects for Ireland, the East coast Mezzogiorno regions and some parts of Spain, but is pessimistic about South West Italy, most of Greece and Asturias.

Most of these latter regions were, according to Quévit (1992), already losing ground in the 1980s. Calabria, an example of a region not expected to benefit, has seen unemployment rise from 15.3% in 1980 to 24.6% in 1990, and output per capita shrink relative to the national average from 47.7% in 1980 to 45.2% in 1990 (SVIMEZ, 1991). The decline of some least-favoured regions is a phenomenon that is particularly worrying in relation to cohesion, since it implies that completion of the internal market may be most threatening to the most vulnerable regions. Their lack of competitive advantages may therefore be a critical stumbling block to the single market.

For Ireland, Bradley et al (1992) have carried out a modelling exercise to ascertain how '1992', the reform of the CAP and the additional resources that will flow from the Structural Funds will affect the country. The main conclusion is that the benefits to Ireland of the single market will be broadly in line with the Cecchini estimates for the EC, but that this may partly be offset by the CAP reform. The flow of resources from the Structural Funds is projected to play an important part in raising GNP. Overall, they estimate that although Ireland's income per head will be higher than it would be without '1992', its growth will fall short of the Community average, so that convergence will not occur. A key reason for this is the effect of faster growth in increasing employment and, thus, slowing emigration (increasing the denominator of the income per head ratio). Bradley et al also note that because of this induced migration effect, the scope for reducing unemployment (especially long-term unemployment) may be limited.

The Irish case exemplifies the difficulties cited earlier in determining whether or not the single market aids cohesion. On the one hand, there is a reasonable prospect of higher income and employment; yet on the other, the position of Ireland *relative* to other Member States shows little sign of improving. Given that the four least prosperous Member States have income levels significantly below the EC average, it may well be that only a steady move towards convergence can assure cohesion. As illustrative arithmetic by the Commission of the European Communities (1991a) shows, convergence requires a growth rate in excess of the EC average to be sustained over many years to make much difference. For example, to move from 50% of the EC average (that is approximately the present level of Greece and Portugal) to 70% over a ten year period, the *annual* growth rate would have to *exceed* the Community average by 3.5 percentage points.

Objective 2 and Objective 5b regions

Because the *Objective 2* regions, on the whole, start from levels of income near the EC average, different criteria may apply in relation to cohesion. If losses of activity appear to be attributable to the single market, the effect on cohesion (in the sense of acceptance of the changes) may be more pronounced than for a lagging region where the existing income gap is a fact of life. The question of social cohesion is also important where rapid restructuring is in prospect, notably in relation to unemployment and urban deprivation.

Most of these regions were particularly hit by the early 1980s recession, but, as Commission of the European Communities (1991a) shows, had enjoyed some recovery subsequently. For the *Objective 5b* regions (more prosperous rural regions with relative incomes well above the *Objective 1* threshold), the fragility of rural economies and concerns about depopulation also figure as cohesion issues. Nam and Reuter (1991) judge that the majority have potentially good prospects and only 2 in the case of Objective 5b - Highlands and Islands and Rural Wales - and 4 in the case of Objective 2 - Pais Vasco, Cantabria, Lorraine and North-East Wales - have problems which are likely to worsen. Part of the problem is that the industrial specialisation of many of these disadvantaged regions lies in industries like clothing and food whose prospects are not good; for clothing, because of the threat from the developing world as the barriers under the MFA are dismantled, and in the case of food, because the way the industry is restructuring towards modern technically advanced and high quality products. Even if they are successful in attracting investment in industries where low cost is an advantage they are disproportionately exposed to exchange rate and other costs, giving them asymmetric adjustment problems. This emphasises their structural divergence rather than leading to greater convergence.

The Fourth Periodic report (Commission of the European Communities, 1991a) notes that the *Objective 2* regions do not at first sight appear to be vulnerable to restructuring induced by '1992', because their markets are already open. The RETI study (reported in Quévit, 1992) is, however, less encouraging. These regions still have relative concentrations of declining or slow-growing sectors and of medium-sized firms ripe for rationalisation. They also tend to have a relatively low representation of high technology industries. A key problem for the *Objective 2 regions* in dealing with the single market will be their poor record in innovation, itself the legacy of earlier decline. Some of these regions will also be affected by the opening up of public procurement for equipment for utilities which may lead to significant rationalisation in production (Cegos Idet, 1989). In the financial and business services sectors, few *Objective 2* regions possess major financial centres (Begg, 1992), though there are several second-tier centres in these regions. Agglomeration economies will, however, tend to concentrate major financial entities in leading international centres, posing a further threat to these regions. Again, the challenge they face is how best to move towards new specialisations.

