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## **FOURTH REPORT**

### **on Economic and Social Cohesion**

(presented by the Commission)

{SEC(2007) 694}

## FOURTH REPORT

### on Economic and Social Cohesion

Article 159 of the Treaty provides that the Commission shall submit a report to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions every three years on the progress made towards achieving economic and social cohesion, and on the manner in which the various means provided in that Article (Member States' and Community's policies) have contributed to it.

This fourth cohesion report provides, firstly, an update on the situation and outlook with regard to economic, social and territorial cohesion and, secondly, an analysis of the impact of policy at national and Community level on cohesion in the Union. Particular emphasis is given to: 1) the preliminary assessment of the impact of European cohesion policy in the 2000-2006 programming period, and 2) to a first assessment of the preparation for the new period 2007-2013, based on the national strategies and draft operational programmes submitted to the Commission by Member States up to the end of April 2007 (see SEC(2007) 694)<sup>1</sup>.

#### 1. THE ADDED VALUE OF COHESION POLICY

There are a range of factors which influence the effectiveness and the impact of European cohesion policy. An economic context characterised by price stability and sound budget balances will benefit from lower interest rates. This, in turn, stimulates investment and capital accumulation, increasing both productivity and employment. It also helps to increase the rate and diffusion of innovation and reduces the cost of capital.

The efficiency and effectiveness of public administrations on national, regional and local level is another critical factor. Finally it is often external factors, notably globalisation, that are the main driving factors of structural changes at all levels and which have a large impact on economic development and job creation.

However, as a result of a rigorous approach, cohesion policy has succeeded in making a difference to standards of living and levels of opportunity across the Union.

- *Convergence is occurring at national and at regional level*

As a group the major financial beneficiaries of European cohesion policy programmes during the period 2000-2006 have continued to exhibit impressive growth rates. At the regional level, strong economic performance in regions with low GDP per capita over the

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<sup>1</sup> In 2000-2006 five funds contributed to cohesion policy – ERDF, ESF, Cohesion Fund, EAGGF Guidance and FIFG. For the current 2007-2013 period the present report focuses on the contribution to Cohesion policy of ERDF, ESF and Cohesion Fund. The former EAGGF guidance section has now been absorbed in the new Rural Development Fund which also contributes to economic and social cohesion.

past decade has meant that, across the EU, regions have been in a process of convergence measured in terms of GDP per capita.

- *Estimates suggests that these trends will continue*

For the period 2007-2013, studies suggest that the investment undertaken under the programmes will add some 5-15% to absolute levels of GDP in most of the new Member States, in comparison with the baseline scenario. In addition, it is estimated that by 2015 around 2 million additional jobs will be generated due to these levels of investment.

- *Cohesion policy supports growth and job creation also outside the convergence regions*

Growth and development in a market economy inevitably mean that restructuring takes place, often associated with job losses and creation of new jobs which are unevenly distributed and can give rise to a territorial concentration of social and economic problems. Reinforcing the Union's capacity to adapt to change and to create new sustainable employment is one of the roles of European cohesion policy, also in the Union's more prosperous Member States. Over the period 2000-2005, estimates suggest the creation of over 450 000 gross jobs in six countries, which account for some two-thirds of the European assistance allocated to Objective 2.

- *Cohesion policy supports the innovative capacity of Member States and regions*

Cohesion policy made an important contribution to R&D efforts in the 2000-2006 period, and strengthened innovative capacity notably in Objective 1 regions. On the basis of the programmes available at the moment of adopting this report, the proportion of cohesion policy resources to be invested in innovation and R&D will more than double in the period 2007-2013.

- *Cohesion policy investment in people has high returns*

Raising the quality of human capital explains more than half of the productivity gains in the last decade. European cohesion programmes co-finance the training of some 9 million people annually, with more than half of them women. A high percentage of beneficiaries either (re)enter into employment after training or report better employment conditions and higher income.

- *Cohesion policy leverages public and private capital in support of productive investment*

Between 2000 and 2006 every euro invested by cohesion policy led to further expenditure in Objective 1 regions averaging 0.9 euros. In the Objective 2 regions, this induced expenditure can go as high as 3 times the amount initially invested. This is achieved through policy rules such as co-financing and partnership and through increasing involvement of private capital, including a variety of public-private partnerships arrangements.

