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"Regional Economies and Globalisation"

Seminar Challenges and Issues for the Spanish Treasury in the global economy

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Ladies and Gentlemen,

It is a pleasure for me to be here today, in this prestigious university, and to share with you some ideas on the challenges and opportunities of globalisation and their likely impact on regional economies in Spain and across the Union.

For the European Commissioner for Regional Policy however, it is difficult to resist the temptation to start by underlining the success of Spain since its accession to the EU more than 20 year ago. Spain has been the main beneficiary of our policy since its creation and this, coupled with sound and efficient national policies, has brought socio-economic convergence and catching up of the country. As a result, Spain cannot be seen anymore as a traditional 'cohesion' country but as a modern and extremely dynamic Member State.

But today I would like to talk to you not about the past but about the future. I shall start by looking at the challenges which might have impact on regional economies in the coming years and decades. Following this, in the second part of my presentation I would like to dwell for a while on how regions can respond to these challenges and what are the lessons which might be useful to European regional policy in this context.

I have to admit that this seminar comes at a very suitable moment for us, since the European Commission adopted the last 30 May the 4th Cohesion Report in which we review the results of our policy in a rapidly changing world and launch some ideas and questions on how to better adapt it in order to make it even more efficient.

So, let me start by mentioning some of the **main challenges** to which the European regions will be confronted in mid and long term perspective. The 4th Cohesion Report provides already some first indications:

On demographic challenge: let me say that it is clear today that Europe's **population is projected to start declining** by around 2020. Between 2000 and 2005, total population growth rate was 0.4% and 86% of that growth was due to migration. Already today, 85 regions of the Union (mainly in the new Member States) are experiencing absolute population decline, and another 76 maintain population growth only thanks to migration. These trends will limit the scope for future employment growth. Although total employment is expected to continue growing up to around 2017, due to rising labour force participation, it will start declining afterwards.

Given its economic dynamism Spain has been one of the main recipients of migration flows in the last years which, in turn, have fuelled its economic growth. The main challenge of the coming years will be to ensure a smooth integration of this new segment of population but also its adaptation to the changing needs of the labour market.

On globalisation: it generates competitive pressures with asymmetric impacts on industries, local, regional and national economies. Many regions throughout the Union have strong concentration of economic activity in sectors where competition from emerging economies is higher. These are regions which need to diversify their economic structure into new, growing sectors, and modernise existing activities to move up the value chain. There are 39 regions which have more then 3% of their total employment concentrated in textile industry, reaching up to 13% in one of the Portuguese regions, 15 regions with the same level of employment concentrating in electric, audiovisual and ICT equipment and 7 regions in steel making. This can be both a challenge and opportunity.

This key challenge also concerns a number of Spanish regions which have suffered loss of industrial activities or just need to modernise their industrial base. To this aim, R&D and innovation emerge as the over-arching priorities in order to be able to attract investments and to compete in international markets with high value added products and services. Basque Country provides here an example of a successful transition which allowed its manufacturing sector (metallurgy) retain significant market niches in high technology, high value added manufacturing.

On urban areas: leading edge economic activities and talent are geographically concentrated in a few **urban centres** that are global players. This is creating opportunities, but also problems such as pollution, urban sprawl, congestion, and social exclusion.

Within the cities, suburbanisation is a clear trend in the Union: in 90% of the urban agglomerations with more than 100,000 inhabitants, population in the suburbs grew recently more than in the core city. Economic activities are starting to follow the same decentralisation pattern. This puts increasing pressure on the environment and can cause the decline of downtown areas.

On climate change: there is also clear evidence that many regions throughout Europe will be increasingly confronted with the asymmetric impact of **climate change** as well as with new challenges in terms of **energy** provision and efficiency. 7% of people in the Union live in areas at high risk of flood; on the other hand around 9% of the EU population lives in an area where there are over 120 days a year, on average, without rain. The combined impact of climate change will pose serious problems to tourism and agriculture, to the quality of life in some of EU regions.

