Chapter 5: A COHESION PACT FOR THE REGIONS A role for industrial policy?

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The Lisbon Agenda of 2000 and the supporting Sapir and Kok Reports have set the parameters of economic policy in the European Union (EU) in the medium term. The asymmetric regime of economic governance locks manifold regions and industries into an inflexible and unbalanced policy environment so that the objectives of Lisbon may be difficult to achieve. The monetary straitjacket of the euro, buttressed by the Maastricht Treaty and the Stability and Growth Pact (SGP) fiscal conditions, limits the degree to which competitiveness and cohesion may be delivered, particularly in an expanded Union. This article explores these issues of economic governance in the EU in order to investigate the possibility of a 'cohesion pact for the regions' which places a more comprehensive industrial policy as the fulcrum for achieving a better balance between growth and cohesion. Operating within an Open Method of Coordination (OMC) framework and by linking industrial policy instruments to a system of fiscal federalism, a more flexible and balanced regime of economic governance may ensue, one in which the ambitious objectives of the Lisbon Agenda may start to be achieved or at least moved towards more efficaciously.

Introduction

The European Union expanded to 27 Member States on 1 January 2007. At the same time Slovenia became the first Accession State to adopt the euro as its currency, thereby joining the single currency area, known as the Euro-Area. The future shape and direction of the EU is beyond the scope of this article, but the very notion of integrating 27 countries with varying capacities, competences, industrial and spatial structures as well as path dependencies is a challenging one. As the EU has expanded, its system of economic governance has become more asymmetric. Key institutions and policies have developed that are in conflict with others. For example, the agendas of competitiveness and cohesion have been and are enabled by different components of the EU's economic governance. For example, the EU's growth agenda is driven by the rhetoric of the Lisbon Agenda of 2000 to make the EU the most dynamic knowledge economy in the world by 2010 and rests in large part on the completion of the Single European Market (SEM) and the efficient operation of the single currency area, the Euro-Area (European Council, 2000). On the other hand, the difficulty of managing the enlargement of the EU to include states from Central and Eastern Europe suggests that strengthening cohesion policy remains an imperative.

The reform of the EU's cohesion plan for the period 2007-2013 focuses on strategic priorities whilst at the same time seeking to address inequality between regions. The reification of the region and territorial solidarity, however, overlooks the role of industrial policy in the distribution of resources to sustain localities and regions that lag the others. Conventionally the purpose of industrial policy in the EU is to help achieve the strategic priorities of sustaining growth and the global competitiveness of EU industries. The regional dimension to cohesion policy and industrial policy appears to run counter to the two major reports undertaken on behalf of the President of the European Commission (the Sapir and Kok Reports - Sapir et al., 2002, and European Commission, 2004a, respectively) which attempt to refocus economic and social cohesion at the national level.

Industrial policy in the EU appears to be caught between the rock of enterprise policy and the hard place of competitiveness policy. On the one hand, enterprise policy appears to have displaced industrial policy in the discourse and policy programmes of EU decision-makers until very recently, whilst on the other hand pursuing the mantra of global competitiveness rather than focusing on the capabilities and path dependencies of different territories. At the same time, cohesion policy focuses on territorial solidarity without explicit reference to differing economic and industrial structures, and thus the role of industrial policy in facilitating cohesion. In other words, the relative neglect of industrial policy within the EU has tended to reinforce the asymmetric nature of economic governance in the EU. Competitiveness policy is led by the Lisbon Agenda, enterprise policy seeks to extend liberalisation within the Single European Market down to the level of the firm, whilst cohesion policy seeks to overcome inequalities across different EU regions. It therefore seems apparent that industrial policy has the potential at least to act an important fulcrum in integrating these policies.

The system of economic governance in the EU is a powerful brew if one considers its main ingredients:

- .completing the Single European Market (SEM) in the context of the EU fulfilling its obligations to the World Trade Organisation (WTO);
- .management of Euro-Area macroeconomic policy, founded in part on the Maastricht Treaty rules (Buiter, 2006) and the constraints of the Stability and Growth Pact (SGP) which restrict the use of fiscal activism to ameliorate the effects of industrial and regional shocks;
- .enlargement to twenty seven Member States; and .the poor pace of implementing the Lisbon Agenda in balancing growth and cohesion agendas.

