ECONOMIC DEVELOPMENT AND REGIONAL GOVERNMENT - WALES, BRITAIN AND EUROPE

Stephen Hill
Cardiff Business School, Cardiff, CF1 3EU, UK.

Annette Roberts
Cardiff Business School, Cardiff, CF1 3EU, UK.

ABSTRACT This paper looks at the relationship between regional policy and the structure of government by contrasting the current lack of regional government in the U.K. to the wider context of regional devolution within the European Union. Whilst economic disparities between European regions are substantial, there is both theoretical and empirical support for the hypothesis that regions with the fastest rates of growth in Europe will be those with the highest degree of regional autonomy. This hypothesis is set to dominate the regional development research agenda in Europe for some time to come.

1. INTRODUCTION

The objective of this paper is to provide some preliminary economic perspective to the issue of regional policies and the relationship between regions, nations and the wider grouping of nations into economic communities. The context within which these are addressed is the growing debate in Britain between those who seek wider regional autonomy, especially in regions historically identified as separate from the English core, and those who see strong central government as an economic necessity, both for the efficient operation of government and as a counterbalance to the increasing powers of European institutions (Morris and Caton, 1994).

The economic arguments in favour of the devolution of government and its primary responsibility - the allocation of public resources - are well-known and straightforward. At its simplest, autonomy relies on the notion that decisions are best made by those whom decisions affect. This notion has been vigorously applied by the British government for more than a decade in all areas of public policy except one - governance itself. The principle of vesting resource allocation decisions upon the affected underlies policies of privatisation, education and health service reforms, the establishment of service delivery agencies for the police, social benefits, and the shift from direct to indirect taxes.

The economic case for devolved government is equally simple: regions have distinct economic characteristics that ensure that their interests are inevitably poorly served by a nation-state that imposes national policies on disparate regions. Devolved responsibility for resource allocation would mean that decisions were taken by those with both the greatest awareness of local priorities and needs and the greatest incentives to develop policies to meet these needs (Hill and Owen-Jones, 1994).

This paper will briefly outline the nature of regional policy in both a national and European context, emphasising differences between European and UK regions and pointing to the paucity of national UK policies (and resources) to tackle these regional disparities. After briefly examining the European Union's growing role in the delivery of regional policy, this paper will go on to summarise recent experiences at regional autonomy in Spain and Germany before setting out proposals for Wales and examining the fiscal relationship between region and state. The paper concludes with some conjectures as to the relationship between regional development and autonomy.

2. REGIONAL POLICY IN A NATIONAL CONTEXT

The UK government has operated a regional policy since the Special Areas Act in 1934, with the implicit recognition that market forces unaided have been insufficient to ensure a convergence of economic well-being between regions. Moreover, the enthusiasm of central government for regional policy has waxed and waned over time. British regional policy has essentially sought to identify those areas needing assistance and then to develop schemes to encourage firms to move to them, to encourage the growth of firms within these designated areas and to discourage the growth of firms from outside these areas. Around 35 per cent of the British workforce are in locations eligible for regional aid (Assisted Areas).

Within the past decade British regional policy has changed substantially, with a decline in overall resources (consistent with the governments view of 'encouraging' markets to work more effectively) and a shift away from automatic entitlement towards more discretionary (selective) assistance. As a result, government expenditure on aid to regions (Regional Preferential Assistance) has declined from £750m in 1986-87 to just £360m in 1992-93.

In the meantime the need for governmental assistance to regions has hardly diminished. Table 1 presents a set of regional disparity indicators, referring to UK standard regions as defined in Figure 1.

Whilst economists argue, as economists do, about whether UK (and European) regions are converging or diverging (NIESR, 1991), the extent of regional economic disparities is clear. Nor do national member states regional policies offer much in the way of encouragement on a European stage.

Table 2 provides a summary of regional policy coverage and expenditure on regions across European nations in 1989, with coverage defined as the proportion of working population employed in regions eligible for aid, and with regional aid spending expressed in £'s/head. National expenditure on aid to regions varied from less than £1/head in Denmark to £57/head in Italy. Not surprisingly there is a paradox, with some of the countries most in need of regional aid being least able to afford it. Britain ranked around the middle of the EU league in terms of coverage and towards the bottom in regional spending.

