

## REGIONAL PROBLEMS AND POLICIES: A EUROPEAN PERSPECTIVE

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**ABSTRACT** Regional disparities in economic performance both within and between the Member States of the EU are immense. These regional disparities have led to economic and social problems which policy makers have felt necessary to address. Considerable experience has been gained with various forms of regional policy in the individual Member States of the EU; and the EU has itself gained valuable experience in developing its own EU-wide regional policy. After discussing the case for reducing regional economic disparities, this paper reviews current EU regional policy and argues that this needs to be strengthened greatly if regional disparities in economic performance are to be seriously addressed.

### 1. INTRODUCTION

This paper is concerned with regional disparities in economic performance in the European Union (EU). These disparities are vast and persistent (Armstrong, 1995). The two most commonly-used variables to demonstrate the magnitude of these disparities are: (i) GDP per capita and (ii) the unemployment rate.<sup>2</sup> At national level, there is an immense disparity in GDP per capita between the southern and the northern Member States of the EU (see Table 1). GDP per capita is nearly five times higher in Sweden, for example, than in Portugal. These wide disparities between countries conceal, however, even greater disparities between the EU's regions (see Figure 1). Moreover, regional disparities in GDP per capita are extremely wide even within individual Member States. A similar picture emerges for unemployment rates. Regional disparities in the unemployment rate are particularly large in Italy, Spain and Belgium, though it is clear from Figure 2 that these disparities are substantial in most Member States. Furthermore, regional unemployment disparities are persistent over time.<sup>3</sup>

The existence and persistence of these regional economic disparities raises several critical questions:

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<sup>2</sup> These two variables are particularly appropriate since they are the primary variables used to identify and delineate areas in need of economic assistance.

<sup>3</sup> See Taylor and Bradley (1997) for a statistical analysis of the causes of this persistence in regional unemployment disparities in Germany, Italy and the UK.

- Why do these regional disparities in economic performance occur?
- Why are these regional disparities regarded by policy makers as a problem?
- What are the benefits of reducing regional disparities in the economic performance of regions? In other words, is regional policy worthwhile?
- Can anything be done to improve the economic performance of the regions with the poorest performance?
- What types of regional policies have been used by policy makers and are they appropriate?
- Have these policies been effective? Can they be improved and, if so, how?

It is far beyond the scope of this paper to attempt to provide comprehensive answers to these critically important questions. It is possible, however, to provide some indication as to how these questions might be approached. The primary purpose of this paper is therefore to provide an overview of: (i) why regional economic disparities occur and persist; (ii) the benefits of reducing these disparities; (iii) the ways in which policy makers have attempted to reduce regional economic disparities at both Member State level and for the EU as a whole; and (iv) whether these policies have been effective and appropriate.

## 2. THE CAUSES OF REGIONAL ECONOMIC DISPARITIES

Since the existence of wide disparities in the economic welfare and economic performance of regions is regarded by policy makers as undesirable, it is important that the causes of these regional economic disparities are understood so that appropriate policy action can be taken. The central question to be addressed is 'why do some regions have persistently low income per capita or persistently high unemployment rates (or a combination of both)?' Recent research suggests that the following factors have had a part to play in explaining regional disparities in economic performance *within* individual national economies.<sup>4</sup>

### *Unit Labour Costs Are Too High in High Unemployment Regions*

The unit cost of labour is defined as the ratio of wages to labour productivity. A region with high unit labour costs relative to other regions will be uncompetitive. This can occur for two reasons. Firstly, wages may be above their market clearing level. Labour markets in high unemployment regions are not sufficiently flexible and are inefficient. Wages need to fall if labour demand is to increase. There are several reasons why wages may be above their market clearing level. These include industry-wide wage agreements which are adopted in all regions, statutory minimum wages, the reluctance of employers to reduce wages when demand for output falls due to the adverse effect on worker morale (the efficiency wages argument), as well as unemployment and related benefits which are 'too high' in relation to the market clearing wage. The second reason why unit labour costs may be relatively high is

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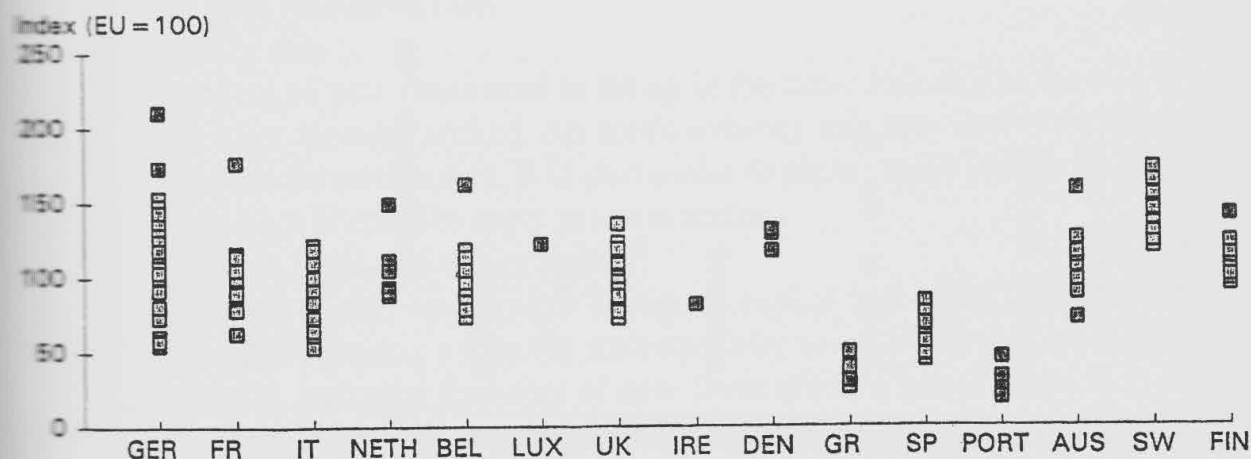
<sup>4</sup> No attempt is made here to explain why disparities in economic performance occur between national economies.

**Table 1.** Regional Economic Disparities in the EU

Member State	Output per Capita (EU = 100) 1994			Unemployment (%) 1994		
	National Average	Regional Maximum	Regional Minimum	National Average	Regional Maximum	Regional Minimum
Germany	113.2	212.9	55.8	10.5	19.8	5.8
France	116.2	178.5	79.3	12.8	17.4	8.6
Italy	96.7	123.4	54.0	12.5	24.5	4.0
Netherlands	104.3	150.8	70.3	9.0	12.4	6.7
Belgium	101.8	163.8	73.8	12.9	25.7	7.4
Luxembourg	121.9	-	-	2.7	-	-
UK	103.7	135.9	77.1	9.8	15.0	5.0
Irish Republic	81.3	-	-	15.6	-	-
Denmark	129.4	131.7	118.2	11.5	13.7	11.2
Greece	37.8	49.6	25.6	9.6	11.9	3.8
Spain	62.4	83.6	44.1	23.6	34.2	13.8
Portugal	31.6	45.6	18.8	7.1	11.3	4.1
Austria	112.6	159.5	72.0	6.7	8.5	4.2
Sweden	144.0	173.4	119.3	8.0	11.3	5.7
Finland	116.0	148.0	93.8	19.9	26.7	15.6

*Note:* The regional maximum and minimum values were calculated from NUTS2 level data using the EU's standard system of Nomenclature des Unités Territoriales Statistiques. Output per capita is measured by gross value added (GVA) since this provides the most up-to-date measure of output per capita at regional level. GVA is measured in purchasing power parities (PPPs) and is defined as gross domestic product plus value added tax plus import taxes.

*Source:* European Regional Database, April 1996, Cambridge Econometrics.



*Source:* European Regional Database, Cambridge Econometrics, May 1996.

