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Regional policies and location firms strategies in the European Union

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1. The regional dynamics in Europe

1.1 Regional disparities and growth

In the EU 15 regional disparities are important, roughly the double of what is observed in the US. Whereas a catching process has been observed regarding the income per capita at the national level since the beginning of the 1980s, the regional configuration is more diversified. Some studies conclude in favor of the lack of regional convergence and of an increasing disparity of the income per capita between the regions (Cappelen, Fagerberg and Verspagen [1999]). Other studies underline the difference of evolution between deciles. The poorest regions, but also the richest ones, have a higher rate of growth than the intermediate ones. Within each country, a general trend cannot be observed. Between 1986 and 1996 regional disparities have increased in Italy, Spain, France and Greece but they have declined in Portugal and the Netherlands (Cour and Nayman [1999]). Since the 1990s the increase of the regional disparities is more pronounced. Regarding the rate of unemployment, the same regional disparities can be observed. A strong negative correlation exists between the standard deviations of the GDP per capita and of the rate of unemployment (Davies and Hallet [2001]).

In a macroeconomic approach, regional growth can be explained by factors such as the share of innovation activities in the region (R&D effort), the potential for exploiting technologies developed elsewhere (diffusion effect), complementary factors like the level of infrastructures, the industrial structure (which can be more or less favorable) or the long term unemployment (which plays negatively). Instead of regional convergence, there exists "growth clubs" which gather regions with similar characteristics and dynamics. The most successful regions are those specialized in services and high-tech industry with a high level of productivity. On the opposite agricultural regions and those specialized in traditional industries are disadvantaged. Investment in innovation activities is a growth stimulus for the more advanced regions and even backward regions may benefit from the adoption of new technologies at a relatively low cost. But many poorest regions have failed to take advantage of this process and R&D effort may play negatively in regions penalised by various blocking factors reflected in long term unemployment and the share of declining activities (Cappelen, Fagerberg and Verspagen [1999]).

These results are coherent with studies on the impact of the systems of innovation on the regional dynamics (Maurseth and Verspagen [1999]). As it will be seen in more details below, there is a high degree of concentration in innovation activities, measured by patenting

activities. Knowledge spillovers are more important between regions with similar or complementary specialization patterns and distance matters a lot. Spillovers are more effective when the receiving region lags somewhat, but not too much, behind the more advanced region. Technology diffusion is not automatic and requires a certain level of development to be efficient. It seems to exist a kind of threshold effect. Lastly, national borders matter, which reflects the existence of national systems of innovation.

The impact of infrastructures on regional dynamics appears more ambiguous (Martin [1997]). Public infrastructures in energy, transports and telecommunications are important factors which sustain regional growth and can help the more disadvantaged regions. However, perverse effects may appear when the infrastructures, especially in transport and telecommunications, play in favor of inter-regional trade. They contribute to open to trade the poorest regions, but induce an increasing penetration of products coming from the most developed regions. This process seems to have occurred, particularly in Southern Italy and Portugal. Econometric analysis confirms that, within each national space, public infrastructures, except the telecommunications ones, have a small impact on regional convergence. If infrastructures contribute to the convergence between European countries, at the national level, it is by accelerating the growth of the richest regions in the less advanced countries, without reducing the internal regional disparities. On the opposite, infrastructures which facilitate intra-regional trade play a more positive role by increasing the size of the local market and helping to attract more capital in the less developed regions.

1.2 An increasing polarization of innovation activities in Europe

In this section we show how the economic activities and specifically, the knowledge intensive activities, are more polarized in some big European regions. Then we'll try to give some theoretical explanation of these increasing phenomena.