Columns four and five of Table 2 give some indication of national and regional income disparities across Europe (considered more fully later), with national GDP/head ranging from almost a third above the EU12 average of 100 for Luxemburg to less than half that average for Greece. The final column identifies poorest region GDP as a percentage of the EU average for each nation, and provides a rough indication of

Table 1. British Regional Disparities

	1993 Average Gross Weekly Household Income	1993 % Share of Household Income from Social Security	GDP/Head (1992)
North	82.5	19.2	91.2
Yorks/Humber	90.0	15.2	92.5
East Midlands	96.8	13.3	95.5
East Anglia	98.3	15.1	102.2
South East	120.0	10.4	115.9
South West	93.6	14.5	94.7
West Midlands	85.3	17.8	92.8
North West	94.9	15.8	90.5
Wales	86.7	19.6	86.1
Scotland	94.6	13.8	98.3
N. Ireland	92.3	17.9	82.0
UK	100.0 (£353.0)	13.9	100.0 (£8766.0)

regional disparities, with poorest region GDP ranging from 66 per cent of the national average GDP in Italy to 90 per cent in Greece, with Germany's less than 30 per cent being a rather special case following integration. This rough indicator places Britain third (behind Germany and Italy) in a European league of regional disparities, although the exclusion of Northern Ireland (on the grounds of its exceptional circumstances) would considerably alter the UK's relative position. Note also that European regional differences may be much more important than regional disparities within member states. For example whilst Greek regional income differences are relatively narrow, this is little consolation when Greek GDP/head was less than half of the EU average (Hill and Munday, 1994).

Table 2. Regional Aid and GDP/Head Across Europe

	1989 Regional Aid		1991 GDP/Head, EC12 Av = 100		
	Coverage %[1]	Spending/Head £'s[2]	National	Poorest Region	
Belgium	33	12.7	108	87	Wallone
Denmark	70	0.8	111	-	
France	38	1.7	115	93	Nord Pas de Calais
Germany[3]	40	10.2	106	30	Thueringen
Greece	58	21.3	49	44	Nisia
Ireland	34	53.8	72	-	
Italy	36	57.0	106	70	Sicilia
Luxemburg	100	42.7	131	-	
Netherlands	20	2.7	104	91	Oost-Nederland
Portugal	100	18.9	60	-	
Spain	58	28.0	80	64	Sur
UK	35	9.9	98	74	N Ireland

