European Union
Regional Policy
and Cohesion

Regional development studies

Cohesion and the development challenge facing the lagging regions



24

European Commission

The Objectives of the Structural Funds

Objective 1 (1994-1999)

Economic adjustment of regions whose development is lagging behind.

Objective 2 (1994-1996)

Economic conversion of declining industrial areas.

Objective 5b (1994-1999)

Economic diversification of rural areas.

New members (1.1.95)

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EC regional policies

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Cohesion and the development challenge facing the lagging regions

European Commission

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Preface

Each year, the Directorate-General for Regional Policy and Cohesion of the European Commission launches a number of studies in the field of regional policy and regional planning. These studies mainly aim at providing a basis for policy formulation internally, as well as the preparation of programmes and initiatives and a basis for analysing the impact of current or planned activities. The most interesting or innovative of these are published in a series entitled Regional development studies.

With this series, the Directorate-General hopes to stimulate discussion and action in a wider sphere on the research results received. The publication of the studies is addressed to politicians and decision-makers at European, regional and local level, as well as to academics and experts in the broad fields of issues covered.

It is hoped that by publicizing research results the Commission will enrich and stimulate public debate and promote a further exchange of knowledge and opinions on the issues which are considered important for the economic and social cohesion of the Union and therefore for the furure of Europe.

Readers should bear in mind that the study reports do not necessarily reflect the Official position of the Commission but first and foremost express the opinion of those responsible for carrying out the study.

Foreword

This report is based upon the results of a study undertaken by the Groupe de recherche européen sur les milieux innovateurs (GREMI) under the direction of Professor Roberto Camagni and Professor Michel Quevit, and involving national research teams in Italy, Portugal, Spain, Ireland and Greece.[1] Comparative research was also undertaken in the USA. The original report set out to examine the economic performance of the Community's lagging regions in recent years, the impact of European integration on these regions and the effectiveness of regional policy initiatives at the national and Community level. In particular, the original study set out to examine the policy implications of adopting an approach in terms of local 'milieux' and innovation networks. This report updates the original GREMI report by including Eurostat data, which were not available at the time, and expanding the analysis.

The production of this document has benefited greatly from discussion and debate between the research team and the Scientific Committee acting on behalf of the Directorate-General for Regional Policy. Particular thanks are therefore due to the members of that Committee: Professor K. Allen, Professor J. Goddard, Professor P. Van Rompuy and Professor R. Velasco.

[1] R. Camagni and M. Quévit, *Development prospects of the Community's lagging regions and the socio-economic consequences of the completion of the internal market; an approach in terms of local milieux and innovation networks,* 1992.

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Executive summary

Main aim of the report

1. The report analyses the economic performance of the Objective 1 regions in the 1980s and makes an assessment of the impact of 1992 on these regions.

Diverging and converging regions

2. The performance of Objective 1 regions was diverse. Indeed, a broad trend was towards greater heterogeneity amongst the group of lagging regions. Thus some regions are catching up, some are falling still further behind (see Table 1).

Table 1: The performance of Objective 1 regions in the 1980s

Member State	Converging regions	Mixed evidence regions	Diverging regions
Italy	Abruzzi Molise	Puglia Sicilia Sardegna	Basilicata Campania Calabria
UK		Northern Ireland	
Ireland	All regions		
Greece	East. Macedonia Ionian Isles S. Aegean Isles Crete		Cent. Macedonia Attica Cent. Greece West. Greece Epirus N. Aegean Isles West. Macedonia Thessalya Peleponnese
Spain	Andalucia Castilla La Mancha Murcia Canarias Valencia	Galicia Castilla Leon Extremadura	Asturias
Portugal	Lisboa Norte	Algarve Centro Alentejo	
France			Corsica

3. In terms of competitive performance in the 1980s, the lagging regions can be classified under four headings.

- Relatively few regions, even among the converging regions, showed strong signs of enjoying a virtuous growth cycle of increasing productivity and employment (NE quadrant in Figure 1).
- Many regions, often those classified as converging regions, were forced into drastic rationalization of productive capacity. This resulted in good productivity growth, but at the expense of falling employment and rapidly rising unemployment (NW quadrant).
- The largest number of lagging regions are following a sheltered development trajectory, storing up problems for the future. These are regions which failed to modernize their economy (low productivity growth), but were able to maintain or increase employment levels, often as a result of explicit or implicit policies of assistance or protection (SE quadrant).
- A small group of regions, finally, seems to have entered a vicious cycle or de-industrialization, where employment cuts and closures are unable to restore competitiveness and job losses continue (SW quadrant).

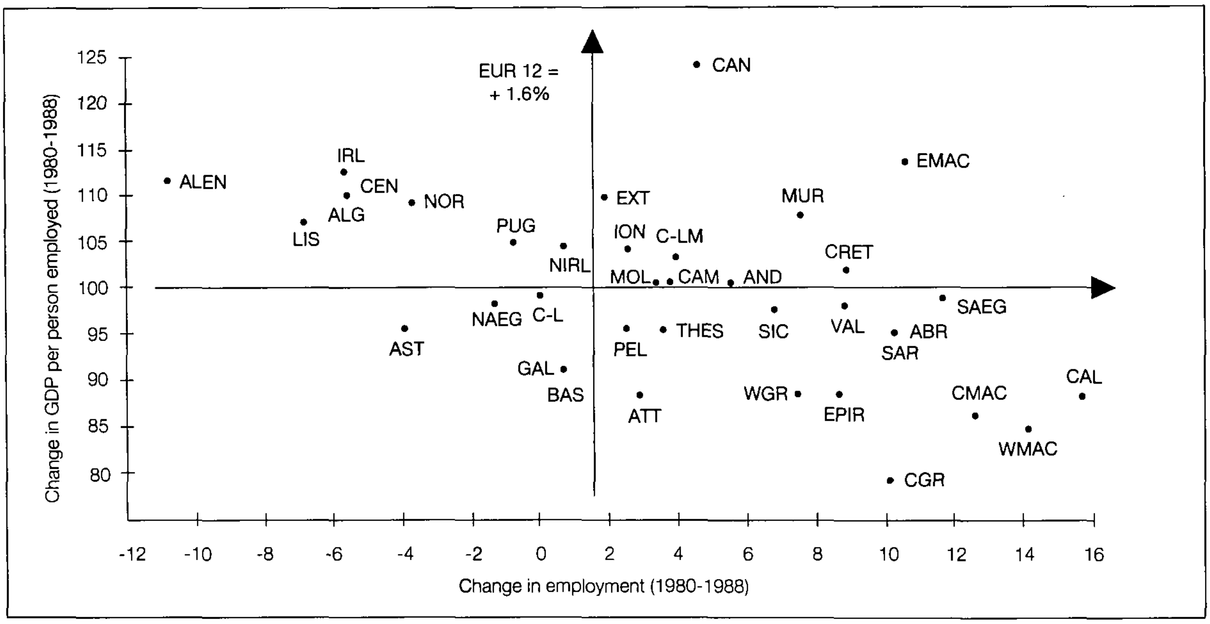
4. There is a risk that the regions in the vicious cycle group (and in a later stage perhaps also some of the regions in the sheltered development group) would not be able to find a place in the international division of labour and drop out of the international economy completely. Their survival will then depend almost entirely on income transfers from economically stronger regions in the same Member State or from other Member States.

Explaining differences in economic performance

5. Obviously, national factors play a major role in determining inter-regional disparity; the generally good performance of Irish regions and the generally bad performance of Greek regions can be put down to their relative macroeconomic policies. Sound macro-economic policies and investment in infrastructure are undoubtedly essential for long-term regional development. It should be noted that all Objective 1 regions still have important infrastructural gaps; this has usually hindered, but not always prevented, development.

6. However, there is diversity of performance within the same macroeconomic context; even within poorly performing regions there may be some local success stories. Nor is good infrastructure a guarantee of success. The best that can be said is that the lack of infrastructure and a bad macro-economic context hinder development. Even then, there

Figure 1: Regional growth patterns of the Objective 1 regions, 1980-88



are examples of success in regions with poor infrastructure (e.g. Ireland) or with a poor macro-economic environment (e.g. Crete). There is undoubtedly more to development than just infrastructure and macro-economics. Therefore, a 'bad' national context does not condemn regions to underdevelopment. At the same time, this stresses the importance of decentralization of decision-making power, especially in countries where the national economic environment is poor.

7. The routes to success are varied; tourism has been important in the Balearics, industry in Abruzzi. For both regions and local successes the task is therefore to identify common factors behind success to see if they can be reproduced elsewhere. Traditional theoretical explanations for success are considered. A review of the literature and a statistical analysis carried out in this study suggests that there is no conclusive evidence in support of any particular theory: for each case that fits one theory, other cases can be found that clearly contradict the theory.

8. From this statistical analysis of regional economic structure and its relationship to performance, a number of conclusions can be drawn. Structural factors did not provide a statistically significant explanation of the performance of each region; correlation and regression analyses confirmed that structural factors may explain the level of regional GDP, but not the growth rate. The presence of a single asset or benefit does not in itself encourage or prevent development. Thus, good road infrastructure, a highly qualified labour force or low labour costs did not automatically lead to a good local performance. At the same time, a peripheral location, or agricultural specialization did not in themselves prevent development opportunities.

9. The absence of an explanation based on the traditional theories necessitates an examination of more unconventional approaches which emphasize the less tangible development factors, factors which are often difficult to measure and quantify. The study examined the concept of 'milieu innovateur'. An innovative milieu is defined as the set of relationships occurring within a geographical area which bring unity to a production system, economic actors, and an industrial culture, generating a localized dynamic process of 'collective learning' and acting as an uncertainty-reducing mechanism in the innovation process. The model is an endogenous growth one, in that it emphasizes the local framework. Specialization is the key, leading to high synergy in the regional economy.

10. The more conventional factors such as education and infrastructure are still important in this story (indeed, the abundance of skills is possibly crucial). But the coherency of the regional economy and intangible factors such as informal networks are also part of the explanation for economic success. Therein lies the attractiveness of the model; not only can the processes outlined in the model be observed in parts of Italy and elsewhere in the EC, but also an explanation is provided for the lack of automatic linkage between success and single factors such as infrastructure. The important thing is not any single feature of the economy, but that it forms a coherent whole.

11. Innovative milieux do exist in Objective 1 regions, but they are rare and incipient. The macro-economic context and local framework affects their development (e.g. the backwardness of the social environment in Greece and the relative absence of local entrepreneurship and synergy in Ireland). Innovative milieux were found within converging and mixed evidence regions. Encouragingly, some milieux were present in diverging regions. There is therefore material for policy to build on. Provided that they are exploited coherently, some seemingly negative factors can play a positive role. For example, a peripheral location can have advantages for environmental protection and possible tourist development.

12. The fact that local resources are utilized in the development of an innovative milieu does not mean that the process can only start as a product of indigenous entrepreneurship. The catalyst for many local success stories in central Italy, for example, was an external firm setting up to take advantage of the skills already there. However, if external investment is attracted to a region, it has to link up with elements other than a cheap labour force or an unspoilt environment if a self-sustaining development process is to emerge. A link with an external dynamic is crucial even in cases where the development process is started by indigenous entrepreneurship. The potential for continued development relying solely on local capabilities is limited in the long run. Cooperation with external institutions, firms or research centres is important, as is the importance of the external dynamic for product and market diversification, in order to continually recreate local competitiveness and innovative capacity. This is even more important in lagging regions where conditions for the generation of local innovative milieux are weak.

The impact of European integration

13. There is a diversity of experience in the different regions. Contrary to what is sometimes argued, sensitive sectors[2] are strongly represented in some lagging regions, while in others their share of total employment is minimal.

14. The industrial structure of the Objective 1 regional economies differs from that of the more developed Member States. In particular, Portugal and Greece are less well integrated and rely upon inter-industry specialization in labour intensive, low technology sectors.

15. The likely impact of 1992 upon Greek and Portuguese regions is to encourage further inter-industry specialization in sectors such as textiles, clothing and footwear. In the short term this may have advantages, but in the longer term these sectors will be subject to competition from developing countries and future adjustment costs will be high. There is therefore a need to modernize the Objective 1 economies, with large scale investments needed to close infrastructure and knowledge gaps and thus enable the upgrading of their economies and a move towards an intra-industry development scenario. One problem is that the scale of the investment needed might not be forthcoming from national sources in a transition period, due to the disciplines imposed by monetary union.

Policy implications

16. From a Community regional policy point of view, the main challenge of the 1990s is to maintain the momentum of convergence in the successful regions and to 'turn round' the situation in the stationary or diverging regions.

17. Given that there are no standard policy recipes on offer, the fundamental aim of EC policy must be to advise, encourage and warn. To advise, first of all, on the lessons of successful experience elsewhere, on the creation or consolidation of technical and organizational capabilities at local, regional and national levels, and more generally on the effective management, piloting and assessment of development efforts. Secondly, to encourage the setting of clear and transparent goals expressing a credible ambition to reduce disparities in specified ways so as to prepare for closer economic integration, and to provide financial support commensurate with the ambition and the practical organization put in place to achieve that ambition. To warn finally, those who are at risk of diverging and those who are clearly diverging, of the likely medium-term consequences of a failure to turn round the situation: the risk, in short, of a growing dependency on transfers from outside.

18. Regions should ensure that policy success is measurable, that results are regularly monitored, and that the public and political authorities are regularly informed of progress. A determined effort should also be made to inform and involve the private sector and general public in the public sectors' development policy, and especially to ensure full information on the various grant systems or other forms of support available. Openness and transparency are key words for public policy in the 1990s.

19. Maintaining the momentum of convergence implies continued progress towards reducing reliance on lower labour costs and labour-intensive production. Regions must progressively establish the type of intra-industry specialization typical of more advanced countries, and develop advanced niches within their traditional sectors. The same approach applies to specialization in markets services, tourism in particular. Unit labour cost advantages should be maintained through productivity increases rather than through wage compression. This represents a major challenge for the lagging regions, because, to make significant progress towards closing the development gap, they will not have to 'run as fast as, but twice as fast as' the economically most prosperous regions.

20. Not all regions will be able to develop capabilities for innovation from internal resources. For this second category of regions, emphasis must be put on external investment as the main catalyst for local economic development. Such a policy will need to be based on a realistic and objective analysis of the

[2] 'Sensitive sectors' are sectors which are currently protected by non-tariff barriers or where barriers prevent the exploitation of economies of scale or where barriers allow the retention of price dicrepancies between Member States. It is thought that these sectors would be particulary 'sensitive' to the completion of the internal market when such barriers are removed.

attractiveness of the region concerned to external investors, and steps should be taken to improve the attractiveness in consequence. Moreover, for this to be successful as a means of stimulating local development, determined attempts must be made to deliberately embed external investment into the local environment.

21. A theme of growing importance should be the provision of information. Information is one of the key factors in creating interaction between local and external economic forces; in networking between firms and institutions, and more generally in successfully adapting to changing markets and technological environments. How information provision and interchange is organized and provided are vital questions in the development process. There is a role for specialized intermediaries to play, helping to put individuals, firms and institutions in contact with appropriate information. There is a role for the use of technology to provide and access information.

22. Secondly, regions need to reinforce their efforts to develop human capabilities in two ways. First there is a need to upgrade the skills and abilities within a region at all levels. Second, there is a need to improve the training of those individuals who will act as intermediaries or development agents. The latter's proactive role within a regional economy is, in any approach, aiming to influence the prevailing entrepreneurial culture, one of the main agents of change.

23. Thirdly, the institutional framework within which policy is designed and implemented needs to be decentralized, coordinated but flexible. In many regions, this framework may not exist and it is difficult to create *de novo*. A major task will therefore be to ensure that an effective and decentralized network of regional institutions exists, particularly in those countries where decision-making is highly centralized, so that policy can be managed from the local level, possibly by a development agency, with the active participation of other relevant local actors.

24. In conclusion, success in an uncertain and fast-changing world is determined by a high level of information, widely shared, a high level of skill attainment, a prevailing entrepreneurial culture, and a well-organized institutional framework. These are the qualities that development policies should seek to promote going beyond meeting basic requirements for infrastructures, education and vocational training. What must be avoided above all, is to encourage a form of sheltered development, isolated from market realities, or, worst of all, to permit by means of progressively greater financial transfers, a rising standard of living despite a diminishing level of productive activity due to an unwillingness to change out-dated and inappropriate economic and social practices.

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Résumé

PRÉSENTATION SUCCINCTE

Finalité principale du rapport

1. Le rapport analyse les performances économiques respectives des régions de l'objectif n° 1 dans les années 80 et il en évalue les retombées en 1992.

Régions divergentes et régions convergentes

2. Les résultats obtenus au regard de l'objectif n° 1 ont varié d'une région à l'autre. La tendance lourde atteste une hétérogénéité accrue dans le groupe des régions en retard de développement. Autrement dit, certaines régions comblent en partie leur retard alors que d'autres sont de plus en plus distancées (voir tableau 1).

Tableau 1: performance des régions de l'objectif n° 1 dans les années 80

État membre	Régions convergentes	Régions mixtes	Régions divergentes
Italie	Abruzzes Molise	Pouilles Sicile Sardaigne	Basilicate Campanie Calabre
Royaume-Uni		Irlande du Nord	
Irlande	Toutes régions		
Grèce	Macédoine orientale Îles Ioniennes Îles du sud de la mer Égée Crète		Macédoine centrale Attique Grèce centrale Grèce occidentale Épire Îles du nord de la mer Égée Macédoine occidentale Thessalie Péloponnèse
Espagne	Andalousie Castille-La Manche Murcie Canaries Valence	Galice Castille-León Estrémadure	Asturies
Portugal	Lisbonne Nord	Algarve Centre Alentejo	
France			Corse

3. Si l'on se réfère à la compétitivité au cours des années 80, les régions en retard peuvent être classées sous quatre rubriques.

- Relativement rares sont les régions, y compris parmi les régions convergentes, où l'on a pu voir des signes manifestes attestant un cycle de croissance vertueuse, dans lequel la progression de la productivité va de pair avec celle de l'emploi (quart nord-est de la figure 1).
- Nombre de régions - d'ailleurs souvent classées parmi les régions convergentes - ont dû procéder à une rationalisation impitoyable de leur capacité de production, d'où une croissance satisfaisante de la productivité, obtenue au prix de réductions d'effectifs et d'une croissance rapide du chômage (quart nord-ouest).
- La plupart des régions en retard se développent dans un contexte de protection artificielle, ce qui recèle des problèmes pour l'avenir. Il s'agit de régions qui ne sont pas parvenues à moderniser leur économie (faible croissance de la productivité), mais qui, souvent, n'ont pu maintenir ou accroître l'emploi que grâce à des mesures d'aide ou de protection explicites ou implicites (quart sud-est).
- Enfin, un petit groupe de régions semblent être entrées dans une spirale de déclin ou de désindustrialisation, en ce sens que les diminutions d'effectifs et les fermetures d'entreprises ne permettent pas de restaurer la compétitivité et que l'érosion de l'emploi s'y poursuit (quart sud-ouest).

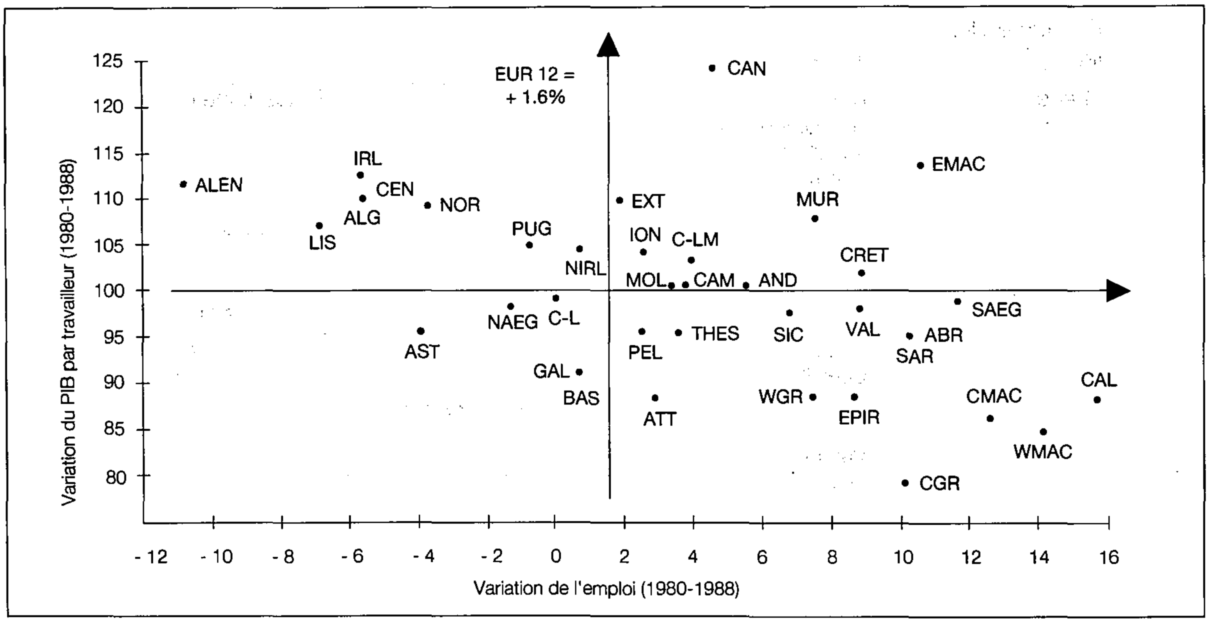
4. Il n'est pas exclu que les régions appartenant à la quatrième des catégories précitées (et peut-être ultérieurement quelques-unes aussi des régions relevant de la troisième de ces catégories) se révèlent hors d'état de trouver leur place dans la division internationale du travail et se voient totalement exclues de l'économie internationale. Leur survie serait alors presque entièrement tributaire de transferts économiques en provenance de régions plus prospères du même État membre ou d'autres États membres.