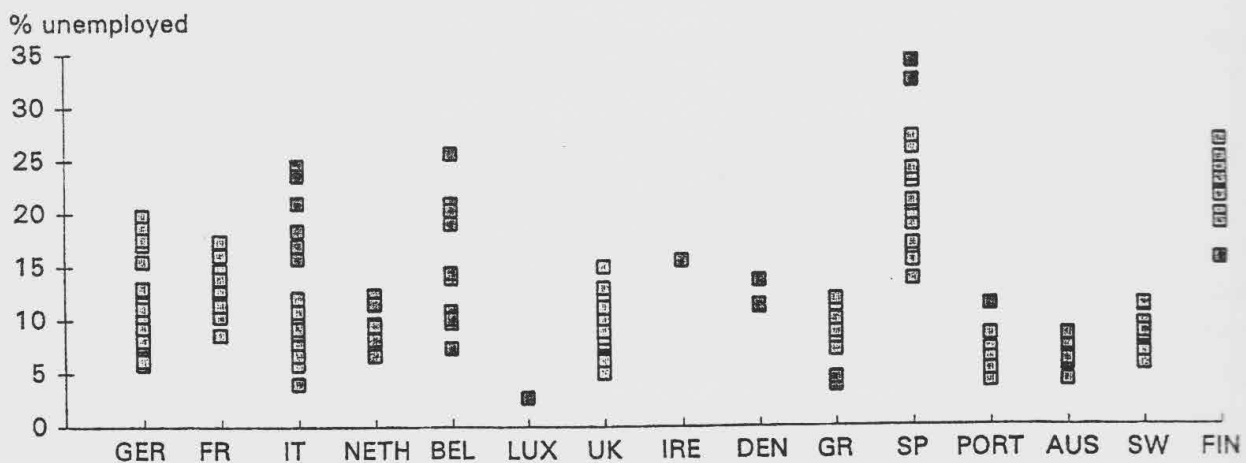
**Figure 1.** Regional Disparities in GDP per Capita in Member States of the European Union, 1994

because labour productivity is low. High unemployment regions tend to have low labour productivity for two main reasons: The labour force is heavily weighted towards low-skill workers who have low educational attainment levels and the industry mix is weighted towards low productivity industries.

Some evidence that regional unemployment disparities are partly explained by corresponding disparities in unit labour costs is provided by Taylor and Bradley (1997). In a multivariate statistical analysis of regional unemployment disparities in Germany, Italy and the UK during 1984-94, they find a statistically significant positive relationship between unit labour costs and the unemployment rate.

### *High Unemployment Regions Tend to Have a Poor Industry Mix, Which is Biased Towards Slow-Growing Industries*

Unemployment is high in some regions because these regions have a high proportion of *nationally* slow-growing industries. Regions with a high concentration of heavy manufacturing industries, for example, are likely to experience higher unemployment rates than regions with a high concentration of business services, which have experienced rapid growth since the early-1980s. Regions that are heavily dependent upon declining industries can consequently be expected to experience higher long-term structural unemployment (due to a spatial mismatch between labour demand and labour supply) than regions with a high concentration of expanding industries. Recent empirical work investigating regional variations in the unemployment rate in Germany, Italy and the UK during 1984-94 indicates that the industry mix of regions is by far the most important explanatory variable (Bradley and Taylor, 1996). Moreover, there is substantial evidence showing that the industry



Source: European Regional Database, Cambridge Econometrics, May 1996.

**Figure 2.** Regional Disparities in % Unemployed in Member States of the European Union, 1994



mix of regions has been an important factor in explaining regional disparities in employment growth (Armstrong and Taylor, 1993), which in turn is highly correlated (negatively) to spatial disparities in the unemployment rate.

***The New Firm Formation Rate is Low in Economically Depressed Regions Leading to An Inadequate Stock of Small-Medium Enterprises (SMEs)***

Small firms have been shown to make a major contribution to the creation of jobs in several countries. They are also important in developing new products and in creating a more competitive environment.<sup>5</sup> Regional disparities in new firm start-ups, however, are immense (see Table 2). This is not surprising since there are considerable differences between regions in the factors that are likely to influence the new firm formation rate. Numerous empirical studies of new firm formation (following Storey, 1983) have identified the following factors as being important:

1. Local demand for the products and services of small firms.

The economic environment for small firms is likely to be more favourable in high income areas and in areas where demand is growing rapidly. Regions with rapid population growth due to net inward migration will therefore have a high new firm formation rate.

2. Occupational composition of the resident population.

Surveys indicate new firm founders tend to have had some experience in management jobs or have some form of professional or technical expertise. Areas with a high proportion of highly qualified workers are therefore likely to have high new firm formation rates.

3. Size structure of firms.

Surveys of new firm founders indicate that a high proportion have had previous experience in small and medium-sized enterprises. Areas with a high proportion of small and medium-sized enterprises are therefore more likely to have a high new firm formation rate.

4. Industry mix.

Founders of new firms tend to set up in the same industry as the one in which they have already worked. An area's industry mix may therefore influence its new firm formation rate. It is also easier to set up some industries than others due to high barriers to entry in some sectors.

5. Access to loans and equity capital.

Financing a start-up requires access to capital and loans. Since the primary method of securing a loan for start-ups is by using owner-occupied housing as collateral, potential founders of new firms are in a better position to raise the necessary finance in areas where house prices (and house ownership rates) are high.

Recent research on new firm start-ups in several countries indicates that all of these factors have been influential to a greater or lesser extent (Reynolds, Storey and Westhead, 1994). A summary of the primary findings in several major economies

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<sup>5</sup> See Thwaites and Wynarczyk (1996) for a discussion of the literature.

**Table 2.** Regional Disparities in the New Firm Formation Rate in Selected Countries

Country	Average Births of New Firms per 10,000 Population		
	Mean	Regional Minimum	Regional Maximum
France (1981-91)	118	67	264
Germany (1986)	55	41	90
Italy (1987-91)	144	74	202
UK (1980-90)	72	42	107
Sweden (1985-89)	88	56	149
USA (1986-88)	33	18	74

Source: Reynolds, Storey and Westhead (1994).

**Table 3.** Determinants of Firm Birth Rates in Selected Countries in the 1980s

Determinants of Firm Birth Rates	Main Results of the Regression of Firm Birth Rates on a Range of Potential Explanatory Variables (Variables statistically significant at 95% are indicated by +)					
	Germany	France	Italy	UK	Sweden	USA
	% in-migration/ population growth	+	+	+	+	+
% of firms classified as small	+	+		+	+	+
Population density		+	+	+	+	
% unemployed	+	+	-		+	+
Growth of regional GDP				+	+	+
% of workforce managers			+	+		+
House prices				+		+
% with higher educational qualifications		-	+			-
% owner-occupied dwellings		+	-		-	
Government assistance						
Number of regions	74	96	84	94	80	382
% of variance explained in best-fit equation	80	87	76	80	77	59

Source: Reynolds, Storey and Westhead (1994).

is provided in Table 3. A further potentially important aspect of small firms pertinent to the economic performance of regions is regional disparities in their innovativeness. Recent research by Thwaites and Wynarczyk (1996) indicates that significant innovations by small firms are more likely to be introduced in the more prosperous South East than elsewhere in the UK. According to this research, innovative small firms in the South East employ more professional directors and have more technical staff than small firms in other regions. Furthermore, small firms in the South East are less likely to be family-run and to be more willing to invest

retained profits than their counterparts in the other regions. Thwaites and Wynarczyk suggest that the reasons for the more enterprising attitude of small firms in the South East is due to cultural differences in the ways that small firms are financed and operated. This gives them a leading edge on small firms in other regions.

### *High Unemployment Regions Suffer From a (Cumulative) Low-Skill Poverty Trap That Adversely Affects Competitiveness*

Regions with a low level of human capital may get stuck in a low-skill poverty trap from which it may be extremely difficult to escape. This is the familiar cumulative causation mechanism. Recent research into the relationship between economic performance, educational attainment and the occupational mix of regions in the UK (Bradley and Taylor, 1996) indicates that regions with high unemployment rates tend to have the following characteristics:

#### Economic performance indicators

- falling employment levels
- low earnings
- low new firm formation rates
- a low rate of in-migration of high-skill workers

#### Educational attainment indicators

- a low proportion of school leavers with good exam results
- a low proportion of school leavers proceeding to further education
- a low proportion of population with higher level qualifications

#### Socio-economic indicators

- a low proportion of the resident population who are professional and managerial workers
- a low proportion of the resident population who are owner-occupiers.

