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INVESTMENT AND THE REGIONS

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Introduction

The European Community's efforts to promote its internal cohesion have recently been reaffirmed and strengthened following the agreement at Maastricht. These efforts are now seen as central to the Community's further development and are coming to take a major share of the Community's budget - a share which is likely to grow further if the terms of the "Delors II" package are agreed by the Member States[1].

The European Parliament has expressed support for the Commission's proposals and has commissioned its own study on "A new strategy for social and economic cohesion after 1992", published for the Second European Parliament/Regions of the Community Conference held in Strasbourg in November 1991. One of the conclusions of the latter study, prepared by the National Institute of Economic and Social Research of London, was that the Community's aid to the regions should pay greater attention to the "leverage" of the public investments supported through the Structural Funds, that is, to the level of private investment in job-creating and wealth-producing economic activity brought forth as a consequence of the public investment, of which most continues to be in physical infrastructure.

The link between private and public investment - whether the latter is in infrastructure or less tangible matters such as training - is a crucial concern for all those who wish to see a real impact on the less-favoured regions resulting from the Community's efforts to promote cohesion. Evidently, investment in a motorway or dam in an Objective 1 region of the Community that is part-financed by Community tax-payers has little sense unless it contributes to the economic growth of the country and region that are the recipients of Community financial assistance and ultimately to a narrowing of the gap in living standards between richer and poorer regions of the Community.

This link remains unclear and, even for regions that have benefited for decades from regional transfers for infrastructure and the attraction of private investment at the national level, there remains a suspicion that public

[1] See Com(92)2000 - "From the Single Act to Maastricht and Beyond"

expenditure has been wasted because it does not correspond to a real need expressed by local people in the area concerned who therefore do not make use of the additional opportunities for economic activity created by the public investment. Furthermore, it seems that in some regions of the Community little private investment is currently being attracted from companies outside the region because of various obstacles which are investigated below.

Nevertheless, it is also generally agreed that no private investment on a scale sufficient to make a difference to the gap between the Community's regions can be expected unless certain prerequisites are fulfilled. Amongst these a minimum level of transport, communications and social infrastructure must be included. Since this level is clearly inadequate in many regions of the Community, there continues to be some justification for intervention at the Community level to improve this situation in regions where financial resources at the regional and national level are inadequate to meet the challenge.

This note investigates what more needs to be done to ensure that the current emphasis on improvements to infrastructure and investments in the educational and training systems of the Member States results in a real rise in the standard of living of the inhabitants of those regions classified by the Community as eligible for support from the Structural Funds.

"Direct investment"

Productive investment in manufacturing or service industries is essential to provide firms and their workers with the machines and facilities necessary to maintain their output and keep their products competitive with those of other suppliers. It is also necessary for new economic activities to begin which can take the place of others in decline. This investment need not necessarily be undertaken by privately-owned firms: the state and the cooperative sector have traditionally undertaken an innovative role in the economy of many European countries. For this reason, economists tend to refer to "direct investment", rather than private investment when discussing investment in productive economic activity, especially in the context of the balance of payments.

However, public authorities are beholden to their electorates and public investment in productive sectors of the economy has frequently been undertaken to prop up dying industries or to provide employment even where the rate of return on the investment is inadequate by commercial standards. Where this public investment supports enterprises which compete in the market with the private sector, the public enterprises benefit from an unfair competitive advantage which conflicts with the competition rules of the Treaty of Rome.

Public investments undertaken for non-commercial reasons also risk distorting the economy of the recipient regions and reducing their capacity to compete in the future, with the prospect in consequence that their economies will not be able to provide the local inhabitants with a high standard of living in relation to that of competing regions.

Investment in itself is not therefore necessarily the answer to the problems of the Community's poorest regions. What is needed is investment with a satisfactory "rate of return". Countries in Eastern Europe, such as Poland, invested heavily in the modernisation of their economies in the 1970s using capital borrowed from the West. It seems that this investment was largely wasted because it did not correspond to the real needs of the economy and was poorly planned and implemented. The best measure for ensuring that an investment is "wise", whether it be in the private or public sectors of the economy is this rate of return on the investment, although it need not be calculated exclusively in financial terms and may include intangible benefits. Usually, private investors are better placed to estimate the rate of return and to calculate the relative advantages of different types of investment in different locations.

