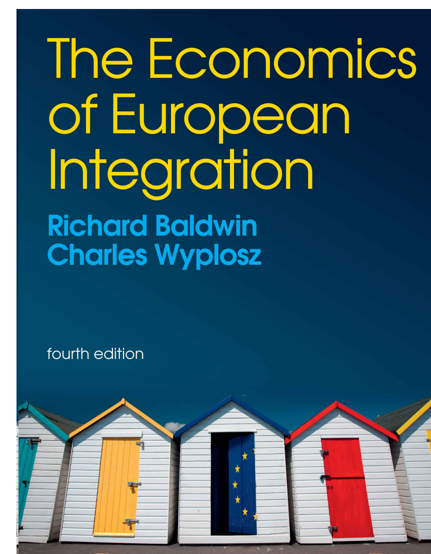
Chapter 10: Location effects, economic geography and regional policy

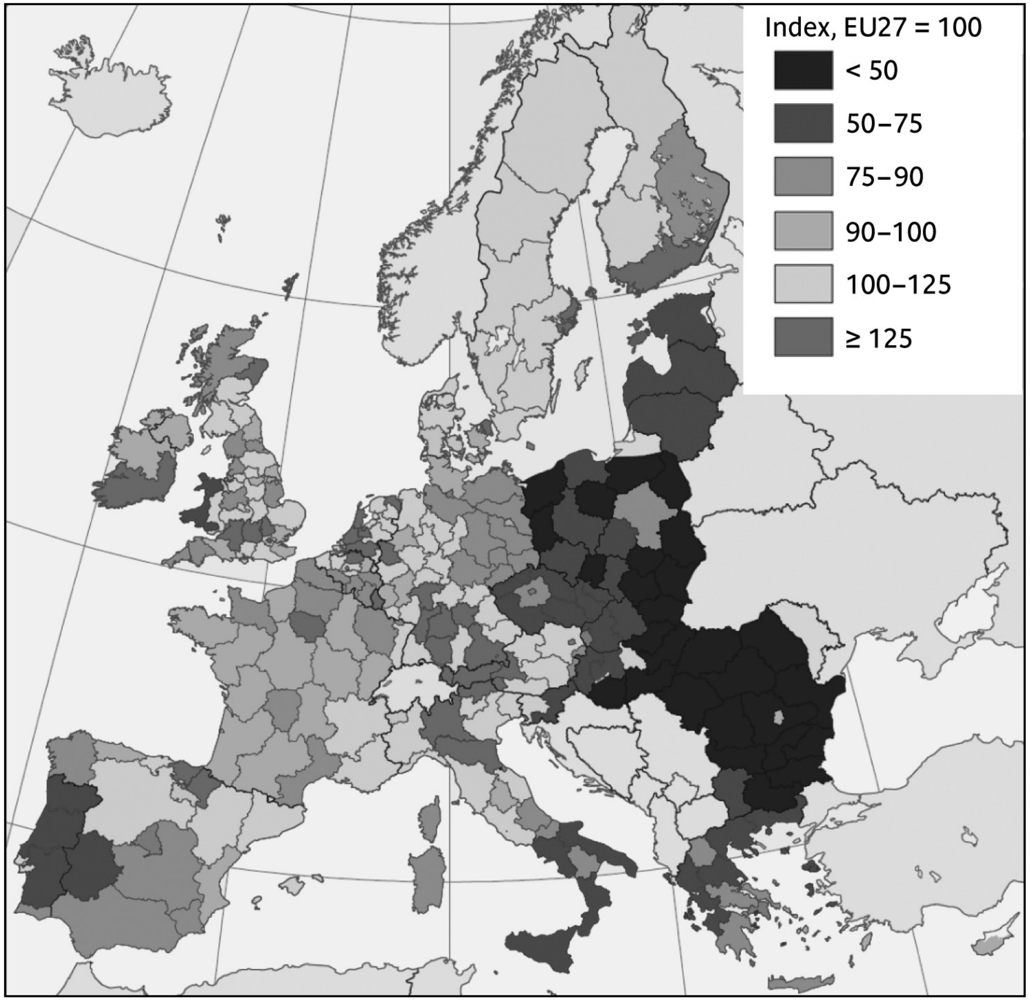
. . . the Community shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions or islands, including rural areas.

