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European Commission

Towards a new partnership for growth, jobs and cohesion

Third progress report on cohesion

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INTRODUCTION

This third progress report presents an update of the situation and trends emerging in the regions since the publication of the Third Cohesion Report in February 2004. The report also addresses a number of important themes in the field of European regional and cohesion policy arising from the mid-term review of the Structural Funds.

The Third Cohesion Report was important in that it set out the main principles for the reform of the Union's regional and cohesion policies for the period 2007-2013, which was then followed by the presentation in July 2004 of the legislative proposals now under discussion in the Council and in the European Parliament.

The period since the adoption of the Third Report has been marked by two other important events for cohesion policy. First, the historic enlargement that took place in May 2004 expanding the Union from 15 to 25 Member States has highlighted the key role cohesion policy plays in the process of European integration by helping to promote the creation of new opportunities throughout the territory of the Union. Second, in March 2005, based on a proposal of the Commission, the European Council launched a growth and jobs strategy aimed at revitalizing the Lisbon agenda following the mixed results of the mid-term review. As discussed in this report, the themes of integration, growth and jobs which are emphasised by this strategy, are highly relevant to the proposed reform of cohesion policy, as the final stages of the negotiations are entered.

1. ECONOMIC AND SOCIAL DISPARITIES IN THE ENLARGED EU

In accordance with Article 158 of the Treaty, the prime objective of cohesion policy is to reduce disparities in the level of development between the regions. The recent enlargement to 25 Member States, with Bulgaria and Romania also set to join the Union in 2007, has dramatically increased disparity levels across the EU. The new Member States have markedly lower levels of income per head and employment rates than other EU countries. At the same time, they have displayed considerable dynamism in recent years, achieving high rates of growth in both GDP and productivity so that the gaps have been closing. The following section provides an updated analysis on levels and trends in disparities.

1.1. Disparity levels

1.1.1. GDP: the gaps widen with enlargement

Disparities in GDP per head between the 25 Member States are considerable. In 2003, levels of GDP per capita (measured in purchasing power parities) range from 41% of the EU average in Latvia to 215% in Luxembourg. Ireland is the second most prosperous country in these terms with GDP 132% of the EU average. In all new Member States, GDP per head is below 90% of the EU25 average, while it is less than half of this level in Poland, Latvia, Lithuania and Estonia, as well as Romania and Bulgaria.

1.1.2. GDP in the regions

In 2002, the most recent year for which regional data are available, levels of GDP per head ranged from 189% of the EU-25 average in the 10 most prosperous regions to 36% in the 10 least prosperous ones. Over one quarter of the EU's population in 64 regions have GDP per head below 75% of the average. In the new Member States this concerns 90% of their total population, the exceptions being the regions of Prague, Bratislava, Budapest, Cyprus and Slovenia. In the EU15, this concerns only 13% of the population. Among the EU15, the low-income regions are concentrated geographically in southern Greece, Portugal, southern parts of Spain and Italy, as well as in the new Länder in Germany.

Average per capita GDP in the EU fell substantially with enlargement to ten relatively poorer new Member States. In certain regions, this has meant GDP per capita rising above 75% of the new EU25 average, although they remain below 75% of the average for the EU15. Around 3½% of EU population lives in such regions. A further 4% live in regions which had GDP per head below 75% of the EU15 average in the 2000-2006 period but which have grown beyond this level even in the absence of the effect of enlargement.

1.1.3. Employment rates: much more progress required

In general, employment rates in Member States remain well short of the 70% target set for the Lisbon Strategy by 2010 (or 67% target in 2005), averaging 62.9% for the EU25 in 2003. In only four Member States - Denmark, Sweden, the Netherlands and the UK – the rate reaches 70%, while it falls as low as 51.2% in Poland. Some 22 million additional jobs are needed to meet the 70% target. In the new Member States, employment would have to increase by one quarter to reach 70%, equating to 7 million jobs.

At the regional level, the picture is again more diverse than at the national level. Only one quarter of the EU25 population resides in regions where the 70% employment rate target has already been achieved – thus 200 of the 254 EU regions are below the target rate. Almost 15% of the population lives in regions where the rate is below 55%. These are predominantly in the new Member States, and in southern parts of Spain and Italy.

Employment rates remain low among most of the least prosperous regions. Above average employment rates are found in only a handful of regions with GDP per head below 75% of the average. Employment rates tend to be higher in more prosperous regions, although some very prosperous regions continue to have low employment rates (such as in the north of Italy).