Nevertheless, especially for those regions that are currently lagging behind - those classified as Objective 1 regions for Community purposes - a high rate of productive investment in competitive branches of the economy is essential if they are to catch up with more prosperous regions. Recent information shows that three of the four poorest Member States of the Community have been narrowing the gap, defined as GDP per capita calculated in purchasing power parities, while the fourth, Greece, has been falling behind[1]. Any study of convergence and the role of the Community's Structural Funds is therefore bound to begin with an analysis of why this should be the case and of the role of investment.

<u>Ireland, Spain, Portugal - and Greece</u>

It is now part of conventional wisdom to assert that good macro-economic policies are necessary at the national level if countries are to enjoy steady growth of their economies. Analyses of the recent experience of these, the four poorest Member States of the European Community, are united in ascribing the relatively good performance of Ireland, Spain and Portugal to restrictive national fiscal and monetary policies, which have contributed to reductions in rates of inflation and to public sector borrowing requirements. On the other hand, the poor performance of Greece tends to be ascribed to an unwillingness to restrain public expenditure, a failure to collect taxes, an excessive growth of the numbers of public employees and massive intervention by the state in the economy, which has diminished its international competitiveness.

These factors are certainly essential elements in the equation concerning the recent economic performance of the four countries. The Commission's Annual Economic Report for 1991-2 does however also draw attention in the case of Greece to the role of investment in the low growth of its economy in recent

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[1] Tables for the main economic indicators published in the Commission's Annual Report for 1991-1992 (European Economy No. 50, December 1991) show GDP per head at current prices and purchasing power standards increasing from 72.8 in 1986 to 79.9 in 1992 in the case of Spain (EC12=100), from 63.4 to 68.9 in the case of Ireland, from 52.5 to 56.3 in the case of Portugal, but decreasing from 55.9 to 52.1 in the case of Greece.

years and to the link with profitability. An analytical study accompanying this Annual Report examines this question of the profitability of fixed investment in detail and emphasises the strong link between "capital formation" (private investment) and profitability in a preceding period.

It follows that if the catching up process is to occur and if a more rapid rate of investment in productive activities is to be attained in the least-favoured regions of the Community than in its wealthier parts, then profitability needs to be higher in the least-favoured regions. Indeed, since Spain, Portugal and Ireland have been successfully "narrowing the gap" in recent years the profitability of investment should have been appreciably higher in these countries than elsewhere in the Community. Unfortunately, the available statistics from national and Community sources do not confirm this hypothesis; although Spain has had one of the highest rates of profitability, Portugal, for example, according to the statistics reproduced in the December 1991 issue of European Economy, has had a low count on all three available indicators relative to more prosperous Member States[2].

The excellent position of Spain and Portugal as a destination for investment is however confirmed by the accompanying table based on figures published by the US Department of Commerce.

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[2] It seems likely that these statistics are inadequate, however, and reference is made in the accompanying text to uncertainties in Greece, Ireland and Portugal about "self-employed imputed income and to the still important weight of the agricultural sector". The considerable size of the black economy in some Member States may lead to some investment going unreported.

RATE OF RETURN ON CAPITAL OF US FIRMS ABROAD - %

	1986	1987	1988	1989	1990	Average
WORLD	12.6	14.1	15.5	15.3	13.8	14.3
EC	15.6	16.7	18.2	15.9	15.1	16.3
BELGIUM	20.1	19.7	17.0	15.8	15.6	17.6
DENMARK	16.0	13.0	13.8	12.9	18.1	14.8
FRANCE	14.9	15.1	17.3	16.5	15.9	15.9
GERMANY	12.9	13.2	13.5	15.9	15.8	14.3
GREECE	-86.9	27.4	35.5	23.1	29.1	5.6
IRELAND	19.7	22.4	20.3	20.1	21.7	20.8
ITALY	26.3	16.5	17.7	15.0	17.3	18.6
LUXEMBOURG	14.1	10.5	6.8	15.8	16.8	12.8
NETHERLANDS	25.6	22.5	18.9	16.5	16.3	20.0
PORTUGAL	37.1	36.8	30.2	21.9	22.3	29.7
SPAIN	18.8	25.7	28.9	27.5	22.2	24.6
UNITED KINGDOM	10.7	15.3	19.5	14.2	12.0	14.3

Source: US Department of Commerce, Survey of Current Business, August 1988, 1989 and 1991 (especially tables on "US Direct Investment Abroad, Country Detail for Selected Items)

N.B. This is a more complete and up-dated version of a table appearing in the OECD Economic Survey for Spain of 1991, p.64. The rate of return for any one year is calculated by dividing the 'Income' figures for that year by an average of the figures for 'Direct Investment position on a historical cost basis' for that and the preceding year. Total capital invested at the end of 1990 amounted to only $590 million in the case of Portugal and $300 million in the case of Greece - much lower figures than for other Member States including Ireland and Luxembourg. This may have resulted in some distortions.