This institutional and policy brew may become more unstable as its ingredients combine less well because of the asymmetric nature of economic governance. For example, monetary policy is set at the EU level with consequent problems for the transmission of an EU-wide uniform policy at different territorial scales that have varying path dependencies (Budd, 1997; Sunley & Martin, 2006). The economic logic of Maastricht and the SGP as regimes of economic governance means that their rules are still relatively poor in managing the effects of asymmetric external shocks that impact on sectors and regions. Moreover, the endogeneity of the euro monetary regime leads to the asymmetric absorption of uniform policy in these different territories (Budd, 2007; Buiter, 2006). Fiscal policies are set nationally and regional policy has arguably become effectively nationalized (that is, set at national levels), whilst expenditure on ensuring regional cohesion has become part of a subset of national mechanisms of the transmission of uniform monetary policy within fragmented national fiscal regimes (Fatas, 1998). That is, Member States still manage fiscal policy and operate its institutions, but expenditure and taxation systems and the degree of their devolution to lower levels of government vary between Member States. In this regard, cohesion policy merely acts to manage the distribution of funds to underperforming regions, whilst not permitting the development of institutions to support local and regional fiscal discretion.

A system of fiscal federalism, as the keystone of a 'cohesion pact for the regions', may fill this void. Currently, the asymmetric economic governance of the EU inhibits this possibility because the regulations pertaining to the completion of the SEM impact on the operation of cohesion policy. Similarly, the conditions of entry for new and potential Members states lock them into a development path of liberalisation, privatisation and minimising state intervention, in the form of fiscal instruments, to overcome sectoral and regional differences, often in anticipation of joining the Euro-Area. By suggesting a 'cohesion pact for the regions', this article addresses some of these problems in the context of an explicit recognition of the role of industrial policy in balancing economic growth and cohesion in order to achieve some regional balance in the EU's economic development.

The Building Blocks of Euro-Area Fiscal Reform

As one of the core elements of economic governance of the EU, the management of the euro can appear to be somewhat distant from the development and performance of the real economies of the Member States, particularly sectors and constituent regions. The Sapir and Kok Reports have both noted the importance of a more flexible fiscal regime in achieving the objectives of the Lisbon Agenda. A resetting of macroeconomic policies, underpinned by the rules and institutions governing the euro, would close this distance and add a degree of flexibility that is currently missing. It is apparent that any regional cohesion pact will have a reformed Euro-Area currency system at its heart, particularly if industrial policy is to be the fulcrum of balancing cohesion and competitiveness. Industrial policy will not be able to undertake this function if the current EU fiscal rigidity remains which places limits on the ability of Member States to fund policy measures and instruments.

At the heart of the Euro-Area management system are the Maastricht Treaty rules, with the implementation and operation of these rules reinforced by the (reformed) SGP which supposedly disciplines Member States deemed to be in breach of the excessive deficit rules. The Maastricht Treaty conditions for membership of the Euro-Area set limits on inflation rates, interest rates and exchange rate variability as part of monetary policy. Limits on fiscal policy are in the form of budget deficit ceilings and a maxima on total public debt. There is built-in asymmetry to this system in that monetary policy is set at the EU level, by the operations of the European Central Bank (ECB), whilst fiscal policy remains within the remit of the Member States.

One of the most virulent critics of the 'Maastricht numerology' is the economist Willem Buiter. He claims that it represents 'economic nonsense' (Buiter, 2003). That is, the fiscal rules are not based on sound economic theory or policy practice but influenced by the political problem of managing ‘excessive’ fiscal deficits that are deemed to be potentially inflationary. Effectively, this concern masks an ideological position over the role of public expenditure in a market economy. The claim of ‘economic nonsense’ appears to have borne out by events since the inception of the euro (Budd, 2007; Buiter, 2006).

The euro has established its credentials as a favoured denominated currency for financial asset classes in many but not all parts of the world and its management has apparently curbed inflationary expectations in the Euro-Area. However, the imposition of a one-size-fits-all monetary policy for the Euro-Area economies has caused difficulties for the management of economic policy and economic governance in a number of Members States (National Institute Economic Review, 2006b; von Hagen, 2006). Moreover, the present design of the euro’s governance lacks one important element. In the theory of optimal currency areas, on which the euro is partially based, fiscal transfers are needed to compensate for inequalities in income and employment within a monetary union in the absence of mobility of capital and labour (Mundell, 1961).

In some accounts the combination of the SGP and re-distributive policies at the EU level (for example, cohesion policy) compensate for this omission (Boschma, 2000). A limited EU budget, however, within an asymmetrical system of macroeconomic policy restricts the scale and scope of this compensation. Moreover, asymmetric external shocks (affecting constituent industries and regions differently) cannot easily be absorbed by a uniform monetary policy of an economic union with manifold capacities and characteristics.

Most of the evidence suggests that greater economic integration, as embodied in the SEM, will reduce the regional effects of the transmission of monetary policy in a monetary union, whereas greater industrial specialisation will increase these effects

(Arnold, 1999; Krugman, 1993). This outcome suggests that any proposal for a 'cohesion pact for the regions' should incorporate industrial policy as one of its principal components. The tension between greater integration and regional industrial specialisation also reinforces demands for a consideration of fiscal federalism to 'balance' the Euro- Area economy.

