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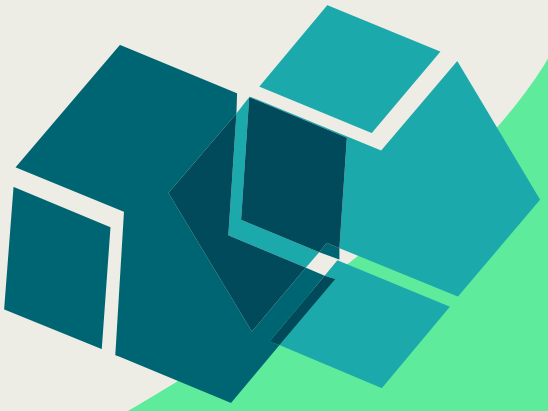

Policy Paper No. 1

Rationale and Design of EU Cohesion Policies in a Period of Crisis with special reference to CEECs

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Rationale and Design of EU Cohesion Policies in a Period of Crisis with special reference to CEECs

Abstract

The aim of the paper is a reflection on justifications and proper design of cohesion policies in a period of deep economic recession. In particular, the paper tackles two important topics. The first deals with the justification for EU regional policies in a period of economic downturn, since they may look less urgent and appropriate than short term demand policies. Instead, as the paper argues, the crisis exerts considerable pressure on several EU countries, and may even, in the worst case, jeopardize two decades of efforts towards EU enlargement and cohesion. In this condition, regional policies are called to rebalance the spatial effects that the ongoing crisis is determining on interregional convergence trends. The second topic relates to the most appropriate design that cohesion policies should follow. The message that the paper conveys from a conceptual point of view, corroborated by empirical results, is that the winning strategy is neither to focus on champion places and regions, in search of the highest efficiency, nor on lagging areas, in search equity; policies designed on each regions' specificities, competitive advantage and needs are the right policies, able to engage all possible assets and enlarge excellences. This pathway at the same time avoids the social and economic costs of a concentrated development and guarantees the highest returns in terms of both competitiveness and cohesion. At the end, suggestions are proposed on how to respond to the specific and particular challenges that New Member countries of the EU are facing now, on the basis of the previous conceptual and empirical evidence.

Content

1 Introduction

The paper addresses some important issues concerning cohesion policies that became most stringent in recent years: how can cohesion policies be justified in a period of crisis when short-term, anti-cyclical policies intended to boost internal demand may look more appropriate than structural and supply-side ones? Which space remains for cohesion policies when macro-economic policies impose strict controls over sovereign deficits and debts? How have cohesion policies to be designed in order to provide the highest returns in terms of both competitiveness and cohesion?

A large debate was recently launched on all these issues. A profound renewal in the design and delivery of EU structural funds 2014-2020 has taken place, with new rules and conditionalities mainly linked to the Barca Report (2009) and to the Smart Specialization approach (McCann and Ortéga, 2009 and 2014).

The specific aim of the paper is to add some new elements to this debate, related to the particular period of economic crisis. The crisis, which started mainly in the financial context and then hit the 'real' economy, brings financial issues back to the forefront, with the difficulties, costs, and risks generated by the financial speculation on sovereign debts and the necessity for tight fiscal policies. This obviously implies a much narrower path out of the crisis, as: i) public funds allocated to structural, long-term, objectives are limited and have to be more carefully justified and ii) the assumed traditional trade-off between competitiveness and cohesion goals is strongly back in the policy debate, generally attributing a higher priority to the competitiveness issue.

More than before, the justification and design of cohesion policies require additional thinking and conceptual reflections, nourished by scientifically-based empirical evidence. This paper is an attempt in this direction.

2 Main challenges and justification for a renewed regional policy strategy

Due to the increasing difficulties that territorial approaches towards development encounter nowadays, a theoretical reflection on the economic rationale for a territorial approach to development is in order. This rationale may be found in the following elements:

A. In a context of international integration, especially in the earlier periods, market forces determine concentration of activities and an increase of regional disparities (Williamson, 1965). This is due to the cumulative nature of development processes (Myrdal, 1957) and the limited capability of spontaneous adjustment processes to rebalance differentiated regional starting conditions (Capello, 2007, ch. 4). In periods of crisis, these processes are enhanced by the higher resilience and reaction capability of stronger regions . Are these spontaneous trends an acceptable or a desirable outcome?

B. The absence, in an inter-regional context, of some powerful macroeconomic adjustment mechanisms that work at the level of countries (devaluation of currencies, flexibility of prices and wages) and that are able to guarantee each country a role in the international division of labour, according to the well-known Ricardian principle of comparative advantage. These mechanisms and policy tools are not present at the regional level and, whenever a region presents lower rates of productivity growth with respect to other regions or other structural deficits (e.g. in accessibility), its fate is out-migration and even, at the extreme, 'desertification'. All this can be summarized in the statement that regions compete according to a Smithian principle of 'absolute advantage', not to a Ricardian principle of 'comparative' advantage

(Camagni, 2002) and confirms that the trend towards increasing disparities inside each country is the most likely outcome.

C. The evidence of huge economic costs of non-intervention in a context of increasing disparities and globalization provides even clearer support to spatial development policies. A strategy of non intervention in fact presents the following drawbacks (OECD, 2001, ch. 1; Camagni, 2001):

- the risk of a super-concentration of population and jobs in advanced regions and cities, with high risks of inflationary pressures. This happened in many EU countries after joining the Union: Italy in the early 1960's, Spain and Ireland in the 1990's; the New Eastern Member Countries in the mid 2000's;
- the high opportunity cost of adding new activities in already successful areas. In a context of full employment, new workers for new activities are found at the expenses of existing activities – therefore, at a cost - while in weak areas, characterized by high unemployment, they are drawn from the unemployment reservoir, and their opportunity cost is close to zero;
- the channeling of a wide share of national savings towards the building and construction industry and real estate speculation in advanced regions and cities, as a consequence of the migration processes, subtracting it from more productive uses;
- a lower exploitation of the creativity potential of all regional communities constrained by the presence of some basic locational disadvantages (accessibility, services, infrastructure).