Another explanation of the failure of high overall investment rates and profitability to show up in the statistics for certain countries may lie in the importance of foreign investment in the recent growth of their economies, for which statistics on volume and rate of return may not be fully integrated into their national statistical surveys. This issue is examined below.

What attracts investment?

Whether or not profitability is the principal determinant of the level of investment, it is highly probable that profitability is itself affected by macroeconomic policy and in particular its impact on inflation and taxes. The priority accorded to adoption of a restrictive economic policy which might allow the profits of firms - and therefore their investment rates - to reach a higher level is itself dependent on the existence of a political consensus and of stable government.

There are however other factors at work: investment by local and foreign firms depends on the availability of a supply of skilled labour, on the level of overall labour costs (including social charges and taking account of the productivity of the workforce) and on proximity and access to markets. In addition to these factors, which to a large extent may lie outside the control of public authorities, at least in the short to medium term, investors will also examine many other factors which are becoming of increasing importance. Investment grants, subsidised loans and tax holidays are, of course, all potentially crucial factors in attracting investors. But in particular, the quality of life for the managers and technicians responsible for ensuring the success of the investment is far more important than it used to be.

Thus, good schools, leisure facilities and an unpolluted environment are as necessary to retain highly qualified people in a particular region as competitive salaries; the image of the region as a desirable destination for new enterprises and for their executives may be transformed by public and private investment in cultural and sports facilities and in the renovation of public buildings. Access to attractive countryside is also of increasing importance.

Another factor that should not be underestimated is the quality of administration. Both at the level of central government and in local administrations, clear and fair legislation, ease of access to those empowered to implement the law and an efficient system of decision-taking which is transparent and uncorrupt are important elements in establishing a competitive economic structure.

<u>Obstacles to investment</u>

A survey of the factors which shape a region's competitiveness was carried out for the Commission in 1989[3]. Its results, reviewed in the Fourth Periodic Report on the social and economic development of the regions of the Community[4], are highly relevant to the question of attracting investment and are summarised in the Annex. The study covered 9000 companies located in Objective 1 or 2 regions, as well as firms in 10 relatively "favoured" regions and asked business managers to identify the three most important determinants of competitiveness out of 37 listed items.

The relatively higher cost of credit in lagging (Objective 1) regions was found to be the determinant mentioned most frequently as a high priority for improvement, although this factor determines investment by local entrepreneurs and need not affect the level of investment by large multinational firms. Other priorities were common to all regions and included a lowering of income and corporate rates of taxation, an increase in the supply of skilled labour, a reduction of indirect labour costs, deregulation of the labour market and a higher rate of general economic growth.

In general, obstacles to investment are frequently the contrary of the positive factors which attract investment that are discussed in the preceding section. They are often very difficult to quantify of even define precisely but a check list of such obstacles might read as follows:

Lack of skilled labour

Excessive direct and indirect costs of employing labour

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[3] "An empirical assessment of factors shaping regional competitiveness", IFO, Munich, 1990.

[4] "The Regions in the 1990s", Directorate General for Regional Policy, Commission of the European Communitites, OOPEC, Luxembourg, 1991.

Excessive cost of credit

Limited availability of risk capital

Polluted environment

Poor leisure and cultural facilities

Inappropriate or inadequate incentives and administrative procedures

Corruption and a lack of 'transparency' in granting authorisations

Poor educational and training facilities

Excessive proneness to strike action ("social climate")

Excessively high cost or limited availability of housing.

Many of these factors figure in the list of "determinants of regional competitiveness" to be found in part F of the Annex. Although some of these obstacles could be attacked by public authorities, it would clearly require a highly determined government acting consistently over a long period if many of these obstacles were found simultaneously to be hindering investment. Since it must be feared that in some of the Community's most backward regions it is indeed the case that private investment is handicapped by many of these factors working together, an enormous task must be faced.