The recent empirical studies show that the innovation activities are more geographically concentrated than the production activities at any regional level and with any innovation indicators (R & D, patents, R & D employees)¹. The southern European countries, France included seem to be those where both innovation and production activities are the most concentrated by contrast with the northern European countries where the regional development seems to be less unequal². The R&D concentration indicator shows that in 1997, Germany, France, the United Kingdom and Italy represent 75 % of the European R & D expenditures³. Furthermore, 20 % of the R&D expenditures are concentrated in only five European regions: one French region (Île de France-Paris), three German regions and one Italian. The R&D expenditures concentration observed in Europe, is also very sharp in the United-States of America. According to *National Science Foundation data*⁴, in 1998, the 20 first states realize 85 % of the total US R & D expenditures and the 20 last states represent only 4 %. California occupies the first place with 20 % of the total R&D expenditures.

⁽¹⁾ for a literature survey see Maurel and Mouhoud, 2001 ; Lallement, Mouhoud et Paillard, 2002.

⁽²⁾ OST, 2002.

⁽³⁾ Germany is at the first position with 30,7 %, followed by France (19,7 %), United Kingdom (15,9 %), and Italy (7,5 %)

⁽⁴⁾ Division of Science Resource Studies, Data Brief, March 23, 2001.

The patent applications indicator confirms the evidence of regional concentration but shows an amplification of this concentration process⁵.

For instance, in the French case, the performances of the Île-de-France (Parisian agglomeration) region (8,95 % of the total European R&D expenditures) and the Rhône-Alpes region (2,07 %) allow them to occupy the first and the seventh rank in Europe. According to the R & D expenditures in percent of the regional GDP, the Midi Pyrénées (3,55 % of its regional GDP), and the Ile-de-France (3,28 %) regions are ranked at the 7th and 8th rank.

Inequalities between countries are much more important in terms of technology (patents granted) than in terms of science (publications). At the local or regional level within the nations, inequalities are more important for science than for technology. The scientific activities polarization could be mainly explained by regional inequalities within the nations related to historical factors about the location of the universities in the large agglomerations. The technological activities polarization reveals divergence between countries development level. Within the manufacturing sectors, the high technology industries seem to be more concentrated (pharmacy, Kraft industry, computers) than the others.

1.3. The polarization factors and the logic of localization of innovation activities

The recent economic geography literature tries to explain and to measure the increasing activities polarization process in the large agglomerations⁶. Polarization forces (economies of scale and positive agglomeration externalities, backward and forward linkages...) are particularly boosted in a large economic integration area as the European Union where many transaction costs have been dramatically decreasing. The knowledge intensive activities are more geographically concentrated because of their knowledge spillover effect. Those knowledge externalities are partly based on the nature of imperfect appropriation of knowledge and constitute for some industries a sharp incentive to the polarization process.

But, this standard literature doesn't take enough in account the specificity of the logic of firm's location strategies which depend not only on the nature of their activity, but also on the type of labor division they implement.

Two types of firms could be distinguished. Some firms implement new patterns of labor organization with a logic of specialization by homogenous knowledge blocs.

Other firms are still organized according to the taylorian division of labor principles. They try to achieve a combination between two opposite strategies: a location strategy based on a low production costs motivation by fragmenting their production process parts on the global level on the one hand, and flexibility with a very fast reactivity to the market fluctuations of demand addressed to their products on the other hand. They tend to invest importantly in the new information and communication technology equipment and in very up to date transports. Those firms which we call "flexible taylorian firms" do not develop the same strategies as the firms which organize and coordinate knowledge intensive activities.⁷

In a knowledge based economy, firms locate their production units in a range wide of territories according to their capabilities to control and develop some specific competencies. They try to seek the competencies which are specific and complementary with their own

⁽⁵⁾ In 1999, Germany, France and United Kingdom grant more than 70 % of the European patents at the European Patent Organization (EPO).

⁽⁶⁾ For a literature survey, see Gérard-Varet et Mougeot, 2001.

⁽⁷⁾ Or firms whic adopt a « cognitive division of labor » concept proposed by Moati and Mouhoud, 1994, 2000.

competencies. Finally, they are less interested by low wage costs or taxes than by an environment which stimulates their learning capabilities. The location of knowledge intensive activities is also limited by the necessity of managing many constraints related to coordination of the different parts or fragments involved in the production process of a final good or service. The critical phase is, actually, the reintegration of the different fragments.