Other justifications can be further proposed in favor of cohesion policies, and they refer to the fact that 'territory matters' in the development process. In fact:

D. Globalization has taken to the fore the growing importance of spatial proximity, not in the sense of a shelter to the benefit of local markets and communities but in the sense of the growing importance of local conditions for global economic success – the so-called 'localization' issue. Territories not only supply the infrastructure and service preconditions for successful location decisions and the skills and competencies needed for economic growth, but represent a crucial stock of non-mobile social and 'relational' capital. These assets are crucial as they may counterbalance the apparent 'hyper-mobility' of some other, globalised production factors, like financial capital (OECD, 1999).

E. The increasing importance of knowledge factors, of immaterial elements linked to culture, taste and creativity in present economic processes are deeply embedded into slow, localized learning processes, fed with information, interaction, long term investments in research and education. These new and more qualitative aspects of the present international economic picture, makes space, or, better yet, 'territory,' enter the economic development scene as key players. Learning processes are inherently localized and cumulative, as they are embedded in human capital, interpersonal networks, specialized local labour markets and local innovative milieux (Camagni, 1991; Camagni, Maillat, 2006).

F. General institutional conditions operating at the national level are crucial. For instance, we can think of factors such as the regulation of the labour market, market transparency and risk control in financial markets, market openness (antitrust practices), fiscal homogeneity (across countries), etc. However, as shown by Armstrong and Taylor (2000), spatial characteristics and local and regional institutions also play a major role in speeding up or hindering the economic

transformation process, and therefore they should be attentively considered by regional development policies.

G. Social and economic cohesion (in other words, 'equity', as it was called in previous decades) represents one of the main political goals of any society and this was authoritatively assumed as one of the founding principles of the European Union. Recently, however, another goal, namely 'efficiency' or aggregate 'competitiveness', has become increasingly prominent (World Bank, 2009). Yet, the relationship between the two goals was never explored in depth: a clear trade-off was often hypothesized and the positioning on this equity/efficiency trade-off was felt as the main task of the political sphere. But further theoretical reflections have put into question the very existence of this trade-off, emphasizing both the aggregate development effects of sound spatial development policies and, on the other hand, the economic and social costs of an unbalanced development process (OECD, 2001, ch. 1 and 6; Camagni, 2001). Many of these reflections could be worth reconsidering.

H. Spatial policies traditionally found their justification in the evidence of multiple cases of 'market failure' in the allocation of resources (spatial and land resources, physical and financial capital resources, etc.) in a general framework of static optimisation. Nowadays, after drastic economic transformations in most of the world – from agriculture to industry, to tertiary activities, to information, knowledge and control activities – the general framework is one of dynamic optimisation, requesting the capability of providing the conditions for fast transformation of local economies and for a quick transfer of resources from declining to 'sunrise' functions (Camagni, 2001). A new crucial task is therefore assigned to regional development policies.

I. Finally, the restrictions to macroeconomic and fiscal policies imposed to highly indebted countries exert an influence on regional disparities, as it will be shown in the following section.

3 Macroeconomic conditions and regional disparities in the EU

The analysis on the impact of macroeconomic constraints on regional disparities is something new in the panorama of regional studies, and is worth some in-depth reflection, focusing on the crisis period.

Macroeconomic trends and policies are likely to generate asymmetric and differentiated regional impacts, especially in periods of financial turmoil and sluggish development, for many reasons. The first, and most straightforward reason lies in the fact that regions belong to different countries, and countries show a diversified resilience to economic downturns because of the different levels of sovereign debt, different public deficits, and therefore different availability of public resources to be devoted to growth policies and regional support. Countries belonging to a monetary union have a further disadvantage, as they cannot rely on a powerful policy tool – though risky and effective only in the short term – such as the devaluation of the currency. This implies further difficulties for countries experiencing a lack of economic competitiveness or an insufficient increase of internal productivity with respect to the other member countries. All this is responsible for some strong and well visible 'country effects' in the map of regional performance in Europe after 2007 (as it will be shown later) and for the re-emergence of the role of national elements and specificities in the global development debate.

The second reason is more subtle and refers to more selective spatial effects. While supply-side elements, related to the structural characteristics of single areas and to the different availability of territorial capital (Perloff et al., 1960; Camagni, 2009), are an immediate and logic explanation for the differentiated spatial impacts of the crisis (Gorzelak and Goh, 2010), the same cannot be said for

the demand-side, macroeconomic elements that – at first glance – are not expected to generate asymmetric effects at regional level. And yet, they do.

Let us consider the most relevant macroeconomic effect of the financial crisis, namely the widening of the spread – the risk premium requested on public bonds with respect to riskless bonds – that hit many European countries in 2011-12 as international markets associated a higher probability of default to wide government debts coupled with poor growth capability. The increase in the spread in some problem countries – Italy, Spain, Greece, Portugal, Ireland – generated three, spatially selective, macroeconomic effects:

1. a strong control on, and reduction of, public expenditure was imposed by the EU, with stronger likely effects on regions relying more on public demand, being generally the poorer and less productive ones;
2. private investments decreased as a consequence of the increase in interest rates on private loans and bonds, penalizing private actors, and particularly industrial regions with large shares of SMEs;
3. a credit crunch came as a consequence of the financial intermediaries' decision to prefer investing on public bonds rather than on the private sector, when sufficient guarantees existed against possible sovereign default; the real sector and the highly productive but financially fragile SMEs were most strongly hit.

A temporal breakdown of the crisis period in different phases is necessary here. In the first phase 2007-09, when the crisis was associated with real estate mortgage bankruptcy, negative regional effects were easily expected in presence of financial activities, directly or indirectly related to real estate, and of an hypertrophic and overvalued building and construction sector. In a second phase, 2009-11, the crisis rapidly involved the real sector through the shrinking of global demand, hitting mainly export-oriented, industrial regions. In a third phase, 2011-13, the crisis hit again the financial sector as a consequence of the international speculation on sovereign debts of the above mentioned countries and the exposure of large financial institutions with public debtors. The credit crunch that followed extended the crisis from exposed sectors to residential sectors (building and construction, commerce) and cumulatively hit internal consumption and demand for investments. Industrial regions joined the less developed ones in unemployment growth and loss of GDP potentials (Capello et al., 2011).