Foreign versus domestic investment

Although the need for a high rate of productive investment by the private sector is generally acknowledged by all those who wish for economic growth in a market economy, the relative roles of foreign and domestic firms are still a matter of unease in many regions of the Community. It is felt that foreign-based companies have less commitment to the region where their investment is to be located, that multinational companies "exploit" their workforces and fail to consult them on important decisions and that investment is often limited to low-value assembly operations with the high-value design and component manufacture retained in the country of origin. Furthermore, the example of Ireland is often cited to show that foreign investment has not had the beneficial impact expected on the local economy, where firms have not incorporated the new technologies and modern management brought in by the newcomers.

However, there are a number of points to be made in reply to these criticisms. Firstly, the foreign nature of firms with headquarters located outside the region should be questioned when these headquarters are in another Member State of the European Community: the whole point of the single market initiative has been to create the perception amongst suppliers and consumers of participation in a single market of 365 million consumers and not in a narrow national market.

Secondly, the "loyalty" of local firms to their region will not prevent their collapse if they are uncompetitive - especially in the context of enhanced competition resulting from the completion of the single market. What counts in retaining firms is the profitability of their investment. In any case, a firm from outside the region, whether its headquarters are located in the same country, another EC Member State or a third country, which has made a major investment and despatched executives to the region will not lightly decide to close down: short-term losses will not cause a withdrawal, provided that there is the prospect of long-term profits.

Thirdly, the question of exploitation and consultation concerns all firms, domestic and foreign. Proper legislation and implementation by the public authorities can require certain minimum standards to be observed by all. As a matter of fact, employment practices of many large international companies are much more generous to employees than those of small firms. What cannot be avoided is the distance between the local employees and the centre of decision-making in the case of multinational companies - but this problem may be mitigated by sensitive policies at the centre.

Fourthly, the respective location of high and low-value-added operations must remain a commercial decision. Although an initial investment may result in concentration on assembly of components or - worse - although a takeover by foreign owners may result in the closure of a design centre, these decisions must be taken on commercial criteria if the viability of the enterprise as a whole is to be maintained. It is certainly not unknown for a multinational to open high-value research facilities in a region outside its headquarters, if suitably trained people are available at a competitive wage.

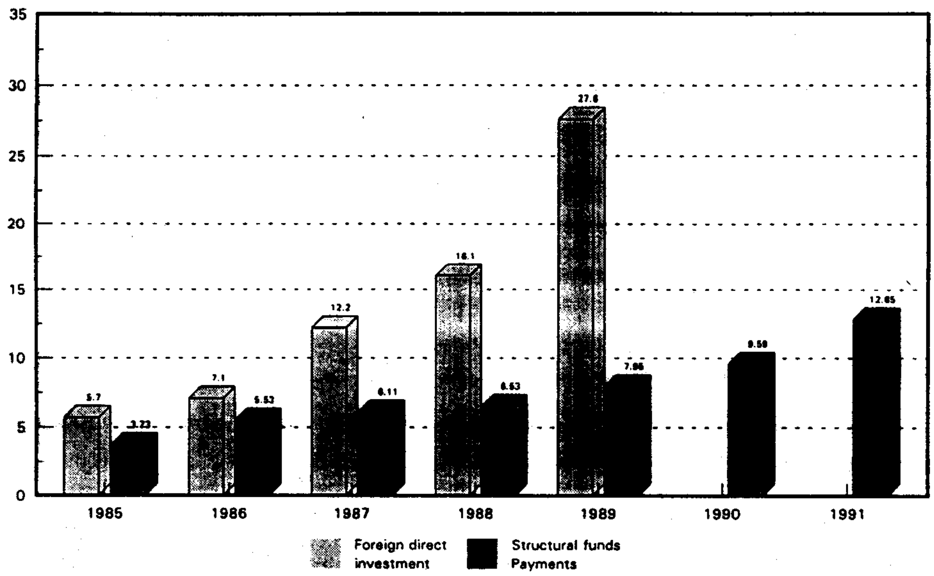
Finally, the links established between multinational branch plants and local industry may indeed be weak in some cases, but this is not true in all. Where there is a very large gap in technological sophistication between domestic industry and new foreign investments, it may indeed be extremely difficult to establish beneficial links (although it may just require a very long time for these links to emerge). On the other hand, evidence from the United Kingdom would suggest that - at least in the case of the motor industry - foreign investment may accelerate the modernisation and vastly improve the competitiveness of existing firms and component suppliers.