Social questions

There can be little doubt that economic integration will cause social change. The spatial reallocations of resources that will be induced by economic change must be expected to affect different social groups unevenly. In particular, if the intensification of competition that is one of the main objectives of integration causes a labour shakeout, the bulk of the resulting job losses will be amongst the least qualified employees. This could create problems for the most vulnerable social groups - ethnic minority immigrants, or displaced agricultural populations migrating to large congested cities, for example - and may also lead to concentrations of social problems in specific localities. In France, as an illustration, the *Délégation Inter-Ministériel à la Ville* (DIV) has identified over four hundred disadvantaged precincts in urban areas, many in cities which are otherwise prosperous.

According to DIV, residents in these areas face multiple handicaps in trying to secure better opportunities. In addition, crime, drug-dependence, declining standards of health and other consequences of social deprivation tend to accumulate in such areas. Social cohesion calls for recognition of the effects of economic and political change in fomenting social problems and for action to alleviate them. Improving social provision can, in addition, be regarded as a political objective aimed at consolidating the sense of belonging to the EC. If residents of less-favoured regions or of disadvantaged communities in favoured regions perceive the gap in social provision between them and more favoured areas either to be excessive or not narrowing sufficiently, social cohesion will be difficult to achieve. In particular, if the Community is not able to address poverty in whatever form it manifests itself (low rural incomes, inactive or discriminated-against inner city or suburban populations), it will struggle in vain to attain social cohesion.

The ultimate test of social cohesion, however, is whether residents of certain regions face long-term inequality in opportunities relative to the rest of the Community. Education and training play a crucial part in determining economic opportunity and consequently deserve attention. Similarly, standards of health care and housing, as well as the quality of the environment contribute substantially to quality of life. Social cohesion, though rather more amorphous as a concept, has to be seen as a key target of policy for the Community in the later 1990s.

Policy implications

The evidence on the likely impact of completion of the internal market on the less-favoured regions as a group is that, at best, they will keep pace with the Community economy, rather than converging in terms of income per head. Some regions will, inevitably, do better, but there are also signs that several, notably amongst the least-favoured, will struggle. As the single market is consolidated, the likelihood is that comparisons across Member States will acquire more importance than at present. If this prediction proves accurate, the difficulties in achieving cohesion will be magnified, since it will be EC partner countries rather than the more prosperous indigenous regions that serve as benchmarks for comparisons.

If the EC is serious in wanting to ensure cohesion, it is an issue which will need to remain high on the political agenda and will require a careful approach to policy, because of potentially conflicting policy objectives. Progress towards cohesion will call for policies to assist restructuring and to help in building up infrastructure and capabilities in relatively less competitive regions. At the same time, policy has to be sensitive to the risk of inhibiting the gains from market integration. If new barriers replace those that are being dismantled, or if spending on cohesion preempts too large a share of resources, the benefits of the single market might be compromised. Equally, policy has to be judged so as to avoid causing undue dependencies in regions which receive assistance, because of the risk of diminishing the incentives to do well. The policy challenge is further complicated by the fact that several tiers of government play a part in advancing cohesion.

Policy responsibility

At present, most cohesion-related policy (such as welfare payments or various aids to industry) is the responsibility of Member States. Yet it has to be recognised that in contemplating cohesion in the EC, it is the lack of capacity of the less-favoured Member States and regions to achieve sufficient progress using their own resources that is often crucial. This makes it clear that a role exists for a higher tier of government in transferring resources and possibly also in helping to administer assistance in regions where shortcomings in public administration seriously impair economic efficiency. At the same time, the case for subsidiarity cannot be neglected: regional authorities are often better placed to assess the needs of their areas and to tailor a package of policies to suit them. It is worth distinguishing, therefore between the funding and strategic character of policy and the formulation and delivery of specific policy instruments and packages.

An additional role for the higher tier is ensuring that the actions of favoured regions do not harm the competitiveness of the less-favoured. In this regard, the whole question of state aids raises difficulties. On the one hand, state aids are a key industrial policy instrument for Member State and regional authorities. But if the use of state aids by richer regions adversely affects the competitive position of weaker regions, it acts counter to cohesion. The problem is exacerbated to the extent that it is the more prosperous regions and Member States that have the fiscal capacity to provide the greatest support to their indigenous companies (Lehner and Meiklejohn, 1991). The Community tier consequently has an important role to play in 'refereeing' the use of state aids.

