REGIONAL ECONOMIC POLICY IN EUROPE
U. Stierle-von Schutze et al., Cheltenham, UK, Edward Elgar Publishing Limited, 2008, pp. 262.

Review*

Europe sees its future as Europe of Regions. In its vision, Europe's regions will be equally developed, without rich-poor, developed-underdeveloped divide. In order to achieve it, European Union is investing a lot into development of poorer regions through its structural funds. These funds have doubled since the end of 1980s, and are becoming the most important section of the EU budget. Why are some regions rich and some poor? How can we correct this? And how successful are EU policies in achieving this goal? These are some of the questions this book tries to provide answers for. The book is divided into four parts and eleven chapters.

In an overview of the book, **Ulrike Sierle-von Shutz** et al. outline reasons for differences in economic development between regions. These reasons concern immobile and partially mobile factors, economies of scale, transport and communication cost and human capital. The rest of the book will elaborate, using models and case studies, how each of these factors influences inequality between regions.

The second part, which consists of two chapters, discusses catching up and convergence between regions. In chapter 2, Angel de la Fuente and Rafael Domenech investigate the impact of schooling on regional income in Spain. Their results show that the schooling level and infrastructure endowments are significant and important determinants of income. The difference between these two factors is the following. Returns to infrastructure are higher in richer areas, while returns to schooling are higher in poorer areas. Therefore, regional inequality is better reduced through investment in educational attainment, which accounts for 40 percent of productivity gap between regions. In chapter 3, **Gabriele Tondl** and **Goran Vukšić** investigate the determinants of regional growth in new EU member states. On a sample of 36 regions from five Eastern European countries in the period 1995-2000, the authors' results suggest that foreign direct investment (FDI) and education are the most important engines of regional growth in Eastern Europe. The

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authors also found evidence of clustering of richer and poorer regions. Richer clusters typically form around capital cities.

The third part, consisting of four chapters, investigates the logic behind localization of economic activities. In chapter 4, **Pascal Hetze** tries to discern the effects of regional technology exchange on economic growth and unemployment. The author uses two-countries, two-sector model (R&D and manufacturing), where growth is driven by R&D at home and abroad, and where technological change has effect on unemployment via labor reallocation. The novelty in this approach is that the author also considers the employment effects of regional technology on jobs. Author's results show that it is unclear what effect economic integration will have on unemployment but it is clear that regional technology trade leads to more job destruction and labor reallocation and that unemployment will be created if skills shortages restrict labor reallocation. Therefore, the author suggests that a more asymmetric removal of trade barriers would obtain better results in countries with skills shortages. Even if trade in technology increases unemployment, it could lead to increase in growth due to increase in labor productivity. But again, this increase in labor productivity might be constrained by the lack of skilled labor. Therefore, gains from economic integration will be overridden by skills shortages. To summarize, if there are no structural differences between countries, both countries will benefit from economic integration. But, if there are structural differences, i.e. one country is superior in R&D sector and the other in manufacturing sector, costs and benefits of integration will be unevenly distributed. In other words, we will have a win-loose scenario. Still, if there are skill shortages, both countries could suffer a loss. In such cases asymmetric integration, where the more advanced country liberalizes both sectors, while the less advanced one keeps protection for its R&D sector, is a more prudent policy. In chapter 5, **Filip Abraham** and **Jan van Hove** use Belgian manufacturing as a case study for the influence of economic integration on intra-industry trade. In their model, intra-industry trade is determined by differences in factor endowments, i.e. income and technology. The novelty of their model is in the way they model technology. The authors distinguish between input and output measures of technology. In addition, they also incorporate technological spillovers in their analysis. The authors also differentiate between vertical and horizontal intra-industry trade. Vertical intra-industry trade refers to trade in products of different quality, while products in horizontal intra-industry trade are differentiated by some other characteristic. Their results suggest that differences in technological innovation and spillovers are the main driver of high-quality vertical intra-industry trade, while differences in income drive horizontal and low-quality vertical intra-industry trade. In chapter 6, **Hailin Sun** and **Luoping Sun** investigate reasoning behind clustering. Their results show that clustering reduces transaction costs. The efficiency of industrial clusters stems in the first place from their ability to reduce transaction costs, which arise from poorly defined property rights that are substantially reduced in industrial clusters. In chapter 7, **Ulrike Stierle-von Schutz** analyses influence of fiscal decentralization, i.e. tax autonomy on regional specialization, using both OLS and fixed-effects model. Independent variables used in these models include tax autonomy, efficiency, GDP per capita, dummy variable for periphery, population and number of patents. Both models suggest that tax autonomy decreases regional specialization. In addition, more populous, peripheral regions with higher research output will be more specialized. These models yield contradicting results in other variables. OLS results suggest efficiency is not statistically significant, while GDP per capita decreases regional specialization, which is a bit surprising. It is believed that specialization in fields with comparative advantage leads to economic growth. On the other hand, fixed-effects results suggest richer regions are more specialized, which is more in line with mainstream economic wisdom. In addition, efficiency also increases regional specialization. The problem with this paper is that the author does not seem to perform Hausman test to determine which set of results we should prefer.