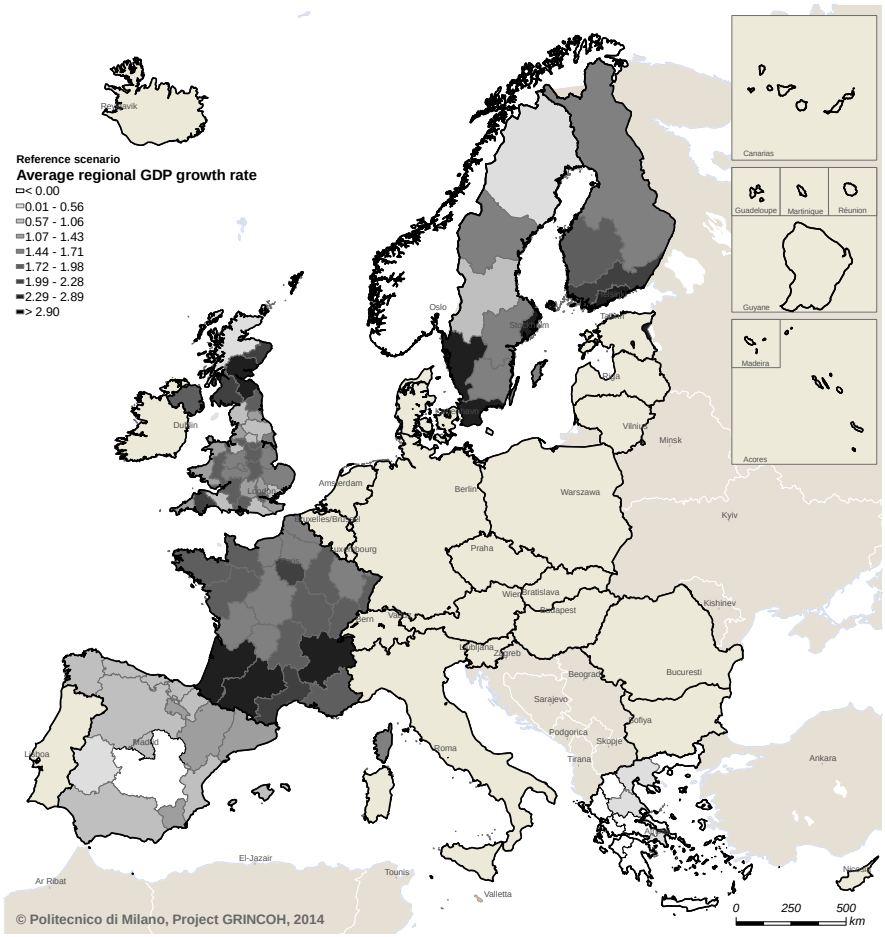
The overall outcome is a highly complex one. In all European countries, international, export-oriented regions certainly suffered from the decrease in world demand, but if they could count on a strong supply structure they were able to more easily recover. Peripheral and agricultural regions were more protected from the decline in international trade but, at the same time, suffered more from a weak and less flexible supply structure, unable to react to the structural changes brought about by the crisis, re-launching their dependence on public transfers and support.

Regional forecasting models, well structured in order to include both regional supply-side assets and national, demand-side macro-economic elements, could assist in disentangling the single different logical chains leading from macro-economic constraints to regional impacts in the recent past, and in building an ex-ante picture of the likely macroeconomic trends out of the present crisis and their regional distribution. A recent simulation exercise was recently carried out in the ESPON - ET2050 project, based on a model of this kind, called MASST (Capello, 2007; Capello et al., 2008, Capello et al., 2011). The last version of the model, MASST3 (Capello et al., 2013) warrants particular attention since it is particularly apt: i) to measure the costs of austerity and growth measures, and their

interactions and feedbacks, both in periods of crisis and of economic expansion; ii) to interpret the heterogeneous regional effects that the economic downturn and the subsequent expected recovery are likely to generate.

The results of the 'Baseline' scenario are presented in Figure 1 in terms of annual average regional GDP growth rate in the 2012-2030 period. The scenario was developed under the assumptions that present restrictive fiscal policies will not be relaxed (keeping the present 3% of allowed yearly deficit over GDP), that the existing monetary tools in the hands of the European Central Bank will continue to discourage international financial speculation, that no new policy tools (like Eurobonds) will be implemented, that cohesion policy budget will be maintained at present levels and that the crisis will end starting from 2015-16.

Figure 1. Average annual regional GDP growth rate forecasted by the MASST3 model, baseline scenario, 2012-2030



The model's conditioned forecasts ('foresights') show that GDP growth will be positive in all European regions, with the exception of a very limited number of regions in southern Europe. Moreover, in terms of GDP growth rate, a two-speed Europe appears, since regions belonging to southern countries grow in general significantly less than northern countries. Finally, the convergence process by New12 countries remains incomplete: Eastern European countries still grow more than the others, but not enough to catch up with the GDP per capita levels of the Western countries by 2030.

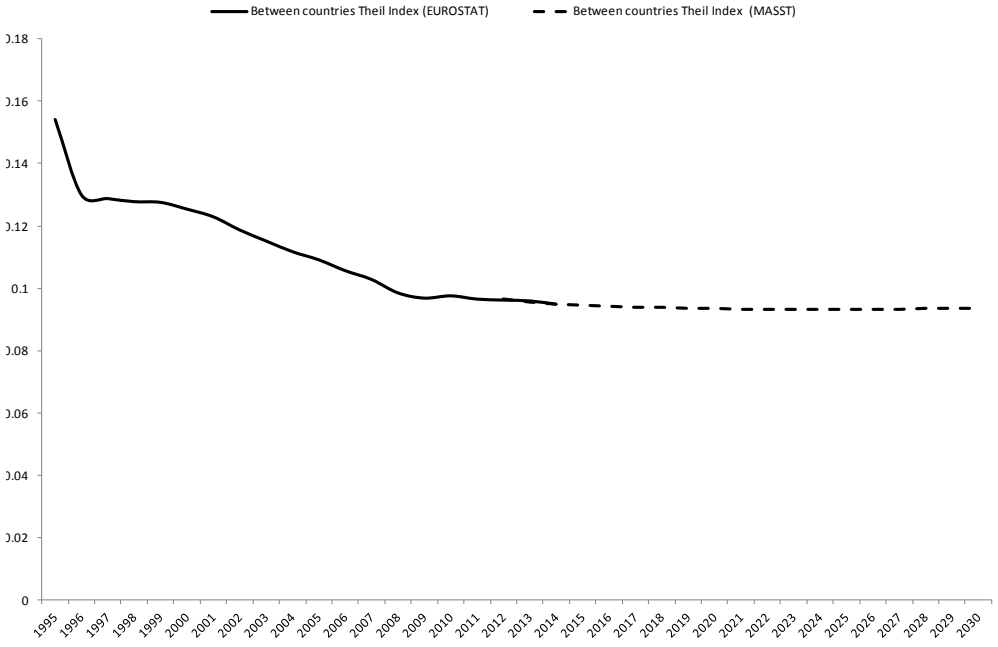
These simulation results confirm that the crisis has permanent effects, and considering the business-as-usual nature of the simulated scenario presented here, they demonstrate that the 15 years of post-crisis (2016-2030) are not sufficient to fully counterbalance the negative trend experienced in