1.1.4. Productivity: recent improvements

Differences in productivity between Member States are more marked than for employment rates. International comparisons of productivity (measured as GDP per person employed) usually use current exchange rates, as these reflect the competitiveness situation most accurately. In these terms the differences between the Member States are stark - less than 30% of the EU25 average in Poland and the three Baltic states, but over 150% in Luxembourg and Ireland. The ten new members stand apart at the bottom end of the scale; productivity in all EU15 countries – except for Portugal – exceeds that in all new Member States. Thus, in spite of strong productivity growth in recent years, continued growth of both productivity and employment will remain necessary for convergence to be achieved.

Productivity differences in PPS terms are more limited (this PPS adjustment is common practice for comparing GDP data in order to reflect living standards more closely in the presence of differing price levels between countries).

At the regional level, higher regional productivity levels are associated with higher GDP levels, highlighting the key role this variable has for economic performance (these data exclude regions in the Netherlands and Portugal). For employment rates, this association with GDP is less strong, although a positive relationship remains clear. Variation in productivity levels around the EU average is much wider than for employment rates – productivity was below 25% of the EU average in 15 regions, and even below 20% in two regions. At the other end of the scale, productivity exceeds the EU average in the vast majority of regions where this is also the case for GDP per head.

1.2. Trends in disparities

Since the mid-1990s, growth in the EU has been disappointing, averaging just over 2% per year, although in Ireland, Luxembourg, Greece, Finland and Spain this rate was comfortably exceeded. The average rate of growth was affected by relatively poor performances in major economies such as those of Italy and Germany. The economies of the new Member States, however, grew at a much faster rate, reaching around 6% per annum in the Baltic States.

The high growth in the new Member States has been associated with high productivity growth, which has generally been accompanied by employment loss at worst or only very limited employment growth at best. This is a reflection of a process of restructuring, increasing overall productivity, without employment growth in the short-run. Hence, relatively high rates of unemployment are often combined with a fall in employment rates (most notably in Poland, the Czech Republic and Slovakia).

On the other hand, relatively large employment increases have been achieved in Ireland and Luxembourg, and to a lesser extent in Spain, the Netherlands and Finland where both employment and productivity increased.

The regions with the highest GDP growth (over the period 1995-2002) are concentrated in the high growth countries, such as Ireland, the Baltic States, Slovakia and Poland. Low growth regions are concentrated in Germany and Italy. But within most countries, regional growth rates vary markedly; this emerges very clearly for the new Member States, as well as for countries such as the UK and Finland. In Germany, low growth at national level has also been associated with marked regional differences. In Italy, growth has been almost uniformly low across all of the regions.

Overall, disparities have been falling across the EU since 1995. This fall has been more rapid between countries than between regions with internal regional disparities in several Member States increasing.

Disparities in GDP per head between Member States remain marked, and continued high growth will be needed for more than a generation in many new Member States if this gap is to be substantially reduced. This process has started as high growth rates have improved the relative position of the least prosperous since 1995. As a consequence, summary measures of disparities in GDP per head have fallen[1].

[1] The standard error across the EU25 Member States, for example, has fallen from 22.8 in 1995 to 18.1 in 2003.

Regional disparity levels are higher than national disparities, but they are also falling[2]. While growth has been generally higher in many of the least prosperous regions, it is noteworthy that the most prosperous regions have also performed well over this period. Thus the shares in total GDP accounted for by the least and the most prosperous regions both increased over this period.

The 10% of EU25 population living in the least wealthy regions accounted for only 2.2% of total GDP in 2002, which compares to 1.5% in 1995. The most prosperous 10% of regional population, in contrast, accounted for 18.3% of GDP in 2002, which has increased from 18% since 1995. Thus the ratio between the GDP shares of, respectively, the most and least prosperous regions has fallen from 12 to 8½ over this period.

Decomposing growth between 1995 and 2001 into its productivity and employment components suggests that productivity has been the principal vehicle for a good economic performance. Employment growth is also clearly positively related to GDP growth, but this relationship is less systematic than might be expected. In part this reflects the low employment growth achieved by high growth regions, notably in the new Member States, especially the three Baltic countries and Slovakia, but also in certain Greek regions. This may be an indication of a particular stage in the development and restructuring process.

A reasonably comparable picture of internal disparities within Member States can be established using the same calculation approach. Comparing shares in national GDP of regions accounting for 20% of population substantially reduces the comparability problems resulting from differing number and sizes of regions in the Member States. Four new Member States are included in this analysis.