1 Share of workforce in regions eligible for aid
2 £/hd using 1989 PPS
3 Includes former East Germany

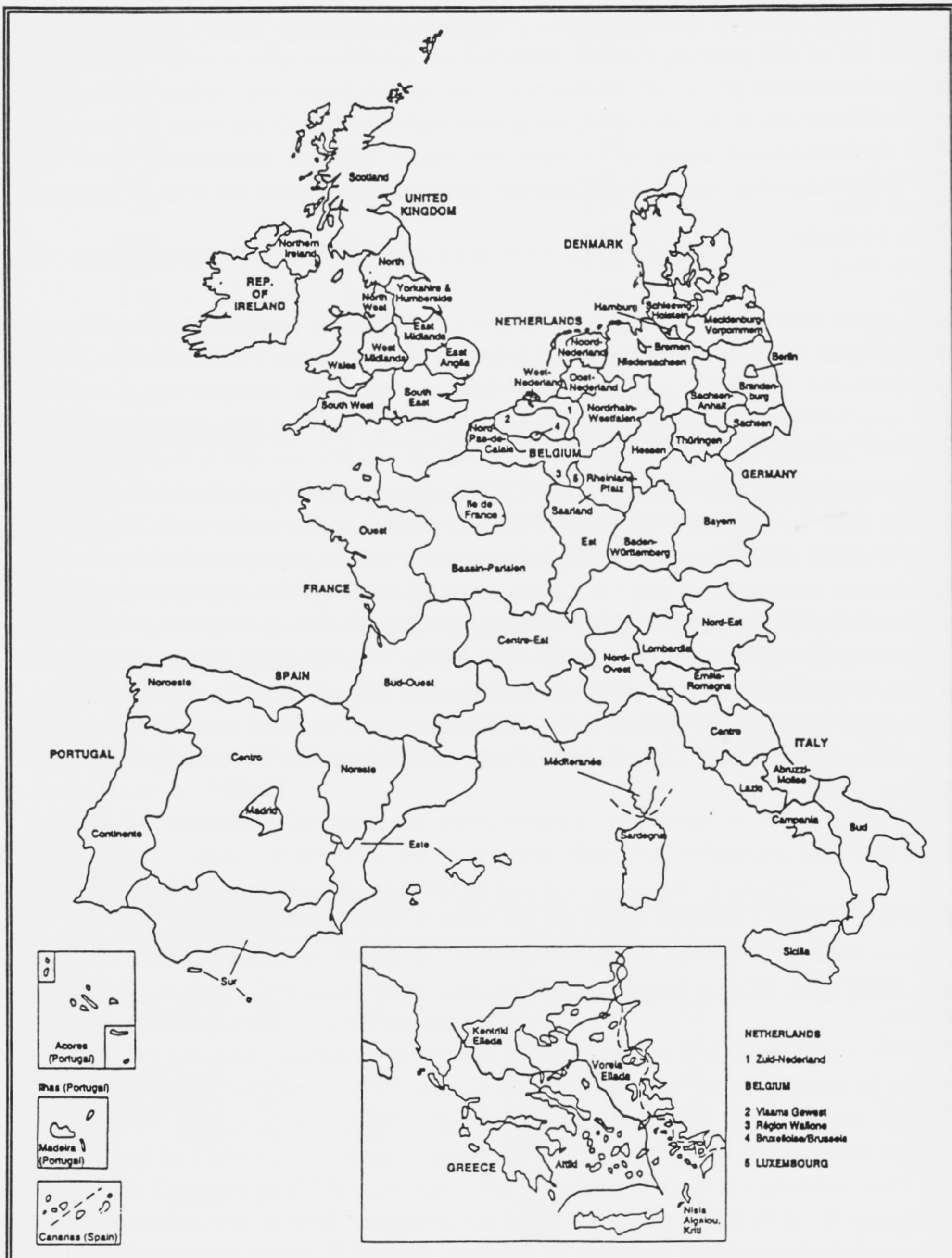


Figure 1. Regions of the European Union

3. REGIONAL POLICY IN A EUROPEAN CONTEXT

Regional policy has been at the heart of policies for an integrated Europe since the European Community was established by the Treaty of Rome in 1958. The preamble to that Treaty stated:

> "Member States of the European Community are anxious to ensure their harmonious development by reducing the differences existing between the various regions and the backwardness of less favoured regions".
>
> Treaty of Rome 1958
> (quoted in Armstrong, 1994)

The justification for European regional policies has been the perceived impact of policies such as the Single European Market (SEM) on existing and future regional disparities. European regional policy is seen as complementary to the regional policies of national governments, designed to protect overall European interests. In particular it has been argued that it is in the economic interests of more prosperous core European regions to promote the well-being of less prosperous regions, in order to generate spillover effects, to promote social and political cohesion and to supplement the resources of poorer nation states, inevitably those with the poorest regions. In addition, many of the European Union's other policies, such as the integration of markets and the harmonisation of taxes, are seen are regionally divisive, so that regional policies are necessary to offset their effects. Finally, the European Union is keen to co-ordinate and supplement the regional policies of member states, providing a pivotal role for those states in the identification of areas for assistance and in the implementation of policies (Commission of the European Communities, 1991).

Some indication of the level of existing economic disparity between European regions is given in Figure 2, which plots regional GDP/head across European regions. The ten most affluent regions of the EU had an average GDP/head in 1990 that was more than three times higher than for the bottom ten regions (Armstrong, 1994). Core regions in terms of prosperity include Lombardia and Emillia in Northern Italy, Bayerne and Baden-Warttemberg in Southern Germany, Brussels, Paris and the South East of England. Less prosperous regions include the whole of Ireland and Greece, most of Portugal and Spain and Southern Italy.

Not surprisingly, there is a heated debate within Europe between those who see free markets as ultimately solving the regional problem and those who consider that the concentration of economic power within core regions would continue in the absence of active regional policies. In particular the internationalisation of trade within Europe has seen the growth of the dominant multinational able to take advantage of scale, localisation and agglomeration economies to establish market positions that inevitably render peripheral regions, with weak infrastructures, high local taxes, low labour skill levels and suffering the loss of most able/best qualified through outwards migration uncompetitive.

