The European Place-Based Policy Framework and Its Contemporary Challenges

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In this paper, we review the policy framework for the place-based policy of the European Union – a policy established in the European Treaties and with a budget of $60-70 billion per year – and identify key directions for its future develop in light of new challenges. We first analyse the place-based features of EU Cohesion Policy, its commonalities and differences with place-based policies in the US. We then identify new challenges for the design and implementation of place-based policies in addressing current problems of European economic and territorial development in the context of new, closely related, climate, industrial, and geopolitical priorities. The points made below will be illustrated with a variety of statistical materials drawn from a set of studies we have carried out on European growth, convergence and place-based policy instruments, some published, some unpublished. It is intended as a contribution to the discussion of the economic rationale for place-based policies, their targeting, the design and scope of the interventions and their complementarity with other policy objectives.

Background: the current EU framework from a place-based perspective

Within the European Union's policy framework, the EU's Cohesion Policy is the main budgetary instrument for regional development, employment and social inclusion. In pursuing its mandate of 'reducing regional disparities' through the spatial redistribution of resources, Cohesion Policy brings with it a strong regional or place-based approach in the achievement of EU-wide overarching policy priorities. In line with the institutional structure of individual Member States, it directly involves regional and local authorities in the definition of strategic partnerships and in the co-management of resources (so-called 'shared management' principle). This governance structure plays a particular role within the EU budget. First, it allows a granular approach to spatial asymmetries when it comes to major pan-European challenges (e.g. digital divide, green deal, migration, etc.). Second, it allows a more focused targeting of resources at the territorial level. Third, it increases local involvement in the definition of policy interventions that are aligned with overarching EU objectives and policies. Fourth, it allows to tailor and adapt these interventions to local characteristics, preferences, and circumstances, which can differ quite significantly across space and time within Europe and often Member States. However, this distinct configuration of different patterns of targeting of resources, tailored to specific Member State contexts and focused on key EU priorities has created a highly complex policy in which its place-based character can be difficult to apprehend.

Cohesion policy has often been put forward as exemplifying place-based policies. Much of the literature focuses on the redistribution of resources to reduce spatial disparities (Ehrlich and Overman, 2020; Moretti, 2022; Neumark and Simpson, 2014; World Bank 2009). Here the rationale for place-based policies, beyond simple redistribution, is that fundamental market failures prevent automatic adjustment mechanisms from working effectively, so that disparities may be persistent as places get trapped in a low-level equilibrium (Venables, 2023). Other authors focus on the important role for economic development of the sub-national level (regions or localities) as well as bottom-up approaches through the involvement of various stakeholders

(Barca, 2009; Barca et al., 2012; Beer et al., 2020; McCann, 2015). Subnational tiers of government (state and local) can design and implement contextually tailored economic development strategies that reflect local socioeconomic and institutional characteristics, conditions, and realities (Rodrigues-Posé and Wilkie, 2017). A further feature of Cohesion Policy is that it has strong elements of vertical fiscal redistribution in which high-order government layers allocate funds for projects to areas in line with predefined goals (Sudekum, 2023). This until recently, with a few exceptions has not been the US approach (Cox 2020). In addition, beyond this first level between the EU and Members States Cohesion Policy has promoted vertical fiscal redistribution within Member States and programmes through a range of dedicated mechanisms and territorial strategies targeting different types of areas (cities, rural communities) and policy objectives (smart specialisation, just transition, industrial strategy). These mechanisms resemble more closely some of the recent initiatives put in place by the Biden administration.

The design of place-based policies in Europe under Cohesion Policy for the coming years will need to address a number of fundamental questions:

- What is a viable development model for high-income countries today in the context of rapid technological change, the need to integrate climate and environmental objectives, new geopolitical constraints?
- To what extent do current European growth dynamics, built essentially on competition in the Single Market and a rule-based international trading system meet the requirements of this model?
- How can the design of place-based policies address these requirements and take account of the structural barriers and market failures that prevent automatic adjustment mechanisms from working effectively to move regions out of the low-level equilibria that characterise increasing parts of Europe? In this respect three types of region are of particular interest: former industrial regions across the EU in particular linked to the green transition, other regions that have become trapped due to stagnating growth, depopulation and institutional weaknesses mainly, but not exclusively in Southern Europe, and finally fast-growing regions at risk of falling into a middle income trap in Central and South Eastern Europe.

There is considerable evidence that policies aimed at training and employment creation and spillovers from industrial and innovation investment have only partially addressed the needs of these regions. Place based policies in the future will need to be less reactive and more directed to the anticipation of change and the bottlenecks that prevent adjustment. We will also need to develop economic analysis tools and models that better capture these new growth dynamics and territorial barriers to growth.