The activities coordination associated to the “cognitive division of labor” logic implies to implement mechanisms and organization framework which is able to encourage the convergence in the actor’s representations, common knowledge and language process implementation, and a common or a shared definition of the way to make the different fragments of the production process compatibles each others. The high intensity of the relations between the actors involved in the production process means an organizational proximity between them and in some cases a physical proximity of the different partners.

The organizational proximity reacquires two sorts of conditions: the similarity and the “belongings”⁸. Actors which are similar, ie who present the same knowledge absorption capabilities even with different competencies (specialization) are not necessarily constrained by the geographical or physical proximity. The need of proximity is more important in the preliminary phases of the technological development (innovation) which are more concerned by more tacit than codified knowledge.

Furthermore, empirical literature about knowledge geographical spillovers shows that when the knowledge externalities diffusion is intra-industry biased, the need of a physical proximity is important. By contrast, when the knowledge externalities diffusion is inter-industries biased geographical dispersion of activities could be also efficient⁹.

Finally, it exists a large spectrum of firms willing *vis à vis* the territories which depends on the one hand on their patterns of organization and their logic of division of labor, and, on the other hand depending on the specificity of knowledge they get or deal (codified or not, intra or inter- industries ...). This diversity is much more pronounced when one takes in account the needs of each firm within the different functions of the firm. The criteria for locating R&D activities differ from the logic of the assembly line in manufacturing industry, for instance.

2. The location firms strategies

The location strategies of the manufacturing production activities are very heterogeneous due to the unequal diffusion of the knowledge based economy in the different industrial sectors. Inside the same firm, some segments of the productive process can be still organized according to taylorian logic, others according to a cognitive division of labor.

2.1. The balance between cost factors attractiveness and territorial anchorage

In front of the diversity of the firms location strategies, the local authorities set up policies not enough well balanced between cost factors attractiveness and stability of the production units on their territories.

⁽⁸⁾ Gilly et Torre, 2000.

⁽⁹⁾ Voir Massard, 2000.

The logic of organization and of division of labor matters in the strategies of firm's production units location and in the selection of the territories. On the one hand, some firms are engaged in the «cognitive division of labor» logic and are specialized in some homogenous knowledge blocs. On the other hand, certain firms are still organized on the principle of the «taylorian division of labor». They try to make compatible a «low costs seeking oriented» location strategy with the constraint of reactivity to the market volatility. These «flexible taylorian firms», are particularly present in some sectors, with low barriers to entry and low elasticity of capital / labor substitution. The European “flexible taylorian firms” seem to be very “volatile” and “public subsidies and low taxes seeking”. They can decide to locate their production or assembly line units in one European region and relocate it very quickly toward an other one or toward a CEEC region. In those sectors the productive flexibility constraint does not prevent assembly continuing to be relocated offshore, since firms can offset the distance handicap by resorting intensively to the new information and communications technologies. Clearly, however, the low-wage regions which are selected by European firms have to offer a combination of cost advantages and efficient low-cost transport and telecommunication infrastructures. That is why this type of relocation has become much regionalized, the CEECs and median European countries tending increasingly to be preferred to developing countries. But the competition between the EU regions themselves is increasing in order to attract those manufacturing production units.

In the knowledge-intensive sectors where the “cognitive division of labor” is more present, location strategies in the European regions are not prompted solely by costs considerations or the existence of efficient infrastructures. In the case of products which are technology-intensive (electronics and information technology, for example) and have a short life span (less than one year), the decisive factor as regards competitiveness seems to be the speed at which markets react.