Fiscal federalism is a system of governmental transfers that enable sub-national governmental authorities to manage the impact of the business cycle and external shocks on their localised economies. There are two aspects to fiscal federalism that correspond to the two roles of government: stabilisation and distribution (Musgrave & Musgrave, 1959). Writing back in 1965, in respect of European economic integration, Musgrave (1965, p. 2) noted:

> Across the Atlantic, fiscal thinking in multi-unit terms has been stimulated by the movement for European economic integration. There the problem is one of rearranging and synchronizing the tax structure of associated countries so that economic frontiers can be eliminated and efficiency gains from tax reduction can be realized without being offset by distorting tax differentials.

The development of the euro notwithstanding, some 40 years on this remains a key problem for the economic governance of the EU. The institutional basis for promoting fiscal federalism is reinforced by sound theoretical work (Musgrave, 1965). The combina- tion of the theory of social wants, whereby the market cannot satisfy or distribute certain wants optimally over space, while individual preferences can differ between areas, means that forms of fiscal federalism can contribute to efficient outcomes in the distribution of social goods. The efficient provision of these goods thereby contributes to the competences of a region and relates to the depth of its institutional embeddedness.1 It can be argued that both factors can operate as regional stabilisers in dealing with asymmetric shocks associated with different industrial specialisations in different regions. Moreover, a system of fiscal federalism could make a significant contribution to cohesion policy by re-balancing its relationship to competitiveness policy.

A system of fiscal federalism would also facilitate reforms of the EU budgetary process in favour of earmarked funds (growth, restructuring and convergence), as proposed by Sapir as part of cohesion policy. Moreover, locating a set of financial instruments to support industrial policy within this proposed system may help overcome some of the asymmetries of economic governance of the EU. These funds could be hypothecated2 for certain objectives of industrial policy, particularly in regions whose industries face restructuring or large plant closures. The Sapir proposals for growth, restructuring and convergence funds have some merits in making EU budgetary policy more flexible but the difficulty remains in assessing the boundaries of each fund. The other problem is that these funds are set within a national rather than regional framework and an explicit acceptance of the growth/competitiveness agenda. A system of fiscal federalism that contains a degree of hypothecation for industrial policy could provide the basis of making the Open Method of Coordination (OMC) the policy vehicle for re-balancing economic policy.

The OMC is an increasingly important dimension of the mode of governance in the EU. Formally introduced as part of Lisbon, it builds on the Broad Economic Policy Guidelines and the European Employment Strategy. The main objective is to coordinate rather than harmonise national policies and it consists of ‘soft law’ mechanisms underpinned by hard regulations, for example, SGP, benchmarking best practice, and mutual learning. The stress is on openness and flexibility in order to compare national approaches and drawing together policy makers at different scales of government. Since 2001, it has been extended to other policy domains, including enterprise policy, structural economic reform and social inclusion. It therefore appears to be a salient framework for incorporating more flexible economic governance, industrial policy and cohesion into ‘cohesion pact for the regions’.

The Building Blocks of Cohesion Policy

The EU’s cohesion policy is summarised by the Commission’s Third Report on economic and social cohesion (European Commission, 2004b, p. 1):

. . major socio-economic disparities between the Member States and between regions persist. These gaps in wealth and dynamism arise from structural deficiencies in certain key factors for competitiveness such as investment in physical infrastructure, innovation and human resources. The Member States and the regions therefore require support from the Community policies to overcome their handicaps.

For the reform period 2007□2013 the European Commission has proposed that cohesion policy should be:

- .more targeted on the EU’s strategic priorities (Lisbon and Gothenburg agendas for a sustainable and competitive ‘knowledge economy’, European employment strategy);
- .more concentrated on the least favoured regions while anticipating change in the rest of the Union; and
- .more decentralised with a simpler, more transparent and more efficient implantation.

Cohesion policy continues to consist of the three building blocks of the EDRF, the ESF, and the Cohesion Fund. The ERDF was established in 1975, and its resources are mainly used to co-finance investment that boosts production, employment stability and job creation or maintenance, as well as infrastructure and small and medium sized enterprise develop- ment in the poorest regions. The ESF focuses on creating and maintaining employment opportunities, particularly business start-ups, and boosting female labour market participation. Created in 1957, the ESF is the EU’s main source of financial support for efforts to develop employability and human resources. Total funds for the 2007□2013 period are t336.1 billion at 2006 prices. Since 1994, the Cohesion Fund has assisted Member States in enabling investment in transport infrastructure and environmental management so as to reduce socio-economic disparities in regions with less than 90 per cent of the average EU gross national income (GNI) per head. In total, the funds to implement EU cohesion policy represent a third of the Community Budget and 0.46 per cent of EU GNI.