All these problems are very well known in Spain where a number of Mediterranean and Southern regions can already be qualified as 'water-stressed'. The likely impact of global warming in agriculture and tourism can be particularly damaging in these areas. At the same time, energy consumption has dramatically increased in the last years (and the associated pollution in terms of CO_2 emissions) due to accelerated growth. Part of the response lies in developing new technologies in the area of water provision and use, as well as alternative energy or energy efficiency. Fortunately, as an example of its ability to seize the opportunities brought by globalisation, Spain is also developing new leading technologies to face these problems like desalination plants and windmills to produce wind energy.

On skills: regions will also have to cope with the **skills needed** to remain competitive in a global, knowledge-based economy. Variations in education levels are more pronounced between regions than between countries: in the less developed regions of the EU27 only 14% of population in working age had tertiary qualification in 2005 against 25% in the more developed regions.

Again, let me reach out to the Spanish case. Spain has made an impressive progress on this issue in the last years. As a result, the young Spanish generations are now among the most educated in Europe, in particular women, who already exceed men at university. The challenge here may be the need to adapt these qualifications to the actual labour market needs.

It is also very encouraging that we see this new focus in many countries in Europe. In Portugal, education has been put on the top of the investment agenda in the years to come, with strong support from the European cohesion policy.

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I am convinced that in the coming years these challenges, and our response to them, will redraw the regional map of Europe and overshadow the traditional descriptions we are using today – such as those referring to new and old Member States. The impact of increasing economic pressure from global competitors, the ageing of our societies, the developments in the energy market, climate change and social polarisation will be felt, with diverse intensity, in all parts of the Union.

So the question of our time is: how European regions and European regional policy can best reply to these challenges?

A couple of months ago European leaders stated in Berlin declaration that: "There are many goals which we cannot achieve on our own, but only in concert. Tasks are shared between the European Union, the Member States and their regions and local authorities". Indeed, in recent years it became clear that development and convergence is best driven through multi-level governance, through the coordinated actions of the Union, the Member States and local and regional authorities.

Member States themselves have recognised efficiency gains embedded in this approach by devolving an increasing amount of responsibility for public investment to the regional and local level. Here, in Spain, the share of local and regional authorities in the total public investment increased over the past decade by 10 percentage points. But there are other examples of this trend in Europe.

This trend will continue. The analysis of the factors which will drive economic growth in the future shows the increasing role of innovation, which already today is responsible for more then 50% variation in the levels of regional GDPs. As a result more and more weight needs to be given to resources at local level, to research institutions, clusters of enterprises, innovative businesses and the skills of the work force. The rationale linking economic efficiency with subsidiarity and decentralisation, with the involvement of local and regional actors in the design and implementation of development strategies, will, therefore, be reinforced.

And there is a good reason for this. Surveys (Eurobarometer 2005) demonstrate that public image of globalisation impact identifies it most often with "delocalisation of companies to countries where labour is cheaper". Indeed, still not so long ago, we could see traditional reasons for geographic proximity loosing importance which led many to claiming "the death of distance" (Cairncross 1997). However, at the same time, in complex, innovation based economy new motivations for geographic proximity emerged. The quality of business environment, the versatile labour pool, innovative SMEs, research capacities, the quality of life, good quality education, which region can offer are ultimately more valuable to firms then the cost of inputs.

But the access to skills or availability of research facilities in not enough in itself. They constitute the hardware of regional innovation systems, which, in order to run smoothly, require also software, a set of networks, triple helix interactions. In business terms, it is reflected in more emphasis put on region-level collaboration among firms. This is due to the emergence of open innovation systems, which foster co-operation allowing large and small firms sharing risks of generating new products or new applications. Recent study published by OECD (Globalisation and Regional Economies, 2007) demonstrates that there are strong advantages to a regional system of innovation that uses proximity to build the kinds of trust-based relationships on which open innovation and other forms of networked innovation depend.

