Investing at Scale: EU Regional and Urban Policy

Philip McCann
Sheffield University Management School

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GOVERNANCE AND PATHWAYS

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This paper has been produced by Philip McCann, Professor of Urban and Regional Economics in the University of Sheffield Management School. Philip is also the Tagliaferri Research Fellow in the Department of Land Economy at the University of Cambridge 2015-2019 and Honorary Professor of Economic Geography in the Faculty of Spatial Sciences at the University of Groningen, The Netherlands, 2017-2022.

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1. The Five Decade-Long Development of the Logic and Rationale for EU Cohesion Policy Architecture

Urban and regional economic development policies across the European Union are officially known as the European Structural and Investment Policies, but more widely nowadays they are known as EU Cohesion Policy. This is because of their underpinning logic which is fundamentally aimed at promoting economic, social and territorial cohesion across the EU, including all of its regions as well as its member states. EU Cohesion Policy, which is the integrated and multi-national regional and urban policy of the European Union, is the largest local and regional economic development programme in the world operating under one broad legal and institutional architecture[1]. The overwhelming focus of the policy is on fostering economic development in economically weaker regions, while also facilitating improved connectivity between places, enhanced environmental quality and climate change mitigation measures, and promoting more socially equitable local societies[2]. The policy currently amounts to some €47bn per annum in direct EU funding, which is also allied to additional domestic co-financing, the details of which we discuss below. In the context of the EU economy, the policy amounts to one third of the overall EU budget and to some 0.35% of the overall EU economy[3].

However, EU Cohesion Policy as we know it today has developed incrementally in response to changing circumstances and evolving needs. The origins of EU Cohesion Policy originally go back to the 1950s experience of the area-targeting policies focussed on the coal and steel communities. Some two decades later the 1973 accession of the United Kingdom and the Republic of Ireland to the European Economic Community created a need for a mechanism which provided for budget rebates, while also addressing the problems of de-industrialisation already faced for two decades in Europe by the coal and steel communities agenda. In 1975 the European Regional Development Fund (ERDF) was established specifically to fulfil both of these needs, and this marked the beginning of a new European-wide approach to addressing regional policy issues.

Meanwhile, the European Social Fund (ESF) has already been established back in 1957 as a means of assisting people facing unemployment, but over time its remit had widened to include all sorts of employment-related issues including skills-training, the enhancing of employability and access to job opportunities, and in recent years also issues of wellbeing quality of life. Over time the ERDF and the ESF increasingly became linked via related coordination mechanisms and a common legal architecture into a single coherent policy schema which formed the core of the EU Cohesion Policy framework.

The legal basis for EU Cohesion Policy is set out in articles 174-178 of the Treaty of the Functioning of the European Union (TFEU)[4] and Article 176 of the TFEU states that the role of the ERDF is "*to help redress the main regional imbalances in the Union through participating in the development and structural adjustment of regions whose development is lagging behind and in the conversion of declining industrial regions*". These articles 174-178 underpin both the ERDF and the ESF and provide for the European-wide implementation of policy actions and interventions supported by these two funding streams.

In 1993 a further funding stream was established and added to the Cohesion Policy portfolio, namely the Cohesion Fund (CF), a funding stream which operates under Article 177 of the TFEU. The CF was set up to underpin large-scale and European-wide investments relating especially to pan-European transport networks, energy networks, and also major environmental challenges[5]. Both in preparation for, and also immediately following, the accession to the EU of the former socialist economies of central and eastern Europe, the Cohesion Fund became very important in land reclamation and rehabilitation activities designed to facilitate private sector commercial investments in the transition economy regions. In addition, its environmental-upgrading role became especially important in the light of the 2001 Gothenburg Agenda (European Commission 2001), whereby the EU launched its sustainable

1. McCann, P., 2015, *The Regional and Urban Policy of the European Union: Cohesion, Results-Orientation and Smart Specialisation*, Edward Elgar, Cheltenham

2. https://ec.europa.eu/regional_policy/en/2021_2027/

3. Ibid, footnote 1.

4. As enshrined and updated in the 2009 Lisbon Treaty

5. McCann, P., and Ortega-Argilés, R., 2021a, "EU Cohesion Policy: The Past, The Present and The Future", in Humer, A., Rauhut, D., and Sielker, F., (eds.), *The EU's Cohesion Policy and Spatial Governance: Territorial, Economic and Social Challenges*, Edward Elgar, Cheltenham, Forthcoming

development strategy. It also acted as a financial stabiliser and buffer in situations where major investments could endanger the fiscal positions of national governments, something which became very apparent in the immediate aftermath of the 2008 global financial crisis.