Treaty establishing the European Community, 1957



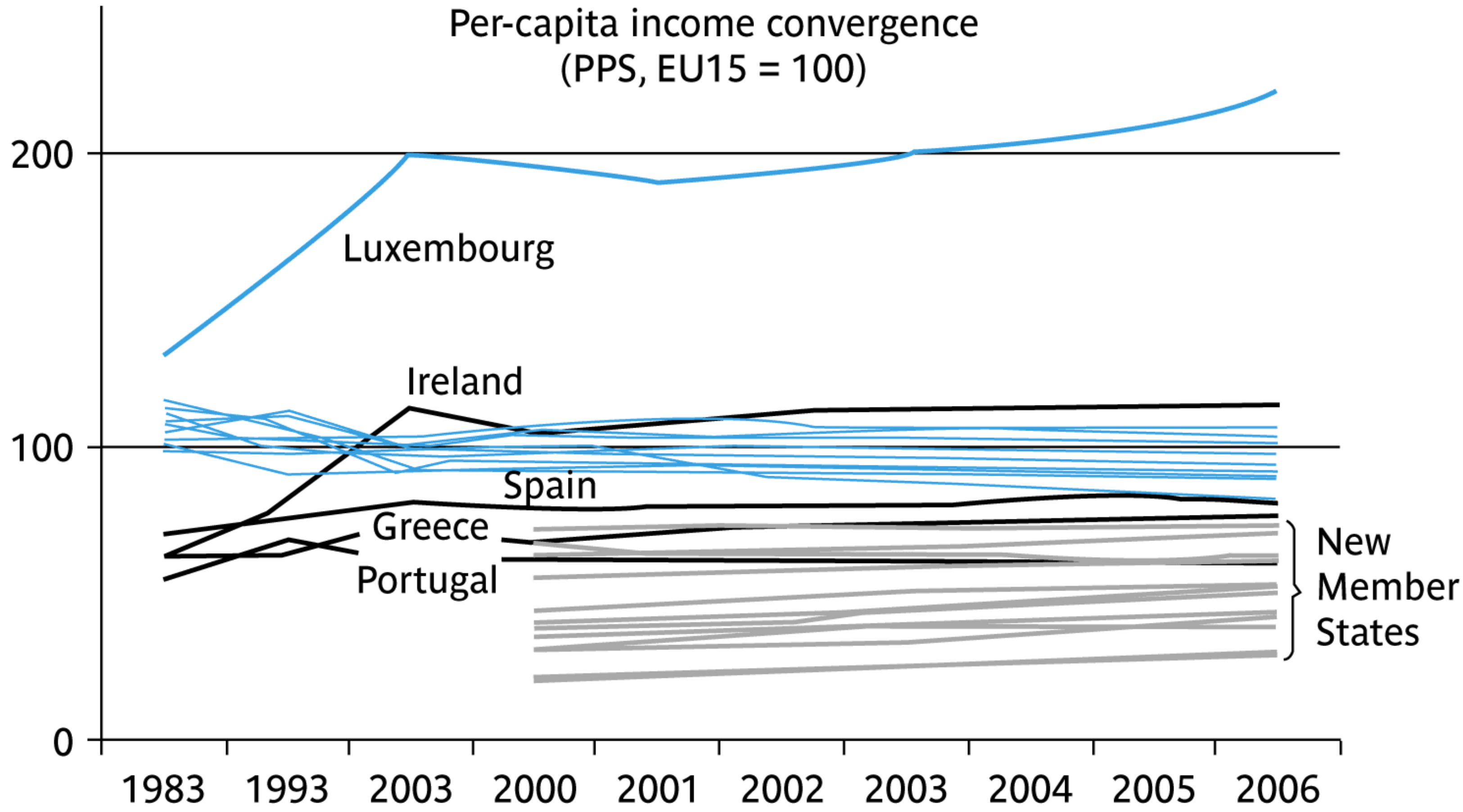
Europe's economic geography: the facts

Rich regions are clustered and form the 'core' of the EU economy, as shown by regional GDP per capita (PPS) in 2007:



