



European Regional Development:

# Fate, Fortune or Good Policies?



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Edited by: Rok Spruk



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## **European Regional Development: Fate, Fortune or Good Policies?**

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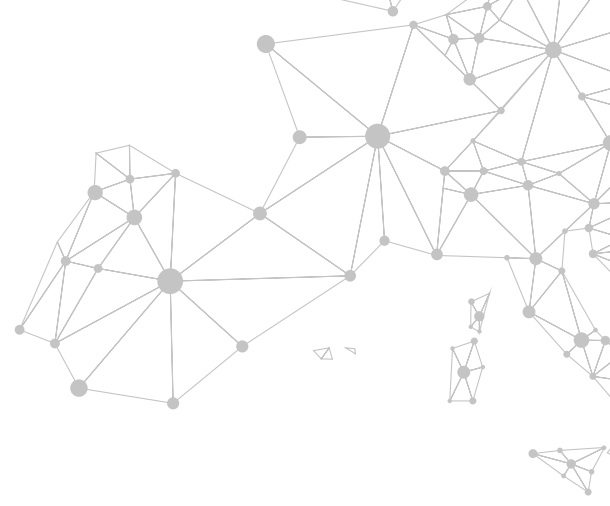
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# ELF & Zavod 14

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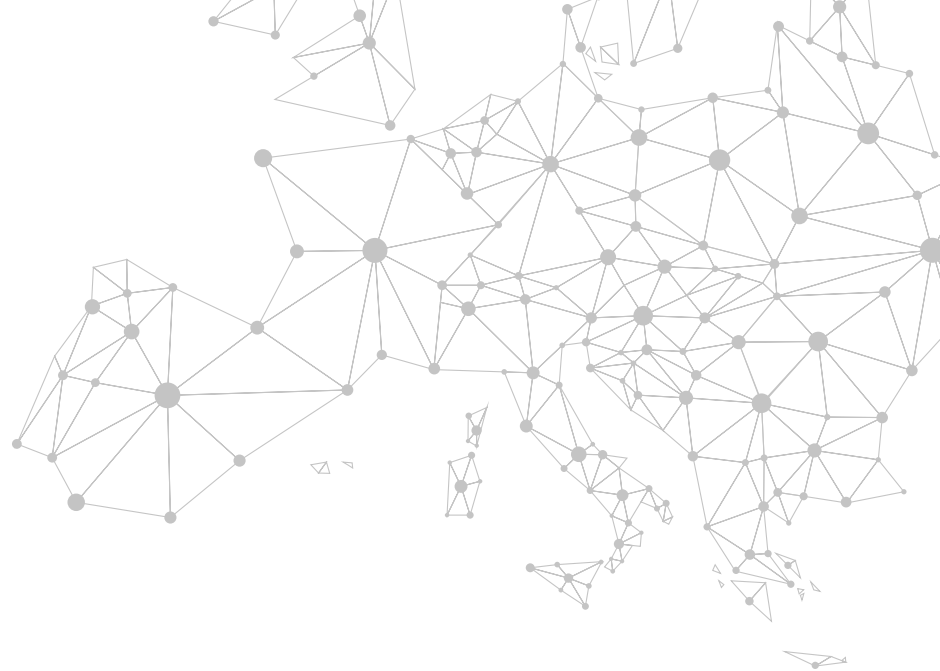
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# 1.

## Introduction



By Rok Spruk

*The origins of the wealth and poverty of nations is an intensely debated issue in development economics.<sup>1</sup> Scholars agree the institutional framework emphasising low transaction costs<sup>2</sup> and secure property rights,<sup>3</sup> broad-based and inclusive de jure and de facto political institutions,<sup>4</sup> a culture of cooperation,<sup>5</sup> a high rate of return on human capital,<sup>6</sup> and perhaps even physical geography<sup>7</sup> account for the wide-standing and*

*persistent gaps seen in the levels of per capita income across countries. Within an institutional framework that fails to foster inclusive political and economic institutions, human capital investment, and a culture of cooperation, countries are rarely able to flourish in the long run.<sup>8</sup> The evidence on the root causes of economic growth at the subnational level is much less certain. Can regions achieve sustained development*

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- <sup>1</sup> Landes, David S. *Wealth and poverty of nations*. Hachette UK, 2015; Easterly, William, and Ross Levine. "Tropics, germs, and crops: how endowments influence economic development." *Journal of Monetary Economics* 50, no. 1 (2003): 3-39; Mokyr, Joel. *The lever of riches: Technological creativity and economic progress*. Oxford University Press, 1992; Hall, Robert E., and Charles I. Jones. "Why do some countries produce so much more output per worker than others?" *The Quarterly Journal of Economics* 114, no. 1 (1999): 83-116; Acemoglu, Daron, Simon Johnson, and James A. Robinson. "The colonial origins of comparative development: An empirical investigation." *American Economic Review* 91, no. 5 (2001): 1369-1401; Acemoglu, Daron, and James Robinson. "Why nations fail." New York: Crown Business (2012); Van Zanden, Jan Luiten. "The skill premium and the 'Great Divergence'." *European Review of Economic History* 13, no. 1 (2009): 121-15; Van Zanden, Jan Luiten, Joerg Baten, Peter Foldvari, and Bas Van Leeuwen. "The changing shape of global inequality 1820-2000: exploring a new dataset." *Review of Income and Wealth* 60, no. 2 (2014): 279-297; Galor, Oded, and Daniel Tsiddon. "Technological progress, mobility, and economic growth." *The American Economic Review* (1997): 363-382.
- <sup>2</sup> Henisz, Witold J. "The institutional environment for economic growth." *Economics & Politics* 12, no. 1 (2000): 1-31; Davis, Lance Edwin, Douglass C. North, and Calla Smorodin. *Institutional change and American economic growth*. Cambridge University Press, 1971; Knack, Stephen, and Philip Keefer. "Institutions and economic performance: cross-country tests using alternative institutional measures." *Economics & Politics* 7, no. 3 (1995): 207-227; North, Douglass C. "Institutions, transaction costs and economic growth." *Economic inquiry* 25, no. 3 (1987): 419-428; Kovač, Mitja and Rok Spruk "Institutional development, transaction costs and economic growth: evidence from a cross-country investigation." *Journal of Institutional Economics* 12, no. 1 (2016): 129-159.
- <sup>3</sup> Torstensson, Johan. "Property rights and economic growth: an empirical study." *Kyklos* 47, no. 2 (1994): 231-247; Acemoglu, Daron, and Simon Johnson. "Unbundling institutions." *Journal of Political Economy* 113, no. 5 (2005): 949-995; Clague, Christopher, Philip Keefer, Stephen Knack, and Mancur Olson. "Contract-intensive money: contract enforcement, property rights, and economic performance." *Journal of Economic Growth* 4, no. 2 (1999): 185-211; Haber, Stephen, Noel Maurer, and Armando Razo. *The politics of property rights: political instability, credible commitments, and economic growth in Mexico, 1876-1929*. Cambridge University Press, 2003; Gould, David M., and William C. Gruben. "The role of intellectual property rights in economic growth." *Journal of Development Economics* 48, no. 2 (1996): 323-350; Weingast, Barry R. "The economic role of political institutions: Market-preserving federalism and economic development." *Journal of Law, Economics, & Organization* (1995): 1-31.
- <sup>4</sup> Spruk, Rok. "Institutional transformation and the origins of world income distribution." *Journal of Comparative Economics* 44, no. 4 (2016): 936-960; Acemoglu, Daron, Simon Johnson, and James A. Robinson. "Reversal of fortune: Geography and institutions in the making of the modern world income distribution." *The Quarterly Journal of Economics* 117, no. 4 (2002): 1231-1294; Przeworski, Adam, Fernando Limongi, and Salvador Giner. "Political regimes and economic growth." In *Democracy and Development*, pp. 3-27. Palgrave Macmillan, London, 1995; Doucouliagos, Hristos, and Mehmet Ali Ulubaşoğlu. "Democracy and economic growth: a meta-analysis." *American Journal of Political Science* 52, no. 1 (2008): 61-83; Durham, J. Benson. "Economic growth and political regimes." *Journal of Economic Growth* 4, no. 1 (1999): 81-111.
- <sup>5</sup> Hofstede, Geert, and Michael Harris Bond. "The Confucius connection: From cultural roots to economic growth." *Organizational Dynamics* 16, no. 4 (1988): 5-21; Guiso, Luigi, Paola Sapienza, and Luigi Zingales. "Does culture affect economic outcomes?" *Journal of Economic Perspectives* 20, no. 2 (2006): 23-48; Maseland, Robbert. "Parasitical cultures? The cultural origins of institutions and development." *Journal of Economic Growth* 18, no. 2 (2013): 109-136; Gorodnichenko, Yuriy, & Roland, Gerard (2017). Culture, institutions, and the wealth of nations. *Review of Economics and Statistics*, 99(3), 402-416; Gorodnichenko, Yuriy, and Gerard Roland. "Which dimensions of culture matter for long-run growth?" *American Economic Review* 101, no. 3 (2011): 492-98; Gorodnichenko, Yuriy, and Gerard Roland. "Individualism, innovation, and long-run growth." *Proceedings of the National Academy of Sciences* 108, no. Supplement 4 (2011): 21316-2131; Zak, Paul J., and Stephen Knack. "Trust and growth." *The Economic Journal* 111, no. 470 (2001): 295-321.
- <sup>6</sup> Benhabib, Jess, and Mark M. Spiegel. "The role of human capital in economic development evidence from aggregate cross-country data." *Journal of Monetary Economics* 34, no. 2 (1994): 143-173; Becker, Gary S., Kevin M. Murphy, and Robert Tamura. "Human capital, fertility, and economic growth." *Journal of Political Economy* 98, no. 5, Part 2 (1990): S12-S37.
- <sup>7</sup> Gallup, John Luke, Jeffrey D. Sachs, and Andrew D. Mellinger. "Geography and economic development." *International Regional Science Review* 22, no. 2 (1999): 179-232; Démurger, Sylvie, Jeffrey D. Sachs, Wing Thy Woo, Shuming Bao, Gene Chang, and Andrew Mellinger. "Geography, economic policy, and regional development in China." *Asian Economic Papers* 1, no. 1 (2002): 146-197; Sachs, Jeffrey D., Andrew D. Mellinger, and John L. Gallup. "The geography of poverty and wealth." *Scientific American* 284, no. 3 (2001): 70-75; Sachs, Jeffrey D., and Andrew M. Warner. "Fundamental sources of long-run growth." *The American Economic Review* 87, no. 2 (1997): 184-188; Diamond, Jared. *Collapse: How Societies Choose to Fail or Succeed*. Penguin, 2005; Sachs, Jeffrey. *The End of Poverty: How We Can Make It Happen in our Lifetime?* Penguin UK, 2005.

*in response to good and prudently designed policies,<sup>9</sup> a broad-based institutional framework, a culture of trust and cooperation, and substantial human capital investment? Alternatively, is regional development determined by luck or by fate? Disentangling the determinants of regional development and their contribution to the long-run growth of regions may provide the necessary insights into the 'black box' of subnational development.*

*The existing evidence on the determinants of growth and development at the subnational level points in several possible directions. Gennaioli et al. (2014)<sup>10</sup> use a newly assembled sample of 1,528 regions from 83 countries to compare the speed of convergence within and across countries. They estimate the rate of regional convergence at about 2% per year, and show that regional convergence is faster in richer countries and in countries with better capital markets. By calibrating a neoclassical growth model, they suggest that barriers to factor mobility within countries are necessary to explain regional convergence patterns in the long term. In a related paper, Gennaioli et al. (2012)<sup>11</sup> closely investigate the drivers of regional development using a dataset comprising 1,569 subnational regions from 110 countries covering 74% of the world's surface and 97% of world GDP. In doing so, they present a regional development model with standard migration framework elements of the Lucas (1978)<sup>12</sup> talent allocation model, and the Lucas (1988)<sup>13</sup> model of human capital externalities. Their results highlight the fundamental importance of human capital in explaining regional differences in development, and suggest that entrepreneurial inputs and human capital externalities*

*help explain the patterns of regional development differences across and within countries.*

*Contrary to the human capital view, Mitton (2016)<sup>14</sup> studies economic development in a cross section of 1,867 regions. The evidence suggests that many geographic factors, such as rugged terrain, a tropical climate, ocean access, temperature range, storm risk and natural resources, may be relatively more important for regional development. While the quality of institutions positively and significantly impacts the level of per capita income, the beneficial effect of institutions is driven by the degree of subnational autonomy, suggesting that strong subnational institutions may enhance development only when they are not dominated by national institutions. The evidence partly highlights the importance of institutional decentralisation as a potential institutional backbone of regional development. Other scholars suggest that culture might be the decisive factor in regional development. Tabellini (2010)<sup>15</sup> asks whether culture causes economic development. Specifically, he attempts to isolate the exogenous variation in culture by considering the historical literacy rates at the end of the 19th century, and the political institutions in place over the past several centuries in a sample of European regions. Controlling for the confounding influence of contemporary human capital investment, historical urbanisation rates and country-level effects, the evidence reveals the paramount importance of culture in fostering regional development.*

*Several scholars contend that the quality of subnational-level institutions might be the missing*

<sup>8</sup> Rodrik, Dani, Arvind Subramanian, and Francesco Trebbi. "Institutions rule: the primacy of institutions over geography and integration in economic development." *Journal of Economic Growth* 9, no. 2 (2004): 131-165; Amin, Ash. "An institutionalist perspective on regional economic development." *International Journal of Urban and Regional Research* 23, no. 2 (1999): 365-378.

<sup>9</sup> Easterly, William. "National policies and economic growth: a reappraisal." *Handbook of Economic Growth* 1 (2005): 1015-1059; Easterly, William, and Sergio Rebelo. "Fiscal policy and economic growth." *Journal of Monetary Economics* 32, no. 3 (1993): 417-458; Munnell, Alicia H. "Policy watch: infrastructure investment and economic growth." *Journal of Economic Perspectives* 6, no. 4 (1992): 189-198; King, Robert G., and Sergio Rebelo. "Public policy and economic growth: developing neoclassical implications." *Journal of Political Economy* 98, no. 5, Part 2 (1990): S126-S150.

<sup>10</sup> Gennaioli, Nicola, Rafael La Porta, Florencio Lopez De Silanes, and Andrei Shleifer. "Growth in regions." *Journal of Economic growth* 19, no. 3 (2014): 259-309.

<sup>11</sup> Gennaioli, Nicola, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer. "Human capital and regional development." *The Quarterly Journal of Economics* 128, no. 1 (2012): 105-164.

<sup>12</sup> Lucas, Robert E. "On the size distribution of business firms." *The Bell Journal of Economics* (1978): 508-523.

<sup>13</sup> Lucas, Robert E. "On the mechanics of economic development." *Journal of Monetary Economics* 22, no. 1 (1988): 3-42.

<sup>14</sup> Mitton, Todd. "The wealth of subnations: Geography, institutions, and within-country development." *Journal of Development Economics* 118 (2016): 88-111.

<sup>15</sup> Tabellini, Guido. "Culture and institutions: economic development in the regions of Europe." *Journal of the European Economic Association* 8, no. 4 (2010): 677-716.

piece of the puzzle needed to explain the contrasting differences in regional development. Rodríguez Pose (2013)<sup>16</sup> finds that the quality of institutions is crucial for regional economic development. However, deploying an institution-based regional development roadmap can be undermined by the lack of a definition for efficient institutions. The key problem arises from the measurement of institutions across both space and time. Further caveats are posited by the interaction of formal and informal institutions as well as by the endogeneity between institutions and regional development, which implies that a one-size-fits-all institutional approach to regional development may be difficult to maintain.

Given the wide-standing regional growth and development gaps persisting across European regions,<sup>17</sup> the question that naturally emerges is whether the EU's regional support helps or harms the growth performance of European regions. Cappelen et al. (2003)<sup>18</sup> discuss the structural funds' impact on the growth rates of EU regions. Their findings suggest the economic effects of the regional support schemes are much stronger at higher levels of per capita income, and also emphasise the importance of complementary policies that improve the competence of the receiving environment. Further, Mohl and Hagen (2010)<sup>19</sup> analyse the growth effects of EU structural funds across 126 NUTS-2 regions, and differentiate between Objective 1, 2 and 3 payments. The evidence based on the dynamic system GMM estimator suggests that Objective 1 payments tend to promote regional development while the total amount of support does not have a positive and significant impact on regional

growth rates. Based on instrumental variable analysis, the evidence presented in Bellini et al. (2012)<sup>20</sup> suggests that cultural diversity is positively and significantly related to regional productivity growth, indicating that diversity might be one of the complementary factors improving the subsidy-receiving environment.

Numerous studies advocate the importance of public policies in shaping growth rates and income levels across European regions.<sup>21</sup> For instance, Del Bo and Florino (2012) examine the rate of return to infrastructure in the EU regions within a spatial framework by combining disaggregated types of infrastructure with spatial dependence. Their results confirm the important role of infrastructure in regional performance, and suggest the highest rates of return are associated with telecommunications, the quality and accessibility of transportation networks, and with a positive impact of roads and railways. This implies that expanding the regional development objectives based on infrastructure-targeted development schemes may hold profound and long-lasting positive implications for regional growth<sup>22</sup> By contrast, Rodríguez Pose and Crescenzi (2010) suggest that R&D spillovers might be one of the most important vehicles of regional growth and development. Specifically, they deploy a structural model of R&D spillovers and conduct a multiple regression analysis for all regions of the group of EU-25 countries, including measures of R&D investment proxies for regional innovation and knowledge spillovers. Their empirical results highlight the fundamental importance of innovation capacity for generating sustained regional development, emphasising the proximity for the transmission of

<sup>16</sup> Rodríguez-Pose, Andrés. "Do institutions matter for regional development?" *Regional Studies* 47, no. 7 (2013): 1034-1047.

<sup>17</sup> Armstrong, Harvey W. "Convergence among regions of the European Union, 1950-1990." *Papers in Regional Science* 74, no. 2 (1995): 143-152.

<sup>18</sup> Cappelen, Aadne, Fulvio Castellacci, Jan Fagerberg, and Bart Verspagen. "The impact of EU regional support on growth and convergence in the European Union." *Journal of Common Market Studies* 41, no. 4 (2003): 621-644.

<sup>19</sup> Mohl, Philipp, and Tobias Hagen. "Do EU structural funds promote regional growth? New evidence from various panel data approaches." *Regional Science and Urban Economics* 40, no. 5 (2010): 353-365.

<sup>20</sup> Bellini, Elena, Gianmarco IP Ottaviano, Dino Pinelli, and Giovanni Prarolo. "Cultural diversity and economic performance: evidence from European regions." In *Geography, institutions and regional economic performance*, pp. 121-141. Springer, Berlin, Heidelberg, 2013.

<sup>21</sup> Martin, Philippe. "Can regional policies affect growth and geography in Europe?" *World Economy* 21, no. 6 (1998): 757-774.

<sup>22</sup> Del Bo, Chiara F., and Massimo Florio. "Infrastructure and growth in a spatial framework: evidence from the EU regions." *European planning studies* 20, no. 8 (2012): 1393-1414.

economically useful knowledge, as the distance effects might influence spillovers.<sup>23</sup>

A different strand of literature suggests that regional disparities might be driven by the efficiency of the labour market. For example, Herwartz and Niebuhr (2010) investigate the differences in labour-market responsiveness and their potential determinants for a cross section of European regions. Based on a dataset covering NUTS-2 regions in the EU-15 member states for the period 1980–2002, their findings highlight substantial differences in labour market effects of output growth among EU countries and regions, and that both national labour market institutions and regional characteristics help explain a significant share of regional performance disparities.<sup>24</sup> On the other hand, some scholars note the fundamental importance of the interplay between human capital and innovation in explaining regional growth. Badinger and Tondl (2003) examine the regional disparities across EU regions and demonstrate the tendency of the disparities to decrease gradually, suggesting that levels of human capital at the regional level tend to explain these patterns.<sup>25</sup> In essence, the relationship between various regional policy outcomes and the growth performance of regions is subject to empirical debate and remains an unsettled question.

While Barro (2001)<sup>26</sup> and Glaeser et al. (2004)<sup>27</sup> show that human capital is a more basic source of

growth than institutions are, whereas poor countries tend to escape the poverty trap through good policies regardless of their political institutions, several studies suggest that standard indicators of human capital stock such as literacy rates, enrolment rates and years of education suffer from several structural flaws. Apart from acting as crude measures of human capital investment, these indicators reflect the input rather than output measures of human capital formation and may produce implausible effects, implying their relationship with economic outcomes is not particularly robust. Weede and Kämpf (2003) suggest the use of average intelligence as a rough proxy for human capital stock. In a cross section of 97 countries in the period 1965–1990, they show that each additional point increase in average IQ is associated with a rise in the growth rate of between 0.5 and 0.8 of a percentage point, respectively.<sup>28</sup> Similar conclusions on the beneficial economic and institutional effects of average intelligence were reached by a handful of other scholars.<sup>29</sup>

Following this strand of literature, Hanushek and Kimko (2000)<sup>30</sup> suggest that direct measures of labour-force quality from international mathematics and science tests are strongly positively related to growth. Hanushek and Wößmann (2008)<sup>31</sup> further the use of mathematics and science test scores and show that countries with better mathematics and science skills, as a proxy for cognitive skills, have significantly

<sup>23</sup> Rodríguez-Pose, Andrés, and Ugo Fratesi. "Between development and social policies: the impact of European Structural Funds in Objective 1 regions." *Regional Studies* 38, no. 1 (2004): 97–113.

<sup>24</sup> Herwartz, Helmut, and Annkatrin Niebuhr. "Growth, unemployment and labour market institutions: evidence from a cross-section of EU regions." *Applied Economics* 43, no. 30 (2011): 4663–4676.

<sup>25</sup> Badinger, Harald, and Gabriele Tondl. "Trade, human capital and innovation: the engines of European regional growth in the 1990s." In *European regional growth*, pp. 215–239. Springer, Berlin, Heidelberg, 2003.

<sup>26</sup> Barro, Robert J. "Human capital and growth." *American Economic Review* 91, no. 2 (2001): 12–17.

<sup>27</sup> Glaeser, Edward L., Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer. "Do institutions cause growth?" *Journal of Economic Growth* 9, no. 3 (2004): 271–303.

<sup>28</sup> Weede, Erich, and Sebastian Kämpf. "The impact of intelligence and institutional improvements on economic growth." *Kyklos* 55, no. 3 (2002): 361–380.

<sup>29</sup> Ram, Rati. "IQ and economic growth: Further augmentation of Mankiw–Romer–Weil model." *Economics Letters* 94, no. 1 (2007): 7–11; Salahodjaev, Raufhon. "Intelligence and shadow economy: A cross-country empirical assessment." *Intelligence* 49 (2015): 129–133; Potrafke, Niklas. "Intelligence and corruption." *Economics Letters* 114, no. 1 (2012): 109–112; Burhan, Nik Ahmad Sufian, Mohd Rosli Mohamad, Yohan Kurniawan, and Abdul Halim Sidek. "The impact of low, average, and high IQ on economic growth and technological progress: Do all individuals contribute equally?" *Intelligence* 46 (2014): 1–8; Kanyama, Isaac Kalonda. "Quality of institutions: Does intelligence matter?" *Intelligence* 42 (2014): 44–52; Jones, Gareth, and W. Joel Schneider. "Intelligence, human capital, and economic growth: A Bayesian averaging of classical estimates (BACE) approach." *Journal of Economic Growth* 11, no. 1 (2006): 71–93; Lynn, Richard, Tatu Vanhanen, and M. Stuart. *IQ and the Wealth of Nations*. Greenwood Publishing Group, 2002; Lynn, Richard. "In Italy, north–south differences in IQ predict differences in income, education, infant mortality, stature, and literacy." *Intelligence* 38, no. 1 (2010): 93–100; Kanazawa, Satoshi. "IQ and the wealth of states." *Intelligence* 34, no. 6 (2006): 593–600; Lynn, Richard. "National IQ and economic development: a study of eighty-one nations." *Mankind Quarterly* 41, no. 4 (2001): 415;

<sup>30</sup> Hanushek, Eric A., and Dennis D. Kimko. "Schooling, labour-force quality, and the growth of nations." *American Economic Review* 90, no. 5 (2000): 1184–1208.

<sup>31</sup> Hanushek, Eric A., and Ludger Woessmann. "The role of cognitive skills in economic development." *Journal of Economic Literature* 46, no. 3 (2008): 607–68.

*better quality economic institutions and achieve higher growth rates independently of other growth confounding channels. Their implications invariably show that the quality of schools and the subsequent formation of cognitive skills might be a missing piece of the puzzle for explaining regional development levels.*

*In this book, we jointly examine the contribution of regional policy support, regional institutional quality and regional intelligence to the per capita income and growth rates of European regions at the NUTS-2 level subject to the previously identified growth and development shifts. For a repeated cross section of 365 regions from EU-28 member states for the period 1990–2015 with roughly 4,000 sample-matched observations in a combined and partially novel dataset, we estimate the responses of per capita income and growth rates to the regional policy support schemes, institutional quality and average intelligence at the subnational level, allowing us to unveil the determinants of regional growth and income disparities.*

*Our results suggest the influence of regional policy support, institutional quality, and average intelligence depends on the level of development. The regions under Objective 1 tend to benefit strongly from higher rates of infrastructure-related investment, health-related investments, basic educational support, and technology investment. Once regions attain higher income levels in response to these investments, policies that strengthen labour market efficiency and innovation appear to be the key drivers of sustainable development. Our findings corroborate the notion that any 'one-size-fits-all' regional policy support is doomed to fail. The findings also suggest that efficiency-improving policies are perhaps the most important determinants of long-run regional development and shed critical light on subsidy-expanding schemes related to industrial policy which do not seriously take growth diagnostics into account.*

*The evidence on the effects of institutional quality suggests that regions with better quality governance in place tend to develop faster than regions without it. We*

*also show the beneficial long-term economic effects of institutional quality are primarily driven by having an impartial government administration. This implies that the absence of government favouritism towards particular industries/interest groups greatly facilitates long-run development, and may be more important for regional development than policy support schemes. In addition, more widespread corruption at the regional level at lower levels of per capita income might not cause a backlash in regional development, and may occasionally support it. These findings support the view that stronger corruption may 'grease the wheels' rather than 'put sand in the wheels' of regional development. At higher levels of income, the influence of corruption on regional development is both negative and statistically significant, implying the persistence of corruption at higher development levels has profound and long-lasting negative implications for long-term development.*

*Our results also show that average intelligence greatly affects European regional development and may be equally important as the role of policy support schemes and institutional quality. Regions with better mathematics, reading, science, and problem-solving skills tend to develop significantly faster than regions with mediocre cognitive skills. At lower income levels, the positive effect of average intelligence is driven by problem-solving abilities. At higher levels of income, the positive effect of problem-solving skills is replaced by equally large positive effects of mathematics and scientific skills. This implies that the level of importance of average intelligence for long-run regional development varies depending on the type of skills and takes skill heterogeneity into account. Finally, our analysis of regional growth disparities using extreme bounds tests suggests that better reading skills, policy support for higher education, improved labour market efficiency, lower corruption, high problem-solving skills and macroeconomic stability have a very robust positive effect on the long-run growth rates of NUTS-2 regions while the policy support of innovation and greater impartiality of government services at the regional level have a strong and robust positive effect on regional*

growth rates. Other policy factors, including the widely discussed schemes to support smart specialisation and industrial policies, appear to be either fragile or weak determinants of regional growth.

Our counterfactual estimations show large and pervasive increases in regional per capita income in response to improved labour market efficiency, improved institutional quality and higher average intelligence. The regions from Eastern Europe and Southern Europe exhibit the highest per capita income gains compared to Central, Northern and Western European regions where the gains are noticeably smaller.

The remainder of this book is organised as follows. In Chapter 2, Mitja Kovač outlines the legal and institutional framework of European industrial policy and its relevance for regional developments. In Chapter

3, Rok Spruk presents the empirical model of regional growth and development. In Chapter 4, Rok Spruk discusses the data used in the empirical analysis. In Chapter 5, Rok Spruk and Mitja Kovač present the results. Rok Spruk and Mitja Kovač examine the counterfactual scenarios in Chapter 6. Chapters 7 to 11 discuss the normative aspects of European regional development. In Chapter 7, Giovanni Vetrutto discusses the division of powers as a fundamental aspect of liberalism. Giulia Carnevale tackles the origins of federalism in Chapter 8. In Chapter 9, Walter Paternesi Meloni examines the evidence from economic reforms aimed at regional development in the past two decades. In Chapter 10, Aurelia Ciacci discusses the relationship between the forms of constitutional arrangement and European crises. In Chapter 11, Alessio Conti and Giovanni Vetrutto present the contours and challenges of Italian federalism in a comparative perspective. Chapter 12 concludes.

# 2.



## Industrial Policy in the EU: Legal and Institutional Framework

By Mitja Kovač

The European Union's industrial policy aims to make European industry more competitive so that it can maintain its role as a driver of sustainable growth and employment in Europe. Since 1960, various strategies have been adopted in order to ensure better framework conditions for EU industry, the most recent being described in the communication 'For a European Industrial Renaissance' from January 2014.<sup>32</sup> Since the EU was initially never intended to be a fiscal union, competition policy was always regarded in the literature as an important policy device for achieving economic convergence.<sup>33</sup> In relation to the EU's industrial policy, the granting of subsidies and state aid was questioned several times for its potential to negatively affect the process of competition, distort incentives to innovate and induce opportunism and all sorts of destructive rent-seeking and free-riding behaviour.<sup>34</sup> Moreover, the Lisbon Strategy (2000) simultaneously employs

industrial policy and innovation policy in order to transform the European Union into one of the most competitive regions of the world.<sup>35</sup>

European industrial and regional development policies are a conundrum of different policies, instruments and initiatives. This includes competition policy, strategies of smart specialisation, initiatives for better regulatory frameworks and the recently renewed EU industrial policy strategy.<sup>36</sup> The Commission now promotes industrial competitiveness in all of its major initiatives: the Investment Plan for Europe, the Single Market Strategy, the Digital Single Market Strategy, the Circular Economy package, the Energy Union, the Capital Markets Union, the New Skills Agenda for Europe, and the Trade for All Strategy.

The EU's industrial policy's highest, all-encompassing legal basis is found in Article 173 of the Treaty on Functioning of the European Union.<sup>37</sup>

<sup>32</sup> President Juncker's Political Guidelines have underlined the importance of a strong and high performing industry for the future of Europe's economy and the need to bring industry's weight in the EU GDP back to 20% by 2020.

<sup>33</sup> See e.g. Aghion, P., Boulanger, J., and Cojen E., "Rethinking industrial policy," Brugel Policy Brief (04), pp. 1-8, 2011; Aiginger, K., and Sieber, S., "The matrix approach to industrial policy," 20 International Review of Applied Economics 5, pp. 537-601, 2006. economics 5

<sup>34</sup> See e.g. Almunia J., "Fighting for a single market," European Competition Forum, 2014, available at: [http://europa.eu/rapid/press-release\\_SPEECH-14-19](http://europa.eu/rapid/press-release_SPEECH-14-19)

<sup>35</sup> See e.g. Curley M., and Salmelin B., "Open innovation 2.0: A new paradigm," Dublin, European Commission 1-7, 2013.

<sup>36</sup> See Communication from Commission to the European Parliament, the European Council, the Council, the European and Social Committee, the Committee of the Regions and the European Investment Bank, "Investing in a smart, innovative and sustainable Industry A renewed EU Industrial Policy Strategy," COM/2017/0479 final, Brussels, 13.9.2017.

<sup>37</sup> Article 173 TFEU reads: "Para 1. The Union and the Member States shall ensure that the conditions necessary for the competitiveness of the Union's industry exist. For that purpose, in accordance with a system of open and competitive markets, their action shall be aimed at: - speeding up the adjustment of industry to structural changes, - encouraging an environment favourable to initiative and to the development of undertakings throughout the Union, particularly small and medium-sized undertakings, - encouraging an environment favourable to cooperation between undertakings, - fostering better exploitation of the industrial potential of policies of innovation, research and technological development. Para 2. The Member States shall consult each other in liaison with the Commission and, where necessary, shall coordinate their action. The Commission may take any useful initiative to promote such coordination, in particular initiatives aiming at the establishment of guidelines and indicators, the organisation of exchange of best practice, and the preparation of the necessary elements for periodic monitoring and evaluation. The European Parliament shall be kept fully informed. Para 3. The Union shall contribute to the achievement of the objectives set out in paragraph 1 through the policies and activities it pursues under other provisions of the Treaties. The European Parliament and the Council, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, may decide on specific measures in support of action taken in the Member States to achieve the objectives set out in paragraph 1, excluding any harmonisation of the laws and regulations of the Member States. This Title shall not provide a basis for the introduction by the Union of any measure which could lead to a distortion of competition or contains tax provisions or provisions relating to the rights and interests of employed persons."

According to Article 173 TFEU, the European Union and the member states shall ensure that the conditions needed for the competitiveness of the Union's industry exist. For that purpose, in accordance with a system of open and competitive markets Article 173 TFEU requires the actions of member states to be aimed at: speeding up the adjustment of industry to structural changes, encouraging an environment favourable to initiative and to the development of undertakings throughout the Union, particularly small and medium-sized undertakings, encouraging an environment that supports cooperation between undertakings, fostering better exploitation of the industrial potential of policies of innovation, research and technological development.

Moreover, industrial policy in the EU is actually pursued at three levels of government: the EU, the member-state level and the regional level. Further, as scholarly literature reports, owing to shifting convictions in economic analysis at large as well as the logic of pro-competitive market integration the nature and intensity of European industrial policy has drastically changed over time.<sup>38</sup> In addition, EU industrial policy can also be divided into horizontal and vertical dimensions.

However, commentators argue there is a great deal of confusion about what a European industrial policy might be.<sup>39</sup> A complete overview of European industrial policy lies beyond the scope of this section and can be found elsewhere.<sup>40</sup> Yet, broadly speaking, one may conceptualise European industrial policy as falling into three broad groups of policies: a) institutional framework aspects; b) horizontal industry policy; and c) sectoral and specific industry policy.

The first encompasses the establishment and maintenance of the EU's internal market (free movement of goods, services, capital and workers, free establishment and FDI), proper functioning

of the internal market (removal of all distortions, transaction costs, implementation of harmonised standards, rules, common regulation, mutual recognition, standards etc.), EU competition policy – antitrust (including regulation of state aids, network industries etc.), common EU policies (transport, trade, agriculture – linked with cohesion and environment policies, environmental regulations), better regulation, regional and structural cohesion policies (measures strengthening hard and soft infrastructure, measures for retraining and skill enhancement, support for adjustment after industrial decline, re-industrialisation, cross-border regional facilitation and removing environmental legacies) and regulation of state ownership.

The second, horizontal dimension includes a wide-ranging tool-kit of industrial policies from the EU's research strategies, innovation stimulus, support for entrepreneurship and provision of risk capital, development of skills and human capital formation (national), EU restructuring funds, public procurement and a competitiveness test for all other policies.

The third, sector-specific industrial policy encompasses all sorts of sector interventions, sector policies, clustering policies, trade policy, specific aspects of regional/cohesion policies, technology policies and defence procurements.

EU industrial policy is horizontal in nature and aims to secure framework conditions that favour industrial competitiveness. It is also well integrated into several other EU policies such as those relating to trade, the internal market, research and innovation, employment, environmental protection and public health. The industrial policy of the EU is specifically aimed at: (1) "speeding up the adjustment of industry to structural changes"; (2) "encouraging an environment favourable to initiative and to the development of undertakings throughout the Union, particularly small and

<sup>38</sup> Pelkamns Jacques, "European industrial policy," in Bianchi, Patrizio and Sandrine Lanory (eds.), "International Handbook on Industrial Policy," Edward Elgar, 2006, at pp. 45-48.

<sup>39</sup> Ibid at p. 46.

<sup>40</sup> See e.g. Mosconi Franco, "The New European Industrial Policy: Global Competitiveness and the Manufacturing Renaissance (Routledge Studies in the European Economy Book 36)," Routledge, 2015.



medium-sized undertakings”; (3) “encouraging an environment favourable to cooperation between undertakings”; and (4) “fostering better exploitation of the industrial potential of policies of innovation, research and technological development” (Article 173 TFEU).

The instruments of the EU’s industrial policy are the same as for its enterprise policy and aim to create the general conditions in which entrepreneurs and businesses can take initiatives and exploit their ideas and opportunities. Nonetheless, industrial policy should take account of the specific needs and characteristics of individual sectors. The annual European Competitiveness Reports analyse the strengths and weaknesses of the EU’s economy in general and its industry in particular, and may trigger cross-sectoral or sectoral policy initiatives.<sup>41</sup>

## 2.1 Historical Development

While in the 1980s and 1990s the EU institutions mainly focused on creating the Single Market, the formation of the Economic and Monetary Union and EU enlargement have shifted attention over to industrial policy. In July 2005, for the first time, a Commission communication entitled “Implementing the Community Lisbon Programme: A policy framework to strengthen EU manufacturing – towards a more integrated approach for industrial policy” (COM (2005) 0474) set out an integrated approach to industrial policy based on a concrete work programme of cross-sectoral and sectoral initiatives.

In 2008, the European Commission issued a communication entitled “Sustainable Consumption and Production and Sustainable Industrial Policy Action Plan” (COM (2008) 0397) that aimed to deliver an integrated package of measures to foster more sustainable consumption and production, while making the European economy more competitive. In order to achieve this ‘virtuous circle’, the 2008 Action Plan proposed making use

of a variety of policy instruments. For example, consumer demands were to be channelled towards more sustainable consumption through a simplified labelling framework.

In response to the challenges involved in securing a sustainable supply of non-energy raw materials for the EU economy, the Commission launched the ‘raw materials initiative’ (COM (2008) 0699), which sought to ensure a level playing field in access to resources in third countries, better framework conditions for extracting raw materials within the EU, and the reduced consumption of primary raw materials through increased resource efficiency and the promotion of recycling. A subsequent Commission communication in 2011 (COM (2011) 0021) proposed reinforcing the implementation of this initiative.

In its 2009 communication on the “Preparing for our future: Developing a common strategy for key enabling technologies in the EU” (COM (2009) 0512), the EU Commission stated the EU would foster the deployment of key enabling technologies (KETs) within its current policy framework, and also suggested setting up a High Level Group (HLG) of experts responsible for developing a common long-term strategy. In its final report, the High Level Group proposed 11 policy recommendations for the development and deployment of KETs in Europe.

In March 2010, the Lisbon Strategy was replaced by the Europe 2020 strategy (“Europe 2020 – A Strategy for Smart, Sustainable and Inclusive Growth” – COM (2010) 2020). The new strategy put forward seven flagship initiatives, four of which are especially relevant for making the EU’s industry more competitive: “Innovation Union” (COM (2010) 0546), “A digital agenda for Europe” (COM (2010) 0245), “An industrial policy for the globalization era” (COM (2010) 0614) and “New Skills for New Jobs” (COM (2008) 0868). The last one, sometimes regarded as a flagship initiative, “An industrial policy for the globalisation era” focuses on 10 actions to promote European industrial competitiveness,

<sup>38</sup> See e.g.

thus placing more emphasis on factors such as the growth of SMEs and the supply and management of raw materials.

Moreover, adopted on 14 October 2011, the Commission communication “Industrial Policy: Reinforcing competitiveness” (COM (2011) 0642) calls for deep structural reforms as well as coherent and coordinated policies across the member states to enhance the EU’s economic and industrial competitiveness and foster long-term sustainable growth. This communication pointed out several key areas in which greater effort was needed: structural change in the economy; the innovativeness of industries; sustainability and resource efficiency; the business environment; the Single Market; and SMEs.

Further, on 10 October 2012 the Commission issued its COM (2012) 0582 additional communication entitled “A Stronger European Industry for Growth and Economic Recovery – Industrial Policy Communication Update”, aiming at supporting investment in innovation with a focus on six priority areas with great potential (advanced manufacturing technologies for clean production; key enabling technologies; bio-based products; sustainable industrial and construction policy and raw materials; clean vehicles and vessels; and smart grids). This Com (2012) 0582 communication also highlighted the need for better market conditions, access to finance and capital, and human capital and skills as a means for promoting industrial competitiveness.

In January 2014, the Commission launched the communication “For a European Industrial Renaissance” (COM (2014) 0014). In this communication, the EU Commission emphasises that fostering growth and competitiveness to sustain and strengthen recovery and to achieve the goals of the Europe 2020 agenda have become the top priority for the Commission and EU member states. The EU Commission also stresses that

the economic importance of industrial activities is much greater than is suggested by the share of manufacturing in GDP. In 2013, industry accounted for over 80% of Europe’s exports and 80% of private research and innovation. Nearly one in four private-sector jobs in 2013 was in industry, often highly skilled, while each additional job in manufacturing created in 2013 0.5–2 jobs in other sectors.<sup>42</sup> In this communication, the EU Commission considered that a strong industrial base is vital for Europe’s economic recovery and competitiveness. In addition, this communication focuses on reversing the industrial decline and achieving the target of 20% of GDP for manufacturing activities by 2020. The Commission states that, in order to attract new investments and create a better business environment, the EU needs more coherent policies in the field of the internal market, including European infrastructure such as energy, transport and information networks, as well as for goods and services. The importance of improved cooperation in the areas of good quality public administration, trade, research and raw materials was also mentioned as a necessary precondition for successful implementation of the set of industrial policy instruments. The EU Commission also recognised the importance of the legal-institutional framework and emphasised that

*“A vision for the internal market for industrial products” presents actions to achieve a more integrated internal market based on rationalising the existing regulatory framework. The Commission will consider elaborating a legislative proposal on how to streamline and harmonise economic sanctions of an administrative or civil nature for non-compliance with Union harmonisation legislation to ensure equal treatment of all businesses throughout the internal market for industrial products. To strengthen support for SMEs in the internal market and further develop assistance for access to finance, to improve their energy and resource efficiency and to increase the innovation management*

<sup>42</sup> Rueda-Cantuche, José M.a, Sousa, Nb., Andreoni, Va. and Arto, Ia. “The Single Market as an engine for employment growth through the external trade”, Joint Research centre, IPTS, Seville, 2012. In this Communication, manufacturing refers to Section C and divisions 10 to 33 of NACE Rev. 2. Industry refers to a broader set of activities, also including mining and quarrying and energy activities.

capacity of SMEs, the Enterprise Europe Network will be reinforced".<sup>43</sup>

Based on the previous policy measures, in 2014 the EU Commission emphasised and decided to pursue the following priorities for industrial policy:

Advanced manufacturing: implementing the Knowledge and Innovation Community on value-added manufacturing and establishing a Public Private Partnership on a Sustainable Process Industry through Resource and Energy Efficiency, Factories of the Future, Photonics and Robotics, upgrading the innovation capacity and competitiveness of Europe's manufacturing sector. The integration of digital technologies in the manufacturing process will be a priority for future work in light of the growing importance of the industrial Internet. The use of 'big data' will be increasingly integrated into the manufacturing process.<sup>44</sup>

b) Key Enabling Technologies (KETs): this taskforce is working to identify potential KETs projects of European interest in several areas, e.g. batteries, intelligent materials, high-performance production and industrial bio-processes; facilitating the pan-European access of SMEs to technological infrastructure; and further exploiting the possibilities of the memorandum of understanding signed with the European Investment Bank.<sup>45</sup>

c) Bio-based products: granting access to sustainable raw materials at world market prices for the production of bio-based products. This will require application of the cascade principle in the use of biomass and eliminating any possible distortions in the allocation of biomass for alternative uses that

might result from aid and other mechanisms that favour the use of biomass for other purposes (e.g. energy).<sup>46</sup>

d) Clean Vehicles and Vessels: adoption and full implementation of the Commission's proposal on alternative fuels infrastructure, implementing the Green Vehicle Initiative and other H2020 initiatives that promote clean and energy efficient transport, pursuing global standards for electric cars and implementing the priorities identified under CARS 2020.<sup>47</sup>

e) Sustainable construction and raw materials: setting up a EUR 25 billion EIB lending capacity for energy efficiency in residential housing; and improving recycling and sustainable waste management in construction.<sup>48</sup>

f) Smart Grids and Digital Infrastructures: defining further targets for the development of smart grid components; revising and broadening standardisation mandates and development and guidance on performance indicators. The infrastructure and connectivity software for the industrial Internet is a priority area in the light of its growing importance and should help integrate high-performance processes, including cloud computing.<sup>49</sup>

In addition, the EU Commission emphasised the role of human capital as one of the most important tools in its all-encompassing industrial policies. Namely, the Commission also focused on the upgrading of skills and facilitating industrial change. According to the EU Commission, skills (human capital) feature as a major policy element in the Europe 2020 agenda.<sup>50</sup> The Commission

<sup>43</sup> European Commission, "Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions: For a European Industrial Renaissance," Brussels, 22.1.2014, COM(2014) 14 final.