More recently, two other much smaller and specific policy streams have been added to EU Cohesion Policy, namely the European Agricultural Fund for Rural Development (EAGRD) and the European Maritime and Fisheries Fund (EMFF), both of which are designed to help address the specific challenges faced by particular types of rural and coastal regions, respectively. As such, EU Cohesion Policy today has five main policy funding streams of which the ERDF and the ESF are largest streams followed by the CF, supported in specific contexts by the two much smaller EAFRD and EMFF funds. With its broad portfolio of differentiated funding streams, EU Cohesion Policy has the ability to respond to the various challenges and specifics of different types of places.

Prior to the 1988 Delors reforms, EU regional policy also had something a '*juste retour*' logic to it, whereby regional funding allocations were seen to some extent by national governments as side payments within the broader budget negotiation processes. The Delors reforms, however, changed this environment and established Cohesion Policy on a much clearer and more solidly based legal and institutional footing (Leonardi 2005). The result was the new policy architecture of 1989, which is basically still the institutional policy architecture that is in place today, albeit with various additional changes and reconfigurations. These subsequent changes were primarily associated with the incorporation of the 2001 Gothenburg Agenda[6] into Cohesion Policy, and also with the accession of the thirteen new countries into the EU between 2004 and 2007, a process which overnight profoundly reshaped the economic geography and patterns of regional inequalities within the EU. This is critical, because Cohesion Policy works on the basis of demarcated regions whose eligibility for funding depends on their economic prosperity (measured in terms of per capita regional Gross Domestic Product: GDP per capita) relative to the overall EU average. This EU-wide average changed instantly with the accession of the thirteen new countries and this also shifted the balance of low prosperity regions decisively eastwards.

6. European Commission, 2001, *A Sustainable Europe for a Better World: A European Union Strategy for Sustainable Development*, Final Communication from the Commission, 15.5.2001COM(2001)264, Brussels

Rural development in Nettuno fields, Italia.
(Source: Cristian Manieri, www.pexels.com)

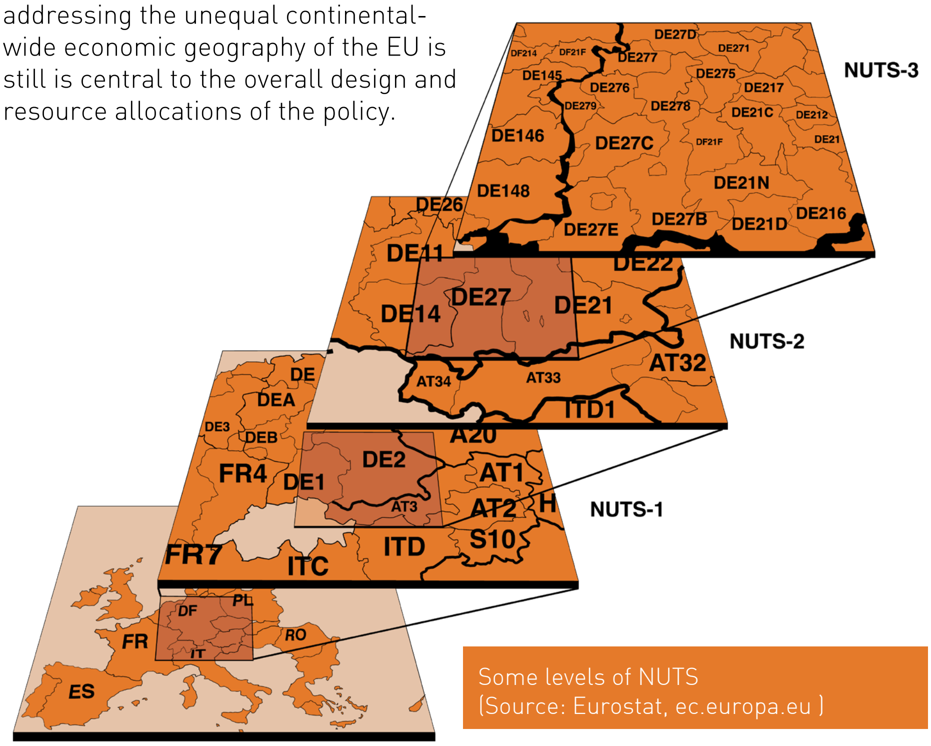
2. The Current Workings of the Policy Set-Up