More recently, the Commission, in cooperation with the international financial institutions, has developed innovative financial instruments, to combine with and to

complement European grant financing: JEREMIE for the promotion of SMEs and micro-credit and JESSICA for urban development. This will transform grants into recyclable forms of finance making them more sustainable over the longer term; it will increase the leverage effect brought about by using such grants to attract and combine with private capital; and will introduce stronger incentives towards better performance.

- *Cohesion policy has fostered integrated approaches to development*

Cohesion policy helps to foster development, including the impact of complex problems such as challenges posed by globalisation, climate change, demographic trends, in an integrated manner which gives coherence to different sectoral policies. This integrated approach has helped to improve the overall impact of sectoral interventions by exploiting synergies between policy domains and controlling for their side effects; by favouring dialogue between administrations; and by better adapting interventions to the socio-economic characteristics of regions and localities.

- *Cohesion policy helps to improve the quality of public investment*

The 7-year programming approach of the policy, based on a secure budget over this period, has significantly improved long-term budgetary planning in many Member States and regions. In addition, cohesion policy helps to identify priorities for public investment decisions, thereby resulting, notably in cohesion countries, in a more effective and efficient use of public investment in general, not only where that investment was co-financed by the Community. In this way, cohesion policy influences the investment pattern, shifting it towards higher productivity and greater sustainability.

- *Cohesion policy has promoted partnership as a key element of good governance*

The partnership principle is a fundamental principle underpinning all aspects of cohesion policy – programming, implementation, monitoring and evaluation – and has now been widely accepted as a key element of good governance. The system of multi-level governance, based on strategic approach and involving Community, national, regional and local authorities and stakeholders helps to ensure that actions are adapted to circumstances on the ground and that there is a genuine commitment to success.

## **2. SITUATION AND TRENDS IN ECONOMIC, SOCIAL AND TERRITORIAL DISPARITIES**

### **2.1. Economic Cohesion**

- *Convergence is occurring both at national...*

The largest beneficiaries of cohesion policy during the period 1994-2006 – Greece, Spain, Ireland and Portugal – as a group have achieved an impressive growth performance. Between 1995 and 2005, Greece reduced the gap with the rest of EU-27, moving from 74% to reach 88% of the EU-27 average in 2005. By the same year, Spain and Ireland had moved from 91% and 102%, respectively, to reach 102% and 145% of the Union average. At the same time growth in Portugal has been below the EU average since 1999. In 2005 its GDP per head was 74% of the EU average.

It is among the new Member States, especially those with a very low GDP per capita, where faster growth and more rapid catching up are visible. The GDP of the three Baltic States has almost doubled over the decade from 1995 to 2005. Poland, Hungary and Slovakia have also performed well with growth rates more than double the EU average.

However, due to very low starting points for GDP per capita, and assuming the current growth rates, it seems likely that it will take more than 15 years before Poland and, most especially, Bulgaria and Romania will reach a GDP per head of 75% of the EU-27 average.

- *...and at regional level*

Relatively strong economic growth in regions with a low GDP per head over the past decade has meant that, overall, EU regions have been converging. Between 1995 and 2004, the number of regions with a GDP per head below 75% of the EU average fell from 78 to 70 and the number of those below 50% of the EU average declined from 39 to 32.

The lagging regions in the EU-15, which were major recipients of support under cohesion policy during the period 2000-2006, showed a significant increase in GDP per head relative to the rest of the EU between 1995 and 2004. In 1995, 50 regions with a total of 71 million inhabitants had a GDP per head below 75% of the EU-15 average. In 2004, in nearly one in four of these regions home to almost 10 million, GDP per head had risen above the 75% threshold.

- *...but disparities remain important*

In spite of this progress, absolute disparities remain large. This is partly as a result of recent enlargement and partly as growth tends to concentrate – during the initial phases of development – in the most dynamic areas within countries.

Even some of the most developed regions (those which have GDP level above 75% of the EU-27 average) are starting to experience very low or even negative economic growth rates. In the period 2000-2004, real GDP per head fell in 27 regions and in a further 24 it grew by less than 0.5% a year. In five of these regions, GDP per head slipped below 75% of the EU average.