the years of crisis (2008-2015). In fact, results point to a striking persistence of the relative slowdown of Mediterranean countries with respect to Central and Northern ones. This also holds for some peripheral areas in Spain, and especially in Greece, where an even negative (although modest) GDP growth rate is maintained for the simulation period, as a result of both out-migration and poor productivity performance. Greece seems to be paying the direst cost in this scenario, and in the absence of more expansive policies, most Greek regions would not fully recover from the current contraction of investment and consumption.

A first important message comes out of this simulation exercise. In the absence of policies able to correct the current imbalances, the growth engine looks unable to overcome the damages caused by a long period of downturn.

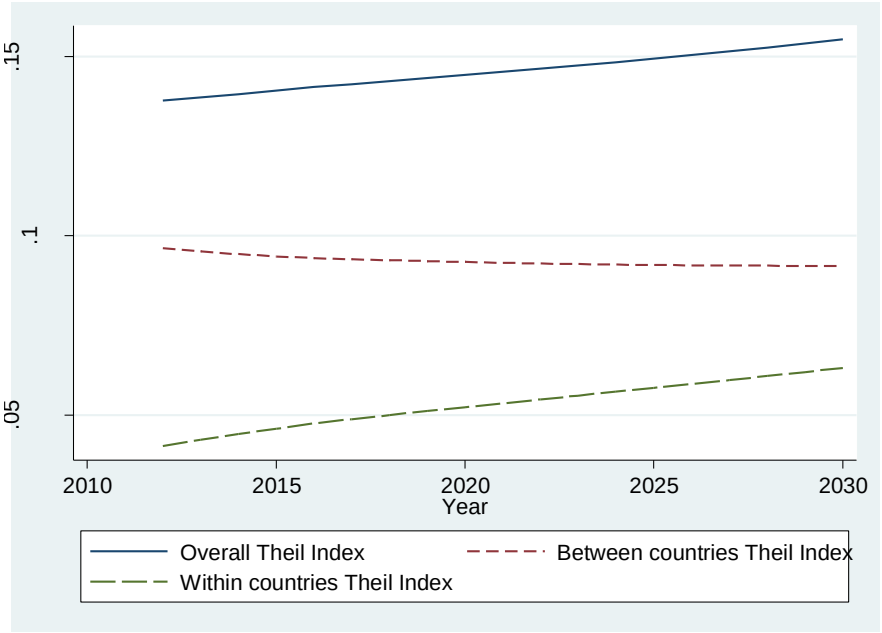
This is not all. Looking at the spatial imbalances caused by the crisis, it appears that the lack of adequate development policies risks to jeopardize two decades of efforts towards EU enlargement and cohesion. By looking at between-countries disparities in GDP (Figure 2), where the values of the Theil index are plotted for the period 1995-2012 on official statistics and then up to 2030 on modeling forecasts, it appears quite evidently that the long-run convergence process was interrupted during the crisis and that it is likely to slow down substantially now on. Its sluggish pace will be insufficient to counterbalance the forecasted increase in inside-countries disparities (that was also observed in past decades), so that the index of overall regional disparities is expected to increase from now to 2030 (Figure 3). The simultaneous process of inter-national convergence slowdown and of regional concentration implies a superior challenge to future cohesion policies.

Figure 2. Convergence interrupted: past and expected inter-national disparities in the EU Theil index 1995-2030



Source: Authors' elaboration (Eurostat and ESPON ET2050 Project)

Figure 3. Expected regional disparities in the EU: Theil index on overall, between-countries and within-countries disparities, 2012-2030



Source: Authors' elaboration (Eurostat and ESPON ET2050 Project)

4 Competitiveness vs. cohesion: a traditional and possibly outdated trade-off

If regional policy finds a strong rationale and justification not just on equity grounds, as it was shown in Section 2, its relation and widely assumed opposition to economic development policy should be carefully revisited.

The trade-off between competitiveness and cohesion, or, in an older lexicon, between efficiency and equity, is not at all a new theme; in fact, it has always characterized the European scientific and policy debate, calling for opposite views on the best policy strategy (Armstrong and Taylor, 2000; Capello, 2007). A strategy favoring the highest returns on investments on core and 'champion' areas, in order to achieve the highest aggregate growth rates and obtain highest fiscal revenues on which redistributive policies can rely, has often been conceptualized as the most appropriate, especially in periods of general crisis (Sapir, 2003; World Bank, 2009). The opposed strategy, oriented towards support to lagging regions, was traditionally advocated mainly for social equity and cohesion goals, but more recently also on the ground of its contribution to growth, when competitiveness of these regions is taken up as its main target (EC, 2005, 2008, 2009; Barca, 2009).

In the presence of particular scarcity of public funds as in the present crisis period, the trade-off of policy goals has come to the fore once again, pushed by the necessity to find the most efficient allocation of public funds in terms of economic development effects.

Theoretical reflections have already put into question the very existence of this efficiency/equity trade-off, emphasizing both the aggregate development effects of sound spatial development policies and, on the other hand, the economic and social costs of an unbalanced development process (OECD, 2001, ch. 1 and 6; Camagni, 2001). In line with these already existing reflections, our impression is that the trade-off between competitiveness and cohesion may be considered a misleading (and old) approach to territorial policies.

That modern spatial development policies should be designed so as to maximize the collective returns to public investments is a right and shared idea. However, this goal is not necessarily

reached through investments in strong areas, but through the capability of single policies to mobilize and "tap" previously "untapped" assets of territorial capital, and use them in the most efficient ways. The aggregate development effects will be in this way maximized, and at the same time the economic and social costs of an unbalanced development process kept under control.