Explication des différences en matière de performance économique

5. Il est manifeste que les facteurs nationaux jouent un rôle considérable en matière de disparités entre régions: si, en général, les résultats se révèlent bons dans les régions irlandaises et médiocres dans les régions grecques, on peut y voir une corrélation avec les politiques macro-économiques nationales respectives. À noter que toutes les régions de l'objectif n° 1 accusent encore des retards importants en ce qui concerne les infrastructures et que ces retards ont le plus souvent, mais pas toujours, entravé le développement.

6. Il reste que les résultats obtenus peuvent varier dans le même contexte macro-économique: même dans des régions faibles, il peut y avoir de brillantes réussites à l'échelon local; inversement, l'existence d'une bonne infrastructure ne garantit pas le suc-

Figure 1 - Représentation de la croissance dans les régions de l'objectif n° 1 (1980-1988)



cès. Tout ce que l'on peut dire, c'est que le manque d'infrastructures et un mauvais environnement macro-économique entravent le développement, encore que l'on puisse citer des exemples de réussites dans des régions mal pourvues en infrastructures (en Irlande) ou pâtissant d'un environnement macro-économique médiocre (en Crète). Il est certain que le développement ne dépend pas uniquement de l'infrastructure et des facteurs macro-économiques. C'est pourquoi un «mauvais» contexte national ne condamne pas au sous-développement les régions concernées. Les observations qui précèdent illustrent bien l'importance que revêt la décentralisation du pouvoir décisionnel, en particulier là où l'environnement économique national est médiocre.

7. Différents itinéraires peuvent mener au succès; c'est ainsi que le tourisme a joué un rôle important aux Baléares et l'industrie dans les Abruzzes. Qu'il s'agisse des régions ou des réussites locales, il faut donc identifier les facteurs communs expliquant tel ou tel succès et se demander s'ils sont reproductibles ailleurs. Les explications théoriques fournies en la matière ne sont pas perdues de vue; si l'on examine la littérature spécialisée et l'analyse statistique figurant dans dans la présente étude, on ne voit aucun élément probant attestant le bien-fondé de telle ou telle théorie: pour un cas qui valide une théorie, on peut en citer plusieurs autres qui l'invalident.

8. Quelques conclusions peuvent être tirées de la présente analyse statistique de la structure économique régionale et de la corrélation existant entre celle-ci et les résultats obtenus. Les facteurs structurels n'ont pas permis d'expliquer de manière statistiquement significative la performance de chaque région; quant aux analyses de corrélation et de régression, elles ont confirmé que les facteurs structurels peuvent expliquer le niveau du PIB régional, mais pas le taux de croissance. En soi, l'existence de tel ou tel atout, de tel ou tel avantage, ne favorise ni n'empêche le développement. C'est ainsi qu'une bonne infrastructure routière, la disponibilité d'une main-d'œuvre hautement qualifiée ou le faible coût-horaire du travail n'ont pas automatiquement débouché sur de bons résultats à l'échelon local. À l'inverse, une situation excentrée ou une spécialisation agricole n'ont pas constitué intrinsèquement des freins au développement.

9. L'absence d'explication fondée sur les théories traditionnelles oblige à examiner des approches moins conventionnelles mettant l'accent sur des facteurs de développement moins tangibles et, par là même, souvent difficiles à mesurer et à quantifier. L'étude a porté en partie sur la notion de «milieu innovateur», par quoi l'on entend l'ensemble des relations qui, sur un territoire donné, fonctionnent comme un facteur d'unité au bénéfice d'un système de production, des acteurs économiques et d'une culture industrielle, ce qui déclenche localement un processus dynamique d'«apprentissage collectif» et qui allège le poids des incertitudes propres à inhiber l'innovation. Il s'agit là d'un modèle de croissance endogène, en ce sens qu'il met l'accent sur le cadre local. La spécialisation est l'élément capital, aboutissant à une forte synergie dans l'économie régionale.

10. Les facteurs plus classiques, tels que l'éducation et l'infrastructure, continuent en l'occurrence de jouer un rôle important (et même vital lorsqu'il s'agit des compétences auxquelles on peut faire appel). Il n'en demeure pas moins que la cohérence de l'économie régionale et des facteurs intangibles tels que les réseaux informels expliquent eux aussi, en partie, les résultats économiques. Là réside l'intérêt du modèle, intéressant en ce sens que les processus cernés dans le modèle peuvent être observés ici et là en Italie et ailleurs dans la Communauté européenne, mais aussi qu'il fournit une explication quant à l'absence de corrélation automatique entre la réussite et divers facteurs tels que l'infrastructure. Ce qui importe, ce n'est pas tel ou tel aspect de l'économie, mais sa cohérence globale.

11. Les milieux innovateurs existent assurément dans les régions de l'objectif n° 1, mais ils sont rares et encore peu implantés. Le contexte macro-économique et l'environnement local retentissent sur leur développement (voir l'arriération de l'environnement social en Grèce et le relatif effacement des dirigeants d'entreprise locaux ainsi que le faible degré de synergie en Irlande). Ces milieux innovateurs se rencontrent tant dans les régions convergentes que dans les régions «mixtes», et quelques-uns aussi, ce qui est encourageant, dans les régions divergentes. Autrement dit, il existe une base sur laquelle peut s'appuyer la politique à mettre en œuvre. Pourvu qu'on sache en tirer parti, certains facteurs apparemment négatifs peuvent jouer un rôle positif. À titre d'exemple, une situation excentrée peut présenter des avantages en ce qui concerne la protection de l'environnement et les possibilités de développement touristique.

12. Le fait que des ressources locales soient utilisées pour développer un milieu innovateur ne signifie pas que le déclenchement du processus doive nécessairement émaner du tissu entrepreneurial indigène. C'est ainsi que bon nombre de réussites locales enregistrées en Italie centrale ont été catalysées par l'établissement d'une firme extérieure à la région, désireuse de bénéficier des compétences existant sur place. Toutefois, si une région attire un investissement extérieur, l'existence d'une main-d'œuvre bon marché ou d'un environnement intact n'est pas suffisante pour amorcer un processus de développement durable. Une dynamique externe est absolument indispensable, même dans les cas où le tissu entrepreneurial indigène est à l'origine du processus de développement. Un développement qui serait entièrement tributaire de capacités locales trouverait fatalement ses limites à longue échéance. La coopération avec des institutions, des firmes ou des centres de recherche extérieurs revêt une grande importance pour la diversification des produits et des marchés si l'on entend que la compétitivité locale et la capacité d'innovation ne soient jamais prises en défaut. Cet impératif est encore plus prioritaire dans les régions en retard de développement offrant des conditions médiocres pour la constitution de milieux innovateurs locaux.

Les effets de l'intégration européenne

13. La situation varie d'une région à l'autre. Contrairement à ce qui se dit parfois, les secteurs sensibles[1] sont fortement représentés dans certaines régions en retard de développement, alors qu'ils ne représentent ailleurs qu'une part minime de l'emploi.

14. La structure industrielle des économies régionales relevant de l'objectif n° 1 diffère de celle qu'on trouve dans les États membres plus développés. Le Portugal et la Grèce en particulier, moins bien intégrés, sont tributaires d'une spécialisation intersectorielle à forte intensité de main-d'œuvre et à faible contenu technologique.

15. L'année 1992 aura probablement pour effet d'encourager les régions de la Grèce et du Portugal à intensifier leur spécialisation dans des secteurs tels que le textile-habillement et la chaussure. S'il est permis d'escompter des avantages à court terme d'une telle évolution, il n'empêche que les secteurs en question seront, à plus longue échéance, affrontés à la concurrence des pays en voie de développement et que le coût social de l'adaptation future sera élevé. Aussi est-il nécessaire de moderniser les économies relevant de l'objectif n° 1, en réservant les investissements à grande échelle à la mise à niveau des infrastructures et au rattrapage des retards en matière de connaissances, moyennant quoi les économies en question pourraient progresser conformément à un scénario de développement industriel global. Le problème est que le volume de l'investissement requis peut ne pas correspondre aux possibilités des sources de financement nationales dans une période de transition, compte tenu des contraintes imposées par l'Union monétaire.

Conséquences politiques

16. Au regard de la politique régionale de la Communauté, le principal défi des années 90 est de maintenir le rythme du processus de convergence dans les régions prospères et d'inverser la tendance dans les régions qui stagnent ou qui prennent du retard.

17. Étant donné qu'il n'existe pas de recettes toutes faites, la politique de la Communauté européenne doit viser avant tout à conseiller, à encourager et à mettre en garde. Les conseils prodigués doivent, en premier lieu, faire connaître les enseignements tirés des succès enregistrés ailleurs, porter sur la création et sur la consolidation de capacités techniques et organisationnelles aux niveaux local, régional et national et, plus généralement, avoir trait aux conditions de l'efficacité quant à la gestion, au pilotage et à l'évaluation des actions de développement. Il s'agit ensuite d'encourager la définition d'objectifs clairs et cohérents exprimant une volonté crédible de réduire les disparités selon des modalités déterminées, de manière à frayer les voies d'une intégration économique plus étroite, et de fournir des moyens financiers qui soient à la mesure de l'ambition affichée et de l'organisation pratique mise en place dans cette perspective. Il faut enfin mettre en garde les régions qui risquent de diverger et celles où le processus de divergence est déjà manifeste, en leur exposant les conséquences qui résulteraient probablement à moyen terme d'une impossibilité de redresser la situation, c'est-à-dire en résumé le risque d'être de plus en plus tributaires de transferts financiers en provenance de l'extérieur.

18. Il appartient aux régions de faire en sorte que l'on puisse mesurer les résultats de la politique mise en œuvre, que ces résultats soient contrôlés à inter-

[1] On entend par là des secteurs dans lesquels il existe actuellement des obstacles non tarifaires assurant une certaine protection, ou d'autres obstacles qui empêchent de bénéficier d'économies d'échelle ou qui permettent de maintenir des disparités de prix entre États membres. Ces secteurs sont censés être particulièrement «sensibles» à l'élimination des obstacles en question, inhérente à la réalisation du grand marché.

valles réguliers et que la population et les autorités politiques soient périodiquement informées des progrès accomplis. De grands efforts s'imposent également en ce qui concerne l'information et la participation du secteur privé et du grand public quant à la politique de développement du secteur public, et il convient tout particulièrement de veiller à une information exhaustive à propos des divers systèmes de subventions ou autres types d'aide disponibles. Ouverture et transparence doivent être les mots d'ordre essentiels de la présente décennie.

19. Si l'on veut maintenir le rythme du processus de convergence, il faut s'efforcer de devenir moins tributaire d'une main-d'œuvre à bon marché et d'une production à forte intensité de main-d'œuvre. Il importe que les régions adoptent progressivement le type de spécialisation industrielle propre aux pays plus avancés et qu'elles développent des créneaux d'excellence au sein de leurs secteurs traditionnels. Il en va de même de la spécialisation dans diverses activités de services, le tourisme en particulier. Mieux vaudrait maintenir les avantages inhérents au coût unitaire du travail par des gains de productivité que par des réductions de salaire. C'est là pour les régions en retard de développement un redoutable défi, car si elles veulent progresser notablement dans la voie du rattrapage, elles devront «courir non pas aussi vite, mais deux fois plus vite» que les autres.

20. Toutes les régions ne seront pas en mesure de se doter de capacités d'innovation en mobilisant uniquement leurs propres ressources. Pour les régions concernées, il faudra privilégier l'apport de capitaux extérieurs en tant que catalyseur principal du développement économique local. Pareille politique devra être fondée sur une analyse raisonnable et objective de l'attractivité de la région en cause pour les investisseurs extérieurs et il conviendra de prendre les initiatives éventuellement nécessaires pour améliorer comme il convient les attraits de la région. Si l'on veut réussir à stimuler le développement économique local en utilisant cette méthode, il faudra, de surcroît, avoir la volonté d'insérer harmonieusement l'investissement extérieur dans le contexte local.

21. L'information est un thème appelé à prendre de plus en plus d'importance; elle est un des facteurs déterminants pour susciter une interaction entre forces économiques locales et extérieures, pour établir un réseau de relations entre entreprises et institutions et, plus généralement, pour promouvoir avec succès l'adaptation à un monde où les marchés et les techniques évoluent. Dans le domaine de l'information, l'offre ainsi que les modes d'organisation et de circulation sont d'une importance capitale pour le processus de développement. Des intermédiaires spécialisés ont ici leur rôle à jouer pour permettre aux particuliers, aux entreprises et aux institutions d'avoir plus facilement accès aux informations adéquates, grâce à la mise en œuvre des techniques appropriées.

22. Il faut, en second lieu, que les régions intensifient leurs efforts visant à développer les capacités humaines en fonction de deux objectifs, qui sont, respectivement, d'améliorer les compétences et les aptitudes dans la région concernée, et de mieux former les personnes qui sont appelées à devenir des acteurs du développement. Dans une économie régionale, la qualité et la résolution des acteurs du développement dans toute approche visant à influer sur la culture d'entreprises existantes sont un des principaux facteurs de changement.

23. En troisième lieu, sans que la flexibilité en pâtisse, la décentralisation et la coordination s'imposent en ce qui concerne le cadre institutionnel dans lequel la politique est conçue et mise en œuvre. Dans bon nombre de régions, ce cadre institutionnel peut faire défaut et il est difficile de le recréer. Il importera donc de veiller à l'existence d'un réseau efficace et décentralisé d'institutions régionales, en particulier dans les pays où le pouvoir décisionnel est fortement centralisé, de telle sorte que la politique adoptée puisse être gérée au niveau local, si possible par une agence de développement, avec la participation active d'autres organismes compétents.

24. En conclusion, la réussite dans un monde incertain en mutation rapide passe par une information de qualité largement partagée, par le haut niveau des aptitudes individuelles, par une culture d'entreprise bien assimilée et par un cadre institutionnel solide. Ce sont là les qualités que les politiques de développement devraient s'attacher à promouvoir, au-delà de la satisfaction des besoins fondamentaux en matière d'infrastructures, d'enseignement et de formation. Il faut éviter par-dessus tout d'encourager un type de développement artificiellement protégé, isolé des réalités du marché, ou, pis encore, d'élever le niveau de vie par un accroissement progressif des transferts financiers malgré une baisse de l'activité productive dans les cas où celle-ci serait imputable au refus de modifier des pratiques économiques et sociales obsolètes et inadéquates.

Introduction

1.1 Regional disparities in the Community

The last 30 years have seen considerable change in regional development patterns within the European Community. Between the early 1960s and the mid-1970s, regional income disparities had declined significantly. Unfortunately this favourable trend came to an abrupt halt in 1975. In the following decade the first oil shock convergence gave way to a regressive phase which returned inter-regional disparities to the levels of the start of the early 1970s. The main factors responsible for this disappointing development were the deterioration of the general economic climate, the end of migration from weaker to stronger Member States as a consequence of the recession, and the emergence of a new industrial paradigm based upon the use of information technologies. However, the situation seems to have stabilized around the middle of the 1980s and recent data suggest a slight reduction in the overall level of disparities since 1986 under the influence of steady growth in Spain, Portugal and Ireland. Nevertheless, in spite of this, the income gap between the Community's poorest and richest regions remains very wide. In 1989 income per capita in the top 10 regions remained more than three times that of the bottom 10 regions. Reduction of these disparities remains a priority as an integral part of creating a more cohesive Community.

While all Member States were affected by recession in the 1970s and more vigorous economic growth from 1984 onwards, the impact on the Community's lagging regions has not been straightforward. In some cases there has been convergence with the rest of the Community, in others there has been divergence. We cannot therefore see all lagging regions in the same light. Some are doing well, and can be classified as 'converging regions', on the verge of joining the rich areas of the Community, others are definite 'diverging regions', on the verge of entering a cumulative downward spiral. How can this heterogeneity be explained? Which factors have led to regional development? Can, or should, these be replicated in less successful regions? How will plans for greater Community integration affect future regional development? What are the implications for policy formation and implementation?

This report on the development challenges facing the Community's lagging regions set out to answer these questions through investigating the future for the Objective 1 regions in the 1990s. It is based upon a longer report compiled by the Groupe de recherche européen sur les milieux innovateurs (GREMI) under the direction of Professor Roberto Camagni and Professor Michel Quevit. This report updates the GREMI document and takes advantage of recently released data which were not available for the original research.

The report examines the performance of the Community's lagging regions over the 1980s with a view to identifying the prospects for development in the 1990s and the policy initiatives needed to help achieve this. It is important to note that the context for development in the 1990s is different from that of the previous decade. The 1980s was a decade that began in recession for the Community and ended in fairly rapid economic recovery. As the report reveals, national differences and national macroeconomic policies played a key role in development prospects at the regional level. The 1990s will be a decade in which these national differences may assume a reduced importance, particularly as the policies set in motion by the 1987 Single European Act for economic and social cohesion take on concrete forms. Member States may increasingly operate within a Community-wide regulatory framework where national macro-economic policies become increasingly similar. This is not to argue that responses will be the same. The impact of Community-wide measures will be filtered through a net of national and regional particularities to create specific outcomes in specific places.

1.2 Structure of the report

The central issue of this report is the difference between converging and diverging regions. Which regions are converging and which are diverging? What factors lead to convergent or divergent development? Will plans for greater Community integration affect whether a region continues to win or lose? Can policy turn a diverging into a converging region?

Chapter 2 analyses data on the economic performance of Objective 1 regions and tries to identify those regions which are converging and those which are diverging.

Chapter 3 gives profiles of the main Objective 1 areas of Greece, Spain, Ireland, Italy, and Portugal. Firstly, this continues the descriptive emphasis of Chapter 2. Secondly, in these countries Objective 1 areas form all or a large proportion of the national economy, and this is an opportunity to see whether there is a link between national economic context and policy on the one hand, and regional performance on the other. There is a clear tendency for regions in countries who pursue sound macro-economic policies to win and regions in other countries to diverge, but every country has its converging as well as its diverging areas. The inference is that sound macro-economic policy is important but not sufficient.

Chapter 4 is an attempt to go deeper, analysing and explaining regional success or failure in terms of economic theory and in the light of available data. Theories such as endogenous growth and 'innovative milieux' are advanced. Some regions fit one theory well, other regions will be better described by a competing theory. The conclusion is that each of the theories has some relevance but none of them is the explanation of regional success or failure.

Chapter 5 looks at prospects for the lagging regions in the light of the Community's internal market programme. For lagging regions, the single market both offers new opportunities and threatens new problems. This chapter attempts to identify those Objective 1 regions which seem to be in a strong position to benefit from the single market process and those regions which are less well placed to take advantage of 1992.

Chapter 6 considers the policy implications of the rest of the report. In view of the different nature of problems and likely solutions from one region to another, and the uncertain effects of economic integration, there is no single 'miracle cure', but a menu of suggestions to be tailored to different circumstances. In the absence of a clear recipe for success, policy should be continuously subject to critical scrutiny to ensure that it is achieving the desired effects.

The annex provides a statistical update, showing the latest available Eurostat data on regional incomes and the trend.

1.3 Objective 1 regions

Finally in this introduction, it is worth outlining both the definitional basis for Objective 1 regions and their location. Lagging regions are taken, in this report, to be the Objective 1 regions of the European Community for the period 1989 to 1993 (defined at the NUTS level II: i.e. nomenclature of territorial units for statistics). Objective 1 regions are defined as regions where GDP per capita is at least 25% below the Community average, although this threshold is relaxed in special circumstances (e.g. for Northern Ireland). The coverage in 1989 was as follows:

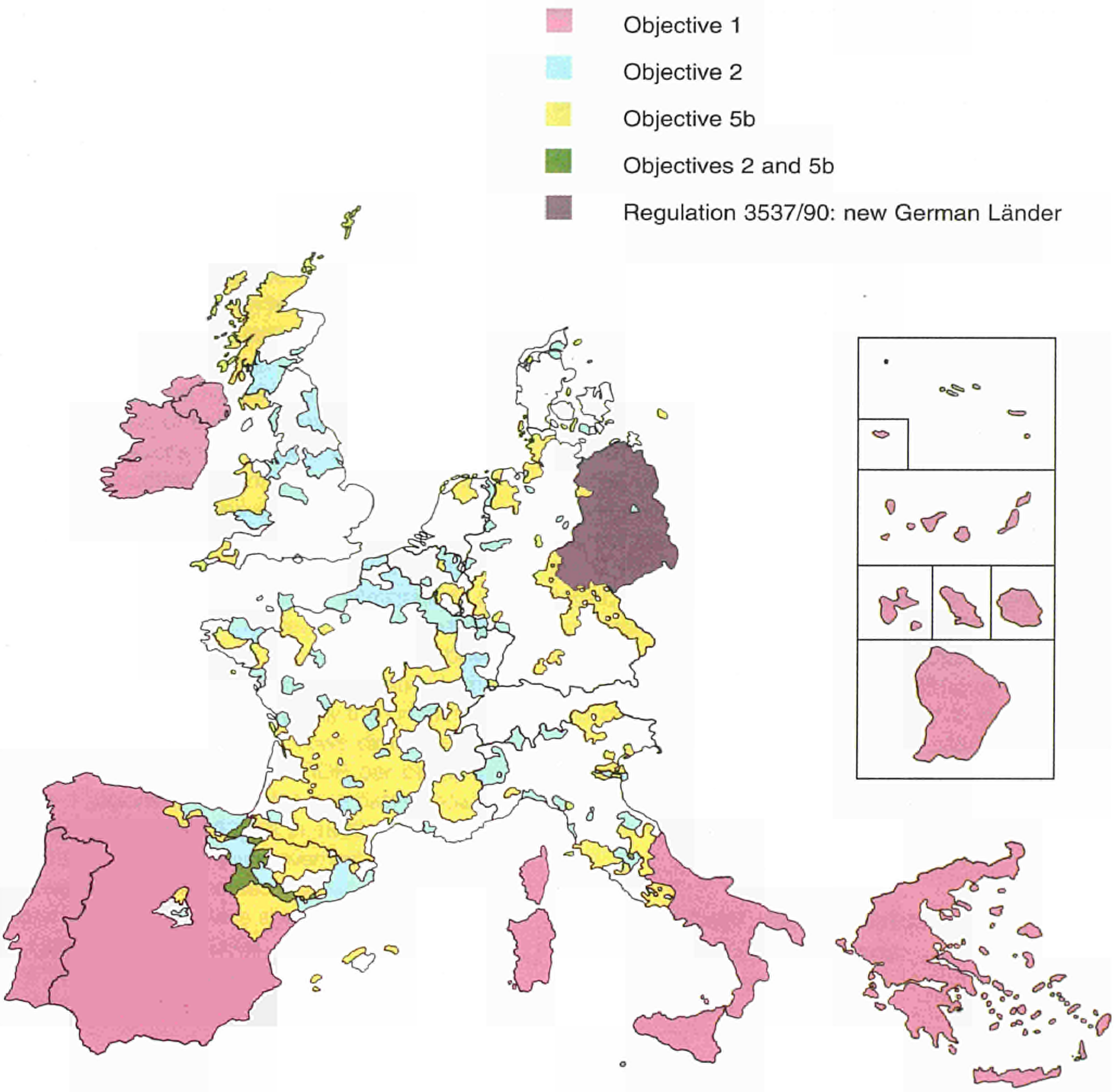
Greece	Entire country
Spain	Andalucia, Asturias, Castilla Leon, Castilla La Mancha, Cueta y Mellila, Valencia, Extremadura, Galicia, Canarias and Murcia

France	French overseas departments and Corsica
Ireland	Entire country
Italy	Abruzzi, Basilicata, Calabria, Campania, Molise, Puglia, Sardegna and Sicilia
Portugal	Entire country
UK	Northern Ireland.

