Danuta Hübner

Member of the Commission responsible for Regional Policy

Regional Policy and the Lisbon Agenda – Challenges and Opportunities

London School of Economics

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Ladies and gentlemen,

I am very grateful to Lord Wallace and to the LSE Students' Union Polish Society for the opportunity to address you today. It is a real privilege, though rather daunting, to be invited to an institution with such a superb academic reputation as the LSE.

As Britain gears up for the referendum on the EU Constitutional Treaty, today's topic – European regional policy and the Lisbon Agenda – is unlikely to compete successfully with the shape of bananas or the fate of the British sausage for the headlines in the tabloids. But I am convinced that this subject is vital for the future of Europe and indeed to the future of the United Kingdom in the European Union.

It is indeed high on the agenda of the Union at this moment and appears in two linked but different debates.

First, the current seven-year regional development programmes, financially supported from the European Union's budget, will come to an end in December 2006. For the next period, 2007-2013, the European Commission has presented a set of proposals for reform of the policy to the Council (that is, Member States) and to the European Parliament. These proposals are currently under negotiation in the context of the much broader discussion on future political priorities for the Union and the size of the Union's budget.

The need for reform of our cohesion policy should be obvious to everyone. The Union has recently enlarged to incorporate ten new member states. Bulgaria and Romania are due to join in 2007. All but Malta and Cyprus have developed as transition economies over the last fifteen years and, though growing fast, are still relatively poor and short of capital. Union investment in these countries, used properly, is bound to yield a high return. In helping these states to grow more quickly, cohesion policy will be generating a faster rate of economic growth in the Union as a whole than would otherwise be possible.

Second, the Lisbon agenda, the programme for accelerated structural reform, agreed by the Member States in March 2000, is being adjusted. The Commission presented its proposals for the mid-term review yesterday, and the main point – as you will have seen in the press – is a sharper focus on jobs and growth.

It is around these two parallel strands that I will address my remarks.

In some people's eyes, EU regional policy and the Lisbon agenda might seem strange bedfellows. But both are working to a growth, employment and competitiveness agenda. My conviction, which is widely shared at the level of the regions, is that we must reinforce the link between the two in the interests of the prosperity of the European Union.

That link is already clear. Cohesion policy is not merely about the redistribution of funds between the rich and the less well-off. It is all to do with investment – modernising the European economy, promoting growth and sustainability and producing beneficial spill-over effects. It is about investing in innovation, human capital and modern infrastructure.

The Lisbon agenda

The Lisbon Agenda was agreed by EU leaders at the Lisbon summit in March 2000, with the overall aim of making the EU the most competitive and dynamic knowledge-based economy in the world. There were specific targets – for example, raising the employment rate to 70 per cent from the current level of around 63 per cent. The main instruments were, in essence, twofold: economic reforms, and investment in growth-enhancing areas like R&D and human capital. Much of the responsibility lay with individual Member States, though the Union also played a part – through measures to complete the internal market, for example, and by organising the process of peer review and monitoring.

Yes, progress with the Lisbon agenda has been disappointing. We know that from Wim Kok's recent report on the first five years of Lisbon, and I am not going to give you yet another detailed diagnosis.

Let me just recall some of the main points:

– despite the relatively good labour market performance in recent years, at least by European standards, we have far to go before reaching what might be called 'full employment' – and we shall almost certainly not be there in 2010;

– productivity growth appears to have continued its long-running downward trend, and not all of this can be put down to rapid employment growth; Europe has not, as yet, made the most of recent technological progress;

– in general, there remains a great deal of room for improved functioning of our product, capital and labour markets;

– we are not on track to meet some of the specific targets in the Lisbon strategy, such as increasing investment in R&D to 3% of GDP, or halving the number of early school-leavers;

– in the social dimension, too, there is room for improvement. For example, gender gaps in the labour market – in both employment levels and pay – are still much too wide.

Then there is demographic change – the ageing of the population and the declining number of new entrants to the workforce. Without reforms of pension systems and retirement provisions, as well as improved labour market performance and a sensible attitude towards immigration, demographic change might foreshadow even more serious challenges to our economic and social model.