As the Community Strategic Guidelines for Cohesion Policy have rightly and trail-blazing pointed out (EC, 2005), the preconditions for development widely lie in a hugely differentiated and scattered endowment of "territorial capital", made up of natural and artificial specificities, varied settlement structures, cognitive and relational assets at different degrees of complexity and development. All these elements – especially those that are not yet fully or creatively exploited –represent the assets and potentials on which any development strategy should rely.

Centralized, top-down development strategies, overlooking regional specificities, explicitly renounce to support and exploit the strategic capabilities of intermediate institutional bodies, both public and private, that are present in a dispersed way in all territories – repeating in a different context the limits of centralized planning habits stigmatized by Friedrich von Hayek (1978). These decentralized bodies are the best fit for interpreting the potential assets present in each territory and for generating, through a bottom-up 'discovery' process, the agreement on necessarily differentiated and 'place-based' development strategies (provided that the right incentives, rules and control systems are delivered from the centre) (Coffano and Foray, 2014).

The suggestion of policy design driven by the needs and based on the specificities of each territory is in line with new recent policy concepts like constructing regional advantage (European Commission, 2006; Asheim et al., 2011), platform policies (Harmaakorpi, 2006; Cooke, 2007), place-based development (Barca, 2009) and smart specialization (Foray et al., 2009, 2011; Morgan, 2013) that have recently been proposed. Though there are differences between the various policy concepts, what they converge to point out is that each region hides its own growth potential in its specific industrial and institutional past, its capital assets, and that it is the task of local stakeholders to build strategies and design appropriate projects to be supported by the EU regional policy (Boschma, 2013).

The need for place-based policies is strongly felt in the field of innovation policies. Traditionally devoted to achieve a "smart growth", inevitably investing mainly in strong areas, innovation policies have been recently forced to move away from the previous conceptualization, in favor of a differentiated strategy tailored upon regional specificities (Coffano and Foray, 2014; McCann and Ortega-Argiles, 2014).

More specifically, these specificities should be found in the way innovation process is implemented in each region, as a consequence of the fact that the preconditions for knowledge creation, for turning knowledge into innovation, and for turning innovation into growth are unevenly distributed in space and embedded in the differentiated cognitive culture of regions (Capello and Lenzi, 2013). This means that each region follows its own path in performing the different abstract phases of the innovation process, depending on the context conditions: its own 'pattern of innovation' (Camagni and Capello, 2013). If this is the case, two conceptual consequences follow: first, a single overall strategy of support to R&D is likely to be unfit to provide the right stimuli and incentives in the different contexts; and second, aggregate growth rate is maximized when policies are tailored on local innovation patterns and not only directed towards most promising 'scientific' regions.

Inference analysis has shown that a substantial impact of R&D over GDP is achieved only in those clusters of regions where a critical mass of R&D activities is present, but that also other patterns of

innovation, less intensive in local knowledge, may generate very successful innovation processes and high growth rates, even higher than those of many 'scientific' regions (Foddi et al., 2013).

These new research achievements prove that even in the case of policies traditionally considered as 'excellence' ones, like R&D and innovation policies, investing only in core, already competitive regions may not be the best strategy for maximizing aggregate growth. If it is true that R&D support should be very selectively directed towards science-based regions, it looks also crucial that other innovation strategies could be devised and supported in regions operating inside other innovation 'patterns', e.g. enhancing inter-regional cooperation in knowledge applications or mobility of researchers, or favoring utilization of more advanced technologies in traditional specializations. In this way, both growth and cohesion goals might be achieved.

Another recent research result bringing support to the thesis that an appropriate and smart design of regional policies could overcome the dilemma between competitiveness and cohesion comes from the already mentioned ESPON project (ESPON ET2050, 2013), concerning the construction and assessment of territorial scenarios for the EU. Beyond a baseline scenario, three "exploratory" scenarios were built, namely:

1. a "Megas" scenario, a typical market driven scenario implying a concentration of investments in European large cities, with a welfare system fully privatized and national economies called to repay public debts by 2030;

2. a "Cities" scenario, in which public policies are mostly at national level with a concentration of investments on second rank cities, actual welfare system reinforced through increased taxation, national public debt not fully repaid in 2050, a constant budget for cohesion policies;

3. a "Regions" scenario, in which public resources are mostly devoted to social and development policies in lagging, rural and peripheral regions, presence of a strong public welfare system at the expenses of the financial debt which is repaid only in 2050, and a budget which is significantly increased for cohesion policies.

The first and the third scenarios can easily be interpreted respectively as a competitiveness and a cohesive scenario. The "cities" scenario, instead, embraces the philosophy of supporting second rank city regions, highly diffused in Europe and representing potentially productive areas, rich of specific, not fully exploited territorial capital assets and un-exploited agglomeration economies: it may be seen as an intermediate scenario, looking at the same time to enlarge the development area in relatively advanced regions and to pick the relatively better structured areas, namely urban areas, in lagging regions.

The results of the three scenarios – obtained by running a third version of the macroeconometric regional growth model MASST – are rather impressive. In aggregate terms, the "Cities scenario" is, at the same time:

- the most expansionary among the three, both in Western and Eastern EU countries (Table 1); and

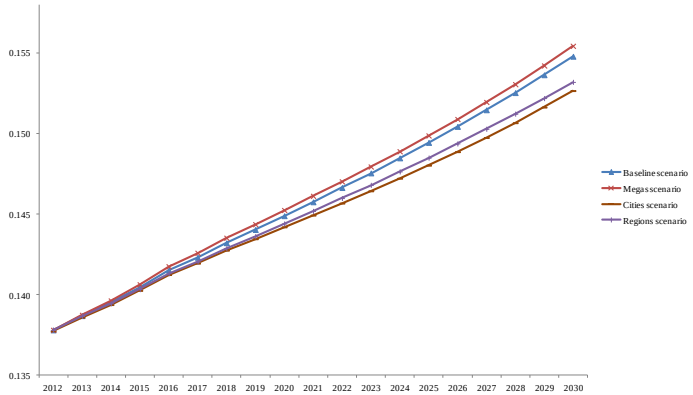
Table 1. Aggregate annual regional GDP growth rate 2012-2030 by scenario