The remoteness due to relocation in low-wage countries is not just geographical, but is also cultural and technological. Relocation in the shape of firms sub-contracting in low-wage countries has the effect of arresting the development of the product for a period of time greater than can be afforded by the race to keep ahead technologically (the dominant form of competition in the sector). Relocation and sub-contracting operations are not disappearing, but are being organized differently on the basis of networks of partners which are geographically close. Ireland, Spain and certain CEECS, for example, offer a variety of advantages, combining efficient infrastructures and labor which is skilled, but less costly than in the advanced countries, while they also benefit from externalities deriving from their membership of a large and integrated regional area.

2.2. The three types of location strategies

Some recent empirical work about the firm's location shows three types of strategies of location of firms, which could sometimes be found together for some different production process fragments¹⁰ : *productive flexibility*, *strengthening innovation capacity*, *strategic flexibility*

Seeking a productive flexibility

⁽¹⁰⁾ Voir P. Moati, 2001.

In a new context of demand uncertainty, firms try to set up productive flexibility organizations. The logistic considerations could be very important criteria of the productive unit location. In the case of some manufacturing production of heavy products (automobile for instance), firms are often looking for a proximity with the final demand and with their intermediate goods furnishers ; the outsourcing partners agglomerate also around the assembly lines sites of the automotive manufacturers. But it concerns particularly the firms for which the demand is concentrated on a small number of purchasers.

In the case of the firms which face to a large number of purchasers and countries, the localization close to the final demand is often preferred. The rationalization strategies which have been implementing by the large companies lead to a centralization movement of logistic flows and to a reduction of the number of distribution points¹¹. In Europe, Belgium and Luxembourg are the most attractive for such centralization process. The French northern and eastern regions share the benefits of this process of centralization automotive assembly and distribution units. Finally the firms which concentrate their efforts on the logistic function, tend to put in competition a large number of territories specialized in such a logistic supply.

Strengthening innovation capability

The strategy of strengthening innovation and learning capability is a new phenomenon, which involves the firms implementing a cognitive division of labor firms. As it's shown by a recent survey with firms processing a permanent and organized R&D activity, generally the higher is the level of the knowledge base complexity, the higher is their inventiveness to locate their units close to their R&D potential partner¹². The professional researchers endowment is also often present in the firm's answers as an important factor of their location choice, after the acceding to the technological resources factor.

Another research studying the foreign firms location strategies in the French regions¹³, considers the notion of « centrality » as an important factor of location choices, the importance of the agglomeration externalities, and the differences between the firm's behavior in terms of their country of origin. For instance, the region "Ile-de-France" has got a very high level of attraction. Then, the regions close to the countries of origin firms (Belgium, Germany, Switzerland). Evermore, this study shows significant, but very limited, effect of the regional policy (approached by the European structural funds) and a negative effect in the case of some countries.

Seeking strategic flexibility

In a context of sharp uncertainty on the future of their markets and their technologies, the firms have also to set up organizations patterns and location strategies in order to avoid the irreversibility in their organization choice when some change in the economic environment

(¹¹) H. Molet et P.P.Dornier, « Les mutations de la logistique européenne », *Les Échos*, supplément « L'art de l'entreprise globale », n° 12, novembre 27th et 28th, 1998, p. VI-VIII. For instance, the américain compagny of laser jet Lexmark prefers the direct livraison from the only European base instead of distribution syst dépôtse nationaux. Nike has concentrated on a single location his 25 European centers.

(¹²) This survey was leaded by Carrincazeaux, 2001, with 614 units.

(¹³) Crozet, Mayer et Mucchielli, 2000, a study on 3902 foreing firms in France, on the 1985-1995 period e firms can locate 92 départements.

mean a change in their strategies. Externalization strategies could be the answer to such problems by a transfer of the supporting the uncertainty costs toward the external actors. More generally, the network organization increases the level of the reactivity firm and makes the change easier.

Finally, those studies show that the large firms location is the result of strategic considerations. The firms tend to seek territories which present potentiality to support their competitiveness effort. More generally, the location criteria are very diversified: those criteria depends on the production unit nature and on the type of competitiveness the firms look for. The labor and taxes costs considerations, even if they are not excluded of the firms strategies, are not the most important factors. The variables related to the new competitiveness criteria (labor skill, Research and Development institutions, infrastructures quality) are very important factors of the firms location strategies.