I am convinced that the key to success is the existence of well developed regional innovation system. It can provide a tangible source of productivity gains, prevent firms from relocating and attract new investment. There is no better example to illustrate this than rural regions, which, to those who see rural exodus, lack of services and aging population as irreversible trends, are synonymous with decline. By no means. At the beginning of the 21st Century, in more than one out of three OECD countries, the region with the highest rate of employment creation was a rural region. And responsible for this success were precisely regional policies targeting innovation.

The lesson we can take from this is that, in the context of globalisation, innovation is a must for all regions. And the more underdeveloped they are, the more innovative they have to be. Clearly, there is no "one size fits all" solution. There are differences -for example, while investment in R&D is crucial in urban areas, rural regions should focus more on investments in education and training. They should also develop the alternative and innovative use of mature technologies rather than try to compete in emerging technologies. But ultimately it is the capacity of regions to support learning and innovation processes which is a key source of competitive advantages.

So, how are European regions scoring on innovation? A model examples here can be Stockholm and Eindhoven (Brainport) regions, which are responsible for more than 200 patent applications per million. On the other end of the scale, however, one third of European regions recorded less than one patent per million (in 2000). 86 regions with 123 million people have an innovative performance below the EU average, the great majority being located in new Member States, Spain, Greece, Portugal and southern Italy.

Therefore, the key issue for European regional policy in the years to come will be to foster innovation based development outside core regions, such as Stockholm and Eindhoven. Already 2000-2006 abounds in examples of innovative projects boosting region's capacity to grow. Such as the one in Extremadura, which connected its 383 municipalities to broad band, linking all public institutions to Internet, to introduce a wide range of educational programmes and foster technological literacy. Here the challenge is to exploit fully the potential of newly created assets.

For the period of 2007-2013 however, we want innovation to be in the core of the regional policy, to turn these "success stories" into a systematic approach to regional development. In terms of amount of investment our preliminary estimates show that innovation expenditure under the new regional policy will triple compared to the 2000-2006 period, up to 55 billion euro. But we also demand from all lagging regions that they have in place regional innovation strategy which is well integrated with their approach to the implementation of European regional policy.

Sustainable convergence can only be achieved if we take into account the broader framework in which the EU economy operates. In the new global context catching up takes different forms. The role of cohesion policy is to help regional economies find their competitive place in world markets, in critical global networks and clusters; to allow them to measure their strengths and weaknesses against global challenges and opportunities and to foster their internationalisation.

The Commission, when adopting the Fourth Cohesion Report, has also proposed 3 groups of questions for the debate on the future shape of the Cohesion Policy:

- is the Cohesion Policy sufficiently adapted to the new challenges?
- how to develop a more integrated and flexible approach of the policy to the challenges ahead of us?
- how to further improve the governance of the Cohesion Policy?

I hope that the questions put forward in the 4th Cohesion Report will constitute a solid basis for a broad and rich debate on the challenges and opportunities of globalisation and the key role to be played by a strong and efficient Cohesion Policy in an enlarged Europe. I also hope that they pave the way for a fruitful discussion on the consequences of such developments in the Spanish public finance system.

We are just now at the initial stage of reflection on the future of Cohesion Policy. As you may know, the Commission has to undertake a review of the EU budget in 2008/2009 and this debate aims at nurturing it.

Let me just conclude by announcing that a prominent step in this debate will take place in Brussels on 27 and 28 September on the occasion of the Cohesion Forum opened by the Prime Minister of Portugal. This event will involve over 800 representatives at European, national, regional and local level from all EU Member States, the candidate countries and EU institutions.

Following the Cohesion Forum, I will also launch an EU-wide consultation process on the future shape of Cohesion Policy. A dedicated internet site will collect the contributions of Member States, regions, cities, EU institutions, economic and social partners and civil society organisations and EU citizens. I intend to present the results of this consultation in spring 2008, together with the fifth progress report on economic and social cohesion.

Thank you for your attention.