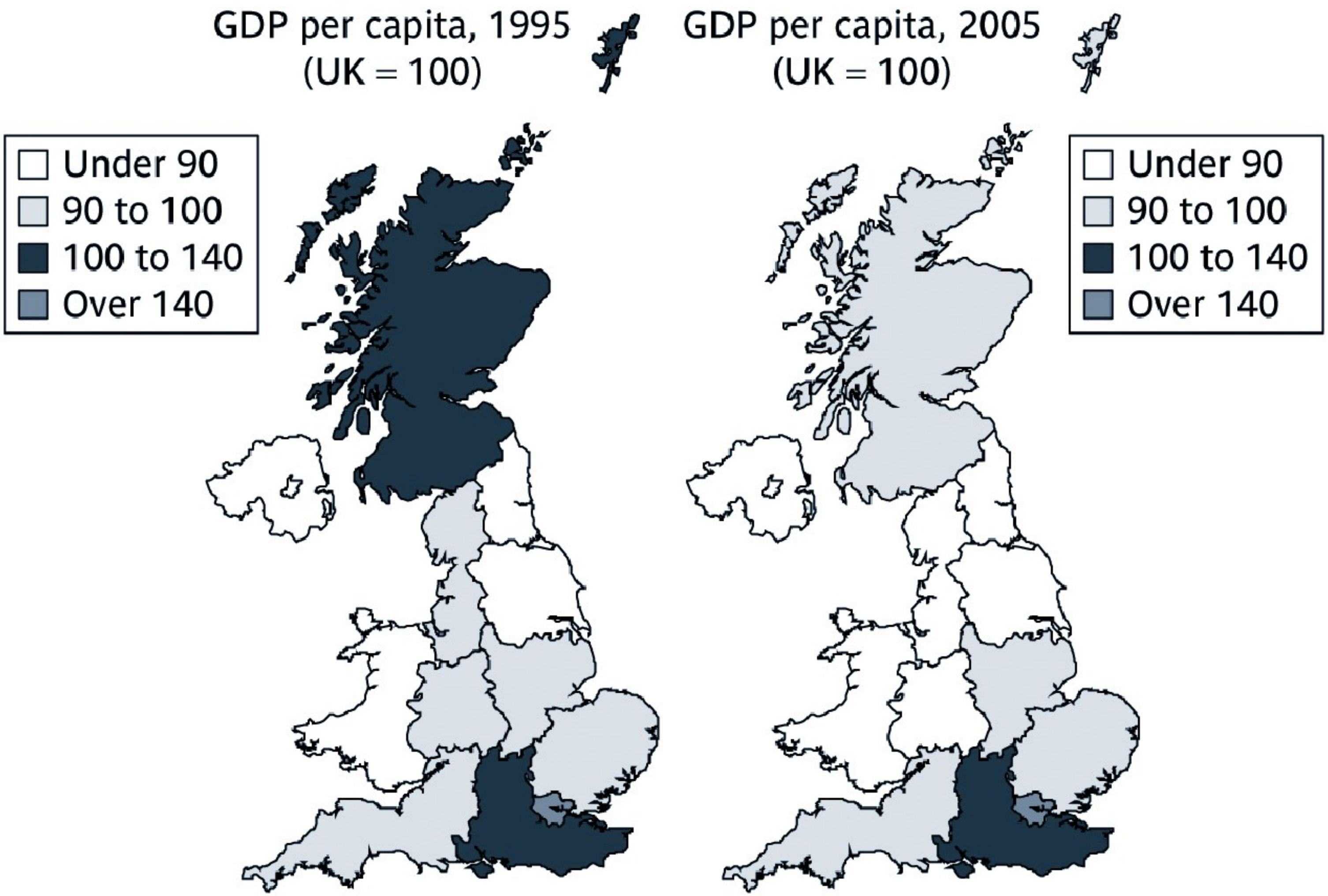
Europe's economic geography: the facts

Still, gaps among EU members have been steadily narrowing:



Europe's economic geography: the facts

However, income inequality within each EU nation has been rising:



Europe's economic geography: the facts

Krugman specialization index: fraction of manufacturing that has to change sector to make a nation's sector-shares line up with the sector-shares of average EU nations.

Most EU nations are becoming more specialized.