3. The regional policies in Europe

The regional policies are implemented at three different levels, local, national and European. In a restrictive sense, they only concern public interventions with a regional dimension. But the regional impact of national (fiscal policy, social transfers, education, public services) and European policies (research, agricultural policy, competition policy) may be greater and have to be taken into account.

3.1. The local policies

The different local authorities (cities or regions) conduct active policies to sustain economic activity and promote employment, following specific ways in each country. The attractiveness policies focus on infrastructures improvement, training, strengthening of the technological potential and development of networks to increase cooperation and spillover effects (Begg 2001).

According to a recent study, three kinds of regional development strategies can be distinguished (Moati 2001). First, some regions concentrate their efforts on the exploitation of their fix resources or of their specific geographic position by developing touristic resources valorization strategy, as cultural or gastronomical, in order to attract the related manufacturing or services activities. Second, other regions take advantage of the history and of the public interventions consisting in the development of *technopoles*. Then, they attract particularly knowledge intensive activities. Third, some regions use their central geographic position and try to become important logistic platforms in Europe. In some cases, they can agglomerate knowledge intensive activities by concentrating their efforts on transport and NTCI (new technologies of communication and information) infrastructures.

Tax cuts and decrease of social charges are also used to attract investments, sometimes at the level of a whole country like in Ireland. Such a strategy is quite more open to criticism, as it leads to a ruinous competition between the sites, without contributing to develop stable employment or strong economic system. Wage pressures are in the same logic, here again to the detriment of a progressive improvement of labor skill.

Regional aids, like subsidies or investment aids, are also criticized because they would alter competition and would finance investments which would have been realized, even without aids. Moreover regional aids might be opposite to regional balance as they could be the more important as the region would be rich. These critics are unequally significant. The possible perverse effects depend of the concrete forms of implementation. Actually, all the regional policies could be criticized as their importance depends directly of the level of development of the region and, in that sense, contribute to increase regional disparities.

3.2. Regional policies at the national level

Two kinds of national policy have a regional impact, the regional policy *stricto sensu* and the redistributive effect between regions of the fiscal policy.

The regional policies stricto sensu

The regional policies are twofold, the explicit policies of fiscal transfer in favour of the poorest regions and the public expenditures with a regional dimension.

The explicit inter-regional fiscal transfers in favor of less advanced regions are more or less developed according to the countries (Davies and Hallet [2001]). They are the most achieved in Germany and work between the Federal State, the Länder and the cities, according to a complex mechanism which is periodically adjusted. The German reunification has been a major shock in that respect. In 2000 these transfers were equivalent to 0.8% of GDP, with an amount in favor of the Eastern Länder of 5.1% of their GDP, which is notable. Some Western Länder are also profiting of a net transfer, but most of them are now net contributor. In Spain the process of decentralization and transmission of expenditures to the regions has not been accompanied by an equivalent increase of their capacity to raise taxes. Consequently, the regions depend of transfers from the central government but a fiscal decentralization procedure is in progress. In Italy an Equalization Fund has been created between the fifteen ordinary regions but its implementation is very progressive.

It is generally recognized that this kind of system sets a problem of balance between equity and efficiency. Equity allows the poorest regions to benefit of sufficient resources to finance public services of good quality while efficiency allows the richest regions to keep through the fiscal autonomy resources according to their level of production. Too much equity creates a not very inciting system which does not induce neither the rich regions, nor the poor ones, to improve their performances. Too much efficiency can prevent the poor regions from having sufficient public resources to realize their catching-up. Moreover problems are more complex as the fiscal decentralization is generally more advanced for the expenditures than for the taxes which remain dependant from the repartition of those collected at the national level. Consequently, regions are not enough accountable at the fiscal level.