The major instruments of European regional policy are structural funds available to tackle regional problems. The primary funds are the European Regional Development Fund (ERDF), the European Social Fund (ESF) and the European Agricultural Guidance and Guarantee Fund (EAGGF). These structural funds have the collective task of meeting five identified European Union objectives:

1. Development of structurally backward regions.
2. Transformation of regions in industrial decline.
3. Reduction of long-term unemployment.
4. Increase in employment opportunities for young people.
5. (a) Adjustment of the structure of agriculture to accommodate reform of EU agricultural policy,
   (b) Promotion of rural development.

Of these objectives, 1, 2 and 5b have a clear regional dimension, although the twin problems of long-term unemployment and job opportunities for young people also have a regional context.

Objective 1 regions have an average GDP/head less than 75 per cent of the EU average, and account for 41 per cent of EU territory and 22 per cent of the EU population (see Figure 3). Objective 2 regions are defined in terms of the unemployment rate, the size of the manufacturing sector and changes in sectoral employment over time, and account for 16 per cent of the EU population. Finally, Objective 5b regions contain 5 per cent of the EU population. In the period 1989-93, the European budget for each was:

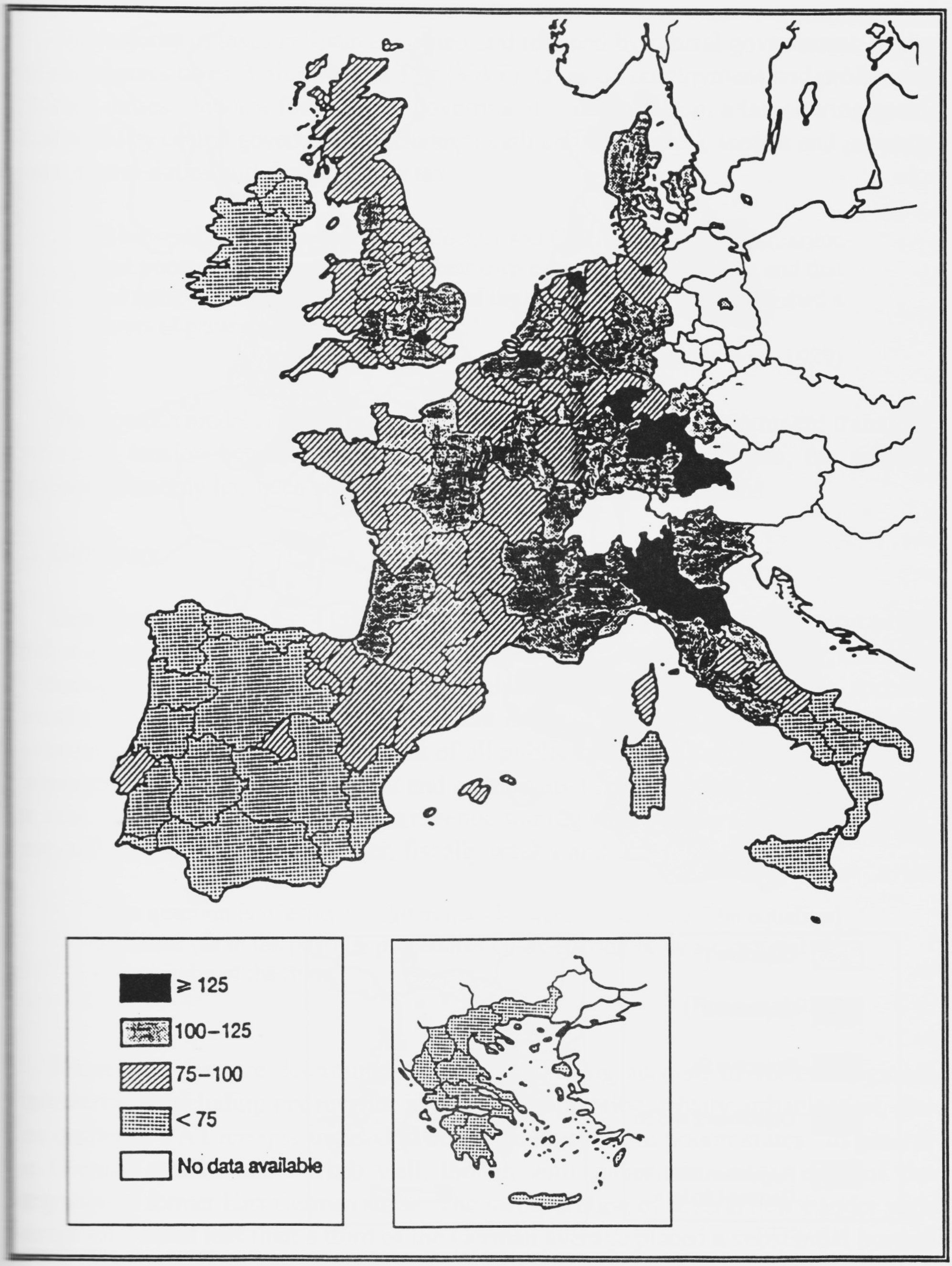
Objective 1	38.3 bn ECU	
Objective 2	7.2 bn ECU	
Objective 5b	2.8 bn ECU	(1 ECU = £0.7)

