THE ECONOMIC, SOCIAL AND TERRITORIAL COHESION IN THE EUROPEAN UNION

THE EIB'S ROLE IN A REVISED POLICY FRAMEWORK

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1. Introduction: A decisive decade for the European Union

Before entering into the core of my lecture, let me widen the scene and mention some major themes of action for the European Union in the coming years. A first challenge is the implementation of the Lisbon Strategy, introduced in 2000 and subject to a recent review by the European Council of 22 and 23 March 2005. It has always been my strong view that the substance of the Lisbon strategy is key for the future of Europe and its citizens. Second, the accession of ten new Member States to the European Union is creating new challenges and opportunities that have to be reflected in the content and structure of the various European policies. This concerns in particular the design of the new European cohesion policy to be operative between 2007 and 2013. Finally, I would like to mention the decisive and growing importance of environmental issues. This includes the realisation of the EU environmental engagement associated with the Kyoto protocol entered into force on 16 February 2005, following its ratification by Russia.

General economic conditions will be important but the achievement of these priorities is also depending on the outcome of the on-going discussions on the new financial perspective for the next programming period 2007 – 2013 and on the result of the ratification process of the EU constitution by the various Member States.

These various challenges are emerging at a time when the European economy and society are engaged in structural changes and restructuring process affecting the competitiveness of Europe and the well being of European citizens. Persistent unemployment, growing inequality between both individuals and European regions and the phenomenon of industrial delocalisation might affect the solidarity across regions and across generations.

In this new environment, how to ensure that the new European Cohesion policy will contribute in a significant way to a greater convergence across regions, to a better cohesion among individuals and territories; and to the strengthening of European competitiveness and growth? And what could be the contribution of the European Investment Bank to the achievement of the EU economic, social and territorial cohesion?

2. Cohesion in a wider Union: The constitutional basis

The proposed constitutional Treaty offers a revised basis for the EU Cohesion Policy, with the inclusion of the notion of territorial cohesion as a EU objective under the same heading as economic and social cohesion. The proposed European constitution stipulates in Article I-3 that the Union "shall promote economic, social and territorial cohesion, and solidarity among Member States".

More precisely, in its Article III-220, the proposed European constitution states that "In order to promote its overall harmonious development, the Union shall develop and pursue its action leading to the strengthening of its economic, social and territorial cohesion. In particular the Union shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions.

Among the regions concerned, particular attention shall be paid to rural areas, areas affected by industrial transition, and regions which suffer from severe and permanent natural or demographic handicaps such as the northernmost regions with very low population density and island, cross-border and mountain regions".

3. An evolving Policy framework

3.1. The current 2000 – 2006 Cycle

The existing framework for the EU Cohesion policy

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covers the period 2000 – 2006. The main policy instruments are the Structural funds – European Regional Development Fund (ERDF), European Social Fund (ESF) and European agricultural Guarantee and Guidance Fund (EAGGF) – and the Cohesion fund[1], channelling important grants to key infrastructures and sectors in order to foster convergence across regions and to come along with economic restructuring in less advantaged regions.

For the current programming period 2000 – 2006, the Community action aims to achieve the following three key priority objectives:

- **Objective 1:** Promoting the development and structural adjustment of regions lagging behind;
- **Objective 2:** Supporting the economic and social conversion of areas facing structural difficulties;
- **Objective 3:** Supporting the adaptation and modernisation of policies and systems of education, training and employment.

I would like to stress that under the coverage of the current programming period, all new Member States have been designated as Objective 1 areas, except for a few areas with a higher level of income that have been classified as Objective 2 regions (Cyprus, Prague and Bratislava). The Structural Funds and the Cohesion Fund will ensure the continuity of EC support allocated through the pre-accession instruments (Special Aid Programme for Agriculture and Rural Development (SAPARD) and Instrument for Structural Policies for Pre-Accession (ISPA)).

3.2. Preparing for 2007

The proposed reforms of the EU Cohesion Policy pursue the following objectives. Structural actions should be more targeted on the EU's strategic priorities, namely the Lisbon and Gothenburg Strategies for a sustainable and competitive knowledge-based economy and the European employment strategy. Resources should be more concentrated on the least favoured regions while anticipating changes in the rest of the Union. Finally, the implementation of structural actions should be more decentralised to integrate in a more responsive way local needs and preferences, in a simpler, more transparent and more efficient implementation framework.