<sup>44</sup> Staff Working Document "Advancing Manufacturing – Advancing Europe," 2015.

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<sup>46</sup> For a description and interpretation of the cascading principle, see [http://ec.europa.eu/research/bioeconomy/pdf/201202\\_commission\\_staff\\_working\\_paper.pdf](http://ec.europa.eu/research/bioeconomy/pdf/201202_commission_staff_working_paper.pdf) - Commission Staff Working Paper that is accompanying the Commission's Communication on the Bioeconomy Strategy – see pages 25-26, 2nd paragraph in section 1.3.3.1. and <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A7-2013-0201+0+DOC+PDF+VO//EN> – European Parliament Opinion on the Commission Communication on the Bioeconomy Strategy – see item 28 on pages 6 & 7.

<sup>47</sup> European Commission, "Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions: For a European Industrial Renaissance," Brussels, 22.1.2014, COM(2014) 14 final.

<sup>48</sup> Ibid.

<sup>49</sup> Ibid.

<sup>50</sup> Ibid.

has put in place an overall strategy for improving education and training systems via anticipation and investment in human capital supported by EU financial instruments, tools to monitor skills as well as training needs and trends, and specific initiatives to bring together the relevant actors who deal with apprenticeships, especially those with crucial information and communication technologies skills, including the social partners.<sup>51</sup>

In this communication, the EU Commission also emphasises that the EU's industrial policy has traditionally paid considerable attention to SMEs, which have been mainstreamed into the EU's policy approach. By the end of 2013, the Commission reports, the Competitiveness and Innovation Programme (CIP) had assisted financial institutions in providing about EUR 30 billion in new finance for more than 315,000 SMEs and have created or directly maintained about 380,000 jobs.<sup>52</sup> In addition, in the same period, the Structural Funds provided some EUR 70 billion in support of enterprises, predominantly SMEs. Nearly 200,000 projects have been funded, each supporting several SMEs, including 78,000 start-ups and the creation of at least 268,000 permanent jobs (and safeguarding many more).

Regulatory and administrative costs can (as stressed by the EU Commission) impact SMEs up to ten times more than larger companies. The Commission claims that it has systematically promoted simplification for SMEs through exemptions for micro-enterprises and the application of the Think Small First principle. Framework conditions for SMEs have been improved considerably since the Small Business Act (SBA) was adopted in 2009. The average time and cost, as emphasised by the Commission in 2014, of starting a business have been cut (from nine to five

days and from EUR 463 to EUR 372). However, in 2014 the time and cost entailed in obtaining all the licences required to start commercial operations still remained very high in some member states.

The new financial perspectives for 2014–2020 made available new, more powerful instruments in support of entrepreneurship and SMEs. For the first time, they include a programme, COSME, specifically targeting SMEs. It has a budget of EUR 2.3 billion to add to the contributions made by other EU policies. The new cohesion policy paid particular attention to SMEs' competitiveness. A dedicated instrument in Horizon 2020 provided funding for early-stage, high-risk research and innovation by SMEs. The new rural development policy further boosts start-ups and the competitiveness of SMEs in rural areas.<sup>53</sup>

Apart from this financial support, the Risk Finance State Aid Guidelines were particularly sensitive to the problems faced by SMEs in financing their activities. Namely, the average SME is smaller in Europe than in the USA. There are also differences among SME-sizes within the EU: The average SME in Germany has 7.6 workers compared to 3.6 workers in Spain and 3.2 in Italy. This holds significant consequences: the smaller the company, the greater its difficulty in investing in innovation, exporting and integrating into global value chains, thereby compromising its competitiveness.<sup>54</sup>

The EU Commission also recognised that the potential of clusters to create favourable innovation ecosystems for mutually reinforcing groups of SMEs needs to be better exploited as a means for promoting growth. The Commission attempted to facilitate the matchmaking of SMEs wishing to integrate into world-class clusters aiming for excellence and cross-European value chains. Moreover, the EU Commission also stressed that those value-added chains, from the procurement

<sup>51</sup> In addition, the Commission is developing a new generation of the Erasmus for Young Entrepreneurs programme, as well as other instruments to make traineeships available in firms on a cross-border basis through the active involvement of industry and SMEs. The Rethinking Education Communication<sup>30</sup> calls for a strong focus on aligning skills supply with labour market needs across Europe, now reinforced and supported by the new Erasmus+

<sup>52</sup> Ibid.

<sup>53</sup> For the specific potential of "blue growth", see COM(2012) 494 final "Blue Growth - opportunities for marine and maritime sustainable growth" of 13.9.2012.

<sup>54</sup> European Commission, "Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions: For a European Industrial Renaissance," Brussels, 22.1.2014, COM(2014) 14 final.

of raw materials to business services and distribution, as well as links with research, training and education centres, must be better integrated. Cluster-facilitated demonstration projects for value chain innovation are financed through Horizon 2020 in support of the implementation of smart specialisation strategies. The Commission also reinforced the Entrepreneurship Action plan to develop entrepreneurial skills and attitudes and to help individuals in developing new ideas commercially.<sup>55</sup>

The Commission also expressly stated that, in order to boost its industrial potential, it will continue to promote international standards and regulatory cooperation, building on the EU's role as a de facto standard setter and to take a leading role in reinforcing the international standardisation system. Regulatory cooperation with other countries will continue to be a priority, especially in on-going bilateral negotiations with the USA and Japan where the primary focus will be on 'behind-the-borders' obstacles to trade and investment. Raising the level of transparency and regulatory convergence will significantly enhance overseas opportunities for EU companies and help reduce the costs of accessing markets.<sup>56</sup>

## 2.2 European Industrial Renaissance

The industrial policy with a European industrial renaissance agenda was complemented in 2016 by a communication called "Digitising European Industry – Reaping the Full Benefits of a Digital Single Market" (COM (2016) 0180), which focuses on digital transformation and addresses related challenges like funding, ICT standardisation, big data and skills. Moreover, the Start-up and Scale-up Initiative (COM

(2016) 0733) launched in 2016 aims to give Europe's many innovative entrepreneurs every opportunity to build world-leading companies. In addition, the 2016 strategy attempts to boost investments in innovation, new technologies, production inputs and skills. It also calls for a systematic simplification and decrease of regulatory and administrative costs (that can adversely impact SMEs' capacity to grow and innovate), it attempts to spur the internalisation of EU firms and contains a set of legislative initiatives for the creation of an integrated, single European market (establishing an attractive place for enterprises and production). For example, the 2016 communication suggests that the competitiveness of industry would benefit from a more integrated market and emphasises administrative burdens and regulatory complexity as some of the most growth-retarding factors.<sup>57</sup> Namely, the EU Commission notes that administrative transaction costs and regulatory obstacles are not being eliminated fast enough, unevenly and that some labour markets are not sufficiently flexible.<sup>58</sup> Pursuant to Article 173 TFEU, the EU Commission increased its monitoring of the EU's competitiveness performance and business environment on a more regular basis (notably through the European Semester). In addition, the Commission has continued to improve the quality of its legislation and overall regulatory environment in order to make it fitter, more stable and predictable.<sup>59</sup> The Commission also urged the member states to employ comparable measures at national and regional levels to help ensure that the efforts of industrial policy increase competitiveness across the EU and also decided to launch an initiative on 'Growth-friendly Public Administration'.<sup>60</sup> Implementing the 'Regulatory Fitness and Performance' (REFIT) programme' and following

<sup>55</sup> Ibid.

<sup>56</sup> European Commission, "Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions: For a European Industrial Renaissance," Brussels, 22.1.2014, COM(2014) 14 final.

<sup>57</sup> Ibid, at p. 7.

<sup>58</sup> Ibid, at p. 7.

<sup>59</sup> Ibid, at p. 8.

<sup>60</sup> Providing a comprehensive overview of best practices in public administration available across the EU, in particular with regard to e-government tools and public procurement; *ibid.*, at p. 8.

up on the Top 10 regulatory burdens should, the EU Commission suggested, simplify EU legislation and reduce regulatory burdens on European industry.<sup>61</sup> The Commission also emphasises its clear commitment to re-industrialisation, the modernisation of Europe's industrial base and the promotion of a competitive framework for EU industry.<sup>62</sup> The Commission concludes its initiative with a statement that the objective of revitalising the EU economy calls for the endorsement of the reindustrialisation efforts in line with the Commission's aspiration to raise the contribution of industry to GDP to as much as 20% by 2020.<sup>63</sup>

### 2.3 Renewed EU Industrial Policy Strategy – 2017 and onwards

In November 2017, the EU Commission published its Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank on 'Investing in a smart, innovative and sustainable industry' with which the EU Commission launched its renewed EU industrial policy strategy.<sup>64</sup> This renewed EU Industrial Policy Strategy should bring all existing and new horizontal and sector-specific initiatives together into a comprehensive industrial strategy.<sup>65</sup> It also clarifies the tasks lying ahead for all actors involved and

sets out the fora – an annual Industry Day, the first edition of which took place in February 2017, and a High-Level Industrial Roundtable – that will allow in a particular industry and civil society to steer industrial policy actions in the future.<sup>66</sup>

In its press release, the EU Commission summarises its renewed industrial policy agenda in the following key points:

a) A comprehensive package to reinforce our industry's cybersecurity which was adopted on 13 September 2017. It includes the creation of a European Cybersecurity Research and Competence Centre to support the development of technology and industrial capabilities in cybersecurity, as well as an EU-wide certification scheme for products and services, recognised in all Member States;

b) A proposal for a Regulation on the free flow of non-personal data which was adopted on 13 September 2017 and that will enable data to circulate freely across borders, helping to modernise industry and create a truly common European data space;

c) A new series of actions on Circular Economy, including a strategy on plastics and measures adopted in autumn 2017 to improve the production of renewable biological resources and their conversion into bio-based products and bio-energy;

d) A set of initiatives to modernise the Intellectual Property Framework adopted in autumn 2017, including a report on the functioning of the Directive

<sup>61</sup> Ibid, at p. 8.

<sup>62</sup> Ibid at p. 22.

<sup>63</sup> Ibid, at p. 23.

<sup>64</sup> EU Commission, "Communication from the Commission to the European Parliament, the European Council, The Council, The European Economic and Social Committee, the Committee of the Regions and The European Investment Bank on Investing in a smart, innovative and sustainable industry: A Renewed EU Industrial Policy Strategy, Brussels, 13.9.2017 COM(2017) 479 final. Moreover, on 13 September, in his annual State of the Union address, President Jean-Claude Juncker said: "I want to make our industry stronger and more competitive. The new Industrial Policy Strategy we are presenting today will help our industries stay or become the world leader in innovation, digitization and decarbonisation."

<sup>65</sup> EU Commission, State of the Union 2017 – Industrial Policy Strategy: Investing in a smart, innovative and sustainable industry, Published on 18/09/2017; available at: [https://ec.europa.eu/growth/content/state-union-2017-%E2%80%93-industrial-policy-strategy-investing-smart-innovative-and-sustainable\\_en](https://ec.europa.eu/growth/content/state-union-2017-%E2%80%93-industrial-policy-strategy-investing-smart-innovative-and-sustainable_en).

<sup>66</sup> To that end, the Commission considers that the following priorities should be pursued to support the competitiveness of European industry: a) Continue deepening the mainstreaming of industrial competitiveness in other policy areas to sustain the competitiveness of the EU economy, given the importance of the contribution of industrial competitiveness to the overall competitiveness performance of the EU. For instance, particular attention must be paid to increasing productivity in business services to increase industrial competitiveness and the competitiveness of the EU economy in general; b) Maximising the potential of the internal market by developing the necessary infrastructures, offering a stable, simplified and predictable regulatory framework favourable for entrepreneurship and innovation, integrating capital markets, improving the possibilities for training and mobility for citizens and completing the internal market for services as a major contributing factor to industrial competitiveness; c) Decisively implementing the instruments of regional development with national and EU instruments in support of innovation, skills, and entrepreneurship to deliver industrial change and boost the competitiveness of the EU economy; d) To encourage investment, businesses require access to critical inputs, and in particular, energy and raw materials, at affordable prices that reflect international cost conditions. The design and implementation of policy instruments for different objectives both at EU and national levels must not result in price distortions that imply disproportionately higher relative prices for these inputs. Action should also be taken in the internal market and at international level to ensure the adequate provision of these inputs, as well as to increase energy and resource efficiency and to reduce waste; e) Do the utmost to facilitate the integration of EU firms in global value chains to boost their competitiveness and ensure access to global markets on more favourable competitive conditions; Ibid., at pp. 22-23.

on the enforcement of intellectual property rights and a Communication on a balanced, clear and predictable European licensing framework for Standard Essential Patents;

e) An initiative to improve the functioning of public procurement in the EU adopted in autumn 2017, including a voluntary mechanism to provide clarity and guidance to authorities planning large infrastructure projects;

f) Extension of the Skills Agenda adopted in autumn 2017 to new key industry sectors, such as construction, steel, paper, green technologies and renewable energies, manufacturing and maritime shipping;

g) A strategy on sustainable finance that should be prepared in 2018 to better orient private capital flows to more sustainable investments;

h) Initiatives for a balanced and progressive trade policy and a European framework for the screening of foreign direct investments that may pose a threat to security or public order which was adopted on 13 September 2017;

i) A revised list of critical raw materials where the Commission will continue to help ensure the secure, sustainable and affordable supply for the EU manufacturing industry which was adopted on 13 September 2017; and

j) New proposals for clean, competitive and connected mobility, including tightened CO<sub>2</sub> emissions standards for cars and vans, an Alternative Fuels Infrastructure Action Plan to support the deployment of charging infrastructure, and actions to foster autonomous driving (should be adopted in autumn 2017).<sup>67</sup>

Moreover, the EU Commission stresses the importance of a better regulatory framework which ensures that economic, social and environmental impacts are systematically assessed and mainstreams competitiveness, innovation, digitisation, investment, SMEs, social and consumer protection and the environment into the EU's policymaking. It aims to ensure that new legislation delivers its objectives at least cost and that existing legislation is checked periodically so that any unnecessary red-tape is identified and tackled.<sup>68</sup> The strong industrial focus of these policies has been complemented by sector-specific measures like in the case of the steel, space and defence industries<sup>17</sup>, and through a strong focus on key enabling technologies.<sup>69</sup>

The Commission again emphasises that a deeper and fairer Single Market lies at the heart of the success of Europe's industry.<sup>70</sup> It must facilitate the integration of our companies into European and global value chains and act as an essential driver of industrial competitiveness. At the same time, it must help industry, people and local communities to adapt to social, economic and environmental change. The benefits of industrial transformation need to be spread widely and those who lose out must be able to find opportunities and support to adapt. Lifelong learning, equal opportunities and fair access to education, training and technological skills are at the core of building such resilience.<sup>71</sup> The Commission also announces its plans to upgrade the EU's industry for the digital age and its future investments in the industry of tomorrow.<sup>72</sup> Further, the Commission also confirms its further support for

<sup>67</sup> EU Commission, State of the Union 2017 – Industrial Policy Strategy: Investing in a smart, innovative and sustainable industry, Published on 18/09/2017; available at: [https://ec.europa.eu/growth/content/state-union-2017-%E2%80%93-industrial-policy-strategy-investing-smart-innovative-and-sustainable\\_en](https://ec.europa.eu/growth/content/state-union-2017-%E2%80%93-industrial-policy-strategy-investing-smart-innovative-and-sustainable_en)

<sup>68</sup> EU Commission, "Communication from the Commission to the European Parliament, the European Council, The Council, The European Economic and Social Committee, the Committee of the Regions and the European Investment Bank on Investing in a smart, innovative and sustainable industry: A Renewed EU Industrial Policy Strategy, Brussels, 13.9.2017 COM(2017) 479 final, at p. 4.

<sup>69</sup> COM(2016) 155; COM(2016) 705; COM(2016) 950.

<sup>70</sup> EU Commission, "Communication from the Commission to the European Parliament, the European Council, The Council, The European Economic and Social Committee, the Committee of the Regions and the European Investment Bank on Investing in a smart, innovative and sustainable industry: A Renewed EU Industrial Policy Strategy, Brussels, 13.9.2017 COM(2017) 479 final, at p. 6.

<sup>71</sup> Ibid.

<sup>72</sup> Investment from within and outside the EU on both infrastructure and new technologies is a precondition for our industry to drive industrial transformation. While overall investment levels are gradually increasing, investment in innovation and other intangible assets remains lower than with many competitors. Europe needs to stimulate more capital investment, facilitate the uptake of promising innovation and provide a favourable environment for the scale-up of dynamic SMEs; *ibid.*, at p. 11.

industrial innovation<sup>73</sup> and stresses the importance of regional industrial policies by suggesting that partnership with member states, regions, cities and the private sector must be strengthened. Namely, the ambition to strengthen European industry at the EU level therefore needs to be matched by national reform efforts, taking specific national and regional differences into account.<sup>74</sup>

Last but not the least, the EU Commission announces that it will present the conclusions of the Industry Day to a High Level Industrial Roundtable to be established in 2018 with representatives of national, regional and local authorities, industry, social partners and civil society. The High Level Industrial Roundtable will provide feedback on the Commission's initiatives and actions, while advising on the implementation of industrial policy at different levels.<sup>75</sup>

## 2.4 EU Complementary Industrial Policy Toolkits

In addition to the previously discussed industrial policy instruments, the EU has a large number of complementary policies, programmes and initiatives that cover a wide variety of fields. For example, there are several initiatives including the EU cohesion policy, Horizon 2020, the Connecting Europe Facility, and the EU programme for the Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME), whose collective budget stands at slightly below EUR 200 billion. On top of this, the Investment Plan for Europe and the European Fund for Strategic Investments (EFSI) aim to mobilise at least EUR 500

billion in private and public investment by 2020.

Moreover, institutionally speaking, the Maastricht Treaty changes to the EC Treaty incorporated industrial policy issues for the first time – an achievement that can be attributed to initiatives of the EU Parliament, which helped stimulate the reorganisation of the steel sector and called for a more dynamic industrial policy. Since then, the EU Parliament has adopted numerous resolutions which have further strengthened the EU's industrial policy. For example, the EU Parliament's resolution of 16 June 2010 on the Europe 2020 strategy expressed strong support for industrial policy and proposed creating an environment conducive to maintaining and developing a strong, competitive and diversified industrial base in Europe; its resolution of 26 October 2011<sup>77</sup> on the Agenda for New Skills and Jobs underlining the importance of developing closer cooperation between research institutes and industry and encouraging and supporting investment by industrial companies in research and development; while its resolution of 15 January 2014<sup>78</sup> on reindustrialising Europe to promote competitiveness and sustainability evaluated the current situation of industry in Europe and proposed several measures to tackle the current challenges.<sup>79</sup>

One may also note the EU Parliament's resolution of 4 February 2014<sup>80</sup> on the Action Plan for a competitive and sustainable steel industry in Europe which stressed the important place of the steel industry in industrial value chains such as those of the automotive and construction industries and mechanical and electrical engineering<sup>81</sup>, and its resolution of 9 June 2016<sup>82</sup> aimed at maintaining

<sup>73</sup> Europe has excellent research results in many technology areas which directly or indirectly contribute to the development of smart, innovative and sustainable industry. We need to raise our game in turning research into breakthrough innovation creating new markets that drive jobs and growth. At present, too few innovative firms succeed in scaling up to become major employers and market leaders. Europe needs to strengthen its enabling environment, to ensure that its risk-bearing disruptive innovations will create new markets and industrial leadership in Europe rather than outside. Action is also needed to accelerate and improve the uptake of technologies, particularly among SMEs and traditional industries; *ibid.*, at p. 13.

<sup>74</sup> *Ibid.*, at p. 16.

<sup>75</sup> *Ibid.*, at p. 18.

<sup>76</sup> OJ C 236 E, 12.8.2011, p. 57.

<sup>77</sup> OJ C 131 E, 8.5.2013, p. 87.

<sup>78</sup> OJ C 482, 23.12.2016, p. 89.

<sup>79</sup> This resolution supported a 'Renaissance of Industry for a Sustainable Europe' (RISE) to pursue innovation towards a new industrial revolution; *ibid.*

<sup>80</sup> OJ C 93, 24.3.2017, p. 59.

<sup>81</sup> It also called for the preservation of competitive European steel production to ensure economic growth and jobs in Europe; *ibid.*

<sup>82</sup> Texts adopted, P8\_TA(2016)0280.



the competitiveness and global leadership of the European rail supply industry.



# 3.

## Empirical Model

By Rok Spruk

Our aim is to consistently examine the contribution of structural policy outcomes, institutional quality and intelligence to regional per capita income and its growth rates. Focusing on per capita income and growth rates allows us to breakdown the overall effect of policy outcomes, institutional quality and intelligence into long-term and short-term components. To this end, the basic fixed-effects relationship that takes place is:

$$\ln y_{i,j,t} = \hat{\lambda}_0 + \hat{\lambda}_1 \cdot P_{i,j,t} + \hat{\lambda}_2 \cdot I_{i,j,t} + \hat{\lambda}_3 \cdot IQ_{i,j,t} + \mathbf{X}'_{i,j,t} \beta + \delta_j + \phi_i + \eta_t + u_{i,j,t} \quad (1)$$

where  $y$  is the level of per capita income in region  $i$  and country  $j$  at time  $t$ ,  $P$  is the policy outcome variable,  $I$  denotes the institutional quality, and  $IQ$  represents the human intelligence variable. Vector  $X$  captures the set of structural covariates systematically related to long-run regional development,  $\phi$  is the set of region-fixed effects capturing time-invariant heterogeneity primarily unobserved by the econometrician,  $\delta$  is the equivalent set of country-fixed effects, capturing time-invariant country-level unobserved factors, and  $\eta$  is the full set of common technology shocks. The stochastic disturbances are captured by the random error term,  $u$ . Eq.(1) allows us to estimate the long-term effects of policy outcomes,



institutional framework and intelligence on regional development. We estimate the growth effects separately by adopting the conditional convergence specification:

$$\bar{g}_{i,t,t-1} = \hat{\pi}_0 + \hat{\pi}_1 \cdot P_i + \hat{\pi}_2 \cdot I_i + \hat{\pi}_3 \cdot IQ_i + \hat{b}_1 \cdot \log y_{i,t-1} + \mathbf{X}_i^T \theta + \varepsilon_i \quad (1)$$

where  $\bar{g}$  is the average rate of per capita income growth in region  $i$  at NUTS-2 level,  $y_{i,t-1}$  is the level of initial per capita income and  $\hat{b}_1$  is the coefficient that measures the speed of regional convergence at the NUTS-2 level,  $X$  is the vector of structural growth covariates, and  $\varepsilon$  is the random error term capturing the impact of transitory shocks. Our key parameters of interest are  $\hat{\pi}_1$ ,  $\hat{\pi}_2$  and  $\hat{\pi}_3$ . The crucial challenge posed by our estimation strategy concerns the reliability of the standard errors, which critically affects the consistency and unbiasedness of the estimated growth and development coefficients from the cross-regional variation in the policy outcomes, institutional framework, and intelligence. A major threat to the proposed empirical strategy relates to the possibility of serially correlated error terms both across and within regions. The failure to control for such multilevel clustering can lead to massively underestimated standard errors, implying that the null hypotheses are

under-rejected using standard hypothesis tests<sup>83</sup>. In repeated cross-sections, such as our region-year income per capita panel, the clustering of standard errors can persist even when the potentially unobserved effects are taken into account, implying that valid standard errors overcome single-way clustering using a multi-way clustering scheme to control for the within-region serial correlation of the stochastic disturbances.<sup>84</sup>

We use a non-nested multiway clustering estimator<sup>85</sup> and cluster the standard errors at the region-, country- and year-level based on the three-way error components model with i.i.d. errors compared to the traditionally used one-way clustering,<sup>86</sup> which may lead to over-rejection of the null hypotheses, and make the standard errors and parameter inference unreliable. This strategy allows us to consistently estimate the model parameters from Eq. (1) and Eq. (2) by allowing for an arbitrary heteroskedastic distribution of error variance, and serially correlated stochastic disturbances both across and within regions.

<sup>83</sup> Moulton, Brent R. "Random group effects and the precision of regression estimates." *Journal of Econometrics* 32, no. 3 (1986): 385-397; Moulton, Brent R. "An illustration of a pitfall in estimating the effects of aggregate variables on micro units." *The Review of Economics and Statistics* (1990): 334-338.

<sup>84</sup> Kezdi, Gabor. "Robust standard error estimation in fixed-effects panel models." *Hungarian Statistical Review*, Special Number 9 (2004): 95-116; Bertrand, Marianne, Esther Duflo, and Sendhil Mullainathan. "How much should we trust differences-in-differences estimates?" *The Quarterly Journal of Economics* 119, no. 1 (2004): 249-275.

<sup>85</sup> Cameron, A. Colin, Jonah B. Gelbach, and Douglas L. Miller. "Robust inference with multiway clustering." *Journal of Business & Economic Statistics* 29, no. 2 (2011): 238-249; Pepper, John V. "Robust inferences from random clustered samples: an application using data from the panel study of income dynamics." *Economics Letters* 75, no. 3 (2002): 341-345; Davis, Peter. "Estimating multi-way error components models with unbalanced data structures." *Journal of Econometrics* 106, no. 1 (2002): 67-95.

<sup>86</sup> White, Halbert. "A heteroskedasticity-consistent covariance matrix estimator and a direct test for heteroskedasticity." *Econometrica: Journal of the Econometric Society* (1980): 817-838; Pfeiffermann, Dan, and Gad Nathan. "Regression analysis of data from a cluster sample." *Journal of the American Statistical Association* 76, no. 375 (1981): 681-689; Liang, Kung-Yee, and Scott L. Zeger. "Longitudinal data analysis using generalized linear models." *Biometrika* 73, no. 1 (1986): 13-22; Arellano, Manuel. "Computing Robust Standard Errors for Within-groups Estimators." *Oxford Bulletin of Economics and Statistics* 49, no. 4 (1987): 431-434; Hansen, Christian B. "Asymptotic properties of a robust variance matrix estimator for panel data when T is large." *Journal of Econometrics* 141, no. 2 (2007): 597-620; Wooldridge, Jeffrey M. "Cluster-sample methods in applied econometrics." *American Economic Review* 93, no. 2 (2003): 133-138; Cameron, A. Colin, and Pravin K. Trivedi. *Microeconometrics: Methods and Applications*. Cambridge University Press, 2005.

# 4.

## Data



By Rok Spruk

### 4.1 The Dependent Variables

Our dependent variables are the level of per capita GDP at purchasing power standard (PPS) and its growth rate in the period 1990–2015. The former variable is used in the empirical analysis of long-term development while the latter is used in short-term growth analysis. Both variables are taken from the Eurostat database.

### 4.2 Regional Policy Outcomes

The data on regional policy outcomes come from the European Regional Competitiveness Index.<sup>87</sup> The index captures several dimensions of regional competitiveness. We screen out and consider eight dimensions of competitiveness capturing the role of EU regional policy. First, the macroeconomic stability dimension comprises the regional general government deficit/surplus at the NUTS-2 level, the national savings rate, inflation rate, public debt, and government bond yields. Second, the infrastructure dimension captures the level of infrastructural development and considers motorway potential accessibility, railway potential accessibility, number of passenger flights, and the intensity of high-speed railways. Third, the public health dimension captures the health policy outcomes and indicators such as road fatalities at the NUTS-2 level, healthy

life expectancy, infant mortality, cancer disease death rate, and suicide death rate. Fourth, the basic education dimension captures the policy outcomes associated with basic human capital investment. Three variables from this particular dimension are considered, namely the share of low-achieving 15-year-olds in reading, mathematics, and science. Fifth, the higher education and lifelong learning dimension captures the higher education potential and level of human capital. It is proxied by five different sub-indicators such as working-age population with a higher educational attainment, participation in lifelong learning, early school leavers, accessibility to universities, and gender balance in tertiary education. Sixth, the labour market efficiency dimension captures the set of labour market policy outcomes such as the employment rate, long-term unemployment rate, unemployment rate, labour productivity, gender balance unemployment, gender balance employment, female unemployment, and youth NEET<sup>88</sup> rate. Seventh, the market size dimension captures the economic potential of the regional GDP at the NUTS-2 level by way of three indicators: (i) disposable per capita income; (ii) potential market size relative to GDP; and (iii) potential market size relative to population size. Eighth, the technological readiness dimension captures the level of technological development and the related policy outcomes across multiple

<sup>88</sup> EU Commission, European Regional Competitiveness Index 2016. Brussels. [http://ec.europa.eu/regional\\_policy/en/information/maps/regional\\_competitiveness/](http://ec.europa.eu/regional_policy/en/information/maps/regional_competitiveness/)

<sup>89</sup> Young people neither in employment nor in education and training.

indicators, which include the share of households with broadband access, frequency of buying over the Internet, household Internet access, availability of the latest technologies, firm-level technology absorption, technological adoption, FDI and technology transfer, enterprises having purchased online, enterprises having received orders online, and enterprises with fixed broadband access. Ninth, the business sophistication dimension captures creativity skills at the regional level through variables such as employment in service-oriented sectors, gross value added in service-oriented sectors, and innovative small- and medium-size enterprises (SMEs) collaborating with others. Tenth, the innovation dimension captures the region-level innovative capabilities and innovation potential. This dimension comprises patent applications, creative class employment shares, knowledge workers, scientific publications, R&D expenditure, human resources in science and technology, employment in technology- and knowledge-intensive sectors, high-tech patents, ICT patents, biotechnology patents, exports in medium-high/high-tech manufacturing, and sales of new-to-market and new-to-firm innovation.

Regional policy outcomes are reflected in 56 observable indicators. Each policy dimension variable is constructed by extracting the first principal component from each particular class of indicators to obtain the component with the largest eigenvector providing for the largest extent of common variation between the indicators.

### 4.3 Regional Institutional Framework Variables

The data on the regional institutional framework for the NUTS-2 variables are taken from Charron, Dijkstra and Lapuente (2014).<sup>89</sup> We consider three distinct variables of institutional quality at the NUTS-2 level: (i) overall quality of government; (ii) impartiality of government administration; and (iii) experience and perception of corruption in health care, government administration, education, and law enforcement. We are able to match the institutional quality covariates of 206 European regions at the NUTS-2 level with the policy outcome data. For a few smaller countries where variation in institutional quality does not exist at the NUTS-2 level, we consider the full-country estimate at the NUTS-1 level as a designated measure of institutional quality.

### 4.3 Regional Human Intelligence Data

The data on human intelligence come from a series of PISA reports.<sup>90</sup> Following earlier studies,<sup>91</sup> our proxy for human intelligence is based on mathematics, reading, science, and problem-solving test scores among 15-year-olds. These data provide a direct measure of human capital output rather than input measure, and thus reflect the cognitive abilities of a certain age threshold better than indicators such as enrolment rates or years of schooling.<sup>92</sup> Table 1 reports the descriptive statistics for our full sample.

<sup>89</sup> Charron, Nicholas, Lewis Dijkstra, and Victor Lapuente. "Regional governance matters: Quality of government within European Union member states." *Regional Studies* 48, no. 1 (2014): 68-90.

<sup>90</sup> Programme for International Student Assessment <http://www.oecd.org/pisa/>

<sup>91</sup> Hanushek, Eric A., and Dennis D. Kimko. "Schooling, labour-force quality, and the growth of nations." *American Economic Review* 90, no. 5 (2000): 1184-1208; Hanushek, Eric A., and Ludger Woessmann. "Do better schools lead to more growth? Cognitive skills, economic outcomes, and causation." *Journal of Economic Growth* 17, no. 4 (2012): 267-321; Hanushek, Eric A. "Economic growth in developing countries: The role of human capital." *Economics of Education Review* 37 (2013): 204-212;

<sup>92</sup> Weede, Erich, and Sebastian Kämpf. "The impact of intelligence and institutional improvements on economic growth." *Kyklos* 55, no. 3 (2002): 361-380; Jones, Gareth, and W. Joel Schneider. "Intelligence, human capital, and economic growth: A Bayesian averaging of classical estimates (BACE) approach." *Journal of Economic Growth* 11, no. 1 (2006): 71-93; Ram, Rati. "IQ and economic growth: Further augmentation of Mankiw-Romer-Weil model." *Economics Letters* 94, no. 1 (2007): 7-11.

Table 1: Descriptive Statistics of Outcomes and Regional Growth Determinants

	# Observations	Mean	StD	Min	Max
<b>Panel A: Dependent Variables</b>					
Log GDP Per Capita	5,265	9.96	0.4	8.31	11.90
Growth Rate of GDP Per Capita	1,207	2.11	7.49	-50.94	198.12
<b>Panel B: Regional Policy Variables</b>					
Convergence Region	7,124	0.32	0.47	0	1
Phase-Out Region	7,124	0.05	0.21	0	1
Phase-In Region	7,124	0.05	0.23	0	1
Competitiveness and Employment Region	7,098	0.57	0.50	0	1
Macroeconomic Stability	7,098	-0.02	0.91	-3.05	1.93
Infrastructure	6,994	-0.15	0.86	-1.46	1.95
Health Policy	7,098	-0.06	0.81	-3.49	1.10
Basic Education Policy	7,098	-0.03	1.02	-3.25	1.81
Higher Education Policy	7,046	0.00	0.80	-3.82	2.19
Labor Market Efficiency	7,098	0.01	0.79	-2.25	1.50
Market Size	7,098	-0.18	0.88	-1.57	2.45
Technology Level	7,098	0.05	0.88	-2.38	1.24
Business Environment	7,098	-0.07	0.85	-1.87	2.99
Innovation	7,098	-0.12	0.83	-1.76	2.28
<b>Panel C: Regional Institutional Framework Variables</b>					
Quality of Government Index	4,102	-0.12	1.04	-2.84	2.64
Impartiality of Government Services	4,053	-0.13	1.06	-3.27	2.80
Level of Corruption	4,053	-0.14	1.00	-3.24	2.67
<b>Panel D: Intelligence Variables</b>					
PISA Test Scores: Mathematics	7,046	494.31	22.52	430	531
PISA Test Scores: Reading	7,046	495.61	19.68	434	524
PISA Test Scores: Science	7,046	503.08	23.67	431	545
PISA Test Scores: Problem Solving	7,020	494.68	28.88	402	523
<b>Panel E: Control Variables and Transmission Channel Variables</b>					
Initial GDP Per Capita	5,265	5265	10.04	0.36	8.52
Population Size	6,357	6357	14.15	0.84	10.10
Area Size	6,039	6039	9.08	1.22	2.56
Population Density	5,787	5787	5.02	1.21	0.34
Fertility Rate	5,438	5438	1.54	0.31	0.81
Life Expectancy	5,406	5406	4.36	0.04	4.20
Primary Balance	1,955	1955	9.52	0.47	7.65
Disposable Income	1,955	1955	9.43	0.42	7.65
Working-Age Population with Tertiary Education	3,931	3931	3.08	0.42	1.31
Early School Leave Rate	3,742	3742	2.55	0.53	0.34
Student Population Share	2,138	2138	4.47	0.13	2.91
Employment Rate	4,208	4208	4.00	0.12	3.37
Internet Use	420	420	1.76	1.92	-4.61
Broadband Conenction	706	706	4.25	0.30	2.66
Deprivation Rate	762	762	2.44	0.78	0.00
Household Share with Low-Work Intensity	1,357	1357	4.06	0.41	2.20
Risk of Poverty Rate	835	835	1.77	1.06	-1.61
Employment in Agriculture	837	837	2.13	0.50	0.53
Manufacturing Employment	837	837	2.74	0.51	0.99
High-Tech Manufacturing Employment	1,767	1767	1.29	0.98	-2.30
Mid-Low Tech Manufacturing Employment	1,774	1774	2.19	0.57	0.18
Low-Tech Manufacturing Employment	1,280	1280	0.08	0.63	-2.30
Private R&D Spending Share	1,822	1822	2.25	0.46	0.34
Public R&D Spending SHare	1,816	1816	1.68	0.48	-0.36
R&D Personnel (%)	3,296	3296	4.29	1.59	0.00
Long-Term Unemployment	3,407	3407	2.88	1.53	-2.30
Unemployment Rate	2,231	2231	0.07	0.73	-2.21





# 5.

## Results



By Rok Spruk and Mitja Kovač

### 5.1 Effects of Structural Policies on Regional Development at the NUTS-2 Level

Table 2 reports the baseline results concerning the effects of structural policies on European regional development. The dependent variable that captures regional development levels is the natural log of per capita income at the NUTS-2 territorial classification level. The table reports the full-covariate model specification to determine which policy-specific effects prevail and appear to be arguably the most important ones for regional development. Column (1) presents full-sample estimates of structural policies' contribution to regional development without any specific sample restriction. The parameter estimates suggest that policies targeting public health, basic education, labour market efficiency and business sophistication appear to be the most important ones for regional development and prevail over the other policies in shaping regional development levels. In particular, a one-basis-point improvement on the latent public health variable scale is associated with increase in regional per capita income *ceteris paribus*. This implies that policies seeking to reduce road fatalities, increase healthy life expectancy, lower coronary heart disease, reduce the cancer death rate and decrease the suicide rate hold significant potential to improve long-term regional development. In addition, a one basis point improvement on the

latent basic education scale tends to improve per capita income by 2.2%, on average, *ceteris paribus*. This implies that policies aiming to shrink the share of low-achieving 15-year-olds in science, mathematics, and reading tend to make a substantial difference to long-term development. The parameter on the contribution of labour market efficiency to regional development is both economically large and statistically significant at 1%. This implies that a one-basis-point improvement on the labour market efficiency scale predicts a 13% increase in region-level per capita income, *ceteris paribus*. Hence, structural policies aimed at increasing employment rates, fostering a gender balance and promoting labour productivity tend to strengthen long-term development substantially. Our estimates also imply that policies improving business sophistication appear to be an important vehicle for regional development. An improvement on the latent scale of business sophistication is characterised by fostering employment and value added in knowledge-intensive sectors and promoting small and medium enterprises with high innovation potential. A one-basis-point improvement on the latent business sophistication scale is associated with an 8.3% increase in regional per capita income, *ceteris paribus*.