Regions get caught in a low-skill poverty trap since a poor economic performance encourages an outflow of workers with the highest skill levels, thus depleting the productivity of the region's workforce. This decline in the stock of high skill workers also has adverse effects on the quality of new entrants into the workforce since the proportion of school leavers proceeding to further and higher education is strongly influenced by the occupational mix of regions (Bradley and Taylor, 1996).

The importance of the stock of high-skill workers to a locality's economic performance is stressed by Baldwin (1993), who argues that the *accumulation* of human capital is directly related to the initial stock. According to Baldwin, localities with a low initial stock of human capital will find it difficult to create additional human capital (through training) since it is easier to train new workers and up-skill the existing workforce if a high proportion of highly skilled workers who can help out with the training already exists.

### **3. THE CASE FOR REGIONAL POLICY**

Regional economic policy exists at two levels in the EU. Each individual Member State operates its own regional policy while the EU operates an EU-wide

regional policy.<sup>6</sup> It will be useful to consider the justification for regional policy at both the Member State and EU level. This section attempts to demonstrate that regional policy is capable of yielding substantial economic and social benefits both to individual Member States and to the EU as a whole.

### 3.1. The Case for Regional Policy in Individual Member States

Views about whether regional policy is *economically* worthwhile vary greatly. In the early 1980s, it was widely accepted that the case for regional policy (at least in the UK) was "primarily a social one" (Department of Trade and Industry, 1983, para.16). The economic case for regional policy was regarded as weak. Regional policy was viewed as a zero-sum game in which one region's gain was bound to be another region's loss. According to this view, creating jobs in high unemployment areas would inevitably mean job losses elsewhere. In this zero-sum world, the only benefit of regional policy is a more *equitable* regional balance of employment opportunities.

An alternative view about the benefits of regional policy has emerged during the 1990s. It is now accepted that regional policy is justifiable on both efficiency and equity grounds. The UK Government's 1995 White Paper on *Regional Industrial Policy*, for example, states that:

"... the Government recognises the importance of enhancing the competitiveness of the Assisted Areas. There has been a refocusing of regional industrial policy to reflect its role in achieving both economic and social objectives." (Department of Trade and Industry, 1995, p.6.)

What then are the main arguments in favour of regional policy? Regional policy is justified at Member State level on several grounds:

#### ***Reducing Unemployment in Areas of High Unemployment Will Lead to Higher National Output***

Some regions have persistently high unemployment rates. Unemployment remains high even during periods of economic expansion and prosperity in the economy as a whole. If unemployment in these high unemployment areas could be reduced, national output would be higher. There would be a real resource gain as unemployed resources are brought into productive use. There would also be dynamic benefits over the longer run since the skill level (and hence the productivity) of the workforce is positively correlated with work experience. The future economic prospects of high unemployment areas would be enhanced if unemployment could be reduced since high unemployment is associated with a poorly trained workforce and a low level of competitiveness. The benefits of higher output would accrue not only to the unemployed but also to the taxpayer since transfer payments from the

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<sup>6</sup> See Armstrong, Taylor and Williams (1996) for a discussion of regional policies in the EU.



taxpayer to the unemployed would fall as unemployment itself fell.

### ***Reducing Unemployment in Areas of High Unemployment Will Yield Substantial Social Benefits***

Unemployment is a major cause of distress not only to the unemployed themselves but also to their families. Unemployment impoverishes and demoralises those directly affected. It is also a source of ill-health, especially for those who are unemployed for long periods. Reducing unemployment will reduce the personal problems that result directly from being unemployed.

The existence of geographical concentrations of high unemployment in particular neighbourhoods can also have adverse effects. Concentrations of high unemployment in housing estates, for example, result in a poor quality environment for *all* residents in these areas and not just the unemployed. Reducing unemployment in these areas of very high unemployment rates would therefore benefit more than just the unemployed.

Finally, the geographical concentration of persistently high rates of unemployment is socially and politically divisive because of the feelings of unfairness which such disparities in economic opportunities engender.

### ***Reducing Spatial Unemployment Disparities Will Reduce Inflationary Pressure in the Economy as a Whole***

The argument that inflationary pressures are exacerbated by spatial disparities in the unemployment rate is not new (McCrone, 1969). The basic notion is very simple. Suppose the economy experiences a sharp increase in aggregate product demand. This increase in the demand for products feeds through into factor markets, resulting in an increase in the demand for labour. The existence of substantial spatial disparities in the unemployment rate means that some local labour markets quickly run into supply constraints far more quickly than others during a business upturn. Labour markets in which there is an excess demand for labour experience an increase in labour costs as firms compete for scarce labour. Cost inflation is therefore initiated during business upturns in those labour market areas where unemployment rates are low.

Once wage inflation rises in these tight labour market areas, the wage increases are then transmitted to other labour market areas regardless of their unemployment rates. This transmission of wage inflation across labour markets occurs very quickly, working through the following mechanisms: national (industry-wide) agreements, inter-plant wage-setting arrangements in firms with plants in several locations, and wage-setting based on wage relativities between different groups of workers in related occupations. Labour shortages in the tight labour markets cause similar wage increases in labour abundant areas elsewhere in the economy. Wage inflation is therefore exogenous to those labour market areas with persistently high unemployment rates. This explanation of the transmission of wage increases from low to high unemployment areas is consistent with the very high correlation of wage



inflation across regions in the UK during 1976-94 (see Figure 3). High unemployment regions experience virtually the same fluctuations in wage inflation as low unemployment regions over time. No clear leads or lags in wage inflation across the UK regions are discernible.

Some evidence of the impact of rapidly falling unemployment rates on cost inflation is provided in Figure 4, which shows the relationship between increases in unit costs (in the UK's manufacturing sector) and the unemployment rate in southern England during 1975-95. This relationship indicates that when southern England's unemployment rate falls below 4%, the percentage of firms experiencing an increase in their costs rises very sharply. An unemployment rate of 4% appears to be critical. A similar result is obtained from the relationship between price inflation and unemployment (see Figure 5). When the South East's unemployment rate falls below 4%, the national inflation rate begins to rise very rapidly.<sup>7</sup> Available evidence therefore suggests that once the unemployment rate falls below 4% in the South East, the inevitable consequence is a sharp increase in cost and price inflation for the UK economy as a whole.

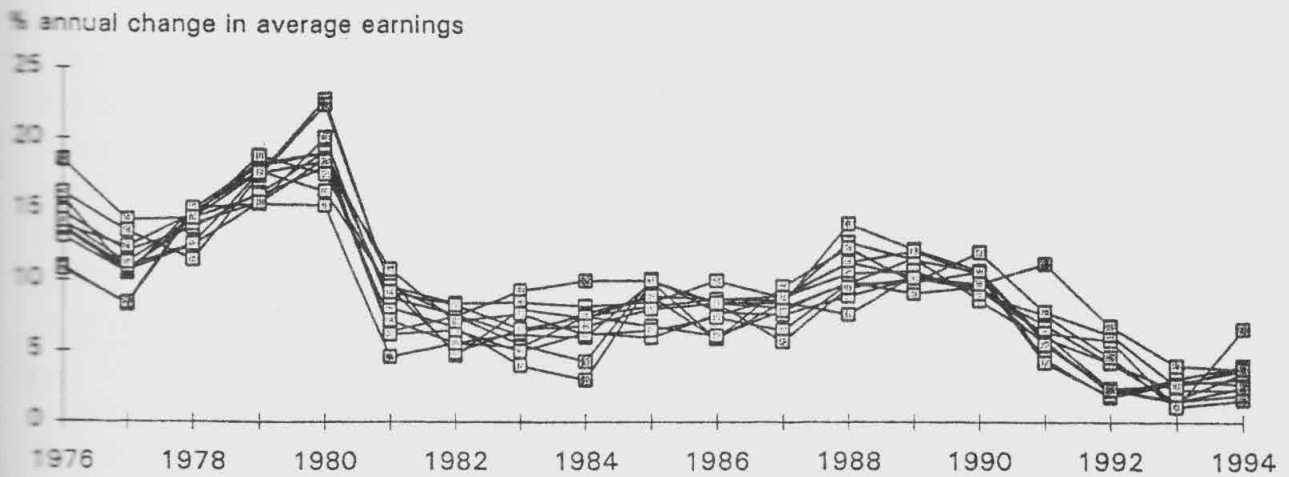
If the argument that *national* levels of inflation are determined primarily by the intensity of labour demand in low unemployment areas is correct, the policy implication is clear: unemployment could be reduced substantially in high unemployment areas without generating serious inflationary pressures. This is not the case for the UK's low unemployment areas. It follows that reducing spatial disparities in unemployment rates will reduce *national* inflationary pressures. In other words, the economy would not run into inflationary bottlenecks so quickly during periods of sustained expansion if regional unemployment disparities were smaller. The consequence of reducing regional unemployment disparities is therefore a more favourable trade-off between inflation and unemployment. The real output gains to the national economy from a more balanced demand for labour across regional labour markets may therefore be considerable.