Cohesion policy is tied to the governmental function of addressing economic inequality, albeit at the EU level. In combination with allocating national funds for providing public goods and merits goods, for example, education and health, the Member States are able to manage the consequences of economic shocks and market failure. However, EU cohesion policy embeds the supply-side market adjustment perspective of Lisbon within the current system of economic governance. Moreover, it ignores both demand factors and interaction with the macroeconomic role of government. In particular, the impact of changes in demand on key industries open to international competition in EU regions does not feature as a central concern of cohesion policy. In this respect industrial policy should be a parameter and not a variable in the construction and operation of cohesion policy. Unfortunately the hegemony of a competitiveness agenda distorts the role of cohesion policy balancing the impact of the cyclical and structural change in the EU economies and regions.

The 'Shadow' of Lisbon

Cohesion policy can be seen as a counterpart to the growth and competitiveness agenda of the EU, embodied in the Lisbon Agenda and its subsequent amendments. The objective is to stimulate economic growth in order to realise the true capacity of the EU whilst at the same time distributing the benefits to underperforming regions. The rhetoric or even propaganda of Lisbon counterbalances competitiveness and cohesion. Yet the emphasis on the former in delivering growth effectively relegates the latter to an externality that arises from the benefits of developing the knowledge economy in the EU. One can say that the logic of current cohesion policy (arising out of Lisbon) is based on growth trickling down to poorer regions. From the literature on economic development, however, it is fair to say that this approach has been found wanting (Parr, 1999; Rostow, 1960). This conclusion is reinforced if one observes the small scale of trickle down from growth poles to poorer regions; see, for example, recent experience in China (Asian Development Bank, 2006). It also contradicts conventional theory of the state which posits a threefold role based on the functions of:

- .allocation: combating market failure through the optimal provision of social goods and the creation of technological and pecuniary externalities;
- .distribution: combating the non-optimal distribution of income and wealth using the tax and benefit system. The provision of merits goods and use of the public budget also form part of this role; and
- .stabilisation: using fiscal and monetary policies to influence the desired rate of growth, employment, price stability and terms of trade.

Clearly these roles can come into conflict with each other. There is a symbiotic connection however, whereby one role is not superior to any other (Musgrave & Musgrave, 1959).

The challenge for EU and Member State policy makers is to identify which roles of the state should be reproduced by the Lisbon Agenda. One criticism is that the Lisbon Agenda explicitly ascribes superior status to the stabilisation role of the state. This criticism appears to be confirmed by the Sapir and Kok Reports (Dunford, 2005; Gardiner et al., 2005; Sapir et al., 2002). The other key challenge for the economic governance of the EU is whether the EU should be considered a unitary economy, shaped to some extent by the material outcomes associated with Lisbon. Lisbon and its antecedents, Sapir and Kok, appear to be driven by the apparent evidence of the EU's inferior productivity performance (and thus its potential to achieve optimal levels of growth) compared to that of the US (Sapir Group, 2005). Unpacking the evidence and the causal factors and effects of this 'inferiority' creates a more complex picture, as noted by Dunford (2005) and Gardener et al. (2005), because of structural and cultural factors.

Underlying much of the growth agenda in the EU and elsewhere is an over-adherence to an Anglo-Saxon structural adjustment model of economic development that suggests the primacy of markets as the only rational response to overcoming regional differences. Within this kind of model, any lack of regional coherence is a function of market imperfections rather than differences in economic, industrial and spatial structures and different path dependencies, not to say policy failure. In this context, policy interventions are meant to operate to make markets function more efficiently. Moreover, any industrial policy becomes subservient to competition policy. It appears to follow that regional policy, in the guise of EU cohesion policy, operates in the realm of limited distribution rather than allocation and stabilisation.

The strategic priorities of Lisbon are to boost EU growth above its long-term rates, and to achieve a 70 per cent employment rate within a framework of developing a information society in which enterprise thrives (European Council, 2000). Sapir and Kok both stress the utility of the Lisbon growth strategy in enabling cohesion through the EU economy reaching its potential. The former (subsequently known simply as the 'Sapir Report') was published in July 2002 as a result of the President of the European Commission inviting a group of independent experts to analyse the strategic economic goals set out in the Lisbon Agenda, with follow-up papers in 2005 and 2006.

The Report suggests that three pillars are in place to address the underperformance of the EU economy:

1. a single market, in order to improve economic efficiency (Single European Market);.
2. an effective monetary system, to ensure monetary stability (Euro-Area); and
3. an expanded Community budget, to foster cohesion (Cohesion Plans and Funds).