Part four consists of four chapters which elaborate experiences and lessons learned from European regional policy. In chapter 8, **John Bradley** and **Gerhard Untiedt** analyse the impact of European cohesion policy on growth and employment in Poland, using three macroeconomic model simulations. These three models yield different results. One model (ECOMOD) shows that European cohesion policy increases growth and employment and the other (HERMIN) that cohesion policy increases growth and employment in the implementation phase, while decreasing them in termination phase. The third model (QUEST) shows that cohesion policy increases growth and employment in the implementation phase, presenting the same as the results obtained by HERMIN, but it also shows that cohesion policy had almost no influence on employment. These differences arise from different assumptions these three models make about how economy functions. In chapter 9, **Michael Stierle** and **Anita Halasz** try to give an answer to a question under which conditions EU structural funds can be effective in contributing to real convergence between regions. Authors reject regression analysis as an appropriate tool for finding relationship between structural funds and convergence. Instead, they use macroeconomic model simulations. The advantage of these models is that they show how structural funds influence supply and demand side of the economy. Their downside is that they assume that structural funds are always turned into productive investment. Using two of these model simulations – QUEST II and HERMIN – on seven Eastern European countries, the authors conclude that structural funds will lead to convergence only if certain preconditions are in place. First, recipient country should have sound national policies, e.g. good governance, regulatory framework and national regional policies. Second, structural funds should be concentrated in the poorest areas and should be oriented towards creating growth even at the expense of temporarily increasing regional inequality. Third, structural funds should be concentrated on policies most likely to lead to growth and employment. These policies should be determined by case-by-case analysis. The last two chapters are case studies of the effects of EU cohesion funds on regional inequality in Spain. Spain is an interesting case study because since its accession to the EU it has been, along with Portugal, Greece and Ireland, the biggest recipient of EU cohesion funds. In addition, out of these countries, Spain has the most detailed regional statistics. But these chapters differ in the methodology used. In chapter 10, **Santiago Lago-Penas** and **Diego Martinez-Lopez** use regression analysis and conclude that EU regional policies do not seem to favor convergence among Spanish regions during 1980s and 1990s. Contrary to their results, in chapter 11, **Simon Sosvilla-Rivero** and **Jose Herce** use HERMIN macroeconomic model simulation and find that EU structural funds increased Spanish growth rate in 1989-2006 period from an annual rate of 2.37 per cent to 2.75 per cent. Also, structural funds increased employment rate by 2.07 per cent. Finally, productivity was 3 percentage points higher due to structural funds. The authors warn about the problems with their counter-factual analysis, because we cannot know what would happen if there had not been for the EU structural funds, but they remain convinced that EU structural funds did have a positive impact on growth, employment and productivity in Spanish regions.

In the future, agricultural policy will not be the biggest part of European Union's economic policy but cohesion policy. Europe has committed itself to reducing present inequalities between regions. The main strength of this book is in providing insights into origins as well as remedies for these inequalities. In addition, a number of articles introduce methodological novelties but the book is not methodologically coherent as it presents articles using different methodologies to answer the same question. Sometimes it leads to different conclusions, as was the case with chapters 10 and 11. For that reason the book itself does not offer any 'agenda for action'; this is done by individual articles. In fact, there is no conclusion chapter which would try to synthesize conclusions presented in different chapters, which seems to be the book's biggest downside.

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