### ***The Economic and Social Problems Resulting From Regional Economic Disparities are Intensified by a Cumulative Causation Process***

Persistent spatial disparities in job opportunities cause workers to move out of localities where employment opportunities are poor and into localities where employment opportunities are good. Although *net* migration flows are generally in the direction predicted by economic theory, this does not necessarily mean that migration from high to low unemployment areas will significantly reduce spatial disparities in unemployment. Indeed, there are reasons for believing that persistent net migration from economically depressed regions to economically prosperous regions may lead to an increase rather than a decrease in regional economic disparities, at least in the short to medium term. This is because of cumulative causation, which may occur for the following reasons.

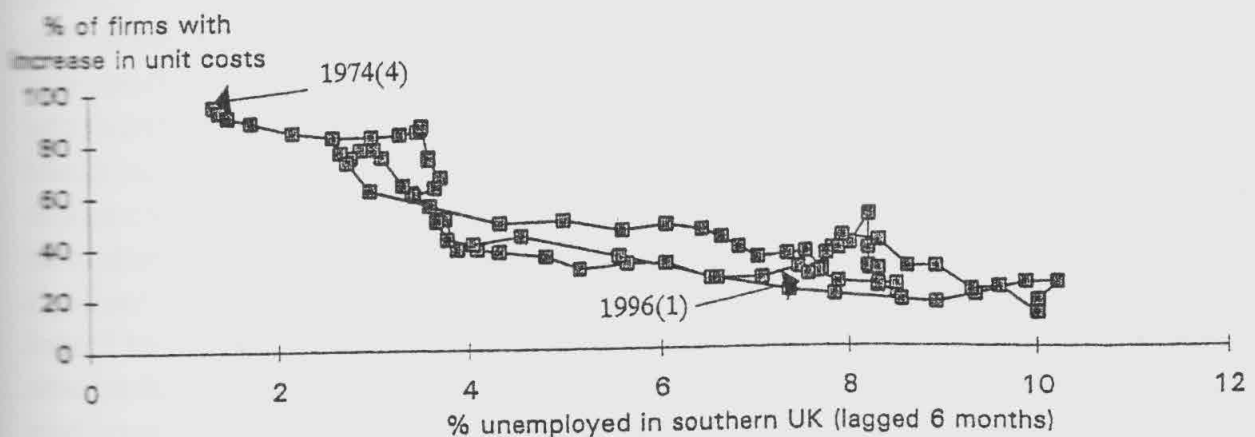
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<sup>7</sup> A statistical test of this relationship indicates a highly significant negative (non-linear) relationship between inflation and the unemployment rate (lagged one year).



Source: European Regional Database, Cambridge Econometrics, May 1996.

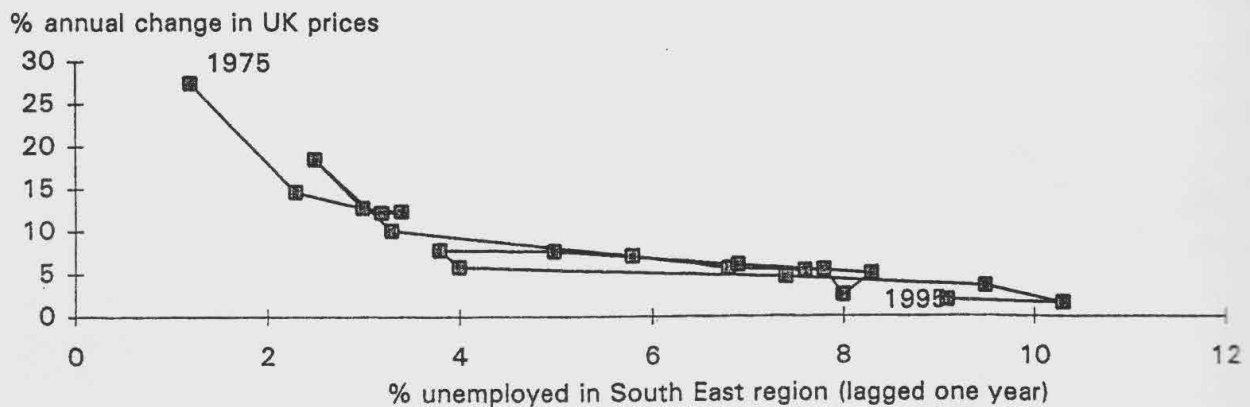
Figure 3. Percentage Change in Average Earnings in UK Regions, 1975-76 to 1993-94



Notes: 1. UK unit costs obtained from Industrial Trends Survey, Confederation of British Industry. 2. Southern UK = South East+East Anglia+South West.

Source: Quarterly Industrial Trends Survey, Confederation of British Industry; Economic Trends

Figure 4. Percent of Firms with an Increase in Unit Costs versus % Unemployed in Southern UK, 1974-96



Source: Economic Trends; Employment Gazette

**Figure 5.** Percent Change in Prices (GDP Deflator) versus % Unemployed in the South East Region of the UK, 1975-95

Firstly, regions experiencing a net loss of population will suffer from reduced demand for locally-produced goods and services with the consequent negative effects on local employment in the short run.

Secondly, labour migration is highly selective. High-skill workers are more mobile over longer distances than low-skill workers. Professional and managerial workers, for example, are more likely to migrate over longer distances than manual workers (Pissarides and Wadsworth, 1989). There is also a strong positive correlation between distance moved and the age at which a person completes full-time education (Halfacree, Flowerdew and Johnson, 1992). The significance of selective migration flows for regional economic disparities has been pointed out by Bradley and Taylor (1996). They argue that the process of selective migration could have severe long-term consequences on regional disparities in economic performance because of the critical effect of an area's occupational mix on human capital formation. Previous research has shown, for example, that a locality's occupational mix is an important determinant of the exam performance of school leavers. Moreover, high-skill workers are attracted to localities with 'good' schools and so the process becomes cumulative: high-skill workers move to localities where there is *already* a high proportion of high-skill workers, thus reinforcing regional economic disparities. The selective nature of migration flows is therefore likely to reinforce spatial inequalities in economic performance since the skill level of high unemployment regions will be depleted while simultaneously improving the skill level of low unemployment regions.

Thirdly, persistent net migration from depressed to prosperous regions may cause congestion and pollution problems in the recipient regions. There are many examples of this phenomenon in the EU's capital cities. Intense congestion problems

already exist in the EU's major conurbations. Roads, railways, airports and land are all under intense pressure in heavily urbanised areas, resulting in a loss of time, higher transport and production costs and higher living costs than in the regions of the periphery. This congestion does not, however, deter in-migration into core regions, since the costs of congestion *to the migrants themselves* are outweighed by the benefits stemming from better job opportunities. The traditional response to increased congestion is to expand the supply of physical infrastructure to meet the ever-increasing demand for it. This is a short-lived solution, however, since increasing the supply of infrastructure to relieve congestion results in a cumulative spiral whereby demand persistently chases supply. Creating more road space to relieve traffic congestion simply encourages more traffic onto the roads.<sup>8</sup>

One of the aims of regional development policy is to counteract the adverse consequences of cumulative causation. Once regions become economically depressed, it is increasingly difficult for them to keep pace with economically thriving regions. Regional policy offers economically depressed regions the chance to regain their momentum and to overcome the downward spiral effects generated by the cumulative causation process.