These main pillars of economic governance appear to be straightforward. However, the emphasis on completing the Single Market may undermine cohesion, if market-led structural adjustment is the only effective policy mechanism. The fixation with setting ceilings for total public budgets and budget deficits that do not take account of differences between the real economies, monetary and fiscal institutions and rules of Member States may limit the degree to which the objective of market efficiency by completing the SEM will be achieved.

Central to the Sapir Report and follow-ups is a six-point agenda that aims to help achieve the goals of Lisbon. The main objectives of this agenda are to make the Single Market more dynamic; boost investment in knowledge; improve the macroeconomic policy framework for Economic and Monetary Union (EMU); redesign policies for convergence; achieve effectiveness in decision-taking and regulation; and refocus the EU budget through creating three new funds: growth; convergence; and restructuring. The last objective seeks to integrate the EU budget within the framework of achieving the Lisbon goals by 2010. This is an interesting proposal and one that could be built on to develop a ‘cohesion pact for the regions’. However, the spillover effects from connecting the budget to earmarked funds may run counter to important constituents of one the main economic pillars of economic governance, namely, the fiscal rules of the Euro-Area system.

Sapir’s central thrust is that growth is the sine qua non of the EU’s development path. It attempts to decompose the relative growth performance of the EU's economies compared to the United States (Sapir, 2006). But it appears to be selective in its use of evidence and analysis in order to substantiate this claim and overlooks the changing nature of the EU. It has absorbed the cohesion countries and the Accession States over its 50 years' history: a feat of political will that may yet come to be seen as unparalleled. The crucial issue, however, is that the manifold nature of the EU constituent economies means that direct comparisons with the US economy may serve no real purpose, despite this being the comparative reference point for EU policy makers. Furthermore, the US has a fully developed institutional system of economic governance, including transfers between different levels of governance under the rubric of fiscal federalism. Moreover, even though the ideology of the universal utility of free markets is dominant, the US operates a form of industrial policy for strategic industries, for example, aerospace, defence and ICT among others (Bailey & Cowling, 2006).

From a policy perspective, a crucial part of Sapir and follow-ups is how they deal with regional policy and consequently regional differences. In respect of convergence and restructuring, Sapir recommends that cohesion policy should have a national and not a regional focus. However, given that within the system of economic governance monetary policy is set at the EU level, and fiscal policy discretion of Member States is boxed in by the SGP, the spatial distribution of industries become a crucial component of convergence and cohesion. Many EU industries are region-contingent so that industrial policy becomes central to regional policy, however configured. Sapir suggests institution-building and investment in human and physical capital for low-income countries, in order that they restructure in order to converge to EU norms. There is no mention however of the sectoral and geographical basis of either proposal. Moreover, the Sapir proposals to refocus the

EU budget to an explicitly EU dimension undermines the logic of a country-specific approach to convergence and does not address the inevitable tension with an EU-wide monetary policy. Furthermore, the effective nationalisation of regional policy envisaged by Sapir suggests that any industrial policy becomes a residual of a top□down growth qua growth strategy. A ‘cohesion pact for the regions’ could integrate the principle of ‘economic subsidiarity’ with EU-level governance, within an OMC framework that coordinates best practice across the Member States, whilst locating industrial policy within it and shifting the locus of cohesion policy from the realm of distribution to that of stabilisation.

The Kok Report is much less grounded in analysis than the Sapir Report and reads more like an end of term report on the progress of Lisbon. Nevertheless, Kok remains unclear about the restructuring of industry beyond repeating the Lisbon mantra of developing the ‘knowledge economy’. The national focus of the Kok Report (in the context of the perceived competitive threats from ‘new global players’), ignores sectoral and regional impacts across the EU. In many cases, these will be the same where certain industries dominate regional economies, but this possible conflation is not investigated. Indeed, the spatial distribution and location of industry generally tends to be overlooked, with the exception of the role of creative industries bridging high-tech industries and universities. Even here, however, there is no distinction between the associated agglomeration economies despite this distinction being an important part of industrial policy. Furthermore, in the context of Lisbon one could say that regional policy is where industrial policy should sustain cohesion. Overall, it is clear that industrial policy suffers from the large shadow that Lisbon casts over the economic governance of the EU.