In column (2), we show that these results remain fairly stable and comparable in terms of magnitude and statistical significance on a subsample of

regions whose per capita income is below the 90th percentile. In the 90th percentile sample split, the only difference from the baseline results for the full-sample specification in column (1) is that the contribution of innovation-related structural policies to long-term regional development is statistically significant. This suggests that a one-basis-point increase of the latent innovation scale is associated with an 18% rise in per capita income at the regional level. Such an increase on the innovation scale corresponds to a greater share of creativity-class employment, an increase in scientific publications,

higher R&D expenditure, greater export intensity in high-tech manufacturing, and an increased density of patents in the ICT and biotechnology sectors. In column (3), we replicate our results on the split sample of regions with per capita income below the 75th percentile, and the estimated parameters remain largely intact. In column (4), the core empirical model specification for per capita income at the regional level is re-estimated on a sample of regions whose per capita income is below-median to examine whether the results remain stable once regions with below-average per capita income are

Table 2: Regional Policy, Institutions, Intelligence and European Regional Development, 1990-2015

	Full Sample	Split Samples			By Treatment Level			Employment and Competitiveness Regions Only
	(1)	Below 90th Percentile	Below 75th Percentile	Below-Median Percentiles	Convergence Regions Only	Phase-Out Regions Only	Phase-In Regions Only	
<b>Panel A: Regional Policy and Competitiveness Variables</b>								
Macroeconomic Stability	-.053 (.035)	-.053 (.035)	-.053 (.035)	-.053 (.035)	-.053 (.035)	-.053 (.035)	-.053 (.035)	-.053 (.035)
Infrastructure	.001 (.034)	.001 (.034)	.001 (.034)	.001 (.034)	.001 (.034)	.001 (.034)	.001 (.034)	.001 (.034)
Health Policy	.266*** (.025)	.266*** (.025)	.266*** (.025)	.266*** (.025)	.266*** (.025)	.266*** (.025)	.266*** (.025)	.266*** (.025)
Basic Education	.022** (.011)	.022** (.011)	.022** (.011)	.022** (.011)	.022** (.011)	.022** (.011)	.022** (.011)	.022** (.011)
Higher Education	-.083*** (.020)	-.083*** (.020)	-.083*** (.020)	-.083*** (.020)	-.083*** (.020)	-.083*** (.020)	-.083*** (.020)	-.083*** (.020)
Labor Market Efficiency	.138*** (.048)	.138*** (.048)	.138*** (.048)	.138*** (.048)	.138*** (.048)	.138*** (.048)	.138*** (.048)	.138*** (.048)
Market Size	.003 (.032)	.003 (.032)	.003 (.032)	.003 (.032)	.003 (.032)	.003 (.032)	.003 (.032)	.003 (.032)
Technology	-.043 (.054)	-.043 (.054)	-.043 (.054)	-.043 (.054)	-.043 (.054)	-.043 (.054)	-.043 (.054)	-.043 (.054)
Business Environment	.083*** (.039)	.083*** (.039)	.083*** (.039)	.083*** (.039)	.083*** (.039)	.083*** (.039)	.083*** (.039)	.083*** (.039)
Innovation	.180 (.028)	.180 (.028)	.180 (.028)	.180 (.028)	.180 (.028)	.180 (.028)	.180 (.028)	.180 (.028)
Constant Term	10.016*** (.032)	10.016*** (.032)	10.016*** (.032)	10.016*** (.032)	10.016*** (.032)	10.016*** (.032)	10.016*** (.032)	10.016*** (.032)
Country Clusters	28	28	28	28	28	28	28	28
Regional Clusters	267	267	267	267	267	267	267	267
Time Clusters	15	15	15	15	15	15	15	15
# Observations	3,972	3,972	3,972	3,972	3,972	3,972	3,972	3,972
R2	0.72	0.72	0.72	0.72	0.72	0.72	0.72	0.72

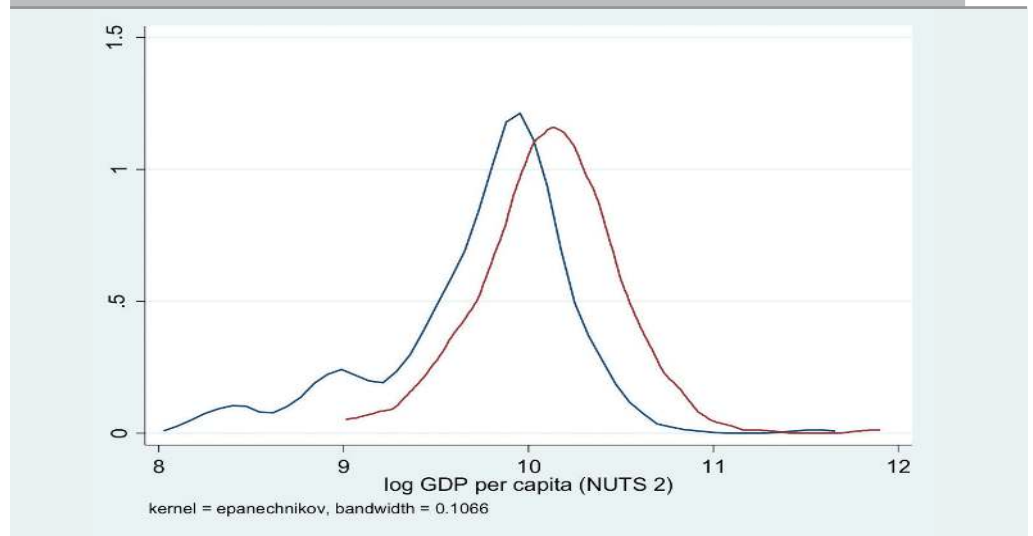
Notes: the table reports the effects of regional policy outcomes on per capita income. Cluster-robust standard errors are denoted in the parentheses. Asterisks denote statistically significant regression coefficients at 10% (\*), 5% (\*\*), and 1% (\*\*\*), respectively.

considered. In addition to the results for columns (1) to (3), we show that market size and policies for strengthening technological readiness tend to foster regional development considerably. Such policies typically target the absorption and adoption of firm-level technologies, technological adaptation, technology transfer and digitalisation of enterprises. Our estimates suggest these policies play a pivotal role in regional development but only insofar as below-frontier regions are concerned, where the adaptation of existing technologies is more prevalent, which is also consistent with the theoretical expectations.

In columns (5) to (8), we re-estimate the full-sample/full-covariate specification by the level of regional policy treatment to examine which policy-specific effects prevail. Column (5) revisits the full-covariate specification from column (1) on the sample of convergence regions. The evidence is consistent with the prior estimates in column (4), and suggests that public health policies, market size, technological readiness, business sophistication, and innovation-enhancing policies matter for regional development. On balance, the size of the coefficient on the innovation policy pillar is by far the highest in the full specification, suggesting that the continuous interplay of firm-level innovation and innovation-promoting policies appears to be easily the most important policy-related pillar of regional development. Columns (6) and (7) revisit the core empirical specification of regional development on the subsamples of phase-in and phase-out regions. These empirical insights are vital for understanding whether any transition from the regional funding scheme from the convergence criteria to the support from regional competitiveness and employment objectives downplays the importance of structural policies in fostering regional development. In column (6), we find that in the phasing-out stage health and education policies, labour-market-efficiency-enhancing policies and market size appear to be hold a discernible and non-negligible role in regional development. By contrast, column (7) shows that in the phasing-in stage the structural policies labour

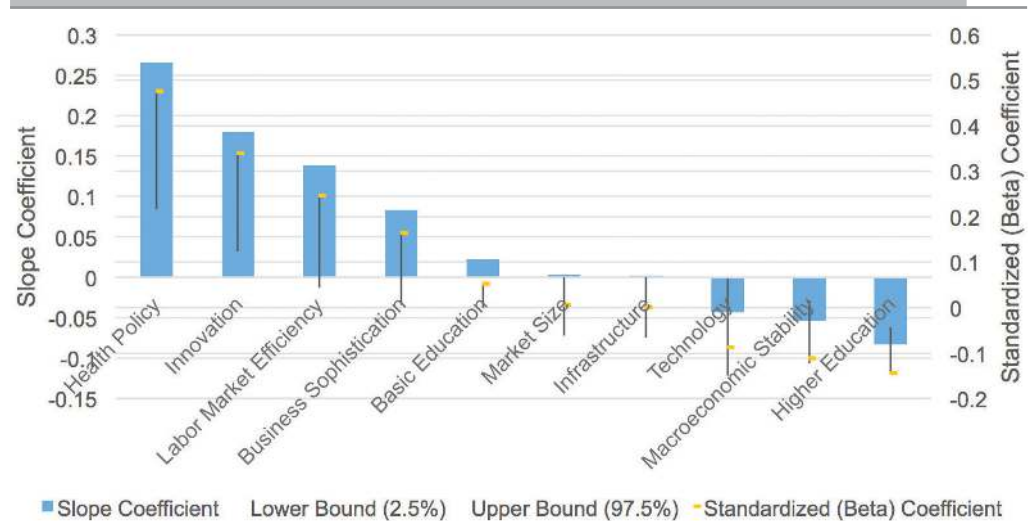
market efficiency and business sophistication prevail and arguably matter a great deal for the long-term development paths of these regions. In column (8), we revisit the core full-covariate specification by splitting non-employment and competitiveness regions off from the full sample. Since employment and competitiveness regions comprise about 57% of our sample, these effects appear to be strongly representative of the EU as a whole without the regions under the convergence criteria. The evidence clearly suggests that, compared to the full-sample estimates in column (1), macroeconomic stability and health policies are pivotal for regional development. Once the regions meet the employment and competitiveness criteria, macroeconomic stability such as a high level of saving and sustainable public finances becomes an important policy driver of regional development. In particular, a one-basis-point improvement on the latent macroeconomic stability scale is associated with an 8.1% increase in per capita income, *ceteris paribus*. The positive effect of health-related structural policies is not surprising and suggests that such policies can be defended on public goods theoretical grounds, although the magnitude of the effect is notably smaller than the pairwise estimates in column (2) and (3). In addition, the parameter estimates in column (8) confirm the significant effect on regional development of structural policies targeting innovation and business sophistication. Our evidence in Table 2 thereby suggests the notion that regional policies have no impact on regional development is largely refuted by the empirical analysis of regional development. Whereas the policies gearing market size, technology level, education, business sophistication and innovation prevail at lower levels of per capita income, macroeconomic stability and innovation-related structural policies prevail at higher levels of regional development as proxied by the employment and competitiveness target objective. In total, the combined effects of structural policies account for up to 72% of the overall regional development variance, respectively.

Figure 1: Distribution of Regional GDP Per Capita in EU



The most obvious question concerning the role of structural policies in European regional development is which ‘policy bundle’ appears to be the most important. In Figure 1, we standardise the slope coefficients from the full-sample/ full-covariate specification in column (1) and compute the beta coefficients, denoting the response of per capita income to 1 standard deviation change in the respective policy variables. The evidence suggests that health policies seem to be the most important ones for regional development followed by innovation, labour market efficiency, business sophistication and basic education. The evidence does not deny the importance of other types of structural policies for long-term regional development but merely suggests which policies affect the level of regional per capita income to the largest degree without neglecting the potential complementarity between various structural policies. Figure 2 presents the standardised structural policy support coefficients in order of relative importance.

Figure 2: The Importance of Regional Policies for Regional Development



## 5.2 Effects of Institutional Framework at the NUTS-2 Level on Regional Development

Table 3 reports the effects of the institutional framework on regional per capita income at the NUTS-2 regional classification level. The estimated effects capture the contribution of the quality of governance, impartiality of government services, and corruption on the level of per capita income and permit an inquiry into the role played by institutions in shaping regional development contours. Column (1) reports the full-sample specification with the full set of institutional covariates without any particular sample restriction. The evidence clearly suggests that the quality of government matters a great deal for regional development. Our point estimates imply that a one-basis-point increase in the latent quality of government variables is associated with a 17% increase in per capita income at the NUTS-2 level, respectively. The estimated coefficient appears to be statistically significant at 1%. The magnitude of the estimated coefficient is comparable to the magnitude of the structural policy coefficients from Table 2 for those variables holding the greatest explanatory power in standardised terms. In addition, we find that regional development appears to be strongly affected by the impartiality of government services, suggesting that government favouritism consistently downplays regional development. In particular, our estimated model specification predicts a 19% increase in per capita income in response to a one-standard-deviation improvement in the impartiality of government services at the NUTS-2 level. By contrast, we find no effects of corruption on the determination of per capita income at the local level. One should be aware that the institutional covariates account for up to 39% of the variance in regional development across NUTS-2 regions. Column (2) splits the regions with per capita income in the 90th percentile off from the full sample. The evidence confirms the importance of the institutional quality variables for regional development. In particular, the parameter estimate

on the quality of government is comparable with the prior estimate in column (1) while we find a notable increase in the magnitude of the coefficient on the impartiality of government services. We also find a marginally positive effect of corruption at the regional level on per capita income. In particular, a one-basis-point shift on the latent corruption scale tends to backdrop the level of per capita income by 9%, on average. In our view, the evidence largely confirms the 'grease the wheels' hypothesis between corruption and economic development, suggesting that in some cases corruption may compensate for bad governance. In columns (3) and (4), where regions with per capita income below the 75th percentile and median cut-off are considered, the estimated corruption coefficient rises from -.099 to -.141 and -.188, and appears to be statistically significant at 5% and 10%, respectively. In contrast, we find that better quality governance and the impartial provision of government services exhibit a strong, positive first-order effect on regional development with a magnitude that roughly outperforms the magnitude of the corruption coefficient. In particular, a region whose per capita income is below the 75th percentile that improves the impartiality of government services by 1 basis point can expect its per capita income to rise by 21.9%, respectively. In column (4), the response of per capita income to a similarly improved provision of government services for a region whose per capita income is below the median is 37.2%. The evidence unequivocally suggests that better-quality government tends to foster regional development, particularly at higher levels of per capita income while government favouritism tends to hinder it across all levels of regional income. On balance, corruption has no effect on regional development. However, at lower levels of income, increased corruption may have a positive effect on regional development by compensating for the low-quality governance, thus 'greasing the wheels' rather than 'putting sand in the wheels' of European regional development.

Table 3: Institutional Framework and European Regional Development, 1990-2015

	Full Sample	Split Samples			By Treatment Level			Employment and Competitiveness Regions Only (8)
	(1)	Below 90th Percentile (2)	Below 75th Percentile (3)	Below-Median Percentiles (4)	Convergence Regions Only (5)	Phase-Out Regions Only (6)	Phase-In Regions Only (7)	
<b>Panel B: Regional Institutional Framework Variables</b>								
Quality of Government	.173*** (.063)	.174*** (.066)	.180*** (.073)	.074 (.051)	.054 (.049)	.011 (.040)	-.091 (.068)	.108** (.052)
Impartiality of Government Services	.190** (.097)	.200** (.095)	.219** (.106)	.372*** (.083)	.263*** (.088)	.041 (.075)	.286*** (.096)	.019 (.088)
Corruption	-.072 (.063)	-.099* (.053)	-.141** (.055)	-.188* (.115)	-.160 (.109)	-.014 (.052)	-.154*** (.051)	-.093 (.085)
Constant Term	9.905*** (.074)	9.889*** (.073)	9.868*** (.078)	9.680*** (.084)	9.559*** (.091)	9.889*** (.018)	9.928*** (.021)	10.179*** (.050)
Regional Clusters	150	150	150	75	60	6	5	78
Country Clusters	16	16	16	9	10			11
Time Clustered	15	15	15	15	15			15
# Observations	2,235	2,098	1,772	947	900	90	75	1,156
R2	0.39	0.35	0.28	0.26	0.16	0.05	0.20	0.03

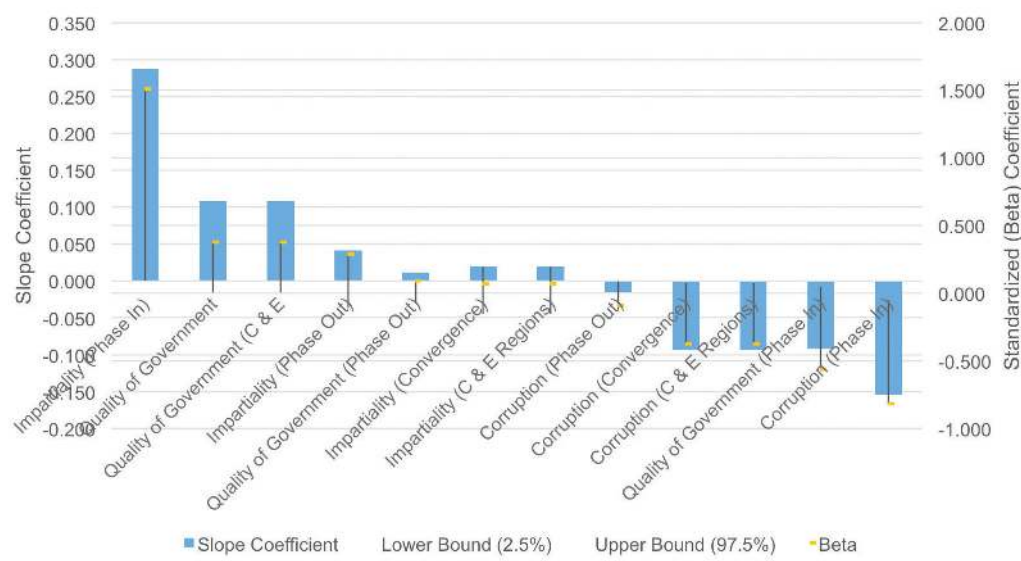
Notes: the table reports the effects of the quality of institutions at the regional level on per capita income. Cluster-robust standard errors are denoted in the parentheses. Asterisks denote statistically significant regression coefficients at 10% (\*), 5% (\*\*), and 1% (\*\*\*), respectively.

Columns (5) to (8) re-examine the contribution of the institutional framework to regional development gaps in the NUTS-2 territorial grid by the level of regional policy treatment. Column (5) presents the effects of institutional covariates on convergence-only regions. The evidence suggests that, compared to the full-sample and split-sample specifications across columns (1) to (4), the greater impartiality of government services appears to be a dominant institutional driver of regional development while the effects of quality of government and corruption do not seem to be statistically distinguishable from zero. In column (8), the core specification is re-estimated on the sample of employment and competitiveness regions, where we find a strong positive effect of the overall quality of government and statistically weak effects of the impartiality and corruption variables. On balance, the evidence strongly suggests that convergence regions below the European frontier may benefit considerably from the improved impartiality of government services as government favouritism may pose a substantial long-term development risk. At higher levels of

income, when regions meet competitiveness and employment criteria, the level of regional development appears to be shaped considerably by the quality of governance whereas there is less supportive evidence for the independent effect of corruption and impartiality in this particular treatment stage. In a sample of convergence-eligible regions, institutional covariates explain up to 16% of the cross-regional per capita income variance while, for a sample of employment-and-competitiveness regions, the fraction of the per capita income variance explained by institutional covariates is about 3%, respectively.

Figure 3 presents the standardised effects of the institutional framework variables on regional per capita income at the NUTS 2 level by policy treatment stage. The figure reports the slope coefficient, standardised (beta) coefficient as well as the upper and lower bounds on the slope coefficient. Standardising the effects allows us to determine which particular institutional framework dimensions are the most important for growth and

Figure 3: The Importance of Institutional Framework for European Regional Development



development. The plot shows that the beta coefficient is by far the largest for the impartiality of government services in phase-in regions, quality of government in convergence-eligible regions, quality of government in competitiveness and employment regions, and impartiality of government services in phase-out regions. By contrast, the positive effect of corruption on per capita income in phase-in and phase-out regions appears to be large and comparable with the effect of the quality of government in convergence-eligible regions.

### 5.3 Effects of Human Intelligence on Regional Development

Table 4 reports the effects of human intelligence on regional development using sub-national PISA test scores as a rough intelligence proxy. The evidence at the NUTS-2 territorial grid level suggests that the regional variation in test scores accounts for up to 34% of the regional per capita income gaps, which is about half the variance of the cross-regional income gaps explained by the structural policies, and about the same fraction of gaps as accounted for by the institutional framework variables.

Column (1) reports the effects of intelligence on regional per capita income in a full-sample specification without sample splits or any other similar restrictions. The parameter estimates suggest that, once multiple intelligence dimensions are allowed to vary simultaneously, the positive effect of intelligence on regional per capita income is driven almost exclusively by problem-solving skills. Improving problem-solving skills by 10 basis points through a standardised test is associated with an 8% increase in regional per capita income in the long run, *ceteris paribus*. The problem-solving skills variable clearly dominates the contribution of mathematics, reading, and scientific skills variables which suggests that such skills might play a pivotal role in regional development, and might be even more important than the role of the institutional framework and structural policies together. In column (2), we split the regions in the upper decile of the per capita income distribution off from the full sample, and find similar results. Column (3) similarly excludes the regions in the upper quarter of the per capita income distribution from the full sample and finds similar results to those in columns (1) and (2). In column (4), we re-estimated

the core empirical specification of regional development using intelligence variables for the below-median NUTS-2 regions. The parameter estimate on the problem-solving skills variable rises from .008 to .010 and is statistically significant at 1%, respectively. This suggests that a 10-basis-point increase in problem-solving skills scores tends to foster per capita income by 10%, respectively, which appears to be economically large, and suggests that such skills have a sizeable potential to improve long-term regional development.

In columns (5) to (8), we re-estimate the core empirical specification by the levels of regional policy treatment. The estimates in column (5) suggest that, when focusing on convergence regions only, improving problem-solving skills and scientific skills tends to foster per capita income, respectively. Column (6) uses the variation in intelligence scores in phase-out

regions only, and shows that a combination of better reading skills and scientific skills predicts higher levels of per capita income. Focusing on employment and competitiveness regions, column (7) shows that better mathematics skills predict a higher level of per capita income. In particular, a 10-basis-point increase in PISA mathematics test scores is associated with a 3% increase in per capita income, respectively, and is statistically significant at 5%, respectively. On balance, the evidence clearly suggests that, at lower levels of development, problem-solving skills importantly contribute to regional growth and help explain cross-regional per capita income variation. At intermediate levels of development, reading skills and scientific skills tend to matter a great deal for regional development. At higher levels, the effect of human intelligence on per capita income is dominated by the level of mathematics skills.

Table 4: Human Intelligence and European Regional Development, 1990-2015

	Full Sample	Split Samples			By Treatment Level			
	(1)	Below 90th Percentile	Below 75th Percentile	Below-Median Percentiles	Convergence Regions Only	Phase-Out Regions Only	Phase-In Regions Only	Employment and Competitiveness Regions Only
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<b>Panel C: Human Intelligence Variables</b>								
Mathematics Skills	.002 (.004)	.001 (.004)	-.004 (.005)	-.007* (.004)	-.013** (.006)	-.005 (.003)	.003 (.003)	.003** (.001)
Reading Skills	-.002 (.006)	-.002 (.006)	.0009 (.005)	.006 (.006)	-.0001 (.0062)	.003* (.001)	-.0007 (.006)	-.006** (.002)
Scientific Skills	-.0002 (.004)	.0004 (.0039)	.002 (.004)	-.006 (.006)	.010* (.005)	.004* (.002)	-.0004 (.0069)	.005 (.002)
Problem-Solving Skills	.008*** (.003)	.008*** (.003)	.008*** (.002)	.010*** (.001)	.005*** (.001)	.0001 (.0011)	-.0002 (.0018)	-.003 (.002)
Constant Term	5.655*** (1.118)	5.811*** (1.130)	6.434*** (1.217)	7.803*** (.616)	8.075*** (.656)	8.697*** (.707)	9.093*** (1.355)	10.119*** (1.228)
Regional Clusters	266	268	266	91	82	13	15	154
Country Clusters	24	24	24	13	16	8	8	15
Time Clusters	15	15	15	15	15		15	15
# Observations	3,957	3,769	2,634	1,126	1,230	192	225	2,280
R2	0.34	0.34	0.32	0.30	0.29	0.07	0.05	0.08

Notes: the table reports the effects of human intelligence at the regional level on per capita income. Cluster-robust standard errors are denoted in the parentheses. Asterisks denote statistically significant regression coefficients at 10% (\*), 5% (\*\*), and 1% (\*\*\*), respectively.



## 5.4 Comparing the Effects of Policies, Institutions and Intelligence

The empirical evidence so far is clear in demonstrating that structural policies, institutional quality and intelligence make a difference to regional development at the NUTS-2 level. The question that most naturally arises from the empirical analysis so far is which particular explanation of regional development gap prevails over the others. In other words, is regional development primarily driven by the differences in intelligence, institutional quality or by the efficacy of structural policies? We address these concerns by pooling the full set of covariates in the multitude of sample-specific model setups used so far to see which particular effects prevail.

Table 5 reports the combined effects of structural policies, institutional quality and intelligence on the level of per capita income at the NUTS-2 territorial grid level. Column (1) reports the estimates from a full-sample/full-covariate specification. Panel D specifically reports the effects of regional policy variables on per capita income. The evidence makes it plain that structural policy outcomes push per capita income onto a higher level. The positive effects of structural policies on per capita income are most likely driven by health policies, improved labour market efficiency, business sophistication policies, and innovation policies. In Panel E, we find that the independent effects of institutional quality appear to be quite weak, while in Panel F improved human intelligence, especially with respect to scientific and problem-solving skills, tends to foster regional development considerably. In particular, a 10-basis-point increase in standardised science test scores tends to push up per capita income by 3%, on average, in the long run. An equivalent increase in problem-solving test scores pushes per capita income

further up by 1%, respectively. Both parameter estimates are statistically significant at 5%. Column (2) splits the NUTS-2 regions with per capita income in the upper 10% of the distribution off from the full sample. The parameter estimates confirm the beneficial effects of health policy, improved labour market efficiency, business sophistication and innovation-related structural policies on regional development. In Panel E, the evidence suggests that institutional quality can also make a crucial difference to regional development. In particular, the parameter estimates indicate a statistically significant and economically large effect of improved impartiality of government services on regional development. Improving the impartiality of government services by 1 basis point on the latent scale is associated with a 4.6% increase in per capita income, *ceteris paribus*. Our parameter estimates imply that a shift in the impartiality of government services from the 25th percentile (observed in Molise, Italy) to the 90th percentile (observed in Aland Islands, Finland) predicts a 9.5% ( $=\exp(.046 \times 1.993)$ ) increase in per capita income, respectively. In Panel F, we confirm the beneficial independent impact of human intelligence on per capita income. Increasing scientific skills from the lowest value in the sample (observed in Calabria, Italy) to the 90th percentile (observed in Oberbayern, Germany) would increase per capita income by 45% ( $=\exp(.004 \times 94)$ ) in the long run, respectively, which is both statistically significant at 5%, and economically large. The regional development gains from better problem-solving skills are similarly large. Improving problem-solving skills from the 20th percentile (observed in Eastern Slovenia) to the 90th percentile (observed in Berkshire, Buckinghamshire & Oxfordshire Region, England) would improve per capita income by 4%, respectively. By contrast, improving problem-solving skills from the lowest value in the sample (observed

Table 5: Policies, Institutions, Intelligence and European Regional Development, 1990-2015

	Full Sample	Split Samples			By Treatment Level			Employment and Competitiveness Regions Only (8)
	(1)	Below 90th Percentile (2)	Below 75th Percentile (3)	Below-Median Percentiles (4)	Convergence Regions Only (5)	Phase-Out Regions Only (6)	Phase-In Regions Only (7)	
<b>Panel D: Regional Policy Variables</b>								
Macroeconomic Stability	-.138*** (.030)	-.145*** (.030)	-.172*** (.032)	-.139*** (.049)	-.081 (.060)			-.014 (.049)
Infrastructure	-.013 (.031)	-.006 (.031)	.010 (.030)	.125** (.053)	.115** (.055)			-.010 (.029)
Health Policy	.238*** (.025)	.240*** (.025)	.225*** (.027)	.012 (.045)	.055* (.032)			.079 (.066)
Basic Education	-.025 (.022)	-.025 (.021)	-.034* (.021)	.131** (.052)	.108*** (.041)			-.010 (.036)
Higher Education	-.046 (.025)	-.034 (.026)	-.037 (.030)	.073* (.047)	.040 (.050)			-.065*** (.022)
Labor Market Efficiency	.156*** (.040)	.160*** (.039)	.144*** (.042)	.021 (.040)	.001 (.036)	-.085 (.073)		.157*** (.031)
Market Size	.054 (.041)	.059 (.043)	.074* (.044)	.016 (.076)	.155*** (.026)			.077** (.034)
Technology	.025 (.034)	.013 (.034)	.033 (.036)	.214*** (.066)	.177*** (.051)			.017 (.053)
Business Sophistication	.085*** (.034)	.081** (.032)	.111*** (.036)	.187*** (.074)	.181*** (.074)			-.00001 (.032)
Innovation	.161*** (.032)	.148*** (.033)	.112*** (.038)	.128* (.075)	.064 (.053)			.161*** (.055)
<b>Panel E: Regional Institutional Variables</b>								
Quality of Government	-.027 (.026)	-.024 (.026)	-.037 (.028)	-.039 (.026)	-.013 (.035)	.373*** (.092)	-.005 (.016)	-.021 (.043)
Impartiality of Government Service	.040 (.028)	.046* (.029)	.063** (.031)	.058 (.055)	-.025 (.047)	.084 (.064)	.065* (.035)	-.003 (.042)
Corruption	-.016 (.040)	-.030 (.039)	-.053 (.043)	-.040 (.065)	.060 (.059)	-.143*** (.046)	-.058*** (.013)	-.021 (.058)
<b>Panel F: Regional Human Intelligence Variables</b>								
Mathematics Skills	-.001 (.002)	-.001 (.002)	-.001 (.002)	.005** (.002)	-.001 (.003)	.055*** (.011)	-.001*** (.0002)	-.006 (.004)
Reading Skills	-.002 (.001)	-.002 (.001)	-.003* (.001)	-.004 (.003)	.0004 (.003)	.025*** (.006)	-.009*** (.002)	-.004** (.001)
Scientific Skills	.003** (.001)	.004*** (.001)	.004*** (.001)	-.006** (.003)	-.004 (.003)	-.082*** (.018)	.011*** (.001)	.011*** (.003)
Problem-Solving Skills	.001** (.0007)	.001** (.0007)	.001 (.0007)	-.001 (.001)	-.001 (.001)	-.034*** (.007)	-.0003 (.0002)	-.003 (.001)
Regional Policy Variables (p-value)	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.244]		[0.000]
Regional Institutional Framework (p-value)	[0.514]	[0.464]	[0.236]	[0.522]	[0.740]	[0.000]	[0.000]	[0.734]
Regional Intelligence (p-value)	[0.079]	[0.059]	[0.010]	[0.004]	[0.044]	[0.000]	[0.000]	[0.003]
# Observations	2,235	2,098	1,772	947	900	90	75	1,156
R2	0.81	0.81	0.77	0.69	0.60	0.24	0.84	0.55

Notes: the table reports the joint effects of regional policies, institutional framework and human intelligence on regional per capita income. Cluster-robust standard errors are denoted in the parentheses. Asterisks denote statistically significant regression coefficients at 10% (\*), 5% (\*\*), and 1% (\*\*\*), respectively.

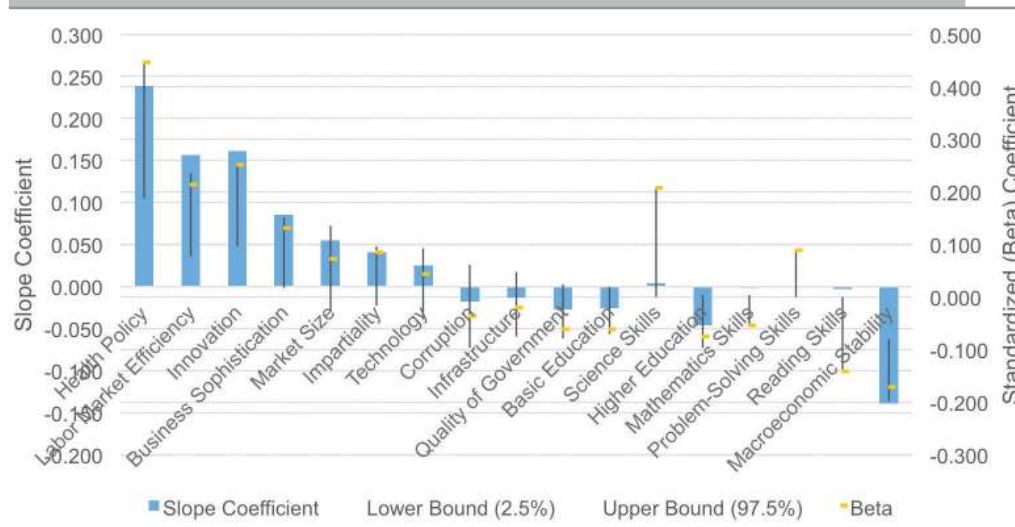
in Nord-Est, Romania) to the 90th percentile would push per capita income up by 12%.

In column (4), we re-estimate the full-covariate specification for a subsample of regions with per capita income below the median. The evidence suggests that, below the median of the regional per capita income distribution, multiple structural policies can make a difference. In particular, we find discernible positive effects of structural policies related to infrastructure, basic and higher education, technology adoption, business sophistication and innovation. Columns (5) to (8) estimate the full-covariate specification by the level of regional policy treatment. Similar to column (4), we confirm the beneficial effects of the same bundle of structural policies but find relatively weaker effects of institutional quality. In contrast, the estimates for the phase-out regions in column (6) demonstrate economically large and statistically significant effects of government quality. Improving the quality of government from the median of the distribution (observed in La Rioja, Spain) to the 90th

percentile (observed in Groningen, Netherlands) would, in our estimates, raise per capita income by 66% in the long run. Column (8) considers employment and competitiveness regions only. The estimates show that structural policies favouring labour market efficiency, market size, and innovation are associated with significantly higher levels of per capita income while in Panel F we confirm the beneficial impact of scientific skills on regional development.

Given the magnitude of the coefficients, the question remains which particular variable appears to be the most important for explaining regional development until the present day. Figure 4 presents the full set of standardised (beta) coefficients, which represent the response of per capita income to a 1 standard deviation change in the policy, institutional quality and intelligence variables. The evidence indicates that policies affecting public health, labour market efficiency and innovation appear to be the most important ones for shaping regional development levels and seem to prevail over the quality of institutions and intelligence variables in affecting per capita incomes.

Figure 4: The Importance of Policies, Institutional Framework and Human Intelligence for European Regional Development



## 5.5 Transmission Mechanisms

Despite the arguable economic and statistical significance of our estimates, one question that remains unclear is through which mechanisms would the impact of structural policies, institutional quality and human intelligence on per capita income survive? To address these concerns, we consider several transmission mechanisms among structural policies, intelligence, institutional quality and regional development. Our vector of transmission mechanism variables consists of: (i) manufacturing employment; (ii) high-tech manufacturing employment; (iii) school dropout rate; (iv) risk of poverty; (v) material deprivation; (vi) unemployment rate; (vii) low-work intensity; (viii) Internet use; and (ix) R&D expenditure, to determine which mechanism transmits the effects of policies, institutional quality and intelligence to varying levels of per capita income. Since the full-covariate specification is considered, we are able to observe which transmission mechanism effect prevails.

Table 6 presents the full set of transmission mechanism estimates. Column (1) considers the mechanism related to manufacturing employment. The results suggest that greater infrastructural investments and innovation-related structural policies tend to foster manufacturing employment while policies shaping basic education and market size tend to dampen it. In Panel F, improved problem-solving abilities tend to decrease the share of manufacturing employment, which holds important implications for regional development. Column (2) shows that infrastructure-related structural policies, improved labour market efficiency and innovation-related structural policies expand the share of employment in high-tech manufacturing. The beneficial impact of improved reading skills and problem-solving skills most likely impacts regional development

through a higher share of high-tech manufacturing employment as presented in Panel F. In column (3), we show that strengthening higher education policies positively affects per capita income through a lower school dropout rate. Concurrently, the estimates in column (5) reveal that health policies and improved labour market efficiency tend to improve per capita income partially through a lower rate of material deprivation. In Panel E, we also show that improved government quality at the NUTS-2 level tends to consistently reduce the rate of material deprivation and find a similar effect for improved mathematics skills in Panel F.

Further, the estimates in column (6) indicate that health policies, improved labour market efficiency and basic education policies, as well as better mathematics skills tend to impact per capita income positively through a lower unemployment rate. In column (7), we show that health policies and infrastructure-related structural policies tend to further the positive impact on per capita income through reduced low-work intensity at the household level. In addition, we also show that low-work intensity drops in response to improved labour market efficiency, enhanced technological readiness policies, greater impartiality of government services and better mathematics skills which, on balance, tends to improve growth considerably. In column (8), we show that structural policies targeting public health, higher education, and firm-level sophistication together with improved reading skills, scientific skills and problem-solving skills tend to favourably affect regional development through greater Internet use. Finally, in column (9), the evidence suggests that innovation-related structural policies as well as the human intelligence variables exhibit a strong impact on regional development through increased R&D expenditure, which is consistent with prior theoretical expectations.

Table 6: Transmission Mechanisms and European Regional Development, 1990-2015

	Manufact. Employment (1)	High-Tech Manufact. Employment (2)	School Dropout Rate (3)	Risk of Poverty (4)	Material Deprivation (5)	Unemploy- ment Rate (6)	Low-Work Intensity (7)	Internet Use (8)	R&D Expenditure (9)
<b>Panel D: Regional Policy Variables</b>									
Macroeconomic Stability	-.051 (.145)	-.065 (.119)	-.279*** (.094)	-.063 (.088)	.259* (.148)	-.031 (.070)	-.067 (.072)	.298*** (.073)	-.812*** (.252)
Infrastructure	.192*** (.048)	.253** (.107)	.269*** (.070)	.009 (.086)	-.362** (.154)	-.186** (.090)	-.340*** (.052)	.208*** (.066)	.018 (.260)
Health Policy	-.035 (.066)	-.273*** (.092)	.314*** (.045)	-.374*** (.073)	-.750*** (.156)	-.195*** (.071)	-.817*** (.115)	-.103 (.089)	.406** (.171)
Basic Education	-.406*** (.098)	-.195*** (.069)	.075* (.042)	.543*** (.140)	-.200** (.101)	.116 (.090)	.708*** (.085)	-.145 (.093)	.207 (.176)
Higher Education	-.037 (.050)	-.611*** (.138)	-.541*** (.092)	.088 (.065)	-.077 (.112)	.318*** (.065)	.244*** (.072)	.372*** (.058)	.260 (.316)
Labor Market Efficiency	.163 (.121)	.496*** (.151)	-.067 (.064)	-.325*** (.086)	-.499*** (.084)	-.627*** (.090)	-.350*** (.070)	.012 (.071)	-.267 (.215)
Market Size	-.288*** (.093)	-.452** (.194)	-.233** (.108)	-.042 (.162)	.485*** (.196)	.207** (.090)	.272*** (.086)	-.084 (.103)	-.229 (.400)
Technology	-.026 (.087)	.172 (.144)	-.057 (.065)	-.366*** (.099)	.097 (.137)	-.056 (.124)	-.491*** (.078)	.114 (.079)	-.362* (.197)
Business Environment	-.641*** (.086)	-.574*** (.144)	.173** (.084)	.010 (.062)	.249** (.125)	-.027 (.063)	.170*** (.084)	.382*** (.095)	.824*** (.264)
Innovation	.329*** (.116)	1.023*** (.169)	-.013 (.096)	-.058 (.070)	.122 (.137)	-.101 (.070)	.005 (.089)	-.311*** (.085)	1.757*** (.457)
<b>Panel E: Regional Institutional Variables</b>									
Quality of Government	.109 (.093)	-.002 (.135)	.056 (.049)	.044 (.074)	-.233*** (.066)	.031 (.045)	-.013 (.045)	.051 (.072)	-.097 (.179)
Impartiality of Government Services	-.122 (.112)	.057 (.168)	.036 (.089)	-.166*** (.066)	.138 (.107)	.062 (.092)	-.157** (.072)	.053 (.072)	.031 (.187)
Corruption	-.083 (.087)	-.141 (.149)	.225*** (.076)	.134 (.088)	.064 (.069)	-.020 (.068)	.212*** (.050)	.030 (.082)	-.194 (.190)
<b>Panel F: Regional Human Intelligence Variables</b>									
Mathematics Skills	.006 (.009)	-.003 (.010)	.0009 (.004)	-.008** (.003)	-.027*** (.009)	-.010*** (.004)	-.018*** (.003)	-.034*** (.006)	-.012 (.017)
Reading Skills	-.001 (.006)	.018** (.008)	.001 (.004)	.005** (.002)	.024*** (.007)	.011** (.004)	.010*** (.002)	.018*** (.004)	-.026** (.012)
Scientific Skills	.007 (.007)	-.014 (.011)	-.008 (.006)	-.003 (.004)	-.004 (.004)	-.004 (.004)	.002 (.003)	.017*** (.005)	.034*** (.014)
Problem-Solving Skills	.004*** (.002)	.008*** (.003)	-.009*** (.0009)	-.004** (.002)	.004 (.002)	.0007 (.0027)	.0006 (.002)	.008*** (.001)	-.003 (.003)
Regional Policy Variables (p-value)	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Regional Institutional Framework (p-value)	[0.124]	[0.375]	[0.000]	[0.016]	[0.004]	[0.352]	[0.004]	[0.021]	[0.316]
Regional Intelligence (p-value)	[0.005]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.042]
# Observations	1,001	672	2,013	721	721	2,382	721	581	1,281
R2	0.62	0.53	0.74	0.82	0.77	0.54	0.57	0.77	0.71

Notes: the table reports the effects of regional policies, institutional framework and human intelligence on multiple income per capita transmission channels. Cluster-robust standard errors are denoted in the parentheses. Asterisks denote statistically significant regression coefficients at 10% (\*), 5% (\*\*), and 1% (\*\*\*), respectively.

## 5.6 Fixed Effects Estimates

The estimated effects of structural policies and institutional quality on human intelligence can be partially driven by unobserved heterogeneity at the country or regional level. By default, the heterogeneity related to historical, cultural or other unobservable factors is unobserved by the econometrician. Another caveat concerning our estimates might arise from the neglect of technology shocks common to all regions in the period of our investigation. In principle, neglecting common technology shocks and country-/region-level unobserved heterogeneity in the levels of per capita income might make our estimates imprecise and inconsistent. We address these concerns by introducing country-fixed effects and region-fixed effects in the core empirical specification.

Table 6 reports the estimates using a region-fixed effects and country-fixed effects estimator with the full set of control variables from Table 1. For the sake of convenience and

comparison, we retain the basic OLS estimates in columns (1) to (3). We consider a full-sample specification and two sample-restricted specifications, one with convergence regions only and the other without convergence regions to better understand the influence of policies, institutional quality and human intelligence in different stages of regional development.

Columns (4) to (6) introduce country-fixed effects to the core empirical specification. Column (4) reports the full-covariate/full-sample estimates. The evidence suggests that regional per capita income responds positively to infrastructural policies and policies related to technological readiness and labour market efficiency. Controlling for country-fixed effects partially renders the estimated impact of institutional quality non-significant. In column (5), we consider convergence regions only. The results point out the beneficial effects of structural policies targeting basic education, technological readiness and business sophistication. Once the convergence regions are excluded from the sample in column (6), regional per capita income

responds positively to structural policies favouring infrastructure investment, improved labour market efficiency and public health. When the convergence regions are excluded from the sample, the evidence confirms the favourable impact of improved mathematics skills on regional development.