Table 10.1 Specialization by nations, 1980 to 1997

	1980–83 (%)	1988–91 (%)	1994–97 (%)
Ireland	62	66	78
Greece	58	66	70
Finland	51	53	59
Denmark	55	59	59
Portugal	48	59	57
Netherlands	57	55	52
Sweden	39	40	50
Belgium	35	38	45
Italy	35	36	44
Germany	31	35	37
Austria	28	28	35
Spain	29	33	34
UK	19	22	21
France	19	21	20
EU15 average (weighted)	30	33	35

Theory part I: comparative advantage

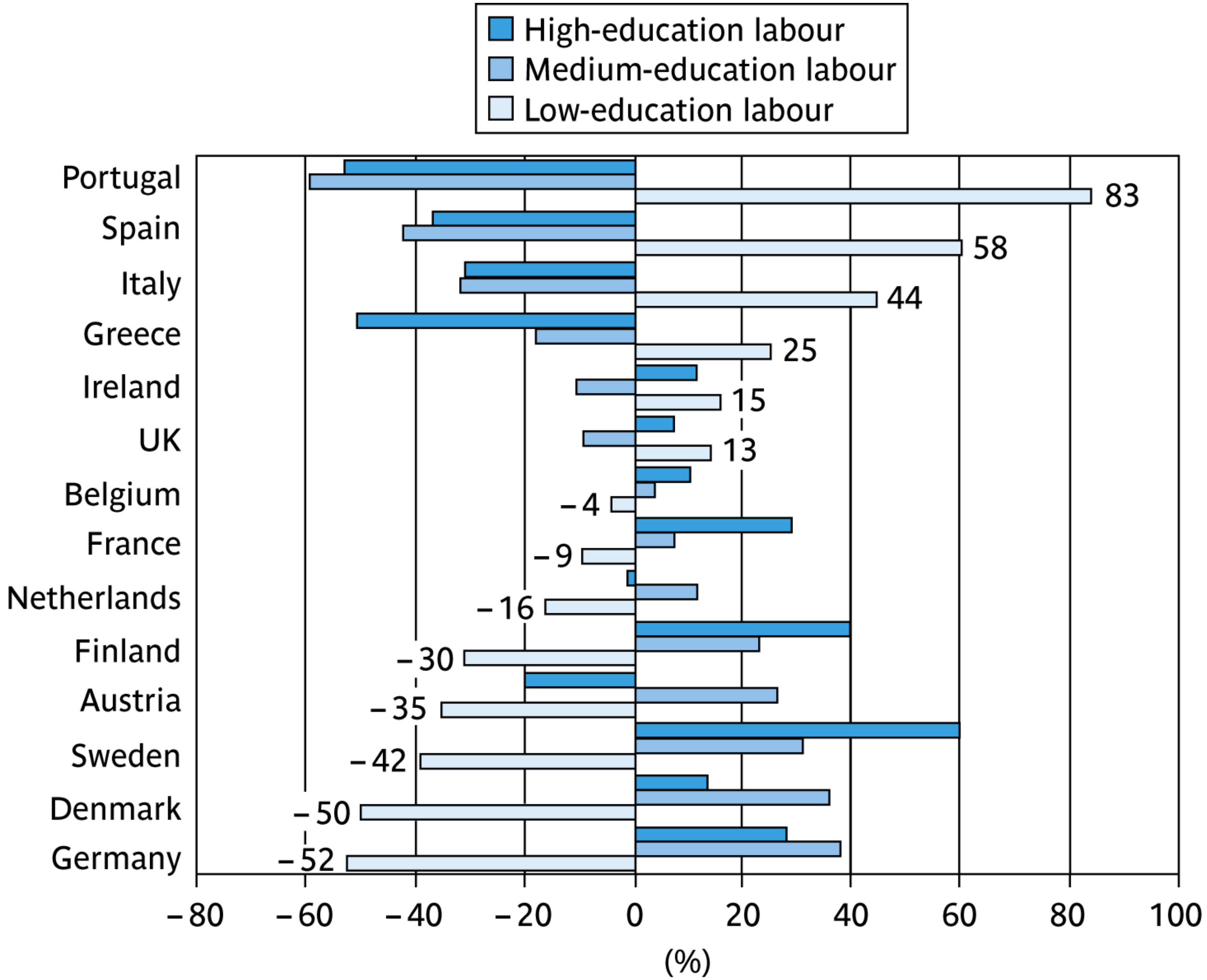
Comparative advantage suggests that nations specialize in sectors in which they have a comparative advantage.

Example:

- Germany abundant in high skilled labour;
- Portugal abundant in low skilled labour;
- with trade: Germany specializes in pharmaceuticals and trades them for cloth from Portugal and the industrial structures of both Portugal and Germany would become more specialized.