### 3.2. The Case for an EU-wide Regional Policy

The need for an EU-wide regional policy was foreseen as early as 1970 by the Werner Committee (CEC 1970), which argued that the attainment of economic and monetary union (EMU) would be impaired if the effects on regional economic disparities were ignored.<sup>9</sup> The achievement of economic and monetary objectives therefore required careful attention to be paid to the spatial consequences of EMU. The need for an EU-wide regional policy became increasingly apparent as more countries joined the Community and as the move towards a single market accelerated in the late 1980s. Regional policy has therefore gradually come to the fore in the EU and there is now a clearly articulated justification for an EU-wide policy to tackle the problem of regional economic disparities. The main arguments used to justify an EU-wide regional policy are as follows.

#### *Economic Integration Will Cause Regional Economic Disparities to Widen*

One of the primary reasons for having an EU-wide regional policy is to maintain economic cohesion within the Community. This is clearly stated in the Maastricht Treaty (1992):

"In order to promote its overall harmonious development, the Community shall develop and pursue its action leading to the strengthening of its economic and social cohesion. In particular, the Community shall aim at reducing the disparities between

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<sup>8</sup> The obvious alternative to creating more physical infrastructure in response to congestion is to impose stiff congestion taxes through road pricing schemes. Politicians have yet to grasp this particular nettle.

<sup>9</sup> See Vanhove and Klaassen (1987).

the various regions and the backwardness of the least favoured regions, including the rural areas." (Council of Ministers, 1992, Article 130a)

It is widely believed that the increasing economic integration of the EU (through the creation of the Single Market in 1992 and the subsequent moves towards full economic and monetary union) is likely to result in a widening of regional economic disparities if left unchecked. This is expected to occur for two reasons. Firstly, the creation of a larger market will result in more regional specialisation in order to exploit internal and external economies of scale. Although the EU as a whole will benefit, some regions will lose since the consequent structural changes will cause economic decline in some sectors and hence in some regions. Secondly, the core group of regions of the EU (with their epicentre in Luxembourg) will be very attractive to mobile resources due to their market power, thus adversely affecting the economically weaker regions on the geographical periphery of the EU. Policies are therefore required to counteract the divergent process generated by the further economic integration of the EU, otherwise the losing regions will see no benefit from further integration.

The need for an EU-wide regional policy became more evident when the UK, Ireland and Denmark joined the European Community in 1974. The plight of the regions on the geographical periphery of the Community received further impetus in 1981 when Greece was admitted, and then again in 1986 when Spain and Portugal became members. The recent admission of Austria, Sweden and Finland, and the probable eventual extension of the EU to include some eastern European countries, means that economic cohesion is likely to remain high on the EU's policy agenda in the foreseeable future. The EU must be seen to be determined to reduce the gap in living standards between economically depressed and economically prosperous regions within the Community.

### ***The Low Income Countries of the EU Do Not Have the Resources to Solve Their Own Regional Problems***

An EU-wide regional policy is needed since several Member States are economically depressed compared to the EU's wealthier nations and do not have the resources to solve their own regional problems. This applies to Greece, Portugal, Spain and Ireland. If regional economic disparities are to be reduced in the EU, the richer Member States will have to support regional development policies in the poorer Member States.

### ***All Regions Would Benefit if the Economically Weak Regions Were More Competitive***

The benefits of improving the economic performance of the most depressed regions will accrue not only to the depressed regions themselves, but also to other regions in the EU since market demand will be higher in the EU as a whole. Moreover, the need for income transfers from the wealthier regions to the poorer regions will be smaller if there are fewer depressed regions.



***An EU-Wide Regional Policy is Needed in Order to Prevent Conflicts of Interest Between Member States***

If individual Member States operated their own regional policies without regard to the interests of their EU partners, this could lead to serious conflicts of interest which would have harmful effects on the Community as a whole. A prime example is the competitive bidding for internationally mobile investment. Without strict rules regarding the award of investment grants to firms looking for a suitable location for investment in new plant, for example, those countries offering the highest grants would inevitably be the most attractive to investors, other things being equal. Multinational firms would then be in a position to drive a hard bargain with countries desperate to attract foreign investment. Such competitive bidding for mobile investment can be avoided only if strict rules on eligibility and size of award are fixed at EU level.

Conflicts of interest may also arise between Member States in border regions. In order to avoid regions on one side of a national border benefiting at the expense of regions on the other side, single cross-border programmes may be needed which tackle regional problems on both sides of the border simultaneously. Co-ordinated regional development programmes which transcend national borders are likely to yield greater benefits to the Community as a whole. A similar argument applies to the development of transport networks, which require a Community perspective if these networks are to serve the interests of all Member States.

***The Benefits of Economic Integration Must Be Equitably Shared Between Member States and Between Regions Within Member States***

The EU is a community of nations. The residents of this community are expected to share the benefits stemming from economic integration with each other. An EU-wide regional policy is therefore required in order to redistribute the benefits of economic integration in an equitable way. Since the EU is not a federal state, there is no effective fiscal mechanism for transferring income from the richer to the poorer regions. The EU's regional policy therefore fulfils this income redistribution function. An economic community that loses sight of the equity objective is likely to find itself in danger of disintegrating.

**4. REGIONAL POLICY IN THE EU**

Regional policy exists at two levels in the EU. Member States have their own 'national' regional policies and the EU has a supra-national regional policy. This section provides a brief overview of the development of regional policy in the EU and the current position.

**4.1. Regional Policy In The Individual Member States**

Although the individual Member States of the EU have their own particular set

of regional policy instruments, the fundamental aim of these policies is basically the same: that is, to improve the lot of the most depressed regions. Many Member States of the EU have consequently had their own 'national' regional policies for several decades. The first assisted areas were designated in the UK, for example, in 1934 when several areas of extraordinarily high unemployment rates were selected as areas in need of government help. This was provided mainly in the form of the creation of industrial estates including the building of factories for sale or rent. Regional policy became increasingly popular in several European countries (the primary examples being Italy, France and the UK) during the labour-scarce 1950s and 1960s. Policy makers saw the possibility of simultaneously relieving national labour shortages while reducing unemployment in the depressed regions by encouraging manufacturing firms to relocate in the regions with the highest unemployment rates. This initial phase of regional policy ended in the mid-1970s when unemployment began to rise generally. Regional policy could not be so easily justified in the late-1970s since creating jobs in the traditionally depressed areas was seen as a transfer of jobs from one region to another rather than as bringing unemployed resources into productive use. In addition, there was increasing pressure to reduce government spending in order to contain the higher levels of inflation being experienced in the 1970s and then again in the early 1980s.

The early 1980s saw a major change of emphasis in regional policy. Attempts were made to induce the depressed regions to grow from within rather than rely on inward investment from more prosperous regions. Stimulating indigenous growth in the assisted areas became the primary objective. Attention switched away from inducing large manufacturing firms to move into depressed areas and towards encouraging small and medium-sized firms within the depressed areas to expand. In addition, the long-term decline of manufacturing jobs in Europe led to the acceptance that service sector firms that serve national and world markets should also be eligible for regional financial assistance in high unemployment areas. In the late 1980s, more strenuous efforts were also made to induce mobile multinational firms looking for an EU location to locate in an assisted area. There has been particularly intense competition between Member States for American and Far Eastern companies looking to establish production facilities inside the EU's tariff wall.

A review of regional policy in the individual Member States of the EU reveals that several alternative strategies are now widely used simultaneously (Armstrong, Taylor and Williams, 1996). These are as follows:

- Encouraging foreign direct investment into depressed regions in order to expand the industrial base and improve their competitiveness.
- Improving the competitiveness of indigenous firms in depressed regions by encouraging investment in new products and new processes (through selective financial assistance).
- Encouraging new firm formation and the growth of small firms through the provision of business advice, industrial sites and premises, investment grants and guaranteed loans.
- Improving the economic infrastructure of depressed regions in order to raise competitiveness and to make the physical environment more attractive to

**Table 4.** The Menu of Regional Policy Instruments

Policies	Instruments
Fiscal incentives	Input subsidies: capital, labour Output subsidies Tax incentives/ rebates Loans at below market interest rates Factory units at low rentals
Location controls	Industrial buildings/ offices Congestion taxes
SMEs and new firms	Business advice Consultancy grants
Infrastructure	Transport links Industrial estates Communication/ information networks (hard and soft) Reclamation of derelict land Recreational amenities Public buildings (schools, hospitals)
Employment/ training policies	Migration grants; housing allowance in destination regions Labour subsidies for LT-unemployed Training/ retraining grants Job search grants Help with job search (Job clubs) Investment in up-skilling the workforce (schools, FE, HE and on-the-job training)

potential investors.