Figure 5: Importance of Policies, Institutional Framework and Human Intelligence for European Regional Development in the Presence of Unobserved Heterogeneity

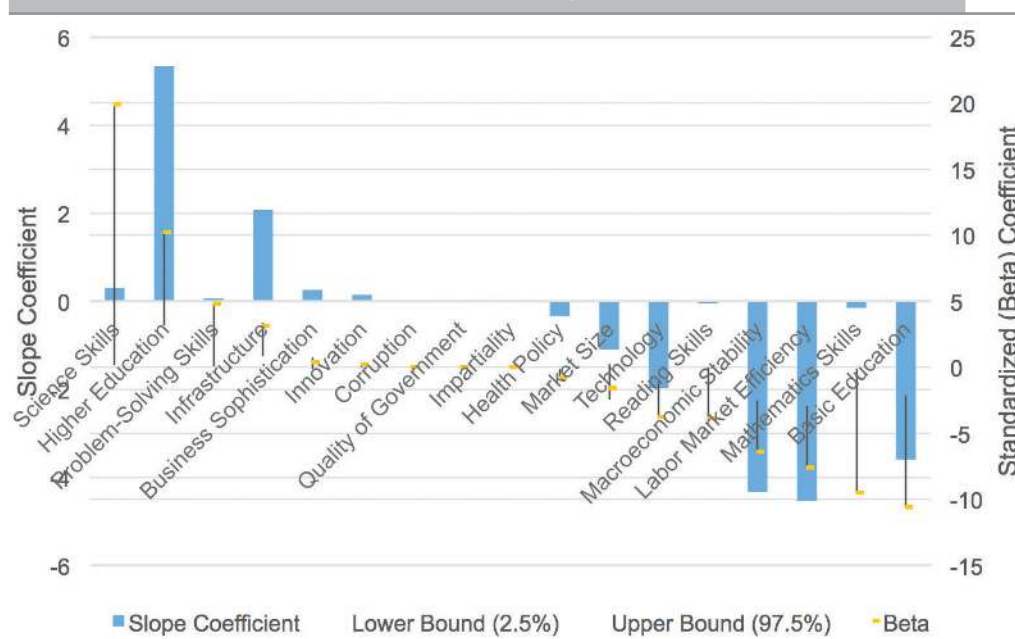


Table 7: The Contribution of Regional Policies, Institutions and Intelligence to European Development, 1990-2015

	Basic OLS			Country-Fixed Effects			Region-Fixed Effects		
	Full Sample (1)	Convergence Regions Only (2)	Without Convergence Regions (3)	Full Sample (4)	Convergence Regions Only (5)	Without Convergence Regions (6)	Full Sample (7)	Convergence Regions Only (8)	Without Convergence Regions (9)
<b>Panel A: Regional Policy Variables</b>									
Macroeconomic Stability	-.081* (.045)	.013 (.103)	-.088 (.059)	-.157** (.071)	-.077 (.195)	-.229*** (.081)	-.433*** (.093)	-.313*** (.097)	-.446*** (.161)
Infrastructure	.049 (.039)	.0009 (.127)	.048 (.037)	.097** (.039)	.161 (.133)	.080** (.032)	-.205** (.063)	.168** (.077)	1.117*** (.327)
Health Policy	.162** (.064)	-.119 (.101)	.301*** (.094)	-.005 (.090)	-.296** (.140)	.258*** (.060)	-.033*** (.007)	.125*** (.041)	-.361 (.283)
Basic Education	.014 (.032)	.113* (.066)	-.046 (.066)	-.053 (.136)	.159** (.078)	-.301*** (.047)	-.360*** (.074)	-.242*** (.067)	-.257 (.399)
Higher Education	-.091** (.040)	.074 (.102)	-.115*** (.039)	-.019 (.047)	.137 (.135)	-.002 (.046)	.533*** (.108)	.268*** (.072)	.987** (.427)
Labor Market Efficiency	.121*** (.043)	-.030 (.082)	.178*** (.050)	.119** (.052)	.014 (.092)	.202*** (.040)	-.452*** (.078)	-.168*** (.051)	-1.749** (.657)
Market Size	.055 (.075)	.406** (.191)	-.032 (.073)	.007 (.069)	.161 (.197)	-.029 (.062)	-.110* (.067)	-.301 (.252)	-.893** (.372)
Technology	.069* (.037)	.135** (.069)	.043 (.072)	.182* (.116)	.290* (.173)	-.040 (.094)	-.197*** (.041)	-.307*** (.074)	-.976 (.823)
Business Environment	.072 (.051)	.222** (.098)	-.017 (.063)	.133 (.056)	.304** (.126)	.038 (.062)	.025 (.021)	-.452*** (.118)	-2.013*** (.655)
Innovation	.048 (.050)	-.154 (.095)	.063 (.049)	-.028 (.058)	-.172 (.108)	-.017 (.057)	.013** (.006)	.589*** (.183)	.802** (.340)
<b>Panel B: Regional Institutional Framework Variables</b>									
Quality of Government	-.047 (.038)	.001 (.060)	-.031 (.039)	-.029 (.032)	.036 (.049)	.004 (.034)	.008 (.014)	.026 (.025)	-.003 (.009)
Impartiality of Government Services	-.031 (.044)	-.016 (.048)	-.013 (.051)	.036 (.040)	-.001 (.049)	-.006 (.049)	.005 (.012)	.008 (.015)	.023* (.014)
Corruption	.026 (.041)	.010 (.067)	-.023 (.036)	-.017 (.035)	.027 (.061)	.029 (.035)	.010 (.009)	.016* (.009)	-.015 (.011)
<b>Panel C: Intelligence Variables</b>									
Mathematics Skills	.003* (.002)	.005 (.006)	.004** (.002)	.001 (.002)	-.008 (.039)	.005** (.002)	-.159*** (.028)	.050 (.044)	.081*** (.025)
Reading Skills	-.003** (.001)	-.003 (.007)	-.006 (.001)	-.004** (.001)	-.001 (.018)	-.004* (.002)	-.061*** (.018)	-.096*** (.030)	.023 (.031)
Scientific Skills	.001 (.002)	-.005 (.005)	.003* (.002)	.001 (.001)	.003 (.017)	-.001 (.002)	.300*** (.059)	.094*** (.021)	-.054* (.032)
Problem-Solving Skills	-.002*** (.0008)	-.005** (.001)	-.002* (.001)	-.0007 (.004)	-.006 (.004)	.003 (.003)	.054*** (.012)	.048*** (.012)	.029*** (.010)
# Observations	672	267	360	627	267	360	627	267	360
R2	0.90	0.86	0.83	0.92	0.89	0.87	0.99	0.99	0.99
Time-Fixed Effects (p-value)	YES (0.000)	YES (0.000)	YES (0.000)	YES (0.000)	YES (0.000)	YES (0.000)	YES (0.000)	YES (0.000)	YES (0.000)
Structural Control Variables (p-value)	YES (0.000)	YES (0.000)	YES (0.000)	YES (0.000)	YES (0.004)	YES (0.077)	YES (0.000)	YES (0.000)	YES (0.002)

Notes: the table reports the joint effects of regional policies, institutional framework and human intelligence on regional per capita income in the presence of unobserved temporal, country-level, and region-level unobserved heterogeneity. Cluster-robust standard errors are denoted in the parentheses. Asterisks denote statistically significant regression coefficients at 10% (\*), 5% (\*\*), and 1% (\*\*\*), respectively.

Columns (7) to (9) replace country-fixed effects with region-fixed effects to further unravel the heterogeneity at the regional level and its confounding influence on per capita income. The evidence roughly suggests that structural policies improving higher education and innovation capabilities tend to foster regional development considerably together with improved scientific skills and problem-solving skills, as revealed in Panel C. Considering the convergence regions only, the evidence shows the beneficial effects of health policies, infrastructure-related policies and innovation capabilities on regional development. In Panel C, the parameter estimates indicate improved scientific and problem-solving skills as a source of improvement in long-run development. Focusing on non-convergence regions in column (9) shows that our estimates remain essentially intact with a few notable differences. First, in a subsample of non-convergence regions, the contribution of the impartiality of government services to regional development is both economically large and statistically significant, and highlights the adverse effects of government favouritism on regional development. Second, the contribution of human intelligence to regional development is both pervasive and statistically significant and confirms the large-scale impact of improved mathematics and problem-solving skills on regional per capita income.

In Figure 5, the set of slope coefficients is standardised to gauge the relative importance of each factor in shaping regional development levels. The figure shows that, in the presence of unobserved heterogeneity, science-related skills, higher education policy, problem-solving skills and infrastructure-related structural policy effects appear to be relatively more important for regional development than other observable factors.

## 5.7 Growth Effects of Structural Policies, Institutions and Human Intelligence

The evidence thus far suggests that structural policies aiming for regional development matter in the determination of per capita incomes across and within regions. More importantly, the evidence also shows that the quality of institutions and human intelligence appear to be important drivers of per capita income, although their role might vary in different stages of regional development. The long-term effects of structural policies, institutional quality and human intelligence are too important to neglect.

The short-term effects of structural policies, institutional framework and human intelligence at the regional level are more uncertain and still await empirical quantification. We examine whether policies, institutional quality and human intelligence matter for the growth rate of per capita income using the Barro and Sala-i-Martin (1992)<sup>93</sup> conditional convergence framework following Eq. (2). This allows us to examine whether, conditional on the initial per capita income, specific structural policies, institutional quality and human intelligence foster the growth rate of per capita income, and facilitate the narrowing of the wide-standing regional income gaps seen at the NUTS-2 level.

Table 8 reports cross-sectional correlates of regional growth. Panel D presents the regional policy correlates. The descriptive evidence in column (1) shows that macroeconomic stability, labour market efficiency, and innovation level correlate strongly with per capita income. In particular, greater macroeconomic stability, improved labour market efficiency and accelerated innovation tend to push income levels higher. In columns (2) and (3), we find very similar estimates when the upper 10% and

<sup>93</sup> Barro, Robert J., and Xavier Sala-i-Martin. "Convergence." *Journal of Political Economy* 100, no. 2 (1992): 223-251; Barro, Robert J., Xavier Sala-i-Martin, Olivier Jean Blanchard, and Robert E. Hall. "Convergence across states and regions." *Brookings Papers on Economic Activity* (1991): 107-182.



Table 8: Institutions, Policies, Intelligence and the Growth of Regions, 1990-2015

	Full Sample	Split Samples			By Treatment Level			Employment and Competitiveness Regions Only (8)
	(1)	Below 90th Percentile (2)	Below 75th Percentile (3)	Below-Median Percentiles (4)	Convergence Regions Only (5)	Phase-Out Regions Only (6)	Phase-In Regions Only (7)	
<b>Panel D: Regional Policy Variables</b>								
Macroeconomic Stability	1.551*** (.312)	1.453*** (.302)	1.238*** (.390)	1.076 (.920)	1.131*** (.377)	1.551*** (.316)	1.646*** (.384)	1.132 (3.088)
Infrastructure	-.234 (.323)	-.256 (.316)	-.125 (.393)	-.795 (.561)	-.267 (.313)	-.226 (.327)	-.247 (.321)	-1.626 (1.979)
Health Policy	-2.572** (1.007)	-1.754*** (1.058)	-2.608 (1.564)	-3.646 (2.316)	-.551 (.989)	-2.495** (1.050)	-2.422** (1.050)	-3.425 (3.036)
Basic Education	-.061 (.851)	.121 (.838)	-.226 (1.173)	1.667 (2.078)	-1.699* (.939)	-.163 (.903)	.109 (.882)	1.339 (5.343)
Higher Education	-.554 (.590)	-.441 (.577)	-.343 (.682)	-.941 (1.012)	.062 (.535)	-.578 (.604)	-.556 (.612)	-1.085 (1.428)
Labor Market Efficiency	.877* (.499)	.867* (.477)	.745 (.570)	.434 (.875)	.536 (.746)	.904* (.505)	.798* (.528)	.617 (1.197)
Market Size	-.021 (.576)	.126 (.567)	-.504 (.765)	.578 (.997)	.024 (.633)	-.062 (.594)	-.019 (.579)	.369 (2.467)
Technology	-2.114** (1.019)	-1.850 (1.188)	-1.576 (1.423)	-1.100 (2.451)	.609 (.922)	-2.120** (1.032)	-2.229 (1.045)	-.566 (2.738)
Business Environment	-1.079** (.409)	-1.165*** (.391)	-.995 (.605)	-.232 (1.140)	-1.386*** (.347)	-1.084*** (.411)	-1.034** (.433)	-2.862* (1.578)
Innovation	1.378*** (.425)	1.288*** (.415)	1.316** (.564)	.840 (.942)	1.072*** (.357)	1.403*** (.435)	1.325*** (.469)	2.914** (1.306)
<b>Panel E: Regional Institutional Variables</b>								
Quality of Government	.567 (.406)	.590 (.405)	.642 (.441)	.457 (.619)	.342 (.518)	.617 (.433)	.517 (.439)	.907 (1.319)
Impartiality of Government Service	-.533 (.557)	-.608 (.528)	-.936 (.622)	-.350 (.685)	-.743 (.571)	-.593 (.594)	-.370 (.616)	.930 (1.114)
Corruption	-.152 (.509)	-.353 (.436)	-.234 (.603)	-1.200 (.834)	.404 (.444)	-.081 (.548)	-.225 (.519)	-2.160 (2.606)
<b>Panel F: Regional Human Intelligence Variables</b>								
Mathematics Skills	-.047* (.024)	-.041* (.024)	-.029 (.026)	-.019 (.031)	-.029 (.037)	-.050* (.026)	-.053** (.026)	-.111 (.158)
Reading Skills	.050*** (.015)	.050*** (.015)	.040** (.015)	.026* (.017)	.016 (.023)	-.054*** (.017)	.064** (.028)	.096 (.093)
Scientific Skills	-.011 (.030)	-.011 (.030)	-.021 (.031)	-.050 (.040)	-.013 (.047)	-.009 (.033)	-.017 (.036)	-.051 (.133)
Problem-Solving Skills	-.040 (.029)	-.040 (.029)	-.037 (.036)	-.013 (.048)	.007 (.029)	-.040 (.029)	-.037 (.030)	-.076 (.091)
Regional Policy Variables (p-value)	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.082]
Regional Institutional Framework (p-value)	[0.567]	[0.433]	[0.420]	[0.413]	[0.521]	[0.541]	[0.683]	[0.623]
Regional Intelligence (p-value)	[0.001]	[0.000]	[0.077]	[0.631]	[0.437]	[0.001]	[0.009]	[0.428]
# Observations	85	61	45	45	55	82	82	36
R2	0.87	0.83	0.79	0.79	0.93	0.86	0.87	0.95

Notes: the table reports the joint effects of regional policies, institutional framework and human intelligence on the growth rate regional per capita income conditional on initial per capita income. Cluster-robust standard errors are denoted in the parentheses. Asterisks denote statistically significant regression coefficients at 10% (\*), 5% (\*\*), and 1% (\*\*\*), respectively.

upper 25% of the growth distribution is split off from the core sample. In Panel F, we show that human intelligence correlates strongly with the rate of growth, particularly through improved reading skills. The influence of human intelligence, particularly reading skills, is especially pervasive in column (4) which considers regions with a below-median growth rate. In columns (5) to (8), we re-estimated the conditional cross-sectional growth estimates by policy-related treatment level. Column (5) considers convergence-only regions and shows that greater macroeconomic stability correlates strongly with the growth rate together with the innovation effort. Column (6) considers phase-out regions only, and confirms the strongly beneficial impact of macroeconomic stability on the growth rate of per capita income. In addition, that growth rate responds significantly positively to improved labour market efficiency, and the level of innovation. The phase-in regional specification presented in column (7) confirms the results. In column (8), we consider employment and competitiveness regions only and show that, for this specific subsample, the growth effects of regional policies correlate almost exclusively with the innovation effort.

Table 10 examines whether regional structural policies, institutional framework and human intelligence foster the convergence of per capita incomes across regions. Our analysis proceeds in two steps. In the first step, we break down the full set of covariates into the three most powerful principal components with an absolute size of the eigenvector in excess of 1. In the second step, we add the level of initial per capita income from the early to mid-1990s as a separate control variable to facilitate conditional rather than unconditional convergence estimates. In the third step, we partially mitigate the multicollinearity between the policy, institutional quality, and intelligence variables by considering only one covariate at a

time together with the latent control variables from the principal component analysis and the level of initial per capita income.

In Panel A, we report the parameter estimates for regional policy variables. The evidence shows that growth rates respond negatively to strengthened infrastructure-related public policies and health policies. On the other hand, the structural policies targeting higher education and labour market efficiency tend to foster growth rates considerably. In particular, a 1-basis-point increase on the latent scale of higher education is associated with an 0.86 of a percentage point increase in the growth rate of per capita income. The impact of labour market efficiency policies is even more powerful. The parameter estimate suggests that a 1-basis-point increase on the latent scale of labour market efficiency tends to increase the per capita income growth rate by 1.03 percentage points. Hence, the evidence points to the significant and sizeable impact of labour market efficiency on the rate of growth. Our estimates imply that improving labour market efficiency from the 25th percentile of the distribution (observed for Galicia, Spain) to the 90th percentile (observed for Cheshire, England) predicts an upward shift in the rate of growth by 1.29 percentage points ( $=1.037 \times 1.244$ ), *ceteris paribus*. Compared to the counterfactual scenario, the per capita income of the regions with labour market efficiency at the 25th percentile doubles about 16 years sooner, which highlights the substantial growth gains from improved labour market efficiency. In Panel B, we report the effects of the institutional quality variables on the growth rate of per capita income. The evidence suggests that decreased corruption tends to foster the rate of growth considerably while the effects of impartiality and overall quality are relatively weaker. The growth effects of decreased corruption are sizeable. For example, decreasing the level of corruption by moving

Table 10: Institutions, Policies, Intelligence and the Growth of Regions with Latent Control Variables, 1990-2015

	Parameter Estimate (1)	Beta Coefficient (2)	Latent Control Variables (p-value) (3)	95% Confidence Bounds (4)	Partial R2 (5)
<b>Panel A: Regional Policy Variables</b>					
Macroeconomic Stability	-.023 (.329)	-.008	[0.000]	{-.675, .628}	0.08
Infrastructure	-.371** (.177)	-.183	[0.000]	{-.723, -.020}	0.02
Health Policy	-.695* (.367)	-.276	[0.000]	{-1.422, .032}	0.19
Basic Education	-.071 (.240)	-.020	[0.000]	{-.546, .403}	0.005
Higher Education	.861*** (.243)	.297	[0.000]	{.380, 1.342}	0.08
Labor Market Efficiency	1.037*** (.297)	.342	[0.000]	{.449, 1.626}	0.12
Market Size	-.534*** (.201)	-.247	[0.000]	{-.932, -.137}	0.009
Technology	-.286 (.444)	-.111	[0.000]	{-.166, .592}	0.01
Business Sophistication	-.088 (.341)	-.045	[0.000]	{-.786, .586}	0.04
Innovation	.382 (.288)	.159	[0.000]	{-.188, .953}	0.07
<b>Panel B: Regional Institutional Framework Variables</b>					
Quality of Government	.390 (.351)	.141	[0.000]	{-.308, 1.089}	0.02
Impartiality of Government Services	.380 (.436)	.132	[0.000]	{-.488, 1.249}	0.04
Corruption	.844*** (.341)	.363	[0.000]	{.164, 1.524}	0.10
<b>Panel C: Human Intelligence Variables</b>					
Mathematics Skills	-.006 (.007)	-.060	[0.000]	{-.022, .008}	0.03
Reading Skills	.013 (.011)	.097	[0.000]	{-.009, .037}	0.14
Science Skills	-.002 (.008)	-.021	[0.000]	{-.018, .013}	0.05
Problem Solving Skills	.008 (.011)	.074	[0.000]	{-.015, .031}	0.14

Notes: the table reports the effects of regional policies, institutional framework and human intelligence on the growth rate regional per capita income conditional on initial per capita income. The set of control variables consists of the first three principal components of the full class of covariates from Table 1. Cluster-robust standard errors are denoted in the parentheses. Asterisks denote statistically significant regression coefficients at 10% (\*), 5% (\*\*), and 1% (\*\*\*), respectively.

from the 25th percentile of the distribution (observed for Lazio, Italy and Adriatic Croatia) to the 95th percentile (observed for Drenthe, Netherlands) predicts ( $=.844 \times 2.521$ ) a 2.12 percentage point increase in the rate of growth. With such an increase in the growth rate, the per capita income of the under-performing region would double 39 years earlier compared to the counterfactual scenario. Nevertheless, the growth gains from lower corruption are sizeable and significant.

Do regional policies, institutional quality and human intelligence robustly explain cross-

regional growth disparities? Following Sala-i-Martin (1997)<sup>94</sup> and many others, we perform an extreme bounds analysis of the growth determinants at the NUTS-2 regional level. Specifically, we consider the full set of policy-related, institutional and intelligence-based growth covariates, which totals 18 covariates. We divide them into sets of three and keep the initial per capita income in the separate set which appears in every specification. This amounts to around 3,000 growth regression combinations per variable to be tested, or 42,000 growth regressions for all considered variables in total.

<sup>94</sup> Sala-i-Martin, Xavier. "I just ran two million regressions." *American Economic Review* 87, no. 2 (1997): 178-183.

Table 11: Extreme Bounds of EU Regional Growth

	Weighted Beta (1)	$\sigma$ (2)	Pr( $\beta > 0$ ) (3)	CDF( $\beta \leq 0$ ) (4)	CDF( $\beta > 0$ ) (5)	Verdict (6)
<b>Panel A: Growth Covariates</b>						
Reading Skills	0.085	0.017	0.993	0.010	0.991	Very Robust
Higher Education	1.490	0.333	0.816	0.022	0.978	Very Robust
Labor Market Efficiency	1.340	0.437	0.831	0.046	0.955	Very Robust
Corruption	0.966	0.443	0.641	0.046	0.954	Very Robust
Problem-Solving Skills	0.037	0.016	0.739	0.069	0.931	Very Robust
Macroeconomic Stability	0.886	0.332	0.650	0.082	0.918	Very Robust
Innovation	0.688	0.355	0.588	0.150	0.850	Robust
Impartiality of Government Services	0.632	0.647	0.209	0.228	0.772	Robust
Business Sophistication	0.291	0.421	0.230	0.317	0.683	Moderate
Science Skills	-0.005	0.018	0.220	0.409	0.591	Moderate
Infrastructure	0.103	0.310	0.387	0.461	0.539	Moderate
Mathematics Skills	-0.012	0.017	0.152	0.509	0.491	Moderate
Quality of Government	-0.157	0.528	0.010	0.566	0.434	Weak
Market Size	-0.130	0.377	0.030	0.615	0.385	Weak
Basic Education	-0.266	0.468	0.019	0.651	0.350	Weak
Initial Per Capita Income	-1.511	1.249	0.451	0.719	0.281	Weak
Technology	-1.295	0.621	0.049	0.792	0.208	Weak
Health Policy	-1.754	0.432	0.000	0.997	0.003	Weak

Notes: the table reports the estimated weighted mean of the estimated coefficients for each variable, the weighted standard error, and the level of significance inferred from generic cumulative distribution function for the full set of covariate-level coefficients.

Table 11 reports the extreme bounds of regional growth determinants. We present the weighted coefficients, their standard error, the probability the estimated coefficient is greater than zero, as well as the cumulative distribution functions (c.d.f.). The latter denote the fraction of regression specifications in which the estimated growth determinant significantly explains the variation in regional growth rates at conventional 5% significance thresholds. Our verdict on the robustness of the regional growth determinants is based on the c.d.f. statistics as follows. If the estimated c.d.f. for each covariate is above 0.9, we conclude that the covariate very robustly explains growth rates. If the c.d.f. is between 0.7 and 0.9, we conclude the covariate explain growth rates robustly. If the c.d.f. is between 0.5 and 0.7, the covariate explains growth rates to a moderate

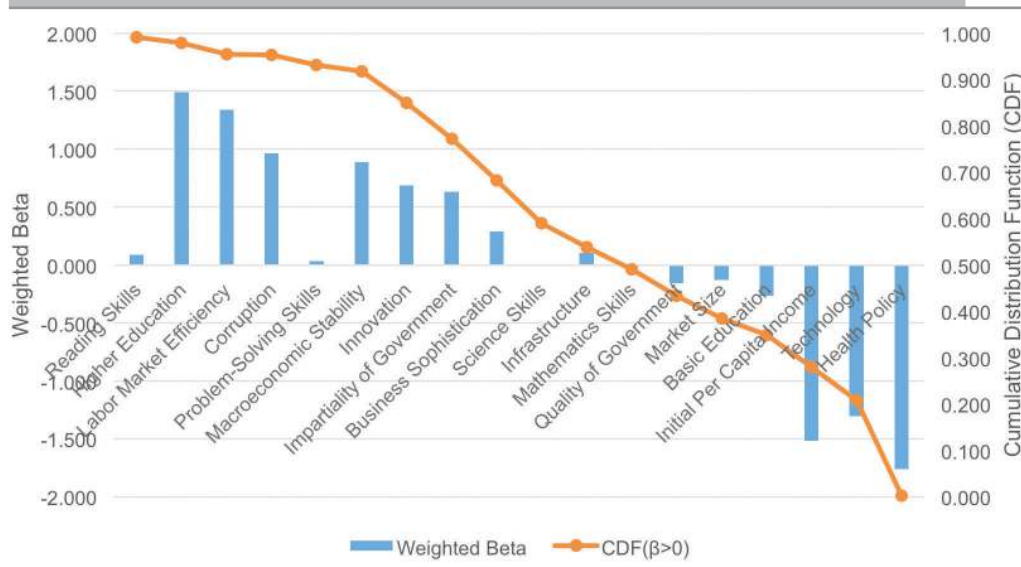
degree. For all covariates where c.d.f. < .5, we infer a weak effect on growth rates.

The evidence suggests that reading skills are by far the most important determinant of regional growth as the variables robustly explain cross-regional growth dynamics with a positive effect across more than 99% of the regional growth specifications. In addition, better problem-solving skills tend to raise growth considerably across more than 93% of growth specifications. We find similarly large and robust effects for higher education variables, labour market efficiency and the level of corruption. The extreme bounds clearly suggest that policies strengthening higher education, improving labour market efficiency, reducing the level of corruption, improving macroeconomic stability and fostering innovation have a strong positive

effect on regional growth in more than 90% of cross-regional growth specifications. Similar effects emanate from the greater impartiality of government services. By contrast, we find inconclusive results for the policies affecting market size, basic education, technological readiness, and health policies. On balance, the evidence suggests that a combination

of high-quality institutions and improved intelligence and intellectual capabilities together with genuine macroeconomic stability and innovation policies might be the key to European regional growth whereas the effects of other policies appear much weaker. Figure 6 depicts the relative importance of each tested growth covariate in ranked order.

Figure 6: Extreme Bounds of Regional Growth





# 6.



## Counterfactual Scenario

By Rok Spruk and Mitja Kovač

The ultimate question concerning the economic significance of our estimates hinges on the counterfactual scenario. Would the poorer regions be better off in the long run if they had improved the structural policies, institutional framework and human intelligence to the levels of the best-performing regions observed in the sample? If the poorer regions were better off, by how much would per capita income rise if they had implemented the right structural policies, reformed the institutional framework and raised the level of human intelligence. To address these concerns, our counterfactual scenario proceeds as follows. In the first step, we consider the baseline parameters from Table 5 on the combined effects of policies, institutional quality and human intelligence. In the second step, we compute the distance between the 25th and 90th percentiles for each treatment variable. In the third step, we estimate the potential per capita income gains from improving the policy outcomes, institutional quality and human intelligence to the level observed at the 90th percentile. This implies that the counterfactual scenario is only estimated for the regions below the 90th percentile of each treatment variable.

Figure 6 reports the counterfactual scenario from improving the efficiency of labour market to the 90th percentile. The evidence suggests that potential per capita income gains are substantial. Our estimates indicate that per capita income would rise significantly, especially in the least

developed regions. If the poorer regions were to improve the efficiency of the labour market to the 90th percentile (as observed in Cheshire, England), our estimates indicate that per capita income would rise by 130% in Nor Est (Romania), 111% in Podkarpackie (Poland), and 110% in Yuzhen Tsentralen (Bulgaria). Among the old EU member states, per capita gains from a more efficient labour market appear to be the highest in Puglia (86%), Calabria (84%), Thessaly (71%), Western Greece (70%), Norte/Portugal (68%), Sicily (62%), Campania (60%), Basilicata (57%), Centro/Portugal (56%), Cornwall and the Isles of Scilly (56%), Extremadura (53%), and Molise (52%). The lowest per capita income gains from a more efficient labour market are observed for Hannover (1%), Karlsruhe (2%), Zuid Holland (3%), Niederbayern (3%), Kassel (4%) and Lombardia (5%). If Eastern Slovenia were to improve its labour market efficiency to the 90th percentile, its per capita income would rise by 20% in response to the efficiency improvement. Our counterfactual scenario clearly shows that the losses arising from an inefficient labour market are significant and show a substantial cross-regional variation.

Figure 7 reports the counterfactual gains from improving the overall institutional quality at the regional level. The evidence outright suggests that per capita income levels would increase substantially if the low-performing regions were to improve the quality of governance to the 90th percentile (as

Figure 7: Counterfactual Per Capita GDP Increase in a Reasonably Efficient Labour Market

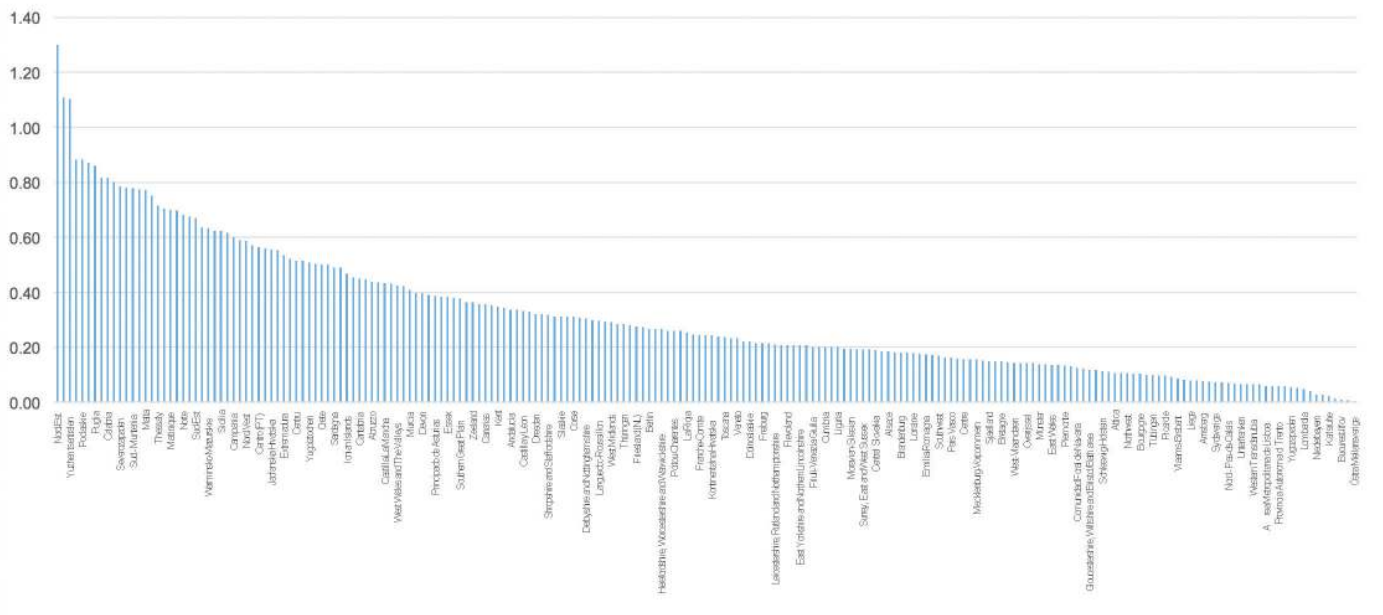
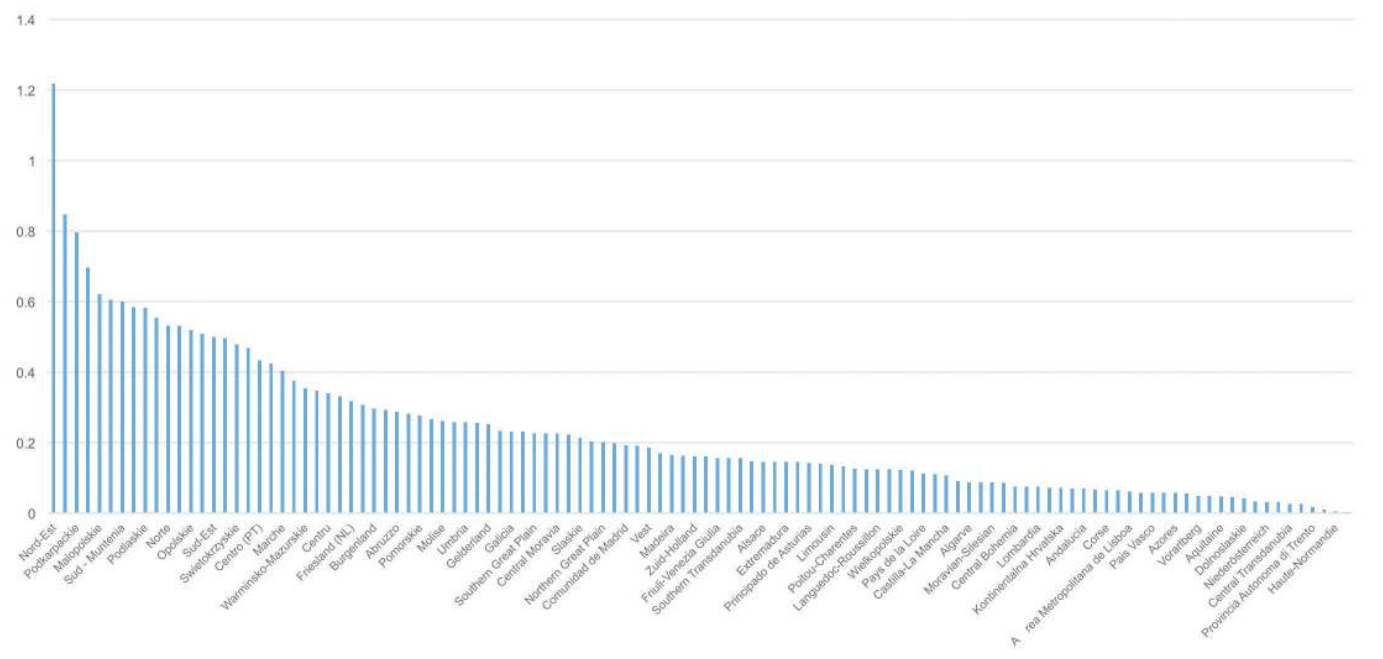


Figure 8: Counterfactual Per Capita GDP from High-Quality Governance



observed in Groningen, Netherlands). The findings indicate the most pervasive per capita income gains for Nord Est/Romania (121%), Yuzhen Tsentralen (84%), Podkarpackie (79%), Sud-Vest Oltenia (69%), Malopolskie (62%) and Puglia (60%). Below the 60% gain ladder, per capita income among the old member states would increase the most in Norte/Portugal (53%), Calabria (49%), Zeeland (46%), Centro/Portugal (43%), Campania (42%), Marche

(40%), Sicily (37%), Friesland (31%), Burgenland (29%), Drenthe (29%), Abruzzo (28%), Basilicata (26%), Molise (26%), Umbria (25%), Gelderland (25%), Limburg (25%) and Veneto (23%). Among the new member states below the 60% gain ladder, per capita income would rise most significantly in Sud Muntenia (59%), Severen Tscentralen (58%), Podlaskie (58%), Lubelskie (55%), Severozapaden (53%), Opolskie (51%), Nord-Vest (50%), Sud-Est



Figure 9: Counterfactual Per Capita GDP from Impartial Government Administration

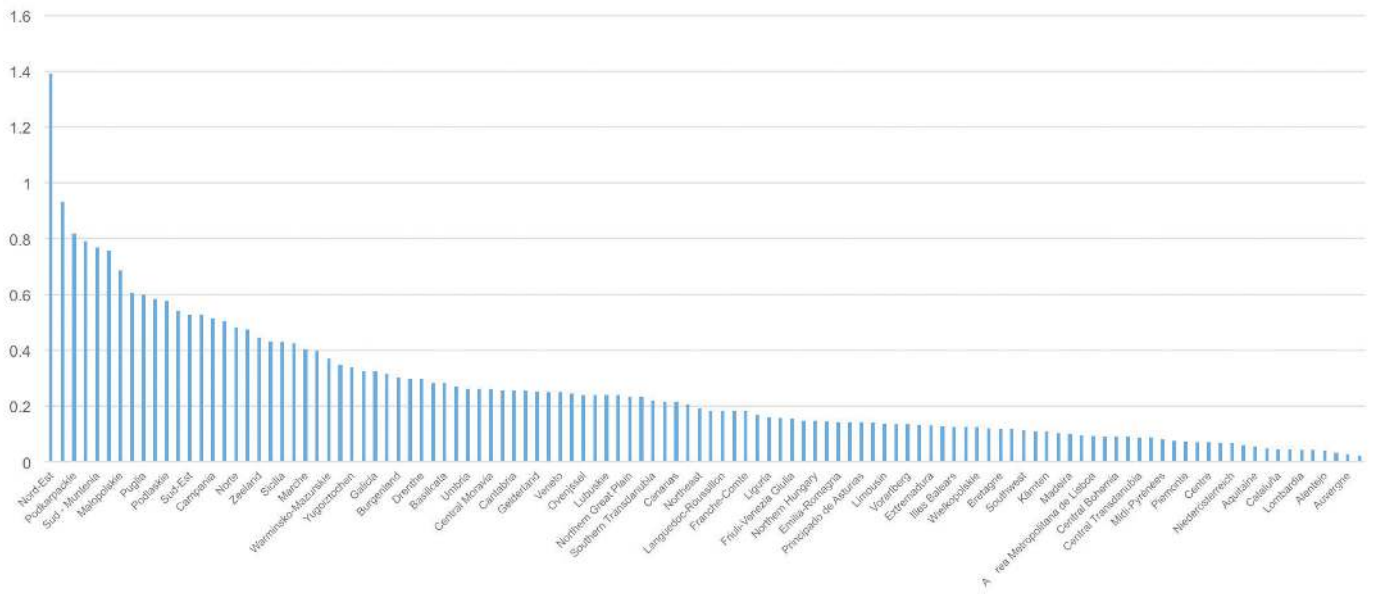
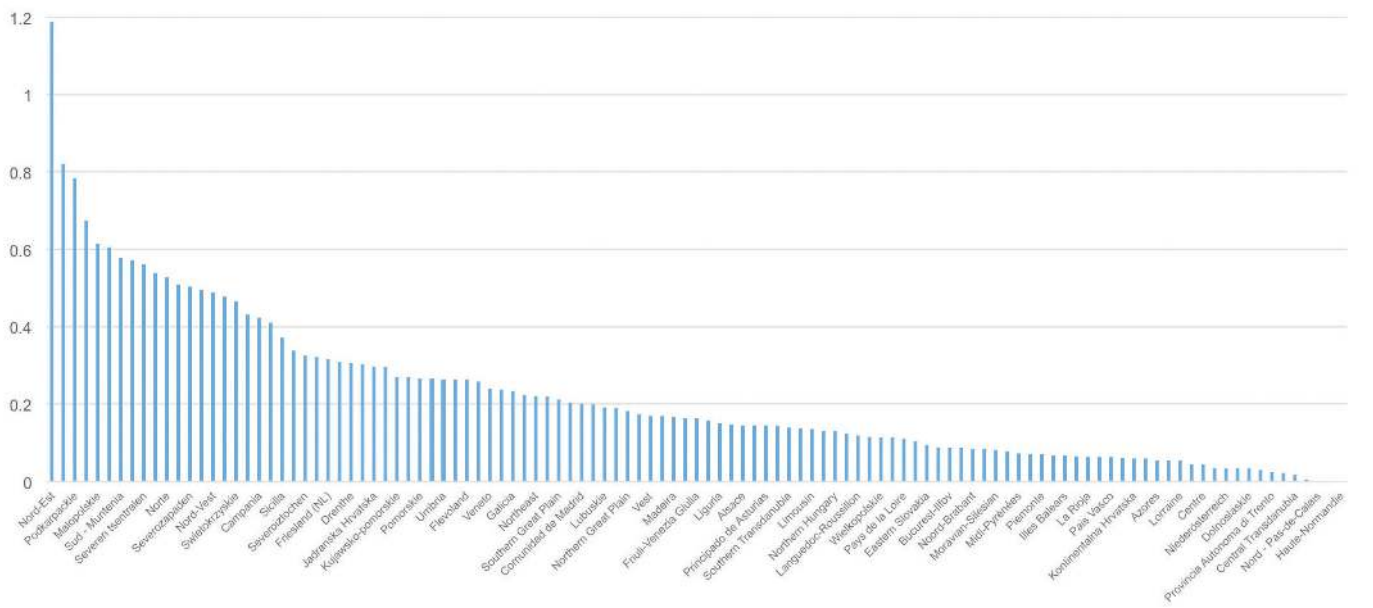


Figure 10: Counterfactual Per Capita GDP from Very Low Corruption



(49%), Swietokrzyskie (47%) and Warminsko-Mazurskie (35%). The lowest gains from improving the quality of governance to the 90th percentile are observed for Catalonia (0.3%), Haute-Normandie (0.4%), Nord-Pas-de-Calais (0.9%), Provincia Autonoma di Trento (1.6%) and Auvergne (2.5%).

Figure 8 reports the counterfactual gains from improving the impartiality of government

administration at the regional level. The evidence clearly suggests that per capita income levels would increase substantially if the low-performing regions were to improve the impartiality of the government administration to the 90th percentile (as observed in southern Finland). The counterfactual estimates indicate the most significant and sizeable per capita income gains for Nord Est/Romania (131%), Yuzhen Tsentralen (93%), Podkarpackie (81%), Severen

Tsentralen (78%), Sud-Muntenia (76%) and Sud-Vest Oltenia (75%). Among the old member states, the counterfactual estimates indicate the largest gain from improving the impartiality for Puglia (59%), Calabria (58%), Campania (57%), Norte/Portugal (48%), Zeeland (44%), Centro/Portugal (43%), Sicily (42%), Marche (42%), Galicia (31%), and Friesland (31%). The lowest gains are observed for Northwest/Czech Republic (1.9%), Auvergne (2.7%), Lorraine (3.3%), Alentejo (4.1%), Azores (4.3%), Lombardia (4.4%), Utrecht (4.4%), and Catalonia (4.4%), respectively.

Figure 9 reports the counterfactual gains from lowering corruption at the regional level. The evidence suggests that per capita income levels would rise substantially if the low-performing regions were to decrease the level of corruption to the 10th percentile in the sample (as observed in Sjaeland, Denmark). The regions gaining most from lower corruption are the same as those gaining most from a more impartial government administration and better quality government in general. The counterfactual estimates indicate the most significant and substantial per capita income gains for Nord Est (118%), Yuzhen Tsentralen (82%), Podkarpackie (78%), Sud Vest Oltenia (67%) and Malopolskie (61%). Among the old EU member states, the regions gaining most from lower corruption are Puglia (60%), Norte/Portugal (52%), Calabria (49%), Centro/Portugal (43%), Campania (42%), Marche (41%), Sicily (37%) and Friesland (31%). The smallest gains from lowering corruption down to the 10th percentile are indicated for Catalonia (0.4%), Central Transdanubia (1.6%), Auvergne (2.2%), Provincia Autonoma di Trento (2.3%), Utrecht (3%), Dolnoslaskie (3.1%), Castilla y León (3.1%), Niederösterreich (3.2%), Kärnten (3.4%), Centre/France (4.4%), Aquitaine (4.5%), Lorraine (5.2%) and Provence Alpes-Côte-d-Azur (5.2%). The gains arising from improving the institutional quality through greater impartiality and lower corruption are both large and significant, with a distinctive

cross-regional variation in the magnitude of the gain.

The evidence thus far suggests that better institutional quality would elevate the levels of per capita income at the regional level to a significant degree. Since the results shown in Table 5 also indicate pervasive effects of human intelligence on regional development, the question that remains is how much would long-run regional development improve in response to better mathematics-, science- and problem-solving skills at the regional level. Figure 10 presents the gains from improving the latent intelligence based on mathematics skills to the 90th percentile of the distribution (as observed in Åland, Finland). The regions gaining most from improving mathematics skills are from new EU member states, particularly Romania and Bulgaria, and include Nord Est/Romania (114%), Yuzhen Tsentralen (84%), Sud-Vest Oltenia (64%), Severen Tsentralen (57%) and Severozapaden (54%). Among the old EU member states, the regions benefitting most from improved mathematics skills include Cornwall and Isles of Scilly (53%), Puglia (52%), Norte/Portugal (45%), Calabria (44%), North Aegean (43%), Dorset and Somerset (42%), Centro/Portugal (41%), Devon (37%), South Yorkshire (36%), Essex (36%), Emilia-Romagna (35%), West Wales and the Valleys (35%) and Merseyside (33%). Apart from Bulgaria and Romania, the regions from new EU member states exhibiting the biggest gains from improved mathematics skills include Adriatic Croatia/Jadranska Hrvatska (32%), Central Moravia (17%) and Continental Croatia (5%). The potential gains arising from improved mathematics-related intelligence are either as large or even larger than the gains from improved institutional quality and labour market efficiency.