Policy instruments

Advancing cohesion is a long-run objective, not something that can be rapidly achieved. It follows that there are neither quick and easy solutions nor realistic alternatives to long-term policy initiatives. This is recognised in regional policy, with the emphasis on investment (i.e. future welfare) rather than transfers to increase consumption (i.e. current welfare). Latterly, as Amin et al (1992) note, the dominant approach to regional policy is on what they call 'growth from below' - the promotion of indigenous industry. The essence of this is to improve the ability of the less-favoured regions to compete and to raise their productivity levels closer to those in the favoured regions.

Despite this emphasis on indigenous growth, inward investment is bound to be a key element in cohesion. In attracting inward investment, lagging or declining regions generally suffer from an undersupply of 'hard' infrastructure (short- and long-range transport, communication, energy) and 'soft' infrastructure (human capital, cultural and leisure facilities). This has left them with an under-representation of large internationalised companies and an over-representation of localised small and medium enterprises (SMEs), which will face the strongest competitive and takeover threats after 1992 (Nam and Reuter, 1991). There is, however, evidence of marked differences between different regions in their attractiveness to inward investment. Amongst Objective 1 regions, Ireland, parts of Spain and Portugal seem to have been more successful than Greece or the South of Italy. Some of the Objective 2 regions such as South Wales have benefited more than others. Figures compiled by the European Parliament (1992) show that for the four years 1986 to 1989, foreign direct investment (FDI) in Spain totalled 20 billion ECUs, over five times as much as receipts from the Structural Funds, whereas in Greece, FDI only reached 1 billion ECUs, less than half the receipts from the Structural Funds. There is little chance that policies to restrict growth in favoured regions and to redirect inward investment towards the less-favoured regions will find much favour in EC policy, although it has to be recognised that this happens *within* Member States such as France.

At present, support from the Structural Funds and from the European Investment Bank for infrastructure, for human capital and, increasingly for business development constitutes the main thrust of EC policy. While such policy instruments can help to improve the underlying fabric of regional economies, they can only compensate to a rather limited extent for economies of scale and other factors which tend to pull economic activity towards more favoured regions. Other EC policies, such as the CAP or spending on research and technology are not regionally targeted and thus do not necessarily affect economic cohesion, although, at least in relation to rural communities, it is argued that the CAP helps with social cohesion.

At the 1992 Edinburgh Council, agreement was reached on the EC Budget for the period 1993-1999. This will see a gradual increase in the resources available to the Community from the 1.2% of GDP in the current year to 1.27% by 1999. Since it is expected that the EC economy will continue to grow during the period of the new *Financial*

Perspective, the real increase in resources will be quite substantial, albeit tiny by comparison with those available to central government in even the most decentralised of countries. Most of the additional resources will be devoted to 'cohesion' related spending and will permit a near doubling of expenditure in the least-favoured regions.

The Edinburgh summit also endorsed proposals for a further reform of the Structural Funds, though not as far-reaching as that introduced in 1988. The further reforms reaffirm the four principles that characterised the 1988 reform, namely:

- *concentration* of resources in most needy areas;
- *programming* to ensure that the actions of the Funds are a coherent response to regional difficulties, rather than piecemeal projects;
- *partnership* with lower tiers of government;
- *additionality*, that is the stipulation that the EC tier contribution should complement rather than substitute for action by Member States or regions.

In the proposed further reforms, the principal changes widen the targets of the Funds to embrace a number of social objectives. In *Objective 1* regions, the Funds will be empowered to contribute to investment in health and education. The *Social Fund* will also be able to address specific forms of labour 'market failure', with provision for action on exclusion from the labour market, the promotion of equal opportunities, and aid to adaptation of workers to industrial change or changes in production systems. These proposals can all be regarded as worthwhile, but are open to the criticism that the resources available to implement them are woefully inadequate.

The questions raised by this recasting of Community policies are, first, whether it is enough to promote real convergence and thus to advance economic cohesion, and second, whether the package of policies pays sufficient attention to the social dimension of cohesion. For those regions which obtain substantial net inflows, the answer may be a qualified 'yes'. But because the available resources have to be thinly spread, the wider answer is that Community policies cannot realistically be expected to play a major role in promoting real convergence. Moreover, the incidence of EC policies on different classes of households within regions is uncertain.