- *Increases in employment and productivity are raising growth in the regions*

The lagging regions are catching up rapidly in terms of productivity. This is particularly evident in new Member States: in the three Baltic States and in parts of Poland productivity grew four times faster than the EU average between 1995 and 2004. Some of these regions, however, start from very low levels. As the employment in these regions shifts to higher added-value sectors, regional productivity is likely to rise even if sectoral productivity remains stable.

In 2004 the regions in Portugal, Greece, Ireland and Spain still had considerably higher productivity levels than the new Member States. Ireland combined the highest employment growth in the EU with significant increases in productivity. Regional economic growth in Spain, on the other hand, relied almost exclusively on employment

growth which suggests that such growth might be difficult to sustain over the long-term. In Portugal, employment rose substantially up to 2001 but has remained flat since, while in Greece employment growth was limited up to 2001, but afterwards has increased significantly.

Nine out of ten of the more developed regions have seen their employment increase and almost as many saw their productivity increase. Nevertheless, between 1995 and 2004, productivity declined in 29 regions in Italy, France, Spain and Germany, while employment declined in 16 regions mostly in Eastern Germany and in Northern England.

## **2.2. Social Cohesion**

- *Employment rates converged at the EU level and the national level ...*

Between 2000 and 2005, regional employment rates converged within the EU. Yet in 2005 employment rates in the lagging regions were still some 11 percentage points lower than those in the rest of the Union.

Over this period certain countries experienced a consistent and widespread increase of employment, while others – such as Romania and Poland – recorded a decline in the majority of regions, in some cases by more than two percentage points.

In order to achieve the Lisbon employment rate targets, the EU needs to generate some 23.5 million more jobs of which 7 million should be taken by women and 7 million by people aged 55-64. Creating jobs on this scale will require investment in new activities matched by trained labour to take them up.

- *... and disparities in unemployment rates have decreased*

Between 2000 and 2005, unemployment fell from 13.4% to 12.4% in the lagging regions, though in 17 of them unemployment increased by over 2 percentage points.

In the more developed regions, unemployment remained stable between 2000 and 2005 with a rate just below 8%, though with Spanish, Italian, French and UK regions generally experiencing a reduction in the rate and German, Austrian, Dutch and Belgian regions, some increase.

In 2005, the unemployment rate of women was higher than the one of men in the EU, but the difference shrank by a third between 2000 and 2005. The gap was biggest in Greece, Spain and Italy.

- *Poverty remains a challenge...*

The share of the population at risk of poverty remains relatively high in some Member States. Defined as those having an income of 60% below the *national* median income, in 2004 the proportion falling into this category reaches around 20% in Lithuania, Poland, Ireland, Greece, Spain and Portugal, but only 10% in the Netherlands, the Czech Republic and Sweden. On average, those at risk of poverty in 2004 totalled 16% of the EU population, or around 75 million people. This risk is higher for women, young children, the elderly and the unemployed.

- *Education levels are increasing but remain low in lagging regions*

An important factor in a competitive knowledge economy is an educated and well qualified workforce. Improvements over time can be seen: the share of young people aged 25-34 with a university degree or equivalent is increasing and is now almost twice the proportion of the older generation aged 55-64. However, educational attainment levels of young people are lagging behind in some Member States, notably in Romania, the Czech Republic, Italy and Slovakia.

In 2005, some 23% of people aged 25-64 in the EU had an education to tertiary level, ranging from 35% in Finland to around 10% in Romania. The differences between the regions are even bigger and they are not converging. On average, lagging regions have a smaller proportion of people aged 25-64 with tertiary education.

### **2.3. Territorial cohesion**

- *Less territorial concentration of EU-27 GDP in the traditional core of Europe...*

Evidence suggests that economic prosperity in the EU is becoming less geographically concentrated: the traditional economic "core" of Europe (the area between London, Paris, Milan, Munich and Hamburg) contributed a substantially smaller share of EU-27 GDP in 2004 than in 1995, while its share of the population remained stable. This tendency is due to the emergence of new growth centres such as Dublin, Madrid, Helsinki and Stockholm, but also Warsaw, Prague, Bratislava and Budapest.