A Cohesion Pact for the Regions? The Context of Industrial Policy

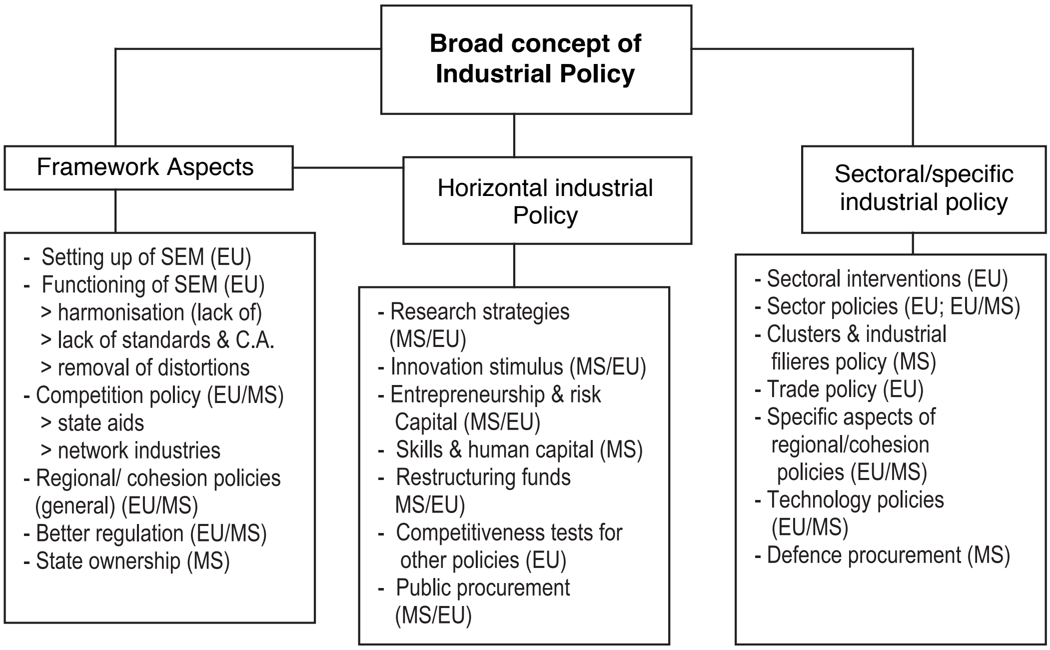
The previous sections have argued that the ‘shadow of Lisbon’ over-determined the shape and direction of cohesion policy because of the dominance of the growth and competitiveness agendas. Moreover, the lack of explicit recognition of the role of industrial policy in balancing competitiveness and cohesion inhibits the goals of Lisbon. Furthermore, the drivers of economic governance constrain the achievement of a competitive, cohesive and sustainable European economy. Perhaps surprisingly, then, industrial policy has made something of a comeback in the EU since 2000. An explicit recognition of its role is shown in a number of policy documents. In attempting to integrate industrial policy into a proposed regional cohesion pact, one finds a number of initial difficulties, though.

First, what constitutes EU industrial policy? Throughout Lisbon, Sapir and Kok there is scant mention of industrial policy. In 2004 and 2005, and updated in 2007, a number of communications were produced by the European Commission on industrial policy but these still seem to be over-determined by enterprise and competitiveness policy (European Commission, 2004c, 2005, 2007). The approach in 2000 was to develop horizontal industrial policy aimed at securing framework conditions that were favourable to industrial competitiveness. By 2004, the emphasis had shifted slightly to include the sectoral dimension and by 2005 to take account of the context of individual sectors, presumably including sectors that tend to be region-specific (Aiginger & Sieber, 2006). The new approach is a ‘matrix’ one that combines horizontal and vertical aspects of industrial policy. The 2007 update acknowledges how industrial policy will have to adapt to current and future challenges including the rise of new global players, facilitating more efficient regulation and developing new carbon technologies (European Commission, 2007). In spite of the 2005 and 2007 developments, the tautological nature of EU industrial policy is not addressed. The following quote from Fostering Structural Change: Industrial Policy in an Enlarged Europe (European Commission, 2004c, p. 3) still appears to hold:

> Industrial policy also has to ensure that other policies contribute to the competitiveness of Europe's industry. It therefore covers a very wide field, while many of its instruments are the instruments of other policy fields. Industrial competitiveness depends on policies such as competition, the internal market, research and development, education, trade and sustainable development.

One can see that industrial policy is almost entirely driven by Lisbon reinforcing the contention that EU industrial policy is squeezed between the rock of competitiveness policy and the hard place of entrepreneurship policy. As noted by Bailey et al. (2007), the Sapir prescriptions were found wanting in the case of Ireland, even through Sapir appears to cite the Irish economy as the ideal-typical model for the EU. Without a sophisticated industrial policy much of the Irish success story going back two decades might not have been sustained. The inevitable question is what are the attributes of industrial policy and what should be its components in an EU setting? Pelksman summaries the wide scope of EU industrial policy as shown in Figure 1 below (Pelksman, 2006).