Before you accuse me of constructing a doomsday scenario, however, let me reassure you that all is not lost. We have made useful progress in some areas – the rapid growth of female employment, for example, or the financial services action plan which is being implemented, albeit at a slightly more leisurely pace than one might have hoped.

Lisbon certainly has not been a waste of time. Part of the added value of the Lisbon agenda has been to put the economy at the top of the domestic political agenda of the Union. It is the European equivalent of former President Clinton's slogan, "It's the economy, stupid". It is above all a reminder that a number of things that we regard as precious in Europe, such as our social welfare systems, or our concerns for the environment, depend on a successful economy.

Re-launching the Lisbon agenda: EU regional policy

Three recommendations in the Kok report are of key importance. First, the Union should not only persuade Member States to implement Lisbon, it should back up its words as far as possible with "financial incentives" from the Union budget. Second, a lack of "ownership" of the Lisbon process in the Member States was identified, requiring the establishment of partnerships for growth and employment. Third, the report called on each Member State to adopt a strategic approach involving "a national action plan" setting out how it is going to achieve the Lisbon targets.

In the Commission's proposals for a renewed Lisbon strategy, regional policy plays a much more prominent role than it did in the past. This is because it contributes in all three of these areas.

The Structural and Cohesion Funds are the main instrument the EU has for increasing growth-enhancing investment

Moreover, this is not just any spending instrument. It is not a simple transfer of money from richer regions to poorer ones, which would reduce income disparities only in the short run.

Transfers for income equalisation remain entirely a matter for national governments in the Member States.

EU regional and cohesion policy has a different logic, seeking to invest in human and physical capital formation so as to raise the **long-run growth potential** of the weakest regions and to improve **competitiveness** across the regions as whole. Accordingly, European regional and cohesion policy measures broadly fall into four types, aiming:

to improve basic infrastructure endowments. This covers transport and energy infrastructures, telecommunications and information technology;

to raise levels of R&D and to support for innovation;

to support the labour market, mostly through training, to improve the adaptability of the workforce to changing economic circumstances; and

to develop enterprise including investment support especially for SMEs, and to improve the attractiveness of cities and regions for new business.

Second, embedded in the management system of European regional policy is the concept of ownership.

Beyond the economic impact of additional investment, there is an equally important effect in terms of governance. Every programme is developed through a close **partnership**, involving the authorities at European, regional and local level, the social partners and civil society. As a result, the strategies are more effectively owned by those responsible for designing them, those who co-finance them and the people who benefit most from a successful outcome.

Third, European regional policy is based on a strategic approach

Being involved in preparing European programmes obliges the regions to think long-term and to identify strategic priorities. The support from the European budget means that they are afforded a degree of isolation from the day-to-day political or other pressures that can have a distorting effect on any public expenditure strategy. Today, the planning period stretches over seven years, well beyond the electoral cycle of any Member State, and long enough to invest in infrastructure projects that make a real difference to citizens' quality of life for many years to come.

Moreover, these are not the only positive aspects of the governance method. In order to ensure the effectiveness of expenditure, the implementation of programmes includes specific **management, monitoring and evaluation** requirements.

Now, the EU does not have the best of reputations when it comes to bureaucracy, though I think this rather unfair. Sometimes it seems as if we cannot win: if we are rigorous, we are accused of binding the policy process up in rolls of red tape. But at the first hint of fraud or mismanagement – even if that turns out, on closer inspection, to be a failure of controls at the national level – it seems we can never be too strict.

But ask the people who manage EU-funded programmes in the Member States. They may be obliged to toe their government's line on regional policy in general. But they will tell you nevertheless that the EU framework has improved the administration of regional programmes, including those financed entirely at national level. That is just as true here in London as it is, for example, in Lisbon or Ljubljana.

Reforming regional policy

The Commission tabled proposals for an extensive reform of EU regional policy in July of last year. This was shortly after the proposal for the whole of the future budget, or "financial

perspectives", from 2007 to 2013. Our proposals reflect the Commission's desire to see the EU budget contribute more effectively to the realisation of the Lisbon agenda.