Figure 11 presents the gains from improving the latent intelligence based on science skills to the 90th percentile of the distribution (as observed in Darmstadt, Germany). If science skills were hypothetically improved to the 90th percentile, the

Figure 11: Counterfactual GDP Per Capita under Good Mathematics Skills

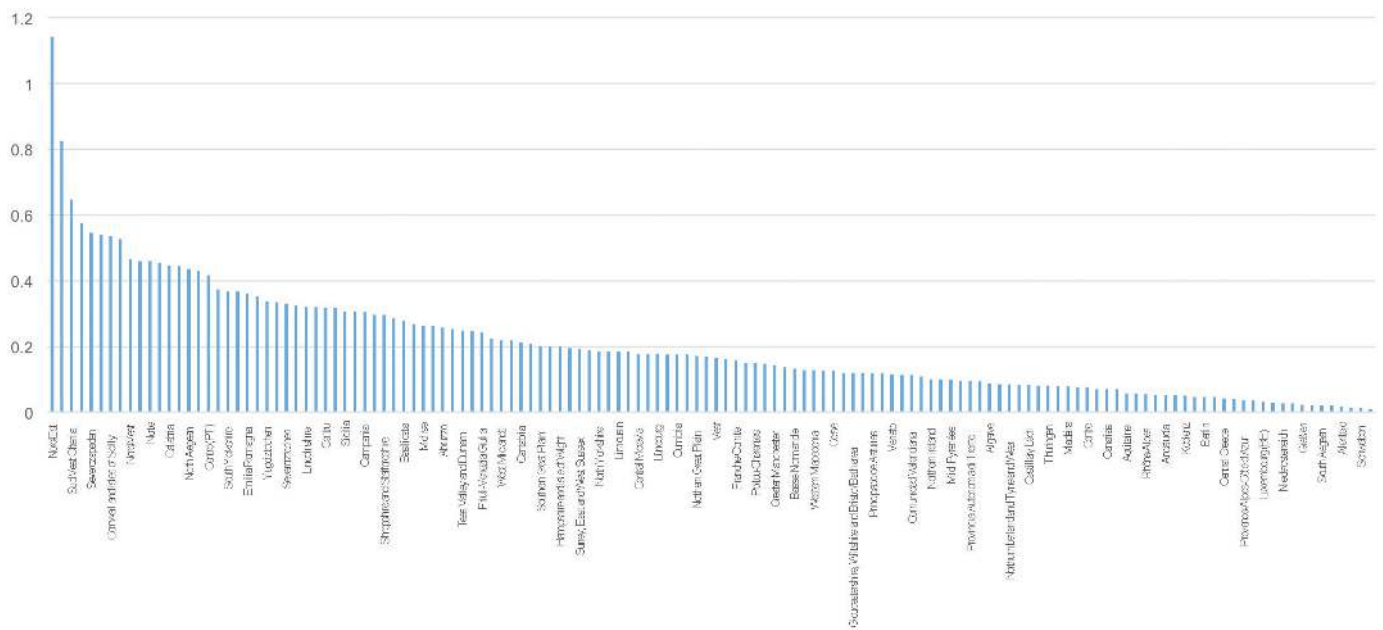
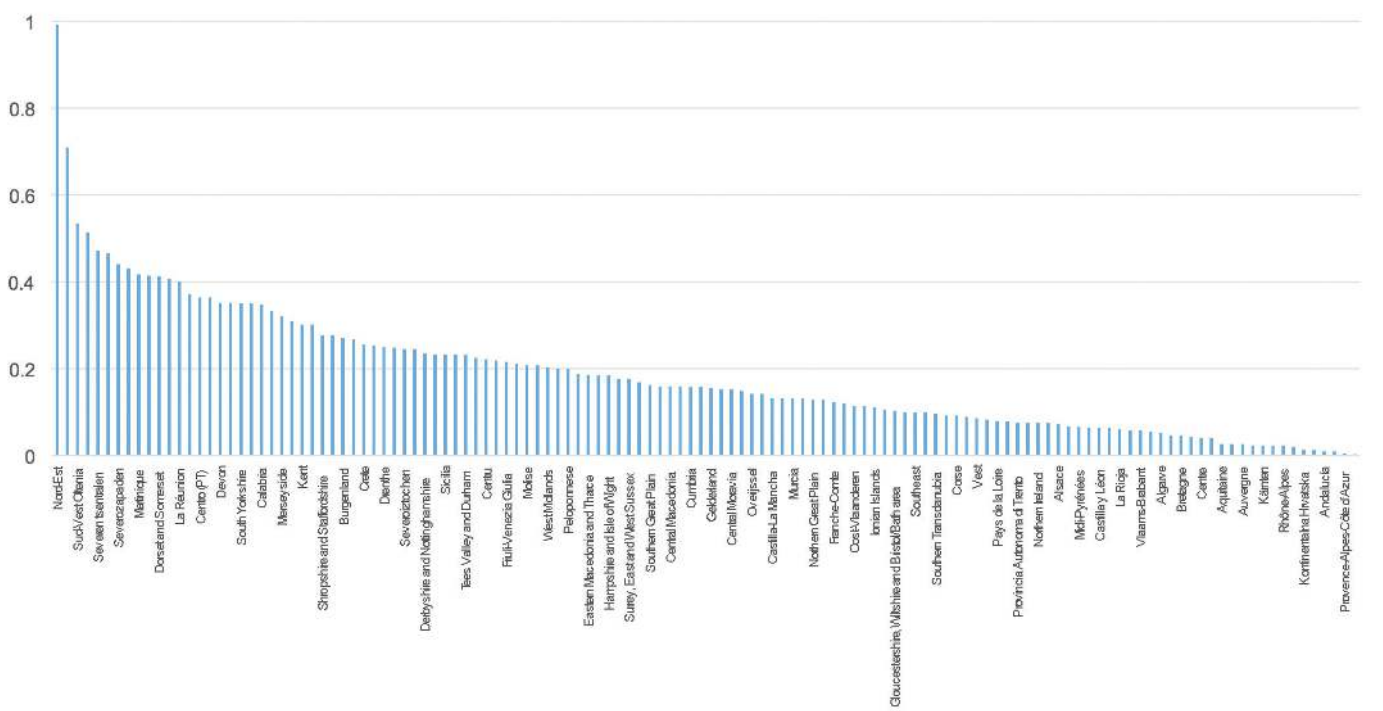


Figure 12: Counterfactual GDP Per Capita under Good Science Skills



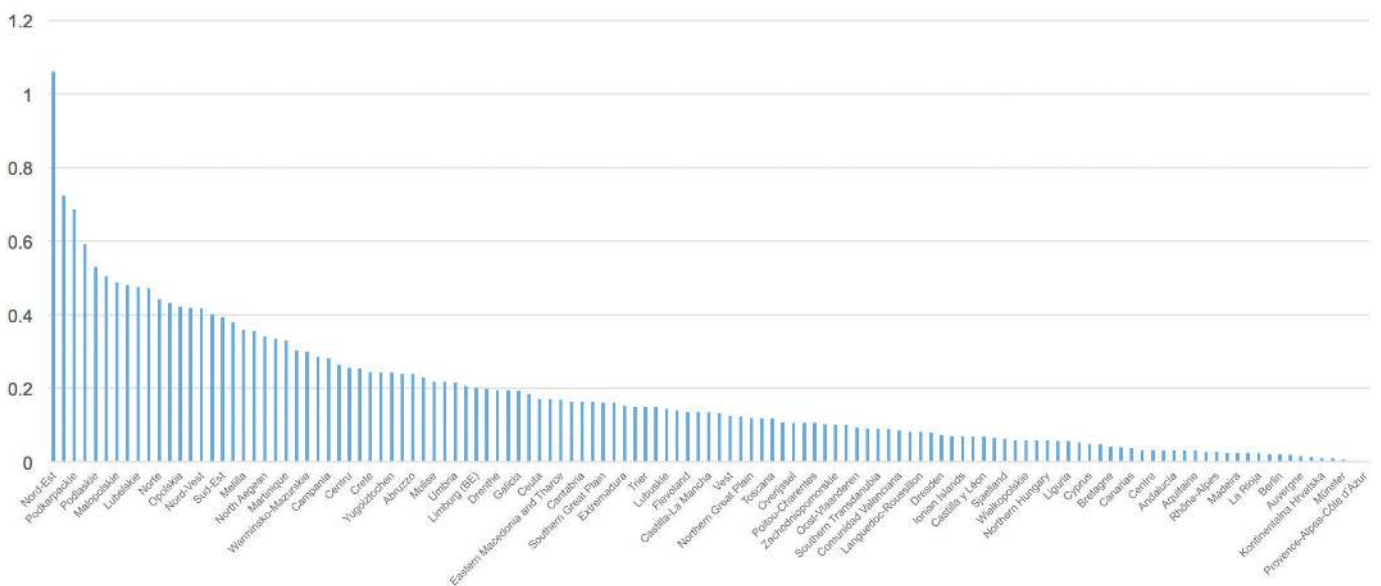
regions with the most significant increase in per capita income are Nord Est (99%), Yuzhen Tsentralen (70%), Sud-Vest Oltenia (53%), and Cornwall and Isles of Scilly (51%). Further, the counterfactual estimates sizeable increases in per capita income in response to improved science skills for Puglia (46%),

Zeeland (41%), Dorset and Somerset (41%), Devon (35%), Calabria (34%), Crete (25%), East Angles (15%), Oost-Vlaanderen (11%) and Asturias (10%). The lowest gains from better science skills are observed for Niederösterreich (0.1%), Provence-Alpes-Côte d'Azur (0.3%), Vorarlberg (0.9%),

Andalucía (0.9%) and Zuid-Holland (1.1%). Finally, Figure 12 presents the per capita income gains from improved problem-solving skills assuming the below-90th percentile regions were to improve these skills to the 90th percentile of the distribution (as observed in Berkshire, Buckinghamshire, and Oxfordshire). The evidence from the counterfactual estimations highlights large and plausibly significant gains from improved problem-solving skills. The regions benefitting most in terms of a per capita income increase from improved problem-solving skills primarily come from Romania, Bulgaria and Poland; namely, Nord Est (106%), Yuzhen Tsentralen (72%), Podkarpacie (68%), Sud-Vest Oltenia (58%) and Podlaskie (52%). Among the old EU member states, regions with the most pervasive gains from improved problem-solving skills are Puglia (50%), Norte/Portugal (44%), Calabria (41%), Centro/

Portugal (40%), Zeeland (35%), North Aegean (34%), Marche (33%), Sicily (28%), Campania (28%), Burgenland (25%) and Basilicata (24%). In the subset of new EU member states, the region achieving a notable increase in per capita income from better problem-solving skills is Adriatic Croatia, where our estimates indicate a 26% rise in per capita income which is in the range of the increases observed in southern Italy. The lowest gains from improving problem-solving skills are indicated for Münster (0.5%), Niederösterreich (1%), Continental Croatia (1.2 percent), Lorraine (1.4%), Auvergne (1.5%), Kärnten (1.7%), Berlin (2%) and Piemonte (2.1%). The gains from improved problem-solving skills are comparable with the long-run development gains arising from improved labour market efficiency and institutional quality.

Figure 13: Counterfactual GDP Per Capita under Good Problem-Solving Skills



# 7.



## Divided Powers as a Fundament of Liberalism. The Vertical and Horizontal Separation of Powers

By Giovanni Vetrutto

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### 7.1 Introductory Remarks

This chapter aims to offer a liberal perspective on understanding the current impasse that is limiting the role of regional and local government authorities, and thus their chances of development, within the complex architecture of the EU's political and functional integration institutions. We then look for a proposal to find a way out of the current situation.

This contribution builds on the conviction that liberalism, despite the modest fortune (and success) of political liberal parties at elections all around Europe (given the still quite heterogeneous meanings embraced in the various ideas of liberalism, divided between moderates, classical conservatives, urban progressives and so on), is still a lively culture that can provide solid principles, methods and solutions to relaunch an effective polyarchal democratic design for the integration process of the European states. Specifically, the political current of liberalism being followed by *Fondazione Critica liberale*, that is described on the next few pages, is the social liberal progressive one that attributes an important role to institutions, even with market dynamics, to help underdeveloped areas improve their condition.

At the last European elections, following the record levels seen in 2004, the share of seats held by liberal forces has dropped dramatically, denoting a clear general crisis of the liberal party family after the successes of the last decade. Remarkably, the

worst performances are seen in countries where liberals have always relied considerably on Europe's stage (Germany and Great Britain where they resist mostly in urban areas; in the Nordic countries, D66 in the Netherlands, and the social-liberal Danes) a precise liberal urban electorate among progressive and libertarian parties is emerging. The 'social-liberal' parties seem to be more successful than the classic, liberal centre-right parties. Nevertheless, there is still no clarification of the EU's current intergovernmental attitude and the sort of its implied *realpolitik* allow no room for the birth of real, coherent political parties, and the centuries-old debate between right-wing and left-wing liberals that could give rise to two, almost totally different movements, both useful in this period like never before. As a result, their approaches are losing ground in the face of new (yet so old) strong enemies.

Populism, nationalism, a closed society, an intolerant neoclassical approach to public budgets and economic issues, the abandoning even of the successful 'European social model', the democratic deficit in EU processes, a clear return to the intergovernmental method in the last 10 or 15 years: all of these factors have discredited the EU integration institutions that in the last 70 years have ensured peace and cooperation among European states. Namely, that is the longest period of peace that history can narrate (Sapir 2005; Stiglitz-Sen-Fitoussi 2009; Dahrendorf 2003).

The crisis of the European Union highlights the parallel crisis facing institutions that for decades have helped Europe's regions and cities play an important role in the main European cooperation policy areas (CoR 2009).

This last phenomenon has much to do with the progressive decadence of the liberal body of thought in European culture, recently described as a total "defeat" (Zielonka 2018). Liberalism has always placed specific attention on institutional frameworks since it considers the division of public powers among different national institutions and among different territorial authorities as a way to avoid the concentration of decision-making that may limit individual and social liberties, turning into the 'tyranny of the majorities'.

There have surely been other political cultures that supported the priority of regional policy during evolution of the design of European cooperation. For example, it is clear that a democratic catholic politician like Jacques Delors worked considerably towards that goal (Delors 1993). Nevertheless, his naïve enthusiasm for total territorial independence and a strong local identity proved in practice to be insufficient for assuring all the conditions needed for both durable institutional growth and solid economic development (Barca 1993). Moreover, such an approach has backfired, little by little, on some identitarian and local political claims that have become bigger and bigger to the point of threatening to destroy the common house that was built over decades.

It is very important, including for this reason, to go back to the basics of liberalism and recall the historical path that characterises the evolution of the liberal body of thought, having regard to the balancing and different dialectics of territorial powers. Here we are referring to a path that runs from the original 'competitive' federalism ideas to the era of 'cooperative' federalism and, through that, to the current 'multilevel public governance' model

as a subsidiary polyarchy (Dahl 1971); a path that has always pursued the goal of dividing territorial powers, opposing one power against another, assuring adequate screening in decision-making via a permanent and adversarial examination of the possible solutions, detecting limits to any power and, as a consequence, to the liberty of local communities.

## 7.2 At the Root of Liberalism and Federalism

Since its origins, liberalism has been characterised by the effort to divide the powers acting within political societies. This works in two directions. On one hand, the aim is to make a horizontal cut between the institutional and administrative powers of national states: from Montesquieu on, a liberal state is one in which political authority is divided into legislative, executive and judicial powers, each acting independently. A very famous quote from "Spirit of the Laws" (Book XI, "L'esprit de loi") is worth recalling:

*In every government there are three sorts of power: the legislative; the executive, in respect to things dependent on the law of nations; and the executive, in regard to matters that depend on the civil law. By virtue of the first, the prince, or magistrate enacts temporary or perpetual laws, and amends or abrogates those that have been already enacted. By the second, he makes peace or war, sends or receives embassies, establishes the public security, and provides against invasions. By the third, he punishes criminals, or determines the disputes that arise between individuals. The latter we shall call the judiciary power, and the other simply the executive power of the state. The political liberty of the subject is a tranquility of mind arising from the opinion each person has of his safety. In order to have this liberty, it is requisite that the government be so constituted as one man needs not be afraid of another. When the legislative and executive powers are united in the same person, or in the same body of magistrates, there can be no liberty; because apprehensions may*

*arise, lest the same monarch or senate should enact tyrannical laws, to execute them in a tyrannical manner. Again, there is no liberty, if the judiciary power be not separated from the legislative and executive. Were it joined with the legislative, the life and liberty of the subject would be exposed to arbitrary control; for the judge would be then the legislator. Were it joined to the executive power, the judge might behave with violence and oppression. There would be an end of everything, were the same man, or the same body, whether of the nobles or of the people, to exercise those three powers, that of enacting laws, that of executing the public resolutions, and of trying the causes of individuals. (Montesquieu 1748)*

In the actual experience of practical politics of the early centuries of liberalism, the horizontal division of powers was indeed quite relevant, especially at the start due to the big effort the new bourgeoisies needed to make in order to 'crush' the pre-existent absolute powers of the Crowns (Tocqueville 1856). The organisation of state power, the birth of a proper autonomous professional bureaucracy, along with the suppression of feudal traditions and rules were the first concerns to be addressed by the modern State.

In contrast, if we look at the vertical cut of powers, a liberal system tends to separate powers along different lines and levels of territorial authority. In fact, almost every liberal state has at some stage made a claim to increase its territorial autonomy (Cedroni 1995). Only in France, the homeland of the Napoleonic centralised state of the prefects (Ongaro 2008), did we have to wait until the end of last century to see the start of a substantial shift from traditions to a brand-new organisation of public powers that assigns a more relevant role to local communities in the form of their "communauté nouvelle" (Faure 2014).

This aim of liberalism manifests itself very clearly on the theoretical level and has done so since the

start, even if it has actually become a practical matter of institution-building only later on, within the debate on approval of the Constitution of the United States of America. In Europe, instead, the centralised State enjoyed greater fortune up until the mid-20th century when regionalist institutional arrangements were first adopted in the major European countries like Germany, then in Italy, more recently in Spain, and finally in France. A separate model has always characterised the British institution, based on self-government rather than on the existence of a strong central institutional actor.

The above statement regarding the misalignment of theory and practice, with both ending up having comparable relevance and impacts on the liberal theory of institutions and development, needs to be specified. In the early period of general considerations on foundation of the modern State, federalism was an immanent implication of the constituent power itself. Moreover, building on experience of the Middle Age Empire, all main theorists of the modern State considered federalism a fundamental part of it (Friedrich 1968, Cedroni 1995). During the 17th century, the first theory of the State based on individual autonomy and business, as opposed to the old *potestas a deo*, was based on federalism, notably in the seminal reflections of the two distinguished authors Althusius (1603) and Pufendorf (1675). It is particularly important to note that in the thoughts of those founding fathers of the theory of the modern State federalism was seen, from the outset, as a useful instrument to allow trade, peace and economic prosperity of territories (Cedroni 1985). Little wonder then that an important liberal theorist like Raymond Aron focused his attention on this early reflection in his youthful writings (Aron Marc 1948).

Incidentally, it is with two of the most relevant liberal philosophers that federalism and the separation of powers among different territorial levels of government becomes in theory an essential part of the liberal tradition concerning the institutional

architecture. In his masterpiece “Two Treatises of Government” (1690), John Locke identifies federative power as one of the fundamentals of the State. The goal of this first, frank liberal State is to ignite cooperation. The whole international prospective of this idea is devoted to ensuring durable peace and cooperation within a system of mutual recognition of States. In his attempt to defy absolutistic theories, to be replaced by a limited authority model based on the citizens’ consent, and no longer on divine will, Locke confers on public powers a fundamental function of guaranteeing inclusive dynamics of cooperation and association at different territorial levels, based on a contractual view of politics.

Then came Immanuel Kant and the ambition to design a liberal State capable of assuring peace, business, individual freedom and collective welfare. And the federalist basis was complete.

“Perpetual Peace” (1795) and “The Metaphysics of Morals” (1797) are the main essays in which Kant sets out a fallible, realistic and constituent theory of federalism as a necessary part of the theory of a liberal State, within a general and ambitious political framework that definitively opens the way to universalism (Bobbio Firpo Mathies 1956). In the age of bourgeois revolutions, that institutional machinery has already emerged as an institutional solution that, in theoretical terms, can grant the maximum decentralisation of powers, avoiding the risk of the excessive concentration of power in a single social or political actor, that could put the liberty of each citizen at risk. In practical terms, that is the most favourable way to assure economic exchanges and territorial growth. The classical debate on approval of the federal constitution of the United States of America at the end of ‘700 can give us a clear view about this crucial point. “The Federalist Papers”, a collection of 85 writings published while the debate was ongoing and then put together in a fundamental book written by Hamilton, Madison and Jay, tells us a lot about how much the élite that built the American federation was fully aware of the problems arising

from the preferred federalist framework; the strong effort of many patriots to defend the idea of a simple confederation of divided states gives us a vivid and still modern view of the implications of a federal integration model.

All the classic achievements of liberal thought found their place in that debate; and gave rise to a paradigmatic debate between Madison on one side, standing for democracy and the will of the people, and Hamilton on the other, standing for limited powers and liberty.

All of the subsequent evolution of the American constitution has occurred within the tension between those two positions. However, apart from particular moments when important choices had to be made (especially about the centralisation of economic and monetary powers in a single National Bank, powers once divided among several national banks), the whole debate confirms the common desire for an interconnected, peaceful, cooperative and single federalist State as the solution for overcoming the limits of competition between divided sovereign States.

As Madison states in paper no. 10: “There are again two methods of removing the causes of faction: the one, by destroying the liberty which is essential to its existence; the other, by giving to every citizen the same opinions, the same passions, and the same interests. It could never be more truly said than of the first remedy, that it was worse than the disease. Liberty is to faction what air is to fire, an aliment without which it instantly expires. But it could not be less folly to abolish liberty, which is essential to political life, because it nourishes faction, than it would be to wish the annihilation of air, which is essential to animal life, because it imparts to fire its destructive agency. The second expedient is as impracticable as the first would be unwise. As long as the reason of man continues fallible, and he is at liberty to exercise it, different opinions will be formed. As long as the connection subsists between



his reason and his self-love, his opinions and his passions will have a reciprocal influence on each other; and the former will be objects to which the latter will attach themselves. The diversity in the faculties of men, from which the rights of property originate, is not less an insuperable obstacle to a uniformity of interests. The protection of these faculties, is the first object of government. From the protection of different and unequal faculties of acquiring property, the possession of different degrees and kinds of property immediately results; and from the influence of these on the sentiments and views of the respective proprietors, ensues a division of the society into different interests and parties. [...]

The inference to which we are brought, is, that the causes of faction cannot be removed; and that relief is only to be sought in the means of controlling its effects. [...] In the extent and proper structure of the union, therefore, we behold a republican remedy for the diseases most incident to republican government. And according to the degree of pleasure and pride we feel in being republicans, ought to be our zeal in cherishing the spirit, and supporting the character of federalists”.

The position adopted by Hamilton in paper no. 84 is even clearer: “Another objection, which, from the frequency of its repetition, may be presumed to be relied on, is of this nature: it is improper (say the objectors) to confer such large powers, as are proposed, upon the national government; because the seat of that government must of necessity be too remote from many of the states to admit of a proper knowledge on the part of the constituent, of the conduct of the representative body. This argument, if it proves anything, proves that there ought to be no general government whatever. For the powers which, it seems to be agreed on all hands, ought to be vested in the union, cannot be safely entrusted to a body which is not under every requisite control. But there are satisfactory reasons to show, that the objection is, in reality, not well founded. There is

in most of the arguments which relate to distance, a palpable illusion of the imagination. What are the sources of information, by which the people in any distant county must regulate their judgment of the conduct of their representatives in the state legislature? Of personal observation they can have no benefit. This is confined to the citizens on the spot. They must therefore depend on the information of intelligent men, in whom they confide: and how must these men obtain their information? Evidently from the complexion of public measures, from the public prints, from correspondences with their representatives, and with other persons who reside at the place of their deliberations” (Hamilton Jay Madison 1788).

The 19th century, the age when liberal culture definitely won its case and was able to finally forge its state institution, was also the time when the USA consolidated its institutional framework, and when the very idea of a federated Europe was born. All of the major liberal authors' thinking moved along the path carved out by Locke and Kant reaffirming the federative and internationalist spirit of liberalism. Patriots from all of Europe fought and died within the walls of Cadiz in Spain in 1812. The fatal year of 1848, known as the “Springtime of the People”, saw the deaths of many Italian and British patriots in the name of the liberty of Greece; and French patriots fighting against the French army in defence of the Roman Republic led by Armellini, Mazzini and Saffi in 1849. The ideals of international fraternity, first modelled by the French Revolution and soon betrayed in the Napoleonic era, returned to give strength to the liberal revolutions all around Europe.

One of the Italian fathers of European federalism, Egidio Reale, wrote in his masterpiece at the end of World War II that, during the 19th century, even national resurrections, like the one that led to the unification of Italy, were based on the belief in liberty, not in the nationalistic will of power, and they had a liberal basis with the aim of building a cooperative Europe very different from the

autocratic and conflictual Europe in the age of absolutistic monarchies (Reale 1944).

Even the republican movement “La Giovine Italia” created by Giuseppe Mazzini had its European counterpart: “Giovine Europa”; as republican, democratic, liberal and proto-socialist movements, they all moved their steps from the ideal of the fraternity of people from all around the Continent; and the ideal of a European federation started to grow.

In 1867, the International League for Peace and Freedom was established in Genève during an international congress chaired by Victor Hugo and attended by John Stuart Mill and Giuseppe Garibaldi. The new-born League called for the end of the death penalty, the construction of a European republican federation, and the creation of a common army. The League had its own journal, “Les États-Unis d’Europe – Die Vereinigten Staaten von Europa”, that continued publishing until 1939.

The rest of the 18th and 20th centuries saw the rise and prevalence of quite a different political culture that soon appeared on the scene and became dominant; the history of political life and institutions took a different turn and liberalism ceased to be the ‘common language’ of the leading classes across Europe; its push to create the European federation became, little by little, less relevant as the fundamental political cleavages changed dramatically due to the new shape of the conflict between capital and labour, of competition in the field of technological modernisation, and of the discourse on the possible crisis of capitalism.

The latter is still one of the bigger problems of recent years: the clash of views between neoclassical and Keynesian opinions is one of the most significant discussions of our time. It is vital to note that John Maynard Keynes, the founder of the modern political economy and a theorist who provided different assumptions for decision-making in the field of

economics, contrasting with the neoclassical views, was indeed a liberal, and liked to call himself one (Keynes 1925). Keynes had in mind a clear view of the important need for cooperative and supportive international political systems able to guarantee some civil rights and standards (well-being) to the citizens of all countries, precisely in an age when totalitarian cultures like fascism and communism appeared like credible competitive political options (Jespersen 2015).

### 7.3 Liberalism in the Age of Nationalism

Liberal culture and liberal parties are never properly acknowledged for their leading role in advanced economies since that period, nor at the end of the second World War. Obfuscation of the tangible legacy of liberalism has much to do with the prevalence of the so-called functionalist method of integration during the years of the European institution-building process. Being shaped by different conflicting political cultures, regional development policies have therefore never played the fundamental role initially intended in their original design, for example, by the fathers of the American federation. Nevertheless, the Italian liberal tradition underpinned the most relevant intellectual and political efforts working hard to launch the United States of Europe as a solution to the tragic and continuous conflicts among European countries. In 1941, three prominent intellectuals who had been confined on a small isle in the Tyrrhenian Sea for being antifascist wrote the Ventotene Manifesto, the most brilliant, inspiring, well-supported, concrete proposal to found a proper federation of States in Europe.

All three of these authors – Ernesto Rossi, Altiero Spinelli and Eugenio Colorni – were friends and disciples of a prominent personality of Italy, Luigi Einaudi, a talented liberal economist and committed supporter of the European federation long before the war. Einaudi used to say that “it is mandatory to eliminate from the heart of persons the disgusting

idol of the sovereign State” (Einaudi 1945); in 1947, at the Constituent Assembly, Luigi Einaudi delivered a comprehensive and effective speech on the need for a proper European federation. Here are some of his powerful words:

*The historical experience, often repeating itself, has proven that the mere leagues of nations and confederate sovereign States have almost no powers to prevent conflicts, even more so they are fomenters of wars among the same confederations of sovereign States; and soon they happen to become nothing but vaniloquent assemblies; in their shadow, wars are plotted and prepared, together with the maneuvers to make the counterpart fall asleep and better oppress it. [...] As the railways improved communications, steamboats and motorships took the place of sailing, people started using the telephone, the telegraph with wires and wireless and airplanes to get closer, this little European flower bed openly started showing its ineptitude to bear so many different sovereignties. Sovereign States have tried in vain to build higher customs barriers around themselves to protect their economic self-sufficiency. [...] If we do not find a way to promote a new human and modern ideal for today's Europe, which is currently lost and uncertain about the way to go, then we will be lost and together with us Europe will be lost too. In this old continent of ours, there exists a frightening vacuum of ideals. The atomic bomb, which we fear so much, unfortunately lives in each of us. Not of the atomic bomb we must mostly have a fear, but of the evil forces which unleashed its use. We must oppose this triggering; and the only possible course of action is preaching good news. What is this good news then? It is the very idea of freedom against intolerance, of cooperation against brute force. Europe as it is in the hopes of Italy, which is the ideal we must fight for, is not a gated Europe closed to anyone; it is Europe open to all, Europe as a place where all persons can freely assert their conflicting ideals, where majorities respect minorities and work to promote the same goals, stretching them to the maximum point, being that*

*the limit, to the point they are compatible with the persistence of the whole community. At the creation of this Europe Italy must be ready to sacrifice part of its sovereignty. [...] It is not enough to preach the United States of Europe and hold congresses among MPs to discuss it. What really matters is that the Parliaments of these tiny states which make up the now divided Europe, decide to give up a part of their sovereignty for the sake of a European Parliament, made of an elective chamber in which the European peoples are directly represented, without distinction between states, and proportionally to the number of inhabitants, and of the chamber of States where all countries are equally represented. [...] Is Utopia the birth of Europe open to all peoples who are determined to conform their behaviors to the ideal of freedom? Perhaps it is utopia. Even so, we are now left with the choice between utopia and death, between utopia and the law of the jungle.*

Only a few years earlier, Francesco Saverio Nitti, the earliest enemy of Mussolini and D'Annunzio, the first politician to be persecuted by Fascism and to be exiled in France, wrote three important books about the necessary federalist perspective of the Continent (Nitti 1921, 1922, 1923). Nitti was a very modern thinker, an economist himself, and for all his life and in his enormous scientific and political opus always celebrated the ideal of a united Europe as a fundamental instrument to promote not only peace and democracy, but also economic development. Nitti was born in one of the poorest regions of Europe, Basilicata, and was one of the first economists to look for a new approach to local development, even producing specific proposals and laws, when he was elected as a member of the Italian Parliament to help each regional administrative entity escape the destiny of underdevelopment and to become, in economic terms, a functioning part of an advanced European architecture (Barabagallo 1984, Vetritto 2013).

At the end of World War II, in short, Italy was one of the countries where federalist liberalism arose

more strongly from the ruins. It was an intellectual, political and ideal movement that animated the Italian minority liberal leading class in the direction of the goal of the political unification of the entire Continent.

But in such a political and ideal environment, the Ventotene Manifest played an entirely different role, due to the quality of its arguments and reasoning, the strength of its proposals and because of the long-run commitment that Altiero Spinelli, the youngest of the Manifesto authors, was able to establish in all European countries in support of its thesis: from the early years of post-war reconstruction, to the first European Treaties, until the first direct elections for the European Parliament were finally held (Rossi Spinelli Colorni 1941).

It is very common to refer to the Ventotene Manifesto as a fundamental document for the European integration process, as it has been historically from the Treaty of Rome until today. Reading the document, on the contrary, it is easy to understand how deep and politically engaging was the perspective it put forward, especially compared to the actual story. The fundamental goal of the Manifesto was indeed not to have well-ordered relations among independent and sovereign States, with some sort of neoclassical budget routine able to tie the states' decisions and actions to some agreed political outcomes. As a consequence and in reaction to the "Hundred Years' War" fought in Europe from the middle of the 19th to the middle of the 20th century, the Manifesto contained a powerful Kantian ambition to provide Europe with both the end of the power clashes among European States and the end of the violent class conflicts lying at the root of the crisis of many European States.

Social policies, antitrust laws, free trade and economic exchanges, individual liberties, common government and political unification were the basic conditions of the new United States of Europe the authors of the Manifesto proposed to shape a better

future for all Europeans. The progressive integration of the European States effectively carried out over the following years, in the form of particular 'communities' on individual issues (Carbon and steel, energy), betrayed the Manifesto's political inspirations and led down a different path.

Following the defeat of the proposal to have a common defence system back in the early 1950s, the purpose of rapid political integration was explicitly resisted; the politically conservative approach of the main founding States (De Gasperi in Italy, Adenauer in Germany, De Gaulle in France) brought to an end the foundation of an interconnected welfare system of social rights common to all European citizens, giving rise to the polemic idea of a 'Carolingian' conservative Europe; the very slow opening of trade barriers provided another sign in the opposite direction to the ideal of the Ventotene Manifesto. It is astonishing to see how often the Manifesto is praised and quoted by politicians who in practice totally evaded the ideals and political horizons of its authors.

The slow and practical agreements that gradually produced the institutions of the European Communities and, after the Single Act of 1986, the upgrade to the European Union, were essentially inspired by a very basic 'functionalism', vastly different from a real and ambitious 'federalist' approach. It is an historical paradox that the Single Act, as a proposal capable of restarting the integration progress, largely arose from the commitment and personal activity of Altiero Spinelli, who never held any ideological position, but always tried all possible and tangible forms of action to help state governments find a way to successfully achieve the fundamental goals of his political and intellectual life. Nevertheless, he never gave up his concrete programme and those politicians, who often had a great fortune via the achievements of the European institutions, never came back to him with feedback for a serious discussion of the 'federalist' objective (Spinelli 1984 1987).

Since the above-mentioned defeat of the proposal for a European Defence Community to the 'empty-seat' politics, since the answers to the cost-led inflation of the 1970s to the Single Act, since the solution to the debate between 'widening' or 'deepening' options and the controversy after the Soviet Union's collapse, since the ideological neoclassical approach to the Maastricht Treaty and the inadequate process for an actual 'European Constitution' through to the egoistic and nationalistic responses to the current epochal problem of migrations, 'functionalism' has always been the only accepted method used by governments and supported by mainstream intellectuals across the Continent. The federalists have also not been given any 'honour of arms' when, with the passing of time and the worsening of problems, their method happened to appear, ex post, more convenient and useful (Vetrutto 2018).

During the decades when European institutions had abandoned any federalist goal, liberal thought produced even more prolific literature that in theoretical terms reaffirmed its original federalist nature; in economic terms, it provided all the 20th century thinking about regional disparities and regional development; in socioeconomic terms, it gave evidence of the need for the large-scale economic reassessment of institutions and policies as well as new evidence of the good old proof of the benefits derived from cooperative and multilevel institutional bargaining, as clarified centuries before in the 'Federalist Papers'.

Even the most relevant new elements of those years, represented by the mounting importance of last-generation technologies never experienced in such a dominant role in every human activity and decision throughout history, and with an ever-accelerating growth, gave a new breath to liberal reflections on territorial governance and inter scale governance. In the age of the ICT revolution, based on different territorial dimensions the role of different socio-economic systems has become prevalent:

the new role of cities in the international economic environment of globalisation, the new regionalist basis of the most influential socioeconomic districts, and the huge problems affecting the so-called shrinking areas give the territorial dimension of the 'separation of powers' concept a new centrality.

Every single condition in these years of transition led to a relevant renewal of the liberal tradition. Nowadays in ethic and social terms the suggestion of John Rawls to describe an effective society as a "social union of social unions" (Rawls 1971) is often mentioned. In political terms, the major challenges to individual liberty emphasise Robert Dahl's construction of polyarchy (Dahl 1971). In social science studies, especially history and the humanities, since the '1990s fresh importance has been given to the reflections of Karl Polanyi (Polanyi 1944), a socialist liberal author who was very devoted to the cooperative dynamic and, more recently, to the studies of a liberal social scientist like Elinor Ostrom who dedicated her life to deconstructing the two ideological and naïve simplifications of the Leviathan State on one hand, and of the Invisible Hand of the economic markets on the other (Ostrom 1990).

In economic terms, the problem of growth, development, overall performances and regional disparities is seen in modern literature through the lenses and perspective of the liberal economist and sociologist Albert Hirschman (Hirschman 1958) and the more recent contribution by Amartya Sen (Sen 1985). The traditional liberal argument about checks and limits on power through the political commitment and democratic control of leaders plays a central role in the reflections of a newly preeminent liberal thinker like Daron Acemoglu (Acemoglu and Robinson 2012).

It is remarkable that almost every influential theoretical author in the current debate about territorial and intergovernmental governance, in every field of study, calls themselves liberal, while

the strength of liberal political organisations and political parties has drastically vanished.

An example here can be very illustrative. The whole work and personal activity of one of the most important liberal authors of the 20th century, Ralf Dahrendorf, were dedicated to help the progress of European integration and to win former Soviet empire States of Europe over to a liberal democracy; he was a key influential thinker in the decisive years of the sunset of Taylorism and the social welfare economic milieu, in the decade of the collapse of the soviet system, in the years of the emergence of the stressing and antipolitical new global arrangements. With reference to all of these dynamics, all forgetful of the liberal humanism, Dahrendorf vigorously fought for decades while the liberal parties relied on the comfortable and unrealistic lie of the “end of history” (Fukuyama 1992) and of their final victory against the traditional enemies of nationalism, authoritarian thoughts and illiberal political traditions (Dahrendorf 1959, 1990, 1995, 2006).

It is quite evident that the populist challenge to liberal democracy is bigger than ever in that, when reviewing the events of the last 25 years, liberalism has gone from being triumphant not only in principle but also in practice as the legitimate form of government, to face multiple challenges on the global stage, both external and internal to Europe. This is seen with unprecedented events, at least in terms of size and speed, like mass migration and widespread social insecurity combined with the privatisation of risk (healthcare insecurity, unemployment, market volatility, pension deficits and natural disasters).

These events have raised ugly sentiments but also legitimate grievances and inconvenient truths that need proper feedback, a response not only by way of economic solutions but also moral and cultural proposals and reframing. Instead, with very few exceptions, European liberals remain silent and are mostly concerned not to confuse their voice with that of the loud populists fuelling the upsurge in

identity politics; and are primarily trying to survive as a parliamentary group, despite the great distinctions they should make between conservative and progressive visions that their culture has produced over the centuries. As a result, liberals are often blamed for not taking a position on the crisis of identity of European citizens, the various challenges that cultural diversity in an era of economic austerity poses to them, and policymaking in practical and symbolic terms.

A big mistake of undermining liberalism from within is to discard all claims for being intrinsically or morally good (like left-wing politics says) or bad (like right-wing politicians tell). A laissez-faire neoclassical attitude to the actual economic and social effects of modernity on Europe’s construction is as untenable as indifference to its principles and fundamentals. This means that liberals need to be in the market with practical ideas to avoid the social ruin of economic crisis, staying loyal to the moral obligation to the wider political integration of humanity, while contemplating Europe’s specific history and geography.

The principle of inclusive growth here needs to be applied across lines of culture and economics as well as geography. Throughout the West, remote and less densely populated areas are losing ground to metropolitan centres in the face of a technologically advancing economy, and also weakened due to competitive pressure and migrations. For this reason, liberal public policy and politics must still address the old traditional issues related to transport infrastructure, democratic participation, metropolitan and rural growth, communications and technology that could help bring isolated communities into the large-scale economy and society. If we believe these are uniquely difficult issues, it is then important to remind ourselves of the huge challenges liberal forerunners had to deal with: revolution and war (Tocqueville), totalitarianism (Popper), poverty and underdevelopment (Keynes, Nitti).

It is exactly when someone starts to believe that everybody agrees with him that his defeat is complete. Two or three decades after the supposed definitive victory of liberalism, when anyone, irrespective of their political tradition, was feeling comfortable describing themselves as liberal, their liberal ideas and policies revealed themselves to be at serious risk in the context of European institutions, particularly in the areas of integration and regional development. Characterised by an imperfect separation of powers, and therefore not adequately liberal in itself, the European system has in the last decades gone through an explicit crisis of its territorial policies, on two levels.

On one hand, the decisional framework of the recent 'intergovernmental regime' has taken an effective role away from the regional institutions of the Union (e.g. the European Committee of the Regions (CoR)); as a consequence, the issue of regional disparities and development patterns has rapidly become, from being a multilevel governance problem, a reason for conflict among member states.

At the very moment the formal regulation was giving greater power to the Committee, its role declined. As a result, within the European debate the voice of territorial authorities can now barely be heard over a very harsh national clash.

On the other hand, the bureaucratic and ineffective use of the European Investment Fund has removed from the territories a fundamental instrument for being a protagonist on the European scene. The importance and political relevance of cohesion policy is now once again strongly in question, especially among Northern European member states. In this very difficult debate, which has lately once more acquired nationalistic nuances, the voice of liberalism has lost its importance. A comprehensive and ambitious proposal to relaunch liberal regional policies can and must be tried in terms of a federalist framework, the polyarchal separation of powers, effective technological multilevel public governance architecture, effective economic regional development policies etc. The following chapters seek to meet that purpose.

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# 8.



## The Origin: Federalism and its Sunset. From Federalism to Multilevel Public Governance

By Giulia Carnevale

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### 8.1 The Case for Federalism: the USA as the Fundamental Paradigm

In order to explain the new way of working of a modern federalist State two centuries after the bourgeois revolutions, it is essential to understand that this polyarchic and liberal framework has undergone a concrete evolution, arriving at a different way of working that puts in the spotlight an important continuity with the current multilevel public governance. In other words, to identify a fresh way of interpreting the dialectical relationship that intertwines the powers at supra-national and regional/administrative centre levels, a proper analysis of federalism as a constitutional process may offer an interesting interpretation of the juridical and political structures upon which multilevel governance rely today. Therefore, with the evolution of modern federalism being the fil rouge of this chapter, the analysis will touch on the process of the constitutionalisation of federalism in two systems with vastly different historical backgrounds: the USA and Germany.