- Improving the skill level of the local workforce by investing in training and retraining schemes. The aim is to reduce unit labour costs by raising labour productivity, thereby improving the region's competitiveness.

A wide range of individual policy instruments has been used over recent decades by Member States of the EU in an attempt to confront the problem of regional economic depression. These include various types of financial investment incentives, labour subsidies, direct controls on the location of industry, public investment in infrastructure, training grants, migration subsidies and business advice for new and small firms. A summary of the types of policy instrument that have been widely used is provided in Table 4. Although regional policies have been adopted by all Member States of the EU, the degree of commitment has varied considerably between countries. A recent example of this varying commitment is provided in Table 5, which shows that Italy is far ahead of all other Member States in its expenditure per capita on regional policy.

#### 4.2. Regional Policy in the EU as a Whole

The EU's regional policy began in 1975 following the accession of the UK, Ireland and Denmark. The European Regional Development Fund (ERDF) was set

**Table 5.** Indicators of the Commitment to Regional Policy in the Member States of the EU

Member State	Expenditure per Capita in Assisted Areas <sup>1</sup> by Each Member State on Regional Financial Incentives (ECU 1990 prices)	Expenditure on Regional Policy as a % of GDP	Percent of Population in Assisted Areas Designated by the Member State	Allocation of Structural Funds <sup>2</sup> between Member States (% of total)	Percent of Population in an Objective 1, 2 or 5b Area
	1990	1992	1992	1994-99	1994-99
Italy	404.6	1.04	35.6	15.0	55.8
Luxembourg	70.1	0.41	79.7	0.1	42.4
Ireland	58.1	0.63	28.0	4.5	100.0
Greece	52.5	0.49	58.0	11.1	100.0
Belgium	44.7	0.11	33.1	1.3	31.5
UK	36.9	0.10	36.8	7.2	41.7
Germany <sup>3</sup>	33.2	0.07	27.0	14.8	39.2
Netherlands	33.1	0.05	19.9	1.5	24.2
Spain	31.9	0.19	58.6	24.1	84.5
Portugal	27.4	0.38	100.0	11.0	100.0
France	7.6	0.02	40.0	9.0	47.2
Denmark	5.4	0.01	19.9	0.5	15.3
EU12	-	-	39.1	100	51.3

<sup>1</sup> The divisor is the population of the assisted areas in each Member State.

<sup>2</sup> The Structural Funds are discussed in the text.

<sup>3</sup> Expenditure per capita in Germany is likely to have increased substantially after the unification of east and west Germany in 1992. This is reflected by the high proportion of the Structural Funds allocated to Germany in the period 1994/99.

Sources: Dignan (1995); Harrop (1996); Yuill *et al.* (1993); Bachtler and Michie (1994).

up with the intention of supporting the regional policies already in place in the individual Member States. During the first ten years of its existence, the ERDF suffered from inadequate funding and from having to consider requests for financing a large number of individual projects. An added problem for the ERDF was that its expenditures were under the control of each individual Member State which meant that EU regional policy was effectively an extension of individual Member State regional policies.

The first major reform to the EU's regional policy came in 1985 when the European Commission was given more discretion over the allocation of ERDF funds between competing requests for grants from the Member States. A further major reform was the switch in policy from financing individual *projects* to a policy of financing regional development *programmes*, some of which covered more than one Member State. The need for strengthening EU regional policy became even more apparent as membership of the EU widened to include the less developed economies



of Greece in 1981, and Portugal and Spain in 1986.

It was not until the late 1980s, however, that EU regional policy began to take off. The second (and most significant) reform to EU regional policy was undertaken in 1989 when the EU's three Structural Funds were strengthened financially and were set specific objectives. The Structural Funds comprise:

- the European Regional Development Fund (ERDF)
- the European Social Fund (ESF)
- The European Agricultural Guidance and Guarantee Fund, Guidance Section (EAGGF).

These three Structural Funds<sup>10</sup> constituted 18% of the EU budget in 1987, 29% in 1993 and this figure is planned to increase to 36% by 1999. (This compares to a planned reduction in the proportion of the EU budget allocated to the common agricultural policy from 64% in 1987 to 46% in 1999.) Expenditure on the Structural Funds doubled in real terms between 1988 and 1993, and is set to increase by a further 36% in real terms during 1994-99.<sup>11</sup> The relative importance of these three Structural Funds in the EU's budget is shown in Table 6.

An equally important development in the EU's regional policy has been the establishment of a set of six common objectives for the Structural Funds. These objectives define the aims of the Structural Funds and spell out the types of problems which the funds are designed to solve. These six objectives are described, along with the particular Structural Funds used to finance each objective, in Table 7.<sup>12</sup> The only major change in the allocation of the Structural Funds between the objectives in 1994/99 compared to 1989/93 is the switch from funding the older industrial areas (Objective 2) to funding the low income areas (Objective 1). The key principles of the Structural Funds are as follows:

- *Concentration* of policy action  
The funds should be allocated to the most needy regions.
- *Additionality*  
The Structural Funds are meant to add to the regional policy expenditure of the Member States (via matched commitments) and not to replace current or intended expenditure.
- *Subsidiarity*  
Control over the expenditure of the funds should be given to the lowest level of authority most appropriate for undertaking the task.

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<sup>10</sup> In addition to these three Structural Funds, two other financial instruments are available for providing help to disadvantaged regions. The European Investment Bank provides long-term loans for infrastructure investment and the European Coal and Steel Community provides financial help to declining coal and steel areas. Finally, a Cohesion Fund was set up in 1994 to provide special help to Greece, Portugal, Spain and Ireland.

<sup>11</sup> See Armstrong and Artis (1996), p.76.

<sup>12</sup> See Bachtler and Michie (1994) for a discussion of recent policy changes to the Structural Funds and an appraisal of the way these Funds are being used. A more detailed appraisal of the support of Objective 2 areas by the Structural Funds is provided in Bachtler and Taylor (1995).



**Table 6.** The General Budget of the EU: A Summary of the Component Parts in 1995

Budget Heading	ECU billion at Current Prices	% of Total Budget
Agriculture	36.9	46.2
Structural operations		
ERDF	10.8	13.5
ESF	6.8	8.5
EAGGF-Guidance Section	3.6	4.5
Cohesion Fund	2.2	2.8
Other	3.0	3.8
Other <sup>1</sup>	12.5	15.7
Administration	4.0	5.0
<b>Total</b>	<b>79.8</b>	<b>100.0</b>

<sup>1</sup> Includes internal policies (e.g. Research, Trans-European Networks, Central and Eastern Europe, humanitarian aid, and reserves).

Source: Harrop, 1996

- *Partnership*  
Applications for funds are expected to be submitted by a partnership of relevant agencies (which will include the central government, local government, local/regional development agencies, and relevant voluntary organisations).
- *Regional planning*  
The Structural Funds will be used to support regional development programmes rather than individual projects. Each Member State is required to prepare, in partnership with regional and local organisations, a regional strategic plan which specifies the source of all funding including the individual Structural Funds.
- *Co-ordination* of funding within programmes  
All regional development expenditure supported by the three Structural Funds must be co-ordinated by the relevant agencies so that the objectives of the regional development programme are achieved efficiently.
- *Compatibility* of structural policy with other Community policies  
The uses of the Structural Funds must be compatible with other EU policies such as environmental policy and competition policy.

There is wide agreement that EU regional policy shifted into a higher gear in 1994, mainly as a result of the Maastricht Treaty (1992) which established 'economic and social cohesion' as a major objective of the EU. Current policy is nevertheless open to several major criticisms.<sup>13</sup> Firstly, it is unlikely to make more than a minor dent in the EU's regional problems because it is seriously under-funded. EU expenditure on regional policy is still at very low levels compared not only to the size of the problem but also to the EU's GDP. For example, the planned expenditure of around 30 billion ECU per year under the Structural Funds during 1994/99 compares with the EU's GDP of over 5000 billion ECU (about one half of one percent). The

<sup>13</sup> See Bachtler and Michie (1994) and Bachtler and Taylor (1996).