The general Proposal for a Council Regulation[2], presented by the EC, laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund defines the objectives and priorities of the new Cohesion Policy and their field of application. It then establishes the principle and process of the programming, and the procedures of management, monitoring and control. In this new framework, the role of the EIB and of its subsidiary the EIF in the implementation of the Cohesion policy remains crucial and is defined in the Article 35[3] of the proposal of new regulation. In this Article, there is also an explicit reference to the possibility for an enhanced collaboration between the EIB and the European Commission. I will come back on this issue later on given the importance of such collaboration for the value added of the EIB contribution in the implementation of the Cohesion Policy.

In operational terms, the new approach for the next programming period 2007 – 2013 is structured around three priorities.

The **convergence objective** is directed to supporting less developed Member States and regions of the EU-25. The focus will be on the modernisation and increase in physical and human capital to strengthen long-term competitiveness and foster environmental sustainability. Additional emphasis would be placed on research, innovation and risk prevention. It replaces the existing Objective 1 measures and will be funded by the ERDF, the ESF and the Cohesion fund. Eligible regions are the ones in which the GDP per inhabitant is less than 75%, the ones affected by the statistical effect and outermost regions. Cohesion fund will be directed to countries whose GNP is less than 90% of the Community average.

The **regional competitiveness and employment objective** covers the other Member States and regions, i.e. the ones not covered under the convergence objective, in accordance with the proposal presented by the Member States and the current Objective 1

[1] The Cohesion Fund as such, which only exists since 1993, has a national rather than regional focus and targets those Member States (Greece, Spain, Ireland and Portugal) whose GDP per capita, expressed in purchasing power parities, is lower than 90% of the EU average and that are following a programme of economic convergence.

[2] European Commission (2004), Proposal for a Council regulation laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund, presented by the European Commission.

[3] More precisely, in its Article 35, the participation of the EIB and of the EIF is defined as follows: "1. The EIB and the European Investment Fund (EIF) may participate, in accordance with the modalities laid down in their statutes, in the programming of assistance from the Funds. 2. The EIB and the EIF may, at the request of Member States, participate in the preparation of national strategic reference frameworks and operational programmes, as well as in activities relating to the preparation of major projects, the arrangement of finance, and public-private partnerships. The Member State, in agreement with the EIB and the EIF, may concentrate the loans granted on one or more priorities of an operational programme, in particular in the spheres of innovation and the knowledge economy, human capital, the environment and basic infrastructure projects".

regions no longer eligible as a result of their economic progress. Funding will be concentrated on policy priorities linked to the Lisbon and Gothenburg agenda and with the European Employment Strategy. Funding will be provided by the ERDF and the ESF.

The **European territorial cooperation objective** is organised on the basis of cross-border and transnational programmes. The focus will be on the promotion of exchanges of experience and good practices, contributing to economic integration across European territories, and to a harmonious and balanced development of areas divided by national borders.

For this redesigned Cohesion Policy, the Commission proposed a financial support estimated at EUR 336 billion (in other words one third of the Community budget), representing an increase of 33% compared to the current programming period. The final amount allocated to cohesion objectives will depend on the outcome of the negotiation on the financial perspectives for the forthcoming programming period 2007 – 2013.

4. Cohesion policy in action: The need for a multidimensional notion

At an operational level, the combination of these different elements requires the implementation of a multi-dimensional policy to support a balanced development, integrating economic, social and territorial objectives in a sustainable way. An extended notion of the concept of 'capital' should be mobilised, going beyond the single concept of 'financial capital', the latter being defined as the capacity of financial markets to steer finance to worthy innovation and to provide funding at appropriate conditions. An integrated strategy should optimise the contribution of a set of different forms of capital, going from the traditional physical capital to more intangible forms of capital. The purpose here is to avoid the emergence of potential bottlenecks which would reduce the growth potential of a country or a region.

Let me try to explain briefly each form of capital starting with the tangible ones. The physical capital corresponding to private physical capital and public infrastructure remains an important factor to support economic growth and cohesion. Adequate transport and communication infrastructure are important factors affecting the attractiveness of a region.