Objectives 3 and 4 were allocated 7.5 bn ECU over the same period, (with 3.4 bn ECU to objective 5a). The United Kingdom was expected to get just 2 per cent of Objective 1 funds and 8 per cent of Objective 5b funding, but 38 per cent of that allocated to Objective 2, reflecting the changing industrial structure of Britain (Commission of the European Communities, 1992).

Although the EU has worked with some success at developing regional policies, the key issue facing the EU over the next few years remains the division of responsibility between different levels of government. The guiding principle remains that of 'subsidiarity' - that resource allocation decisions be taken at the lowest possible level - a principle reinforced by Britain in its relationship with Europe, but often lacking in the British government's relationship with its own regions.

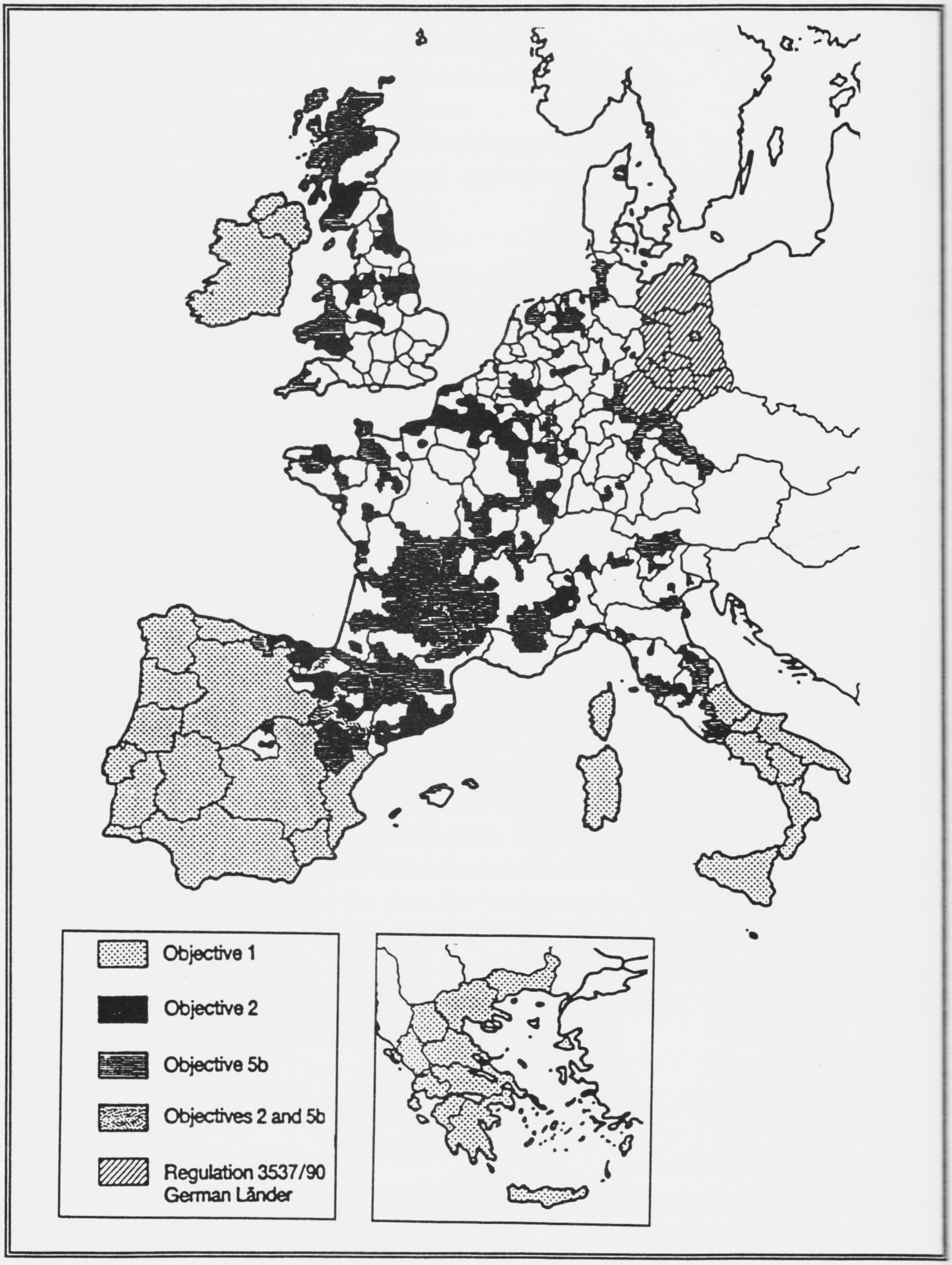
4. FUNDING REGIONAL GOVERNMENT - SPAIN, GERMANY AND BRITAIN