Public interventions with a regional dimension take the form in each country of public infrastructures, investment in education and research or aids to private investments, often with a co-financing from the European Structural Funds. The efficiency of these interventions to impulse regional growth and reduce disparities is controversial. Some concentration of the means is necessary to improve the efficiency and avoids dispersion but may increase disparities. The investment programs must be sufficiently lasting but may begin too

permanent to promote an endogenous dynamics. Development strategies may lack of consistency.

State aids with a regional dimension are more specifically criticized, mainly because they would alter competition. They used to be important in Germany (0.6% of GDP), in Italy (0.9% of GDP), in Greece (0.8% of GDP) and in Portugal (1.2%). They have been reduced under the pressure of the European Commission and have been brought to roughly 0.3 % of GDP in 1999, as in the mean of the other countries. These critics are again of an unequal value. The concept of regional State aids is less clear than it seems. If subsidies are directly accused, many of the research or training aids, which are better accepted in their principle, are not fundamentally of a different nature.

The redistributive effect of fiscal policy

The fiscal policy induces automatic transfers between regions whose volume is far more important than the explicit regional interventions. Regions affected by a higher unemployment benefit of more social transfers and pay less tax. The tax system is more progressive and the public expenditures system is more uniform, which strengthens the redistributive effect of the fiscal policy. These transfers create a disequilibrium between regional demand and regional GDP which generates a deficit financed by public transfers and intra-regional capital flows. This deficit can be very important. It was equivalent to 46% of Eastern-Germany GDP and 12% of South-Italy GDP in 1999 (Sinn and Westermann [2001]). In this case most of the regional State policy aims to preserve consumption in the less developed regions, without being able to sufficiently sustain the investment effort, with a risk of keeping these regions in a dependant position. All these questions will be discussed in more details later on.

3.3. The European regional policy

Since the accession of the Southern European countries, the European regional policy has reached a rather important level, as the Structural funds and the Cohesion funds represented yearly 0.45% of the EU GDP between 1994 and 1999, with financial contributions far higher for the Southern countries (4% of GDP in Portugal, 3.7% in Greece, 2.8% in Ireland and 1.7% in Spain). But, for the period 2000-2006, a decrease has been planned, with 260 billions of euros for the whole structural measures (0.4% of EU GDP each year), 195 billions for the Structural funds, 18 billions for the Cohesion funds and the rest for the applicant countries. Three objectives have been retained for the Structural funds: 1/ promote the development and structural adjustment of regions whose development is lagging behind (with a GDP per capita less than 75% of the EU average) and which would receive an amount of 70 % of the total Structural funds; 2/ support the economic and social conversion of areas facing structural difficulties; 3/ support the adaptation and modernization of policies and systems of education and employment (long term and youth unemployment, persons excluded from the labor market).

The efficiency of Structural funds in reducing regional disparities is questionable. According to some authors, they seem not to have a great impact (Fagerberg and Verspagen [2000]) or, though econometrically significant, to have only a limited impact (Fayolle and Lecuyer 2000). According other studies, they could explain half of the convergence observed between 1989

and 1993. Following the results of national modeling, they could have fairly increased the growth of the Southern countries during the years 1994-1999 (Cour and Nayman [1999]). Structural funds invested in infrastructures would have contributed for a third to the reduction of productivity gaps between the Spanish regions during the 1980s. Their impact on private investment would also have been positive for the Cohesion countries. But, in the case of Portugal, this effect would have been more important when the investments were realized in the richest regions. This result confirms Martin (1997)'s conclusion, already mentioned. Public infrastructures have strengthened convergence between countries by accelerating the growth of the most advanced regions of the poorest countries, without reducing internal intra-regional inequalities. The efficiency of Structural funds would be marked more especially as the concerned region is rich.

On a more practical plan, the elaboration and implementation of projects financed by Structural funds suppose complex interactions between the regional, national and European institutions. In many countries the projects management appears too centralized. Due the complexity of the European documents, the control requirements at the national level and the co-financing recourse, the consumption of the Structural funds is often very slow.