Today the policy-setting processes within EU Cohesion Policy are framed in the context of seven-year 'programming periods' which correspond to the EU's multi-annual financial framework (MAFF). The seven year MAFF is a result of the negotiation processes which takes place between the 27 member states and the European Commission. These long periods allow for policy actions to be designed and implemented largely independent of changes in national governments and thereby provide stability and security for longer-term interventions. At the same time, the eligibility of different regions for funding streams is determined both by the MAFF negotiations, which sets both the overall EU budget envelope, and also the national Cohesion Policy allocations that each member state are eligible to receive. For individual regions within each member state, policy funding allocation are then determined on the basis of various criteria.

Firstly, each region in Europe is categorised according to a common statistical reference framework, namely the NUTS system. The acronym NUTS stands for Nomenclature des Unités Territoriales Statistiques[7], and this is the standard framework which divides and sub-divides the spatial economic area of the European Union into hierarchically embedded nested areas. There are 104 NUTS1 major socio-economic regional areas with an average size of 4.28 million, 281 NUTS2 meso-level areas with an average size of 1.59 million and these are the basic regions for the application and administration of EU Cohesion Policy, and also 1348 NUTS3 small region areas of the order of 331,000 people for specific diagnoses. There are also NUTS4 and 5 which are sub-urban neighbourhoods, and which are used for measuring particular socio-economic characteristics, but have no policy role. In Europe the NUTS2 classifications largely correspond to the OECD Territorial Level 1 (OECD-TL1) classifications, although in the cases of Belgium, Germany, France and the UK, the OECD-TL2 classification corresponds to the NUTS1 category.

For EU Cohesion Policy the standard area categorisation for funding allocations for the ERDF is the NUTS2 area classification, and each region is classified into different 'Objective' categories on the basis of their level of development, as defined on the basis of the regional (NUTS2) GDP per capita. Objective 1 regions are the least prosperous regions, and Objective 2 regions are those facing industrial decline. The poorest regions are eligible for the largest shares of funding, with progressively more prosperous regions eligible for progressively less funding. For the ESF the funding allocations are also determined on the basis of NUTS2 regions, but in some particular cases they are also based on the more disaggregated NUTS3 classification areas outside of the NUTS2 areas. The categorising of all EU regions according to the features of the NUTS framework provides clarity and a system of benchmarking policy actions according to the characteristics of the prosperity and needs of each region. This also ensures that the lion's share of the funding goes to places that most need the policy assistance, thereby largely breaking away from much of the *juste retour* logic of earlier decades. Obviously, EU regional policy is one, albeit the largest, component of the overall MAFF negotiations, so this *juste retour* logic is not entirely eradicated, but the NUTS system ensures that addressing the unequal continental-wide economic geography of the EU is still is central to the overall design and resource allocations of the policy.

7. https://ec.europa.eu/eurostat/web/nuts/background



Some levels of NUTS
(Source: Eurostat, ec.europa.eu)

Meanwhile, institutionally, the links between the national and sub-national governance set-ups of each EU member state are different. Sub-nationa l governance systems differ enormously across the EU in terms of the nature and range of the powers, legal bases, authority and autonomy, political logic, and accountability. The quality of governance also varies enormously[8] as well as across countries[9]. As such the governance and institutional challenges involved in delivering EU Cohesion Policy in a manner which is both efficient and effective are very significant. Therefore, in order to ensure that the policy is implemented in the manner that the policy is designed and intended for, the key institutional and organisational aspects of the policy are: programming; thematic prioritisation; partnership and shared management; co-financing; outputs and outcomes; monitoring and evaluation.