All of these regions occupy peripheral positions within the Community, mainly to the south and west (see Figure 1.1). They covered nearly 40% of the Community's territory and contained 21.7% of its total population. Average per capita income was 62% of the Community average.

The French overseas departments do not figure in this report, due to problems of data availability. Lack of data also limited the extent to which the Azores, Madeira and Corsica could be included in the study.

Figure 1.1: Objective 1 regions for the period 1989-93



Identifying converging and diverging regions

2.1 Overview

As a prelude to examining the prospects for the Objective 1 regions in the 1990s, the performance of regions in the 1980s is examined. Within the category of Objective 1 regions, we need to differentiate between those regions which have experienced success and those which have performed poorly.

Before considering the specific performance of each region, an analysis of the aggregate performance of all Objective 1 regions with respect to the European average is instructive. During the first half of the 1970s, Objective 1 regions caught up substantially with the EC average income per capita. This was due to a combination of higher than average GDP growth and a process of population outmigration. In the first half of the 1980s, however, GDP growth in the Objective 1 regions was only marginally above the Community average. Moreover, population in the Objective 1 regions grew more rapidly than in the rest of the Community as migratory flows diminished or reversed. The result was that GDP per capita in Objective 1 regions (measured in purchasing power parities) fell slightly from 62.0% in 1980 to 61.5% in 1985. Due to the relative improvement in their economic performance in the second half of the 1980s the Objective 1 regions were able to make up for the ground lost in the early 1980s, and by 1989 per capita GDP in these regions had increased to 62.1% of the Community average.

While the relative level of per capita GDP in purchasing power parities in the Objective 1 regions hardly changed between 1980 and 1989, a different trend occurred with respect to productivity. In 1980 labour productivity in the Objective 1 regions was 57.6% of the Community average (measured as GDP per person employed at current exchange rates). In the period 1980-88, the lagging regions underwent drastic rationalization of their productive capacity. In consequence, productivity increased to 62.2% of the EC average by 1988. The result was an increase in surplus labour in many regions and rising levels of unemployment.

Against the background of the general trends in disparities within the Community, there have been differences between Member States, with some of the weaker countries achieving rates of growth above the Community average. In Spain, Ireland and Portugal, the tendency was towards very gradual convergence on Community average GDP per head beginning in 1985-86, with most (but not all) regions displaying this tendency. The position of Greece and of most of its regions worsened in relation to the rest of the Community. The Mezzogiorno showed mixed results. The overall result is that disparities in incomes per head converged slightly at the inter-regional level.

2.2 The recent performance of Objective 1 regions: winners and losers

The principal indicator of regional performance chosen was relative change in GDP per capita in purchasing power parities over the period 1980-89 (particular attention was paid to the 1985-89 trend). It was chosen as a guide to the capability of each region to provide, from internal activities, an increasing living standard to its population. The second indicator was the productivity growth (change in GDP per employee) to show the growth of local competitiveness representing the main instrument to achieve increasing living standards. The two indicators were used to produce a list of converging and diverging regions. The quality of growth was analysed by comparing productivity changes with employment creation to indicate whether growth could be ascribed to protection of basically uncompetitive industry, to rationalization and cuts of the least productive jobs, or to a virtuous cycle of increased productivity stimulating industry. The results of this were then compared with the list of converging and diverging regions. All data are provided in Annex I of this report.

2.3 Performance of Objective 1 regions: GDP per capita

Figure 2.1 shows GDP per capita levels in purchasing power parities in 1980 plotted against GDP per capita growth over the period 1980-89. Figure 2.1 reveals four groups of regions.

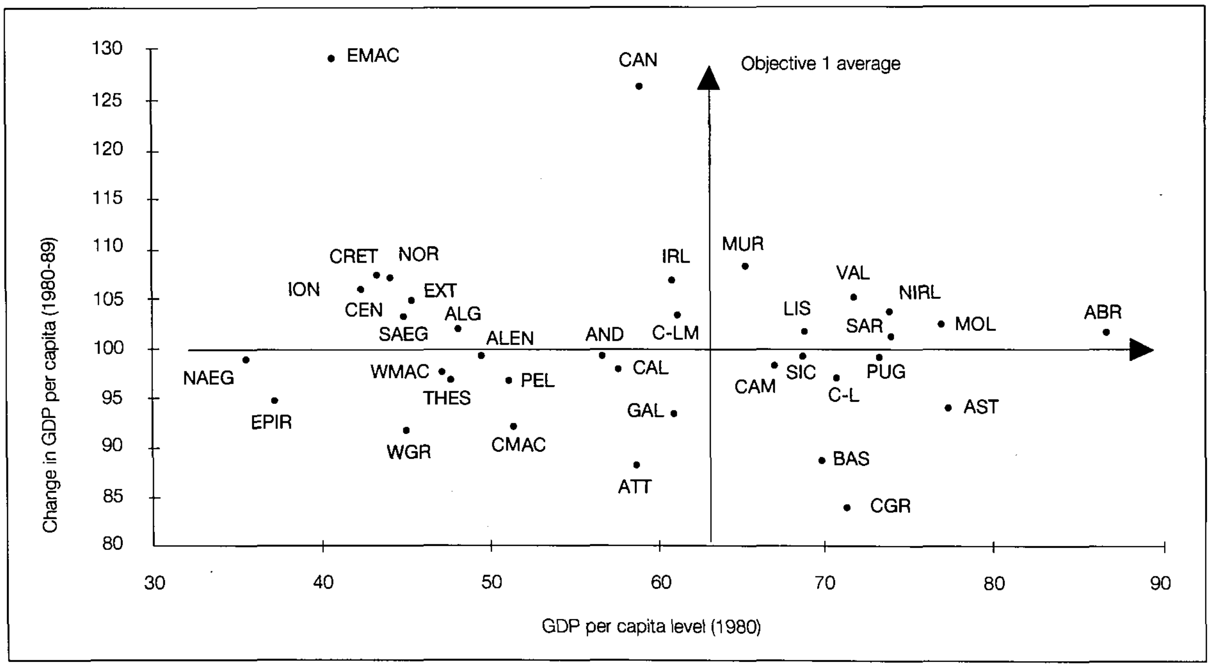
• First, there are those which were relatively strong in 1980 and have improved their position over the period 1980-89. Examples of such regions are Murcia, Valencia, Lisboa, Molise, Abruzzi and Sardegna.

• Then, there are those regions which had very low initial levels of GDP per capita in 1980, but which have grown at a faster rate than the EC average. This group comprises e.g. Canarias, Extremadura, Norte, Centro, Algarve, Ireland, Eastern Macedonia, Crete, the Ionian and Southern Aegean Islands.

• There are regions which had a low level of GDP per capita in 1980 and which have experienced lower than average growth rates. These are; Andalucia, Galicia, Calabria, Northern Aegean Islands, Western Macedonia, Thessaly, Peleponnese, Epirus, Central Macedonia and Western Greece.

• Finally, there are regions where GDP per capita in 1980 was higher than the Objective 1 region average, but where growth has been lower than the EC average. These regions include among others Central Greece, Castilla Leon, Asturias, Basilicata and Campania.

Figure 2.1: GDP per capita: level and change



Source: see Annex 1.

2.4 Performance of Objective 1 regions: productivity

Figure 2.2 divides the regions into four categories in terms of their productivity rate in 1980 and their productivity performance in the period to 1988.

• The figure reveals a group of regions with higher than average productivity levels in 1980 and improved productivity levels at a rate greater than the EC average. These regions comprised e.g. Castilla La Mancha, Murcia, Canarias, Puglia and Northern Ireland.

• A second group of regions had low productivity in 1980 and an increase of less than the EC average. Apart from Galicia, this group consisted entirely of Greek regions (e.g. Central and Western Macedonia, Thessaly, Epirus, Western Greece and Peleponnese).

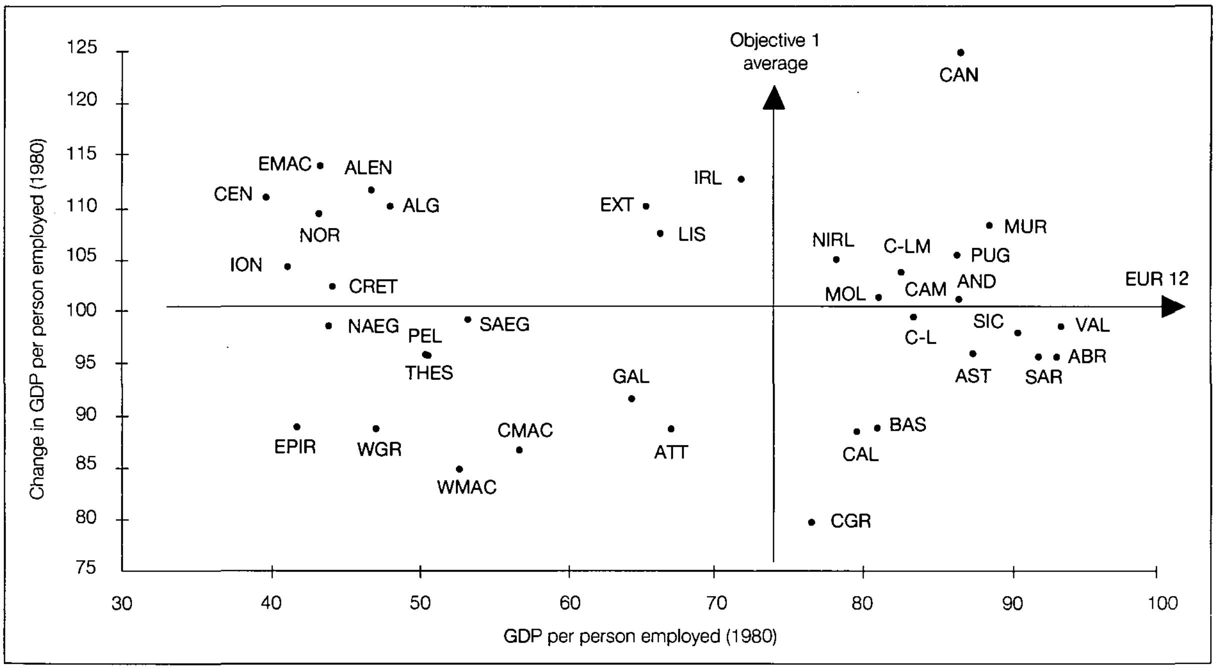
• Some regions had low initial productivity levels and managed to improve productivity at a level greater than the EC average. These regions include e.g. Crete, Ionian Islands, Eastern Macedonia, Centro, Norte, Alentejo and Algarve.

• Finally, a number of regions had 1980 productivity levels greater than the Objective 1 region average, but had a poor productivity performance over the 1980-88 period. These regions include among others Basilicata, Calabria, Abruzzi, Sardegna and Asturias.

2.5 The performance of single regions

In this section the analysis so far is summarized and a final classification of Objective 1 regions presented, based on their performance over the 1980-89 period. This classification also took into account qualitative assessments by national experts. It is important to note that the classification of converging or diverging regions is a difficult task and one which is often subject to arbitrary value judgements. Thus strategic sectors vary in different locations and the same performance indices can result from very different processes with different meanings. The behaviour of individual regions can be positive on some indicators and negative on others. Nevertheless, a simple classification is useful as a starting point for policy.

Figure 2.2: GDP per person employed: level and change



Source: see Annex 1.

The Objective 1 regions are therefore divided into three categories defined in relation to regional performance with regard to the EC average over the 1980-89 period. These categories are:

- converging regions with a performance higher than the EC average, 1980-89;
- diverging regions with a performance lower than the EC average, 1980-89;
- mixed-evidence regions which display different characteristics dependent upon which indicators are utilized, or which have important specific features.

It is useful to note two characteristics of this classification. First, it is based upon economic performance rather than upon static economic strength or structure. The main emphasis is upon the capability of Objective 1 regions to withstand competition from, and catch up with, stronger European regions. Second, the point of reference is the EC average rather than the more usually employed national averages. Table 2.1 summarizes the categorization and Figure 2.3 presents the results in map form.

Note: Ireland as a whole falls into the converging category. Classifications at NUTS 3 level were determined mainly on the basis of population and employment statistics and on some proxies such as average industrial wages and net output per employee in industry. These data suggest that Donegal and North West and Midlands should be classified as diverging regions. The remaining regions (East, West, South East, South West, Mid West and North East) were converging.

2.6 Regional growth patterns

The next step in this categorization of Objective 1 regions, is to analyse regional patterns of growth in terms of two variables; productivity and employment growth. This analysis attempts to identify the 'sustainability' of regional development and to differentiate positive and negative features. For example, a positive performance in productivity growth could result from either a virtuous process of rising competitiveness and growth or from a process of rationalization, with employment cuts. Four

Table 2.1: The performance of Objective 1 regions in the 1980s

Member State	Converging	Mixed evidence	Diverging
Italy	Abruzzi Molise	Puglia Sicilia Sardegna	Basilicata Campania Calabria
UK		Northern Ireland	
Ireland	All regions		
Greece	East. Macedonia Ionian Isles South Aegean Isles Crete		Cent. Macedonia Attica Cent. Greece West. Greece Epirus North. Aegean Isles West. Macedonia Thessalya Peleponnese
Spain	Andalucia Castilla La Mancha Murcia Canarias Valencia	Galicia Castilla Leon Extremadura	Asturias
Portugal	Lisboa Norte	Algarve Centro Alentejo	
France			Corsica

possible patterns of regional growth are revealed (see Figure 2.4):

- a virtuous cycle, where a higher than average productivity growth is associated with a good employment performance;
- rationalization, where a higher productivity growth is attained through severe employment cuts;
- a vicious cycle or de-industrialization, where employment cuts and closures are unable to restore competitiveness and job losses continue;
- sheltered development, where explicit or implicit policies of assistance aid the rapid initial development of backward areas and employment generation, irrespective of poor productivity performance.

Figure 2.4 classifies the Objective 1 regions into these different categories. While not all of those in the virtuous cycle category are 'converging' regions, the majority are (Canarias, Castilla La Mancha, Andalucia, Murcia, Ionian Islands, Crete, Eastern Macedonia and Molise). Extremadura is in the mixed-evidence category and Campania is (just) a 'diverging' region. Four regions, Asturias, Galicia, Castilla Leon and the Northern Aegean Islands, fall into the vicious cycle category. Asturias and the Northern Aegean Islands were both classified as diverging regions indicating major development problems in these regions. Galicia and Castilla Leon are mixed-evidence regions. The former had a poor performance in the early 1980s, but has considerably improved its performance since 1985. Of particular interest are the large number of regions which fell into the sheltered development category, including converging, diverging and mixed-evidence regions. The restructuring category largely consists of Irish and Portuguese regions indicating improvement at the expense of employment cuts.

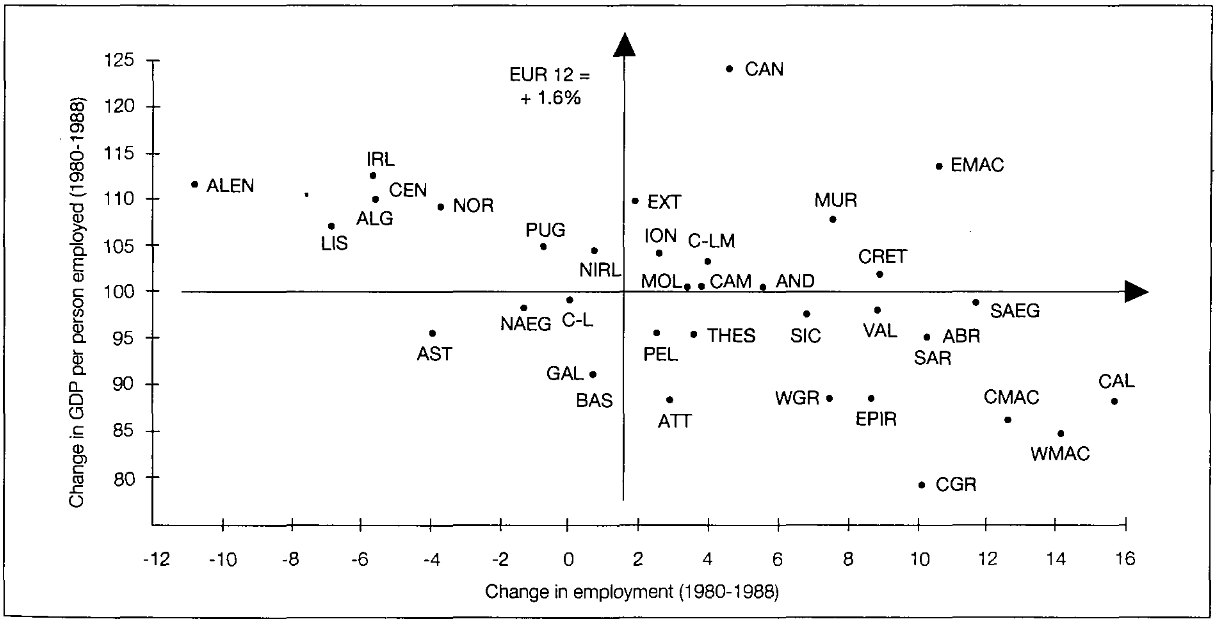
2.7 Conclusions

This section has identified the converging and diverging regions amongst Objective 1 regions in the 1980s. A number of conclusions emerge from this analysis.

- The performance of Objective 1 regions was diverse. Indeed, a broad trend was towards greater heterogeneity amongst the group of lagging regions. Thus some regions are catching up, some falling further behind.

- There is no automatic link between the relative strength of the region at present and whether it is catching up or not, but those poorer Objective 1 regions which happen to be falling behind have the

Figure 2.4: GDP regional growth patterns of the Objective 1 regions, 1980-88



Source: see Annex 1.

worrying prospect of entering a downward spiral.

• Even for those regions catching up, disparities remain very wide and it will take a long time for convergence to occur. It should also be noted that conditions in the late 1980s were favourable for the Objective 1 regions and it remains to be seen whether they will maintain their position in the current recession.

• With regard to competitiveness, many Objective 1 regions, often those classified as converging regions on the basis of GDP changes, were forced into drastic rationalization of productive capacity. This resulted in good productivity growth, but at the expense of rapidly rising unemployment. Conversely, there are a significant number of lagging regions (again including converging regions) in the sheltered development category which indicates problems stored up for the future. Few regions, even among the converging regions, showed strong signs of a virtuous cycle of increasing productivity and employment.