The concept and mantra of competitiveness still dogs much of the policy debates around the economic development of EU as expressed in the Lisbon Agenda. In addition, recent contributions on competitiveness are still characterised by disagreement over conception and context. In a large part, discussion of this elusive concept is still overshadowed by the work of Porter who conflates two types of competitiveness into one category (Budd & Hirmis, 2004). There have been subsequent attempts to clarify the elusive beast by focusing on industrial competitiveness within an EU context (Bailey et al., 2006; Grilo & Koopman, 2006; Kohler, 2006). The utility of these interventions notwithstanding, the pursuit of an elusive concept that is frequently misunderstood by policy makers can create perverse outcomes for policy. As Pelksman (2006), p. 140) wryly observes, competitiveness almost becomes a cure for all economic ills:



Key:

SEM	= Single European Market	EU	= EU powers
C.A.	= Conformity Assessment	MS	= Member States' powers
EU	= Strict EU constraints with little Member States' leeway	EU/MS	= Shared powers
		MS/EU	= Shared powers but mainly national

FIGURE 1
Elements of industrial policy in the European Union
Source: Pelksman (2006)

> Competitiveness is now so widely defined that it serves as a 'container, in which almost any idea can be dumped. Not only are ill-defined policies rarely good policies, the nebulous approach acts as an open invitation for (industrial) lobbies and national ministers to argue attention to almost anything, resulting in waves of 'fashionable' topics.

Pelksman goes on to describe how industrial policy at the symbolic level went out of fashion in the mid-1990s to be replaced by competitiveness policy. The crucial issue about EU industrial policy in respect of Lisbon is spelt out by Bailey and Cowling (2006, p. 27):

> Overall, there has been quite extensive public policy intervention in the United States, but this is often opaque and hidden. This industrial policy has involved both vertical

> measures in targeting new technologies and emerging industries, and horizontal measures to support all industries, suggesting that the current focus in Britain and the EU with the horizontal aspects of industrial policy has been largely misplaced. This may have relevance in the European context, given the desire to re-activate the EU's 'Lisbon agenda'.

Their comment is pertinent in assessing the role of industrial policy in balancing economic governance in the EU. Perhaps the most overlooked aspect in discussions of industrial policy is policy which directly bears on industry. In Pelksman's original paper the figure above included policies that affect industry under the rubric of 'buffering industry'. This rubric includes monetary and fiscal policy, wage setting and industrial relations, among others, and non-industrial policy measures 'directly affecting industry'. The original horizontal and framework nature of post-Lisbon EU industrial policy would appear to be consistent with achieving the aims of Lisbon. How this type of policy plays out in different regions and sectors is almost entirely determined by policies that affect industry however. The new 'matrix' approach may go some way to resolving this tension. Pelksman (2006) identifies three cross-cutting issues expressed in the following questions:

- .Does EU industrial policy amount to 'competitiveness' policies?
- Do services matter for industry? What can Europe do about infrastructure and
- How critical is that for industrial policy?

He could have added to these questions the cross-cutting role of cohesion policy and exploring them within a regional framework. All these cross-cutting issues can be located within a 'cohesion pact for the regions'. The starting-point for such a pact is an appropriate policy framework. One that lends itself here is the OMC approach. The latter attempts to integrate the operations of EU-level and Member State policy processes more flexibility and consists of:

1. subjecting national policies to EU-wide guidelines.

2. establishing measures of best practice against which the performance of Member States can be compared; and
3. calling on Member States to adopt action plans in order to operationalise EU guidelines.

In this regard, Begg (2003), p. 177) notes the potential of the OMC approach:

> Following the example of employment policy, the starting-point would be to set out objectives for both regional development and equity. Governments would then be asked to put forward comprehensive strategies for achieving these objectives, to commit themselves to meeting target, and to show how national and EU-level policy instruments contribute to the policy aims.

Begg also observes that the OMC approach depends on the political will of the Member States within a framework without means of enforcement. He refers to suggestions that the 'soft law agreements' of OMC could be reinforced by EU-level agreements (Scharpf, 2002). Given the extension of the OMC approach into other areas of policy, including economic restructuring, it appears to be relevant for integrating industrial policy into processes for balancing competitiveness and cohesion. A 'cohesion pact for the regions' could then operate along the following lines:

1. Create an OMC governance framework in which the key institutions and actors of the EU, Member States and regional governing bodies sign up for and are integrated into the management of operations of a cohesion pact. This would include the Committee for the Regions at the EU level and the regional governments and institutions of governance within the Members States, among others. The institutional basis of the pact would be the locus for discussions of how industrial regional and cohesion policy are integrated more effectively. Within soft law agreements, explicit recognition would be given to the role of EU industrial policy in balancing

competitiveness and cohesion and its activation at the sectoral level through the creation of new regionally based financial instruments. The hard rules of monetary policy and the SGP would be made more flexible, taking into account different monetary and fiscal characteristics and institutions, and the economic path dependencies of the Member States through better integration of the Broad Economic Guidelines. There has been considerable debates and a number of reform proposals made in this area (Begg & Schelkle, 2004). This reform would be supplemented by the introduction of a system of fiscal federalism at the regional level that would correspond to a soft law agreement, with benchmarks and mutual learning from best practice in Member States with developed federal or decentralised governmental systems.