Although the funding is made available via the EU budget, the European Commission is not involved in the design of the projects or policy actions. Rather, individual member states must first design and propose their projects within an overall programming framework. This is undertaken in the context of 'Operation Programmes' which are constructed at a higher thematic or cross-thematic level and are also framed at a broad geographical vase. The Operational Programmes set out the thematic priorities which need to be addressed in the region and the key organisational, information-provision and reporting systems which will govern the implementation of the policy. In very small countries, Operational Programmes will operate at the national level, whereas in large countries they tend to work at the level of the large NUTS1 socio-economic regions. These operational programmes set out the broad themes which will govern the allocation of resources and the priorities and sequencing of individual projects, actions and interventions. Funding is then allocated according to the particular eligibility at the more spatially disaggregated NUTS2 levels (and sometimes also NUTS3 for the ESF).

In terms of partnership and shared management, the overall Operational Programmes are initially developed by national and sub-national governments working in partnership and are also agreed with the European Commission, in order to ensure that the Operational Programmes are also aligned and consistent with the EU legal basis of the overall policy. The partnership principle is also important because the EU policy actions must also be consistent with the legal provisions and institutional set-ups within the country.

When a policy at the national level is designed and agreed, the partnership principle also works on two other levels. Firstly, although funding is made available from the European Commission, subject to an agreed budget envelope, this does not provide for all of the funding required. Individual countries are required to co-finance every project, with different co-financing ratios agreed with individual countries as part of the MAFF. The need for co-financing is essential in order to ensure fundamental commitments from each country regarding the EU projects undertaken locally, and to avoid free-riding behaviour or a lack of commitments by member states. Richer countries have higher co-financing ratios relative to economically weaker countries, reflecting the greater resources available to them. In the economically weakest countries, some of these co-financing requirements were temporarily suspended in the wake of the 2008 global financial crisis due to the rapidly deteriorating budget positions of some national governments.

Once EU Cohesion Policy projects have been designed and the financing and co-financing arrangements have been established, then projects need to be implemented. Implementation requires 'shared management'. In the context of EU Cohesion Policy, the principles of shared management in part follow the principle of subsidiarity, which states that the management of the policy should be devolved downwards to the lowest level that is meaningful. As such, local sub-national governance authorities should be managing and delivering the project in a manner which is close to enough to the context to allow them to genuinely understand the opportunities, challenges and personnel involved in the activities.

8. Charron, N., Lapuente, V., and Dijkstra, L., 2014, "Regional Governance Matters: Quality of Government within European Union Member States", Regional Studies, 48.1, 68-90
Charron, N., Lapuente, V., Annoni, P., 2019, "Measuring Quality of Government in EU Regions Across Space and Time", *Papers in Regional Science*, 98.5, 1925-1953

9. Kaufman, D., and Kraay, A., 2020, *The Worldwide Governance Indicators (WGI)* Project, World Bank, Washington DC, See: http://info.worldbank.org/governance/wgi/

Each Operational Programme has a designated Managing Authority which has the primary responsibility for ensuring the delivery of the programme and its embedded projects and in medium and large countries the managing authorities will be sub-state bodies at the state or regional levels. However, the activities of the Managing Authority are also linked to those of the central state. At the level of the nation, the state also has a stake in the EU Cohesion Policy programmes and projects, given the state's co-financing requirements and arrangements. As a result of this, the shared management arrangements which have emerged in most member states involve both central and local or sub-national governments working together in order to ensure that projects are designed and delivered effectively. The roles and responsibilities of the different partner institutions and bodies involved in the EU Cohesion Policy programmes, as well as their shared management functions, are all detailed in the Operational Programmes. Indeed, these shared management practices across the EU Cohesion Policy landscape are themselves a key part of building multi-level governance arrangements across Europe aimed at delivering territorial development and integration.