4. Lessons and perspectives

4.1 The opposition between “technopoles” and “local excellence centers”

The knowledge-based economy doesn't involve only the “technopoles” in the European regions. It also concerns the “local excellence centers” (LCCs), which are less technological intensive and concentrate their efforts on their specific competencies and the innovation behavior of the local actors.

The technological innovation activities are generally geographically more concentrated than the other economic activities. France and the other southern European countries seem to be the countries where this regional concentration of the technological innovation activities is the most pronounced. Technological innovation activities are more concentrated in some large regions because the knowledge intensive activities benefit from large increasing returns and from knowledge spillover. Then, it seems necessary for a region to get a big size in order to organize those activities and to develop intense relationship between the actors within the firms and between the firms and their partners.

But, beside those “technopoles”, which are much more efficient when concentrated in some large agglomerations, local excellence competencies centers exist and are much more scattered within the European countries. Those local competencies centers (LCC), which are some times described as a « local system of production » or a « cluster » are based on specific competencies in different fields : technology, production organization and related activities, as marketing... Those clusters are focused on a specific sector agglomerated to the activities associated to such a sector. A significant example of such local system of production is the « slide cluster » of Aquitaine in the South West of France is a cluster based on a strong connection between firms associated to this large sector (boats, windsurf, surf, surf apparel, diving equipment...). The LCCs competitiveness is based on non price factor competition advantages (innovation, quality, marketing, differentiation, labels...) which permit them to resist to the global competition pressure.

Regional policy makers have trouble finding a balance between strategies consisting in attracting firms seeking to minimize their costs or firms looking for specific skills. The first strategy might lead enterprises to become too « volatile » and the second might result in over-specialization which would jeopardize the adaptation capacity of regions. At the same time, the national and European authorities are faced with the dilemma between policies that promote geographic concentration of activities and policies of regional cohesion.

The main policy recommendation of this paper is that, instead of a policy of « *laisser faire* » inducing a geographic concentration of economic activities, *an alternative European policy toward regions is possible* consisting in helping and consolidating everywhere the local competencies based on local excellence knowledge in various domains which are not be reduced to the technological knowledge.

4.2 The local policies

The local policies of cities or regions must not be reduced to attractiveness policies of investments funded on costs reduction or tax cuts which induce a devastating competition and a risk of locking in low range specialization not adapted to the new forms of international competition. The target must be to take advantage of the specific competencies of the local systems (labor skill, know how, networks) through:

- the strengthening of the local scientific basis (links between universities, research centers and firms, technological parks);
- the promotion of marks and labels with a strong territorial specificity (label policy, quality improvement and diversification, aid to inter-firms cooperation and to trading);
- a training policy and an help to new technologies diffusion;
- an improvement of the environment quality (infrastructures and way of life).

Each region has not the vocation of being a scientific and technological pole. The increase of the R&D effort promotes the catch up only in a region with a minimum level of infra structures. Technological diffusion occurs between regions, but with a threshold effect for regions which are not too much lagging at the beginning. But each region can form in its specific fields a local excellence center by identifying and building progressively its specific advantages. The attractiveness of the region is gradually increased for the local, national or foreign investors. In this general framework, adjustable to each specificity, the local policies can be implemented and be supported in a consistent way by the national and European policies.

4.3 Regional policies at the national level

The main scientific programs and infrastructures expenditures can favour the technological poles with a national or European size in order to avoid dispersion and allow scale economy and spill over effects. National financing and human resources can sustain the local strategies. But this policy increases the polarisation of technological innovation activities.

At the opposite, more selected and specialised technological programs, innovation or investment aids and training policies can support the specific competences which have been identified at the local level. Such public interventions are destined to be more scattered on the whole territory.

The preservation of public services of quality regarding transports, post, telecommunications and energy supply are necessary conditions to help the less developed regions to restructure and find new growth factors. The improvement of the education system for initial and permanent training, with a national support, is also a necessary condition.