Annex 1: Indicators of economic performance of Objective 1 regions

		GDP per head (PPS) Index (EUR 12 = 100)				Total population % change 1980-89
		1980	1985	1989	1980-89 change[1]	
EUR 12		100.0	100.0	100.0	100	2.5
Eastern Macedonia	EMAC	40.6	53.3	52.5	129	-0.2
Central Macedonia	CMAC	51.3	49.8	47.3	92	8.0
Western Macedonia	WMAC	47.3	47.2	46.1	97	1.7
Thessaly	THES	47.6	48.0	46.1	97	4.5
Epirus	EPIR	37.2	36.6	35.3	95	4.0
Ionian Isles	ION	40.6	44.7	43.0	106	3.4
Western Greece	WGR	45.0	43.4	41.4	92	6.0
Central Greece	CGR	71.3	62.9	59.9	84	6.7
Peleponnese	PEL	51.1	51.4	49.4	97	3.8
Attica	ATT	58.6	53.7	51.8	88	5.4
North Aegean Isles	NAEG	35.4	36.0	35.0	99	0.5
South Aegean Isles	SAEG	44.9	49.3	46.5	103	9.4
Crete	CRET	43.4	48.7	46.5	107	6.4
Galicia	GAL	61.0	55.1	57.0	93	0.6
Asturias	AST	77.3	73.1	72.7	94	0.0
Castilla Leon	C-L	70.5	67.3	68.5	97	4.4
Castilla La Mancha	C-LM	61.0	56.7	63.1	103	6.3
Extremadura	EXT	45.4	47.8	47.6	105	9.0
Valencia	VAL	71.8	73.4	75.4	105	4.0
Andalucia	AND	56.7	53.7	56.3	99	9.4
Murcia	MUR	65.2	63.4	70.5	108	9.6
Canarias	CAN	58.9	67.5	74.5	126	5.1
Ireland	IRL	60.8	62.4	64.9	107	3.4
Campania	CAM	67.0	69.7	65.8	98	6.8
Abruzzi	ABR	86.6	88.8	88.0	102	4.2
Molise	MOL	77.0	78.2	78.9	102	2.2
Puglia	PUG	73.2	71.0	72.7	99	5.7
Basilicata	BAS	69.7	65.9	61.9	89	2.0
Calabria	CAL	57.7	61.5	56.6	98	4.9
Sicily	SIC	68.6	68.6	68.1	99	5.8
Sardegna	SAR	73.8	75.6	74.7	101	4.6
Norte	NOR	44.0	40.2	47.1	107	1.2
Centro	CEN	42.4	47.8	44.9	106	1.5
Lisboa e Vale do Tejo	LIS	68.7	66.9	69.9	102	0.7
Alentejo	ALEN	49.4	43.6	49.3	100	2.5
Algarve	ALG	48.0	44.1	48.9	102	4.6
Northern Ireland	NIRL	73.8	78.0	76.5	104	1.6
Objective 1[2]	O1R	62.0	61.5	62.1	100	4.8

1 1980-89 change: Calculated as ((X**i/X*i)/(X**n/X*n))*100 where 'X' represents per capita GDP, (PPS: Purchasing power standards);"*" the beginning of the period and "**" the end, 'i' the region concerned and 'n' EUR 12.
2 Objective 1: Sum of the regions in the table (it therefore excludes Corsica, DOM, Cueta y Melilla, Madeira and Azores for which no complete data-set could be assembled).

Sources: Eurostat and GREMI study (national statistical sources).

		GDP (PPS) per person employed Index (EUR 12 = 100)			Total employment % change 1980-88
		1980	1988	'1980-88 change[1]	
EUR 12		100.0	100.0	100	1.6
Eastern Macedonia	EMAC	43.0	48.9	114	10.7
Central Macedonia	CMAC	56.6	48.9	86	12.6
Western Macedonia	WMAC	52.6	44.6	85	14.1
Thessalya	THES	50.3	48.1	96	3.6
Epirus	EPIR	41.5	36.9	89	8.7
Ionian Isles	ION	41.2	42.9	104	2.6
Western Greece	WGR	47.0	41.7	89	7.5
Central Greece	CGR	76.5	60.9	80	10.2
Peleponnese	PEL	50.5	48.3	96	2.6
Attica	ATT	67.1	59.4	89	3.0
North Aegean Isles	NAEG	43.9	43.3	99	-1.3
South Aegean Isles	SAEG	53.1	52.6	99	11.7
Crete	CRET	44.1	45.1	102	8.9
Galicia	GAL	64.3	58.8	91	0.7
Asturias	AST	87.4	83.7	96	-3.9
Castilla Leon	C-L	83.6	83.0	99	0.1
Castilla La Mancha	C-LM	82.8	85.7	104	4.0
Extremadura	EXT	65.5	72.0	110	1.9
Valencia	VAL	93.3	91.7	98	8.9
Andalucia	AND	86.6	87.2	101	5.6
Murcia	MUR	88.6	95.7	108	7.6
Canarias	CAN	86.7	107.8	124	4.6
Ireland	IRL	72.0	81.0	113	-5.6
Campania	CAM	82.8	83.2	100	3.8
Abruzzi	ABR	93.1	88.7	95	10.4
Molise	MOL	81.1	81.7	101	3.4
Puglia	PUG	86.4	90.9	105	-0.7
Basilicata	BAS	80.9	71.7	89	1.6
Calabria	CAL	79.7	70.4	88	15.8
Sicily	SIC	90.4	88.4	98	6.8
Sardegna	SAR	91.9	87.7	95	10.3
Norte	NOR	43.1	47.2	109	-3.7
Centro	CEN	39.7	44.0	111	-5.5
Lisboa e Vale do Tejo	LIS	66.3	71.1	107	-6.8
Alentejo	ALEN	46.7	52.1	112	-10.8
Algarve	ALG	47.9	52.6	110	-5.5
Northern Ireland	NIRL	78.4	82.0	105	0.7
Objective 1[2]	O1R	73.4	73.9	101	2.6

1 1980-89 change: Calculated as ((X**i/X*i)/(X**n/X*n))*100 where 'X' represents per capita GDP, (PPS: Purchasing power standards);"*" the beginning of the period and "**" the end, 'i' the region concerned and 'n' EUR 12.
2 Objective 1: Sum of the regions in the table (it therefore excludes Corsica, DOM, Cueta y Melilla, Madeira and Azores for which no complete data-set could be assembled).

Sources: Eurostat and GREMI study (national statistical sources).

Analysis of the Objective 1 situation

3.1 Introduction

Once converging and diverging regions amongst Objective 1 regions have been identified, the obvious next step is to try and explain the different performances. A glance at Table 2.1 reveals an important first link. There are definite country effects appearing in the table. Thus Spain has a large number of converging, Greece has large numbers of diverging regions. Italy has a more mixed experience. It is worth looking in some detail therefore at the national context of the Objective 1 regions to assess the importance of this 'country effect' and to gain an overview of the situation.

There follows a series of profiles of those nations which are wholly or substantially Objective 1, i.e. Greece, Spain, Ireland, Italy, and Portugal. They are partly intended to give an overview of the national situation and a background for the examination of local economic performance. However, they also provide material with which to answer the following questions:

- What national factors have significant influence on regional performance and how strong is that influence?
- How do nations measure up in terms of these national factors both now and in the future?

3.2 General observations

There are two recent historical trends in disparities. First, a decrease in inter-regional disparities was common to all of the EC 12 both in the 1960s (with the exception of the United Kingdom) and in the 1970s (with the exception of Germany). Second, the 1980s saw the cessation or reversal of the first trend. Disparities increased in most countries, albeit at different times. The exceptions were Spain, where disparities remained almost constant, and Portugal, where disparities continued to decrease.

Within the national macro-economic context it is possible to observe a diversity of experience. Even within a poor national context, some regions can still be converging. In addition, this process also operates at the regional level. Thus, even within 'diverging regions' it is possible to find local success stories. This experience fits in with evidence from a comparative study undertaken in the USA for the GREMI report, where good economic performance was found in 'sunspots' rather than across the 'Sunbelt' (see box on next page).

3.3 Country profiles

Greece

In the post-war period, economic development in Greece occurred at high rates until the mid-1970s, fuelled by high investment rates (30% of GDP in some years) and inward investment by foreign capital. This period led to polarized development in the main urban areas of the country, the Greater Athens area and Thessaloniki in Central Macedonia. A

The US experience: The 'Snowbelt-Sunbelt shift'?

It was thought that the experience of the USA would offer some interesting parallels to the development prospects of the Community's lagging regions. The dominant spatial trend within the US has been a substantial move of economic activity towards previously underdeveloped areas of the country (the Sunbelt) and a revalorization of such areas. A study for GREMI addressed these issues to try and draw out the implications for EC integration. Obviously conditions within the Sunbelt vary considerably, both internally and in comparison with Europe's lagging regions. Sunbelt economic growth was closely allied with massive population movements, both internal to the US, as well as from Mexico, Asia and Latin America. The roots of development, at least in the South, have their origins in the New Deal and later on in the 1960s as part of a deliberate attempt to end the dependence of the region upon raw material production and cheap labour and create autonomous indigenous industrial modernization. This phase provided the infrastructural preconditions for the subsequent phase of development in the 1970s. Much of this was achieved through national legislation to impose the same conditions of work and pay as nationally. Similarly much economic development has resulted from Federal decisions on defence expenditure.

Some parallels with the lagging regions do exist: southern industry has traditionally been based upon a combination of local resource-based industrialization and low-skilled labour. The principal form of manufacturing growth in the post-war South has been less the attraction of new types of plant or industrial sectors so much as a reconcentration of classic manufacturing sectors in one of their traditional centres of strength. These industries remain vulnerable to international competition and domestic economic downturn. Where high technology employment has been gained in the South, the overwhelming share is in standardized production and assembly plants. Growth within the Sunbelt has been concentrated at two levels: at the level of states, growth has predominantly occurred within Texas and Florida; within states, growth has been a metropolitan phenomenon. Despite the major employment gains which have been achieved in the South, Gordon considers that there is little evidence that the South has generated any genuine long-term capability for indigenous innovation or dynamic comparative advantage.

High technology industry development in the US has been driven not by purely local or global dynamics, but based upon precise articulations of regional processes and external dynamics. Gordon considers that there is no single lesson for Europe in the experience of the Sunbelt - even where innovative milieux exist their form is complex and irreducible to a single model or logic. Thus traditional branch plant industrialization coexists with more dynamic innovative high-technology milieux and with centralized core agglomerations of financial and producer services. The basis of growth also varies: some regions have exploited temporary cost-based locational advantages, others have deployed local know-how and expertise to restructure product and process innovation in traditional sectors. In total then, diversification of conditions and logics within the Sunbelt is deemed to be as important as any differentiation between the Sunbelt and traditional manufacturing zones.

In a parallel with the European single market, the integration of the Sunbelt market presupposed far more than the passive elimination of barriers to mobility of goods, services, capital and labour. It involved active and extensive government intervention in infrastructure development, labour market formation, the imposition of socio-economic standards and both direct and indirect economic development. By comparison with Europe, cultural and economic homogeneity in the US was far more advanced immediately prior to the Sunbelt's take-off. The framework for Sunbelt growth in the US fused three critical historically-specific elements: aggressive state economic intervention, a new cycle of technological transformation, and global political, military and economic hegemony. That is, market completion in the US coincided with particularly advantageous domestic and international conditions. As Gordon notes, insofar as they are relevant, these factors constitute goals, not preconditions, of 1992.

growth axis was developed between these two, with intense urbanization and increasing concentration of employment. In 1981 the Greater Athens area had 42.7% of total secondary employment and 45.6% of total tertiary employment, while the equivalent figures for Central Macedonia (Thessaloniki) were 17.6% and 14.6%. Against a background of strong population growth (from 6.7 million in 1950 to 10.2 million in 1991) population became increasingly concentrated into the Attica region (20% of national population in 1951 and 37.5% in 1988). The rest of the country consists of regions with difficulties engendered by peripherality, weak agricultural and industrial structures and unfavourable geographical conditions.

With the advent of the international economic crisis from the mid-1970s onwards, capital accumulation declined dramatically, as did population out-migration. Greece never fully recovered from this period and macro-economic internal and external equilibrium were never restored. The country entered the phase of international economic expansion between 1983-90 with huge problems of inflation, an external balance deficit and public finance disorder. The Greek economy is suffering from structural problems involving:

- a permanent deficit in the balance of payments;
- continually increasing public sector deficits;
- the simultaneous problems of inflation and unemployment ('stagflation');
- decreasing investment, stagnating production and de-industrialization.

The Greek balance of payments was historically kept in balance by trade in 'invisibles', particularly from commercial shipping, tourism and migrants' remittances. However, from the mid-1980s these were reduced. Greece's share of world manufactured exports has fallen, and Greece specializes in resource and labour intensive products for which world demand has declined. This contrasts with other southern European countries where exports have grown significantly faster than total world trade over the last two decades. The consequent restrictions on monetary and fiscal policies, together with the weakness of the productive sector, prevented Greece from taking advantage of either international expansion or EC membership.

Moreover, public sector imbalances have curtailed public investment, which is important given Greece's infrastructural deficiencies. Severe supply shortages developed in the 1980s. Greece lags considerably behind other European countries in infrastructure, particularly in the fields of transportation, communications, water supply and sewage works. Without a higher level of investment in these it will be difficult to restore higher rates of growth. The core areas of Greater Athens and Thessaloniki also have severe environmental problems which need increased infrastructural spending. The range and quality of Greek public services are thought to be considerably below average European standards. Public expenditure on health and education is considerably lower than in the rest of Europe. For higher education, student supply is restricted and demand controlled through entry restrictions. More than one quarter of total university students study abroad. The shortage of higher education graduates leads to skills shortages which impede the modernization of the economy and society. Overmanning in the public sector is at high levels and public pension spending levels are, at 15% of GDP, one of the highest in Europe. Relatively short pension contribution periods provide a strong incentive to retire early and work in the black market economy. Tax evasion is endemic and discourages movement of labour into more productive sectors of the economy where taxation is more effective.

With the exception of Attica, all regions of Greece have a high proportion of employment in primary sectors. Only in the Southern Aegean Islands does the proportion drop below 30%. The agricultural labour force represents as much as 26% of total employment in Greece. As agricultural activities virtually escape taxation there is a strong disincentive to move into sectors with a higher productivity potential, in addition to the taxation forgone. Industrial employment is concentrated into Attica, Western Macedonia, Central Macedonia and Central Greece. In the 1971-81 period only Attica had rates of employment growth greater than the national average. Employment losses were especially high in the Northern Aegean Islands, the Ionian Islands and the Peleponnese. Unemployment is also concentrated into the Greater Athens area (45.4% of the total in 1988) and Thessaloniki (15.1%).

The core Attica area ran into problems in the 1980s. While the 1971-81 period had seen the expansion of employment in Attica the consequences were not all favourable. There was a huge growth of low productivity, low income jobs together with growing unemployment and massive urban problems. In the subsequent period to 1987 total Greek employment fell and Attica lost 2.9% of its industrial jobs per year. The region's share of national GDP declined from 42% in 1970 to 36% in 1985 and GDP per capita fell to the national level. Even though Athens constitutes the major part of Greece's black economy (estimated at 30% of GDP in total) there are definite signs of a deep-seated metropolitan and regional crisis. High starting wage levels and insufficient training are thought to be major impediments to raising employment levels.

The crisis in the core region of Attica benefited almost all other regions where, from the late 1970s onwards, new, dispersed light industries and tourism had developed in some of the former problem regions. Particular benefits were felt in the two more industrialized regions of Central Macedonia and Central Greece, but Thessaly and Crete also gained. In the 1970s all regions, with the exception of the Northern Aegean Islands, moved closer to the national average GDP per capita. In the 1980-85 period the reduction in disparities continued although the success of Central Macedonia and Central Greece disappeared in terms of total GDP and GDP per capita. However, they continued to display employment growth. The success stories of this period were based on the development of light industries such as food processing, clothing and leather products and on tourism. These developments were prevalent in Eastern Macedonia, Thrace, the Ionian Islands, the Southern Aegean Islands and Western Macedonia.

However, these endogenous developments have never been built upon, through policy. In part this is a recognition that many of the necessary conditions for indigenous development, such as a skilled labour force and good infrastructure, are lacking at the local level. Instead, a growth pole strategy, coupled with the aim of reducing the dominance of the Athens area, has been followed. Future plans for a regional development strategy are limited, although recently, policy has shifted from the alternative growth pole strategy to an emphasis on 'development from below'. Historically, industrial support has been directed towards traditional industries where long-term viability is in doubt, diverting investment from more profitable activities. Textiles and clothing, followed by food, are still the most important industries. In a trend which could run counter to European integration, some policy makers believe the potential for future development may rest with the opening of Eastern European markets, particularly in relation to Bulgaria and Romania.

Spain

Economic growth in Spain in the 1960s and early 1970s was concentrated into the most advanced and industrialized regions of Catalonia, the Basque country and Madrid. Diffusion of growth in this period was limited to the regions immediately surrounding these three core areas, as well as to a limited number of provinces (Valencia, Alicante, Zaragoza and Sevilla). Meanwhile, the more rural, internal areas of Galicia, Andalucia, Aragon and Extremadura declined in both economic and demographic terms, mainly due to the rationalization of agriculture. The situation changed in the period from 1975-85 against a background of international crisis and restructuring. Internal migration ceased or was greatly reduced and crisis conditions emerged in the older industrial areas, particularly in the Basque regions. At the same time, development spread to new areas of industrialization such as the Mediterranean axis, south of Barcelona, from Gerona to Murcia and some Andalucian coastal provinces, and the Ebro Valley. The Baleares and Canarias islands were also dynamic, due to the impact of tourism. Madrid's growth continued, based upon its role as the capital and service industry centre.

In the period 1985-89 these trends continued and the period from 1985 saw strong growth. The Mediterranean axis expanded through the Andalucian provinces of Malaga and Almeria and the Catalonian economy was revitalized. The Ebro Valley increased its dynamism, as did the island and tourist areas of the Canarias and Baleares. However, the Cantabrian coast continued to experience problems. Industrial take-off occurred in new industrial areas such as Valencia, Murcia and the coastal provinces of Andalucia. In the regions along the Ebro Valley (Navarra, Rioja and Aragon) industrialization came together with the modernization of agriculture. The Spanish economy has been the beneficiary of large-scale foreign investment, amounting to over USD 10 billion in 1989 alone.

The population has grown from 31.5 million in 1964 to 39.0 million in 1989. Population is greatest in Andalucia (17.6% of the total in 1989), Catalonia (15.7%) and Madrid (12.7%). Between 1981-86 only Andalucia and the Canarias had a positive balance of population growth.

Employment in agriculture is still an important factor in some regions. In 1985, Galicia (43% of total employment) and Extremadura (32%), for example, both had very high levels of agricultural employment compared to the national average (16.5%). Industrial employment accounts for a fairly low proportion of the total in most Spanish Objective 1 regions, with the exception of Valencia and Asturias. The black economy is particularly strong, accounting for around 24% of total employment for all the Objective 1 regions, and is particularly important in Murcia (31.9%), Andalucia (28.9%) and Valencia (24.5%). Unemployment rates were high in Andalucia (27%), Extremadura (26.4%) and Canarias (21.5%) in 1989, compared to the national average of 17.8%. Unemployment was a particular feature of the younger age groups aged between 16-24 in all regions. Infrastructure remains a problem in most regions, particularly for motorways, railways and telecommunications. In terms of human capital, only parts of Valencia, Andalucia, Asturias and Galicia have above average levels of educational attainment.

Regional policy up to 1975 was limited and controlled from the centre, although it did contain a concern for regional imbalances. Attention was directed towards national economic planning, partly because the nature of the economic crisis in the late 1970s necessitated macro-economic action, but also because of political considerations. From 1978 new 'Autonomous Communities' were established with a consequent transfer of power and policies from the centre. The internal 'regional debate' has been galvanized by EC membership, but also through this process of federalization whereby regional governments have increasing powers to act.

Ireland

Since accession to the EC in 1973, there has not been an appreciable convergence of Irish GDP per capita with the EC average. GDP per capita in 1986 was 62.4% of the EC average. Some convergence did occur in the 1970s, mainly due to a high level of investment. The 1960s and 1970s saw the Irish government establish an 'open door' policy to investors, a radical break with the policies of protection that had been followed prior to this period. Foreign capital was encouraged through substantial grants and tax concessions, annual GDP growth rose from 1 to 4% and absolute employment levels increased. However, this investment generated little growth in subsequent years. The 1970s also saw greatly increased public debt and a large balance of payments deficit. The late 1970s and 1980s exposed the limits to this policy of relying on mobile foreign capital and the failure to create a competitive indigenous sector. Divergence occurred in the period 1981-86 when Ireland experienced very low growth rates of GDP, GDP per capita, private consumption per capita and capital investment. Emigration also recommenced at high levels from the end of the 1980s. Population growth over the decade 1976-86 had been the highest in the Community and the country has a very high dependency ratio (0.66) compared to the EC average (0.49). From 1986, the national situation improved with high GDP expansion and lower population growth.

Employment in Ireland is divided between a dynamic export-oriented sector based on foreign direct investment by transnationals, and local industry which is, with a few exceptions, oriented towards the domestic market. There is virtually no direct linkage between the two sectors. This leads to particular weaknesses, such as low investment in research and development in firms. For example, although the electronics sector is well-developed in Ireland, foreign firms account for over 90% of employment and most of their research is done outside Ireland.

This shortcoming in research and technological capacity is perhaps surprising given that one of Ireland's strengths is its high output of science and technology graduates. However, while potential human capital is high, much of this 'leaks' from the country through emigration at present. In 1985, 13% of first degree holders found their first employment destination overseas, and this figure increases to 22% for higher degree holders.

New manufacturing employment developed in the 1960s and 1970s. While this was quite evenly spread spatially, growth has been too small to offset falling agricultural employment. The decline in agricultural employment has been the most important single influence upon regional employment change in Ireland. The share of agriculture in total employment declined from 39% to 12% over the period 1950-88. Individual regions vary in terms of agriculture's contribution to total employment from only 4% in the East region to 28% in the West in 1988. This has an impact at the inter-regional level, where one of the few consistent trends has been the decline of the North West and North East regions related to declining agricultural employment together with decline in traditional industries. The only area to have increased employment post-war has been the East region, which increased its share of national employment from 30% in 1950 to 39.3% in 1988. Much of this has been the product of service sector growth associated with the presence of the capital city, Dublin, and reflects increasing centralization. Only the Mid West region appears to have maintained industrial employment in the 1980s.

Unemployment in all regions increased over the 1980s. The rate of unemployment is highest in Donegal and the North West (22.1% in 1988) closely followed by the North East (20%). Unemployment is particularly concentrated amongst male workers, reflecting the low participation rates of females in the workforce. The latter probably indicates a high level of underemployment within the Irish economy. Unemployment is amongst the highest in the EC and represents a major problem for policy makers.

Infrastructural shortcomings — especially the relatively poor quality road network — are important and considered a barrier to growth. Peripherality is aggravated by the absence of a land link to other members of the Community (a factor which will be heightened by the completion of the Channel Tunnel).