Theory part I: comparative advantage

Relative labour endowments in Europe:



Theory part II: new economic geography

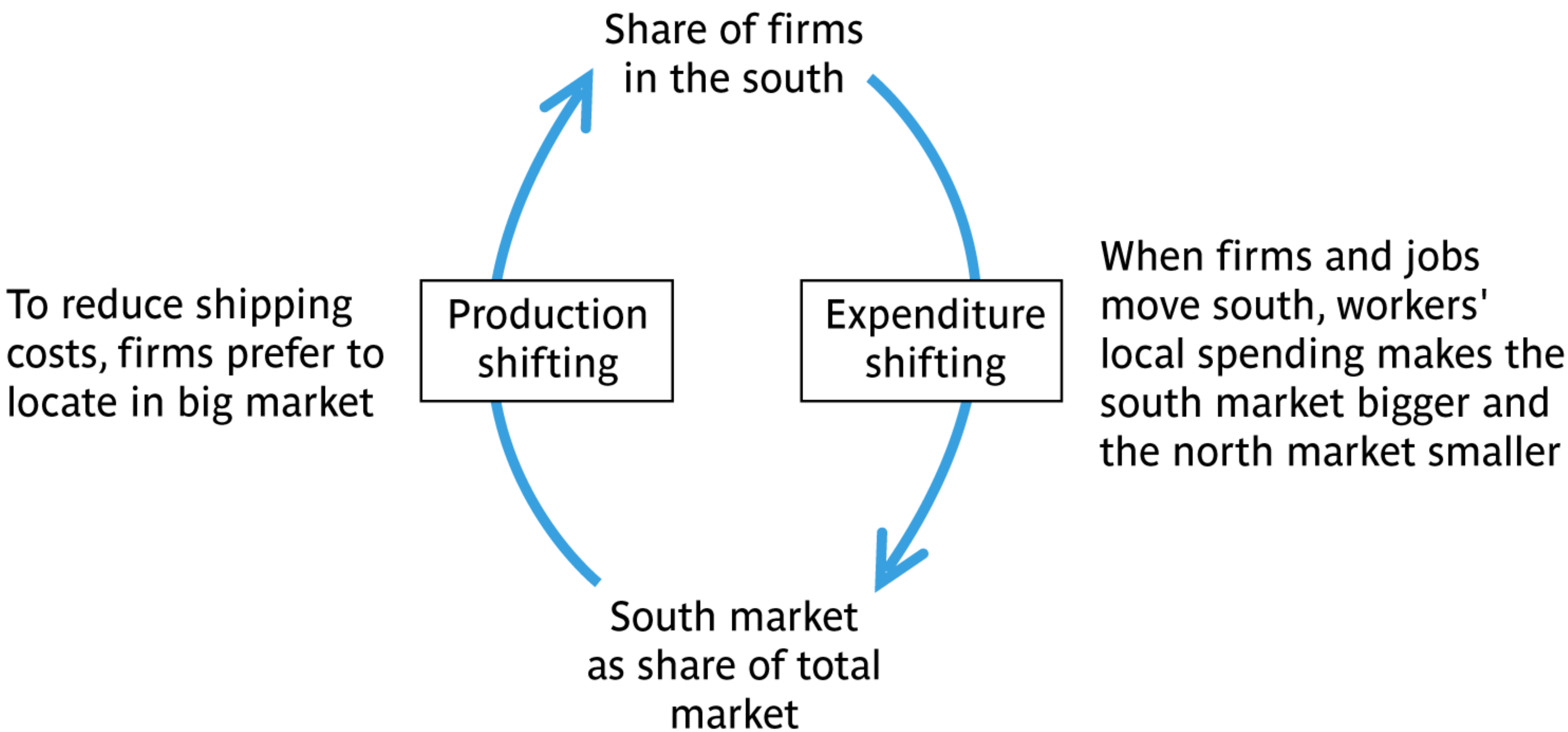
New economic geography suggests that integration tends to concentrate economic activity spatially.

It is based on two pillars:

- dispersion forces favour the geographic dispersion of economic activity (e.g., higher rent and land prices, high cost of non-traded services, competition with other firms);
- agglomeration forces encourage spatial concentration:
  - demand linkages: big markets;
  - cost linkages: availability of suppliers.