In terms of the goals of the EU Cohesion Policy programmes, the goals of each of the policies are specified in terms of observable outputs which can be observed and measured. These common outputs are agreed with the European Commission, and are intended to facilitate the monitoring, tracking and ex post evaluation of the projects. Because of a history of some high-profile projects failing the tests of accountability and traceability, many of the reforms to EU Cohesion Policy over the last three decades have concerned issues of reporting and accountability. In reality, less than 1% of the projects and funding associated with EU Cohesion Policy have fallen foul of the European Court of Auditors, the ultimate arbiter of good governance on these matters.[10]

Every three or four years a new European Union Report on Economic, Social and Territorial Cohesion is published by the European Commission[11] in order to monitor the progress of the policy across many different dimensions. In addition, the Directorate General for Regional and Urban Policy, which is the arm of the European Commission tasked with managing the EU Cohesion Policy programme on behalf of the European Union institutions, publishes many detailed papers on evidence of policy impacts and examples of policy initiatives from all over the European Union. These are updated regularly, as are the sources of EU-wide data underpinning the policy and its analysis. In addition, since 2002, another EU initiative, namely the ESPON[12] European Spatial Planning Observation Network based in Luxembourg, both funds and publishes dedicated research activities aimed specifically at improving our understanding of the European urban and regional economic landscape and thereby enhancing the design and delivery of EU Cohesion Policy over the coming years. Indeed, there is now a wide body of evidence using advanced econometric techniques that demonstrates the effectiveness of EU Cohesion Policy[13] in achieving its intended goals of raising the development levels of the less prosperous regions and narrowing the gaps between the economically stronger and weaker regions.

10. McCann, P., 2015, *The Regional and Urban Policy of the European Union: Cohesion, Results-Orientation and Smart Specialisation*, Edward Elgar, Cheltenham

11. European Union, 2017, *Investing for Jobs and Growth: Promoting Development and Good Governance in EU Regions and Cities*, Seventh Report on Economic, Social and Territorial Cohesion, Luxembourg
European Union, 2021, *Cohesion in Europe Towards 2050*, Eighth Report on Economic, Social and Territorial Cohesion, Luxembourg

12. https://www.espon.eu/

13. Becker, S.O., Egger, P.H., von Ehrlich, M., 2010, "Going NUTS: The Effect of EU Structural Funds on Regional Performance", *Journal of Public Economics*, 94, 578–590
Becker, S.O., Egger, P.H., von Ehrlich, M., 2012, "Too Much of a Good Thing? On the Growth Effects of the EU's Regional Policy", *European Economic Review*, 56, 648–668
Becker, S.O., Egger, P.H., von Ehrlich, M., 2013, "Absorptive Capacity and the Growth and Investment Effects of Regional Transfers: A Regression Discontinuity Design with Heterogeneous Treatment Effects", *American Economic Journal: Economic Policy*, 5.1, 29–77
Pellegrini G., Terribile F., Tarola O., Muccigrosso T., and Busillo F., 2013, "Measuring the Effect of European Regional Policy on Economic Growth: A Regression Discontinuity Approach", *Papers in Regional Science*, 92, 217–233
Ferrara, A., Pellegrini, G., Stelder, D., and Terribile, F., 2017, "Assessing the Impacts of Cohesion Policy on EU Regions: A Non-Parametric Analysis on Interventions Promoting Research and Innovation and Transport Accessibility", 2017, *Papers in Regional Science*, 96.4, 817-841,
Ferrara, A., Dijkstra, L., McCann, P., and Nistico, R., 2022, "The Response of Regional Well-Being to Place-Based Policy Interventions", *Regional Science and Urban Economics*, See: https://doi.org/10.1016/j.regsciurbeco.2022.103830

The European Court of Auditors (ECA)
(Source: flckr.com)

3. EU Cohesion Policy Current and Future Challenges and Opportunities: Brexit, the Covid-19 Pandemic and the EU Green Deal

Arguably, the whole of EU Cohesion Policy today faces a fundamental turning point and potentially its greatest combination of challenges and opportunities in a generation. The three grand challenges and opportunities that EU Cohesion Policy now simultaneously faces are those of the impacts of Brexit, the fall-out from the Covid-19 pandemic and the agenda set out by the EU Green Deal.