One continuing argument used by central UK government is that regional autonomy would be too expensive - both directly in terms of spending and indirectly in terms of inefficiency - for the public purse. Within the rest of Europe the notion of funding regional government is rather more developed than in the UK. Two example will follow - chosen for their contrasts. Spain is one of Europes newest democracies, with regional devolution quickly following on from the death of General Franco. Germany has an older tradition of federal government, established in the aftermath of the Second World War. These will be followed by a brief description of the British situation.



Source: Eurostat, 1991, Rapid Reports: Regions 1990(3), Luxemburg

Figure 2. GDP Per Capita in EC Regions, 1990 (EC12=100)



Source: Commission of the European Communities

Figure 3. Map of EC Assisted Areas, 1988-93

4.1 Spain

The majority of taxes in Spain are levied and retained by central government. These include incomes taxes, Value-Added Tax (VAT), taxes on employment and profits and customs duties. Income for regional government is derived from a tax-sharing grant, taxes ceded by central government (including death and gift duties), wealth and property taxes, stamp duties and the gambling tax.

> "The wealthier regions, the Basque Country and Catalunya in particular, argue that poorer regions are a drag on their own economic development and that indulging the autonomous aspirations of the poorer regions has established a series of parasitic mini governments..."
>
> (Mason Browne, 1989)

The Spanish model is then a mixture of local taxes and central government transfers, provoking tension between richer and poorer regions. Within Spain, the greatest regional autonomy has been sought and attained by the richest regions.

4.2 Germany

Germans pay four types of taxes, three of which are paid directly to the appropriate level of government (federal, state or community taxes). The fourth category, common or shared taxes, are allocated between levels of government according to specific formula. The German system of government is heavily federal, with central (federal) government accounting for 45 per cent of all public spending, with regional (Lander) government accounting for 35 per cent and community taxes spending the remaining 20 per cent. The major difficulty is then revenue sharing with transfers going from large, financially strong Lander to smaller, fiscally weak Lander.

> "The question is whether the differences between states should be equalised in future (as in the past) by procedures of tax-sharing or by a territorial re-organisation of the State"
>
> (Bennett, 1989)

These transfers are determined by formula, taking account of various regional characteristics including tax revenue per capita, population density, urbanisation, etc. One quarter of VAT receipts are used to boost the revenues of poorer states. In general the German system has worked well, though with some strain as a result of the integration of former East German states. The incorporation of several new Lander with average GDP/head less than a third of the German average placed a substantial burden on the transfer system and reduced per capita GDP from 117 per cent of the EU12 average in 1990 to just 106 per cent of the EU12 average in 1991.

4.3 Britain

Britain currently has three tiers of local government (community, district and county) about to be re-organised into two (community and new county) in many places, of which the new counties will be dominant, responsible for public matters such as local public health, local roads, planning, education and transport. In practice the level of resources available to the (current) 46 counties of Britain are strictly limited and circumscribed by national government. Britain has no system of regional government, although Wales, Scotland and Northern Ireland each have their own government departments and own Secretaries of State within the British government cabinet (executive). Standard British planning regions (eleven) were set out in Figure 1.