These arguments have not touched on the main benefits of attracting foreign investment: jobs, exports and tax revenue. Other less obvious advantages can include incentives for the modernisation of society as a whole - ranging from the quality of local administration to air transport links with other countries. Foreign investments can also contribute to an enhancement of a region's "image", with one firm's investment quickly leading to investments by rival companies in the same or related industries and by a process of mutual attraction to a general revival of domestic investment in the region.

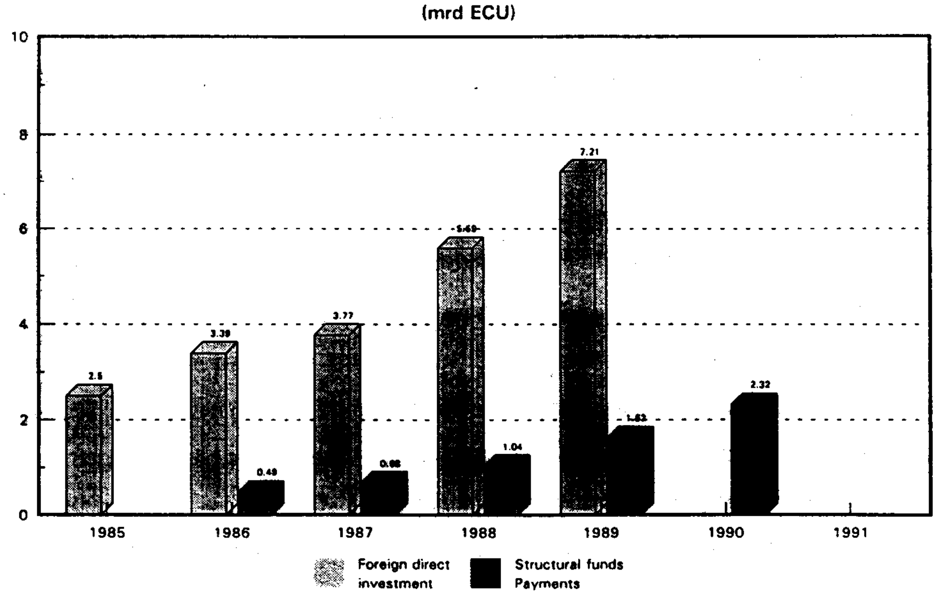
It is widely believed that the rapid increase in per capita incomes which has brought Spain and Portugal towards the Community average GDP per capita in the years since their accession to the Community is in large part to be ascribed, whether directly or indirectly, to the inflow of foreign investment. The reasons usually given for this increased flow from outside are their free access to Community markets, linked to relatively low total labour costs in the manufacturing sector. Foreign investment has also played a major role in the growth of Ireland's manufacturing sector and much of the increase in exports has been accomplished by foreign-owned companies. The relative size of foreign investment flows and receipts from the structural funds is investigated in the following graphs, based on the data collected in the annex to this paper.

THE RELATIVE IMPORTANCE OF FOREIGN DIRECT INVESTMENT AND THE EC STRUCTURAL FUNDS FOR SOME MEMBER STATES

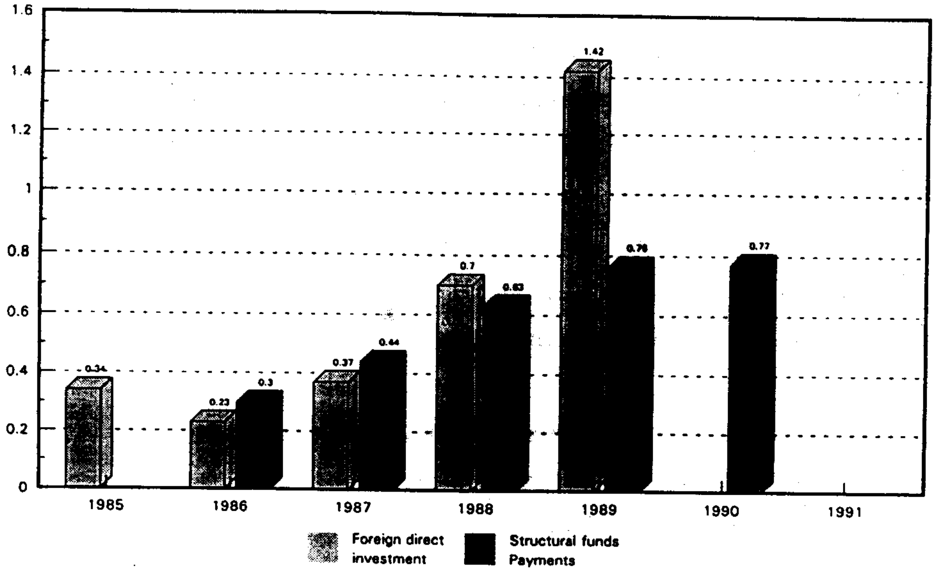
EC
(mrd ECU)