Brexit has profound implications for EU Cohesion Policy on many levels. As already mentioned, the original establishment of the ERDF was in part related to the accession of the UK to the EEC in 1973, and the final withdrawal of the UK from the EU on 31 January 2020 changes the funding logic underpinning both the MAFF and also EU Cohesion Policy itself. The UK was the second largest net contributor to the overall EU budget and in terms of EU Cohesion Policy was only the twelfth largest recipient.[14] As such, the withdrawal of the UK from the EU budget mechanism significantly changes the relative balance between the funding and the distribution of EU Cohesion Policy resources. These are issues which have initially been addressed in the 2021-207 MAFF negotiations, but these are also serious long-term implications of Brexit at the regional level.

Brexit itself will almost certainly change the EU-wide regional balance of prosperity and vulnerability. The economic shock effects from Brexit are more likely to impact on the regions in the north and west of Europe because these regions are more interconnected with the UK in terms of trade and global value-chains than other parts of Europe. In particular, the regions which are likely to be the least affected by Brexit[15] are primarily in the east and south of Europe, many of which are regions which are generally economically weak and relatively more dependent on EU Cohesion Policy than the northern and western European regions. Indeed, the scale of the likely trade-related adverse shocks in the more prosperous regions of Europe is of the order of five times the likely shocks in the weaker regions of the EU.[16] This in turn implies that the relative balance of EU interregional prosperity between north western Europe and the south and east of Europe, which itself heavily shapes the regional allocation of Cohesion Policy funding, is likely to narrow due to the trade-related impacts of Brexit. The Cohesion Policy allocations in the current the programming period 2021-2027 are based on the pre-Brexit regional GDP per capita values, but Brexit is likely to reshape the relative productivity positions of the EU regions, especially during the current programming period. This suggests that the MAFF negotiations for EU Cohesion Policy allocations which will take place in seven years' time for the following programming period may be rather different than at present.

The second major issue which will affect EU Cohesion Policy in the medium and long-run is the impact of the coronavirus pandemic, which is likely to be different in different regions. At the national level, the first wave of the pandemic in early 2020 impacted primarily on western European countries, and in particular on large and densely populated western-European regions which tend to be wealthy by EU-wide standards. Some of the European Union's most dynamic and prosperous economies such as Madrid, Milan and Paris were severely hit in the first half of 2020, but over time the impacts of the pandemic tended to spread out to other regions within these same countries. Central and eastern European countries tended to suffer much less severe impacts during the first wave of the pandemic, whereas during the second wave of the pandemic in early 2021 the reverse was the case. Central and Eastern European countries were relatively more severely affected than many western European countries throughout 2021, so in terms of the long run interregional implications of the pandemic, these will depend on the overall distribution of these impacts after the various waves of the pandemic throughout 2020 and 2021 have played out, at least until vaccination roll-outs cover all of the population of all of the EU countries. The likelihood is that the pandemic gaps between the western and central

14. McCann, P., 2015, *The Regional and Urban Policy of the European Union: Cohesion, Results-Orientation and Smart Specialisation*, Edward Elgar, Cheltenham

15. Chen, W., Los, B., McCann, P., Ortega-Argilés, R., Thissen, M., and van Oort, F., 2018, "The Continental Divide? Economic Exposure to Brexit in Regions and Countries on Both Sides of the Channel", *Papers in Regional Science*, 97.1, 25-54
Thissen, M., van Oort, F., McCann, P., Ortega-Argilés, R., and Husby, T., 2020, "The Implications of Brexit for UK and EU Regional Competitiveness", *Economic Geography*, 96.5, 397-421

16. Ibid.

and eastern European countries which widened during 2020 will be greatly narrowed during 2021, although the inter-country implications on regional prosperity will take several years to be realised.

The EU has provided an emergency additional funding package[17] of €47.5bn directly to EU Cohesion Policy for 2021-2022 in order to help respond to the immediate impacts of the pandemic. This comes as part of the REACT-EU programme, whereby REACT-EU stands for Recovery Assistance for Cohesion and the Territories of Europe. However, while this additional assistance is very significant, and equivalent to a full extra year of EU Cohesion Policy funding, in reality, in comparison to the scale of the shock it is small, representing less than 0.4% of the size of the EU economy.