The rationale for such a choice is, probably, self-evident: the two countries engaged in the dynamic institutional development of the early concept of federalism, which allows some reflections on contemporary models of governance coordination. Finally, a brief comparison will be made with respect to multilevel public governance in order

to suggest areas for reciprocal improvement and enrichment for federalism and multilevel public governance, and their models of the distribution of power.

But, first of all, we need some preliminary considerations extracted from the *Federalist Papers*, as already quoted in the previous chapter concerning the seminal debate on polyarchic frameworks. This masterpiece of political science and cornerstone of liberalism is still a fundamental work for understanding the birth and evolution of the US Constitution and institutional framework. At the same time, since being published the *Federalist papers* has always been a credible point of reference for federalist theories.

### 8.2 At the Roots of Federalism: Federalist Papers Numbers 10 and 51

Thomas Jefferson called the *Federalist Papers* “the best commentary on the principles of government ever written”. John Stuart Mill saw the collection of these 85 short essays as “the most instructive treatise we possess on federal government”. Alexis de Tocqueville spoke about the collection as “an excellent book, which ought to be familiar to the statesmen of all countries”.

The *Federalist Papers* were largely the product of Alexander Hamilton and James Madison. John Jay,

later named as the first chief justice of the Supreme Court, only contributed to five of the essays. It is interesting to note, albeit not being the focus of the present analysis, that Hamilton, Madison and Jay did not use their individual names as authors of the *Federalist Papers*; instead, they wrote all of them under a single pseudonym: “Publius”. They chose this name because it was the first name of Publius Valerius Publicola, one of the core supporters of the Roman Republic: they wished to appear as similar supporters of a new federal republic. The main, and for some reasons obvious, aim of the *Federalist Papers* was to build trust and consistency in a new definition of federalism as an immediate answer to the institutional renewal succeeding the defeat of the British oppressive monarchy.

Madison proposed that, instead of the absolute sovereignty of each State under the Articles of Confederation, the States would retain a “residual sovereignty” in all those areas which did not require national concern. The very process of ratifying the Constitution, he argued, symbolised the concept of federalism rather than nationalism:

*This assent and ratification is to be given by the people, not as individuals composing one entire nation, but as composing the distinct and individual States to which they respectively belong... The act, therefore, establishing the Constitution, will not be a national but a federal act. (Madison, 1788)*

In essay number 78, Hamilton defended the Supreme Court’s right to rule upon the constitutionality of laws passed by national or state legislatures. This historically crucial power of “judicial review”, he argued, was an appropriate check on the legislature, where it was most likely that “the pestilential breath of faction may poison the fountains of justice” (Hamilton, 1788). Hamilton explicitly rejected the British system of allowing the Parliament to override by majority vote any court decision it might find displeasing. Rather, “the courts of justice are to be considered the

bulwarks of a limited Constitution against legislative encroachments”.

The contribution to the federalist culture of all 85 essays is undoubted; but the analysis of each one of them goes beyond the intentions and possibility of these pages. Within the entire collection, two of them are deemed to be representative of the interpretation of federalism they offer, namely papers 10 and 51 by James Madison.

The *Federalist* 10, «The Utility of the Union as a Safeguard Against Domestic Faction and Insurrection» addresses the question of how to guard against “factions”. Specifically, the question Madison tries to answer is ways to eliminate the negative effects of them. He defines a faction as “a number of citizens, whether amounting to a minority or majority of the whole, who are united and actuated by some common impulse of passion, or of interest, adverse to the rights of other citizens, or to the permanent and aggregate interests of the community”. However, he thinks “the most common and durable source of factions has been the various and unequal distribution of property. Those who hold and those who are without property have ever formed distinct interests in society”.

He saw direct democracy as a danger to individual rights and advocated a representative democracy in order to protect what he viewed as individual liberty from majority rule, or from the effects of such inequality within society. “A pure democracy can admit no cure for the mischiefs of faction. A common passion or interest will be felt by a majority, and there is nothing to check the inducements to sacrifice the weaker party. Hence it is, that democracies have ever been found incompatible with personal security or the rights of property; and have, in general, been as short in their lives as they have been violent in their deaths” (Madison, 1788). Madison was substantially influenced by the work of Montesquieu, although Madison and Montesquieu disagreed on the question addressed in this essay.

He also relied heavily on the philosophers of the Scottish Enlightenment, especially David Hume, whose influence is clearest in Madison's discussion of the types of faction and in his argument for an extended republic (Adair, 1974).

Madison thinks the damage caused by a faction can only be limited by controlling its effects through the principle of popular sovereignty, which should prevent minority factions from gaining power. Majority factions are then the problem, and he offers two ways to check them: prevent the "existence of the same passion or interest in a majority at the same time", or alternatively make a majority faction unable to act (Epstein, 1984). From this point of view, Madison concludes that a small democracy cannot avoid a majority faction because small size means that common passions are likely to prevail among the majority of people, and democracy means the majority can enforce its will. A republic, Madison writes, is different from a democracy because its government is placed in the hands of delegates and, as a result, it can be extended over a larger area. The fact that a republic can encompass larger areas and populations is a strength of that form of government since he believes that larger societies will have a greater variety of diverse parties and interest groups, which in competition will be less likely to produce a majority faction (that, in brackets, is a forgotten truth that may be very useful in Europe in these years of rising nationalism and populism). This is a general application of the 'checks and balances' principle which is central to the American constitutional system. Briefly put, Madison emphasises that the greater size of the Union will allow for more effective governments and counterpart of factions than single States to remain more independent.

While in Federalist 10 Madison focused on the contrast of factions in terms of competition, in Federalist 51 named «The Structure of the Government Must Furnish the Proper Checks and Balances Between the Different Departments» he provides the reader with a definition of general good

which necessarily needs to coincide with an internal equilibrium of the new-born federal government. James Madison wrote: "In the extended republic of the United States, and among the great variety of interests, parties, and sects which it embraces, a coalition of a majority of the whole society could seldom take place on any other principles than those of justice and the general good" (Madison, 1788). Accordingly, we must regard it as Madison's rule that, so long as the extended republic of the United States endures, it operates on the basis of the formation of majority coalitions grounded in principles of justice and the general good.

Further, we must note that the condition for it so enduring is that restraints upon the majority do not go so far as to transfer power to any minority; which the requirement of a super-quorum in the legislature would do. In all cases where justice or the general good might require new laws to be passed or active measures to be pursued, the fundamental principle of free government would be reversed. It would no longer be the majority that would rule: power would be transferred to the minority (Madison 1788). His definition of the general good therefore implies this: a form of social life wherein the weaker party may forcefully maintain its claims of right within the very structure and processes of the government. In these conditions, political and social contradictions (e.g. class conflict) are eliminated (Erlor 1981):

*... The great security against a gradual concentration of the several powers in the same department consists in giving to those who administer each department the necessary constitutional means and personal motives to resist encroachments.... Ambition must be made to counteract ambition. The interest of the man must be connected with the constitutional rights of the place.*

The discussion of the 'mutual relations' of the branches of government occupies but the first half of the paper. The second half examines the safety to be derived from the "federal system of America". Here

Madison offers “two considerations”. The first repeats the argument that the “compound” relationship of the general government and the States will operate to the same effect as the separation of powers among the branches of government, thus offering “a double security” with respect to the people’s rights. The entire discussion takes only four sentences, being in a certain sense self-evident for the author and expressed in a very assertive way.

The rest of the paper discusses a further question: after a society is guarded ‘against the oppression of its rulers’, how is ‘one part of society’ guarded against the injustice of the other part? This argument is of peculiar interest not only because of its restatement (not just repetition) of Federalist 10. It is of special interest because Federalist 51 starts by invoking the ‘foundation of authority’, society as the ‘primary’ ruler in a republican government. As far as people indeed rules, the protection of one part of the people from the other is still a protection against the oppression of rulers. The critical problem of the majority faction, which in Federalist 10 we find as the only problem to be solved, returns to explain how the minority faction would be handled by the ‘republican principle’. But now, equally importantly, we see that once the people’s direct authority has been qualified it becomes important to protect one part of the people, namely, the ruling majority, against the violence or injustice of another part, namely the minority or the few, since Madison writes explicitly of only two parts, “one part” and “the other part” (Dahl 1966).

What sets the system in motion are the persistent interests of the “different classes of citizens”. It is precisely because the people rule that, “if a majority be united by a common interest, the rights of the minority will be insecure”. The danger in this system is in fact the same that the natural majority establishes in every republic (Hobbes 1651). It is inconsistent with republican principles to put in place a “will in the community independent of the majority, that is, of the society itself”. This means

the minority is left exposed to the violence of the majority, which appeared to be the problem we were handed. So here Madison reaffirms the Federalist 10 solution, although it remains unclear how “one part” of society is protected against “the other part”. The reaffirmation does no more than assure that no minority “will” or veto is permissible. And the minority cannot otherwise be expressly defended without giving a veto on the will of the majority. Hence, the minority must be left theoretically exposed.

Madison responds to this danger with a peculiar interpretation of the majority rule. The majority must govern, but in such a way that the minority no longer requires protection because the majority is made unable to act in the pursuit of unfair political ends. Suspicious self-interest must limit the seeking of extra advantages to the degree that minorities will benefit. This method ‘will be exemplified’ in the new constitutional order.

The rule of the stronger faction, of the majority, is distinguished here from majority tyranny. The definition of majority tyranny applies most forcefully in a democracy (as opposed to a proper republic) where the effective separation of powers is impossible. Here, the rule of the stronger faction is not rooted in a mere abuse of power, its aim is exactly the opposite: the denial that only force legitimises power, and the achievement of an ultimate, collective, public good (Kesler, 1987).

The question of how a majority can protect itself from minority violence remains. Madison’s repeated return to the question of preventing majority violence proves to be difficult, but this reiterated theme is at last solved by federalism itself, by taking another voice into account. The “multiplicity of interests” is a natural event that is artificially encouraged in a “proper federal republic” to an extent to prevent any easy prevalence of any faction’s interests (be they of the majority or the minority). The point is to avoid government under the majority’s “unjust views” (Allen, 2000). It is not the power of the majority, but

its injustice that is curtailed; hence, it remains able to defend itself against minority violence, but in a public-debate environment where the diversity and clash of interests and points of view make it harder to maintain the prevalence of any faction. Federalism formally becomes in political theoretical terms part of the liberal 'checks and balances' instruments of the constitutional defence of individuals and minorities' liberty.

### 8.3 The Evolution of American Federalism, from the Contrast of Powers to the Cooperation of Powers

The heritage of the Federalist Papers is a valuable instrument for understanding the early intentions of the American Constitution: drafting a federal framework that aims to balance the forces of decentralised and centralised governance in general terms. As every careful reader notes, the Constitution does not provide standard operating procedures precisely defining how the States and the Federal governments handle every kind of policy contingency. Therefore, officials at the state levels have some power as they operate within the Constitution's federal design. This has led to changes in the configuration of federalism over time, changes corresponding to different historical phases that progressively found different balances between state and federal authority. A shift from the juxtaposition of powers to a collaborative (although always confrontational) arrangement can be observed and explained in an historical evolution as follows.

#### *i. First phase (1789–1870): conflict among states and federal powers and its solution according to the Supreme Court*

An interesting episode describing how the new-born federalism was facing the natural difficulties in the dialectics of power attribution concerns the establishment of the Bank of the United States. At

the times of the Washington presidency, Hamilton was secretary of the treasury. His main aim was to create a publicly chartered bank which, according to him, was fully within Congress' authority. The role Hamilton hoped for the bank was to foster economic development and provide loans to the Federal government.

Thomas Jefferson, Secretary of State, staunchly opposed such a plan on the constitutional grounds that the Federal government had no authority to create such an institution. Hamilton prevailed, but his creature rapidly expired, and was then substituted by a Second Bank of the United States under Madison's presidency: the constitutional debate was at his highest level since many states rejected the Second Bank, arguing the Federal government was infringing upon the States' constitutional jurisdiction. This debate came before the US Supreme Court when James McCulloch, an agent for the Baltimore branch of the Second Bank, refused to pay a tax that Maryland had imposed on all out-of-state chartered banks. The standoff raised two constitutional questions: Did Congress have the authority to charter a national bank? Were States allowed to tax Federal property? In *McCulloch v. Maryland*, Chief Justice John Marshall argued that Congress could create a national bank even though the Constitution did not expressly authorise one (Ellis, 2007).

Under the necessary and proper clause of Section 8 of Article I, the Supreme Court asserted that Congress could establish "all means which are appropriate" to fulfil "the legitimate ends" of the Constitution. For the purpose of this analysis, this statement by the highest court in the USA is a fundamental starting point for development of the federalist debate: the judicial body referred to the supremacy of the powers of Congress over the States, even if this predominance was not explicitly written in the Articles of the (brief) American Constitution. For the observant reader, John Marshall is all but a new name in US Supreme Court history. He is widely

remembered as the author of the principle of judicial review established in *Marbury v. Madison* in 1803, which reinforced the influence and independence of the judicial branch of the US government. This ruling established the doctrine of implied powers, granting Congress a vast source of discretionary power to achieve its constitutional responsibilities (Nelson, 2000). The Supreme Court also sided with the Federal government on the issue of whether the States could tax federal property. Under the supremacy clause of Article VI, legitimate national laws trump conflicting state laws: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding".

As the Court observed, "the government of the Union, though limited in its powers, is supreme within its sphere of action and its laws, when made in pursuance of the constitution, form the supreme law of the land. Maryland's action violated national supremacy because "the power to tax is the power to destroy". This second ruling established the principle of national supremacy, which prohibits states from meddling in lawful activities of the national government (Clinton, 1991).

Another important statement for the constitutional and institutional framework was established, clearly demonstrating how essential was the active role of the US Supreme Court in identifying the scope of national power in the first phases of American federalism, and it continued to do so in other complementary interpretations it offered in later cases. In *Gibbons v. Ogden* in 1824, the Court had to interpret the commerce clause of Section 8 of Article I, determining whether the federal government had the authority to regulate the licensing of steamboats operating between New York and New Jersey. Aaron Ogden, who held an

exclusive licence from New York State to operate, sued Thomas Gibbons, who was operating under a coasting licence issued by the federal government. The Supreme Court delivered a two-part ruling in favour of Gibbons that strengthened the Federal government's power (Cox, 2008), establishing that "the acts of New York must yield to the law of Congress".

What the Court was shaping through its interpretations was not what the States' courts and governments had expected: the centralisation of power was perceived as a constriction rather than a collective benefit, and the vacuum left by the Constitution in this regard was considered insufficient to justify such an address of the highest court. These decisions represent the earliest crucial crisis of the ideals of the 'original' federalism in the minds of Madison and Hamilton, as described in the previous paragraph.

It is even more interesting that such discontent did not wait too long to manifest. The first example dates back to when the Sedition Act was signed in 1798. This Act made it a crime to speak openly against the Federal government, and the Kentucky and Virginia legislatures passed resolutions declaring the Act null on the grounds that they retained the discretion to follow national laws; these resolutions articulated the legal reasoning underpinning the doctrine of nullification: States had the right to reject national laws they deemed unconstitutional (Kirk Wood, 2008). After then, a 'nullification crisis' spread all over the jurisdictions of the States willing to affirm their independence from the decisions of Congress. Such a conflict culminated, and found an early solution, in the years of the Civil War.

Before that historical moment, the Supreme Court ruled that the Federal government had lacked the authority to ban slavery in the territories. The election of President Abraham Lincoln led 11 southern states to secede as they believed Lincoln would challenge the institution of slavery. What was

a conflict to preserve the Union became a conflict to end slavery when Lincoln issued the Emancipation Proclamation in 1863. The defeat of the South had a huge impact on the balance of power between the States and the Federal government. First, the Union victory put an end to the right of the States to secede and challenge legitimate national laws. Second, Congress imposed several conditions such as the ratification of the Fourteenth and Fifteenth Amendments.

In conclusion regarding this historical phase, it can be peacefully stated that after the Civil War the power balance shifted toward the Federal government, a shift that had begun several decades before with *McCulloch v. Maryland* as well as *Gibbons v. Odgen*. Even though a 'decentralisation' parenthesis took place, these ages were the achievement of the constitutional design hoped for by the Federalists, and Madison in particular: the Federal government established its role within the newly created federal design. In this regard, the Supreme Court played a fundamental role in settling the power struggles between the States and the Federal government (Marbach Katz Smith 2005).

*ii. Second phase: opposite rulings of the Supreme Court, road open for dual federalism (1870-1929)*

In the years after, the Lincoln presidency brought US federalism into a new phase, clearly as a result of the mentioned debate. Under dual federalism, the States and Federal government exercise exclusive authority in distinctly delineated spheres of jurisdiction. The levels of government do not mix with one another but are instead clearly defined. Many factors contributed to the emergence of this conception of federalism, although some several Supreme Court rulings were fundamental for directing such a new institutional framework.

During this phase, the Court's role took on a new shape: rather than validating the constitutional

powers of Congress, it turned to blocking attempts by both State and Federal governments to step outside their jurisdictional boundaries. The grounds of such interpretations were offered by the heating up debate about the concentration of market power as there was no national regulatory supervision to ensure fairness in market practices. Years later, Congress passed the Sherman Antitrust Act of 1890, making it illegal to monopolise or attempt to monopolise and conspire in restraining commerce. In the early stages of industrial capitalism, federal regulations mostly focused on promoting market competition rather than on addressing the social dislocations resulting from market operations, something the government began to tackle in the 1930s (Eisner 1995; Skowronek 1982).

The new federal regulatory regime was destined for a legal blow threatening its existence. A case showing the problems of the approach was *United States v. E. C. Knight* in which the Supreme Court ruled the Federal government lacked the authority to regulate manufacturing. If manufacturing activities fell within the purview of the commerce clause of the Constitution, then "comparatively little of business operations would be left for State control", the Court argued. This case dates back to 1895, but the seeds of the collapse of such models did not wait long to sprout. The excess rigidity of such an interpretation of federalism offered little room for effective coordination among States and the Congress, from both a political and a judicial perspective.

*iii. Third phase: the birth of Cooperative Federalism (1929-1969)*

The paradigm of legislative and judicial activity addressed by the Supreme Court in the last years of the 19th century, drafting the institutional framework by regulation of the market, immediately became an outdated means of interpreting federalism. This was mainly due to the Great Depression of 1929, which is a discrimen not only for the course of American political economy: it is a true turning point

in the construction of a new federal institutional framework.

When considering data on unemployment (25%), industrial output (which dropped by one-half) and gross domestic product (which shrank by one-quarter) at the time, the impact of such a crisis on political processes is self-evident (Crafts Fearon, 2010). The natural outcome of this spread of poverty and discontent was a certain pressure on the Federal government to coordinate a robust national response along with the States. This deep need for coordination and collaboration in response to the Depression is the seed from which 'Cooperative Federalism' sprouted.

Born by way of necessity, this new way of interpreting federalism (which is even different from the German cooperative federalism, as we will see in the next paragraph) became the main model for American federalism in the 20th century. Adopting a cooperative institutional framework, both levels of government coordinate their actions to solve common problems, starting from the Great Depression and arriving at the civil rights struggle of the following decades.

The differences with dual federalism are many, but may be boiled down into one: it erodes the jurisdictional boundaries between the states and the national government. The era of cooperative federalism implied the gradual incursion of Federal authority into the jurisdictional domain of the States, as well as an expansion of the Federal government's power into concurrent policy areas (Marbach 2005). The great political interpreter of Cooperative Federalism was Roosevelt whose New Deal, proposed as a way of tackling the Great Depression, faced a long jurisdictional challenge before the Supreme Court. At the time, the highest court was still embedded with a dual-federalism mindset; the Court's will was to strike down key pillars of the New Deal on the grounds the Federal government was working on matters that fell within the power sector of the States.

The Court was in an extremely obstructionist position, at least from Roosevelt's point of view. This clash among the different branches of power culminated in the 1937 presidential proposal of a 'court-packing' plan. By adding one new judge for each one over the age of 70, the president would have been allowed to make a maximum of 6 new appointments. The political body exerted such strong pressure to the detriment of the judicial body: deplorable conduct for Montesquieu, the Federalist Papers and all cultural bases upon which the original federalism rested on (and even nowadays for a classical liberal attitude).

In spite of this, before Congress took action on the proposal, the Supreme Court began leaning in support of the New Deal as it had changed its view on federalism (Shesol 2010). It is extremely interesting for the whole line of reasoning of this paper that this happened in the field of the State's economic role with regard to regional policies: a sort of first proof of the need for the complex, combined policy action of different levels of government, but with a very strong role of the more distant but more powerful centre, for a more effective regional development, that found its new model in the Tennessee Valley Authority designed by Roosevelt as an original new strategy to fight regional underdevelopment.

The New Deal changed the relationship Americans had with the Federal government: after the New Deal, the Federal government started to provide a variety of public services and regulatory agencies and bodies created during Roosevelt's Administration. This centralised management of development and welfare policies offers clear evidence of how relationships among the Federal government and the States have changed over the years, with the States becoming an active (and, to some extent, even independent) part in the implementing of common national policies and strategies. This era witnessed a broadening of Federal powers in concurrent and State policy domains, but was also an era of deeper coordination between the



States and the Federal government in Washington. The nationalisation of policies emerged as a result of Federal legislative activism aimed at addressing national problems, although the flexibility that States and local authorities were given in implementing the Federal social welfare programmes balanced such nationalisation.

*iv. A fourth period? Decentralising trends in modern federalism: New Federalism*

The welfare and State-led economy created to respond to the Great Depression lasted more or less coherently for decades until the cost-led inflation crisis of the 1970s (ignited by the oil crisis), that led little by little to the conservative *revanche* that is seen today. During the administrations of Presidents Nixon and Reagan, attempts were made to restore the States' prominence in policy areas into which the Federal government had moved in the past. This address became a new conceptual purpose called New Federalism.

New Federalism is based on the idea that the decentralisation of policies enhances administrative efficiency, reduces overall public spending, and improves policy outcomes. Nixon distributed funds to the State and local governments with minimal restrictions on how the money was to be spent. Ronald Reagan marked the advent of a "devolution revolution" in US federalism in which the return of authority to the States was conceived as the only possible way of interpreting Federalism, according to a newly restricted reading of the Constitution.

Reagan consolidated many federal grant programmes related to social welfare and reformulated them in order to give states and local administrators greater discretion in using federal funds. Several Supreme Court rulings also promoted New Federalism by hemming in the scope of the national government's power, especially under the commerce clause already mentioned for the dual federalism phase. For example, in *United States v.*

*Lopez* the Court struck down the Gun-Free School Zones Act of 1990 which had banned gun possession in school zones, arguing that the regulation in question did not "substantively affect interstate commerce".

This ruling came after a long period in which the Court had broadly interpreted the commerce clause to allow the Federal government to regulate many local commercial activities. However, this trend ceased immediately to fascinate the highest levels of power since the tragic fact of the Twin Towers in 2001 made the demand for security turn to more centralised systems of control.

#### **8.4 Germany and the Basic Law, a Different Structure of the Constitution in a Civil Law System**

Before describing the German model of cooperative federalism, it is necessary to explain one premise. The methodology adopted for analysing the American way of interpreting federalism was strictly linked to its evolution in both the Supreme Court's rulings and the political-economic situation related to such rulings. Germany's deeply different institutional framework, being a civil law country with a long, detailed and (quite) recent Constitution, calls for a radically different methodological approach. Therefore, the analysis will be performed with regard to the provisions contained in the Basic Law, i.e. the German Constitution, which better describe how Germany rebuilt its institutions in a regional republic after the turbulent and tragic course of history in the 20th century.

The official translation of Article 20 of the Basic Law states the Federal Republic of Germany is a "democratic and social federal state" (German Bundestag). Representatives of the *Länder* met in 1948 to draft a new constitution and to form the Parliamentary Council which negotiated with the Allies over the final text in 1949. The German Constitution, or Basic Law, was then approved by

the parliaments of the Länder rather than by popular referendum. It contains the text of 146 articles, about one-half of which directly or indirectly relate to federalism, whose solidity is even protected by a “perpetuity clause” (Article 79) which forbids changes in “the division of the federation into Länder” or which affects their fundamental participation in the legislative process, the participation in the Bundesrat.

The general principle guiding the division of powers or functions in the Basic Law is stated in Article 30 of the Basic Law: “State powers and the implementation of state tasks are the responsibility of the Länder”, unless the Basic Law provides otherwise. This creates the presumption that governmental powers lie with the Länder in cases of doubt. Article 70, the first of the articles dealing with legislation, is closely related to Article 30. It simply states that “the Länder have the right of passing legislation insofar as this Basic Law does not grant legislative authority to the federation”.

This reveals Germany’s deeply different position compared to the previously mentioned doctrine of implied powers in the United States. Article 70, par. 2, says that legislative authority is granted in the form of exclusive and concurrent legislative powers. Another requirement imposed by Article 70 is that powers of the federation are derived from provisions of the Basic Law. Finally, one should add that European law is an increasingly important source of law in Germany, which affects both federal and Länder law-making powers.

However, the constitutional reality today is that there are relatively few legislative powers that have not been granted to the federal level by various means (Gunlicks, 2003). Articles 71–75 make it clear that the legislative powers of the federation are much greater than those of the Länder. Article 71 denies the Länder any powers in the areas of exclusive federal jurisdiction unless federal law has specifically granted them. Therefore, a law passed

by a Land or a popular referendum in a Land under the area of exclusive jurisdiction of the federal powers would be unconstitutional. The federation’s exclusive legislative powers are listed in Article 73.

Articles 72 and 74 are concerned with concurrent powers. Article 72 contains three paragraphs. The first paragraph states simply that the Länder have the power to act in the area of concurrent legislation so long and so far as the federation has not exerted its power to pass legislation in the area of concern: there is no “dual authority”. Therefore, some legal scholars suggest that ‘precedence’ legislation might be a better term than ‘concurrent’ legislation.

Something similar happened in Italy when the constitutional implementation of new regional authorities during the 1970s was initially blocked exactly because the State had not managed to produce the “Leggi cornice” that would have allowed the specific pieces of regional legislation. The Italian Supreme Court in any case bypassed this problem by declaring that those State laws are not needed every time a clear Constitutional principle exists in relation to any specific issue because it is written in the Constitution itself or argued by the same Supreme Court.

In Germany, Article 72 was amended in 1994 so that the federation can claim a concurrent power for itself only if “essential” or “required” and not just because it perceives a “need” to act. The simple “need” to act had been a widely criticised instrument for broadening federal central authority, weakening that of the individual Länder. Now, the federation can claim the “need” to act as “essential” only in the general interest of preserving “equivalent living conditions” or the legal and economic unity of the country (Larsen, 1996).

Further, under a new provision added to Article 93 by the constitutional reform of 1994 the *Land* governments, *Land* parliaments and the Bundesrat can disagree on what is “essential” before the

Federal Constitutional Court, something they could not do before the 1994 changes. Finally, a third paragraph for Article 72 was introduced in 1994 in order to return power to the Länder if and when a “requirement” for federal action no longer exists.

Article 74 provides a list of the concurrent powers that, in theory at least, could have remained with or been assumed by the Länder. The list now contains 28 subject areas, including several areas that have always been and remain responsibilities of the American states, such as civil and criminal law. One article that is very important for our analysis is Article 83 and its relationship with “dual federalism”.

Article 83 states: “The Länder implement federal legislation on their own responsibility so long as this Basic Law does not provide otherwise”. Its logic bounds with the already mentioned Articles 30 and 70 is evident. Some scholars argue that Article 83 reflects the concept of “dual federalism” in Germany as the federation carries most of the responsibility for legislation, while the Länder are primarily responsible for administration. However, this definition is quite insufficient in describing the institutional relations existing in the German constitutional framework.

The division of powers in German federalism is closer to a system of cooperation, interconnections and interrelationships. The Federation holds the greatest responsibility for legislation, but the Länder participate in legislation via the Bundesrat. The Länder are generally responsible for administration, but in carrying out federal laws they may be subject to many federal instructions and restrictions, which they can usually influence via the Bundesrat. This represents a clear difference between the German and American federal traditions, for which the meaning of cooperative federalism was intended in terms of the erosion of the independence of single States.

Another fundamental – cooperative – role in German federalism (even more different from the

USA) was played by the Finance Reform of 1969, which introduced “equalisation payments”, a system for redistributing revenue in Germany, an important tool for financing regional development. In this regard, Article 106 of the Constitution regulates the allocation of tax revenue between the Federation and the Länder. For many, this was the crucial element in distinguishing German cooperative federalism from others because it realised the concept of cooperation in a model of shared incentives to Länder through the redistribution of local and federal taxation. However, this measure is expected to expire in 2020, and will be replaced by a new financial reform.

Other provisions coming after Article 83 describe the dynamics of cooperation in the German administration. The administration of federal law can be carried out in three ways, according to the Basic Law. An obvious, but not common, method is administration solely by federal officials as either required or authorised by the Basic Law. A second method is administration by the Länder of the federal laws delegated to them, that is, administration by the Länder according to federal instructions. This represents a ‘middle way’ between administration by federal agencies and by Land agencies at their own responsibility; however, it is still a Land administration in which the federal government pays the managing costs but the Länder pay the administrative costs. The third type of administration, which is the most common of all, is that performed by the Länder themselves. According to Article 84, if the Länder execute federal legislation they establish the agencies and regulatory procedures under their organisational powers as matters of their own responsibility, which is generally referred to as autonomous *Land* administration.

Moreover, the Länder also implement EU legislation at their own administrative responsibility. In implementing federal laws, if there is a conflict and no satisfactory resolution can be found, either side

may take the case to the Bundesrat for a decision. If dissatisfied with this decision, either side can appeal to the Federal Constitutional Court. In part, the increased role of the Bundesrat is also due to the Federal Constitutional Court's interpretation that any federal law which contains a single provision concerning how the statute is to be administered by the Länder requires, as a whole, the consent of the Bundesrat. This makes it more difficult, but not impossible, for the government and Bundestag to separate one legislative bill's section from the others in order to avoid opposition and even a veto by the Bundesrat.

The weakest form of federal participation in Land administration is federal supervision and control. If one Land is administering a federal law delegated to it, the federal minister responsible holds power over the subject matter and legal supervision; they only exercise legal supervision if the law is being administered as a matter of *Land* responsibility. In practice, supervision usually consists of an exchange of information and consultation.

### 8.5 Examining the Relationship between Federalism and Multilevel Governance

Society has changed rapidly over the past century. The key to survival is adaptation, and that has never been truer than in the world of governance. Institutional developments such as the European Union, in the context of globalisation, have called for unprecedented research. Much of this research focuses on whether the traditional political science concepts still apply to these new developments or demand something new, whether as an adaptation or entirely original.

The new concept of multilevel governance can be clearly related to the classic theory of federalism: the federalism of Hamilton, Madison and Tocqueville is the starting point. Federalism's contribution to understanding, and therefore to identifying, the

limits to the sovereign State experience lies in the complaint about its exclusive character arising from the ties of national solidarity that do not tolerate any loyalty to communities smaller or larger than the nation itself.

Moreover, federalist theorists demonstrated centuries ago several lessons that are still useful today: a plurality of interests and conflicts is helpful for limiting power, and especially for avoiding the tyranny of the majority; it is essential to flexibly adapt to different situations to promote and ensure regional development; it is hard to regulate the great differences among territorial situations *ex ante* by legislation, while it is more efficient to differentiate projects and strategies on the *ex post* administrative level; progress in technology is leading to a more cooperative and interconnected way of governing.

However, national solidarity does not have to be abandoned in the globalisation era. It should instead be seen as a necessary step towards broader forms of solidarity shared between nations within regional federations which will themselves be bound together in a wider federation: the EU, for example, if it were to reconsider its history and recent defeats. At the same time, national solidarity does not exclude other forms of solidarity within regional and local communities, but can exist alongside them. In this sense, the federal model must be seen as an institutional formula that allows for the coexistence of solidarity between territorial communities of varying sizes ranging, where necessary, from small local communities to entire continents.

In fact, this may be the direct contribution to a federalist approach that multilevel public governance can benefit from, realising the well-described concept of polyarchy Robert Dahl described in his best-known work, *Who Governs? Democracy and Power in an American City* (1961). Federalism may only be of help in renewing the multilevel approach if understood as a cause for economic integration, a

safeguard against unique governments and against possible conflicts among the State and, ultimately, war. Its aim must be to enhance local governments' ability to detect and maximise the preferences of their citizens; the centre must be interpreted as a point of equilibrium rather than the concentration of power.

It is only with this interpretation of federalism, the sole one able to maintain democracy in geographically large or ethnically diverse political entities (Feeley Rubin 2008), that the federalist culture may assist in enriching multilevel governance and be compatible with institutional frameworks governed by the subsidiarity principle.

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# Some Evidence from Reforms in Europe in the Last 20 Years: Place-based Development Policies at Work

By Walter Paternesi Meloni and Alessio Conti

## 9.1 Multilevel Governance at Work. Reforms in Europe in the Last Few Decades

In most European countries, there is a large and converging reorganisation process involving local and regional government and a redefinition of administrative and institutional structures in line with the current paradigm of multilevel public governance (Pollit Bouckaert 2002).

These efforts are driven by globalisation and changes induced by the technological revolution of the organisational paradigm; the new boundaries imposed on central and local institutions by the Treaty on European Union and the European integration process require member states to reform their institutional system; the broader access to information and growing awareness of EU citizens about their rights (and how to exercise them) have inspired citizens with the desire to become involved in community life and the political decision-making process. The Madison idea of participation is gaining greater value in people's thinking than Hamilton's view of limited power.

The ways European countries have responded to these new challenges are quite similar and it is easy to list the characteristics they have in common. They are gradually abandoning the idea of adopting the same administrative structure in every local

scenario. They are moving towards a decentralised administrative system in which the scale of the optimal level of government, for a given community, is defined by its ability in that specific area to meet the population's needs and manage local services efficiently and effectively. The ICT technologies that are wholly transforming the way public functions are provided are forcing states to abandon the old parish administrative level and search for more efficient aggregations of basic municipalities so as to reduce the number of mid-area administrations and regions (OCSE 2005).

In modern society, there is no longer any space for a hierarchical, pyramid-shaped and centralised organisation of the state or federalist states in which local and central authorities compete with each other and do not cooperate. These old structures simply cannot handle the new challenges which require a multilevel approach and need to take orographic, economic and social trends of a particular context into consideration. Through its administrative networks and institutional reorganisation, each country can improve the interoperability of its public administration, the delivery of public services and the citizens' participation in public decisions (Vetritto 2014).

Today is a time for institutional cooperation, for sharing knowledge and best practices among different authorities in order to promote the economic well-

being of the citizens, to satisfy their desire for civic protagonism. In this framework, collaboration and cooperation among municipalities must be encouraged at every institutional level. In fact, we can improve local governance by empowering municipalities, the union of municipalities and local authorities and by strengthening civil society organisations. A (hidden and big) risk lies in having various and mixed groups of interests involved in the decision process whilst ever there is a network of authorities that is not used to deciding together on a specific subject. Events move quite rapidly and it is vital that each administration strive to make more dynamic decisions in responding to citizens' problems: the time factor is crucial and pursuing a consensus can ultimately lead to not deciding at all (Vetritto 2008).

The real challenge is knowing how to avoid this situation and to translate this in terms of political action. First, the institutional transformation process requires a clear vision and knowledge of the territories (and their peculiarities) by the policymakers and must be accompanied by intensive and effective policy coordination. It is worth being very clear on this point. It would be a mistake to think that one big, large and top-down administrative reform is able to solve or deal with complex problems like these. That was the old 19th century thinking that ended up proving inadequate.

What is needed is legislation able to be adapted and shaped in different contexts, the gradual and progressive modernisation of the administration system and a policy-decision-revision mechanism which, step by step, can check and balance whether the decisions that have been taken are still a good choice. We can talk of a paradigm shift here in stating the legal system should be established by a single act but should be built day by day by the strong dialectic interactions among institutions, economic and social players and citizens (Castells 1996).

What is described above are the underlying factors supporting the passage from the New Public

Management to the Multilevel Public Governance framework. The former, with its abstract address solely to quasi-market, non-integrated and microeconomic solutions really only lived for less than a decade (Osborne Gaebler 1995); today, it has almost totally left the scene to the latter, which is a more complex, innovative, integrated and technological way to disrupt the old administrative bodies and rebuild the entire public sector based on large social and institutional agreements on strategic perspectives (Dunleavy 2005).

With multilevel public governance, the principle of subsidiarity works in a vertical sense: the responsibility for dealing with a particular issue is up to that level of government able to operate most efficiently and effectively; a flexible (as opposed to *ex ante*) attribution of the competences in the specific local context. At the same time, the new framework works in a horizontal sense, leading to a new definition and distribution of competences between institutions and social society: the systematic involvement of civil society and economic and social players in exercising public power in the investigation, decision-making and management phases, along with the growing presence of "social entrepreneurs" (Goldsmith 2010).

In this setting, intermediate territorial authorities are more relevant than central government or small cities. As seen in the above section, the latter are perceived as (and actually really are) too far from the territories, too slow in delivering solutions due to the high level of bureaucracy unable to involve citizens in the decision-making process. The former cannot ensure economies of scale in delivering public services and cannot constitute themselves as a specific homogeneous area in an economic, social or cultural sense: that is why they need to cooperate, share administrative functions or merge with other local authorities (Calafati 2009; Trigilia 2007).

Intermediate government forms create the space existing between these two extremities. Even if each country may have chosen a different administrative structure, they have to deal with the same technical/



economic organisational issues (economies of scale of public services, for instance), they are committed to making the public sector efficient and effective, and to stimulating and promoting the active and democratic participation of European citizens, cooperation and mutual understanding.

Regions are no longer the sort of regulatory intrastate they used to be but are becoming a new scale in the development of public policies affecting the efficacy of territorial district; in this new setting, they are changing their borders and functions along with seeing a reduction of their number in most relevant European states. Medium and large cities are taking the reins of the national economic system and they (should) have an important task to perform in defining and constructing the metropolitan areas which are becoming crucial for their power to attract the more qualification-dependent functions of the international value chain's productive process (Vetritto 2014).

One can find different examples of how the metropolitan government concept has been translated in the institutional administrative systems of European countries: systems that are more or less City-State or Region-State (Berlin, Hamburg, Madrid, Vienna, Brussels), where the metropolitan area matches another authority with legislative powers (German Land or region); Country-level city (Monaco, Frankfurt and a large part of German cities), where most power is in the hands of the capital city (kreisfreie stadt) which is surrounded by many municipalities; a metropolitan authority (London, Stuttgart, Amsterdam, Rotterdam) with enhanced powers but no legislative power, made up of a plurality of municipalities but without a main town; an associative form (Lion, Bordeaux, Marseille, Strasbourg, Lille and a large share of French municipalities) among the municipalities concerned (communes urbaines); sector authorities (Barcelona, London before the 2000 reform and Paris after the 2010 reform, Grand Paris), they are metropolitan structures organised in different concentric circles according to the service

to be provided (transport, for example); collaboration and partnership agreement (the Paris model again), where the sectorial authorities are supported by a cooperation agreement with the other municipalities (Vitali 2014).

All of these government solutions chiefly wish to achieve one (or more) of the following objectives we have regrouped in three different blocks: improve the level and quality of the governance, increasing the ability to make strategic decisions and plan, to coordinate policies for the metropolitan area and to realise infrastructure: ensure social cohesion and equal rights, which means a guarantee of uniformity in service provision, in tariff and local taxations and in the regulation, in order to improve the quality of the community's life; simplify the administrative structure, reduce government levels, redefine the competences and give private operators clear and definite rules.

It is important to highlight the leading role played by innovation and new technology in the renovation and modernisation of the public administration; supporting ongoing digital transformation, proposing, sharing and promoting tools and approaches for organisational evolution. With their unprecedented power to find an ideal solution to every different problem in an innovative way, technologies are totally transforming the way policies are imagined and helping to make cities and territories smarter. All of these common tendencies and behaviours are establishing roots in all European countries and constitute the origin of a new Multilevel Digital Governance paradigm (Dunleavy 2005).

## 9.2 An Endless Question: Does Local Development Need Specific Policies?

As early as at the end of the 1980s, Professor Joseph Stiglitz, who would later be given the Nobel Prize in Economic Science at the start of the new century, stated in the preface of a widespread book that "it is hard to think of the

sophisticated economic and social network of present-day societies without the role of the State” (Stiglitz 1989). However, while several economists agreed about the need for state intervention in the economy, some Washington D.C.-based institutions – namely, the International Monetary Fund and the World Bank – were working on a set of ten economic policy prescriptions considered to make up the standard reform package promoted for crisis-wracked developing countries.

Based on the political willingness to strengthen market forces within the domestic economy, this agenda quickly became the blueprint for all market economies worldwide, encompassing a reduction of government intervention in the economy, the gradual retrenchment of the welfare state and a generalised openness to foreign markets in terms of both trade and capital flows. According to these principles, commonly termed the “Washington consensus” (Williamson 1990), during the ‘1990s several mature countries took the path of fiscal strictness, meaning the macroeconomic policy stance became ever more confined to the point that public budgets were limited to fixed GDP thresholds, as clearly prescribed by the Maastricht Treaty and the Stability and Growth Pact in the European framework.

Intuitively, in the current context of economic policy, the emerging need to use scarce resources in the most efficient way is remarkable, particularly in EU countries characterised by limited public funds for promoting economic development, in the sense of both economic growth and social inclusion addressed by Barca (2011a). On one side, this issue crucially regards the possible nature of State intervention (direct production of goods through state-owned enterprises, taxes and transfers to reallocate resources among citizens and territories, and so on) and, on the other side, which public actors operating in a multilevel public governance hierarchical construct (central government, regional or local administrations) are supposed to strategically plan and effectively implement public policies.

According to the relevant literature, one of the best strategies for effectively using public resources in promoting economic development combined with inclusive growth entails “place-based policies”, conceived as policy strategies and interventions based on a modern approach to local policy which, by shifting the focus from sector-based investments to territories-based measures, calibrates all public efforts according to the socio-economic peculiarities of each regional area, including knowledge hubs and industrial districts.

This approach perfectly matches the progressive, liberal, post-Keynesian view of economics, the administrative machinery of the current effective “multilevel governance framework”, a promising lesson for inclusive modern European federalism. Its importance is also shown by its inclusion in the EU 2014–2020 programming funds which considers a division of competences – and then policies – among three different regional dimensions; namely, metropolitan cities, medium-sized cities and inner areas. In this framework, the enhancement of each single territory’s socio-economic potential becomes central even for the EU cohesion policy agenda. In fact, while a development policy based on sectors would further benefit the richest territories in which important portions of a country’s productive structure are located, a place-based policy approach would guarantee more inclusive growth due to this enhancement and the reinforcement of all local areas and their given potential.