There has been little national debate over regional disparity, perhaps understandably given that Ireland as a whole forms a single NUTS 2 level region of the EC. Debate has occurred over the strategy of attracting external investments and whether this can be maintained in the face of competition from other countries or whether policy should focus instead on encouraging indigenous development. There has, however, been little evidence of policy shifts in this matter. 'Regional policy' has been more concerned with promoting industrial employment in the less developed regions to compensate for agricultural decline. Debate has also centred upon the relative merits of concentrating development into a small number of selected centres as against general regional dispersion of economic activities. A related concern has been the growing concentration of population in the East region (containing nearly 40% of the Irish population).

Italy

The underdevelopment of the Mezzogiorno remains a problem of long-standing national importance in Italy. With 36% of the national population, it constitutes the largest lagging macro-region in the EC. The features of the Mezzogiorno's adverse economic condition are well-known: a high level of dependency, both upon northern Italian decision-making and government assistance, limited access to external and international markets through exports, limited growth of an indigenous industrial base and growing unemployment.

In the immediate post-war period growth was concentrated into North West Italy. From the 1970s onwards growth spread to Central and North East areas — the 'Third Italy'. Diffusion of growth into the Mezzogiorno occurred mainly as a result of direct State intervention, both through the location of large State-owned enterprises (in iron and steel, petrochemicals and automobiles) and through the attraction of branch plants of Northern firms. GDP per capita in the South in the period 1960-75 grew from 55.7% to 70.8% of the national average. Inter-regional disparities declined due to both the growth of production and outmigration.

The period from the mid-1970s until 1984 saw the onset of economic crisis for the whole country, although the growth of the Third Italy continued. Convergence occurred between the North and West and the Central, North and Eastern regions, while the South was largely excluded. While the 1960-75 period had seen the Mezzogiorno's share of national GDP increase from 23% to 25.1%, after this date the share stabilized. In 1984 the South's share of GDP (25.2%) was the same as in 1975. Coupled with higher natural demographic growth, GDP per capita declined to 66.3% of the national average. Thus, while Northern Italy is more prosperous, in terms of GDP per capita, than the average levels reached in Germany, the South is similar to Spain, and not much greater than much of Portugal and Greece.

The period from 1985-88 saw national economic recovery with increases in both GDP and productivity. However, this was most pronounced in the North West, mainly due to high levels of investment and faster adoption of new technology. The Mezzogiorno performed badly with regard to both GDP per capita and unemployment, even in the relative success story of Abruzzi. Productivity is also low in the Objective 1 regions: productivity per employed person was around 75% of the Northern level in the late 1980s. Unemployment rates in Italy in 1987 ranged from 5.9% in Valle d'Aosta to 21.6% in Calabria and 23.3% in Campania. High unemployment is perhaps the most serious single regional problem, particularly amongst young people. Falling wage differentials between North and South have contributed to unemployment and acted as a disincentive to both new private investment and interregional migration. Overall economic performance was particularly poor in the South-Island regions (the southern regions of Puglia, Basilicata, Calabria and the islands).

The Mezzogiorno consists of eight Objective 1 regions which, in contrast to many of the other Objective 1 countries, have been the subject of substantial regional policy intervention in the post-war period. Indeed, relative disparities in production capability have not been paralleled by disparities in personal well-being and consumption levels. Personal disposable income in the Mezzogiorno is increasingly supported by public income transfers. From the late 1970s onwards, expenditure shifted away from investment and towards such transfers. While this policy may have supported demand, it hindered productivity increases and did little to increase local supply side factors. While the figures need looking at with care, it can be observed that external assistance to the Mezzogiorno over the past 35 years has consistently formed around 18-20% of its GDP. While these transfers reduce inter-regional disparities in disposable incomes and consumption they create their own problems of dependency and reduce potential for endogenous development. The need to reduce national public sector deficit will, in future, limit funds available to address regional differentials. While the decrease in the wages gap between North and South may have hindered a rise in productive employment, any attempt to restore differentials runs the dual risk of increasing migration and trying to compete with other low cost producers.

The 1980s thus saw changes in the Southern regions with the continued underdevelopment of regions such as Basilicata and Calabria and growth in other areas such as Abruzzi and Molise. Indeed, differences within the South are now more significant than the difference between the Southern average and the Italian average. The more successful areas have an experience which is closer to that of Central Italy than the rest of the South. It has been argued that the Adriatic Objective 1 regions may break away from the South if these trends continue throughout the 1990s. Conversely, the remaining regions have undergone little development, with the exception of a few isolated success stories.

Portugal

Post-war industrialization in Portugal occurred as a product of three important factors. First, strong governmental support and protection to basic industry occurred in the 1950s and later the 1970s. This was concentrated in the Lisboa et Vale do Tejo, Setubal and Sines areas. Second, after joining EFTA in 1960 there was a spontaneous growth of textile, clothing and footwear firms in the Porto area. Third, an exchange rate depreciation policy was operated between 1977-85 which supported export industries, particularly those based on labour intensity. Few of these developments took place in the context of a developed regional strategy. Regional policy until EC entry in 1986 was virtually non-existent. Only the petrochemical complex at Sines, on the Alentejo coast, was specifically developed in this context with the (disappointed) aim of establishing a growth pole. After the 1974 revolution a new system of autonomy emerged at the municipal level. This has led to the establishment of local infrastructure which could be of importance in the longer term. However, such local infrastructure is far from widespread and this, together with the lack of an intermediate regional policy authority, is thought to be likely to hinder indigenous development in the short to medium term.

The potential for development varies by regions. Norte is a highly industrialized region, but the structure of industry is biased towards labour-intensive sectors. All regions have problems of internal divisions, with coastal areas being industrialized while the interiors are backward. Some 80% of national GDP is produced in the coastal areas while the interior comprises the country's poorest areas. Indeed, the interiors of the Norte and Alentejo both have one of the lowest development levels in the EC. Education levels and infrastructure, for example in telecommunications, are low and these may hinder future development. Only Lisboa and Norte look likely to be the beneficiaries of any development, at least in the short to medium term. Norte, however, may be subject to strong competitive pressure given the region's dependence on labour intensive, 'sensitive sectors' such as textiles, clothing and footwear. Both Lisboa and Porto are subject to severe problems of overconcentration and congestion. Development within Portugal to date has been highly concentrated into these two regions, and within these regions largely in the coastal areas. Lisboa produces 46% of national GDP, and the Norte region an additional 31%.

Overall Portuguese GDP per capita was 57% of the EC average in 1989. Lisboa had around 75% of the EC average GDP per capita, Algarve and Alentejo between 50-55% and Norte 50%. Regional disparities in disposable income are diminished to some extent by remittances from emigrants, as most emigrants come from regions other than the Lisboa region. In total, emigrants' remittances comprise around 2.5% of national GDP. Both Centro and especially Alentejo have high levels of employment in agriculture (41.1% and 47.9% respectively). Agriculture in Alentejo has low levels of efficiency and will struggle to be competitive in a European context. While agriculture is also important in the Algarve (25.6% of employment), the region has benefited from infrastructural improvements as a consequence of tourist development. For Portugal as a whole, tourist revenues constituted 6.3% of GDP in 1980.

The 1980s have seen rapid growth of the economy — since 1985 national GDP has been growing at an annual average rate of 4.2%. There has also been a large increase in foreign investment in Portugal, with the share of foreign investment originating from other EC countries virtually doubling since 1985. Despite this, many of the success stories of the Portuguese economy, such as the export industries of Norte and tourism in the Algarve, would seem to have rested upon the country's policy of exchange rate depreciation. This is not a policy which will be able to continue under the discipline imposed by EMS. Labour costs are likely to rise and competitiveness decrease. The 1980s saw a reduction in disparities within Portugal. This was a product of two parallel processes. First, the richest region, Lisboa, increased its share of GDP but also had a high level of in-migration which reduced per capita GDP levels. Second, the poorest region, Centro, lost population which increased GDP per capita performance despite a static share of national GDP. The country's improved position has also been related to EC entry. After 1985, the country took up new trade and development opportunities largely based on the comparative advantage of low labour cost.

3.4 Synthesis of profiles

In retrospect, it is possible to see a marked break in the evolution of inter-regional disparities within the European Community dating from the period of economic crisis in the mid-1970s. This resulted in a reduction in large multinational investment projects which countries such as Greece and Ireland had relied upon to overcome late industrialization. Moreover, inter-regional movement within countries, whether private sector-led or induced through government policy, also came to a halt. In addition, crisis in the more developed regions of the Community resulted in a reduction in, or even a reversal of, the process of out-migration from the Objective 1 regions which had helped offset demographic trends. Greece, Spain, Ireland and Portugal were all hit hard by this latter process. These factors, combined with renewed international crisis from the early 1980s brought to an end the long-term trend of decreasing disparities within the EC.

When renewed growth came from 1983-84 onwards, it occurred within a different context to the development phase of the 1970s. In particular, international agreements on monetary and exchange rate policies restricted the use of devaluation as a tool of industrial and development policy. This, together with technological changes and increased European integration, favoured development within the core areas of national economies. Some countries were able to adapt to this and have displayed relative growth, particularly Spain. Conversely, others such as Greece have so far been unable to cope with these changed conditions. In part, this is a product of structural adjustment policies. While in Spain and Portugal market reforms in areas such as labour and finance have been introduced, Greece has been slow in coming to terms with the need for structural reform. Spain's particular success and earlier market liberalization are interrelated. Greece has maintained limited export markets in manufactures and tends to specialize in those areas, such as textiles and clothing, where international competition and cost competition is strong. Conversely, Spain and Portugal have gained export market shares as they adjusted their production structures to sell products for which world demand is growing fastest and have improved their competitiveness, quality and marketing.

Structural reforms in Spain and Portugal have also encouraged both foreign and domestic investment and induced a shift towards advantageous trade and production structures. Both Spain and Portugal were quick to lift import barriers and export subsidies after EC accession and subsequently enjoyed a sharp improvement in their terms of trade. In Spain, productivity in those sectors which have been the target of foreign investment has risen twice as fast as the national average. Investment in Spain and Portugal has resulted in both substantial job creation and more efficient economic systems. Conversely, in Greece the sluggishness of investment has led to a levelling off of both productivity and the volume of employment. However, all these countries still suffer from infrastructural inadequacies, especially for communications, which explains why investment has been concentrated around the larger towns. Infrastructural problems in terms of skill shortages also need attention in the southern European countries, although Ireland is relatively well-placed in terms of human capital.

3.5 Conclusions

National factors appear to play a major role in determining inter-regional disparity; the generally good performance of Irish regions and the generally bad performance of Greek regions can be put down to their relative macro-economic policies. Sound macro-economic policies and investment in infrastructure are undoubtedly the best basis for regional development which lasts in the long term. It should be noted in this context that all Objective 1 regions still have important infrastructural gaps such as in transport and communications, education and training; this has usually hindered, but not always prevented, development. Similarly, some countries have important structural inadequacies.

However, there is a diversity of performance within the same macro-economic context; even within poorly performing regions there may be some local success stories. Nor is good infrastructure a guarantee of success. The best that can be said is that the lack of infrastructure and a bad macro-economic context hinder development. Even then there are examples of success (e.g. Ireland) with a relatively poor infrastructure. There is undoubtedly more to development than just infrastructure and macro-economics.

The routes to success are varied; tourism has been important in the Balearics, industry in Abruzzi. For both regions and local successes the task is therefore to identify common factors behind success to see if they can be reproduced elsewhere. Theoretical explanations for success are considered in the next chapter and tested in the light of the country profiles in this chapter and other statistical information.

Explaining the development patterns of the 1980s

4.1 Introduction

So far the analysis has described and categorized the development experiences of the Objective 1 regions on the basis of performance. In Chapter 2 the converging and diverging regions were identified and contrasted. In Chapter 3 the influence of the national context upon the Objective 1 regions performance was examined. The latter provided some indication of the factors underlying differences in levels of development and in regional growth performance. Both chapters clearly demonstrated the diversity of experience within Objective 1. This chapter is an attempt to analyse what makes a region a strong or weak performer, a diverging or converging region.

First a number of structural variables are examined to see if they help explain differences in the performance of the lagging regions. The choice of variables derived from a reading of existing regional development literature. Thus, an attempt was made to assess empirically whether the main development factors put forward by theory provide us with a sufficient explanation. As will become evident, these factors help to explain the level of development to some extent, but none of the theories convincingly explain the performance of the Objective 1 regions during the 1980s. In an attempt to provide a more satisfactory explanation for the differences in growth rates of Objective 1 regions, GREMI advances the theory of 'innovative milieux'. In the last part of this chapter, we examine in more detail the concept of 'milieu innovateur' as this captures many of the intangibles in development (such as district economies and entrepreneurial spirit) which the empirical analysis does not.

4.2 The theoretical background

The basic approach to regional development in this project was to define regional development as the ability of each region to produce — by virtue of either a competitive advantage — the goods and services that are demanded by the national and international system of which they form a part. This definition highlights two elements at the basis of development; supply elements, in the form of a comparative or competitive advantage for local production, and demand elements, mainly external to the local economic system. While both sides of the equation are important, the research team identified supply el-ements as the soundest basis for long-term development potential. First, only a highly flexible, diversified and innovative local economy can secure the continuous regeneration of an export base. Second, a growing proportion of traded goods concerns products which are new, and where previous demand did not exist. Third, the international mark-et is broad by comparison with the size of a single region. Even specialization in traditional, slow-growing or stagnant sectors may be beneficial to a region if it succeeds in controlling a growing share of the international market.

At risk of oversimplifying, we could argue that the post-war debate on regional development has been dominated by two major schools of thought, namely the 'convergence' and 'divergence' schools.

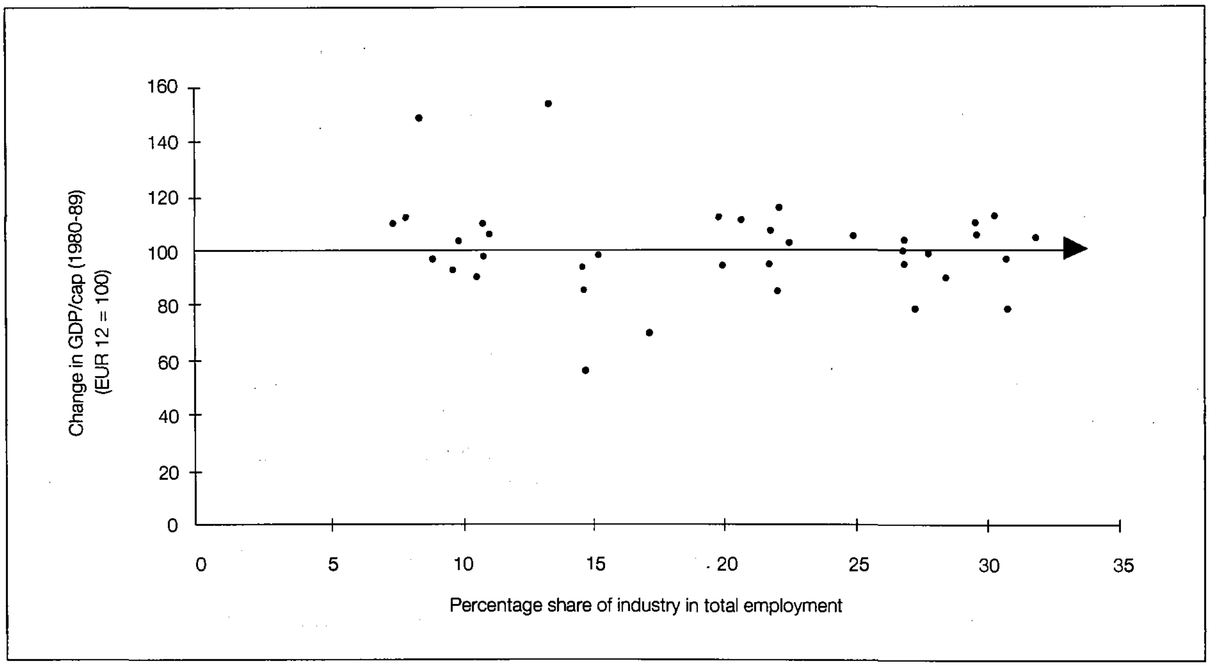
The 'convergence' school, which is also the oldest of the two, builds on the neo-classical theory of international trade. According to this theory, national or regional differences in factor endowments are the main reason for international and inte-rregional differences in factor income. However, according to the neo-classical international trade theory, the free movement of goods and services will equalize factor returns and standards of living among countries. At the regional level, mobility of factors of production would bring about regional convergence in factor income and in standards of living. The persistence of income disparities in the Community is due mainly to poorly functioning product and factor markets (non-tarrif barriers to trade and imperfect mobility of labour or capital). Proponents of the neo-classical school would therefore argue that the creation of a fully-integrated European economy is likely to facilitate income convergence among Member States and regions.

At the other side of the spectrum, there is a well-established line of thinking in the regional debate which stresses the mechanisms working towards divergence rather than convergence. Theories of cumulative causation challenge the view held by the neo-classical school that inter-regional factor movements would automatically lead to factor income convergence. They argue that agglomeration and scale economies as well as externalities (including economies of urbanization) play a crucial role in the location of new economic activities, a view based on the empirical observation of location patterns in most industrialized countries. As a result, proponents of this school of thinking warn of the risk that the increase in factor mobility which further economic integration will bring will also increase the attractiveness of the most developed parts of the Community, and this to the detriment of the poorest regions.

4.3 Statistical analysis

In their study on the development performance of Objective 1 regions, Professor Camagni and Professor Quévit make an attempt to identify the factors which have led to differential economic performance of these regions in the 1980s (see Section 2 above). The study places a particular emphasis upon examining those factors which may help to indicate the existence of, or potential for, development suggested by the main strands of regional development theory. The aim of the study was to look at whether there were any crucial elements upon which some regions have built a competitive advantage and

Figure 4.1: GDP performance and degree of industrialization of lagging regions



which has allowed them to successfully cope with the macro-economic and international conditions of the 1980s. The focus was solely upon Objective 1 regions as the intention was to examine to what extent traditional regional development theory is able to explain different performances within this group of regions.

Looking at Figures 2.1 and 2.2 in Chapter 2, it is obvious that neither of the two main schools of thought in the regional debate offers a satisfactory and comprehensive explanation for the differences in economic performance among Objective 1 regions. While many of the lagging regions are catching up and while it is also true that those furthest behind are often catching up the fastest, it is equally clear that there are a very significant number of Objective 1 regions which have continued to diverge from the Community average. It is not very surprising then that no significant statistical relationship could be established between the initial level of development (as reflected by per capita GDP in 1980) and the economic performance of Objective 1 regions between 1980 and 1989 (as measured by the rate of growth of per capita GDP during that period).

A second important question that emerges is whether it is possible to identify, on the basis of the existing regional development literature, certain structural factors that lead lagging regions to success or failure. A first attempt at answering these questions involved undertaking correlation and regression analyses of the relationship between economic performance indicators (per capita GDP level and growth) and a number of structural variables which have frequently been advanced as important development factors in regional economic theory. These included variables reflecting:

• the industrial structure of the regions,
• the degree of external control over the regions' industrial fabric;
• average wage levels in industry;
• human capital endowment and investment (i.e.

Table 4.1: Correlation between economic performance and structural indicators

	AGR	IND	SAL	EXT	EDUC	GRAD	R&D	URB	CEN	INFR	GDP1	GDP2	PERF
AGR	1.00	-0.56	-0.34	-0.37	-0.46	-0.50	-0.27	-0.58	-0.54	-0.54	-0.57	-0.59	-0.04
IND	-0.56	1.00	0.54	0.41	0.49	0.31	-0.09	0.35	0.76	0.39	0.69	0.61	-0.19
SAL	-0.34	0.54	1.00	0.31	0.55	0.37	-0.31	-0.10	0.71	0.53	0.67	0.63	-0.12
EXT	-0.37	0.41	0.31	1.00	0.52	0.08	0.09	0.31	0.31	0.50	0.43	0.41	-0.07
EDUC	-0.46	0.49	0.55	0.52	1.00	0.22	0.02	0.21	0.54	0.58	0.76	0.70	-0.24
GRAD	-0.50	0.31	0.37	0.08	0.22	1.00	0.38	0.29	0.36	0.33	0.29	0.24	-0.13
R&D	-0.27	-0.09	-0.31	0.09	0.02	0.38	1.00	0.52	-0.09	0.07	-0.11	-0.12	-0.02
URB	-0.58	0.35	-0.10	0.31	0.21	0.29	0.52	1.00	0.22	0.32	0.22	0.27	0.12
CEN	-0.54	0.76	0.71	0.31	0.54	0.36	-0.09	0.22	1.00	0.47	0.80	0.76	-0.12
INFR	-0.54	0.39	0.53	0.50	0.58	0.33	0.07	0.32	0.47	1.00	0.62	0.57	-0.18
GDP1	-0.57	0.69	0.67	0.43	0.76	0.29	-0.11	0.22	0.80	0.62	1.00	0.94	-0.19
GDP2	-0.59	0.61	0.63	0.41	0.70	0.24	-0.12	0.27	0.76	0.57	0.94	1.00	0.15
PERF	-0.04	-0.19	-0.12	-0.07	-0.24	-0.13	-0.02	0.12	-0.12	-0.18	-0.19	0.15	1.00

AGR Percentage share of agriculture in total employment
IND Percentage share of industry in total employment
SAL Average monthly labour costs of manual and non-manual workers in industry
EXT Percentage share of manufacturing employment in externally controlled plants
EDUC Percentage of 15-19 year age-group in full-time education or training
GRAD Number of graduates of tertiary education per 1 000 inhabitants
R&D R&D expenditure as a percentage of GDP
URB Percentage of regional population living in cities with more than 50 000 inhabitants
CEN Peripherality index
INFR *Infrastructure endowment index*
GDP1 Per capita GDP in 1980 (in purchasing power standards)
GDP2 Per capita GDP in 1989 (in purchasing power standards)
PERF Growth of per capita GDP between 1980 and 1990

number of graduates of tertiary education, participation rate of 15-19 year olds in education, R&D expenditure);
- degree of urbanization/rurality;
- degree of centrality;
- level of infrastructure endowment.