- *... But more so at the national level...*

Within the Member States, however, economic activity has become more concentrated in capital city regions throughout the EU, with the exception of Berlin and Dublin. Between 1995 and 2004, on average the capital region's share of national GDP increased by 9%, while their population grew by 2%. This trend was particularly strong between 1995 and 2000, especially in Warsaw and Bucharest.

Increasing concentration of population and economic activity in capital city regions could in the longer term constrain overall economic growth as negative externalities such as increases in housing costs, shortages of business space, congestion and pollution negatively affect their image and competitiveness. Secondary growth poles might help to reduce the pressure on the capital city region and promote higher overall growth potential.

- *... With a trend towards suburbanisation, ...*

The dominant trend in European cities is towards suburbanisation. Between 1996 and 2001, in 90% of urban agglomerations, population in the suburbs grew at higher rates than in the core of the city. One third of these urban agglomerations lost population over this period, yet most of these cities saw their suburbs grow while the city centres declined. The suburbanisation of population inevitably places greater strains on the urban transport system, while the suburbanisation of economic activity can lead to the economic decline of the traditional city centre.

The concentration of deprivation in urban neighbourhoods remains an issue in many European cities. Despite the concentration of employment in cities, city dwellers, especially the less qualified, have difficulty finding a job, while one third of jobs are taken by people commuting into the city.

This is combined with the concentration of unemployment in particular city districts. In these high unemployment districts, other aspects of deprivation are typically concentrated. This includes low quality housing and inadequate public transport and other services such as education as well as low income levels and high crime rates.

- ... while some rural areas continue to lose population

Significant outward migration from rural areas is still the prevailing trend in large parts of the EU, notably in the South of Italy, the North of Finland, Sweden and Scotland, Eastern Germany and in the eastern parts of Poland. The lack of job prospects outside agriculture and lower living standards drive people, especially the young and qualified, to seek opportunities elsewhere. This has cumulative effects on the areas concerned, leaving them with an ageing population and shrinking basic services<sup>2</sup>.

- ... and there is large potential for more cross-border exchanges

Many years of cross-border programmes have improved co-operation between border regions within the EU-15, especially between the Benelux countries, Germany and France. The new internal borders are not as permeable yet and traffic flows are much lower.

Increasing the permeability of these borders, both physically and administratively, will facilitate the flow of people and goods between these regions and lead to the levels of economic exchange matching the economic potential of these regions. This type of cooperation activity is even more important for the border regions located along the external border.

### 3. THE REFORM OF COHESION POLICY – 2007-2013

The European Spring Council in 2005 indicated that:

*"It is essential to re-launch the Lisbon Strategy without delay and re-focus priorities on growth and employment. Europe must renew the basis of its competitiveness, increase its growth potential and its productivity and strengthen social cohesion, placing the main emphasis on knowledge, innovation and the optimisation of human capital.*

*To achieve these objectives, the Union must mobilise to a greater degree all appropriate national and Community resources – including the cohesion policy – in the Strategy's three dimensions (economic, social and environmental) so as better to tap into their synergies in a general context of sustainable development."*

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<sup>2</sup> The rural Development Fund has an important role to play to meet these challenges. See Communication from the Commission to the Council and the European Parliament on Employment in rural areas: closing the job gap - COM(2006) 857, 21.12.2006.



The bulk of the EU effort to reduce disparities in the EU at the territorial level is through cohesion policy. This takes the form of a conditional grant, with the conditions attached to the transfers at the level of aims and at the level of the implementation system. In particular, Member States are required to draw up a medium-term strategy for the use of the resources, to co-finance European aid from national resources, to work in partnership at national, regional and local level, and to respect EU laws and policies. These conditions have resulted in the development of a shared management system, between the European, national, regional and local levels: in short, a system of multi-level governance.

Following the reform of cohesion policy in 2006 for the period 2007-2013, the main aim of cohesion policy remains to reduce disparities between the Member States and regions through the concentration of resources on the less developed areas. For the period 2007-2013, the bulk will be concentrated on the poorest regions and countries: whereas in 1989, 56% of available resources were allocated to the lowest income regions, at the end of the new programming period, the proportion will be 85%. The new Member States, which represent around 21% of the population of the EU-27, will receive just over 52% of the total over the period. However, in line with the new growth and jobs agenda and in the context of globalisation, cohesion policy is putting increasing emphasis on improving the competitive position of regions in the world economy. Thus, resources are focused on all the regions coping with structural adjustment and on investment with a particular emphasis on the cluster of activities around research, innovation, and the information society and business development.