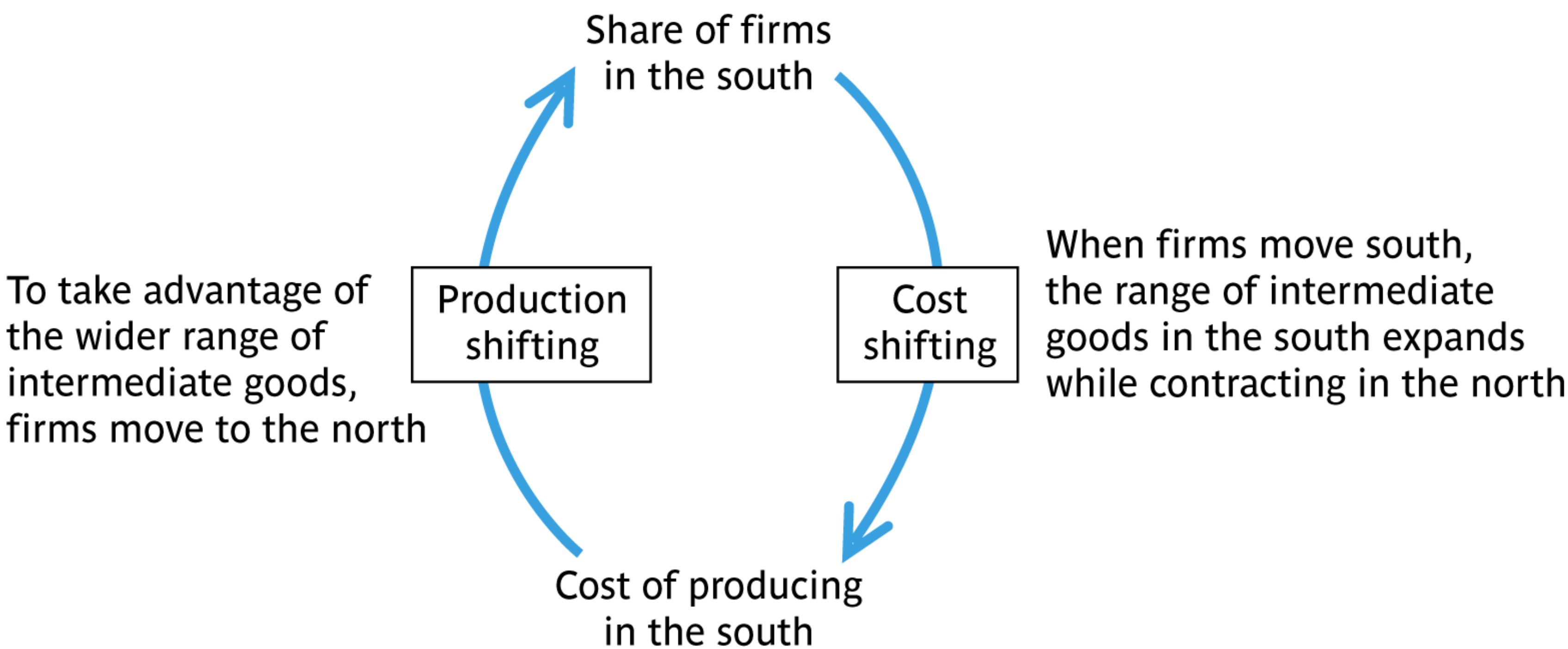
Theory part II: new economic geography

Demand-linked circular causality:



Theory part II: new economic geography

Cost-linked circular causality:



The locational effects of European integration

European integration affects the balance of agglomeration and dispersion forces in complex ways.

A very simple analytical framework:

- assume away all dispersion forces except ‘local competition’;
- assume away the demand-linked circular causality;
- assume away cost-linked circular causality (by assuming firms buy no intermediate inputs);

→ one pro-agglomeration and one pro-dispersion consideration:

- firms would, all else equal, prefer to locate in the big market in order to save on trade costs;
- firms would, all else equal, prefer to be in the market where there are few local competitors.