The results of the correlation analyses are presented in Table 4.1. Scattergrams showing the relationship between regional performance and the most important structural factors are shown in Figures 4.1 to 4.4.

Figure 4.2: GDP performance and labour costs in industry in the lagging regions

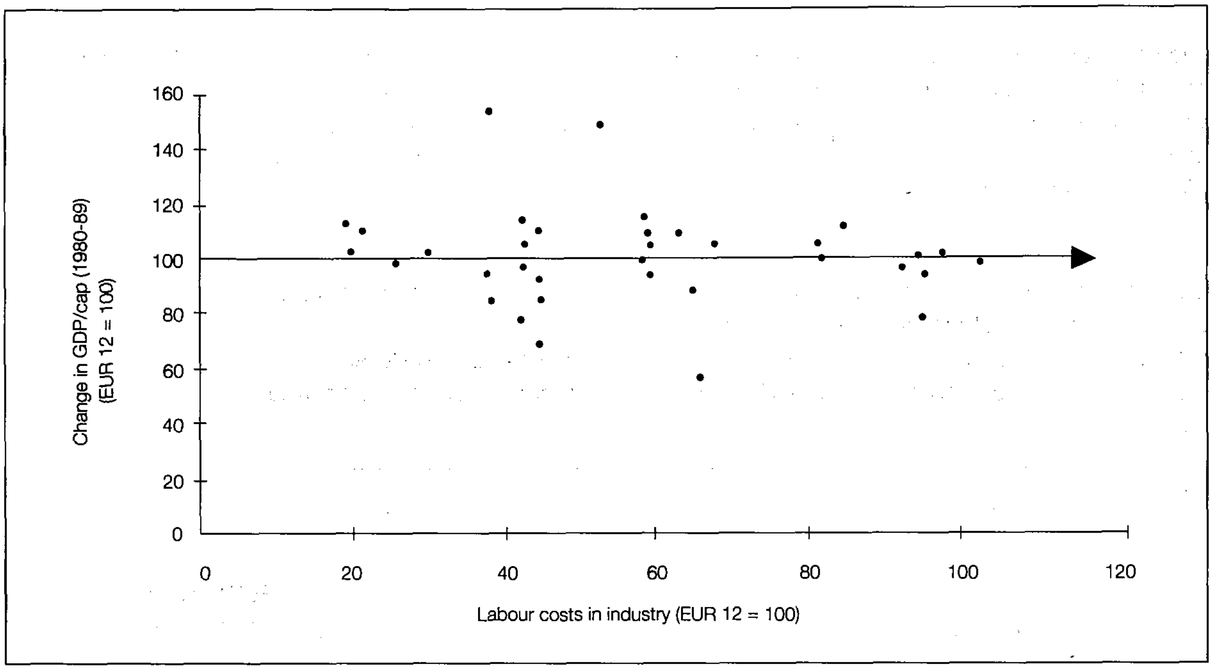


Figure 4.3: GDP performance and degree of peripherality of the lagging regions

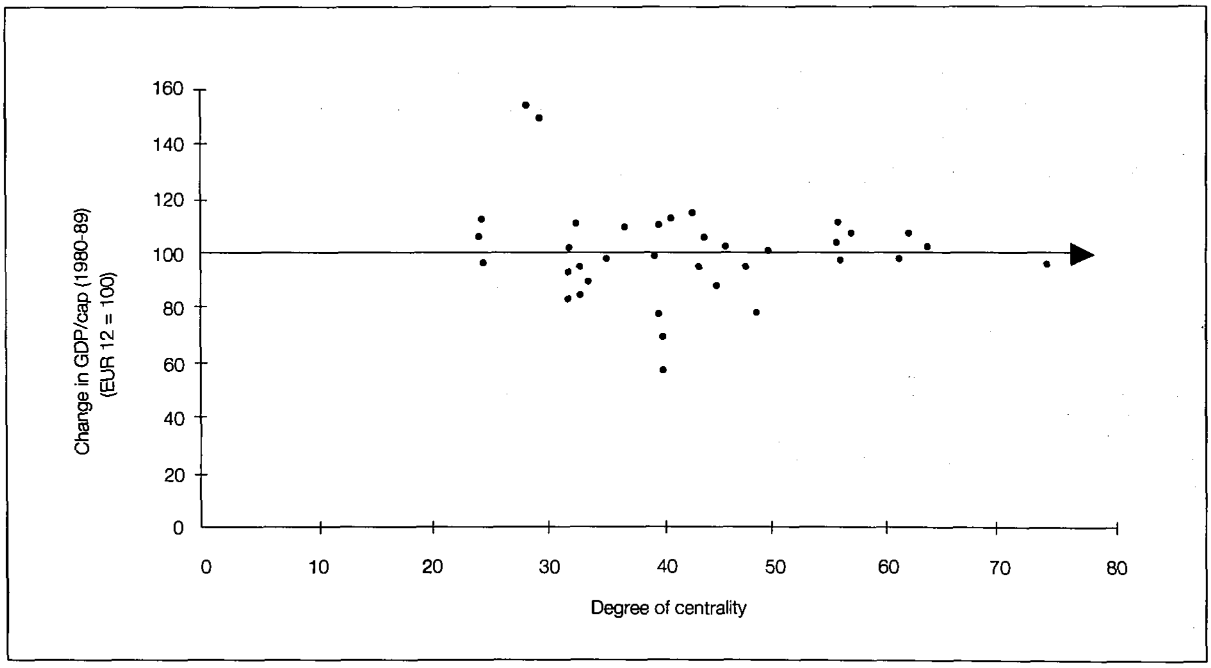
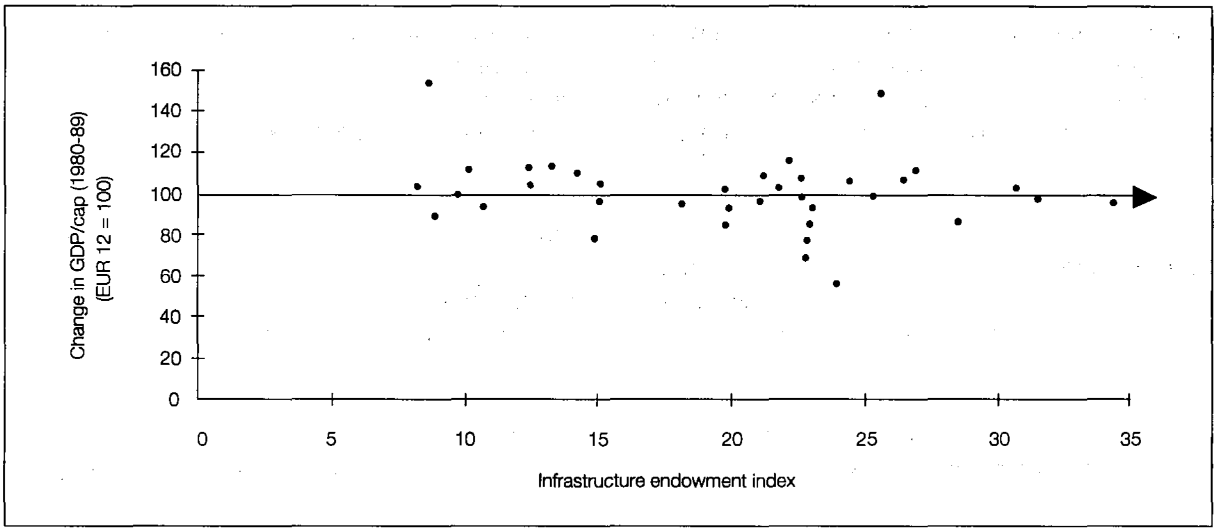


Figure 4.4: GDP performance and infrastructure endowment of the lagging regions



As can be seen from the table, the analysis produced statistically significant and positive correlations between the level of per capita GDP in 1980 and in 1989 and structural variables such as degree of industrialization, secondary education participation rates, urbanization, centrality and infrastructure endowment and a statistically significant negative correlation of per capita GDP levels and the share of agriculture in total employment (which is arguably also a measure of the degree of rurality). However, correlating the above structural factors with per capita GDP growth between 1980 and 1989 did not produce any statistically significant results. This means that, at best, the theories outlined above are only part of the story.

These statistical analyses are useful, in that they indicate that certain structural factors are important in explaining the level of development within a region, but there is little or no explanation of performance. From this analysis we therefore have no real explanation of why certain Objective 1 regions are converging and others are diverging. In total then the combinations of possible structural success factors are too wide to be captured by even a complex taxonomy. Regional specificities are so varied that in different historical and macro-economic contexts they can give rise to a wide spectrum of alternative behaviour. In so far as it can be defined through these rough statistical indicators, regional structure therefore only partially explains regional performance. Moreover, these indicators do not provide us with any indication of how regions will perform in the future. From this analysis, infrastructure, industry and human capital are all important factors in explaining levels of regional GDP. The task that remains is therefore to identify the specific catalytic elements that have generated growth/economic take-off in different regional contexts and those factors that can be built upon through policy measures.

4.4 The concept of 'milieu innovateur'

During the 1980s, regional analysts became increasingly aware that neither of the two main schools of thought could offer a satisfactory explanation to the complex patterns of locational changes in the more developed parts of the world. Whilst traditional theory stressed the importance of the relations between regions (e.g. the centre-periphery relations, inter regional factor mobility), new approaches focused on the endogenous development potential of individual regions and on the factors capable of acting as a catalyst for the mobilization of that potential. Theories which emphasize the importance of innovation-led regional development have subsequently served to emphasize the conclusions from endogenous growth models.

Building on these new approaches, the GREMI group developed the concept of 'milieu innovateur' which it sees as a dynamic counterpart to the concept of industrial districts which evolved in the endogenous growth model. Its main differences reside in the attention paid to innovation processes and in the emphasis placed upon external and district economies and synergy. An innovative milieu is defined as 'the set of relationships occurring within a geographical area which bring unity to a production system, economic actors, and an industrial culture, generating a localized dynamic process of "collective learning" and acting as an uncertainty-reducing mechanism in the innovation process'.

Originally, the innovative milieu concept was used by GREMI to explain the success of industrial districts in the 'Third Italy'. These areas tend to focus on one particular craft-based industry and are called 'Third Italy' to distinguish them from the heavily industrialized regions in the north of Italy and the underdeveloped Mezzogiorno. GREMI studies have identified common features of innovative milieux: some specialization in a technology or 'filiere', strong interactions and synergies within the area, wide imitation and collective learning processes and a strong psychological sense of belonging to a local community.

The model is an endogenous growth one, in that it emphasizes the local framework. Specialization is the key, leading to high synergy in the regional economy:

- a large pool of labour with skills specific to the sector;
- a network already in place of suppliers and buyers of the products;
- new firms start up readily in this fertile environment, especially since the entrepreneurs can draw on a lot of expertise in the sector;
- flexibility of supply as a firm can choose between many suppliers. A consequence of this is strong competition between suppliers and a high level of competitiveness;
- because of local sense of community, staff turnover and supplier relationships, there is widespread collective learning and the rapid spread of innovation. There is also far more innovation as many firms are producing it;
- the region acquires a reputation for the sector and links with external suppliers, customers and investors.

The more conventional framework factors such as education and infrastructure are still important in this story (indeed, the abundance of skills is possibly crucial). But the coherency of the regional economy and intangible factors such as informal networks are also part of the explanation for economic success. Therein lies the attractiveness of the model; not only can the processes outlined in the model be observed in parts of Italy and elsewhere in the Community, but also an explanation is provided for the lack of automatic linkage between economic success and single factors such as infrastructure. The important thing is not any single feature of the economy, but that it forms a coherent whole.

The fact that local resources are involved and utilized in the development of an innovative milieu does not mean that the process can only start as a product of indigenous entrepreneurship. The catalyst for many Third Italy industrial districts was an external firm setting up to take advantage of the skills already there. However, if external investments are attracted to a region, they have to link up with and involve elements other than a cheap labour force and unspoilt environments if a self-sustaining development process is to emerge. Local synergy among local actors and between them and external investments can compensate the local economy for the lack of other, more traditional advantages such as economies of scale and advanced production.

A link with an external dynamic is crucial even in cases where the development process is started by indigenous entrepreneurship. The potential for continued development relying solely on local capabilities is limited in the long run. Cooperation with external institutions, firms or public agencies and research centres is important, as is the external dynamic for product and market diversification, in order to continually recreate local competitiveness and local innovative capacity. This is perhaps even more important in lagging regions where conditions for the generation of local innovative milieux are weak.

The policy implications that flow from this are forms of external intervention that can mobilize and activate indigenous resources synergetically, through technological cooperation agreements, know how transfers and the movement of resource 'packages' such as complex technological projects or production and training. If development is to occur then it must take place through the processes identified by GREMI. These are the involvement of local resources, the creation of synergies among local actors and factors, a link-up with external energies, and a continuing process of innovation.

Innovation in the context of lagging regions must of necessity be conceived of in a wide ranging sense rather than solely as a leading edge technological advance. Indeed, a spectrum of innovation can be observed with an increasing order of complexity and a decreasing probability of introduction:

- intersectoral job shifts, for example from agriculture into light industry, or from trade to advanced services;
- rapid diffusion of successful practices across the local 'district', for example of products, technologies, organizational schemes and marketing strategies;
- application of advanced technologies into traditional spheres of production and organizational forms;
- incremental innovations on existing products and technologies;
- radical innovations.

It is difficult to produce a watertight statistical identification of innovative milieu. This is, firstly, because of the fact that innovative milieux are characterized by intangibles and, secondly, because they usually cover areas much smaller than NUTS 3 and they are statistically 'drowned out' by the surrounding area. It is possible, however, to look for certain tell-tale signs such as concentrations of one or several industries, rapidly growing income and/or employment, and a reputation for quality and innovation. In finding these signs, the advice of national and local experts is as important as statistical data. A broadbrush view is given below. For an attempt at complete classification of Objective 1 regions, see the GREMI report.

The evidence presented indicates that local success stories exist in every country. Moreover, investigations by the national teams revealed that innovative milieux do exist in Objective 1 regions. These identified milieux are found in both converging and diverging regions. Of the total identified by GREMI, ten are found in converging regions (Limerick-Shannon, Andalucia, Castilla La Mancha, Murcia, Valencia, Heraklion, Xanthi, Rhodes, Val Vibrata, Raiano), five in diverging regions (Asturias, Patra, Kastoria, Solofra and Volos) and the remaining eleven in mixed-evidence regions (Extremadura, Galicia, Castilla Leon, Castelo Branco, Aveiro-Viseu, Leiria, Barletta, Costa Smeralda, Calangianus, Casarano and Canicatti). This means that there is a basis on which to build everywhere.

A caveat to the above is that innovative milieux are the exception rather than the rule in Objective 1 regions. Much more common were isolated developments of branch plants or State-owned enterprises or areas of handicraft and light industry producing for local markets.

Innovative milieux are based on different kinds of activity. Barletta in Puglia Italy is based on leather goods and sport footwear (70% of Italy's sport footwear comes from there). Pinhal Litoral in Portugal specializes in traditional ceramics and glass which has lead via skill availability to more modern things such as plastics and industrial moulds (this innovative milieu is a major innovator in moulds). Alto Deva in Spain specializes in metal transformation, Costa Smeralda in tourism. It should be noted that some of this is high-tech, some commonplace, but always featuring innovation

It is difficult to tell in advance whether a region will become an innovative milieu, but many have the potential. Two possible trajectories towards an innovative milieu are: first, an external innovative intervention can take place, which is then subsequently embedded and integrated into the local society, partly due to public policy; second, through the development of local synergies.

The identified milieux fall into two main categories. First there are a group of milieux which are in a virtuous cycle where future regional growth patterns have good prospects. These comprise Costa Smeralda, Limerick-Shannon, Valencia, Val Vibrata, Raiano, Murcia, Canicatti, Leiria, Castelo Branco, Casarano, Solofra and Aveiro-Viseu. Investigations by the national teams indicate that the development trajectories of these milieux vary widely. In the Irish case the development trajectory is based upon linking external investment with indigenous development. Innovativeness rests upon internal synergy and employment development. But in the Spanish and some Portuguese examples, synergy and local employment growth rest upon innovativeness and productivity growth. The Italian experience is somewhere between the two. A number of milieux appear to be in a less favourable position, where development has rested upon protection through public intervention, or 'sheltered development'. These are: Andalucia, Barletta, Volos, Patra, Xanthi and Kastoria. The task of moving these milieux and areas with no milieux in existence into a virtuous cycle offers opportunities for policy interventions which are investigated further in Section 6.

Examples of innovative milieux experiencing a virtuous cycle

Costa Smeralda

The Costa Smeralda in Sardegna has, like Limerick-Shannon, developed on the basis of large external investments. However, in this instance a consortium developed by the Aga Khan has led to success based on tourism. External investment has encouraged the development of local entrepreneurship, both in the tourism sector itself, but also in related 'traditional' activities such as agriculture and food processing. The consortium has created important infrastructural externalities for local firms, particularly in transport and communications. It is argued that the large scale tourist development of the consortium acts as both a model and a school for independent local operators.

Limerick-Shannon

The development of this area has occurred under the direction of the Shannon Free Airport Development Company (SFADCO), which is responsible for industrial development policy and implementation. Such regional responsibility for development is rare in Ireland and accounts for much of the area's success. The international airport plays an important part in increasing the attractiveness of the area. The work of SFADCO promotes the integration of, and interaction between, a range of agencies, institutions and firms. These include the University of Limerick, Plassey Technological Park and a number of electronic or computer-based multinationals. New firm formation is also important. Linkages between the university and industry have been fostered by SFADCO and a range of organizations established. These include an Innovation Centre, a Marketing Centre for Small Business, an Innovation Board and an Entrepreneurship and High Technology Programme. All these institutional structures mesh together, largely through overlapping representation at board level, to help reduce uncertainty, promote innovation and create synergy. Informal contacts between individuals involved in these organizations and in industry are also important.

Valencia

Valencia's success rests upon the development of local industrial enterprises. The majority of these are based upon traditional sectors such as food, textiles, footwear and clothing and the area has a strong business tradition with entrepreneurs coming from families of craftsmen and tradesmen. In specific areas there are strong specializations of production, with almost industrial monoculture in some areas. Few barriers to entrepreneurship exist and success by some firms has spawned a process of imitation. One of the strengths of the area is the high level of local savings and subsequent investment. Few entrepreneurs rely upon the financial markets to finance their businesses. Subcontracting and household work leads to a certain amount of firm interdependence, although such business interchange is not well developed.

4.5 Conclusions

From this statistical analysis of regional structure and its relationship to performance, a number of conclusions can be drawn. Structural factors did not provide statistically significant explanation of the performance of each region; correlation and regression analyses confirmed that structural factors may explain the level of regional GDP, but not the growth rate. However, the absence of an explanation derived from these statistical indicators necessitates an examination of the more intangible factors associated with innovative milieux.

The presence of a single asset or benefit does not in itself encourage or prevent development. Thus, good road infrastructure, a highly qualified labour force or low labour costs did not automatically lead to a good local performance. At the same time, a peripheral location, or agricultural specialization did not in themselves prevent development opportunities.

Short cuts or recipes for development do not exist; there is no single 'miracle ingredient' (e.g. infrastructure) which explains success or failure. Development builds upon a multiplicity of preconditions that have to be present at the same time and that need to be creatively exploited by the region. There are many different factors which make a region more competitive:

- A favourable local business environment with good infrastructure, education, financial service provision and sound macro-economic policies. This is necessary but not sufficient, in that a good environment does not cause development, but the lack thereof constrains it;

- Specialization which leads to synergy between firms and, to some degree, to an innovative milieu.

What should the role of policy be? Policy should aim to deal with the most pressing shortcomings of the regional business environment, i.e. to fill the gaps. The availability of human capital, infrastructure, services and entrepreneurship appear to be the decisive assets for a long term development strategy. Policy should also encourage coherency and synergy in the local economy, building on innovative milieux where they exist. This means that regional assets and specificities should be identified and exploited within a specific strategy (tourism in Sardegna, local enterprise in Valencia for example). The main question that then arises is whether the raw material for policy is there, i.e. do the lagging regions have specificities which can be exploited, do they have the makings of innovative milieux?

Innovative milieux do exist in Objective 1 regions, but they are rare and incipient. The macro-economic context and local framework affects their development (for example, the backwardness of the social environment in Greece and the relative absence of local entrepreneurship and synergy in Ireland). Innovative milieux were found within converging and mixed evidence regions. Encouragingly, some milieux were present in diverging regions. There is therefore material for policy to build on. Provided that they are exploited coherently, some seemingly negative factors can play a positive role. For example, a peripheral location can have advantages for environmental protection and possible tourist development.

EC integration and development prospects

5.1 Introduction

So far, the preceding sections of this report have investigated the performance of the Objective 1 regions over the 1980s with a view to identifying the prospects for development in the 1990s. In this section we consider how the completion of the Community's internal market will affect the lagging regions, and how this can be related to the analysis in previous sections.

Four sets of issues receive particular attention. In Section 5.2 we look at the main issues for Objective 1 regions that arise from implementing the internal market measures, Section 5.3 contains a sectoral analysis and pays particular attention to the importance of 'sensitive' sectors, Section 5.4 links the analysis to the development prospects for the Objective 1 regions and Section 5.5 deals with the impact of monetary union.

5.2 The internal market programme

While the internal market programme consists of over 300 individual measures for the completion of the internal market, the main issues facing Objective 1 regions can be grouped into six categories. They include:

• the removal of border barriers;
• the harmonization and mutual recognition of technical norms;
• the opening up of public markets;
• the liberalization of capital movements and financial services;
• the free circulation of workers and their families;
• the resultant increased industrial cooperation between companies.

Below, each of these issues is examined in turn to identify the likely impact upon the lagging regions.