The result of these aims is that, in the period 2007-2013, cohesion policy will pursue everywhere the same growth and jobs agenda, but with the intensity of support from the Union reflecting the needs and available resources of Member States and regions. The outcome of the negotiations on the Financial Perspective for the period 2007-2013 which resulted in a major allocation to cohesion policy (35% of the total EU budget) suggests that there is a high degree of political consensus around this system for delivering Community priorities.

### **3.1. Delivering Europe's new growth and jobs strategy**

The generation of growth and jobs has historically been at the centre of EU cohesion programmes and the reform of the policy for 2007-2013 has sought to reinforce this dimension.

- *A new strategic approach*

A more strategic approach based on European priorities will frame the process of implementation at EU level of cohesion policy, at the national level and then down to the regional and local level. This should contribute to increased economic effectiveness, as well as increasing transparency and facilitating political accountability. This is the approach set out in the Community Strategic Guidelines, which reflect the priorities set by the renewed Lisbon strategy and which create in turn the framework for the preparation of the national strategies under cohesion policy and programmes.

- *Earmarking*

Member States decided in December 2005 that the authorities responsible for preparing the new generation of cohesion programmes should "earmark" a certain proportion of the resources for the key investments linked to the renewed strategy for Growth and Jobs (R&D and innovation; infrastructures of European importance; industrial competitiveness; renewable energies, energy efficiency, eco-innovations; human resources), and in particular 60% in the least developed regions and 75% in other regions.

According to the programming documents available for this report, these targets have been largely reached. In the EU-27 the average proportion of the resources earmarked for key Lisbon investments is 61.2% under the Convergence objective and 76.7% under the regional competitiveness and employment objective. Overall, around € 200 billion will be allocated to these investments. Compared to the previous period, this represents an increase of more than € 50 billion.

### **3.2. Better regulation: simplification and proportionality**

While the use of the resources of cohesion policy needs to fulfil the standards of control and good financial management, important steps have been taken to streamline legislation and simplify rules for managing cohesion policy. In particular:

- *One set of management rules*

There is now a single Commission implementing regulation for the 2007-2013 programming period, which replaces 10 regulations for the 2000-2006 programming period. The rules for management of programmes financed by the Cohesion Fund have been aligned with those of the Structural Funds. This will make managing the Funds easier and less costly.

- *One set of eligibility rules for expenditure*

Member States will be able to use national eligibility rules for co-financed projects, rather than two sets of rules as in the past (one for Community co-financed projects and one for nationally-funded projects), thus greatly simplifying project management.

- *Simplification of financial management*

The financial plans, the setting of the intervention rate and EU reimbursements will now be made at a higher level (at programme or priority axis level, instead of at measure level, as before). This will simplify management of the programmes, and limit the cases where financial plans need to be modified, thus giving a wider autonomy to the national authorities in charge of the management of operational programmes.

- *Increased proportionality and simplification for control systems*

For smaller programmes, a part of the requirements on control arrangements can be carried out by national bodies established according to national rules, thus reducing the need to comply with certain Community audit requirements.

- *Clearer rules on information and communication*

Citizens and potential beneficiaries of the Funds in all Member States will have the same access to information on funding opportunities and awards from cohesion policy, thus reducing the time and effort they have to spend in finding such information.

- *Electronic government in practice*

For the first time, document exchange between the Member States and the Commission will be done only electronically. This marks the beginning of a new era in terms of electronic data exchange and e-Governance. It will save much time in running programmes and will reduce the risk of disagreement between the Commission and Member States on the amount and type of information to be provided.