Moving now to more intangible forms of capital let me start with the well-known concept of human capital developed by Gary Becker[4], winner of the Nobel Prize in 1992 for having extended microeconomic analysis to a wide range of human behaviour and interaction, including non-market behaviour. Accumulation of human capital is crucial to economic prosperity. Although this idea is fairly old, it is currently gaining a lot more of attention among economists and decision-makers. It corresponds at the individual level to abilities, education and training and at society levels to the aggregate stock of human capital. As you know, technological and organisational evolutions observed in industrialised countries make high-skilled individuals more important than ever. It implies that the acquisition of knowledge and skills by individuals in a lifelong perspective affects their professional development potential and hence contributes to their social integration and personal peak.

In parallel to the development of the notion of human capital, the concept of social capital has emerged, based on the works from Robert Putman[5] in the US. It tries to capture the impact of social networks on local development. Social capital includes networks, norms, rules and social values (trust…) representing collective human values and relations. The novelty of this approach is to consider sociability and associational participation, norms, shares values and trust, as a stock of capital at the macro-social level and to raise it as an important principle able to explain multiple economic and social phenomenon. Social capital may be high in safe and supportive, friendly and tolerant, creative and open societies. It stresses the importance of the social characteristics of the population living in a given area, and of the level of existing social cohesion on the potential attractiveness of a territory.

Finally, I would like to mention the fact the existing cultural context could affect the dynamism of a region through its impact on entrepreneurship and innovation. Differences exist between European regions in terms of their ability to start new businesses based on product and process innovation, in terms of the availability of an efficient innovation system favouring the cooperation between research institutions and firms, or of the existence of a pool of risk-taker entrepreneur.

The efficient mobilisation of these different forms of capital requires a strong administrative and institutional capability embedded into a stable macroeconomic context. The design and implementation of national or regional cohesion policies rests on the existence of efficient and of high quality public insti-

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[4] Becker G.S. (1964), Human Capital, Columbia University Press, New York.

[5] Putman R. (1993), Making Democracy Work, Harvard University Press and Putman R. (2000), Bowling Alone: The Collapse and Revival of American Community, Simon and Schuster.

tutions, on a strong partnership and cooperation between the different stakeholders (private companies, social partners…).

To illustrate the role of institutional capability, let me refer to the Irish example. The various studies trying to identify the source of the strong growth of the Irish economy stressed the crucial role of the Industrial Development Authority (IDA) in the design and implementation of a supportive industrial strategy favouring foreign direct investment via the creation of adequate telecommunication and transport infrastructures, of an attractive administrative, fiscal and social climate; while at the same time promoting a reactive education and training policy to adapt the available skill supply to the need in workforce (in qualitative and quantitative terms) of foreign firms and local suppliers. This strategy has been implemented in parallel with the improvement and stabilisation of the macroeconomic environment of the country, namely in terms of control of public-sector deficit and inflation level.

5. The European investment Bank's contribution to economic, social and territorial cohesion

Until now in this lecture, I have addressed and discussed the content of the existing and future European cohesion policy and why there is a need to refer to a multi-dimensional notion of capital to ensure an efficient operational implementation of such a policy. I would like now to introduce in this picture the role of the European Investment Bank and explain how the EIB has progressed in its vocation as a EU policy-driven public bank. This concept reflects the result of an intensified on-going dialogue with other European institutions with the purpose of optimising the value added of the EIB contribution to the objectives of the European cohesion policy.

5.1. Supporting cohesion in an enlarged Europe, a priority for the EIB

Since 2000, corresponding to the start of the current programming period, the volume of lending in assisted areas within the EU-15 represented around EUR 82 billion. Within the EU-25 countries, individual loans (loans for individual projects appraised by the Bank) worth EUR 21.5 billion were granted in 2004 for investment contributing to the strengthening of the economic potential of assisted areas. A further EUR 7 billion was made available as credit lines (global loans) to partner banks for the financing of SME ventures and smaller-scale public investment. The total lending of EUR 28.5 billion for regional development represents some 72% of the EIB's aggregate lending within the EU-25.