The United Kingdom has recently experienced a renewal of interest in the possibilities and opportunities of regional assemblies, especially for the Celtic regions - Wales and Scotland. This renewal has been fed by a number of forces, including interest in a 'Europe of the Regions', the movement towards regional autonomy in mainland Europe, growing awareness of continuing economic disparities, continued low levels of political support for central government from the periphery and at least the suggestion that regional government may offer better prospects for economic advancement than the constraints of national economic policy (Hill and Minford, 1993). Certainly many of the more prosperous and fast growing regions of Europe have pro-active decentralised governments, such as Lombardy, Catalunya and Baden-Wurttenberg. What is absent, of course, is any serious investigation of the economic relationship between region and state, including both fiscal relationships and whether local autonomy can be related to the future economic development of the region. Certainly these increasingly prosperous European regions have invested in education and training, and have established regional financial institutions as an aid to regional growth (Morris and Caton, 1994).

5. REGION AND NATION - TAX RECEIPTS AND SPENDING

This section will look in some detail, albeit briefly, at the fiscal relationship between one UK region (Wales) and national government. Wales provides an interesting example, having both its own government department (Welsh Office) aiding the estimation process and some indication of public support for a regional government (Osmond, 1994). Moreover, as one of the poorer regions of the UK (see Table 1), demands for a Welsh regional government are constrained by an anticipated budget deficit between Wales and the rest of the UK.

The actual estimation of this 'deficit' is complex, since accurate figures for government spending or receipts by region are conspicuously absent. After some pressure the Treasury now provides estimates of identifiable government spending by country, i.e. expenditure that can be associated with a particular area (Table 3).

Table 3. Government Spending by UK Country 1992/3

	£m	£/hd	UK = 100
England	150,591	3,290	96
Scotland	20,267	3,968	116
Wales	10,997	3,803	111
N Ireland	7,324	4,594	135
UK	197,179	3,411	100

Source: Hill and Owen Jones, 1994

Figures exclude spending on defence, overseas service, central government and debt interest impressive growth rates, but this needs to be systematically and empirically established. One possibility would be to define some scale of regional autonomy per region, and to seek the empirical relationship between this and regional economic development, probably using GDP growth as an indicator. This would then raise a number of econometric problems of estimation and interpretation, especially in the assessment of relative autonomy and in the pooling problems of using data across regions and over time. Moreover, other influences on regional economic development would need to be discounted, opening the vexed question of what other factors influence regional development, or why do regions grow at different rates? This is of course an issue that could (and perhaps does) engage a whole army of economists and regional scientists over time.

The most that the analysis in this paper has attained has been to place UK regional policy in a national and European context, and to locate the call for regional government in Britain inside this framework. In addition, the fiscal relationship between region and state has been identified as a complex two way flow of funds, with little basis for the presumption that one direction of flow dominates the other. Certainly regional governance has public resource implications, but there is plenty of room within existing revenues and responsibilities for the negotiated devolution of power and resources to regions.

REFERENCES

Armstrong, H. (1994) EC regional policy. In El-Agraa, A M, *The Economics of the European Community*. London: Harvester. pp 349-75.

Bennett, R.J. (ed.) (1989) *Territory and Administration in Europe*. London: Pinter.

Commission of the European Committee (1992) *Community Structural Policies: Assessment and Outlook.*

Commission of the European Communities (1991) *The Regions in the 1990's: Fourth Periodic Report on the Social and Economic Situation and Development of the Regions of the Community.*

Hill, S and Owen Jones, J. (1994) Calling the tune: funding a Welsh parliament. In Osmond, J (ed.), *A Parliament for Wales*. Llanysul: Cromer. pp 81-98.

Hill, S. and Munday, M. (1994) *The Regional Distribution of Foreign Manufacturing Investment in the UK*. London: Macmillan.

Hill, S. and Minford, P. (1993) Regional analysis. *Welsh Economic Review*, 6(1), pp 3-5.

Mason Browne, E. (1989) *Political Change in Spain.*

Morris, D. and Caton, M. (1994) A Europe of the people. In Osmond, J (ed.), *A Parliament for Wales*. Llanysul: Cromer.

National Institute of Economic and Social Research (1991) *A New Strategy for Social and Economic Cohesion after 1992*. Brussels: European Parliament.

Scottish Constitutional Convention (1990) *Towards Scotlands Parliament*, November