The essential background to these reforms is, of course, the enlargement of the European Union to 25 Member States. This has had a dramatic impact on regional income disparities within the EU as a whole. In the new Member States, 92% of the population lives in regions where average GDP is below 75% of the EU average – the threshold used for determining eligibility for the highest level of aid. Not only are there many more people in regions below this threshold, but they are much further from the threshold than was the case in the poorest regions before enlargement. GDP per head in the 10 new members averages 46% of the EU-25 figure. Two-thirds of people in these countries live in regions where GDP per head is below 50% of the average.

Within the total package, the Commission has proposed a structural funds budget totalling €336bn for the whole period, which, compared to the current period, represents a roughly stable share of Community GNP, at around 0.41%. This, if anything, errs on the side of prudence, given the scale of the challenges. After all, you cannot have more Europe for less money.

It is hardly surprising, in view of enlargement, that the Commission has set real economic convergence as the main objective for the future. In financial terms, this would absorb some 78% of total resources over the period of the next financial perspective. A little over half the regions that will benefit are in the new Member States.

In the new Member States, this represents in most cases a **stimulus of 4% of GDP** and a much higher proportion of national public investment budgets. This is higher than the rate applied historically to any of the former fifteen Members States, and has the potential to make a real and long-run difference to the level of development. An independent evaluation has suggested that this alone should raise total GDP in the new Member States by over 10% over the period.

But the policy needs to continue to intervene **outside the poorest regions** – and it is here that the Commission's reform proposals are more radical. In effect, they are a specific response to the limited success in progressing towards the Lisbon objectives, especially in the fields of R&D and innovation, accessibility and sustainable development. They would allow the regions to contribute to the Lisbon process and to make it more effective. As Michael Porter, for example, has recently concluded, *"Since many of the essential determinants of economic performance appear to reside in regions, national policies will be necessary but not sufficient".*

We propose to keep 18% of the budget for use in regions that, though they are not the poorest, still face competitiveness and employment challenges. The remaining 4% of the budget would go on projects to strengthen territorial cooperation.

Outlook

As I have indicated, the future of the Commission's proposals is very much bound up with the negotiations on future European policy priorities and their financing as set out in the Commission's draft "Financial Perspective" for the period, 2007-2013.

This is a difficult discussion in the Council of Ministers. No member state is keen on transferring public revenue to the Union budget. But as I have already mentioned, the Commission, fully aware of the pressures on member state budgets, has been particularly prudent in its proposals. Not only have we proposed no increase in Cohesion Policy spending as a proportion of EU GDP, but we have also proposed measures that will mean that available resources are used more effectively and efficiently.

The debate is especially robust with a group of six Member States calling for major cuts in the Commission's proposal. With spending on agriculture already ring-fenced, any savings would have to be found elsewhere.

In view of everything that I have said on the contribution of European regional policy to good governance, you will understand that I am among the many who believe that the proposals of the group of six would be a retrograde step. But here in the London School of Economics and Political Science, I would like to I would like to say that this would be a step back in political terms too.

By this I mean, firstly, that it would have a negative impact on the political visibility of the Union. For many people, European regional policy is the most visible presence of the Union on the ground. Take it away and the Union becomes an abstract entity for laying down rules, directives and regulations.

Second, it would be a political mistake to create a new division in Europe between a West that gives and an East that receives. True, it is fully justified to target regional policy on the East and South in the enlarged Union in view of the huge economic and territorial disparities. But it would be impossible to explain to people in the less well-off parts of the richer countries, experiencing industrial closures, high unemployment or social deprivation, that they are no longer entitled to EU regional aid. A rule-book with no resources is not the adequate response.

Finally, I believe that the Union, and especially our national governments, need to listen to what the regions themselves are saying. We in the Commission have received around 300 contributions to the major debate that was launched in 2001 on the future of regional and cohesion policy. There is, in particular, overwhelming support at regional level for the Commission's proposals.

It is interesting to reflect that the development of a regional policy and the creation of the Regional Fund owed much to the persuasive arguments coming from London soon after the accession of the United Kingdom to the European Communities. These arguments, are as valid today as they were 30 years ago. But then what would you expect? Many of them were derived from the insights of illustrious LSE professors.

Thank you for your attention.