The main sectors of lending in regional development areas were transport and telecommunications infrastructure (accounting for 39% of the individual loans granted), investment in industry and the services sector (20%), urban infrastructure (14%) and health and education infrastructure (11%).

The experience of the EIB in the financing of projects and programmes supporting greater economic, social and territorial cohesion allows me to emphasize the following aspects. First of all, the design of regional strategies should integrate the different notions of capital and the identified enabling factors to overcome potential bottlenecks, which I have discussed in Section 4.

In the second place, the initiatives and measures implemented at a regional level should be integrated into a long-term sustainable perspective. This principle is at the core of the EIB's intervention and it is completely integrated in our operational approach. The selection of the projects financed by the EIB is based on criteria that should maximise the value added of our action. The quality of a project rests on three pillars of sustainable development: the economic, social and environmental dimensions. The selectivity in the financial contribution we are adding to projects concerns all sectors of intervention of the EIB, from traditional infrastructure projects, industrial projects, human capital or urban projects.

Finally, the implementation of global strategy to foster local and regional development should be based on a strong partnership involving an active participation of the various stakeholders engaged in this process. The EIB's experience in the co-financing of regional investment programme demonstrates the need of having adequate partnership mechanisms, based on a clear definition and allocation of responsibilities between each partners and on the implementation of appropriate mechanisms to ensure accountability and transparency.

Although bound to increase the complication of the decision-making at the preparation stage, consultation and inter-governmental partnership should secure a good integration between bottom-up and bottom-down decisions and reduce the probability of conflicts at later stages in the implementation process. I would like to insist on the need to achieve a trade-off between the additional complexity resulting from partnership and the improvements in design and implementation, which it can bring.

Some of the new financial instruments are fully developed in-house. The EIB develops its capacity to grant loans containing a higher lending risk than under its standard rules. The specific provisioning reserve for operations under what we call the Structured Finance Facility (SFF) has accordingly been increased. The further development of lending under SFF is among our clear priorities for the coming years. Such operations can also cover small or medium sized operations. They typically arise when financing innovative SMEs or mid-cap companies, which count among the drivers of new technologies and favour the development of regional centres of excellence, in particular when developing as spin-outs from universities, incubators or research centres, or under sub-contracting arrangements with larger corporates.

Other efforts to define new financial instruments aim at increasing the leverage between loans and grants (typically from EU, but also of national origin). EIB is actively brainstorming with the Commission to develop a "toolbox" of financial engineering instruments (including risk sharing and mezzanine-type arrangements). They could go into the new framework programmes for the programming period 2007 – 2013.

In this framework of promoting a closer collaboration between the services of the EIB and of the EC, I would like mention discussions currently engaged with DG Regio about a potential new partnership initiative. Final agreement has to be reached but I think this partnership, if effective, can have an important potential to the benefit of all concerned actors. The name considered for this initiative is JASPER – Joint Assistance in Supporting Projects for European Regions and I am confident we will hear more about it in the coming months. The underlying rationale is to ensure a better project preparation and implementation of the measures financed by the EU structural funds; and a fuller appraisal of the EU Funds' key interventions ("large projects") after 2007 by having a systematic and institutionalised recourse to the EIB's know-how and experience.

This evolution is also reflected in the approach pursued by the EIF. The EIF is increasing its upstream activities by being more involved in new advisory services/technical assistance in financial engineering, for instance helping regional public authorities to design appropriate financing schemes for SMEs and start-ups.

To optimise the value added of the European support, it is crucial to develop in parallel with project preparation works a culture of evaluation. Our experience demonstrates that to ensure an efficient implementation of the projects the implication of the EIB's services should follow and be modulated along the life cycle of the project. An adequate monitoring system should be implemented to evaluate the impact of the different measures on economic development, social cohesion and territorial integration. It requires the definition of appropriate indicators and the generation of relevant information on the progress of the implementation of the projects and programmes. Based on the outcome of the evaluation and monitoring exercise, adjustments could be implemented during the programming period to reallocate resources in favour of certain sectors, not benefiting from a sufficient support or level of priority. This continuous process should contribute to increase the value added of the initiatives benefiting from EU funding and will provide meaningful information for the design of future Cohesion policies.

I am very pleased to see that this important aspect has been integrated by the EC in the content of the future European Cohesion policy.