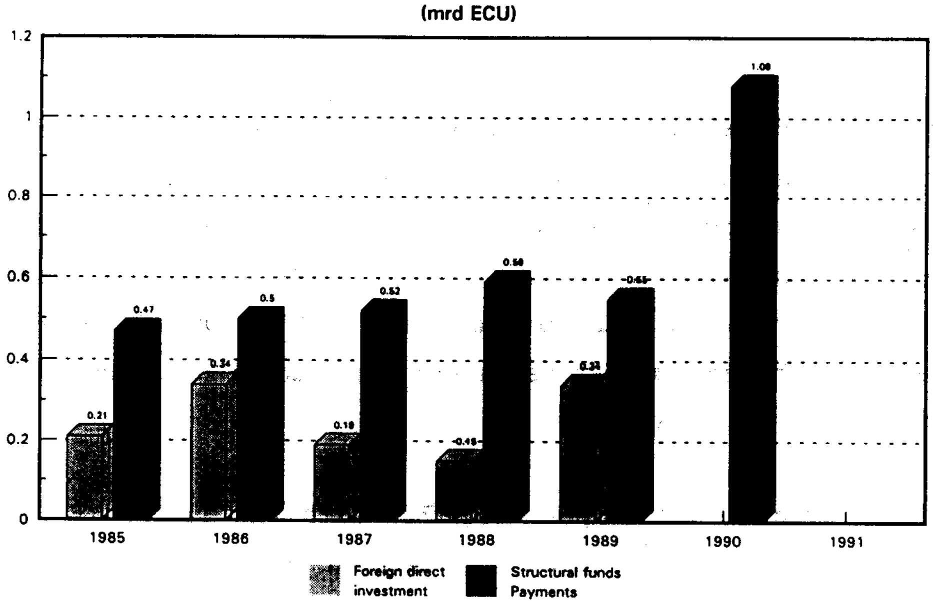
Spain
(mrd ECU)



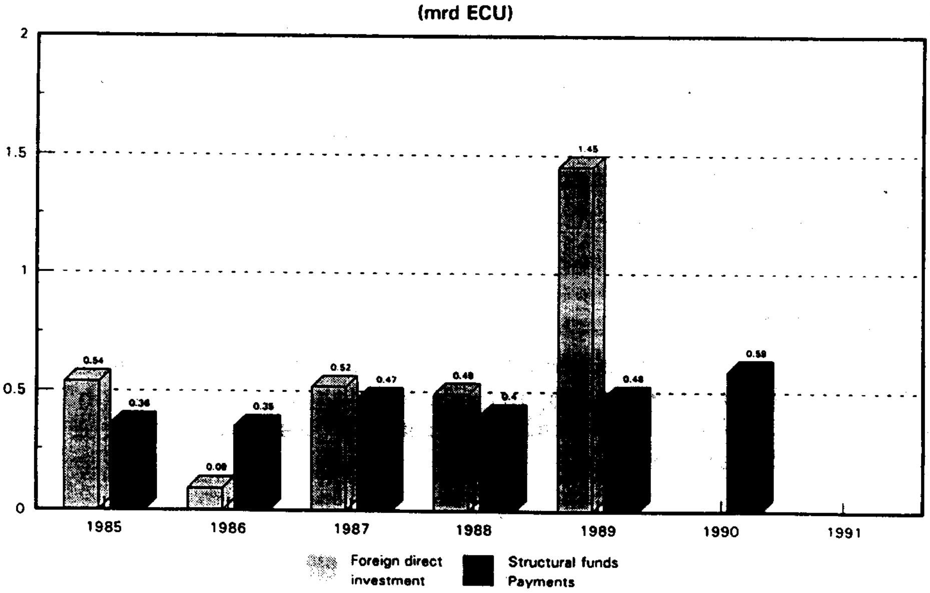
Portugal
(mrd ECU)



Greece
(mrd ECU)



Ireland
(mrd ECU)



Unfortunately complete data on investment is not available; "Gross Fixed Capital Formation (GFCF)", the statistical concept in the European System of Integrated Economic Accounts which is used to measure investment, is not a completely satisfactory measure for the purposes of this study. Firstly, for Greece and in part for other Member States a complete annual series of statistics showing the breakdown between investment by enterprises, households and governments within GFCF is not available.