### **3.3. Cohesion policy and the projection of EU values and policies**

Countries outside the Union have been expressing increasing interest in, and a desire to learn more about, European cohesion policy as a means of fostering more balanced regional development. In particular:

- On 15 May 2006, a Memorandum of Understanding on regional policy co-operation was signed between the Commission and China. The Chinese authorities made a balanced regional development one of the key priorities of their five-year development plan and are increasingly concerned with widening regional income gaps. Since 2005 China and India have also agreed joint action plans and signed memoranda of understanding in the area of employment and social policy with the European Commission.
- On 23 May 2007, a Memorandum of Understanding on regional policy cooperation was signed with the government of the Russian Federation to exchange information and best practices on experiences in setting up and implementing cohesion policy.

Similar approaches are being discussed with countries such as South Africa and Brazil and with economic integration groupings such as Mercosur. At the same time European cohesion policy is raising the interest of the United Nations, OECD and World Bank Committees. A key part of the added value of European cohesion policy in this context is to underpin European views on such issues as free markets, gender equality and equal opportunities, sustainable development, and a system based on participative democracy.

## **4. NEW CHALLENGES**

Berlin declaration on the occasion of the 50<sup>th</sup> anniversary of the signature of the Treaties of Rome:

*"There are many goals which we cannot achieve on our own, but only in concert. Tasks are shared between the European Union, the Member States and their regions and local authorities."*

Growth and employment in Europe require policies which are able to anticipate and manage new challenges. Some of these challenges are particularly relevant to cohesion policy since they have an uneven impact on Europe's territory and may widen social and economic disparities.

- *Increasing global pressure to restructure and modernise*

Virtually all regions are confronted with the need to restructure, modernise and facilitate continuous knowledge-based innovation, in products, management and processes as well as human capital, to face the challenge of globalisation. Even against a background of impressive growth rates, regions of the new Member States have an economic structure largely concentrated on sectors where competition from the emerging Asian economies is high. The economic imperative for these regions will be the anticipation and facilitation of change. This will help minimise the costs of change and also be an enabling factor for change. For these reasons, anticipative measures must be taken well in advance to equip and prepare the people and the regions for change.

Similarly, many regions in the more prosperous Member States have a high share of employment in traditional sectors, where competitive advantage is largely based on lower-cost, lower-wage production methods.

Competition based on cost factors alone is not a viable option, and regions need to modernise and diversify their economic structure into high added-value sectors by creating the conditions for businesses, and particular SMEs, to adopt and adapt innovative products and processes, to establish cooperation networks with other enterprises and with research institutes, to access risk capital, and to internationalise their activities.

Leading edge economic activities and talent tend to be geographically highly concentrated in a few urban centres that are global players. This is creating opportunities, but research shows that after a certain size, negative externalities linked to the concentration of population such as pollution, urban sprawl, and congestion start to emerge.

There are many regions in the Union which rank among the most competitive and innovative regions in the world and which are benefiting from globalisation. This has been achieved by investing in new skills, building or attracting new reservoirs of talent, and favouring networks and clusters. It is by building on these successes and development strategies that the Union can mobilise all its potential and place its economy on high-growth, sustainable path.

- *Climate change*

Many regions throughout Europe will be increasingly confronted with the asymmetric impact of climate change. This will pose serious challenges to agriculture, fisheries and the tourism industry in certain areas, and will require significant investment to face drought, fires, coastal erosion and flooding. These changes may have disproportionate effects on disadvantaged or low income groups which might lack the means to adapt to them. Significant investments will also be necessary to comply with the Community acquis and the emission reduction targets that result from the Spring Council of March

2007. All available economic reports indicate, however, that the cost of not acting in terms of natural disasters by far exceeds the costs of reducing greenhouse gas emission to a level that is compatible with the EU's objective of limiting climate change to 2 degrees Celsius.

The fight against climate change provides regional economies with new economic incentives and opportunities through eco-innovation, the growth of environmentally friendly industries and employment in this area.

- *Increased energy prices*

Increased energy prices will affect EU regions in different ways depending on their energy mix, economic structure and the energy efficiency of their firms. Increased transport costs tend to hit the geographically peripheral regions, such as the northern parts of Finland and Sweden or the most southern parts of Portugal, Spain and Italy, and in the islands, including Malta and Cyprus. Key sectors for many such regions, such as tourism, could be vulnerable to cost increases although this could be offset in the short-term by the gains in efficiency from low-cost air carriers. Increases in energy prices have a disproportionate effect on low-income groups and increase the energy poverty of the disadvantaged.