### 9.3 Why Governments Should Intervene in the Economy (and How)

Before focusing on place-based strategies, that is, a particular approach to dealing with public policies, we consider it appropriate to introduce the ‘economic intervention’ concept as well as its background and motivations. Generally speaking, an ‘economic intervention’ can be considered as any action taken in a market-based economy by the government or its regional administrations with a view to impacting

the economy beyond the basic regulation of fraud and enforcement of contracts and provision of public goods. Consistently, state intervention, or broadly intended macroeconomic policy, is aimed at several objectives and goals, including promoting growth, sustaining employment, and making income distribution more equitable. Academically, the textbook wisdom indicates that economic policies are conceived to address the so-called market failures and hence state intervention in capitalist economies takes place where government action leads the market forces at play through regulations or active policies in different markets, sectors and areas.

To be fair, in all strands of economic thought there is a clear reference to the role of the State since free competition can only happen within a set of institutions and norms, including the respect for private property and contracts, which facilitate exchanges by increasing information, lowering transition costs and reducing uncertainty. Albeit to different extent, most economists also seem to agree that the State should provide public goods, offer education, guarantee basic health services and social protection, intervene in the case of natural monopolies, and foster technical progress (Mazzuccato 2005). Indeed, this may be considered as a 'soft' intervention, as typically advocated by supporters of *laissez-faire* and free markets: these scholars basically consider market forces themselves as able to produce the best allocation of resources and then to lead the economic systems towards full employment, with a moderate role played by the State in assuring the working of the invisible hand (Smith, 1776).

Yet the empirical evidence helps disprove the neoclassical idea we can identify as Say's law, stating that supply creates its own demand: it is widely recognised that market-based economies, not only cyclically, experience underemployment crises due to a lack of aggregate demand (Keynes, 1936). Moreover, data also show, particularly in the European setting in the last two to three decades, rising inequality at both the personal (Piketty and

Saez 2014; Milanovich 2016; Tridico and Paternesi Meloni 2018) and regional levels (Iammarino et al., 2018; Roses and Wolf, 2018), which according to a fast-growing strand are also among the determinants of slow output and productivity growth. Basically, it is today recognised, even by mainstream economists, that fiscal stimuli should be seen as the better policy answer in the event of persistent unemployment, high income inequality and prolonged economic stagnation (Krugman, 2012; Summers, 2015).

For these reasons, the State might also in specific conditions participate in the economy by means of 'hard' interventions, and it generally has, if politically desired, the possibility of being the main character working to:

- assure full employment, and this can happen only with the active intervention of the State that has proper macroeconomic policies able to create jobs by stimulating aggregate demand and then output; and
- promote balanced and inclusive growth, and in doing so public intervention might entail fiscal redistribution among citizens and areas, as well as through direct or indirect support to underdeveloped areas.

Summing up, one can assert that these days developed countries feature a free market in which the State, although to different extents across socio-economic models, creates incentives for people to invest and innovate by guaranteeing private property rights and enforcing contract law (also enabling investment and growth by providing education and infrastructure). Moreover, whereas the market 'fails' to reach full employment and an equitable income distribution, the State can directly intervene to sustain aggregate demand (and then employment), as well as to rebalance the distributive outcome stemming from market forces.

In addition to economic policy, a more recent strand of research also highlights the relevance

of the institutional framework, as well as sound democratic involvement in decision-making processes (Acemoglu et al. 2014) for shaping socio-economic models and growth opportunities. In contrast to those countries which develop “inclusive economic institutions” that encourage economic development, it has been argued that “extractive economic institutions” actually dampen economic growth (Acemoglu and Robinson, 2012; World Bank, 2013). Compared to extractive institutions, inclusive ones can be defined as those that grant equal rights, enable equal opportunities and are based on the principles of universality, non-discrimination or targeted action. If the institutional context plays a key role in economic development, good institutions can thus contribute to what determines whether a country is able to rectify market failures: in other words, unemployment and disparities (both income and regional) are supposed not to be uniquely affected by the socio-economic framework that each country is willing to build, but also by their specific institutional framework.

#### 9.4 A Place-Based Approach to Local Development Policies in a Federal Context

If, as discussed, the State’s role in the economy is driven by its own motivations and goals and that what is most relevant for economic development is the set of policies and their implementation strategy, each country is actually capable of coping with specific undesirable outcomes of a market-based economy.

However, to promote inclusive growth and development the State can intervene in the operations of a market economy in different ways, which the literature (Barca 2011b) cluster in five different approaches:

1. the *perfect institutions* (or best practices) approach, stating that good institutions, such as education, health, labour markets and so forth, are the primary drivers of growth; then, the state knows best what they are and their effectiveness is not context- (or place-) dependent;
  2. the *agglomeration approach*, considering the agglomeration as promoting growth as well as recognising that development requires appropriate institutions and investment suited to whichever set of unique optimal set of agglomerations that market forces may uncover;
  3. the *redistributive approach*, claiming that agglomeration not only brings about efficiency but also social exclusion and the response is either a market-oriented approach by those who are constrained in approaches to redistribution through belief in an optimal set of agglomeration outcomes or a softer redistributive approach by those who believe, on the contrary, ‘that the world is flat’;
  4. the *communitarian approach*, arguing that locals’ awareness of their own knowledge and preferences is the primary driver of development and that development is the result of a local deliberative process; and
  5. the *place-based approach*, endorsing long-term strategies aimed at tackling persistent underutilisation of potential and reducing persistent social exclusion in specific places via external interventions and multilevel governance; according to Barca (2009), a place-based approach is able to promote the supply of integrated goods and services tailored to contexts, as well as to trigger institutional changes.
- In the words of Barca (2009), the place-based approach is “superior to alternative strategies that do not make explicit and accountable their territorial focus, or even hide it behind a screen of self-proclaimed space-blindness, fail to integrate services, and either assume that the State knows best or rely on the choices and guidance of a few private actors”. This is because policies endorsing the place-based

approach “rely on local knowledge and are verifiable and submitted to scrutiny, while linkages among places are taken into account”.

Confirming the analytical supremacy of this approach, economic development policy has recently shifted its emphasis on local and regional development from linkage and externally-based relations to an increasingly more *bottom-up*, place-based approach. This shift was a counter-thesis to the then prevalent *top-down* models which seemed to be spatially-blind and isolated regional development to regions that are already thriving. Not surprisingly, this happened as several institutional contributions advocated place-based approaches to sub-national economic policy (Barca, 2009; Barca et al., 2012; OECD, 2009; 2012).

Basically, a place-based approach is somewhat different from a space-neutral (or spatially-blind) approach since the first aims to consider “a combination of geography, history, culture and institutions create unpredictability, heterogeneity and uncertainty in the urban system and market outcomes” (Hildreth and Bailey, 2014). However, the distinction between the place-based and space-neutral approach is not crucially focused on the terminology since both approaches are concerned with places and people: what characterises the place-based approach is that it puts major emphasis on arguing that “the wellbeing of each person (...) also depends on the context in which he/she lives” (Barca, 2011b).

The starting point for a place-based approach analysis is that economic development in ‘lagging’ areas is not to be mechanically expected as the result of automatic convergence between backward and advanced regions and that, therefore, the most appropriate development policy is not to maximise competition among all agents in all sectors and places (Seravalli, 2015). The conventional spatial equilibrium view of regional economies – at least in its strong form – precludes the need for place-based

policies; in fact, with the assumptions of perfectly competitive labour and land markets and perfectly mobile factors of production, place-based policies implemented to create jobs are distortionary in that model (Kline and Moretti, 2013).

This latter strategy, compatible with spatially-blind policies, would however be more effective where resources are perfectly mobile across regions, stimulating productivity and efficiency but at the expense of the desertification of lagging areas. Yet, if we admit that some resources are not perfectly relocatable (productive capacity already installed, particular know-how related to the territory, as well as specific natural resources of each areas), place-based policies could trigger or support a development process which would otherwise remain trapped.

Moreover, one of the key pillars of the place-based approach is what is called “territorial competitiveness” (Camagni, 2002), which together with local institutions and public policies can address the economic development processes and their redistributive effects. Particularly when thinking of structural development policies, it is essential to consider the institutions and social conventions of the places, the organisation and distinctive features of the geographical space and their allocation of productive resources (including the social endowment). More specifically, as far as organisation of the geographical space is concerned, Barca et al. (2012) argued that large conurbations and metropolitan areas, which are genetically characterised by the presence of a variety of medium and small municipalities, all have the potential to give a significant contribution to the overall economic growth process; but, only where they are able to enhance those industries and sectors in which they hold some sort of “competitive advantage”.

In this regard, it is not strictly necessary to focus on large urban areas but to properly exploit the potential of clusters and districts of different sizes and densities. Here, public intervention can significantly

contribute by supporting and developing industrial areas and clusters of firms. This intervention can take many forms, from direct incentives for companies through to the formation of specific skills and professional figures functional in certain development trajectories. However, policies aimed at fostering learning-by-doing processes and stimulating networks and connections between know-how and skills on territories may be considered to have great spillover effects on systems of production. In other words, more than interventions aimed at supporting individual production units, a need is emerging for measures immediately addressed to the system that bring these units together, establish links of interest, opportunities for cooperation, the sharing of knowledge, experiences and operational practices: focusing on the organisation and development of local business systems, place-based policies can reshape the boundaries, allowing a place to return to playing a major role in the strategy of revitalising the economy.

When local development is concerned, academic research (Sassen 1997; Calafati, 2009) focuses on the role of cities in affecting inclusive economic growth and competitiveness. Cities are places where the greatest challenges posed by globalisation can be faced better through innovative and sustainable policies (from environmental, economic and social perspectives) with a view to improving the quality of human life. In so doing, place-based measures represent a necessary rethink of the old policy paradigms based on place-neutral approaches since they recognise the relevance of the local context, namely the set of social, cultural and institutional features of each city. Adopting an approach based on urban policy means involving local communities, using their knowledge, collaborating with all actors in the territory and promoting inter-institutional cooperation.

Local development also involves the productive system of each area to a non-negligible degree. In this regard, neoclassical economics postulates that

growth, and then development, is basically driven by technical progress fostering productivity and factor endowments. Moving away from this paradigm, it may be argued that development processes can be positively affected by linkages and networks among places and products, following the seminal lesson of Albert Hirschman (1958) and the recent widespread literature endorsing a network view of development (Hausmann and Hidalgo, 2011; Bartelme and Gorodnichenko, 2015).

If as suggested by the consolidated literature we admit the presence of positive externalities (Meane, 1952) and increasing returns to scale stemming from economies of scale and scope (Kaldor, 1966; Krugman, 1979), it is reasonable to state that productive districts, networks of firms and local production systems are the most likely dimensions where spillover effects may take place. Within a place-based approach to development policies which is genetically focused on the complex nature of the interactions among subjects and places, the stylised image of a “triple helix” was proposed in the ‘1990s by Etzkowitz (1993) and Etzkowitz and Ranga (2015). This approach interprets the shift from a dominating industry-government dyad in the old ‘industrial society’ to the growing triadic relationship between university-industry-government in what can today be defined as the ‘knowledge society’.

The triple helix argument is that the potential for innovation and economic development currently lies in a more prominent role for the university and in the hybridisation of elements from university, industry and government to generate new institutional and social formats for the production, transfer and application of knowledge. This vision encompasses not only the creative destruction that appears as part of natural innovation dynamics (Schumpeter, 1942), but also the creative renewal that arises within each of the three institutional spheres and their intersections. Accordingly, the triple helix is considered a driver of local development, providing the key to efficiently designing public policies.

Attention should be paid, however, to difficulty stemming from the presence of intermediaries that, exploiting information asymmetries, tend to drain the public resources introduced into the triple helix, thereby preventing circulation and making place-based public intervention inefficient. To avoid these critical aspects, a recent institutional document suggested abandoning the traditional schemes of state intervention which might bind public incentives to the performance and output itself (strictly making the provision of public resources conditional on achieving success public resources to achieving success), while a shift of focus from actions and financial means to their outcome in terms of people's well-being and progress through appropriate indicators can contribute to policy effectiveness and shape the agenda for budget decisions (see Bonaccorsi, 2009). In other words, public demand that would also stimulate supply may be a driver of development and innovation in territories when also targeted to enhance the public interest and social well-being.

Further, the specificity of the place-based approach relates more to hypotheses concerning knowledge and local elites. First, the place-based approach argues that no actor knows in advance what should be done. It posits that sensible and reasonable decisions can emerge as the innovative result of a process of *interaction* and even *conflict* between endogenous and exogenous forces, i.e. between the knowledge embedded in each place and the external knowledge. In conjunction with this assumption, it also stresses the role played in producing under-development by the failure by local elites, even when democratically elected, and their innate tendency to seek rents from public interventions. For these two reasons, while sharing with the communitarian approach an emphasis on the knowledge, preferences and values of local agents, the place-based approach assigns a much greater role to exogenous institutions – their knowledge, preferences and values and – therefore advocates exactly the framework for managing multilevel governance.

The success of place-based strategies largely depends on maintenance of an adequate balance between *cooperation* and *competition* and between *exogenous push* and *endogenous choice* in the process of designing and implementing measures. According to Barca (2009), five principles are important in this process:

- in every candidate area (whose boundaries should not be pre-defined *ex ante* but drawn according to the responsiveness of local actors), a preliminary *ex ante* search would seek to identify comparative advantages in terms of innovation potential;
- as the information on the knowledge base is largely held by local actors (businesses, researchers, specialised workers), they need to be given a stake in the process with a scale of intervention that encourages them to reveal information and to invest;
- on the basis of an *ex ante* search, a bundle of interventions should be designed, combining the supply and demand sides, and establishing an appropriate system of incentives in order to reduce the risks of adverse selection and moral hazard;
- a context of competition must be maintained, with promotion of the mobility of researchers; and
- finally, since by definition much uncertainty hampers any *ex ante* decision, and learning is the essence of the policy, an experimental and cautious attitude should be adopted, and room should be kept for replacing projects when the first steps do not look promising.

However, these principles partially conflict with each other – for instance, mobility exacerbates the “innovate here, benefit elsewhere syndrome” – and only a dynamic process governed by an external actor can reconcile them.

## 9.5 A Multilevel Governance for Place-Based Development Strategies

Before turning to the main points, let us consider what precisely is multilevel governance in the EU policy framework. In this regard, the European Commission (2015) indicates multilevel governance as a way to describe “collective decision-making processes where authority and influence are shared among players at multiple levels of governance. This may involve public and non-public societal or private sector players. In other words, multi-level governance describes decision-making processes that engage various independent but interdependent stakeholders. Multi-level governance does not define a model of exclusive decision-making powers nor propose stable hierarchies of authority”.

Consistent with the natural features of place-based strategies, a challenging issue of place-based policy is the ‘missing space’ between central government and locally-based governance institutions. Basically, in conceiving the forms of public intervention in support of local economies, it is useful to keep in mind certain controversial aspects of the implementation of any territorial development policy. In our case, when applying the aforementioned combination of endogenous and exogenous forces in an interactive but even conflict scenario (Barca et al., 2012), place-based policies require appropriate multilevel governance to deal with the development enhancing the conflict between these forces. According to the place-based approach, basic institutions and essential services need to be tailored to the place, but such tailoring requires multilevel governance involving both exogenous institutions (State, international organisation or community institutions) and endogenous agents (those belonging to the place).

As argued in Barca (2009), the shift from the separation of responsibilities in terms of types of services to one in terms of tasks in their provision can be appreciated by reference to the concept of

subsidiarity; namely, the general principle stating that central authorities should perform only those activities which cannot be performed effectively at a more local level. As we shall see, the subsidiarity principle contributing to the policymaking architecture called multilevel governance (a system by which the responsibility for policy design and implementation is distributed across different levels of government and special-purpose local institutions) may be considered the ‘legal’ equivalent of the ‘economic’ place-based principles for policymaking. This is because, in the context of place-based policies, subsidiarity must be interpreted with reference to responsibility not for whole sectors, but for whole tasks. The subsidiarity criterion, therefore, needs to govern the allocation of tasks. In this construct, it is up to the top levels of government to set general goals and performance standards and to establish and enforce the rules of the game. It is up to the lower levels to have the freedom to advance the ends as they see fit. Special-purpose local institutions, comprising both public and private actors with responsibility for delivering specific services, play a decisive role in eliciting the knowledge and preferences of citizens of specific places. In their absence, multilevel governance can degenerate into a system of negotiation between bureaucracies representing different elites, with an authority being defined by purely jurisdictional boundaries.

As we will explore below, EU cohesion policy is where multilevel governance has flourished, responding to both a strong cultural tradition supporting the active role of local governments and communities and the awareness of the Commission’s limits in directly managing interventions. In order to assess the extent to which cohesion policy has lived up to the model it helped establish, Barca (2009) lists four key aspects which together determine how successful multilevel governance is:

- the allocation of tasks among levels of government and the role of jurisdictional regions;
- contracts between levels of government;



- decision processes at the local level; and
- public debate that is focused on objectives, learning and counterfactual impact evaluation.

In summary, a place-based development policy can be defined as a long-term development strategy whose objective is to reduce persistent *inefficiency* and *inequality* in specific areas. Moreover, this strategy is supposed to be pursued through the production of bundles of integrated, place-tailored public goods and services, designed and implemented by eliciting and aggregating local preferences and knowledge through participatory political institutions, and by establishing linkages with other places. Finally, place-based strategies should be promoted from outside the place by a system of multilevel governance in which grants subject to conditions on both objectives and institutions are transferred from higher to lower levels of government.

## 9.6 Place-Based Policies and Multilevel Governance in the EU Programming Period 2014–2020

As argued, place-based policies refer to government efforts to enhance the economic performance of an area within its jurisdiction. Consistently, perhaps the best known are place-based policies that target underperforming areas – such as deteriorating downtown business districts or regions that lag in terms of employment and productivity dynamics. An example of place-based policies may be found within the European Union referring to relatively disadvantaged areas which are supposed to be eligible for regional development support. Indeed, how did the European Commission incorporate the place-based approach while planning the current Programming Period 2014–2020 and taking the Territorial Dimension into account?

In this regard, in October 2011 the European Commission proposed a reform of European cohesion policy for 2014–2020 which takes a

major step towards a place-based model for local development. Territorial cohesion is a milestone goal for the European Union on both the community and national levels. In fact, in addition to strengthening economic and social cohesion by reducing the disparities among regions, the Treaty of Lisbon introduced a third dimension of territorial cohesion which responds to the fact that the EU hosts outstanding territorial diversity. As an objective, territorial cohesion is about ensuring that people are able to make the most of the inherent features of the areas in which they live: for instance, no European citizen should be disadvantaged in terms of access to public services, housing or job opportunities simply by living in one region rather than another. Finally, territorial cohesion aims for more balanced and sustainable development.

The EU's territorial policies of cohesion, which include all the interventions aimed at correcting territorial disparities and achieving economic convergence, have experienced many changes over the years, going from a mere 'compensatory' approach to an integrated and multi-sector strategy. In recent times, the European Commission has opted for an integrated approach, which implies better coordination between sectoral policies at each governance level (from local administrations to communitarian authorities), entails closer cooperation and improved connections. As anticipated, a quite pervasive reform came at the start of the EU 2014–2020 programming period when, endorsing a general shift in the paradigm of economic development, the sectorial interventions promoted up to that moment were overtaken by policies aimed at the territory and local dimension: put simply, from a sector- to a place-based strategy. The place-based argument essentially claims that development strategies should be centred on mechanisms which build on local capabilities and promote innovative ideas through the interaction of local and general knowledge and of endogenous and exogenous actors in the design and delivery of public policies, creating a multi-sectoral policy framework involving the provision of various bundles of public

goods to different localities (Barca et al., 2012). Thus, assessing development policy on the basis of the convergence criteria alone, as happened with the EU's cohesion policy before its recent change in paradigm, may appear questionable since economic convergence does not capture the socio-economic goals of the policy, which is to emphasise institutional and learning behaviour (Rodríguez-Pose and Fratesi, 2004). For example, the programming period 2000–2006 involved a spatial approach (ESDP – European Spatial Development Perspective); while the 2007–2013 was more focused on territorial aspects (the Leipzig agreement on urban development and cohesion policy); finally, the programming period 2014–2020 termed «Towards an Inclusive, Smart and Sustainable Europe of Diverse Regions» endorsed a place-based approach.

As testimony that place-based policies are linked to multilevel governance, a recent EU institutional study tried to match these two concepts by designing the broader concept of 'territorial governance'. As the study report stated, "territorial governance is a relatively new and complex concept. It brings together the place-based approach and multi-level governance". Accordingly, "the increasing focus of fund allocation via national programmes is challenging for regionalised territorial governance processes and place-based approaches to regional development". Basically, this reinforces the idea that there is no longer a 'one-size-fits-all' approach for working with territorial governance and strengthening territorial governance in EU cohesion policy.

Since territorial governance is not supposed *a priori* to be linked to any specific institutional setting, it encourages players to stretch beyond the existing institutional frameworks. Given its flexible approach, territorial governance can work in all institutional systems of EU member states. However, the way territorial governance is performed and exercised depends on the institutional context and existing governance legacies and it usually takes time to change governance cultures. Nevertheless,

change can be brought about and, in many cases, depends on individuals. In practice, it is often one individual who steps up, identifies the need to do things in a more innovative manner and facilitates the process of collaboration and coordination. The individual 'kick-starting' of territorial governance processes is typically carried out by either a political representative or a high civil servant. It may also be an individual from civil society or the private sector with the necessary network of contacts.

Territorial governance has many different aspects and is a concept that is presently still being defined. To facilitate understanding of it, three major territorial governance issues can be listed: the territorial (place-based) dimension in policymaking; an attempt to bring stakeholders together from different sectors in appropriate multilevel governance processes; and a strategic and long-term orientation to achieve overarching societal objectives.

## 9.7 Winds of the Storm in Europe

The overall political and societal discourse in Europe is not favourable to the above points as the main pillars of territorial governance. Many recent developments point in the opposite direction. Further, the greater relevance of a policy approach more focused on territories than place neutral-based strategies follows from the fact that, compared to the previous one, the 2014–2020 programming period offers additional potential to strengthen the place-based approach: this largely originates from the stronger focus on the partnership principle, the earmarking of 5% of ERDF resources under the "Investment for growth and jobs goal" for integrating actions for sustainable urban development and to some degree also from the new territorial instruments Community-Led Local Development (CLLD) and Integrated Territorial Investment (ITI).

This implies two parallel scenarios. On one hand, the increasing focus of fund allocation via national programmes is challenging for regionalised territorial

governance processes and place-based approaches to regional development: the regulatory changes offer potential to strengthen the multilevel governance dimension of the EU's cohesion policy, and this mainly comes through the better coordination of different funds, namely the European Regional Development Fund (ERDF), European Social Fund (ESF), European Agricultural Fund for Rural Development (EAFRD) and European Maritime and Fisheries Fund (EMFF).

On the other hand, the new thematic concentration challenges a governance approach that seeks to bring together a wide range of players important for developing a territory: despite a stronger focus on linking EU structural and investment funds to policy agendas, the regulatory framework does not assist the strategic dimension of decision-making. Specifically, the indicator-driven results orientation is expected to focus decisions on short-term investments to ensure that targets are met. Long-term or higher-risk-level investments will probably be avoided so as not to endanger delivery on key indicators.

In the early months of the discussion on the post-2020 European budget, the European Commission's position in favour of a place-based economic intervention is fading in front of the reductive and nationalistic intergovernmental approach of the member states. The current 2014–2020 programming period is suffering from the lowest rate of financial and thematic efficacy due to the clash of the innovative address of the central institutions that have seen their power decreasing and the demand by nation states for the more independent use of money. The growing complexity and self-referential regress of the common regulation on the use of funds is wholly discrediting any strong central role of the common institution. The regression from the Unique Act enthusiasm for Europe to the current nationalistic and Eurosceptic *nouvelle vague* is leading back the next multi-year budget logic to the selfishness of each member state.

Confirmation of this latter attitude at the European parliamentary elections to be held in spring 2019

could give the fatal blow to structural funds and regional policies in Europe. As discussed, an effective place-based development policy can be pursued without different levels of government negotiation and conflicts on each's choices, preferences and knowledge. The necessity to relaunch a serious local and regional development strategy meets, for this reason, the need for a more united and federalist Europe, able to adopt a serious multilevel governance framework.

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# 10.



## Polyarchic Constitutional Arrangements and the Crisis of Europe's Construction

By Aurelia Ciacci

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### 10.1 The European Union: From a New Polyarchic Paradigm to an Intergovernmental Crisis

Chapter 3 provided evidence of the need for a strong and dialectic relationship among different levels of government, each with their own preferences and knowledge, to give underdeveloped areas a chance to 'catch up' with richer economic areas in the common economic environment. After the Maastricht Treaty, that should have led to firm decisions to complete the political union of Europe, in which both a constitutional federalist cooperative and an administrative multilevel governance framework are realised. Yet things have gone down a different road.

In its early years, the European integration process reflected the consolidation of a new polyarchic paradigm which, however, was not preceded by a phase of rigid federalism. Indeed, in juridical terms it is undisputed that the EU's institutional identity differs from the various possible declinations of the federal State, if only for the lack of a central state placed above the member states. Instead, it represents a unique institutional setting comprising elements typical of federations, confederations and intergovernmental cooperation. The European Communities then (the European Union today) thus never became the federalist state their founding fathers originally envisaged.

The pioneering text of the Manifesto of Ventotene, as shown in Chapter 1, envisioned a federation at the outset of the process that would have led to a unified Europe, and the crucial idea put forward by Spinelli was that, without a unitary power, in the long run unification becomes an arduous conquest (Glencross Trechsel 2010). Nevertheless, although the better part of the original community seemed to share similar ideas as to the final aim of the political project, there were different positions on its immediate realisation. For pragmatic reasons, the functionalist approach (which preferred a process of integration area by area aimed at the eventual formation of a European federation) prevailed over Spinelli's more radical idea to create a political community.

As time went by, as the creation of a political union seemed ever more difficult, Spinelli believed the greatest result achieved by the growing European integration was not what Jean Monnet defined as "concrete achievements" and their blinkered hope that eventually the European administration would play a more prominent role with respect to national governments. Rather, he thought the real conquest of such a process was the conversion of this progress into political consciousness which, based on what has already been achieved, prompts to reason in European terms, despite the middling results and the vast number of opportunities missed in past decades (Glencross Trechsel 2010).

His ideas resonate to this day since the process of integration actually undertaken shows that what proved to be unsuccessful was not the constitutionalism fostered by Spinelli, but the realisation of the functionalist idea of incremental change promoted by Jean Monnet. Indeed, it can arguably be inferred on the basis of concrete recent experience that implementing the intergovernmental method ultimately fostered a tendency to prioritise issues that show some degree of national interest, while confining and restricting the importance of truly European interests (Glencross Trechsel 2010; Gilbert 2008).

As previously noted, there were many chances to transform the European project into an authentic supranational entity. Despite the widespread sentiment of post-war intellectuals to make the fight against the Nation State rather than class cleavages, the pivotal idea of future debates – with the political programme to spread federalist ideas about European unity – from the outset the European integration process had to cope with enduring and tough resistance against the creation of a European federal state.

Indeed, the very cornerstone of the Europe we know today, the European Coal and Steel Community of 1951, was founded on Schuman and Monnet's idea that European integration should not start with a political solution to European divisions but with a gradual process toward economic integration that would eventually export the supranational idea to wider fields (Sidjanski 2002). Nevertheless, the functionalist method soon experienced some setbacks and the subsequent attempt to build a supranational European Defence Community – and along with that a European Political Community – proved to be unsuccessful due to the opposition against supranational integrations mounted by Gaullists (Gilbert 2008). The failure of the EDC restored the philosophy of economic integration and undermined the idea of political integration for

decades: up until 1957, the ECSC was the sole supranational Community in Europe.

The European Economic Community and the European Atomic Energy Community were then created in 1957 alongside the pre-existing European Coal and Steel Community, instead of being incorporated in a unitary and comprehensive organisation with a single treaty.

The signing of different treaties of course raised some concerns as to the duplication of certain institutions and these were all addressed by the Merger Treaty of 1965. Nonetheless, while establishing a common set of institutions for the Communities, the treaty did not bring them together and, for the next 15 years, their coexistence was regarded as neither precarious nor problematic regarding questions like democratic legitimacy or institutional performance (Glencross Trechsel 2010).

Further, compared to the ECSC Treaty, the EEC Treaty did not contain any references to the concept of supranationalism and returned to a more international decision-making format: it charged the Council, not the Commission, with the task of meeting the objectives of the Treaty (Shütze 2015). In the 1960s, the European integration process experienced a major crisis. It was caused by De Gaulle's state-centric conception of a Community being built in such a way as to leave the member states with full decisional power, excluding the chance of any type of supranational development.

In the mid-1960s, Commission President Hallstein introduced some reforms that significantly increased the powers of the Commission and of the Parliament, planned the attribution to the Community of its own resources (in particular to finance the CAP) and sought to give the Commission greater power in elaborating the budget. The Commission's proposals, with a clear supranational connotation, were thought to be too autocratic and matters were



made even worse by the extension, provided by the Treaty of Rome for the third transitional phase, of the instances in which a qualified majority vote, rather than the unanimity rule, would suffice for the Council of Ministers to take decisions on certain subjects (therefore ruling out the possibilities for states to oppose their veto) (Gilbert 2008).

The unanimity rule seeks a consensus of all member states – therefore with the veto power they possess a tool to safeguard their own and the most pressing interests – while the majority vote is the decision-making procedure adopted by the institutions of a democratic state. The issue divided the member states so either one of these two positions on the future of the integration process were taken: first, one aiming at intergovernmental cooperation in the form of a confederation (taken by France) and, second, the federalist position, inspired by Spinelli, which planned to create a federal European community.

In stark contrast with this, De Gaulle was ready to eradicate the Commission's political ambitions and halt any sort of development of the European Community in a federal sense (Gilbert 2008; Shütze 2015). Therefore, after the Commission made a new proposal, the French minister decided to boycott the Council, with such a step being remembered as the 'empty chair crisis': France decided not to take its seat on the Council unless a compromise that balanced the move to majority voting with its national interests was reached. The compromise that followed later between supranational and national interests is known as the Luxembourg Compromise and provides an intergovernmental obstacle to the EEC's supranational machinery by requiring the unanimous approval of any decision in which important national interests are at stake.

After more than a decade of stagnation, it was only in the 1980s that some unease started to be felt due to the fragmentation between the European Communities system and the intergovernmental

developments made in the meantime (such as the distinct European Political Cooperation in foreign affairs, EPC) (Shütze 2015). The Single European Act of 1986 signals the revival of the commitment to the European integration process after a period of economic, monetary and ideological crisis (Bilancia 2002). It emerged to increase the connection between the two institutional threads, although the goal has not always been fully achieved (Shütze 2015). Indeed, while expanding the Community's competences, it did not bring within the scope of the European Communities the intergovernmental developments of the preceding decade: the European Monetary System remained outside the supranational system, the EPC foreign affairs competence was not integrated and neither were justice and home affairs, and the European Council was not promoted as a Community institution.

## 10.2 The Maastricht Treaty as a Turning Point

A more significant step came with the Maastricht Treaty, which elevated to the supranational level the economic and monetary union (although with the provision of differential integration) and placed the European Council, the two intergovernmental policies and the supranational European Communities under the same legal roof of the European Union, thus narrowing the gap present in the European Community system.

Nevertheless, Maastricht did not solve all the problems raised by some concerns due to the creation of the European Union, which was a separate international organisation different from the European Communities, and by the various opt-outs provided for individual countries and groups of countries (Gilbert 2008). The Treaty represented a constitutional compromise between the willingness to realise a greater supranational Europe and the need to safeguard the interests and choices of the member states.

All of these reforms were propelled by the need of the latter to address their more pragmatic concerns and therefore established a set of institutions that could fit in with the fragmented policy developments put forward up to that moment (Glencross Trechsel 2010). Consequently, the result consisted of a legal order that epitomised the functionalist method, allowing to sacrifice the need for systematic consistency for the sake of finding a compromise through intergovernmental agreements.

As a consequence, the Maastricht Treaty arguably represented a step backwards rather than a solution for a more integrated Europe (Glencross Trechsel 2010). It introduced two new systems of interstate cooperation in common foreign and security policy (CFSP) and justice and home affairs (JHA) that lacked some of the supranationalism that instead characterised the pre-existing European Community. It was this exact feature that in fact led to the rejection by several national governments of the draft treaty text presented by the Dutch presidency in the Intergovernmental Conference leading up to Maastricht: the draft proposed including the fields of common foreign and security policy and justice and home affairs within the European Community framework, but it was discarded due to the fear held by most member states that the Community legal framework and its supranational features would restrain the intergovernmental method in these two areas of cooperation (Glencross Trechsel 2010).

Thus, not only was the chance missed to pursue a federal Europe but, once again, intergovernmental forms of cooperation prevailed. The European Union created by Maastricht was not a federal State, but a confederation with a complex government structure. Moreover, the very tight limits that were bid on the fiscal State policies, in the context of progressive adoption of the common currency, started to create serious conflicts among member states that led, little by little, to emptying the functionalism itself, while being more and more replaced by an ever-growing intergovernmental method and dynamic.

The institutional setting remained essentially the same with Treaty of Amsterdam of 1996, where the hopes for greater integration were left unsatisfied by the persistence of two separate treaties and the unpopular three-pillar structure. The dichotomy between economic and technical integration, with clear federal connotations, on one hand, and the intergovernmental method adopted in specific policy areas, on the other, remained deep despite the efforts and numerous projects to transform the Union into a supranational entity (Sidjanski 2002).

The bits and pieces left by the Maastricht Treaty were finally collected into a single comprehensive structure with the merger operation facilitated by adoption of the Constitutional Treaty of 2004, also thanks to the initiative of the chairman of the working group on Legal Personality of the Convention on the Future of the Union, Giuliano Amato, who advanced and fostered the idea that the next step in European integration had to be assimilation within an overall structure of the different organisations and their treaties: the Constitutional Treaty would create “one Union, with one legal personality, on the basis of one treaty” (Glencross Trechsel 2010; Shütze 2015).

Although such a reform was welcomed by the IGC adopting the Constitutional Treaty and was not a controversial issue during the French and Dutch subsequent referendums, the ratification crisis that followed halted the unification process (Gilbert 2008). The idea of repealing the existing Treaties to make place for a new, comprehensive one was abandoned and the European Council of 2007 decided to split and pour the innovative content of the Constitutional Treaty into the separate treaties set up by the Lisbon Treaty (the EU Treaty and the Treaty of the Functioning of the EU, which is the new name for the former EC treaty) for the creation of one single organisation: the European Union.

Therefore, the result of absorbing the European Community in the European Union was finally achieved, but without any significant discontinuity

in a federal sense, and with the Lisbon Treaty the inclusion of the innovative and farsighted provisions proposed by the Spinelli Draft Treaty of 1984 was brought forward, albeit without realising Spinelli's vision of a more closely integrated European Union and of an integration process fulfilling his federal aim (Glencross Trechsel 2010).

### 10.3 Towards an EU Multilevel Governance Framework?

Despite having come a long way, the European Union is currently not a federation. Nevertheless, the persistence of a liberal mentality in the judicial and constitutional culture in the most advanced western countries has led to this different framework that may still be defined as liberal. Indeed, all over the world traditional federalist states have rearranged their government laws and practices to a new paradigm; while the traditional centralistic states, like France, have progressively decentralised powers and functions, moving toward the same goals of efficiency, optimisation of functions, search for better spending scale levels, strong regional frameworks, like Germany, have strengthened the role of a centre with the power to provide a more adequate solution to the existing problems of excessive fragmentation (Vetritto 2015).

In other words, there has been a sort of confluence of traditionally separated models in a polyarchic system, that has maintained several traditional specific characteristics but, on the general level, has the same functioning model. These polyarchal arrangements retain the original liberal approach, but decline it in a more effective way to ensure the needs of modern individuals and societies. On the contrary, the European Union has been loosening, with the passing of decades, the original effort of its Founding Fathers for a more responsible and fair community of states, in some sort of continental *res publica*, and moved ever closer towards an intergovernmental supranational organisation (Vetritto 2018).

Even in the EU the method adopted is that of multilevel public governance, which embodies the idea of shared authority and policymaking influence across multiple levels of government in the drafting and implementation of public policies (subnational, national and supranational) (Hooghe Marks 2001). It is opposed to the model of previous 'government', which is the classical model of the primacy of the central public authority legitimated by democratic representativeness (Dominichelli 2007). It is evidently moving away from the state-centric interpretation of the integration process that would have asked for a clearer federalist process, aiming at an original model: "EU is controlled by and strengthening the sovereignty of states as the supranational EU institutions serve the interest of states, depending on the consequences of intergovernmental negotiations and the aspirations of them" (Hooghe Marks 2001).

The idea of multilevel governance fits the description of a public space that does not have a state dimension and is characterised by a plurality of levels of government and by a fluid and not much a hierarchised process of decision-making. It therefore represents a new model for the process of integration, situating itself in between the federal and intergovernmental ones, with the idea to deepen the integration not by strengthening the system's centre, but by moving the competences upwards and downwards toward the Commission and the subnational entities (Dominichelli 2007). But, as described in Chapter 3, without a strong political centre able to match the decisions of states on one side and local and regional authorities on the other, the fundamental condition for a real and effective multilevel synthesis will be missing.

The model of governance adopted thus affects the way in which the Union exercises its powers by involving not only its institutions and member states, or the central administrations, but also regions, cities, local autonomies and civil society. On the theoretical level, such a model addresses the need to ensure a

high degree of participation and openness in the decision-making process, with closer interaction with local and regional entities – now involved not exclusively via the mediation of member states, but also in a direct way. This conception is founded on the shared principles of democracy and legality that involve as corollaries the principles of openness, participation, responsibility, efficacy and coherence (CoR 2009; Dominichelli 2007; Lang Sanna 2005).

The participation of local autonomies thus has to become part of the decision-making process so that these entities can help decide on the necessity of legislative initiatives, the level of implementation (European, national) and the specific measures to adopt. Giving an active role to subnational entities also grants the formal recognition of their competences for the implementation of policies in several areas of EU law: agriculture, the environment, energy, transport (Ippolito 2007).

Consequently, territorial autonomies play on paper several significant key roles in the community legal order (Savino 2007). For instance, they represent a source of democratic legitimation of supranational decisions. Considering that the greater the power acquired by European institutions, the greater the distance between the citizen and the institution exercising public power, then the involvement of the regions and local autonomies in the supranational decision-making process makes up the perceived distance, being the political units closest to the citizens. Indeed, it is fundamental for the European Union to strengthen its relationship with citizens so as to favour the better communication of its aims and policies and fully legitimate its decisional structures (Dominichelli 2007). Due to this, systematic dialogue with the level of government in direct contact with the population undoubtedly brings benefits.

Further, regions and local entities formally represent the places where the actual enforcement and implementation of European policies take place. Hence, consulting them during the formation of

a national position in the phase of policymaking negotiations allows foreseeing the solution to implementation problems that would otherwise be confronted in the subsequent step (of the transposition of European norms into the domestic legal order) by local administrations with different degrees of capability. The issue then deals with both the efficacy and effectiveness of the European decision-making process.

Finally, several member states are characterised by either a federalist or a regional legal order, where the legislative and executive competences are distributed between different levels of government. Therefore, any major transfer of territorial power to the European level restricts regional autonomy and modifies the distribution of power in the domestic setting, especially if participation in decision-making is not guaranteed. Thus, a “two-dimensional structure of the European Union” would determine a sort of state “neo-centralism” phenomenon (Savino 2007).

Regions and local autonomies must play a prominent role in a multilevel governance model and, because of this, the Committee of Regions and the European Parliament have lamented the pluralistic deficit in the EU legal order. Indeed, while flaunting its adherence to a pluralistic vision with the mantra ‘unity in diversity’, for a long time the European Union did not effectively assign to the subnational level any actual weight in the decision-making process. This regional ‘blindness’ was due to the internationalist state-centric approach influencing the EU institutional setting (Savino 2007).

The very conception of the European Economic Community followed an internationalist logic and the relationship between the new supranational entity and the member states reflected a dualistic approach: on one hand, the Community legal order and, on the other, the national legal order. Following this logic, participation in the European decision-making process was reserved for the state

executive power, like with any other foreign affairs matter. At the time, the exclusion of subnational entities from this process was not really a cause of concern since the only federal state among the founding members, Germany, had adopted some information mechanisms for the Länder with respect to community decisions (Savino 2007; D'Ignazio 2011; Gragnani 2008).

This indifference to the involvement of local autonomies lasted until the 1980s. At that time, in fact, a series of transformations – such as the ripening of the federal process in Belgium, the accession of new states with autonomist features (like Spain) or the expansion of Community competences – exacerbated the feeling of discontent regarding the disinterest shown in subnational authorities (Savino 2007). Indeed, the Community appeared incapable of considering any level of government that was not the State, which was also the reason for excluding regions from the processes of the creation and management of community institutions. Subnational entities were considered as a passive subject, the mere receiving end of decisions taken without their say. The process of integration that took place in the following decades managed to remedy the situation.

Regional policy has in fact had a major impact and, although at the time of its creation in 1975 – with the establishment of the European Regional Development Fund and of the Committee on Regional Development – regions were referred to as mere economic areas rather than institutional subjects, the perceptions started to change already in the 1980s (Savino 2007; Dominichelli 2007). The first engagement between subnational entities and the Community was within the field of regional policy relative to financial administration and of reforms of the distribution criteria for the structural funds, which were introduced in that period and required the collaboration of national authorities (Dominichelli 2007; Chieffi 2011). Hence, alongside the European Commission and the member states, this signified the recognition of local entities in

the planning and management of financial matters. The Council then began to provide for effective involvement in the formation and implementation of European decisions and assigned the regions and other local autonomies with various tasks – such as the ability to stipulate programme contracts with the Commission, the member state and third parties (Savino 2007; Lang Sanna 2005).

Council Regulation No 2052/88 of 24 June 1988, for instance, provided that, according to the principles of subsidiarity, “close consultations should be instituted between the Commission, the Member State concerned at the competent authorities designated by the latter at national, regional, local or other level, with each party acting as a partner, within the framework of its responsibilities and powers, in the pursuit of a common goal”. Subsidiarity, partnership and complementarity were also declared as the bases of the reform regulations of the following decades, thus helping to enforce cross-border cooperation among regions (Ippolito 2007).

These reforms had a very relevant indirect impact on national reforms. Member states have different cultural traditions and some already had an internal structure with various levels of legislative and administrative powers as an outcome of their constitutional development, in which the role of local and regional autonomies evolved based on territorial demands for autonomy. However, in other member states the regionalisation process was driven by the need to better plan and manage European cohesion policies and the Structural Funds, leading to the transformation of some national legal orders, especially unitary ones (Savino 2007; Bilancia 2002; Chieffi 2011). Indeed, in order to be able to implement the European cohesion policy, those member states that originally did not have a composite internal structure decided to establish subnational entities and adopt decentralisation policies (France, Greece, Ireland, Finland, Portugal). The same happened with member states that joined

the EU later – in order to respect the financial and statistical criteria demanded by the structural funds regime – (Hungary, Czech Republic).