**Table 7.** Allocation of the Structural Funds Between the Six Objectives During 1989/93 and 1994/99

The Six Objectives of the Structural Funds (policy instrument)	Type of Assisted Area	Example	Allocation of the Structural Funds Between Objectives (%)	
			1989/93	1994/99
Objective 1 (ERDF, ESF, EAGGF)	Economically disadvantaged regions with GDP per capita less than 75% of EU average.	Greece, Portugal, Spain, southern Italy, Ireland, eastern Germany, Northern Ireland, Merseyside	63	74
Objective 2 (ERDF, ESF)	Older industrial areas suffering from decline of manufacturing industries.	Widely spread across the older industrial areas throughout the EU.	11	6
Objectives 3 and 4 (ESF)	Funds for training and retraining unemployed young people and the long-term unemployed.	Not 'regional' policies. Apply to all parts of the EU.	12	11
Objective 5 (ERDF, ESF, EAGGF)	Agricultural regions requiring structural adjustment. Rural areas suffering from rural depopulation.	Rural areas of France, Germany, Italy, UK, Benelux, Austria, Sweden and Finland. Excludes Objective 1 (low income) areas.	10	9
Objective 6 <sup>1</sup> (ERDF)	Isolated areas in the sub-Arctic with very low population density.	Sweden and Finland.	-	-
Other (unspecified)			3	0
Total			100	100
(Total expenditure in billion ECU)			(58.3) <sup>2</sup>	(141.5) <sup>3</sup>

<sup>1</sup> Added to the list of Objectives on the accession of Sweden and Finland in 1995.

<sup>2</sup> At 1988 prices.

<sup>3</sup> At 1992 prices.

Sources: Dignan (1995); Harrop (1996).

Structural Funds are more important for some Member States, however, than for others. Taking the Structural Funds and the Cohesion Fund together, expenditure is expected to be 4% of GDP in Greece, 3.8% in Portugal, 2.7% in Ireland, 2.3% in Spain, and 1.7% in the five east German Länder in 1999 (Dignan 1995).

Secondly, the coverage of the assisted areas is extremely wide. One of the aims of the Structural Funds is to concentrate financial aid in those regions with the most severe economic problems. Over 50% of the population of the EU is currently

located in an assisted area (defined as an Objective 1, 2 or 5b area). Italy, for example, has 56% of its population in an EU assisted area, France has 47% and the UK has 42% (see Table 5). This hardly appears to be consistent with the principle of concentrating resources in the most needy regions. Moreover, regions such as Nord-Pas de Calais (France), Hainaut (Belgium) and Flevoland (Netherlands) are designated as Objective 1 regions even though they do not strictly qualify under the rule that GDP per capita must be less than 75% of the EU average. It is also difficult to see how these regions could be termed 'economically disadvantaged' given their location at the heart of the EU.

Thirdly, EU regional policy is based on the objective of achieving 'economic and social cohesion' even though this term has not been clearly defined, presumably deliberately. Despite the fact that an increasing proportion of the EU budget is being allocated to regional policy, the concept of 'cohesion' is vague and unquantified. One interpretation of 'cohesion' is that steps to achieve economic and social cohesion will be taken to reduce regional economic disparities in line with the availability of resources. The Member States will negotiate future budgets for the Structural Funds (or their successors) according to the perceived need to reduce regional disparities in economic performance. This need to reduce regional economic disparities is likely to be motivated primarily by political considerations, which have had a substantial influence on the development of EU regional policy.

Fourthly, EU regional policy has been heavily criticised for being 'administratively complex, time-consuming and expensive' (Bachtler and Michie, 1994). Several northern Member States, for example, find themselves paying money into the EU budget and then getting it back through the Structural Funds. This appears to be a costly and inefficient process to these States. The benefit, as seen by the EU's policy makers, is that the process forces Member States to commit these resources to regional policy. It also forces a consistent methodology (imposed by the EU) on the Member States in the way in which they develop and execute their regional development programmes.

Despite these problems with current policy, the framework for a comprehensive regional policy covering the entire EU has been created. Fundamental reforms to the EU's regional policy have been undertaken in the light of experience and it now appears that a firm foundation has been established for implementing a more vigorous regional policy in the foreseeable future. This assumes that the political will exists to provide sufficient resources to tackle regional disparities seriously. One of the problems facing policy makers is that there is still very little known about the efficiency and effectiveness of the EU's regional policy.

## 5. EVALUATION OF REGIONAL POLICY

Since the EU's regional policy is still in its early stages, research on its effectiveness is in very short supply.<sup>14</sup> The proponents of EU regional policy rely on

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<sup>14</sup> See Bachtler and Taylor (1996) for a recent assessment of the Structural Funds expenditure in Objective 2 areas during 1994-96.

the logic of the case for regional policy rather than upon hard supporting evidence. The case for regional policy therefore still rests heavily on faith rather than on fact.

EU regional policy is justified by policy makers on the grounds that it is politically necessary. It is the means by which income can be re-distributed from prosperous regions to poor regions. While this may be desirable in its own right, the case for an EU-wide regional policy would be considerably stronger if it could be established that it yields significant economic benefits to the Community as a whole. But there is still no hard evidence that the EU's regional policy has so far been economically worthwhile. Examining broad trends in regional disparities in variables such as GDP per capita or unemployment rates is inadequate since these variables are only likely to be affected very marginally by regional policy measures. If the evaluation of EU regional policy is to be significantly improved, this will require the collection and publication of far more economic and social data than is currently available at local and regional level. More work is also needed on developing methods capable of measuring the effect of EU funding on target variables such as job generation, inward investment, income levels, occupational choice and the competitiveness of the assisted areas.

The evaluation of regional policy has been taken more seriously at the Member State level. Several studies have been undertaken during recent years in the UK, for example, attempting to estimate the effectiveness of specific regional policy instruments. It will be useful to review some of these studies since they indicate the ways in which regional policy instruments can be evaluated. Ideally, cost-benefit techniques should be used to evaluate each individual policy instrument (Armstrong and Taylor, 1993). In practice, researchers have been less ambitious due to the massive data demands of the cost-benefit approach. They have consequently concentrated on estimating the *effects* of regional policy on three crucial target variables: namely, inward investment, jobs created, and the exchequer cost-per-job created. This section briefly reviews some recent research into the effectiveness of regional policy in the UK.

### *Inward Investment*

The importance of inward investment to the UK economy is widely recognised (Hill and Munday, 1992, 1994; House of Commons, 1995). Its relative importance, however, is greater for the peripheral areas than for the UK as a whole. Table 8 indicates that the UK's peripheral areas have varied, however, in their ability to attract foreign investment, with the Northern region and Wales having been far more successful than Scotland and Northern Ireland (Stone and Peck, 1996) since the late-1970s.

Studies into the effect of regional policy on the location of foreign manufacturing investment indicate that regional financial incentives have been "instrumental in attracting a substantial amount of inward investment into the UK that would otherwise have been located in assisted regions elsewhere in Europe or further afield" (Cambridge Economic Consultants, 1993). Japanese inward investors, for example, have exhibited a strong preference for assisted area locations (Taylor,

**Table 8.** Manufacturing Employment in Foreign and Domestically-Owned Companies in the Assisted Regions of the UK, 1978 and 1993

Region	Employment (000s)					
	1978			1993		
	Foreign-Owned	UK-Owned	Foreign-Owned as a % of Total	Foreign-Owned	UK-Owned	Foreign-Owned as a % of Total
Northern Ireland	30.1	100.9	23.0	27.9	71.1	28.2
Scotland	108.1	468.3	18.8	86.1	261.9	24.7
Wales	59.0	245.0	19.4	68.0	135.0	33.5
North	49.2	362.1	12.0	55.7	188.3	22.8

Source: Stone and Peck (1996).