The locational effects of European integration

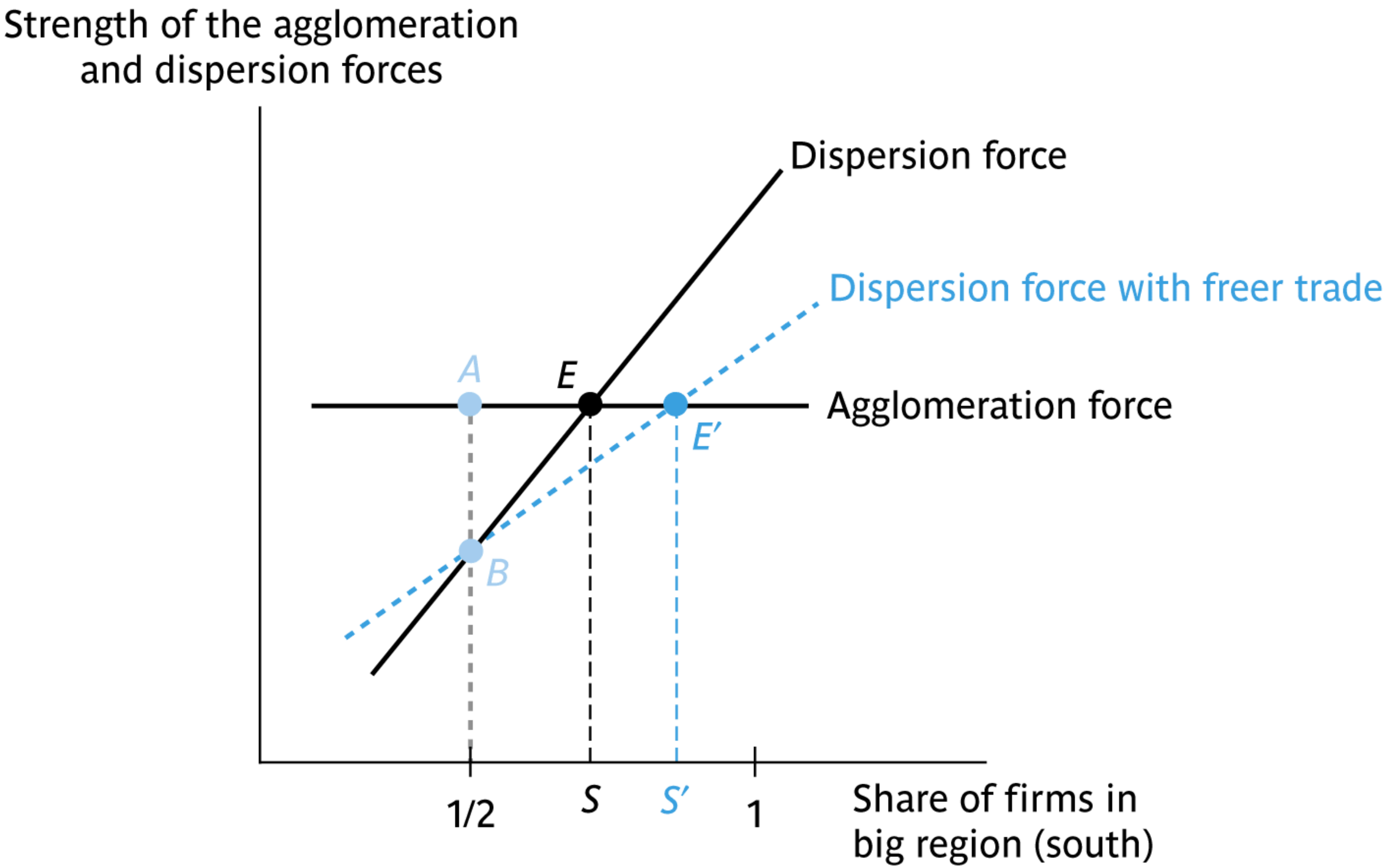
With these simplifications:

- ‘agglomeration force’ is flat in the share of firms in big region;
- ‘dispersion force’ line is rising in the share of firms in big region since the benefit of staying in the small region rises as more firms move to the southern market.

The location equilibrium is given by the intersection of these lines.

Economic integration reduces trading costs and weakens dispersion forces → more concentration of economic activities.