Outline

1. *Introduction and literature survey – see above for summary*

2. *The European growth model in world perspective:*

    - In recent decades, Europe's *PCI (per capita income) growth sources* are principally:
        - Scale increases due to European integration
        - Comparative advantage effects from globalization – sectoral succession

    - *Labor –substituting automation* in consumer services and in manufacturing and other trade-able sectors – high hourly labor productivity
- Europe's PCI *growth limitations* come from:
    - Sluggish demographics
    - Low working time and short working years by world comparative standards
    - Low labor force participation in certain regions
    - Weak first-mover labor-augmenting innovation sector: Europe's big companies are too much in legacy activities and industries
- Let's compare Europe's growth model to the other developed world growth model, the USA. The USA's differences are:
    - More demographic increase than EU (labor force growth)
    - Longer working hours and working years than EU (less leisure)
    - Higher labor force participation across the life cycle;
    - Similar *labor-substituting automation* in trade-ables and standardized consumer services
    - A bigger innovation-driven sector (finance, high-tech, entertainment) with more labor-intensive "frontier work" and "new occupations" -- this is *labor augmenting innovation*
    - A bigger *labor-intensive personal services sector* driven by high incomes
    - Much higher income inequality than most of the EU

3. A narrow corridor for European growth

- All developed economies face similar technological constraints and possibilities that affect the potential for PCI growth.
- Overall, technological change has polarized labor demand between high-skill and low-skill occupations and tended to hollow out of the middle (with growing wage-income inequality the result).
- However, innovation can also *create* new forms of relatively labor-intensive employment. This comprises work that is in "new" occupations and industries that have not yet been routinized and offshored; "frontier" work that is highly tacit and involved in the work of creation and innovation itself; and older work that is "augmented" with new technology tools to become more productive.
- Innovation-driven, labor-augmenting employment growth is the main way that developed economies can dynamically compensate employment losses from labor substitution, offshoring and importing.
- The European corridor is especially narrow, because it is unlikely to augment the quantity of work through labor force growth.
- Europe is not about to abandon its social model, which impacts PCI by reducing working hours, protecting leisure and high quality of life for those who work.
- Demographics are probably not going to change– can't raise PCI this way in the short-run by increasing pop-based output.
- Labor-substituting automation is unlikely to slow down.

4. The spatial dimension to European growth

- The overall level of PCI is the population-weighted average of the PCIs for the patchwork of territories respectively, for each member state (MS) and for the EU as a whole. For example, think of two equal-sized regions: Region A's productivity/PCI index is 150 and region B's is 80, the average is 115. Each territory is contributing to the average.

- If we modestly raise Region B's index to 90, and Region A's to 160, the baseline equilibrium income potential of the national (or EU) economy increases to 125. Assume that we can do so while maintaining the inter-personal income distribution of both regions in the desired range. This is a balanced positive-sum growth pathway.
- In addition, there are limits to territorial redistribution, which has been a cornerstone of past EU cohesion policies.
- Inter-regional redistribution occurs in many ways, whether deliberately through regional policy, or implicitly through health, education, pensions, that attach to people, including mobile people across the life cycle.
- Superstar metropolitan regions already trickle-down considerable income to other regions: through fiscal redistribution that attaches to people-based and place-based formulas; through de-agglomeration of routine functions from value chains; through residential income/spending and the local multipliers from that. In some Member States, this is a very big part of the income of non-Superstar regions.
- But redistribution is limited because maintaining or improving PCI in the most dynamic regions is itself very costly in terms of fiscal-public resources. The highest-performing metro regions have non-linear ("cost disease") dimensions, such as for increasing education and infrastructure and abating congestion. There is thus an inevitable tension between super-leading regions and the rest in the attribution of fiscal public resources. This isn't inherently a zero-sum game to non-Superstar regions, unless it gets too extreme.
- Regions must be made to grow their PCI from *widely spread* productivity and employment changes, not just from redistribution or trickle down.
- In this light, convergence should no longer be the goal of place-based policies, but rather, a *growth and development contributions* from all regions, allowing all regions to increase their potential to contribute to the integrated European economy, rather than a strict convergence of incomes metric. In the European context this process has been described as "upward convergence".
- Concretely, place-based policies must be shaped so as to bring more territories into the narrow corridor for European growth, defined above, or to enhance and maintain those places that are already in it and are motors of the European economy. As we see below, in the already-prosperous regions the challenge is to maintain or enhance labor-enhancing productivity growth; but in others, raising labor force participation by generating both better labor supply and but finding activities that are generated by a more dynamic EU growth process that offer new highly productive labor roles in the face of ongoing automation and capital-labor substitution.