Scenarios Macro-regions	Baseline	Megas	Cities	Regions	Megas vs. baseline	Cities vs. Baseline	Regions vs. Baseline
EU27	1.89	2.22	2.31	1.82	0.33	0.42	-0.06
Old15	1.88	2.22	2.32	1.81	0.34	0.44	-0.07
New12	1.93	2.22	2.23	1.98	0.29	0.30	0.05

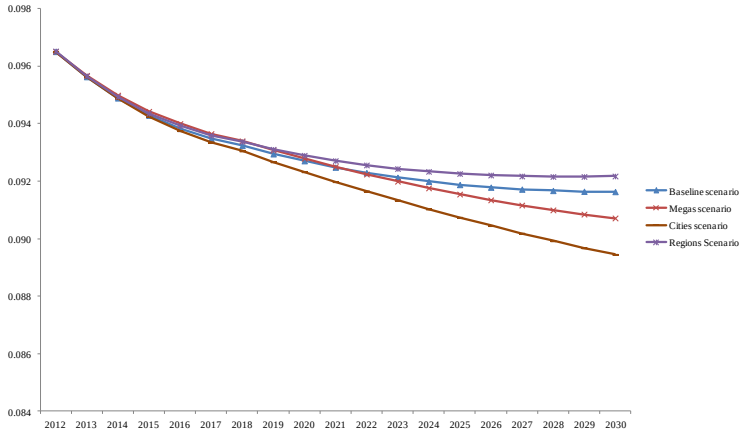
- also the most cohesive one, showing the least increase in overall regional disparities (Theil index: Figure 4a), thanks to the best outcome in terms of reduction in between-countries disparities (catching up of lagging countries: Figure 4b) and a limited relative increase in the within-country disparities (Figure 4c). As expected, the "Megas" scenario is the less cohesive, due to a very high increase in the within-country disparities; on its turn, the "Regions" scenario is – almost by definition – the most cohesive in the within-countries disparities.

Figure 4. Theil Index by Scenario: Regional Disparities

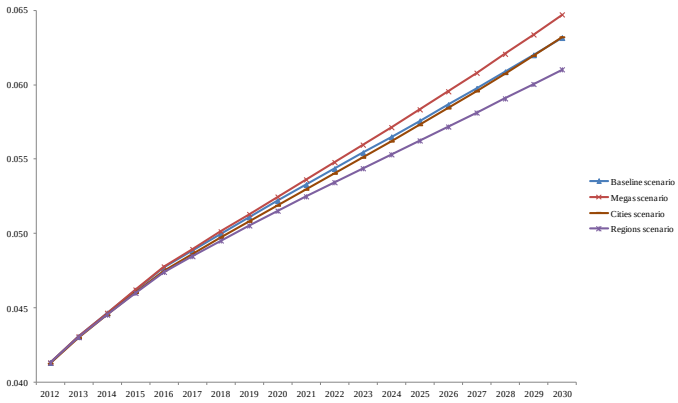
a) Total disparities



b) Between countries disparities



c) Within countries disparities



Trying to widen development outside the traditional core areas in the direction of second and third-rank European cities is likely to bring multiple advantages: exploiting a wider mass of potential territorial capital assets, avoiding the drawbacks of agglomeration diseconomies and the inflationary costs of excessive spatial concentration and supporting spill-over effects towards the urban poles of lagging and peripheral regions.

5 Regional development policies: acting through "territorial platforms"

Territories may be conceived as multi-dimensional spaces: each dimension represents the presence of stocks of single typologies of territorial capital: location, size, quality, internal and external interactions. Relationships of a functional, hierarchical or co-operative nature may take place inside the single dimension (economic, social, environmental, cognitive, identitarian, …) or, more interestingly, among the different dimensions, generating huge and diversified cross-externalities and synergy effects.

The conceptual breakthrough allowed by the relatively new concept of territorial capital (OECD, 2001; EC, 2005; Camagni, 2009) consists in the almost infinite widening of the structural and functional relationships that are assumed to determine the growth potential of the single places / regions, along the scientific trajectory of the last seventy years, in the direction of an ideal place-based production function with heterogeneous capital assets. At the beginning, this trajectory was epitomized by Solow's simplified and stylized model with only two explicit arguments, namely capital and labor, and a third black box encompassing a large residual called 'technical progress' (Solow, 1957). Since the 1980's, Solow's production function was enriched by the consideration of infrastructure and energy inputs (Biehl, 1986) and later on of different labour typologies (Romer, 1986), elements of social capital (Putnam, 1993), information (Capello, 1994) and knowledge (Paci and Marrocu, 2013). In this pathway, the 'quasi-production function' loses the possibility of interpreting distributive shares, but maintains the logical link with single, total and cross- factor productivity, ideally reducing the width of the residual unexplained element in regional development.

The full spectrum of territorial capital typologies may be considered and included, provided that good measures or proxies are available, ranging from material natural and cultural heritage to immaterial human and cognitive capital, from artificial public goods to private capital goods, from the structure of the urban system to identitarian capital, from club goods – like private networks – or impure public goods - subject to congestion effects and opportunistic behavior – to social or relational capital.

Regional policy interventions following a place-based philosophy should first of all recognize the multi-dimensional nature of development processes and the multi-layered nature of the territorial realm. This means:

- re-visiting the old standing literature on the 'balanced' nature of economic development (Yung, 1928; Rosenstein Rodan, 1943) and the structural characteristics of the historical 'stages of development' (Rostow, 1960), as well as the literature on the 'localised' and path-dependent trajectory of innovation (and consequently of innovating territories) (Nelson and Winter, 1981; Malerba and Orsenigo, 1997; Dosi, 1982);
- recognizing the necessity of an integrated and inter-sectoral approach to policy delivery, as perfectly demonstrated by the huge, pervasive and unexpected success of one of the best-designed European programmes, namely the Urban Initiative;
- tailoring each policy tool on the structural and territorial specificities of each place, interpreting its 'stage of development', its socio-economic structure, its knowledge endowment and learning capability, its typical 'innovation pattern' (as seen before);
- forcing actions addressed to achieving specific goals to interact synergetically with other policy goals: accessibility with environmental equilibrium; exploitation of natural and cultural heritage with the requirements of the identitarian evolution of places; knowledge creation with local production 'vocations' and entrepreneurial enhancement;
- addressing the conservation, completion, improvement and best use of the various typologies of territorial capital, selecting the excellence and most promising ones and combining those which look crucial for pursuing the most appropriate development strategy, devised from-below. This means the harmonious merging of material and non-material elements, functional and relational assets, economic, social and environmental aspects; the creation of new cooperation networks among local actors, and between them, policy-makers and external bodies, through renovated, willing and cohesive local communities; and the support of innovation through synergetic behavior, internally but also in cooperation with external actors (Camagni and Maillat, 2006; Camagni, et al., 2013).