**Table 9.** The Spatial Concentration of Japanese-Owned Manufacturing Establishments in the UK in 1994: Travel-to-Work Areas<sup>1</sup> with Four or More Japanese Establishments

Travel-to-Work Areas	Regions	Assisted Area Status <sup>2</sup>	Number of Japanese Manufacturing Establishments	Estimated Employment in 1994
Sunderland	North	DA	12	7606
Telford	W Midlands	IA	12	4950
Glasgow	Scotland	DA	9	1654
Coventry and Hinkley	W Midlands	IA	8	3877
Lanarkshire	Scotland	DA	8	2674
London	SE	NAA	8	1624
Manchester	NW	IA	7	1670
Wrexham	Wales	DA	7	2343
Milton Keynes	SE	NAA	6	1025
Bathgate	Scotland	DA	5	2234
Bishop Auckland	North	DA	5	2237
Belfast	N Ireland	DA	4	1879
Cardiff	Wales	IA	4	2378
Merthyr and Rhymney	Wales	DA	4	1241
Newport	Wales	IA	4	1685
Plymouth	SW	IA	4	1359
Total with four establishments or more			107	40436
Total all travel-to-work areas <sup>3</sup>			224	73046

<sup>1</sup> There are 334 travel-to-work areas in the UK.

<sup>2</sup> DA = Development Area; IA = Intermediate Area; and NNA = non-assisted area. Development Areas have the most advantageous rates of assistance.

<sup>3</sup> This excludes 27 establishments for which employment data are not available.

Source: List of Japanese Manufacturing Companies in the UK, August 1994, Invest in Britain Bureau, DTI.



1993). Table 9 shows that in 1994 over 40% of the 224 Japanese manufacturing establishments located in the UK (and over 50% of the associated jobs expected to be created) were in only 16 of the UK's 334 travel-to-work areas. Only two of these 16 were non-assisted areas. Further investigation of the location of Japanese inward investment in assisted area locations reveals that around 75% of the jobs in Japanese-owned manufacturing establishments in the UK are located in an assisted area (Taylor, 1993). The importance of regional financial incentives in attracting foreign direct investment into the UK's assisted areas is indicated by the fact that over 40% of Regional Selective Assistance has gone to foreign-owned companies in recent years (Taylor, 1996).

Although regional financial incentives have had a substantial effect on the locational choice of Japanese-owned companies in the UK, it is likely that other factors have also been influential. There is strong evidence, for example, of a follow-the-leader effect. The location of large Japanese-owned manufacturing plants has attracted other smaller companies into the same area, one of the reasons being that smaller firms prefer locations where there is already a substantial presence of other Japanese companies. The natural development of supply networks may also have been a critical factor. According to Stone and Peck (1996), such a process has been occurring in north-east England. There is very little evidence, however, that low wages or high levels of unemployment have exerted a significant influence on the location of inward investors (Taylor, 1993).

### *Job Creation and Cost-per-Job*

Estimating the job creation effects of regional financial assistance has proved to be notoriously difficult and several different approaches have been used by researchers. The most satisfactory studies are based upon the collection of detailed information from those firms which have received financial assistance. These microeconomic studies attempt to discover how different types of financial assistance have affected assisted firms. Wren and Waterson (1991), for example, estimate the jobs created (in north-east England during 1975-83) by various types of financial assistance in order to compare the cost-per-job between alternative schemes, such as financial assistance provided by local authorities compared to financial assistance from central government. Attempts have also been made to estimate the cost-per-job of automatic investment grants compared to discretionary financial assistance. Not surprisingly, discretionary grants have been found to be more cost-efficient than automatic grants because of a smaller 'deadweight' effect; that is, public grants replacing private investment expenditure.<sup>15</sup>

Several studies have been undertaken on the effectiveness of discretionary financial assistance to firms investing in the UK's assisted areas. King (1990) and Cambridge Economic Consultants (1993), for example, estimate not only the number of jobs created but also how long the jobs last. This research also takes into account the extent to which existing jobs are created at the expense of other firms in the same

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<sup>15</sup> See Wren (1989).

area. These 'displacement' effects appear to be more or less outweighed by the indirect and induced jobs created through the regional multiplier process. The main conclusion of these studies is that although the total employment impact has been relatively small (especially when compared to unemployment levels in the assisted areas), the cost-per-job of the regional selective assistance has been extremely favourable when compared to the benefit payments made to the unemployed. These studies indicate that the *net* Exchequer cost per *net* job created are between £500 and £700 per job year (at 1990 prices). This is extremely good value for money.

Cost-per-job estimates have also been calculated for small firms receiving financial assistance in the assisted areas. In a detailed statistical analysis of the effect of investment grants on assisted small firms in Northern Ireland during 1986-90, Hart and Scott (1994) show that these grants have successfully created jobs at a low cost-per-job.<sup>16</sup> In comparing a sample of assisted firms and non-assisted firms, Hart and Scott find that the assisted firms had a lower closure rate and created more jobs than non-assisted firms. Moreover, the cost-per-job was relatively low compared to other methods of creating jobs and compared to expenditure per capita on unemployment and related benefits.

## 6. CONCLUSION

Regional disparities in economic performance both within and between the Member States of the EU are immense and this has led to economic and social problems which policy makers have felt necessary to address. There has now been wide experience with various forms of regional policy in European economies over several decades; and the EU itself has gained valuable experience in developing its own EU-wide regional policy (primarily through the European Regional Development Fund), especially since the radical changes to regional policy in the late 1980s (with the expansion of the Structural Funds). Regional economic policy has in fact become a standard requirement not only for individual countries but also for the EU as a whole. The primary purpose of these policies is to help the most depressed regions to improve their competitiveness and hence their economic performance.

This paper has argued that the case for regional policy at the Member State level is based largely on economic and social factors. Reducing unemployment in high unemployment regions is not only economically efficient, but also results in substantial social gains for those living in depressed areas. This still leaves open the question of how much regional policy there should be. This question has still not been satisfactorily answered, though recent research into the effectiveness of regional policy instruments in the UK indicates that the policy instruments used since the early 1980s have been extremely cost effective.

For the EU as a whole, the major justification for regional policy is that it is a political necessity. Put in its simplest form, the EU needs a regional policy in order to keep the poorer regions of the EU satisfied that they have something to gain from

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<sup>16</sup> See also Hart, Scott, Keegan and Gudgin (1993).

membership. Whether the EU's regional policy is effective and efficient is an unanswered question due to the absence of serious (published) research on this crucial issue.

There is now a wide consensus among policy makers in Europe that some form of regional policy is required, both at Member State level and for the EU as a whole. There is less consensus, however, over the division of responsibility for regional policy between the Member States and the EU. Some Member States, for example, want to retain tight control over expenditure on the regional development programmes financed by the EU's Structural Funds. The UK is a prime example.<sup>17</sup> The EU's response to this has been to insist that the effective implementation of regional policy requires a partnership approach between the EU itself, the Member State and the region's own institutions and organisations. The EU is particularly keen to ensure that the Member States do not use the EU's regional policy funds as a substitute for their own regional policy expenditures.

EU regional policy has developed substantially in size and content since the mid-1980s. It is likely to face demands for further expansion over the next decade for two main reasons. Firstly, monetary union will put further strains on uncompetitive regional economies which have to share a single EU currency. Labour markets within the single currency area may not be sufficiently flexible to take the strain of losing the exchange rate as a safety valve for adjusting to a deterioration in a country's international competitiveness. Secondly, the expected addition of new members from eastern Europe will require a considerable expansion of the Structural Funds budget if the depressed regions of the existing Member States are to continue to receive adequate financial aid to relieve their own regional problems. This problem will have to be confronted as part of the process of extending the frontiers of the EU eastwards.

A serious weakness of EU regional policy is that inadequate attention has so far been paid to estimating the net *economic* benefits of the various expenditures incurred. Even within individual Member States, the need for developing an evaluation methodology to assess the effectiveness of their own regional policy instruments has not been taken sufficiently seriously by policy makers. This will have to be corrected if the right type and the right quantity of regional policy is to be achieved.

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<sup>17</sup> The UK Government currently withholds 12% of its allocation of the regional policy budget from the EU's Structural Funds to distribute on the basis of a Regional Challenge initiative whereby regions bid against each other for financial support. This Challenge initiative is likely to be abolished if the Labour Party win the 1997 election.

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