The locational effects of European integration



EU regional policy

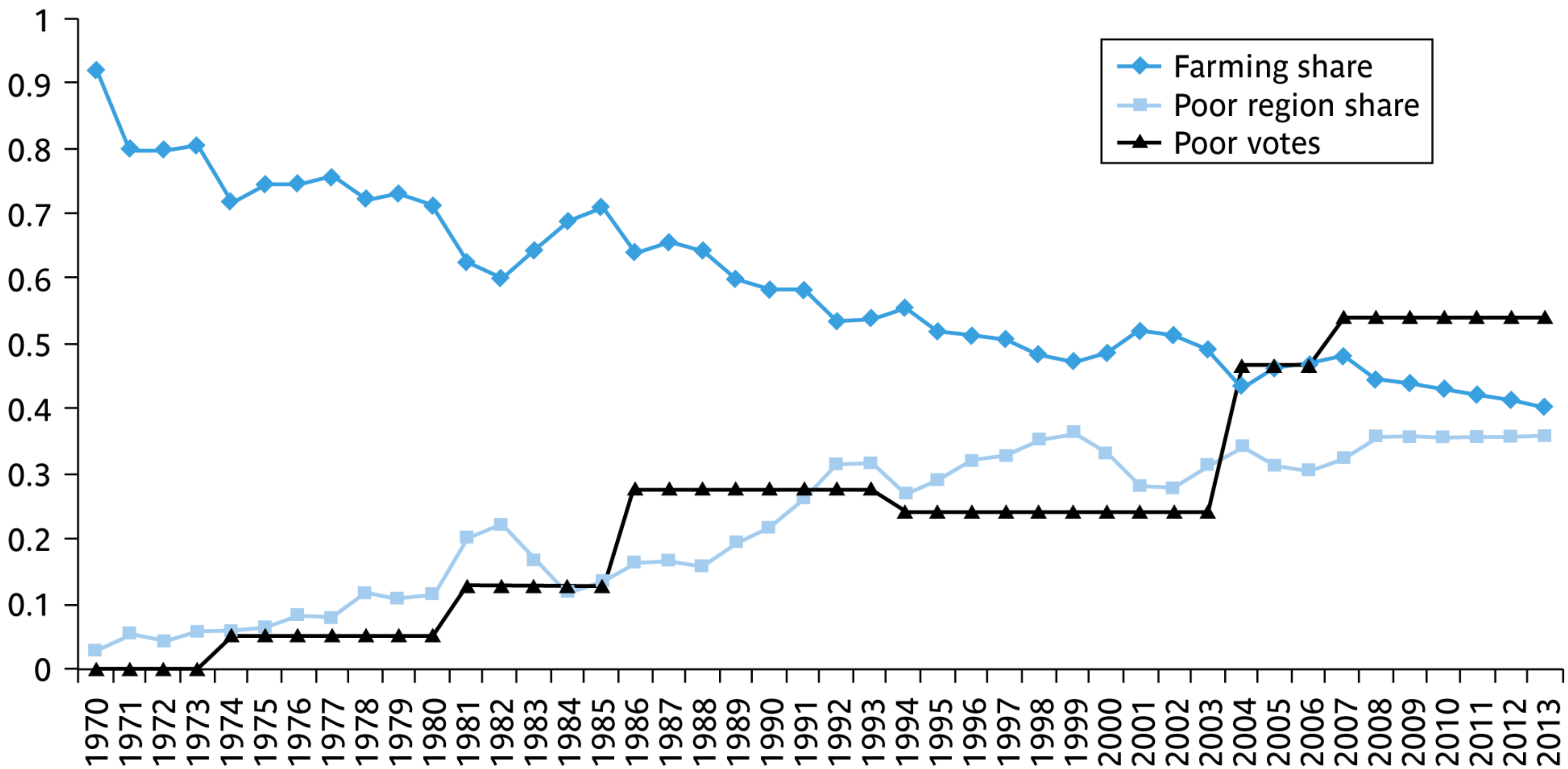
Concern for Europe's disadvantaged regions has always been part of EU priorities (i.e., part of Treaty of Rome preamble).

Still, major EU funding for less-favoured regions was introduced only when the first 'poor' member, Ireland, joined in 1973: the European Regional Development Fund (ERDF) was set up to redistribute money to the poorest regions, but its budget was minor.

The situation changed in the 1980s when Greece, Spain and Portugal joined: these nations were substantially poorer and did not benefit from CAP funding. The voting power of Greece, Spain, Portugal produced a major realignment of EU spending priorities.

EU regional policy

EU budgetary expenditures, 1965–2013, CAP vs. Structural Funds:



EU regional policy

The EU's regional policy for the period 2007–13 has 3 main objectives:

- convergence: aimed at reducing income differences across regions;
- regional competitiveness and employment: aimed at strengthening the competitiveness and attractiveness of the regions, as well as regional employment;
- territorial cooperation: aimed at reinforcing cooperation at cross-border, transnational level.

Table 10.2 Share of cohesion budget for convergence, regional competitiveness and employment, and territorial cooperation

	% Cohesion budget	% of EU27 population covered
Convergence	82	Standard convergence regions (34), Phase-out convergence regions (3), Cohesion Fund nations (34)
Regional competitiveness and employment	16	All non-convergence regions (66)
Territorial cooperation	2	100