In terms of assessing the likely impacts of the Covid-19 pandemic on EU Cohesion Policy in the long run. Yet the likely regional implications of Covid-19 are complex, with different economic shock mechanisms at play.

In terms of the local and regional implications, rather than inter-national implications of the pandemic, there are three broad mechanisms which the covid-19 pandemic has set in train, each of which is likely to reshape regional policy funding allocations between countries in the next programming period, and also within individual countries in the shorter and medium term. These three different effects are: the tourism and hospitality sectoral shocks; the so-called 'zoomshock'[18] effect on remote working or working-from-home;[19] and the capital shocks effects of the pandemic.

The first of these Covid-19 pandemic-related effects on the EU interregional economic system is the impact of the pandemic on key sectors such as tourism and hospitality and international travel. Many European regions, and especially so those in southern Europe, are heavily dependent on tourism for their economic livelihoods, and the lockdowns and international travel moratoria imposed throughout 2020 and 2021 will have devastated many of these local industries. The full implications of these lockdowns will not become apparent until after the covid-19 emergency is over and all government-related support to businesses have been withdrawn. However, in all likelihood, the prosperity of these tourism-dominated local economies will have receded significantly in comparison to other regions, so in both the short term and the medium term, EU Cohesion Policy funding in many countries will be being redirected towards development projects in these localities via the redesign and reorienting of Operational Programmes towards the most severely affected places. However, exactly how these sector-specific shocks will affect the overall EU Cohesion Policy funding allocations in the next MAFF negotiations will depend largely on the speed of recovery of these tourism and hospitality-related activities in different countries in comparison to other sectors, as well as the scale of scarring from the lockdowns.

The second of these Covid-19 pandemic-related effects on the EU interregional economic system is the so-called 'zoomshock'[20] implications on regions, whereby workers will increasingly be able to work full or part time remotely from home. This will have implications for large cities, with the likelihood of some geographical spread effects taking place whereby workers, and also some small firms, are likely to relocate to smaller towns and rural areas. Depending on the availability of broadband infrastructure around large cities and in more remote locations, some workers will choose to move out of the main cities while still remaining in the city hinterlands to allow for some commuting, whereas for workers whose pandemic experience is that they are able to work remotely more or less full-time, these groups will be able to consider movements to more remote rural and small town locations. The shift to more remote working by higher income groups and their relocation to smaller town and rural areas may offer new possibilities in these places for newly emerging markets and local business opportunities. These changing distributions potentially offer advantages to more remote and smaller town regional economies, which tend to be economically weaker than larger city and urbanised regions. At the same time, the new work-from-home opportunities may also increase the hinterland attraction of larger cities, thereby engendering something of a new urban hierarchy in which

17. https://ec.europa.eu/commission/presscorner/detail/en/QANDA_20_2381

18. de Fraja, G., Matheson, J., and Rockey, J., 2021, "Zoomshock: The Geography and Local Labour Consequences of Working from Home", *Covid Economics: Vetted and Real Time Papers*, Issue 64, CEPR Press, Centre for Economic Policy, London, 13 January

19. Bond-Smith, S., and McCann, P., 2022, "The Work-From-Home Revolution and the Performance of Cities", TPI Working Paper 026, The Productivity Institute, Manchester, September, See: https://www.productivity.ac.uk/research/the-work-from-home-revolution-and-the-performance-of-cities/

20. Ibid. footnote 18

economically weaker lose market share to stronger and larger places.[21]

Traditionally, in many countries EU Cohesion Policy has provided strong support for these often somewhat weaker local economies. However, these remote-working changes my alter the balance of EU Cohesion Policy funding to rather more urbanised areas which have been severely hit by the pandemic while also losing some of their long-run attractiveness. As such, these changes may in the long run influence the spatial balance of EU Cohesion Policy funding somewhat slightly away from these places.