This integrated strategy can be synthesized by the concept of 'territorial platforms', a concept depicting a "territorialisation" philosophy of close matching and full integration – in functional, physical, economic, social and aesthetic terms – between new development projects and the local realm, at the same time mobilizing multiple local resources on a wide area in synergy with public action (Camagni, 2011). Four kinds of territorial platforms may be conceived:

- 'knowledge platforms', enlarging the scope of R&D and innovation policies beyond the geographical limits of development poles, involving competences, human capital and mobility/education services on a wider geographical space (corridors, valleys, metropolitan areas, networks of cooperating cities);
- 'identity platforms', integrating conservation and wise exploitation of natural, cultural and landscape resources with complementary activities not only of tourism receptivity but also of research (environment and culture), education and training, advanced services provision (wellness and health services for new retired residents);
- 'infrastructure platforms', allowing the best integration of new infrastructure into the local environment, landscape and physical networks, considering feed-back effects of the provided new accessibilities on locational decisions of companies and real estate developments;

- ‘urban platforms’, enlarging development potential from single cities to city networks – metropolitan urban systems, second-rank cities interlinked and co-operating on ‘synergy’ or ‘complementarity networks’ (Camagni, 1994), city-regions organized on nodes, corridors and green networks – mainly operating on transport, communication and information infrastructure.

6 New challenges for Central and Eastern European Countries

In European Western countries regional development strategies and policies have to be necessarily different from the ones addressed to Central and Eastern countries (CEECs), who are now facing different challenges and difficulties in carrying out their transition phase (European Bank for Reconstruction and Development, 2013). Moreover, CEECs are no longer a single and homogenous area: they are nowadays characterized by a clear eastern periphery and are showing differentiated patterns of growth, based on different assets and territorial structure.

The main economic and spatial challenges, requiring appropriate policy answers, may be indicated as follows.

The first challenge refers to the macro-economic sphere: the necessity – shared with all other European countries showing difficulties in this sphere – of carefully monitoring the trend of external competitiveness, synthesized by the trend of unit labour costs, or better, of the real effective exchange rates, keeping wage increases in line with productivity increases. Empirical evidence shows that the initial cost competitiveness of all CEECs was rapidly reduced from 1994 to 2010, and that only a few countries (like Poland, Slovenia and to a lesser extent Hungary) succeeded in maintaining their 2004 level of competitiveness afterwards (Figure 5).

This challenge should not be met relying on currency devaluations, a tool that might be useful in very critical circumstances but that provides only short term advantages. Elements that should be strictly monitored: the transfer of high monetary wages from the modern sectors (and regions) to traditional sectors (and regions); real estate bubbles; process and product innovation; productivity/wages equilibrium.

The second challenge, of an industrial nature, refers to the necessity of moving towards a new and different stage of development, relying less on FDI and more on endogenous investments, taking advantage of technological multipliers and technological spillovers from MNCs into the local fabric. Enhancing local entrepreneurship is also crucial, relying on existing industrial relations and existing skills, competencies and specializations.

The third challenge refers to the control on rent increases and monopoly powers, in real estate and in commercial activities but also in industrial and financial ones. Rents erode personal disposable incomes and industrial profits, lowering the endogenous growth potential of countries. The counter-measures in order to restore an acceptable equilibrium refer to fight against monopoly practices and corporatist limits to supply, anti-trust policies, discouragement of real estate speculation and strengthening of its taxation.

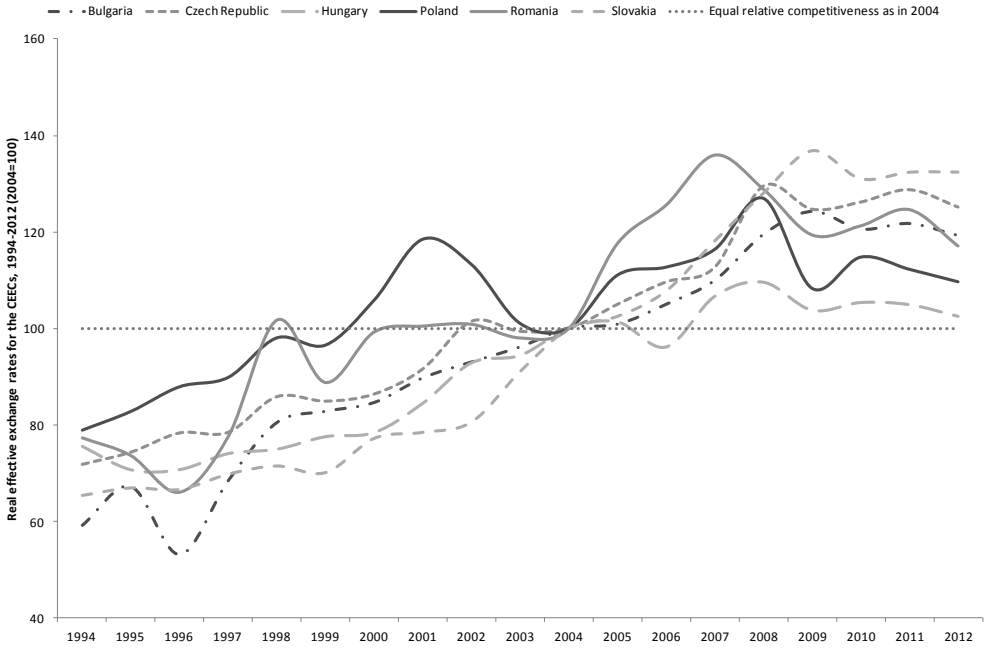
The fourth challenge, of a territorial nature, refers to the necessity of enlarging development areas beyond the small bunch of core areas (metropolises, capital regions), towards second (and third)-rank cities. This strategy reduces inflationary pressures, enlarges the economic base of countries and allows a better exploitation of existing, diffused territorial capital.