5. *Considering place-based policy instruments for different types of European region*

- The two main channels by which changing the employment base of a region can increase PCI are upward occupation-industry switching, and increased labor force participation. These are the channels for labor-augmenting employment growth.
- Territorially, this is already occurring in a tier of dynamic middle-sized and large cities in Europe. They benefit from high interaction with one another as well as with superstar regions. They manifest systematic urban productivity (and hence, income) surpluses. Though they are relatively well-off, they should receive additional attention as particularly feasible locations for raising employment and productivity in the EU. They are a huge target of opportunity for dynamizing the European city system.
- In addition, there is a widespread tapestry of "quality-based production" in Europe, located throughout the continent from small towns to large cities, which gives European industry competitive positions in world industries as quality (sometimes niche)

producers. Attention has been paid to supporting these decentralized innovative regions, and it should continue, to build on historical European strengths;

- Let's consider three rather more problematic cases: former industrial regions across the EU in particular linked to the green transition, other regions that have become trapped due to stagnating growth, depopulation and institutional weaknesses mainly, but not exclusively in Southern Europe, and finally fast-growing regions at risk of falling into a middle-income trap in Central and South Eastern Europe

6. *Lagging older industrial regions*

- Many of these are the less dynamic middle-sized cities/metro regions.
- They are not attractive to the skilled and the young
- They are not particularly innovative.
- There are not very many examples in EU or USA of reconverted old industrial regions: Rochester and Pittsburgh are cases, where anchor institutions, firms and networks kept innovators in place or attracted new ones. This is the key.
- Contrast the stagnant such regions to the up-and-coming places. In the USA, they are young and multicultural (Austin, the area around Denver). There are nevertheless there are also good examples in Europe at a smaller scale. (Audretsch 2015). We need to think more about how these conditions could be generated in additional older industrial regions.
- There are qualitative or perceptual barriers to renewalSome of it is perceived social openness – less conservative and closed local society might
- Some of it is objective concentration of innovation organizational tissue (firms, labs, start up conditions, higher education);
- Some of it is perception that local labour market offers limited turnover/sequential matching/experience potential;
- Thus, there is a two-fold problem: adapting the insiders, who are already there, to labor-intensive functions in the new economy; and creating a climate where outsiders want to come.
- In Europe, many regions still bear the scars of long-processes of deindustrialization. A new wave is now occurring due the phasing out of fossil fuels and restructuring of carbon-intensive sectors. There is therefore a strong focus on Just Transition in these sectors. In some Member States this discussion has been extended to sectors affected by changing patterns of demand and regulation such as the automobile industry, which remains a major employer in many more prosperous regions.

7. *Trapped regions*

- The EU has many regions that are not marked by high levels of urbanization nor distinctive high-skill regional specializations, but nonetheless offer decent PCI and standards of living
- With good infrastructure, good living conditions, and a productive and available labor supply they can become attractive for secondary positions in continental value chains….more routine functions that need to leave the areas in which they are created.
- However, the potential for doing this is in part related to making the EU economy as a whole more dynamically innovative so that there are more of such routine but highly productive functions to potentially decentralize to relatively attractive regions; enlarging the pie as well as redistributing it;
- The main local blockage is their rigid labor markets, with low LFP and the fear by employers that they will suffer labor shortages in these places should they invest there.

- Labour market reform will be key to allowing these regions to become more dynamic places within the overall European place mix.

8. *Catch-up regions*
   - Catch-up regions in accession countries unlike parts of Southern Europe, have done very well in PCI growth. In most case PCI has doubled since enlargement.
   - This is because the first stage of European integration has had immediate benefits notably through the attraction of large FDI inflows and a relatively well-educated workforce.
   - But then, many of them have hit or will hit, a middle-income development trap (similar to many Sunbelt American regions)
   - That is a much more difficult stage, because it requires order-of-magnitude changes in skills, innovation, and agglomeration economies.
   - The larger of these regions have more potential than the smaller ones: this is what the US evidence clearly shows.
   - But even the larger ones will hit a middle-income trap unless they focus on education, innovation, immigration-open-ness and social open-ness; and good governance -- the "high road".

9. Concluding remarks.
   - All in all, the principal challenges to making the EU place-based approach under Cohesion Policy more effective are to (a) focus it on growth and development contributions more than strict convergence; (b) increasing growth and development contributions by more effectively meeting the conditions of the narrow corridor at a Europe-wide scale; (c) preparing regions to take their place in the refashioned spatial division of comparative advantages that emerge from a reinforced European growth model, by addressing structural barriers to adjustment; (d) developing place-based instruments that can better address the specificities of different territorial dynamics ;(e) strengthening the link with other policy areas such as industrial strategy, innovation and labour market regulation; and (f) developing new economic tools and models to better support policy.