Viewed in this way, disparities are highest in Hungary, where the most prosperous 20% of regional population accounted for 2.6 times the GDP share of the least wealthy. This figure has also increased most markedly in Hungary since 1995. The Czech Republic, Slovakia, the UK and Belgium also have high levels of internal disparities, while they are lowest in Greece, Germany, the Netherlands, Finland and Sweden.

Italy is the only country where this measure has visibly declined over time, although in Spain and Austria it also fell marginally. Apart from Hungary, internal disparities increased substantially in two of three remaining new Member States, excluding only Slovakia, as well as in the UK and Sweden (although to a relatively low level in the latter). In general, it is not unusual for economies that are in a catching up process to experience increases in internal disparities, reflecting an initial geographical concentration of growth, to be followed at a later stage by a more even pattern of development.

It is also to be noted that disparities in the EU between urban and rural areas generally increased as a result of enlargement.

The prevailing disparity levels across the EU provide ample evidence of the need for an active cohesion policy. At the same time, the focus of the proposed reform of cohesion policy as well as that for rural development policy on jobs and growth is acutely relevant to the prevailing policy context. It should help to remedy the inadequate implementation of the Lisbon Strategy, which has weakened the Union's response to growth of GDP and employment. Under the proposed reform an active cohesion policy is maintained outside the least prosperous regions, in order to provide a stimulus to the Lisbon strategy for growth and employment. This will not only provide a financial incentive for these policy measures, but also raise policy impetus at the local level.

2. EU COHESION POLICY AND THE LISBON STRATEGY IN THE 2000-2006 PERIOD

2.1. Structural Funds and the Lisbon strategy[3]: overlapping objectives

A recent evaluation[4] has stressed the similarities between the Lisbon strategy decided in the year 2000 and cohesion policy expenditure priorities. The analysis shows that the share of Structural Fund support for Lisbon-type investments is frequently above 50% in the programmes evaluated. The degree of congruity appears to be significantly higher in relatively more prosperous regions while it is lower in the less developed regions. The picture changes when investments in transport and energy are taken into account, which are part of the renewed Lisbon Strategy decided in March 2005 by the Member States on the basis of the Commission's proposed growth and jobs agenda (see Section 3.3).

[2] The standard error was 27.3 in 2002; but this is lower than the figure of 29.3 for the year 1995.
[3] The 2001 European Council in Gothenburg incorporated an environmental dimension to these objectives.
[4] "Thematic Evaluation of the Structural Funds' Contributions to the Lisbon Strategy" published by Danish Technological Institute, February 2005.

With regard to governance, the decentralised delivery system of the Structural Funds was seen as allowing for greater synergies between global policy objectives set at EU level such as the Lisbon strategy with the specific needs and conditions on the ground in the regions. In addition, cohesion policy with its comprehensive variety of actors is capable of enhancing the ownership of the Lisbon strategy by the regions and of managing complex development tasks under different conditions on the ground.

The main recommendations included in the evaluation were the following:

- A thematic concentration on specific priorities in order to have a direct positive influence on regional competitiveness.
- Exchanges of experience in order to promote policy learning between regions as an efficient way of fostering the establishment of regional innovation systems. The study insists here that such policy learning does not take place automatically, it must be actively organised.

2.2. The mid-term review: an opportunity to make adjustments

The year 2004 saw the end of the mid-term review process of the Structural Funds in the current programming period for EU-15 which included the allocation of the performance reserve following the mid-term evaluations carried out in 2003. The mid-term evaluations were carried out under the responsibility of the managing authorities but in partnership with the national authorities and the Commission. This process was in two stages:

(1) Mid-term evaluations. The evaluation of the contribution of the Structural Funds towards meeting the Lisbon objectives suggested that investment is generally targeted at sectors which are important for the achievement of the Lisbon objectives.

(2) Allocation of the performance reserve. The performance reserve is an innovation in the 2000-2006 programming period. Over €8 billion across all Objectives were allocated to successful programmes or priorities by the Commission in close consultation with the Member State.

The mid-term review provided an opportunity to adapt the different programmes while taking account of changes in the socio-economic situation or labour market. This led to qualitative shifts in a number of priority fields and provided an opportunity to better contribute to the priorities of the revised European Employment Strategy (EES) and to the achievement of the Lisbon targets while taking into account the experience of the current programming period and the specificities of each Member State.