The third of these Covid-19 pandemic-related effects on the EU interregional economic system is the capital shock effect. In the wake of the Covid-19 pandemic, the scale of the debt and deficit positions of national governments are unprecedented and at present the long-run willingness of the capital markets to lend to governments is unclear, especially in the current context of fears about inflation. In particular, there is detailed evidence[22] that the capital shocks associated with the 2008 global financial crisis adversely affected smaller cities and town in comparison to larger cities and urban areas, whose fortunes actually improved through the crisis. The reason for this is that in a context of profound financial uncertainty, large and prosperous cities become, in effect, an extension of the global bond markets, capital with capital seeking safety first. The effect of this is to increase the supply of capital in already-strong areas, at a lower price and with more favourable collateral terms for local entrepreneurs and investors, whereas smaller and more remote locations are faced with dwindling supplies of finance, offered at higher prices and with more onerous collateral positions for entrepreneurs and investors. These differential capital shocks provide a powerful explanation as to why in the post 2008-crisis era the interregional economic systems of the majority of countries shifted from a regime of convergence to one of divergence.[23] There are also very strong arguments to suggest that the Covid-19 pandemic will engender similar spatial effects, which widen the prosperity divide between the stronger and the weaker regions.[24] Moreover, the worsening debt and deficit positions of national governments means that the public funds available for economic development are likely to be much more limited than is typically the case.

Istanbul (Turkey)
(Source: Furkan Demir, www.pexels.com)

21. Ibid, footnote 19

22. Daams, M., McCann, P., Veneri, P., Barkham, R., and Shoenmaker, D., 2022, "Capital Shocks and the Great Urban Divide", SSRN Social Science Research Network Paper, See: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3795957

23. European Union, 2014, *My Region, My Europe, Our Future*, Sixth Report on Economic, Social and Territorial Cohesion, Luxembourg

24. McCann, P., and Ortega-Argilés, R., 2021b, "The Covid-19 Shock: The UK National and Regional Implications in the Light of International Evidence", in McCann, P., and Vorley, T., (eds.), *Productivity and the Pandemic: Challenges and Insights from Covid-19*, Edward Elgar, Cheltenham

The overall balance of the three broad Covid-19 pandemic effects on the EU interregional system, depends on the strengths and longevity of each of these effects.

The final broad challenge and opportunity facing EU Cohesion Policy in the coming years relates to the climate change agenda. Just prior to the onset of the Covid-19 pandemic in Europe, the European Commission had launched its flagship 'EU Green Deal'.[25] This aimed to re-orient the portfolio EU policies squarely towards climate-change mitigation activities, and EU Cohesion Policy is one of the EU policies that offers the greatest advantages and leverage for pushing forward the green agenda.[26] The principal reason for this is that EU-wide success in pushing forward the green agenda depends on overcoming the inherent region-specific internal opposition to the green agenda. Genuine EU-wide progress in driving forward the green agenda requires the engagement of numerous stakeholders and actors across the whole of Europe. Progress across a very wide range of fronts is essential to make progress. However, many of the economically weaker regions of Europe not only have much to gain from climate change-mitigation strategies in that they are very vulnerable to global warming, but also, they are the most vulnerable to climate change mitigation strategies. The reason is that many of the EU's weaker regions are relatively specialised in activities which are carbon-intensive and energy-intensive, such as heavy industry and manufacturing. Activities which seek to curb emissions will disproportionately hurt these localities, which are often already relatively weak. As such, there is likely to be a natural social and political opposition in these regions to climate change mitigation strategies, and without the wholehearted participation of such regions, the EU Green Deal is unlikely to fully prosper.

EU Cohesion Policy is uniquely and ideally located to help provide the locally-targeted incentives for weaker regions to engage in the green agenda and by also providing the resources to cushion the local effects of transitioning to greener technologies and activities. The reasons for this are that EU Cohesion Policy has a genuinely EU-wide footprint at a local level, involving multi-level governance actors and processes across the continent. At the same time, its orientation towards enhancing development in economically weaker regions is ideally suited to facilitating industrial restructuring that will necessarily be central to the green transitioning processes. EU Cohesion Policy already has both the systems and the multi-level governance arrangements embedded in it to take on board such a green agenda.

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