This evolution shows how the ‘functional’ requirements associated with the effective implementation of communitarian policies can overcome the original European indifference to subnational entities so that territorial autonomies are now involved in the formation and execution of EU decisions (Savino 2007). The State is therefore left out, in some circumstances, of the administrative sphere and is obliged to abandon the original state-centric approach in favour of a plural internal organisation that is actually multilevel. In the process of integration, these reforms were considered very meaningful for developing the multilevel public governance approach. Further, regions and local autonomies began to feel ever more involved in the EU’s decision-making process due to some changes that reduced the EU’s regional blindness, even in an institutional point of view.

In this sense, the Maastricht Treaty’s establishment of the Committee of Regions and of the possibility to include local representatives in national delegations to the Council were crucial. A further meaningful development came with the Lisbon Treaty with recognition of regional and local autonomies as an integral part of the national identity of each member state – that the Treaty proposes to respect by reconfirming the importance of the principles of subsidiarity and proportionality (whose interpretation is thus not exclusively in reference to the relationship between the Union and nation states) (Ippolito 2007; Chieffi 2011). Moreover, the Lisbon Treaty establishes the commitment to introduce extensive consultations with local and regional autonomies before proposing a legislative act so as to check its compliance with the subsidiarity principle (Ippolito 2007).

## 10.4 From Paper to Reality: In Search of True Multilevel Reform

Nevertheless, in practice these institutional reforms did not have their expected impact and were not as successful as the functional ones since the process of adopting European policies and distributing power in the decision-making process do not seem to have substantially changed despite the formal recognitions noted above. The Committee of Regions, representing regional and local authorities’ interests at the supranational level, does provide a channel of representation at the communitarian level for subnational entities, instead, the institution holds weak advisory powers and little internal cohesion (Lang Sanna 2005). Indeed, while the Committee’s nature appears to be potentially decisive for vigilance in correct implementation of the principle of subsidiarity, the Treaty does not always put it in a position where it can fulfil its tasks.

The Council and the Commission only consult the Committee when necessary or where explicitly required by the Treaty, and very often give no concrete follow-up to the Committee’s advice. The issues on which the Treaty limits the Committee’s advisory functions are not, in practice, those that involve most of the political priorities and competences of regional and local authorities, or are on the level closest to citizens (such as agricultural policy, research and development, immigration, social security, security and justice).

Further, the opportunity to access the Council by means of including local representatives in national delegations is not really a mechanism of regional or local representation, but a mechanism whose real significance lies at the intrastate level: regional influence has a more prominent role in a national delegation’s internal preparation than within the Council since the interests looked after by the delegates are defined in cooperation with the central government in the domestic phase of preparation (Lang Sanna 2005).

Hence, if one considers the growing importance of the formal role attributed to the Committee from Maastricht to Lisbon, the Committee has, on paper, quite some political significance. Nonetheless, a more insightful analysis shows several incongruences between, on one hand, the tasks assigned to the Committee to value the instances coming from local and regional settings and, on the other, its current set-up as regards its juridical nature or its activity (Lang Sanna 2005; Ippolito 2007).

As to the former, the Committee is not counted amongst the main European institutions and remains a mere advisory body – a situation that reduces its potential and downgrades its functions. It acts on the side lines and under the pressure of institutions without being able to autonomously propose a certain political direction in regional and local policies. Regarding its activity, although it covers an increasing number of policy areas, even when it is mandatorily required it is not binding. Moreover, when institutions disregard its opinion, there is no obligation to explain the rejection (although that would increase the transparency of EU law) (Lang Sanna 2005).

Accordingly, there is clear asymmetry between the functional and institutional integration of subnational authorities (Savino 2007). This has led to a loosening of power of the European institution over regional and territorial policies that are becoming ever more a national problem. The role of the main European institution giving voice to the territorial actors (the Committee of the Regions) has gradually lost its effective power and role, exactly at a time when their formal juridical position in recent treaties gives them recognition they are unable to use anymore (Vetritto 2018). Therefore, despite recent developments, the subnational entities' participation in the decision-making process remains limited and strongly influenced by the will of governments.

On a more subtle level of analysis, one can say that multilevel public governance, as the complex

dynamic of relations and conflicts among different levels of government described in Chapter 3, stops at the borders of each member state. The example of cohesion policy is extremely relevant here: thus, although the 'Barca proposal' of 2009 required a more relevant role for the Commission DGs in the concrete management of each national or regional programme and strategy, the current 2014–2020 period sees no substantial progress in this sense (Barca 2009). There are no "preferences and knowledge" of the central directive core of EU governance DGs in contrast to the "preferences and knowledge" of the regions, cities, metropolis of each state. The only relevant role for the Commission remains controlling the financial performances of programmes and strategies; nothing that anyone could call 'multilevel governance' in action. In fact, Barca himself recently recalled for a further renewal of cohesion policy and a strong role for the Commission DGs in the future European social model (Barca 2018).

The actual results achieved regarding effective multilevel governance in the EU were not the ones desired: the community regional policy has given political and institutional visibility to regional and local autonomies, but actual control of structural funds and other resource flows is still in the hands of states. The influence of the regions in the decision-making process is restricted: the Committee of Regions is merely a consultative body and implementation of the delegation of the right to vote in the Council is limited by the internal articulations of states. For instance, in Italy the calls to reform the state in a federal sense were not adequately addressed and, despite the reform of Title V of the Constitution, the state has kept its central role as regards the relationship with the EU (Savino 2007).

The Committee's position must therefore be considered more carefully in its potential to revitalise the European integration process, lately stuck in a stage of impasse, especially given the desire for the greater democratisation of European institutions

by involving local entities. The materialisation of greater participation within the EU also requires the various levels to deepen their contacts and interconnections. These can be extended by various means, especially with communication technologies, which make the exchanges immediate and create

horizontal networks of communications – so that the concept of territorial frontiers is replaced by one of spheres of action (Sidjanski 2002). Indeed, true cross-border solidarity can only emerge in such a dynamic context.

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# The Case of Italy: No Urban or Territorial Policies in the Nation that Gave Birth to Local Government

By Alessio Conti and Giovanni Vetrutto

## 11.1. Why a Case Study

The previous chapters discussed the framework needed to provide effective regional policies that are useful for ensuring local development in the globalisation context and the changing paradigms of the new digital era.

Starting from a liberal social perspective, the evolution of the federalism concept has been discussed, together with the emergence of the new administrative framework of multilevel public governance, to offer a way to compose a coherent system. It has been shown how, after years of centralistic approaches dominating as well as the era of local empowerment, both have been unable to help less advanced areas of Europe develop strongly (in both economic growth and social inclusion), the current prevalent economic theory of local development recommends a “place based” approach focused on continuous tension between different levels of government, presenting respective preferences and knowledge in the context of institutional coordination (e.g. which is exactly what multilevel governance tends to assure).

This last chapter considers the example of a national case study of particular significance for the mentioned perspective: the case of Italy, a country unable over more than 150 years to resolve its dramatic economic dualism, with all the southern

regions being clearly underdeveloped; and not by chance, a country with a very weak liberal tradition, institutions far from a liberal design, a model situation of “extractive” leading classes (in the oft-quoted sense of Acemoglu and Robinson 2012; also see Putnam 1993).

Italy is divided into 20 regions; 5 of which are governed by a special autonomous statute (Aosta Valley, Friuli-Venezia Giulia, Trentino-Alto Adige, Sardinia, and Sicily) but with the region of Trentino-Alto Adige nearly powerless because the two autonomous provinces into which it is divided exercise all the powers given by a special statute. The Constitution (Art. 116) grants those regions home rule, allowing them varying levels of legislative, administrative and financial power, depending on their specific statute. These regions became autonomous in order to consider cultural differences, protect linguistic minorities and keep the Italian Republic together and prevent their secession after World War II. Each region (except for the Aosta Valley) is divided into provinces.

The regions (and the two autonomous provinces) hold legislative power together with the state in matters of concurrent legislation, except for fundamental principles reserved for state law. The regions have exclusive legislative power with respect to any matter not expressly reserved for the state level.

In general, currently there are 110 provinces in Italy (including 14 metropolitan areas), slightly more than 7,954 municipalities (as at March 2018), called *comuni* (half of those have fewer than 3,000 inhabitants and 6,000 have fewer than 5,000 inhabitants). The local authorities (provinces, metropolitan cities and municipalities) constitute the administrative level of the State and possess regulatory and coordination powers with respect to the organisation and fulfilment of the functions assigned to them.

This system is very expensive and not at all effective, with many institutions based on a very low population sizes (small regions, such as Valle d'Aosta with slightly below 130,000 inhabitants; hence many small municipalities; some provinces made up of only 8 or 10 municipalities). The whole framework has been strongly criticised for decades and is no longer in line with the citizens' needs in terms of their desire for civil participation; it no longer represents the sort of efficient and effective institutional backbone every modern country should have in place to support its economy, develop innovation, promote social and cultural growth, compete (and win) against other modern countries. Part of the blame lies in the incapacity shown so far by central and local politicians to design a coherent framework for urban and territorial policies and for a cooperative and not a competitive relationship between local and central government; constituting a great embarrassment for the nation that gave birth to local government during the Middle Ages.

Below the political, social and economic factors that mainly influenced the Italian Republic after World War II are described, followed by the biggest modifications to the Italian institutional system, the main reforms of the Constitution and the ways the local authorities are administratively organised. It does not purport to be a comprehensive analysis but a factsheet to help the reader better understand the scenario and orientate their considerations.

## 11.2. Italian Economic, Political and Social Highlights in the Last 70 Years

In 1946, Italy became a republic and in 1948 adopted its Constitution (*Costituzione Italiana*) in which, among other things, regions were no longer an administrative district of the central state (like they had been during the monarchy) but on paper obtained considerable autonomy from the centre, including legislative power on subject matters where the state fixed the fundamental principles of the law (concurring legislation, Art. 117). Provinces and municipalities continued to exist (also today): the former, operating mainly in local planning and zoning, the provision of local police and fire services, and transport regulation: the latter, providing many basic civil functions and administrative services. Regions were on paper the only real innovation of the institutional framework, with everything else more inspired by the pre-fascist (and already old) traditions; historians tend to describe the constitutional period in the sense of strong "continuity" (Pavone 1974).

Autonomous regions under a special statute were created in 1945–1948 (Sardinia, Sicily, Trentino-Alto Adige/Südtirol, Aosta Valley) and in 1963 (Friuli-Venezia Giulia) and regions under an ordinary statute were created only in 1970 following their first elections and were fully functional only a few years later. Their implementation was postponed for political reasons because the post-war government (centre democratic Christian party called *Democrazia Cristiana*) did not want the opposition (a communist party called *Partito Comunista Italiano*) to gain power, but also due to the central state's reticence to lose power once the functions were transferred (Giannini 1978). This late implementation attracted much criticism: one of the most important liberal thinkers of the period, Piero Calamandrei, wrote about a "betrayed Constitution" (Calamandrei 1955).

After 1977, the regions finally gained power over fields like agriculture, the environment, healthcare

and social welfare and much of the power (and money) held by the Southern Development Fund (*Cassa per il Mezzogiorno*), which was abolished in 1984, was transferred to the southern regions. In particular, healthcare and social services became crucial for achieving a political consensus but generated significant inequality in the quality of care given in the northern and southern regions: the lack of efficiency and effectiveness in managing the public healthcare system was to become a major factor in shortfalls of many (south-centre) regional budgets some years later. On the other side, the northern regions, already more advanced and industrialised since the early years of the 20th century, developed faster and more efficiently and their local politicians became more conscious of regional interests and more intent on running their own affairs without central government interference. The result was an increase in the (political, social and economic) distance between the north and south of the country, which still persists today (Lanaro 1997).

In the meantime, Italy left the 1960s having completed its economic 'miracle' consisting of its post-war transformation from a largely agrarian, relatively poor country to one of the most economically and socially advanced countries in the world. In 1975, Italy became a founding member of the group of the six largest advanced world economies (G6). Italy remained internationally competitive for two decades, after the two oil crises (1973 and 1979) up to the early 1990s, mainly based on its industrial inheritance and then the regular devaluation of its currency. Italy then started to lose competitiveness because of its high public debt levels (that rose during the 1980s as a result of distorted and non-productive use of public expenditure), the decline in its manufacturing sector industry as well as its insufficient investments in R&D and human capital (Targetti Lenti 2014).

In those decades, Italy experienced cultural, political and social changes. In the late 1960s, a large popular movement of students and workers arose

in America and Europe in reaction to the Vietnam War and military and bureaucratic elites; it called for civil rights, better working conditions, respect for minorities, gender and racial equality. There were demonstrations and riots all over the world, most of them being repressed and sometimes ending in bloodshed.

Protests inspired by these international movements arrived in Italy in 1968. Here, a modern culture began to develop; on one hand, the post-war education system allowed a large share of citizens to be educated and become fully aware and able to question societal functions: on the other hand, the full employment level seen in northern Italy gave the workforce political leverage to reclaim its rights. Thus, students and workers marched together, mainly with the aim of reforming the education system, introducing better pay and work conditions (the 40-hour working week), extended social and civil rights in order to change the traditional, capitalistic and patriarchal Italian society. During this period and over the following years, there were mass demonstrations, factory occupations and strikes, especially in northern Italy. All of these factors led to different reforms such as introduction of the Statute of the Workers, liberalisation of access to university by abolishing student quotas while also extending civil rights: contraception became readily available after 1971, in 1974 a divorce law (confirmed by a referendum) was passed followed by a family law reform and, in 1978, a law permitting abortion was also passed and later confirmed by referendum in 1981 (Lanaro 1997).

In those same years, Italy was struggling with organised crime (that continues today) and political terrorism. These are the 'Years of Lead', indicating a period of turmoil that lasted from the late 1960s until the early 1980s, marked by robberies, bombings and kidnappings and multiple attacks on military and institutional and civilian targets by neofascist and far-left groups along with the support of some miscreant branches

of the Italian secret services in order to subvert the established order. These changes completely transformed Italian society and also affected the relationship between citizens and the institutions, giving Italy a new set of challenges: to reorganise the local administrative systems; to redefine the dominance of post-industrial cities and metropolitan areas; the relationships between central, regional and local government and the division of their legislative and administrative functions. In addition, a transformation was necessary to help the new urban areas develop, overcome inefficiency in the delivery of public services, respond to citizens' needs and their desire to participate in public life, build integrated infrastructure but also to combat poverty, inequality and social exclusion and reduce the gap in the quality of life and opportunities between city centres and their outskirts.

Political parties were totally unable to catch the winds of change, guide the necessary innovations, channel the new ways of thinking in the traditions of strong political cultures; their reputations plummeted and since then the never-ending 'Italian crisis' has been underway; liberal parties (PLI, Partito Liberale Italiano; PRI, Partito Repubblicano Italiano; Partito Radicale), heirs of the Unity and "Risorgimento" traditions, were the first to disappear, leaving an empty space that cultural institutions have been unable, even today, to fill for the good of a complete and cultured public debate (Colarizi 1998).

### 11.3 The Italian Administrative and Constitutional Reforms: Missed Opportunities

The first attempt to reorder the Italian administrative system came in 1990 when the so called decentralisation process was launched: the legislator's objective was to reform the link between local governments and their communities and lower central government control over the local level. In that year, Parliament adopted law no. 142/1990 (*Ordinamento degli Enti Locali*) on the structure

of local self-governments which, according to the subsidiarity principle, redefined the ways the provinces and comuni were organised, rewrote their functions and gave them statutory autonomy and regulatory power.

For the first time, reference is made to the metropolitan areas, identifying them in the urban agglomerations of Bari, Bologna, Florence, Genoa, Milan, Naples and Turin and other comuni in the surrounding area with a socio-economic connection to them (Art. 17). In the metropolitan area, local government was to be reorganised around a metropolitan city, which was initially designed on the boundaries of the local province and *comuni* (Art. 18). The law gave the metropolitan city the functions of the province and those of *comuni* regarding the management of the supra-municipal competences (metropolitan territorial planning, public roads and transportation infrastructure, protection and promotion of cultural and environment assets etc.) which needed to be performed on a large scale and in a more efficient and effective way (Art. 19). In the second step, the law made the regions responsible for redesigning the boundaries of the metropolitan city, promoting the merger of comuni and the creation of new ones in order to produce a more coherent administrative organisation and assure the full exercise of the institutional functions, the optimal provision of public services and citizens' participation (Art. 20): in particular, one should mention here law no. 241/1990 (*Nuove norme in materia di procedimento amministrativo e di diritto di accesso ai documenti amministrativi*) on regulation of the administrative procedure along with transparency rules, such as the right to access documents produced by public administrations for the citizens.

The reform was never truly implemented because the regions were reluctant to transfer and lose their power, while technical and political difficulties along with mistrust created a big obstacle to the merger processes. On top of that, the central government

did not exercise its right to act in place of the regions in cases of inaction (Art. 21) because a new wave of reforms was being prepared.

Starting in the early 1990s, some legislative acts reviewed the functioning and powers of the local authorities such as the consolidated text of laws on the structure of local authorities – approved by legislative decree no. 267/2000 (*Testo unico delle leggi sull'ordinamento degli enti locali*) – that gathered all the previous local governments acts, including: legislative decree no. 29/1993 (*Razionalizzazione della organizzazione delle Amministrazioni pubbliche e revisione della disciplina in materia di pubblico impiego*) which redefined office organisation methods and labour relations in public administrations; law no. 415/1993 (*Modifiche ed integrazioni alla legge 25 marzo 1993, n. 81, sull'elezione diretta del sindaco, del presidente della provincia, del consiglio comunale e del consiglio provinciale*) on direct elections for the mayor, president of the province, the municipal and provincial councils; legislative decree no. 77/1995 (*Ordinamento finanziario e contabile degli enti locali*) prescribing financial and accounting rules and procedures for the local authorities.

After 1997, the Italian Parliament adopted several laws and legislative delegate decrees, regrouped under the name of the then Italian Minister of Public Administration and Regional Affairs, Franco Bassanini (*the Bassanini Acts*), to reform and simplify the public administrations. These four legislative acts were: law no. 59/1997 (*Delega al Governo per il conferimento di funzioni e compiti alle Regioni ed enti locali, per la riforma della Pubblica Amministrazione e per la semplificazione amministrativa*); law no. 127/1997 (*Misure urgenti per lo snellimento dell'attività amministrativa e dei procedimenti di decisione e di controllo*); law no. 191/1998 (*Modifiche ed integrazioni alle leggi 15 marzo 1997, n. 59, e 15 maggio 1997, n. 127, nonché norme in materia di formazione del personale dipendente e di lavoro a distanza nelle pubbliche amministrazioni. Disposizioni in materia di edilizia scolastica*); and law no. 50/1999

(*Delegificazione e testi unici di norme concernenti procedimenti amministrativi – Legge di semplificazione 1998*) (Pajno Torchia 2000).

The aim of this legislative initiative was to establish a vast programme of devolution of government functions among the various institutional levels and redefine their competences in order to realise 'administrative federalism', but without amending the Constitution. Law no. 59/1997 and law no. 127/1997 (so-called *Bassanini I* and *Bassanini II*) along with legislative decree no. 112/1998 constitute the core of the reform which, according to Bassanini himself, in its entirety provided: a general reallocation of administrative powers among central, regional and local governments according to the subsidiarity and decentralisation principles; a strong reduction of central government control over regional and local governments; a significant increase in regional and local organisational autonomy; a strong downsizing of the central administrative organisation following the reduction of national functions; a general programme aimed at lowering the regulatory burden and red tape, the start of a process of the systematic simplification of administrative procedures and introduction of an analysis of the impact of regulation; the launch of a far-reaching public administration reform envisaging temporary office for public managers, performance reviews and appraisals, executive responsibility for results, and linking public managers' remuneration to performance.

The results included: a strong increase in the sectors and services assigned with regional and local administrative responsibility, for the first time including industrial and labour policies; effective strengthening of regional and local regulatory power in the same sectors; the introduction of vertical and horizontal subsidiarity principles; and the allocation of new financial resources to the regional and local governments (Bassanini 2012). Yet all of these efforts were not enough to make deep changes in the structure of the state so a period of constitutional

reform (some failing, some succeeding) started in the early 1980s and is still underway today (Passaglia 2017).

In 1985, a bicameral commission presided over by liberal MP Aldo Bozzi proposed considerable amendments to the Constitution (40 articles), including introduction of differentiated bicameralism with both chambers deciding only on laws to do with institutions of government, fundamental rights, and the budget: the first Chamber would decide on all other legislation, the Senate on activities of control over Government and both Chambers came together in one for a vote of confidence: the law was not approved but did provide food for thought for following attempts. In 1992, a new bicameral commission, enforced by constitutional law no. 1/1993 and presided over by Ciriaco De Mita and Nilde Iotti, was created with the task to draft an organic reform of the entire second part of the Constitution providing guidelines for a new electoral law and reviewing the 'form of state' (based on a new system of legislative competences) and a new constitutional guarantee system. Among other things, the project also involved a new distribution of powers between the state and the regions (which would imply amending Art. 117 of the Constitution), with an explicit definition of the state's legislative powers and the devolution of all other legislative powers to the regions, new tools for guaranteeing regional autonomy but not a modification to ensure perfect bicameralism.

The final report attracted a large consensus (without including the part on reviewing the constitutional guarantee system which met with considerable dissent), yet but there was not enough time for the bill to be voted on by Parliament because the Chambers were dissolved at the beginning of 1994, followed by early elections. The last big failed attempt came in 1997, parallel to the start of the Bassanini reforms when a new bicameral commission on institutional reforms was set up in order to prepare the reform projects concerning Part II of the

Constitution, particularly the state structure ('form of the State'), the government organisation ('form of government'), the bicameral system and the system of guarantees. This second Commission also failed in its purpose because no political agreement could be reached by the heterogeneous, transversal small majority on the final text (in particular, on the subject of whether Italy had to be a Presidential Republic or not) and was disbanded in June 1998 (Gilbert 1998).

After so many failed attempts, two reform proposals prepared by the centre-left government were approved in 1999 and 2001. Under constitutional law no. 1/1999 (*Disposizioni concernenti l'elezione diretta del Presidente della Giunta Regionale e l'autonomia statutaria delle Regioni*), by amending Articles 121, 122 and 123 the Parliament modified the form taken by regional government, introduced direct elections for President of a Region and established regional statutory autonomy. In 2001, the Italian Parliament approved (and a constitutional referendum confirmed) constitutional law no. 3/2001 (*Modifiche al titolo V della parte seconda della Costituzione*) concerning modification of the Fifth Title of the second part of the Constitution and, in particular, with relevant changes affecting Articles 114, 117, 118 and 119.

This reform tried to bring Italian regionalism closer to federalism and recovered a substantial part of the work done by the De Mita/Iotti Commission on the attribution of powers to the state and regions (Art. 117), providing a different distribution of competences and defining their legislative areas: the state's exclusive legislative areas are now listed and the regions have exclusive legislative power with respect to any matters not expressly reserved for state law, except for the list of areas of concurrent legislation. This new framework has caused some problems. In fact, in the following years the Constitutional Court had to resolve many conflicts (more than 1,500 in the first 15 years) regarding the attribution of competences to the central and regional governments (for instance, which level of the State

was entitled to legislate on a specific subject). Most of its decisions, in particular in no. 303/2003, went in the direction of giving a restrictive interpretation in favour of recentralisation and establishing that the distribution of competences determined by the constitutional reform of 2001 was flexible in reintroducing, in a smoother way, the “national interest” concept (no longer present in this reform along with the supremacy clause) which prevails (but must be proportionate and not unreasonable) when a certain level of government is inadequate for achieving a certain goal and when the unitary element has a greater scope than the regional one (Groppi Scattone 2006).

Beyond this, the reform was also important for local government. The amendment to Article no. 114 included metropolitan cities (still non-existent, as we have seen) among the institutional bodies that make up the Italian Republic so as to gain their constitutional dignity: the same articles, at comma 3, listed Rome as a metropolitan city and (obviously) the Capital of the State, providing it with special statutory autonomy under law no. 42/2009 (Art. 24) and the following legislative decrees 156/2010 (*Disposizioni recanti attuazione dell'articolo 24 della legge 5 maggio 2009, n. 42, in materia di ordinamento transitorio di Roma Capitale*) and no. 61/2012 (*Ulteriori disposizioni recanti attuazione dell'articolo 24 della legge 5 maggio 2009, n. 42, in materia di ordinamento di Roma Capitale*), which defined its organs and the institutional system while giving Rome more competences and functions in line with its Capital status. Lastly, the new Article 118 established that administrative functions are bestowed on local authorities according to the principles of subsidiarity, differentiation and proportionality, and Article 119 granted them financial autonomy (including the power to introduce new taxes in addition to the national one).

After that, there were two other main attempts to modify the Constitution. The first came in 2005 when the centre-right government led by Silvio Berlusconi,

as a reaction to the 2001 reform, proposed a bill to ‘reverse’ it by introducing a presidential model (the Prime Minister was to gain power to dissolve Parliament, appoint and sack ministers and control government policy. It could only be changed through a vote of constructive non-confidence) and, at the same time, it provided the regions with more exclusive legislative powers.

This part of the reform went by the name of ‘Devolution’, inspired by the federalist impulses of part of the government, gave the regions control over education, healthcare, law and order, and representation in the Constitutional Court. Regarding Parliament, the reform created a federal Senate according to the US Senate model, with legislative powers over laws of regional interest but excluding it from the mechanism of a vote of confidence in favour of the Government: foreign policy, defence and immigration was to have been a legislative prerogative of the Chamber of Deputies. The bill sought to reintroduce clauses referring to national interest and supremacy too. The Parliament approved constitutional law no. 269/2005 (*Modifiche alla Parte II della Costituzione*), but it was rejected by the citizens in a constitutional referendum held in June 2006.

The second failed reform was in 2016 when the centre-left government led by Matteo Renzi (leader of the political party that was a continuation of ex-Communist and Christian democratic traditions) proposed a bill to change the composition and powers of the Parliament as well as the division of powers between the state, regions and local authorities. One of the main points was to overcome the symmetric bicameralism and abolish the ‘concurrent competences’ in order to reduce institutional conflicts between the state and regions. It was proposed that the Senate and the Chamber of Deputies would still decide in a few limited areas (for instance, implementation of the Constitution regarding matters related to the protection of linguistic minorities, *referenda* regulation, functions

and electoral legislation concerning municipalities and 'metropolitan cities', the Senate's electoral system, legislation giving the regions greater autonomy than already envisioned in the Constitution) with a bicameral procedure, but the new Senate was proposed to represent the regions and local governments with the power to decide on regional and local matters and would have been elected by local governments and not directly by the citizens. In the constitutional design, the Senate would have been excluded from the vote of confidence, thus leaving the Chamber of Deputies the only one to directly control the Government's political accountability. Constitutional law no. 8/2016 (*Disposizioni per il superamento del bicameralismo paritario, la riduzione del numero dei parlamentari, il contenimento dei costi di funzionamento delle istituzioni, la soppressione del CNEL e la revisione del titolo V della parte II della Costituzione*) was approved by Parliament but was again rejected by the citizens in a constitutional referendum held in December 2016.

#### 11.4. Is There a Space (and Time) for an Urban Agenda in Italy?

Having now outlined the main constitutional reforms, we can return to the administrative level and 2014 and consider the last concrete attempt made by a centre-left government, led by Enrico Letta first and then by Matteo Renzi, to reorganise local government. Law no. 56/2014 (*Disposizioni sulle città metropolitane, sulle Province, sulle unioni e fusioni di comuni*), commonly known as the *Delrio Law* after Graziano Delrio (the Minister for Regional Affairs and Autonomies during the government led by Enrico Letta, and Secretary of the Council of Ministers during the government led by Matteo Renzi), was adopted by the Italian Parliament in 2014. It provides for the creation of 10 metropolitan cities (Rome Capital, Turin, Milan, Venice, Genoa, Bologna, Florence, Bari, Naples and Reggio Calabria) in addition to the four other metropolitan cities established by the autonomous regions of Sardinia and Sicily: Cagliari, Catania, Messina, and Palermo,

the new rules on the union and merger of *comuni*, the transformation of the Italian provinces into "institutional bodies of the second level" waiting for the upcoming constitutional reform which aimed to abolish the provincial level of government itself. So, this was the idea which had inspired Parliament when it decided to give the provinces a transitional regime that today has become permanent considering the rejection of the constitutional reform in 2001.

The provinces now are living in limbo: with their budget cut (by the outrageous "linear cuts" the government made in these years to the local authorities), they are no longer able to fulfil their duties and provide services to their community. They also need flexible "variable geometry" legislation (Vetritto 2016) that is able to change and to offer different institutional opportunities that really allow local government to adapt its boundaries to the orographic, economic and social specifics of its territory or to dissolve itself if another level of government is more efficient and effective in delivering services to that community. It is necessary to recall that almost 75% of Italy's surface area is made up of mountains and high hills so, for this reason, the country needs specific ways to organise local government to reflect this characteristic; moreover, almost 23% of citizens live in 'shrinking' internal areas, far from the fundamental services (school, health, transport) for citizens.

For this to happen, Italy would need inspired politicians with a clear vision, a coherent policy agenda and the will to fight a long political battle, for example, against the opposition between different levels of government in the distribution of competences and functions: to overcome the local mistrust between cities promoting their collaboration in managing specific functions (for instance, public transport, waste management) and encouraging the union of *comuni* when necessary; against extractive local political élites potentially threatened by any concrete modernisation (Calafati 2014). In fact, the metropolitan areas also share



these problems along with some other peculiarities. Policymakers should stop viewing a metropolitan area as a place containing a centre surrounded by outskirts which expand in concentric circles: this an old (but difficult to replace) framework.

Today's big cities are the engine of innovation and growth of the country and, in order to do so, modern metropolitan cities are built on functional relationships among (economic, social, cultural) homogenous areas, interconnected within a perimeter orographically similar with mutual interdependences: a big network in which local government must face the problem of the collective as a whole and provide it with social solutions. There is a need to start planning those territories' development and promote and enforce their economic bases in a strategic and long-term way in this regard, the adoption of a real strategic plan for these areas is mandatory and, moreover, the Delrio Law forces the metropolitan area (but not all the provinces) to adopt it. Further, the process of redistributing competences between the regions and metropolitan areas must be guided by the interests of the local community according to the subsidiarity principle.

These considerations can help policymakers install a new administrative geography according to an urban agenda built with the collaboration of different government levels, with the contribution of economic, social and civil partners and shared with the territories to guarantee transparency and the maximum level of accountability. It is only when decisions are made within this framework that policymakers can, for example, evaluate which of today's metropolitan cities have these characteristics (and thus can retain their status) or which province can be empowered or which must be abolished.

### **11.5 The 'Improbable Reform': A Matter of Liberalism?**

The above brief description of the unsuccessful yet repeated attempts to change the governance

framework in Italy shows how difficult it can be in a very conservative country, with a very common nostalgic attitude of people, the large majority of whom are very scared of any innovation, to alter the institutional framework: any reform becomes "improbable" (Capano 1992).

The above overview included a comment about the early decline of the traditional political liberal parties that left the public debate lacking in the most relevant political culture centred on institutions, freedom and innovation. In the concluding remarks of this chapter, it is contended that the lack of liberal culture and knowledge in Italy described in this paper, that would have provided strong roots for polyarchal frameworks and a culture for guiding the reinvention of our local development institutions, is the primary reason for the impasse the country has encountered for decades.

Italy, and namely the governments led by Silvio Berlusconi, was one member state that played a major role in abandoning the 'communitarian method' in favour of a reborn unique intergovernmental decisional process worse than that imagined by conservative leaders like Charles De Gaulle during the 1950s. The clear and growing need to have a common aggregate level for decision-making to avoid war and the tyranny of the majority, explained in this paper as a foundational element of liberal true culture from the Federalist papers to the Ventotene Manifesto, has been completely forgotten in the last few decades.

The idea of a plurality of states bargaining among themselves without any concern for the consequences for citizens (in terms of potential economic instability, limits on movements and commerce rights, mutual understanding) reveals a conservative and non-liberal culture. The continuity of the rudimental, pre-modern local government framework is due to the prevalence of the anti-liberal attitude held by the surviving or new-born political parties in modern Italy: the recent decision of the

new government to abandon the (weak) design of law 56/2014 in favour of returning to the design adopted in Italy under the unification laws of 1865 is extremely relevant in this sense, coming from a self-declared para-fascist party like the current Lega. A design, it is important to note, that the most influential juridical administrative theorists of the 20th century declared out of time in the early 1970s (Giannini 1971).

The absence of a modern national urban agenda is itself revealing of the absence of liberalism. As described above, all the modern calls for the cities to play a more relevant role in national economies rely on a liberal literature that directly arises from the tradition of the first territorial modernisation battle fought in Britain in the years of the electoral laws against “rotten boroughs” (Taylor 2003). A tradition that the neo-liberal concepts of an influential author such as Benjamin Barber arrive at by imagining an international parliament of mayors (Barber 2013).

The discontinuity that any comprehensive reform of territorial institutions could trigger is largely feared by the leading classes that rely on the solid extractive non-written pact described above. The place-based economics of local development require an open, well-informed, democratic, well-coordinated, transparent decision-making process that uses both the Hamiltonian clash of interests of many territorial authorities on different levels (in one sense) and the Madisonian call for consideration of the “will of the people” (in a second sense). This is exactly the opposite of the ‘announce and defend’ logic that for decades has been leading Italy into some sort of total stagnation regarding every decision in the public interest, while leaving real power in just a few hands. It is no surprise then that one of the most ineffective and reluctant national systems that is opposed to both European Federalism and national multilevel public governance is Italy, the land of forgotten liberalism.

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# 12.

## Conclusion



By Rok Spruk and Giovanni Vetrutto

In this book, we have examined the contributions made by regional EU policy support, regional institutional quality and regional intelligence to the per capita income and growth rates of European regions at the NUTS-2 level subject to the previously identified growth and development shifts. For a sample of 365 regions at the NUTS-2 level for the period 1990–2015 containing roughly 4,000 sample-matched observations in a combined and partly novel dataset, we estimated the responses of per capita income and growth rates to regional policy support schemes, institutional quality, and average intelligence.

Our results suggest that the influence of regional policy support, institutional quality, and average intelligence depends on the level of development. The regions under Objective 1 tend to benefit strongly from higher rates of infrastructure-related investment, health-related investments, basic educational support and technology investment. Once regions attain higher income levels in response to these investments, policies that strengthen labour market efficiency and innovation appear to be the key drivers of sustainable development. Our findings corroborate the notion that any ‘one-size-fits-all’ regional policy support is doomed to fail.

The findings also suggest that efficiency-improving policies are perhaps the most important determinants of regional development in the long run and support criticism of subsidy-expanding

schemes related to industrial policy that do not seriously take growth diagnostics into account. The evidence on the effects of institutional quality suggests that regions with better quality governance tend to develop faster than regions without such governance. We also showed the beneficial long-run economic effects of institutional quality are primarily driven by an impartial government administration. This implies that the absence of government favouritism for particular industries/interest groups greatly facilitates long-term development, and may be more important for regional development than policy support schemes.

In addition, more widespread corruption at the regional level at lower levels of per capita income might not necessarily harm regional development, and may even occasionally support it. These findings support the view that greater corruption may ‘grease the wheels’ rather than put ‘sand in the wheels’ of subnational development. At higher income levels, the effect of corruption on regional development is both negative and statistically significant, which implies that the persistence of corruption at higher levels of development has profound and long-lasting negative implications for long-run development.

Our results also show that average intelligence greatly affects European regional development and may be as important as the role of policy support schemes and institutional quality. Regions with better mathematics, reading, science, and problem-

solving skills tend to develop significantly faster than regions with mediocre cognitive skills. At lower levels of income, the positive effect of average intelligence is driven by problem-solving abilities. At higher income levels, the positive effect of problem-solving skills is replaced by equally large positive effects of mathematics and scientific skills. This implies that the level of importance of average intelligence for long-run regional development depends on the type of skills and should take skill heterogeneity into account. Finally, our analysis of regional growth disparities using extreme bounds tests suggests that better reading skills, policy support for higher education, improved labour market efficiency, lower corruption, high problem-solving skills and macroeconomic stability have a very robust positive effect on the long-run growth rates of NUTS-2 regions while policy support for innovation and the greater impartiality of government services at the regional level have a strong and robust positive impact on regional growth rates.

Other policy factors, including the widely discussed schemes to support smart specialisation and industrial policies, appear to be either fragile or weak determinants of regional growth. Our counterfactual estimations reveal large and pervasive increases in regional per capita income in response to improved labour market efficiency, improved institutional quality and higher average intelligence. The regions from Eastern Europe and Southern Europe exhibit the highest per capita income gains compared to Central, Northern and Western European regions where the gains are noticeably smaller.

The evidence presented in this paper shows the need for a shift in paradigms to sustain local government and local development in an effective way. The illusion of the 20th century about the chance to help regions and areas in all kinds of different situations to exit from under-development by simply using two or three macroeconomic instruments is nowadays totally shattered.

The extended literature, which not by chance relies on the thoughts of important liberal thinkers, now shows us that local conditions, social capital, effective institutions not only at the local level but on different scales of the aggregation of interests and knowledge, the mutual recognition of these plural institutions, financial but even more knowledge transfer and conflicts among different views, and the abandoning of a useless 'top-down' view of programming in favour of a 'bottom-up' dynamic of the progressive integration of preferences and knowledge are the key elements for helping less advanced regions and areas catch up in development (in the dual sense of economic growth and social inclusion).

Place-based economics has been shown to work much better than rigid centralism and naïve localism. But place-based economics need to be enforced by a plural and interconnected institutional framework on the basis of the contributions of authors like Albert Hirschman, one of the most often cited old thinkers, in these last few years, in the literature of the economics of development. Several circumstances of our current era suggest that this complex machinery must be extended to a supranational level, and that a pure intergovernmental structure cannot play the important role that economic theory and institutional practice demonstrate is necessary in a modern economy and society.

The key element of the transformation that is needed is technology. During the First and Second Industrial Revolutions, it was already clear in the mind of leading politicians and liberal thinkers that the rapid and ever-growing changes led by technologies were about to disrupt the old balances and interests, thereby requiring a higher level of government than the old nations.

In these times of the Third Wave (Toffler 1980), it is very clear to all that the major challenges politics must face are impossible to win at a national level. Epochal migrations, climate change, human

trafficking, land grabs, global security, international value chains, new transport means – each of these big issues needs two conditions in place if they are to be faced at the level of the countries of the old Europe: strong political unity, the only instrument to give us a critical mass to have a voice at the global level; and extreme attention to regional and local problems to avoid the sort of identity-making regression that is impacting our democracies, putting them at risk and limiting our global role without any chance to resolve any of the problems and threats that are challenging the life of citizens living in the diverse and rich fabric of European regions.

Further, technologies, especially last-generation technologies, provide us with instruments to collect, confront and reveal evidence of data without historical precedent. The idea of the act of programming as constituting a way to confront, measure and solve a plurality of preferences is now a practical alternative to the old and never proven idea of the ‘invisible hand’ of the market, denounced as a ‘myth’ even by liberal economists (Roncaglia 2005), being relied upon to face the uncertainty and take collective decisions.

Even the current debate about the necessary reform of the European cohesion policy shows it is necessary to totally overhaul the terms of the game. Place-based economics in the context of European federalism with the administrative machinery of multilevel governance may prove to be the right answer to the current crisis of Europe, of national democracies, and of ineffective regional policies. Multilevel governance is known to be a fortuitous formula that has many interpretations

Some constitutionalists with a fixed old idea of federalism being a competitive structure even regard multilevel governance as being opposed to federalism itself (Bin 2010). But the prevalent literature sees it as part of the evolution of cooperative federalism, the administrative machinery for it (Marks 1993). As described in these pages, the liberal debate on

federalism since its origins has always taken all the implications of federating powers into account; always exposed its dual face, namely, partly competitive and partly cooperative; going back to the roots of liberalism provides us with so many solutions and warnings for our troubled times.

The only element that is missing is liberals. The gradual defeat of liberal parties is largely responsible for the current crisis facing Europe; the new naïve and inconsistent ideas of direct democracy overlook 300 years of reflections and debate on the risks and problems of the ‘tyranny of the number’; the total surrender of too many liberal political parties and cultural organisations to a neoclassical and laissez faire one-dimensional idea of liberalism has slowly discredited our culture as a whole, forgetting the complex, rich and growing tradition that sustained it for three centuries.

It is as if every liberal thought has been reduced over three decades to the barely 20-year-old reflections of two or three (albeit important) Austrian conservatives (not necessarily liberal in a comprehensive sense: Pecora 2002) and some new, not too well-educated American conservatives of the 20th century. Things are not so simple. Liberalism is alive and supplies its own answers; often, being better supported and proven. Let us prepare our tools and continue with the struggle.

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*The origins of the wealth and poverty of nations is an intensely debated issue in development economics. Scholars agree the institutional framework emphasising low transaction costs and secure property rights, broad-based and inclusive de jure and de facto political institutions, a culture of cooperation, a high rate of return on human capital, and perhaps even physical geography account for the wide-standing and persistent gaps seen in the levels of per capita income across countries. The evidence on the root causes of economic growth at the subnational level is much less certain. Can regions achieve sustained development in response to good and prudently designed policies, a broad-based institutional framework, a culture of trust and cooperation, and substantial human capital investment? Is regional development determined by luck or by fate? Disentangling the determinants of regional development and their contribution to the long-run growth of regions may provide the necessary insights into the 'black box' of subnational development. To this end, We examine the contributions made by regional EU policy support, regional institutional quality and regional intelligence to the per capita income and growth rates of European regions at the NUTS-2 level subject to the previously identified growth and development shifts. For a sample of 365 regions at the NUTS-2 level for the period 1990–2015 containing roughly 4,000 sample-matched observations in a combined and partly novel dataset, we estimate the responses of per capita income and growth rates to regional policy support schemes, institutional quality, and average intelligence.*

*Our results suggest that the influence of regional policy support, institutional quality, and average intelligence depends on the level of development. The regions under Objective 1 tend to benefit strongly from higher rates of infrastructure-related investment, health-related investments, basic educational support and technology investment. Once regions attain higher income levels in response to these investments, policies that strengthen labour market efficiency and innovation appear to be the key drivers of sustainable development. Our findings corroborate the notion that any 'one-size-fits-all' regional policy support is doomed to fail.*

*Place-based economics has been shown to work much better than rigid centralism and naïve localism. But place-based economics need to be enforced by a plural and interconnected institutional framework on the basis of the contributions of authors in the literature of the economics of development. Several circumstances of our current era suggest that this complex machinery must be extended to a supranational level, and that a pure intergovernmental structure cannot play the important role that economic theory and institutional practice demonstrate is necessary in a modern economy and society.*

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