2. Developing the Sapir proposals for budgetary reform based on the three funds of growth, restructuring and convergence. Financial instruments hypothecated for individual sectors and ones that are particularly region-contingent would be developed within the proposed system of fiscal federalism. Hypothecating funds for the restructuring and growth of strategic industries through the development of regional bond markets, underwritten by EU funds, is one possibility. This might create a virtuous circle in that the financial instruments used to fund industrial policy interventions could create financial and business services associated with the development and operation of localised bond markets and different circuits of capital. Moreover, this outcome would connect services into an industrial policy framework in a more holistic manner.

3. The OMC framework would coordinate the establishment of benchmarks, best practice and mutual learning in integrating industrial policy, regional policy and cohesion policy, again subject to the hard constraint of a more flexible EU monetary policy and SGP within the context of completing the SEM and effective management

of the expansion of the EU.

The major challenge is the last one, that is, the degree to which the macroeconomic benefits of EMU, the SEM and the accompanying fruits of economic growth can be more evenly distributed in an expanding EU within a ‘cohesion pact for the regions’. Moreover, how regions whose path dependencies continue to make them vulnerable to structural change and economic volatility are cohered within a larger EU is a major challenge to policy makers at all governmental levels. In spite of the regional disdain displayed in the Sapir and Kok Reports, the region remains the locus of how growth and cohesion agendas are balanced. In this balancing act, the incorporation of industrial policy into a ‘cohesion pact for the regions’ appears to provide the framework and policy instruments to overcome the drawbacks of an asymmetrical regime of economic governance in the EU.

Conclusion

The promise of the 2000 Lisbon Agenda to make Europe the most dynamic economy in the world by 2010 appears to have faded. Lisbon Mark II reads rather like end of year school report (‘Must Try Harder’), but still omits any critical discourse on the EU’s development, particularly one that appears to be weakened by the enlargement to 27 Members States and possibly more in the future. The shadow of Lisbon continues to dominate the policy field in the EU, and although Sapir and Kok contain some useful proposals for making the regime of economic governance more flexible, the asymmetric nature of this regime constrains significant reform.

The reification of the knowledge economy and advancing it through growth and competitiveness agendas in order to generate higher aggregate demand overlooks the diverse nature of the EU’s economies and industrial structures. The emphasis on EU-wide growth, sui generis, ignores important different spatial structures and path dependencies. Indeed competitiveness has become a container into which any nebulous idea and policy response can be thrown. The essential problem is that Lisbon and its antecedents assume that competitiveness and cohesion can be balanced but do not address how this is to be achieved. The neglect of explicit industrial policy, until its very recent revival, had removed one important policy sphere in which these potentially conflicting objectives could be made more mutual. Unfortunately, the previous stress on horizontal/framework industrial policy has tended to make this conflict more difficult to resolve as it tends to privilege competitiveness over cohesion. Moreover, the Sapir Report's emphasis on declining nations and not regions constrains the role of a more comprehensive industrial policy in this regard, particularly at the regional level. By locating industrial policy within a regional framework, important economic stabilisers can be created to manage asymmetric shocks arising out of the transmission of a uniform EU monetary policy. In combination with a system of fiscal federalism, some of the negative aspects of the EU's regime of asymmetric governance can be addressed. Within an OMC policy framework these elements would form the basics of what we term a 'cohesion pact for the regions'.

At present, there is no explicit cohesion plan for Accession States experiencing uneven development. Without a clear regional commitment, expansion is less likely to be cohesive than previously. In the present economic environment, global developments are playing out differentially, defeating any notion of 'Europe of the Regions'. The political consequences of these weaknesses could potentially destabilise the next stage of the EU project. A flexible and more balanced approach to the economic governance of the EU, which activates policy instruments at all levels of governance, could make a significant contribution to achieving the objectives of growth and cohesion under the Lisbon

Agenda. This will only occur if there is an explicit recognition of the role of a more comprehensive industrial policy operating at a regional level and one not subscribing to the dominant discourse of the 'knowledge economy'.

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NOTES

1. Institutional embeddedness refers to the degree to which regional economic develop- ment benefits from the interaction of local institutions and their degree of governance power.

2. Hypothecation is the process whereby fiscal instruments are used for particular policy objectives. For example, in the UK the revenue gained by local authorities from imposing residential parking charges can only be used for transport improvements.

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