Secondly, the investment concerned in the GFCF measurement is limited to durable goods (not military) "acquired by resident producer units in order to be used for a period of more than one year in their process of production..."[5], but public investment is generally conceived as a much wider concept than is compatible with the GFCF definition. Training and education, for example, would be excluded.

For this reason, comparisons between the value of the investments undertaken with support from the EC structural funds and of flows of foreign direct investment may be misleading. Only the European Regional Development Fund could be said to be truly comparable. Similarly, reliable data comparing foreign and domestic investment or public and private investment for all EC Member States are not available, although some estimates are included in the statistical annex which are related to these questions.

Despite these caveats, the graphs, together with the tables in the annex, make the important point that, in terms of financial flows, the structural funds contribute less to the Community's poorest Member States than does foreign invetsment (except in the case of Greece). For the European Community as a whole and for Spain the volume of foreign direct investment has in fact vastly exceeded the flows from the structural funds. This gap is also apparently growing rapidly. For Ireland and Portugal, the value of foreign investment is now also drawing away from the structural fund receipts, although there have been recent years in which the latter exceeded the value of foreign investment.

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[5] European System of Integrated Economic Accounts, Second Edition, Eurostat, Luxembourg, 1979, paragraph 337. "Gross capital formation" is defined as GFCF and change in stocks. "General government" is one of three categories within gross capital formation.

Only in Greece have receipts from the structural funds consistently exceeded foreign investment.

On the other hand, the importance of foreign direct investment in relation to total investment defined as GFCF is very variable. The ratio for the five-year period 1985 to 1989 is highest in Ireland (in 1989 it reached nearly 25%), but is high also in Spain and Portugal, averaging between 7 and 8 %; Greece, on the other hand, again lags behind with an average of just over 3% (see Annex, Table D).

A comparison of the structural funds with total investment would be less valid for the reasons discussed above. In any case, the volume of aid from the funds has been rising rapidly and figures for payments since 1990 may show a rapid rise. Nevertheless, if Southern Europe and Ireland continue to attract foreign investment at the same rate or better, which they are likely to do if only because of lower labour costs and access to the single market, it seems unlikely that the structural funds will again overtake the value of foreign investment, except in the special case of Greece.

The data therefore is compatible with the assumption that the good economic performance of Spain, Portugal and Ireland in recent years is linked to - although not necessarily caused by - their success in attracting foreign investment, while the opposite is true of Greece. The government of Greece is now making efforts to attract investment, but the question of the direction of the Community's efforts also needs to be raised.

A case study : Portugal

Although strictly comparable and complete statistics are hard to find, the OECD's recent Annual Report on Portugal[6] does provide an interesting comparison of the share of inward direct investment in the Gross Domestic Product of all OECD countries, reproduced in the Annex. The report examines the role of EC financing in Portuguese development, but draws especial attention to the enormous increase in capital inflows in recent years of both short-term and long-term nature. In both 1989 and 1990 these reached about 9% of GDP and

[6] Portugal, OECD Economic Survey 1991/92, Organisation for Economic Co-operation and Development, Paris.

represented an addition of over 30% to national saving as a source of financing for domestic investment. The EC structural funds were estimated by the Portuguese authorities to represent a further 7% of national saving.

Of these inflows, foreign direct investment (FDI) is stated by the OECD to be "a vital channel to achieve real economic convergence as well as to effect industrial restructuring". Foreign firms in Portugal have higher productivity levels and are more oriented to 'high-tech' and skilled labour-intensive industries, with a possible favourable demonstration effect on Portuguese entrepreneurs. On the other hand they are said to undertake little R&D in Portugal, to have restricted vertical linkages and possibly to engage in "transfer-price manipulation".