4.4 European regional policy

European regional policy faces traditional problems due to the complexity of the procedures and the difficulty of management and monitoring of the projects financed with Structural or Cohesion funds. In some cases, the endowment is underutilized because of problems of definition and coordination between the different participants; in other cases, the utility of projects can be discussed. But the Eastern enlargement of the EU brings new challenges which have been clearly diagnosed (Begg, 2002). With the entrance of the candidate countries, the average EU GDP per capita will fall dramatically and take many regions currently receiving Structural funds (with the Objective 1) over the 75% eligibility threshold. This will pose a dilemma as a region in Southern Spain or Eastern Germany that will move above the threshold will have its support reduced, without any change in its absolute GDP per capita. According to the Cohesion report (European Commission, 2002), the number of EU-15 regions below the threshold will drop from 46 to only 19.

A distinction can be made between countries with a weak fiscal capacity and the richest ones which believe that they pay too high a net contribution to the EU and regard the Structural funds as a one of the channels through which they can recoup some of their net contribution. The poorest countries, measured with an aggregated indicator, regroup Greece, Portugal and the new entrants. Some countries are not relatively poor, but contain regions which are below the threshold, sometimes significantly, like Spain, Italy and Germany. Lastly, in the other cases, neither the country, nor the region is below the threshold, but there are structural and specific problems which allow Structural funds (mainly through Objective 2). As there is a Treaty commitment that obliges the EU to act to lessen regional disparities, the political challenge in the perspective of enlargement would be to rise the threshold, for instance at the level of the Cohesion funds (90% of EU GDP per capita). But this would raise difficult budgetary constraints with a EU budget limited to 1.27% of the EU GDP.

Regarding the new entrants, the current proposals have put a ceiling of 4% of GDP for the transfers due to the limited absorption capacity. This would give a cost estimated between 0.18% and 0.38% of the EU GDP, according as the estimation is made in current prices or in PPS. On the whole, this cost would be bearable, but this kind of transfers (4% of GDP) would favor the richest new entrants, mainly Slovenia.

In this context, three scenarios can be considered:

-If the EU budget remains to its present level (1.27% of the EU GDP), the temptation would be strong to reserve, for the main part, the Structural funds to the new members. In the EU-15 the regional policies would be *renationalized*, which would be coherent with the fact that regional policies are already mainly financed by the State and local budgets. Moreover neo-liberals consider that regional problems must largely rely on market mechanisms and on private capital flows. However this prospect raises two kinds of problems. The current EU members, especially the richest ones, would be excluded from any European financing. This situation would be difficult to manage in the long term, the richest countries being progressively reluctant to finance a solidarity mechanism, from which they would be permanently excluded. On the other hand, the new members, often reserved with regard to the implementation of any European economic government, would be in a rather paradoxical situation where they would benefit of transfers without accepting the political counterpart.

-In a more favorable perspective the EU budget could be progressively raised to around 5% of GDP at medium term. This would give more room to maneuver thanks, for instance, to an increase of the eligibility threshold for the Structural funds. A larger number of less developed regions could benefit of transfers, including in the more advanced countries of the EU-15.

-These two first scenarios are not the most likely, due to the political environment. A new compromise could be searched in a double direction. As for the precedent institutional changes, new Structural funds could be created and dedicated to the new members, with financing by borrowing through the EIB and the ERDB. The present Structural funds could be shared between the EU-15 members and the new entrants with a re-negotiation of the eligibility threshold, in order to give to both groups of countries a sufficient amount of funds. Lastly, the procedure of the Structural funds could be reformed in order to improve their efficiency. More autonomy could be given to the local, regional and national development plans with the Structural funds playing a complementary role, without a too tight examination of the Brussels bureaucracy. High levels of support for lagging countries would be linked to broad public investment strategies. Objectives for eligible EU-15 regions would be determined by country and regional indicators to increase the consistency.

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