Developing or expanding renewable energies and investing in energy efficiency provide major opportunities for most regions, with a high local job potential. For example, it is estimated that the annual revenues of the global solar equipment industry will increase four-fold in the three years to 2010. Also, increases in energy prices could encourage growth strategies, especially in the lagging regions, based on less energy-intensive methods of production.

- *Emerging demographic imbalances and social tensions*

One in three regions in the Union experienced population decline between 2000 and 2003. In the majority of cases, this was due to both natural population decline and net outward migration. Projections indicate that natural population growth will continue to decline, including in many of the lagging regions. These regions will thus face a double challenge of fostering growth and employment while tackling the adverse impacts of aging and population decline.

Demographic change and decline puts future employment growth at risk. Until 2011, there is still scope for significant employment and economic growth. Between 2012 and around 2017 rising employment rates can be expected to offset the decline in the size of the working-age population. From 2017 onwards, however, the shrinking working-age population could lead to stagnation and, subsequently, a reduction in the absolute level of employment.

In parallel, regions will have to cope with a number of social challenges posed by skill mismatches (labour market segmentation between high skills/high salaries and low skills/low salaries, increased immigration) as the economy moves up the value chain into knowledge based activities, against an environment where traditional security institutions are eroding.

- *National policies face increasing difficulties in keeping up with the rapid pace of change imposed by these trends*

While public investments are increasingly managed at the sub-national level, the trend over the past years has been on a declining path as national and sub-national budgets are confronted with the consequences of an ageing population (reform of the pension system, more costly systems for health, education and social services) and economic reform based in part on lower taxation.

In addition, resources which remain available to accompany the modernisation of the economy are mainly directed towards growth poles. This may create large diseconomies of agglomeration (congestion, pollution, social segregation, urban sprawl) on the one hand, and increasing regional disparities on the other.

## 5. NEXT STEPS

During 2007 and 2008 the Commission will develop its approach to the budgetary review 2008/2009, setting criteria for policy assessment, looking at future policies, testing the viability of different options. Within this framework, and without prejudging the outcome of the budgetary review, this report indicates a range of challenges with which cohesion policy may be confronted in the coming years. The Cohesion Forum, which will take place on 27/28 September, will provide a first opportunity to discuss them with relevant stakeholders. More specifically, the Forum could be organized around the following questions.

1. What lessons can be drawn from the experience of preparing the 2007-2013 programmes? In this context and in the light of the analysis provided by this report, how far is cohesion policy adapted to the new challenges European regions will face in the coming years? For example:
  - 1.1. How can the regions react to restructuring pressures from dynamic competitors in low and medium tech sectors?
  - 1.2. Given wide differences in birth rates, death rates and migratory flows at regional level, what is the role of cohesion policy in responding to demographic change?
  - 1.3. To what extent is climate change a challenge for cohesion policy?
2. How can cohesion policy further develop an integrated and more flexible approach to development/growth and jobs in this new context?
  - 2.1. How can cohesion policy better promote harmonious, balanced and sustainable development taking into account the diversity of EU territories, such as least favoured areas, islands, rural and coastal areas but also cities, declining industrial regions, other areas with particular geographic characteristics?
  - 2.2. What are the impacts of the challenges identified in the report for key elements of social cohesion such as inclusion, integration and opportunity for all? Are further efforts needed to anticipate and counteract these impacts?

- 2.3. What are the key future skills that are essential for our citizens in facing new challenges?
- 2.4. What are the critical competencies that should be developed at the regional level to make regions globally competitive?
3. Following the appraisal of the previous questions, what is the assessment of the policy management system for the period 2007-2013?
  - 3.1. Given the need for efficient management of cohesion policy programmes, what is the optimum allocation of responsibility between the Community, national and regional levels within a multi-level governance system?
  - 3.2. How can cohesion policy become more effective in supporting public policies in Member States and regions? What mechanisms of delivery could make the policy more performance-based and more user-friendly?
  - 3.3. How can we further strengthen the relationship between cohesion policy and other national and Community policies to achieve more and better synergies and complementarities?
  - 3.4. What are the new opportunities for co-operation between regions, both within and outside the EU?