Many Member States used the performance reserve to strengthen their support of the knowledge-based economy through co-operation between research institutes and businesses, the development of business clusters and research centres, investment in broad-band access, the development of regional innovation strategies and the training of researchers, as well as applied research projects. The performance reserve was used to support entrepreneurship through grant aid to start-up, small and innovative enterprises, the development of business parks, consultancy support and the introduction in some Member States of risk capital financing measures.

Measures promoting economic growth and competitiveness seem to have been reinforced particularly in Objective 2 while education and vocational training continues to be an important dimension in the majority of Objective 1 and 2 programmes. Objective 1 programmes remain oriented towards traditional projects such as those in transport and other infrastructure although in some Member States with large Objective 1 areas, more emphasis seems to have been placed on research and innovation.

Under Objective 3, the initial strategies were considered to be still valid while taking into account the revised European Employment Strategy (EES) and Employment recommendations. The majority of the changes aimed at simplifying the programmes, increasing flexibility to respond to socio-economic challenges and taking account of needs.

2.3. Cohesion policy in the new Member States: off to a good start

In June 2004, the European Commission formally adopted the programmes setting out the strategies to be supported by the Structural Funds for the ten new Member States. Together with Cohesion Fund allocations, the Structural Funds are making more than EUR 24 billion available from the European budget to the 10 new Member States between 2004 and 2006, of which over one third (EUR 8.5 billion) has been allocated to the Cohesion Fund. Thus, the Cohesion Fund has taken on greater significance (from nearly one-tenth of overall structural assistance to one third). For individual Member States like Cyprus, Estonia, Latvia or Slovenia, Cohesion Fund assistance represents nearly half of overall structural assistance.

The Funds will support not only investment in economic and social development, but also technical assistance measures to strengthen administrative capacity. The programmes in the new Member States have a range of priorities to reflect circumstances, including measures to improve business competitiveness and human resource development, basic infrastructure, environmental conditions and rural and/or fisheries development. Rural policies pursue territorial cohesion objectives and the Lisbon goals.

The European Social Fund is providing support to all new Member States, to tackle labour market and employment challenges in accordance with the European Employment Strategy. The labour market problems which should be addressed by each of the new Member States in order to make progress towards the EU employment objectives were identified in advance in the Joint Assessment Papers on employment policies (JAPs). The ESF translates the priorities identified in the framework of the European Employment Strategy into concrete priorities and measures for funding, including measures for social inclusion. These priorities are principally increasing employment and labour supply, adapting labour force skills to the changing labour markets and ensuring that the functioning of the labour market supports the on-going restructuring of the economy.

2.4. Additionality

The objective of the additionality principle is to ensure that the Structural Funds add to, rather than substitute for, national efforts to promote economic and social cohesion. The average annual level for public structural expenditure in real terms had to be at least equal to the established baseline.

The mid-term verification of additionality for the 2000-2002 period was completed at the end of 2004 for the EU-15. Out of thirteen Member States covered at least in part by Objective 1, nine complied with the principle, while four did not (Germany, France, Ireland and Italy). In particular, countries such as the UK or Greece even exceeded their spending targets. Germany and Italy, with the highest amounts of public expenditure, failed to meet their objectives in this respect, due to deteriorating macro-economic conditions, which led to a lower-than-expected amount of public investment. However, in order to respect the additionality criteria, these two countries, as well as France and Ireland, will have to bring their public structural expenditure in the remaining years of the programming period back into line with the levels required by the Article 11 of the general Structural Funds regulation. In general, the Structural Funds are having a significant leverage effect in maintaining high levels of public investment compatible with their efforts to ensure sound public finances.

The 9 new Member States eligible for Objective 1 (Cyprus being classified Objective 2) completed the ex-ante exercise by late 2003. The results showed that domestic structural expenditure will be maintained or even increased over the coming period. As there was no reference data from the previous period to use as a baseline for public structural spending, the data from the most recent years for which there was an out-turn were used. This served to reproduce a target baseline figure for public structural spending in 2004/2006. The challenge in the coming period will be to ensure that this expenditure schedule is is maintained in practice.

3. THE FUTURE OF COHESION POLICY AND THE GROWTH AND JOBS AGENDA

Following the publication of the Third Cohesion Report in February 2004, and the proposed regulations for the Structural Funds and instruments in July, the debate on the reform of cohesion policy post-2006 became more focused and intensive during the last year. The debate has also been given additional impetus with the approval by the European Council in March 2005 of the Commission's proposals on the re-launch of the Lisbon strategy.