The fifth challenge refers to governance: the imperative consists in improving national and local government activity in the promotion, financing and management of regional development projects:

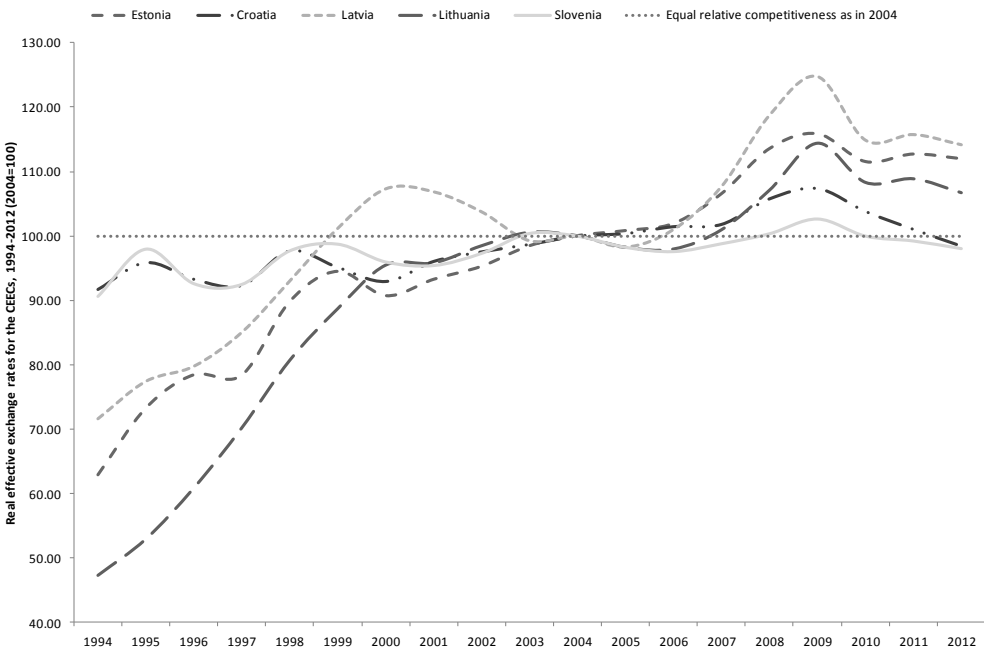
exploiting untapped local resources through strategic industrial plans, avoiding lock-in strategies reinforcing existing local monopolies, limiting rent-seeking behavior by local stakeholders, fighting corruption.

Figure 5. Trends in competitiveness of CEECs (Real effective exchange rates, 1994-2012; 2004=100)

a) Bulgaria, Czech Republic, Hungary, Poland, Romania, and Slovakia



b) Estonia, Croatia, Latvia, Lithuania, and Slovenia



Source: Authors' calculations.

The sixth challenge is a cognitive one: avoiding the risk of losing a strong potential advantage residing in the present scientific excellence of CEECs in many pure and applied science fields. In absence of a cooperation tradition with the local production fabric and of a market-oriented organizational capability, the scientific milieu of these countries could easily out-migrate towards western countries.

The seventh challenge is methodological: regional development policies should act through integrated territorial projects and "territorial platforms", keeping in mind the multi-dimensional nature of development and the necessity to lever on the specificities and potentials of territories.

7 Conclusions

The present long period of crisis and the related imperatives of tight fiscal policies in highly indebted countries has generated a impressive outcome on the EU space: an interruption of the long term, historical trend towards decreasing inter-regional disparities. The preceding trend was mainly fuelled by the vigorous catching-up process of many relatively weak countries that in different times joined the Union – Italy in the early founding years, and subsequently Spain, Ireland, to a lesser extent Portugal and Greece, and finally the new Eastern Member countries – while intra-national disparities, especially in the early phases of integration, were always showing a rising, but less vigorous, trend. The crisis added a new challenge to policy makers: the evidence of large negative country effects in southern European countries and a lower catching-up pace in Eastern countries, all trends that econometric forecasts indicate that will not be easily overcome in the next future.

In these conditions, cohesion policies are now facing new, partly unexpected challenges, having to operate inside tight macroeconomic constraints, reduced public resources and increasingly pessimistic political attitudes. Beyond that, the necessity to be more selective in targeting public development resources generates the risk of a shift in policy priorities away from cohesion goals and in favor of competitiveness goals that inevitably redirects attention – and resources – towards core areas, where returns on public and private investments look faster and higher.

The paper advocates in favor of a strengthening of cohesion policies, recalling their multiple economic justifications especially in difficult periods of crisis and denying the existence of the assumed, traditional trade-off between cohesion and development goals, if a new concept and style in regional policies is followed. The new target should be the largest mobilization of existing territorial capital assets, and in particular of local excellences, present and dispersed in almost all regions, though a bottom-up 'discovery' process led by local élites and intermediate bodies, tailored upon the potentials and specificities of the single places.

Innovation policies too should renovate their intervention philosophy, pursuing a wise concentration of R&D investments – very different from the past – but also devising new intervention strategies in non-core regions. These strategies should fit with the actual 'innovation pattern' followed by each region, supporting the blending of external knowledge (in different forms: patents, researchers, scientific consultancy, direct investments) with local productive 'vocations', competences and productive traditions, deepening and widening the present specialization through 'smart' incremental innovation.

Recalling the 'balanced' nature of any long term development process, policy interventions should pursue an integrated nature – acting on multiple dimensions – and matching with the specificities of places. The concept of 'territorial platforms' could help in this case, suggesting and supporting the potential complementarities among material and non-material, economic and cognitive, social and environmental actions and goals.

The case of Central and Eastern European Countries is considered at the end, focusing policy suggestions on the specific challenges that these countries are now facing in their structural and institutional transition. Macroeconomic issues – e.g. controlling the trend of unit labour costs and real effective exchange rates – are coupled with spatial ones – e.g., the necessity to enlarge development areas towards second-rank cities and to control real estate bubbles and land rents;

industrial and social issues converge in the necessity to enhance local entrepreneurship and to better mobilize the present excellences in many scientific fields in order to enter a new development stage, relying less on foreign investments alone but exploiting all the potential synergies, economic and cognitive, between foreign investments and local culture.

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