Even if regional disparities in income per head can be diminished, there is, as Mrs Papandreou's introduction to the 1992 issue of *Employment in Europe* (Commission of the European Communities, 1992) emphasises, a 'more general problem of social cohesion' which derives from inadequate job opportunities for many social groups. Amongst these, some of the barriers confronting the long-term unemployed have been shown by the *ERGO* programme[5] to be particularly intractable. It can also be argued that success in achieving balanced regional development will not necessarily ensure that the benefits of economic integration accrue sufficiently to low-income households. In addition, policy-makers need to be alert to the tensions, already evident in many larger prosperous cities of Northern Europe, that arise from concentrations of deprivation, and of disadvantaged groups 'excluded' from effect competition in the labour market. Regional economic adjustment brought about by migration is a two-edged mechanism. Although it helps to mitigate unemployment disparities, it risks an accentuation of social polarisation in both home and host regions.

This raises the question of whether, as is the case in most nation states, it would be desirable for the EC to have some automatic system for redistribution of income. The MacDougall report (1977) demonstrated the role of income transfers operating through the tax and expenditure systems and fiscal equalisation between different levels of government in

[5] An EC Commission programme concerned with action to alleviate long-term unemployment

attenuating regional disparities. Although political considerations make it highly unlikely that a system akin to Germany's Länderfinanzausgleich could be introduced in the foreseeable future, such a mechanism will have to be reconsidered if the EC does become an EMU.

Conclusions

Cohesion is an issue that the EC cannot afford to treat as secondary to the over-riding aim of achieving the single market. As the European economy becomes progressively more integrated, the distribution of costs and benefits will become an increasingly visible political matter. Regions or social groups which feel that they do not share sufficiently in the gains from integration will be tempted to opt out, putting the whole process at risk. Policy responses, consequently, have to be fashioned so as to ensure that the benefits are achieved while providing scope for the less competitive to participate effectively.

Reductions in regional disparities are bound to play a key role in cohesion, although the latter needs to be interpreted more widely. The effects of the single market may be damaging for regions which currently enjoy levels of income close to the Community average. In this context, what is needed is a policy framework that enables such regions to react. Similarly, for the lagging regions, the objective should be to provide scope for improving their economic performance, rather than compensation for disadvantages. This implies attempts to secure *equality of opportunity*, rather than to secure equality of outcome. Given that the single market is concerned with the creation of a level playing-field, improving the competitive ability of the players is an appropriate counterpart.

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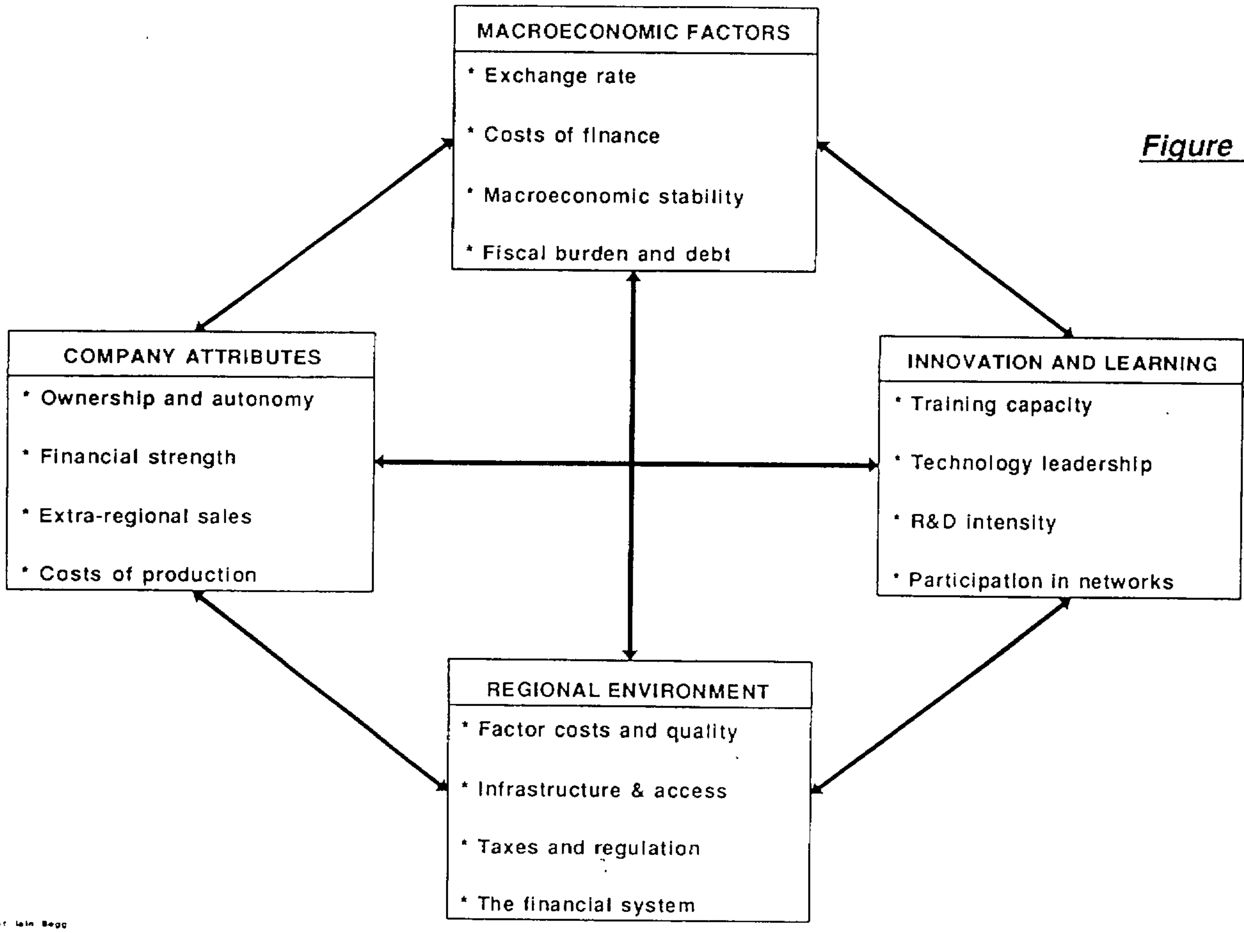
DETERMINANTS OF REGIONAL COMPETITIVENESS