3.1. Opinions of other EU institutions and bodies

The discussion on the main elements of the Commission's legislative proposals on the reform of cohesion policy continued during 2005 in the European Parliament, the Committee of the Regions and the European Social and Economic Committee. Discussions in the European Parliament reflected extensive support for the Commission's proposals. The European Parliament also carried out a thorough analysis on the financial perspectives for the 2007-2013 period, particularly through the report of the Temporary Committee on Policy Challenges and Budgetary Means of the Enlarged Union 2007-2013 set up with the main objective of defining the EP's political priorities for the future financial perspectives. This committee underlined the need for equipping an enlarged European Union with the means of ensuring social and territorial cohesion as well as economic growth and employment creation. The Commission on Regional Development of the European Parliament (REGI) was also active in producing several reports on the Commission's proposals for the General, ERDF, ESF, and Cohesion Fund Regulations.

The opinions of the Committee of the Regions and the European Social and Economic Committee have also been very positive in particular to the need to keep an adequate financial package for structural funds and to keep the structural policy at the European level, strongly resisting demands for its re-nationalisation. The perceived reinforcement in the Commission's proposals of the coherence between cohesion policy and the Lisbon strategy was also welcomed.

3.2. Events on cohesion policy: a major mobilisation of the key actors

The Commission's proposals were discussed and largely supported in a series of debates organised at European, national and regional level. All players continued to contribute to a high-quality debate, which became more intensive at the level of the EU institutions in autumn 2004. The European Commission facilitated the ongoing debate through a number of activities and events, of which some are highlighted below. This approach safeguarded a transparent and lively debate, a fact widely appreciated by all parties concerned throughout the process.

Details of the main events are given in the Annex (Table 8).

3.3. Spring European Council: the regions at the heart of the Lisbon process

As indicated above, the Spring European Council of 22-23 March 2005 issued several key recommendations on re-launching the Lisbon strategy in its growth and jobs agenda. It was also a ground-breaking occasion for EU cohesion policy, with an explicit endorsement at the highest political level of its importance as an instrument for achieving the Lisbon strategy.

A number of key points emerge from the conclusions of the Spring Council. First, it recommended that the EU mobilise the appropriate national and Community resources, including cohesion policy, within the three dimensions of the strategy – economic, social and environmental. Second, it urged regional and local actors, among others, to take greater ownership of the strategy and actively participate in the achievement of the Lisbon objectives. In areas such as innovation, support for SMEs or access to risk capital financing, high-technology start-ups, the Spring European Council concluded that innovation poles and partnerships at regional and local levels were needed. Similarly, the Spring European Council called for greater synergies between Community funds and the EIB in R&D projects.

A fourth recommendation was that a reduction in the general level of state aid should be accompanied by its redeployment in favour of certain horizontal objectives such as research, innovation, an inclusive information society and human capital allowing for a higher level of investment and a reduction of disparities in line with the Lisbon objectives. The fifth recommendation was the need to invest in infrastructure to foster growth and convergence along economic, social and environmental lines. The importance of finalising the 30 priority projects of the Trans-European Transport network was also emphasised, as were measures to improve energy efficiency. A sixth recommendation was the need to create more jobs with more active employment policies. Finally, the European Council concluded that on the basis of integrated guidelines issued at Community-level, Member States should establish national reform programmes on growth and jobs, in consultation with regional and national partners.

3.4. Community Strategic Guidelines 2007-2013

In addressing the Lisbon strategy under the next generation of cohesion policy programmes, the Commission has proposed a more strategic approach in an effort to ensure that their content is firmly targeted on growth and jobs. Strategic Guidelines would be established at Community level by decision of the Council, with an opinion of the European Parliament, setting the context for frameworks at the level of each Member State to be negotiated in partnership and taking account of differing national and regional needs and circumstances. The National Strategic Reference Framework is intended to define clear priorities for Member States and regions, underpinning the synergies between cohesion policy and the Lisbon strategy and increasing the consistency with the Broad Economic Policy Guidelines and the European Employment Strategy. Consistency with other Community policies and priorities would be enhanced in areas, *inter alia*, such as competition, research[5], environment, transport and energy policy, including addressing problems of restructuring linked, for example, to trade openness.

A similar approach to strategic planning is proposed for future rural development policy. Rural development actions will seek to contribute to the growth and jobs agenda of the renewed Lisbon strategy, to sustainable land management and to the quality of life in rural areas.

[5] Communication from the Commission "Building the ERA of Knowledge for Growth", COM(2005)118.

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