The removal of border barriers

The removal of border barriers such as customs formalities and VAT regulation will have a positive impact upon the economies of all Objective 1 regions. In particular, administrative and transport costs will be reduced for companies involved in exporting. Small and medium-sized entreprises (SMEs) are likely to obtain the greatest benefits as the cost of customs formalities, for example, can be 30-45% higher than for larger firms. The two major impacts on Objective 1 will occur in relation to export potential and inward investment.

First, reduced barriers may encourage SMEs to expand their export capacity. Positive impacts are expected in those countries and those regions where export activity is already high, such as the East and South East regions of Ireland, Valencia, Murcia, Centro, Lisboa, Puglia, Abruzzi, Campania and Sicilia. In a number of regions, though, the benefits generated by the removal of border formalities are likely to be rather small. This is likely to be the case for regions such as the West and Mid West of Ireland where export sectors are dominated by large multinational companies which have already absorbed many of the administrative costs. Also in Greece, the measures will have less impact partly because of the distance from European markets and because of the greater orientation to local and regional markets.

There are also, of course, some direct threats associated to the removal of border formalities. A particular challenge for a significant number of lagging regions is the suppression of Article 115 which allows Member States to introduce restrictions on imports from outside the Community if these cause serious damage to their domestic industry. Sectors likely to be particularly affected include textiles and clothing, footwear, agricultural produce and mechanical engineering. These are activities where competition from newly industrializing countries and Eastern Europe is strong. Regions specialized in these production areas, such as Norte and Centro in Portugal, Valencia and Castilla La Mancha in Spain, Campania, Puglia and Molise in Italy and Central and Eastern Macedonia in Greece could be hit especially hard.

On inward investment, the suppression of trade barriers may affect in-movement of firms to these regions. Whether these measures positively increase the lagging regions' accessibility or encourage firms to locate there will depend on the overall configuration of improved accessibility with factors such as infrastructure, market potential, labour quality and costs within individual countries. Few major impacts are expected in Greece, Italy, and Ireland. Spain is likely to be the major beneficiary, particularly in Valencia, Murcia, Castilla Leon and, to a lesser extent, Andalucia. Both Spain and Portugal have benefited greatly in recent years from substantial increases in foreign direct investment. It is important to note that such development has been concentrated in coastal areas, thus there is likely to be a differential impact within regions.

Harmonization and mutual recognition of standards

These measures will have a relatively limited impact upon Objective 1 regions in the short term. The reasons for this are threefold. First, the lagging regions tend to specialize in sectors such as textiles and clothing where technical barriers are relatively unimportant. Second, Objective 1 firms are mainly oriented towards their domestic markets, even in sectors such as foodstuffs and construction where technical barriers are high. Finally, most firms in Objective 1 have low levels of technological content or R&D involvement. In the longer term pressures for modernization will result in improved product quality and competitive ability and engender a positive impact. However, for those Objective 1 regions unable to satisfy high Community standards or where services to help them meet such raised standards are lacking, harmonization could have negative consequences.

The limited impact of the measures was observed within the majority of the lagging regions with a few exceptions. Overall, the impact of harmonization measures is likely to have most impact in Italy. Three regions, Molise, Abruzzi and Campania have sectors with important technical barriers and high export levels (motor vehicles and telecommunications). Greek firms appear to be less than well prepared for the harmonization of technical norms. Even in Attica and Central Greece, where the comparatively larger number of firms producing for export and with a higher technological content means that harmonization measures will have a greater impact than elsewhere, company managers are paying little attention to the changes.

Opening public procurement markets

To date only 2% of the public markets for suppliers or works are awarded to extra-national firms. Opening public procurement markets will engender two main processes. First, price differences between Member States will be reduced, as national suppliers fall into line with the most competitive firms. Second, there will be a restructuring process as the number of producers is reduced and firms merge. In assessing the impact of these measures, it is important to make a distinction between traditional public markets (especially in construction industry) and high technology public markets (such as computing, office equipment, telecommunications and medical equipment).

Objective 1 regions should be able to benefit from the expected reduction in the cost of public supplies and works. At the same time, producers in Objective 1 regions are not likely to be greatly affected (either positively or negatively) by the opening up of advanced technology public procurement markets mainly because this type of activity remains concentrated within the core regions of the Community, with some exceptions such as Abruzzi, Campania, Andalucia and Castilla la Mancha. However, the same is not true for those regions where traditional public procurement markets, protected by government, are important. Trade in such sectors is weak. Firms reliant on such markets are frequently in poor financial health, have low productivity levels and a weak technological capacity. Many firms in Objective 1 depend upon local and regional preference, but the opening up of markets and the end to regional preference are likely to lead to closure and/or take over of the market by more competitive firms. These processes will particularly affect Greece, Portugal and, to a lesser extent, the Mezzogiorno. Firms in the construction sector are likely to be especially affected by these developments, particularly for large-scale civil engineering projects.

Freedom of capital movement

Freeing capital movement is likely to result in greater competition to national banks from foreign entrants. The latter are likely to be more competitive and offer more diversified services. Freeing capital movements may also make local credit markets more vulnerable to competition. Furthermore, domestic savings may be reoriented towards the core countries of the Community in search of greater profitability than can be found locally. However, small local banks are unlikely to disappear as they have advantages of local knowledge and demand. Some of these smaller banks may play an important intermediary role between the financial needs of SMEs and foreign banks. In total then, Objective 1 regions may gain a better quality of financial service at a lower cost.

One negative feature common to many Objective 1 regions could be the restructuring of, and potential job loss within, the domestic financial system. This will mainly affect capital city regions such as Dublin, Athens and Lisboa. Overall, Greece and Portugal will be most vulnerable for two main reasons. First, their capital markets are underdeveloped and second, their financial systems are split between a strongly concentrated national banking system which is not competitive, and foreign financial institutions oriented towards the growth sectors of these countries (the latter, however, have a poor presence in the peripheral regions of these countries). In addition, their national banking systems are inefficiently organized and managed, and heavily involved in financing public sector firms, many of which are heavily in debt and unlikely to be profitable. Conversely, Spain and Ireland have either reorganized, or are in the process of reorganizing, their financial systems to confront foreign competition.

Free circulation of labour

For Objective 1 there are two important aspects of the liberalization of labour: deregulation of the labour market and the potential exodus of qualified workers. The former may encourage further development of the black economy, but the latter is the potentially most damaging consequence for Objective 1. A rapid loss of highly qualified workers could inhibit attempts to modernize the local economy. This is especially likely to affect Ireland, where outmigration has traditionally been to the United Kingdom, Australia and the USA, and the Lisboa and Norte regions of Portugal. With exception of Portugal, it is not envisaged that there will be strong intra-Community movements of unskilled workers, for cultural as well as economic reasons. Indeed, in Greece there has been a return of low qualified labour from other parts of the Community, notably Germany. Within some countries it is thought there may be internal movements of low qualified labour towards urban areas, as in Spain and Italy.

Industrial cooperation

Encouraging industrial cooperation across the Community aims to increase the realization of technical and non-technical scale economies and to decrease fragmentation of EC industry, especially *vis-à-vis* the USA and Japan. Two main processes of industrial cooperation are envisaged. First, through internalization which aims to increase concentration. Second, through encouraging contractual cooperation agreements between firms. Industrial cooperation across Europe is unlikely to have substantial involvement by firms located in Objective 1. Such firms have a low technological content to their product ranges, are oriented towards the home market, and are generally below the minimum efficient size threshold. Most Objective 1 firms will not benefit from movements towards merger between local firms. In some cases they may be involved in merger with national or Community firms, especially where the latter can obtain advantages of technical know-how or brand names, for example in textiles, footwear and agricultural produce.

Contractual inter-firm relations are most likely to encompass three forms of industrial cooperation:

first, in the technical field, where the major advantages are in shared R&D operations; second, in the commercial field in order to enlarge market, share or achieve larger distribution networks; third, in the financial field in order to bring together capital needed by all the partners. Only a few dynamic firms in Objective 1 regions are likely to be accepted into strategic alliances, whether on a national or Community-wide scale.

Across the Objective 1 countries the major benefit is likely to be felt within Spain. Even here there are differential impacts, with the greatest benefits felt in those regions with relatively qualified labour, low transport costs and reasonable infrastructure. In Spain, merger between local firms and national or Community firms is likely to be more important in the Mediterranean axis in Andalucia, Valencia and Murcia. Some moves in this direction have already occurred, especially by foreign firms seeking a share of the Spanish market. External investment in these regions is also strong. Other regions will see fewer advantages. With the exception of Lisboa, Portugal is likely to experience only limited industrial cooperation. In Lisboa, foreign investment is predominantly in the fields of finance, real estate and commerce. Similarly in Greece, acquisition by large Greek and European firms is limited, as is foreign investment. Both are largely confined to Attica and Central Greece.

5.3 Sectoral impacts

While the measures examined so far will have an impact upon the entire economic fabric of the Objective 1 regions, implementing the internal market will have a differential impact upon specific industrial sectors. In particular, some sectors have been judged to be particularly 'sensitive' to the effects of the 1992 programme. In this section, we assess the extent to which regional economies are more or less sensitive to the internal market programme on two counts. First, on the basis of the relative importance of the sensitive sectors in the economic fabric of the Objective 1 regions, and second on the basis of the competitiveness of these same sensitive sectors.

A substantial amount of work in this area has been undertaken by Buigues, Ilzkovitz and Lebrun (see Commission of the European Communities, 1990, *The impact of the internal market by industrial sector: The challenge for the member states,* Directorate-General for Economic and Financial Affairs/Directorate-General for Employment, Industrial Relations and Social Affairs) who examined the manufacturing sector of the Community. While manufacturing only accounts for between 15-30% of GDP in Member States, industrial products account for a major share of exports of goods and services. In total, manufactured goods comprise almost 70% of total trade between Member States. In this section we draw upon this analysis, as well as upon our own calculations which attempted to regionalize this analysis. This proved to be difficult due to substantial problems with the regional data.

Of 120 industrial sectors considered by Buigues, Ilzkovitz and Lebrun, 40 were identified as being currently protected by non-tariff barriers, or where barriers prevent the exploitation of economies of scale, or where barriers allow the retention of price discrepancies between Member States. It was thought that these sectors would be particularly 'sensitive' to the completion of the internal market when such barriers are removed. Buigues, Ilzkovitz and Lebrun identified a number of characteristics of 'sensitive sectors', reflecting their degree of openness to Community trade, and their tendency to support price differences between Member States - for identical products. Typical characteristics were: high technology public procurement markets or sectors where demand is growing rapidly and where technological content is high, such as telecommunications, medical equipment and informatics; traditional or regulated public procurement sectors; and sectors with moderate non-tariff barriers, including activities where technical, administrative or fiscal barriers still exist but where wide price differentials remain.

In addition, at the national level, each Member State was inspected to see whether there were sectors which, due to specific national characteristics, would be 'sensitive' to 1992 although they had not been included in the list of 40 sectors identified at Community level. For example, some sectors were included because of the presence of important non-tariff barriers in one Member State only, such as knitwear in Greece which receives significant export subsidies in that country. Some sectors were eliminated from the sensitive list because they are insignificant for that Member State, such as the wine sector in Ireland.

Table 5.1: Share of sensitive sectors in employment and value added in 1987				
	Share in manufacturing employment	Share in total employment	Share in manufacturing value added	Share in total value added
Portugal	68%	17%	60%	16%
Greece	62%	11%	57%	9%
Germany	57%	18%	60%	18%
Italy	52%	12%	50%	12%
France	51%	11%	53%	11%
Belgium/Luxembourg	50%	12%	49%	10%
UK	50%	11%	53%	12%
Denmark	49%	10%	42%	7%
Spain	48%	11%	49%	12%
Ireland	47%	9%	61%	14%
Netherlands	45%	8%	47%	9%
EUR 12	53%	13%	54%	13%

Source: Buigues, Ilzkovitz and Lebrun (1990) and DG XVI calculations.

Subsequently, the sensitivity of the sectors identified in each Member State was assessed by each national expert, by estimating the impact which the removal of non-tariff barriers could have. Important changes were made to the list of sensitive sectors for Portugal, Greece and Spain. Generally, the sectors added to the list in these countries are subsectors of the textiles, food-processing and car industries. Overall, 'sensitive sectors' were found to be important in the economies of the Objective 1 countries (see Table 5.1 above).

Table 5.1 reveals that the sensitive sectors account for over 50% of both manufacturing employment and value added, and 13% of total employment and GDP for the Community as a whole. For the Objective 1 Member States, the sensitive sectors account for higher than average manufacturing employment (Portugal and Greece) and manufacturing value added (Portugal, Greece and Ireland).

Following the identification of the sensitive sectors and examination of their relative importance within

Table 5.2: Relative strength of weak and strong sensitive sectors				
	Share in manufacturing employment		Share in manufacturing value added	
	Weak sectors	Strong sectors	Weak sectors	Strong sectors
Portugal	16%	29%	24%	15%
Greece	18%	19%	22%	18%
Germany	4%	38%	5%	27%
Italy	13%	28%	22%	26%
France	14%	23%	17%	16%
Belgium/Luxembourg	10%	22%	13%	24%
UK	16%	16%	21%	21%
Denmark	12%	30%	na	na
Spain	17%	14%	na	na
Ireland	15%	23%	na	na
Netherlands	16%	22%	17%	28%
EUR 12	12%	26%	14%	23%

Source: Buigues, Ilzkovitz and Lebrun (1990) and own calculations.

Member States, Buigues, Ilzkovitz and Lebrun assessed the competitive position of each of the sectors. This was undertaken by looking at the present trade performance of each Member State in each sensitive sector. On the basis of four indicators relating to the export performance and specialization in the period 1985-87, the sensitive sectors of each country were classified into three groups: those sectors where Member States have a competitive advantage (deemed 'strong' sectors); those sectors where Member States are at a disadvantage ('weak' sectors); and those sectors which are 'balanced'. In our analysis we focused upon the differential between strong and weak sectors to try and determine the competitive strengths of regions. Table 5.2 divides manufacturing employment and value added in the sensitive sectors into their weak and strong proportions. Buigues, Ilzkovitz and Lebrun complemented this static analysis by examining historical trends and made adjustments for the current dynamism of sectors. We now turn to an analysis by Member State to examine the competitiveness of the Objective 1 regions as a consequence of 1992.

Greece

In total, Greek manufacturing is composed of more sensitive sectors than the EC average (see Table 5.1). Greece has 62% of manufacturing employment and 57% of value added in the sensitive sectors. However, the share of manufacturing in the Greek economy is relatively low. In consequence, the Greek sensitive sectors have a relatively lower weight in total employment and GDP.

In terms of the competitive position of the sensitive sectors, the Buigues, Ilzkovitz and Lebrun static analysis reveals that the employment share of strong sectors (19%) in Greece is virtually equal to that of weak sectors (18%) (see Table 5.2). When analysed in terms of value added, the share of strong sectors (18%) is lower than the weak sectors (22%). This contrasts with the position for the EC as a whole, where the employment share of strong sectors (26%) is more than twice as large as the weaker sectors (12%). In Greece, the strong sectors are dominated by the textiles, clothing and footwear industries. These sectors together account for 15.6% of employment and 12.1% of value added.

The historic performance of the sensitive sectors in trade terms over the 1980s was poor. Most of the sensitive sectors experienced a deterioration in their performance. In total, 33.8% of employment in manufacturing fell into this deteriorating category. Only a minority of sectors, accounting for 17.4% of all manufacturing employment, improved their position. Moreover, of the seven strong sensitive sectors in Greece, four experienced a deterioration in their competitive position over the 1980s (accounting for 11.4% of manufacturing employment). Only one strong sensitive sector improved its competitive position significantly (accounting for 5.3% of manufacturing employment). Of the 38 sectors designated as 'balanced' or 'weak', 20 experienced a deterioration in their competitive position in the 1980s (22.4% of manufacturing employment). Only 10 sectors of the 38 improved their competitive situation (12.1% of manufacturing employment). Indeed, with very few exceptions, the only sectors showing some improvement over the 1980s were those which are not very important to the Greek economy. Virtually all the sectors which are important for the Greek economy performed badly.

It is worth noting that a large proportion of the strong and balanced sensitive sectors is made up of textiles, clothing and footwear industries. These are low technology, labour-intensive sectors which are under threat from low-cost producers in Eastern Europe and South East Asia. Most of these sectors had a poor performance over the 1980s, which does not bode well for the impact of 1992. Meanwhile, virtually all the modern, sensitive industrial sectors are weak. With the exception of food industries, nearly all the Greek consumer goods sectors are weak.

In summary then, Greek industry is likely to be sensitive to the impact of the single market, even though the relatively low importance of manufacturing in Greece in total will help to mitigate these impacts. A very large proportion of Greek sensitive sectors are in a weak competitive position and even the strong sectors have been performing badly in the 1980s. As noted, these strong sectors are concentrated in industries which will be subject to competition from lower-cost producers outside Western Europe. The overall prospects for industrial activity in Greece as a consequence of 1992 appear bleak.

With regard to the regional situation, the share of sensitive sectors is particularly high in Attica, Central Greece and Central Macedonia (accounting for between 22-24% of total employment) and is only low in the islands and the Peleponnese. Poor regional data preclude an analysis in terms of weak and strong sectors.

Spain

Compared to the Community as a whole, Spain has a lower overall share of sensitive sectors in manufacturing employment (48%) and total employment (11%). Table 5.1 indicates that this is also true in terms of value added. With regard to the competitive position of Spain's sensitive sectors, figures are only available for employment (Table 5.2). These reveal that Spain has a higher than average proportion of sensitive sectors in a weak competitive position, and a lower than average proportion in a strong position. It is worth noting that due to data problems Buigues, Ilzkovitz and Lebrun limited their analysis of competitiveness to the initial 40 sectors (which account for 40% of manufacturing employment) rather than the total list of sensitive sectors for Spain (which account for some 48% of manufacturing employment).

By comparison with total manufacturing activity, the 40 sensitive sectors in Spain were found to be more open to international trade and more vulnerable to external competition. While the EC is the major trading partner for Spain, the trade flow with other countries is also high, especially in the sensitive sectors. The sensitive sectors also exhibit higher labour productivity and labour cost than is the case for total manufacturing. Since accession to the EC Spain's manufacturing imports, especially in the most sensitive sectors, have increased as a consequence of a drastic reduction in protective measures, particularly high tariff and indirect restrictions. This helps to account for the rather unexpected dominance of weak sectors in Spain. In addition, the recovery of the Spanish economy and the appreciation of the peseta in the period 1985-87 also contributed to a worsening manufacturing trade balance. Thus, some sensitive sectors which were relatively strong before accession to the EC (pharmaceuticals, machine tools, shipbuilding) are now in the weak category, indicating that their competitive position largely rested upon high trade barriers.

At the regional level, sensitive sectors account for a higher than average proportion of manufacturing employment in Valencia and Castilla La Mancha. Andalucia and Castilla Leon also contain high proportions. Conversely, there are much lower than average shares of sensitive sectors in Canarias and Galicia. As Table 5.2 shows, for Spain as a whole weak sectors account for a higher proportion of manufacturing employment than strong sectors. This is also the case for most Spanish Objective 1 regions, apart from Castilla Leon, where the situation is balanced, and Valencia, where strong sectors dominate. Rising foreign direct investment may help to improve productivity, competitiveness and trade performance in the Spanish regions, but it is worth noting that the majority of this goes to the non-Objective 1 regions around Madrid and Barcelona.

Portugal

Portugal has a higher proportion of manufacturing employment in the sensitive sectors (68%) than any other Member State (see Table 5.1). While its share is lower when measured in terms of value added (60%), this is still above the EC average. This discrepancy between value added and employment suggests that Portuguese sensitive sectors are labour intensive and have low productivity compared to the rest of the manufacturing industry. In total, Portugal's industry shows a marked polarization between a limited number of strong sensitive sectors and a large number of weak sectors.

Strong sensitive sectors are slightly more important in Portugal (29%) than for the EC (26%) as a whole, in terms of manufacturing employment. However, the position is reversed in terms of value added. A large proportion of the Portuguese sensitive sectors are in a weak competitive position and even the strong sectors have been performing badly in the 1980s. As with Greece, these strong sectors are concentrated in traditional, low technology, labour-intensive industries which will be vulnerable in the medium to long term to competition from low cost producers outside the EC. Excluding the limited number of more advanced sectors such as insulated wires and cables, Portugal's strong sectors include knitwear, ready-made clothing, household textiles and footwear. Such sectors have been competitive because of low wage costs and the widespread use of flexible work practices, including home-working and limited employment contracts. As in Spain, Portugal's sensitive sectors have been protected by tariff barriers and they are vulnerable to competition. This is especially true of foodstuffs which may need substantial restructuring if the industry is to survive in the single market. The overall prospects of Portugal in the light of 1992 therefore appear to be poor.

Potential sensitivity to the internal market varies by region. There is a low proportion of sensitive sectors in Algarve, where they account for only approximately 5% of total employment. Conversely, much greater shares of sensitive sector employment are found in Norte (up to 27% of total employment) and Lisboa. Centro, Alentejo and Norte are in a relatively balanced position as regards competitiveness. The sensitive sectors in Centro and Alentejo largely consist of ceramics, while in Norte textiles and clothing predominate. In Lisboa weak sensitive sectors are much more prominent than strong sensitive sectors.

Italy

Table 5.1 reveals that Italy's share of sensitive sectors in terms of both employment and value added is similar to the Community average. In relation to the competitiveness of these sensitive sectors, Table 5.2 reveals that overall, Italy has a slightly higher than average proportion of sectors in a strong competitive position in terms of manufacturing employment. In terms of value added, Italian sensitive sectors show a strong dichotomy between weak and strong sensitive sectors. In addition to the 40 sensitive sectors, Buigues, Ilzkovitz and Lebrun identify three additional important sectors which will be affected by the single market: the automotive sector, motor cycles and textiles and clothing. In addition to the direct impacts upon these sectors there are also important secondary effects transmitted through inter-industry linkage to sectors such as parts and accessories for motor vehicles and weaving, spinning and man-made fibres.