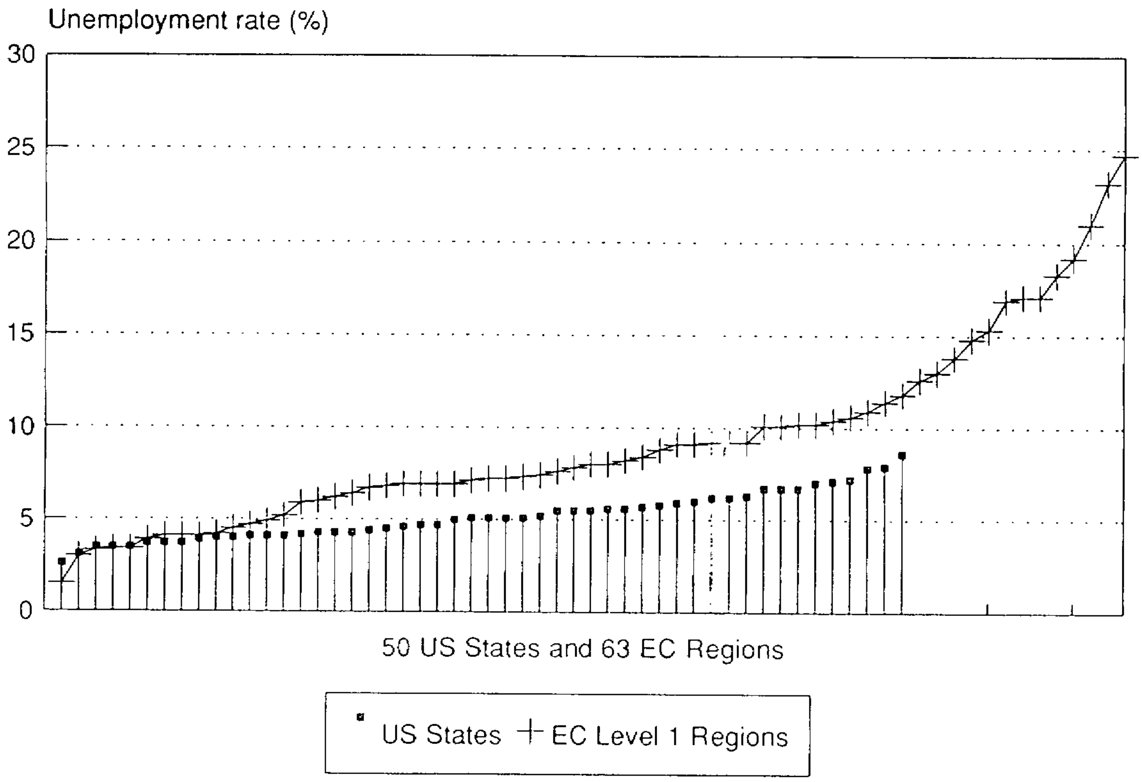
Figure 1



US & EC: Comparative Unemployment Rates

(1989 rates for US, 1990 rates for EC)

Figure 2



Source: Statistical Abstract of the United States, 1991; Eurostat Rapid Report Regions 1991 No. 3