However, despite the important potential impact of the single market upon Italian industry the effects in the Objective 1 regions will be limited. In few of Italy's Objective 1 regions do the sensitive sectors account for a large proportion of regional employment and none have a higher share of total employment than the national average. Sardegna, Sicilia, Basilicata and Calabria in particular appear to be much less sensitive to the impacts in 1992, as in all four regions the sensitive sectors account for less than 5% of total employment. In other regions of Abruzzi, Puglia and Campania, the share of sensitive sectors is still relatively low. Strong sectors are more prominent than weak sectors in Abruzzi and Puglia, while Campania has a more balanced situation.

Abruzzi and Campania have a slightly higher proportion of employment accounted for by the sensitive sectors. Campania (automobiles and telecommunications) and Molise (automobiles) have a large proportion of their sensitive sectors in a weak competitive position. Basilicata, Puglia and Abruzzi have a high proportion of strong sensitive sectors (clothing in all three regions, as well as chemical products in Basilicata). Campania, as well as having a high proportion of weak sensitive sectors, also has a high proportion of strong sensitive sectors (clothing, footwear and chemicals).

Ireland

In employment terms, the Irish economy is less sensitive to 1992 than the Community average (see Table 5.1). However, in terms of value added in manufacturing (61%) it is more sensitive than the EC as a whole (54%). A large proportion of the sensitive sectors are dominated by multinational enterprises and, as a consequence, a large proportion of value added can be rapidly withdrawn from Ireland in the form of repatriated profits. It is therefore thought that employment shares better represent the importance of the sensitive sectors to the Irish economy.

The employment share of strong sensitive sectors in Ireland (23% of all manufacturing employment) is larger than weak sensitive sectors (15%). The strong sectors are dominated by multinationals in industries such as pharmaceuticals, office machinery, telecommunications, medical equipment and domestic appliances (in total, these account for 14.9% of all manufacturing employment). In addition, some food sectors are also strong, and these account for an additional 7.9% of manufacturing employment. But in relation to the weak and balanced sensitive sectors, many of these strong sectors are 'incomplete': that is, they produce only a small part of the total product range of the broader sector.

Overall, the historic trade performance of the sensitive sectors was strong in the 1980s. Most sensitive sectors (accounting for 36.7% of all manufacturing employment) experienced an improvement in their performance. Conversely, only for a minority of sectors (accounting for 7.4% of all manufacturing employment) did performance deteriorate. In total, of the 11 strong sectors, 9 improved their performance in the 1980s. Of the 28 weak or balanced sectors, only 11 experienced a deteriorating competitive position. Indeed, the majority improved their position.

It is worth nothing that some 56% of employment in the Irish sensitive sectors is contained within foreign-owned firms, compared to only 40% for all manufacturing industry. This implies that the sensitive sectors are probably stronger in international markets than other sectors of Irish manufacturing industry. This could mean that the effect of 1992 will be to exacerbate the problems of the dual Irish economy outlined in Chapter 3.

In conclusion then, it would seem that Ireland is not particularly sensitive to the impacts of the single market. The majority of the sensitive sectors are in a strong competitive position and have been improving that position over the 1980s. Additionally, the strong points of the manufacturing economy are those where demand is growing rapidly. Ireland should therefore be well placed to take advantage of 1992 and the main risks are further dualization of the manufacturing economy.

A fairly low level of regional employment is accounted for by the sensitive sectors. Only in the North East is the share appreciably greater than the national average. The impact of 1992 is likely to be greater in the North East, especially given the higher proportion of manufacturing employment accounted for by the sensitive sectors in this region. Both the Midlands and the East region have a relatively low share of sensitive sectors, and the East region is much less sensitive to the impact of 1992, largely due to the high degree of employment in services and public administration.

5.4 The impact of the internal market on Objective 1

It has proved difficult to identify accurately which of the Objective 1 regions will gain from the internal market programme and which will lose out, given the wide range of measures and potential responses. Despite this, it is possible to come to some general conclusions as to the future prospects of the Objective 1 regions. We identified two main categories of lagging regions on the basis of their sensitivity to the impact of 1992 and their competitive position.

First, there are regions which are dominated by labour intensive sectors. The removal of non-tariff barriers may encourage firms in these sectors to

Table 5.3: Past performance and future prospects

	Converging	Mixed evidence	Diverging
Weak sectors dominating	Murcia Andalucia Castilla La Mancha Lisboa e Vale do Tejo East Macedonia	Extremadura	Asturias Central Macedonia Attica Central Greece Western Greece Epirus West Macedonia Thessalia
Strong sectors dominating	Valencia Ireland Abruzzi	Puglia	
Balanced position	Norte	Castilla Leon Centro Alentejo	Campania
Relatively unaffected by 1992 programme	Molise Canarias Crete South Aegean Isles Ionian Isles	Algarve Sicilia Sardegna Galicia	Peleponnese Basilicata Calabria North Aegean Isles

increase production in areas where they have a competitive advantage. Such firms could improve internal capacity, introduce process innovation and concentrate upon the domestic market. This scenario has a number of short-term benefits for the regions concerned as non-tariff barriers are lifted, but in the longer term such regions will face competition from lower labour cost developing and Eastern European countries. Objective 1 regions in this category are: Extremadura, Norte, Algarve, Central and Eastern Macedonia, Thessaly, Eastern Greece and the Greek islands.

Second, there are regions where the industrial structure is dominated mainly by capital and/or research-intensive sectors. In these sectors scale economies are achievable consequent upon the removal of non-tariff barriers. Firms in such regions could concentrate upon product differentiation and increased investment in R&D. While this appears to be a positive development, in many Objective 1 regions this rests upon foreign direct investment by multinational companies in the advanced sectors of the economy. Regions in this category were identified as: Asturias, Castilla Leon, Lisboa, Alentejo, Molise and Mid West (Ireland).

These two categories largely accord with Buigues, Ilzkovitz and Lebrun's two potential development scenarios of inter-industry specialization, where Member States specialize in those sectors for which they have a comparative and competitive advantage, and intra-industry specialization, where specialization occurs within industries, and industrial production in the Objective 1 Member States becomes similar to that in the most developed Member States. The evidence would suggest that Ireland has followed the latter path, and that Spain is making significant progress towards achieving this.

In both Ireland and Spain, the movement into higher skilled and higher technology industries has come about through high levels of foreign direct investment. While this scenario has a number of advantages, it also has its risks — as the case of Ireland illustrates. The risks come with the development of a dual economy, split between reliance upon foreign multinationals in the expanding, high-technology sectors and a domestic sector confined to traditional industries. However, adopting an inter-industry specialization strategy risks future competition from developing countries with cheaper labour costs and potentially greater adjustment costs at some future date.

The longer-term outlook for some regions in Portugal ' and especially Greece looks bleak, given their reliance upon labour ' intensive traditional sectors with low technology content such as clothing, textiles and footwear. Combining the analysis of the impact of the internal market programme with the earlier categorization into converging and diverging regions produces the results shown in Table 5.3 above.

5.5 Monetary union

The development prospects for Objective 1 regions during this decade will be strongly influenced by the advent of other measures being taken for the integration of the European Community. The creation of the EMS has begun to lead to a convergence of interest rates and wage levels across the Community. While this has benefits, in that it creates a sound macro-economic environment across the Community, it will have serious effects upon some Objective 1 regions during a transitory period. In adopting fixed exchange rates countries abandon the option of altering the value of their national currency. This is important because exchange rate flexibility enables a country to compensate for a loss of international competitiveness. There is evidence, for example, that both Greece and Portugal have relied heavily in the past upon devaluation in order to assist their industries. The loss of this important policy instrument could place Objective 1 regions in a position of 'absolute disadvantage'. This is serious given that other factors which are most important for success once a monetary union is established, such as skill attainments, technological capabilities, sophisticated services and complex networks of cooperation, are in short supply in many of the worst-off Objective 1 regions.

While the longer term benefits of a sound macroeconomic framework are certain, the transition difficulties could be considerable for some Member States and Objective 1 regions. Development related expenditure will need to be maintained while budget deficits, debt ratios and inflation rates are brought into line with macro-economic performance targets. Fiscal consolidation and high real interest rates, if required, must not endanger private investment and business confidence. The Community and its Member States will need to manage carefully the goal of simultaneously converging in both real and nominal economic terms.

5.6 Conclusions

It is worth reiterating the point that it is difficult to predict precisely which regions will win and which lose from further integration. However, from the analysis in this section it is possible to formulate some tentative general conclusions as to the development prospects of the Objective 1 regions in the light of the progress towards economic and monetary union.

• There is a diversity of experience in the different regions. Contrary to what is sometimes argued, sensitive sectors are strongly represented in some lagging regions, while in others their share of total employment is minimal.

• There are substantial differences in sensitivity between Member States. In particular, some Greek and Portuguese regions contain high proportions of sensitive sectors (although even here there are regions with low proportions), while the Italian Objective 1 regions contain very low proportions of sensitive sectors.

• There are also substantial differences in the performance of the sensitive sectors in different Member States. In some countries they have had a good performance in the 1980s, in others this was not the case.

• The industrial structure of the Objective 1 regional economies differs from that of the more developed Member States. In particular, Portugal and Greece are less well integrated and rely upon inter-industry specialization in labour intensive, low technology sectors.

• The likely impact of 1992 upon Greek and Portuguese regions is to encourage further inter-industry specialization in sectors such as textiles, clothing and footwear. In the short term this may have advantages, but in the longer term these sectors will be subject to competition from developing countries and future adjustment costs will be high.

• There is therefore a need to modernize the Objective 1 economies, with large-scale investments needed to close infrastructure and knowledge gaps and thus enable the upgrading of their economies and a move towards an intra-industry development scenario.

• One problem is that the scale of the investment needed might not be forthcoming from national sources in a transition period, due to the disciplines imposed by monetary union. Here, there are important implications for the Structural Fund interventions.

A policy for Objective 1 regions in the 1990s

6.1 The new context

In this chapter, the findings of the previous chapters are brought together and a number of policy conclusions are drawn. The first chapters of this report provide renewed confirmation of the existence of considerable regional disparities within the Community and that, overall, very little progress has been made towards reducing the disparities during the 1980s. This global picture however, disguises a much more complex reality. In fact three broad categories of region can be distinguished — those which are converging in terms of their economic performance (approximately 40% of the Objective 1 population or around 9% of total Community population), those which are clearly diverging still further from the Community average (just over one quarter of the Objective 1 population or some 6% of Community population) and those which are stationary in relative terms with no clear trend in either direction.

In subsequent chapters this report reviews the explanatory power of economic theory and empirical analysis. It concludes that while many insights can be obtained, none of the theoretical or empirical explanations offers an explanation of general application — some observations can be explained with reference to them, but many others cannot. Thus there is no general theory or explanation of the reduction in regional disparities on which standard policy prescriptions can be confidently based throughout the Community.

While there is no general theory or explanation, there is, nevertheless, a prevailing climate of opinion which emphasizes the need for a broadly based approach. For the potential benefits of closer economic and monetary union to be realized, there are basic preconditions to be met in terms of infrastructure endowment and human capabilities. Secondly, there must be an export base within the region, and, moreover, one which can benefit from market widening. Thirdly, a region must have production vocations or specificities which are not based on low labour cost alone, but also on local know-how as well as on natural resource endowments. Finally, and very importantly, a region must have an entrepreneurial culture and a political and social organization which is sympathetic to that culture.

In the 1990s, a new policy context is being created. Closer economic and monetary union should reduce the importance of national differences and increase the importance of regional differences. During the transition period to economic and monetary union, the liberalization of markets, and the general economic conditions resulting from the effort to restore macro-economic equilibrium, may reduce both public and private investment in the lagging regions. Within an economic and monetary union, in which there are fixed exchange rates, regions can suffer from an absolute disadvantage in the international division of labour, and some could progressively drop out of the Community and world economy. They would become increasingly dependent on financial transfers and on the non-respect of the economic and social rules generally prevailing elsewhere for the maintenance of activity and employment.

In periods of rapid economic growth, disparities between strong and weak regions can be disguised by the transfer of part of the surplus generated by the more competitive sectors and regions for income support in the weaker regions. In times of slower growth, and pervasive employment crisis, the political and economic cost of such transfers will be higher. The Community has also to take account of the needs of the countries of Central and Eastern Europe. That is why the pressure for a clear demonstration of value for money in terms of the Structural Funds' development impact on the performance of the regional economy and not just in terms of income support, is much greater than in the previous decade. At the same time, this demonstration is complicated by the absence of any agreed policy consensus, or recipe for development, against which the development impact of transfers can be tested '*ex ante*', and by means of which the experience as it unfolds can be assessed in an agreed way.

6.2 Regional development policy in the 1990s

The challenge for the 1990s is:

a) to maintain the momentum of convergence in the successful regions;
b) to attempt to 'turn around' the situation in the stationary or diverging regions;

but in a political, economic and social context which is likely to be much more difficult than in the second part of the 1980s, and with very little theoretical or empirical underpinning for policy.

Given that there are no standard policy recipes on offer, the fundamental aim of Community policy must be to advise, to encourage, and to warn. To advise, first of all, on the lessons of successful experience elsewhere, on the creation or consolidation of technical and organizational capabilities at the local, regional and national level, and more generally on the effective management, piloting and assessment of development efforts. Secondly, to encourage the setting of clear and transparent goals expressing a credible and achievable ambition to reduce disparities in specified ways so as to prepare for closer economic and monetary union, and to provide financial support commensurate with the ambition and the practical organization put in place to achieve that ambition. To warn finally, those who are at risk of diverging, and above all, those who are clearly diverging, of the likely medium-term consequences of a failure to turn round the situation: the risk, in short, of a growing dependency on transfers from outside.

Of course, it is disappointing that it is only a minority of regions which are successfully converging at present, but it is also encouraging that within that family of converging regions, there is a great diversity of situations. In other words, there is no fatality of divergence because a region is predominantly rural, or because a region is relatively peripheral, or even because a region belongs to a Member State in which macro-economic disequilibria persist. Nevertheless, while regions can improve their situation even in the most adverse contexts, it is obviously desirable that improvements be made to that context.

Maintaining the momentum of convergence implies continued progress towards reducing reliance on lower labour costs and labour-intensive production. Regions must progressively establish the type of intra-industry specialization typical of more advanced European areas, and develop advanced niches within their traditional specialist sectors. The same approach applies to specialization in market services, tourism in particular. Unit labour cost advantages should be maintained through productivity increases rather than through wage compression.

But not all regions will be able to develop capabilities for innovation from internal resources. Innovation is a product of a wide range of factors and advantages which are difficult to influence through public policy. Innovation may be inherently spatially imbalanced and there are limits to what can be expected from an innovation-oriented regional policy. It is also important not to overemphasize the role of local forces and actors, and not to underestimate the importance of the global economic context. Regional development may be influenced by indigenous forces but these do not mean that a region can be shielded from the impact, positive or negative, of wider economic and political forces.

For this second category of regions, greater emphasis could be put on external investment as the main catalyst for local economic development. Such a policy will need to be based on a realistic and objective analysis of the attractivness of the region concerned to external investors, and steps should be taken to improve the attractiveness in consequence. Moreover, for this to be successful as a means of stimulating local development, determined attempts must be made to deliberately embed external investment into the local environment. Regions can bargain with external firms over matters such as co-operation in vocational and managerial training, joint development and implementation of infrastructure projects, and assistance in creating a local network of subcontractors.

The fundamental aim is to put regions on the virtuous path to growth, combining both productivity growth and employment growth. This implies, in addition to promoting productive activity, a large degree of continuity in investment in basic economic infrastructures. Some new directions are nevertheless required for the 1990s. These are a still stronger accent on improving human capabilities; where appropriate, a reform of the institutional framework within which policy is designed and implemented; and thirdly the full provision and free circulation of information of all kinds.

A crucial policy theme should be the provision of information. Information is one of the key factors in creating interaction between local and external economic forces; in networking between firms and institutions; and more generally in successfully adapting to changing markets and technological environments. Information can come in several forms. It can be internal to the region, for example, in providing detail of new technologies or spare production capacity. It can help to link the regional economy to the broader national, Community and world economy, for example, through linking firms to markets or through accessing databases. Finally, it can be information about the area, helping to improve external perceptions of the region, and hence to encourage inward investment or other forms of partnership with economically stronger regions.

How information provision and interchange is organized and provided are vital questions in the development process. There is a role for specialized intermediaries to play, helping to put individuals, firms and institutions in contact with appropriate information. There is a role for the use of technology both to provide and access information. While there may be a case for a 'high technology showcase' in some areas, such as the use of interactive video and broad band technologies, a more appropriate route, especially in the lagging regions, would be to build upon existing skills and techniques, such as accessing information through narrow band technologies. Demonstration projects should be supported at the local level, and the lessons learnt from these spread out to all lagging regions.

As part of this exercise, regions should ensure that policy success is measurable, that results are regularly monitored, and that the public and political authorities are regularly informed of progress. For example, an aim such as developing regional entrepreneurial strengths needs to be translated into a form which can be monitored. Regions need to ask if this should be numbers of new firms created, the establishment of venture capital funds, numbers of trainees passing through business development courses or some other measure. A determined effort should be made to inform and involve the private sector and general public in the public sectors' development policy, and especially to ensure full information on the various grant systems or other forms of support available. Openness and transparency are key words for public policy in the 1990s.

Secondly, regions need to reinforce their efforts to develop human capabilities in two ways. First, there is a need to upgrade the skills and abilities within a region at all levels. But to be effective, these training measures must be of a high quality. Second, there is a need to improve the training of those individuals who will act as intermediaries or development agents. The latter's proactive role within a regional economy is, in any approach aiming to influence the prevailing entrepreneurial culture, one of the main agents of change. Their role is crucial and therefore much greater attention needs to be given to this vital function. It may come from within existing intermediary bodies, such as local or regional authorities, or from secondment, or from consultants.

Thirdly, the institutional framework within which policy is designed and implemented needs to be decentralized, coordinated but flexible. In many regions, this framework may not exist and it is difficult to create *de novo*. Attempting to replicate successes from elsewhere dependent upon strong institutional structures may not work in certain Objective 1 regions. The shift from top-down to bottom-up strategies within Member States may shift too much responsibility to local institutions which are inadequately equipped for the task. A major task will be to ensure that an effective and decentralized network of regional institutions exists, particularly in those countries where decision-making is highly centralized, so that policy can be managed from the local level, possibly by a development agency, with the active participation of other relevant local actors.

In conclusion, success in an uncertain and fast-changing world is determined by a high level of information, widely shared, a high level of skill attainment, a prevailing entrepreneurial culture, and a well organized institutional framework. These are the qualities that development policies should seek to promote going beyond meeting basic requirements for infrastructures, education and vocational training. What must be avoided above all is to encourage a form of sheltered development isolated from market realities, or, worst of all, to permit by means of progressively greater financial transfers a rising standard of living despite a diminishing level of productive activity where this is due to an unwillingness to change out-dated and inappropriate economic and social practices.

Updating GDP data in Objective 1 regions[1]					
		GDP per head (PPS) Index (EUR 12 = 100)			
		1989	1990	1991	1989-91 change
EUR 12		100.0	100.0	100.0	100
Eastern Macedonia	EMAC	43.9	42.6	43.6	99
Central Macedonia	CMAC	48.5	46.8	45.4	94
Western Macedonia	WMAC	52.4	51.7	46.6	89
Thessaly	THES	44.7	42.8	43.4	97
Epirus	EPIR	36.6	35.6	36.5	100
Ionian Isles	ION	44.4	43.2	41.3	93
Western Greece	WGR	41.2	39.6	40.9	99
Central Greece	CGR	59.0	56.6	57.5	97
Peleponnese	PEL	48.1	46.3	47.2	98
Attica	ATT	52.7	51.9	53.8	102
North Aegean Isles	NAEG	35.6	34.9	34.9	98
South Aegean Isles	SAEG	55.4	54.4	47.0	85
Crete	CRET	47.6	46.1	43.0	90
Galicia	GAL	58.2	57.2	59.1	102
Asturias	AST	71.6	69.8	72.6	101
Castilla Leon	C-L	66.3	65.9	67.4	102
Castilla La Mancha	C-LM	61.2	62.5	64.4	104
Extremadura	EXT	48.3	49.5	50.4	104
Valencia	VAL	74.2	75.6	77.7	105
Andalucia	AND	55.6	57.6	59.8	108
Murcia	MUR	69.0	71.3	73.4	106
Canarias	CAN	74.0	72.7	76.5	103
Ireland	IRL	64.7	68.6	69.8	108
Campania	CAM	69.9	70.4	70.2	100
Abruzzi	ABR	89.6	90.4	90.4	101
Molise	MOL	79.0	78.6	78.7	100
Puglia	PUG	74.6	73.7	73.8	99
Basilicata	BAS	64.3	64.5	64.6	100
Calabria	CAL	60.6	56.5	56.7	93
Sicily	SIC	66.6	67.8	67.8	102
Sardegna	SAR	73.7	74.3	74.3	101
Norte	NOR	48.9	49.5	51.7	106
Centro	CEN	38.9	39.1	41.0	106
Lisboa e Vale do Tejo	LIS	73.4	76.0	79.5	108
Alentejo	ALEN	34.3	33.1	34.9	102
Algarve	ALG	45.5	47.5	49.6	109
Northern Ireland	NIRL	77.4	76.1		

1/ Note: These are the latest harmonized statistics provided by Eurostat. The figures shown in the above table (1989) will differ from the figures used for the original GREMI study, as a result of continual updating of GDP statistics, and the use of updated population statistics.
The 1989 to 1991 change calculation is made on the same basis as that described in Annex 1 of Chapter 2.

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