In recent years flows of FDI have exceeded $2 billion per annum (3.5% of GDP and 13% of gross fixed investment. In 1989 it represented a higher proportion of GDP than that in any other OECD Member State apart from Belgium and Luxembourg. Further increases are likely in future, assisted by the availability of EC-financed investment incentives, which have been instrumental in attracting major projects such as the Ford-Volkswagen joint venture to manufacture "people carriers" south of Lisbon.

The table below - reproduced from the OECD's Annual Report on Portugal - indicates the distribution of FDI by sector and origin. It will be noted that, while investment has grown strongly in most sectors, finance, real estate and business services have come to attract the lion's share, since - according to the OECD - these "remain undeveloped, yet highly profitable". In manufacturing,the most significant growth has apparently been in the traditional exporting sectors, such as textiles and clothing, and in "resource-based industries".

FOREIGN DIRECT INVESTMENT IN PORTUGAL BY SECTOR AND ORIGIN

$ million

	1986	1987	1988	1989	1990
Total	166	367	692	1 577	2 171
of which:					
Agriculture, forestry, hunting, fishing	3	14	24	22	24
Mining	7	12	20	25	12
Manufacturing	76	108	226	344	456
Utilities	0	0	0	1	0
Construction, public works	2	4	30	113	197
Trade, restaurants, hotels	48	69	122	279	214
Transport, storage, communications	0	13	6	17	8
Finance, real estate, business services	29	144	248	741	1 209
Community, personal, social services	1	3	16	35	27
Not specified	0	0	0	0	24
of which from:					
OECD	160	340	642	1 387	1 900
EC	127	241	478	1 149	1 579
Germany	18	26	51	115	141
Spain	14	57	63	184	238
France	17	36	74	270	395
United Kingdom	64	80	174	364	491
Others	14	42	116	216	314
Other Europe	17	38	77	154	196
USA	15	52	81	71	81
Japan	1	8	6	12	43
Rest of the world	6	27	50	190	271

Source: Bank of Portugal.

Source: Portugal, OECD Economic Survey 1991/2, Paris.

Future strategies for cohesion: Options for the European Parliament

This study argues that an increased flow of productive investment is necessary if lagging regions are to improve their economic performance and narrow the gap in living standards with more advanced regions of Europe. Some parts of Spain, Portugal and Ireland are now implementing this prescription with great success. Other regions within these countries and the whole of Greece are not doing so well. Many other potential new Member States of the European Community also require much higher flows of private investment to modernise their economies and create jobs which are durable and well-paid.

Given the shortage of capital within many poor regions and the shortage of 'Know-how' for successful investment, it is likely that much or most investment will have its origin outside the regions concerned, frequently from other Member States of the Community. Membership of the Community should be seen as an opportunity for improving the standard of living in relatively poor regions by attracting new economic activities and new investors from other Member States.

The main burden of attracting foreign investment - insofar as this is susceptible to action by public authorities - will continue to lie with Member States who are alone capable of reducing existing obstacles, albeit over a long period. The Community may part-finance programmes to attract industrial investment, as is already the case with the Portuguese PEDIP programme, but the major actions required are in the domain of national governments. They include an appropriate fiscal regime, a non-discriminatory legislative framework and a welcoming economic, political and administrative climate.

But the Community can do more to ease the flow of private investments to its less-favoured regions, whether these originate in the Member State concerned or not. Ideas for action at the Community level which warrant further investigation and could be the subject of Parliament amendments to the forthcoming Commission proposals on the reform of the structural funds include:

* Programmes to identify the obstacles to private investment in regions which are failing to attract it, accompanied by EC financial support to public authorities committed to

administrative and other reforms aimed at facilitating such investment

* Special treatment for stock markets and other mechanisms for raising capital in the regions and for channelling private resources to the less-favoured regions

* Further development of twinning arrangements between successful and lagging regions for

  - Chambers of Commerce
  - local and regional authorities
  - schools, academic institutions and vocational training establishments
  - charitable and non-profit organisations

* 'Adoption arrangements' whereby large multinational enterprises will second staff to individual lagging regions to assist in the development and implementation of plans to attract new economic activity

* Special programmes to improve the export capabilities of enterprises in less-favoured regions and to subsidise market research for their products, thereby attracting further investment

* Aid for the promotion of specific regions' attractions as a destination for private investment

* Training for local and regional authority planners in cost-benefit analysis and other financial management techniques to ensure that public funds for economic development are used to the best possible effect and that all programmes are implemented with the explicit objective of attracting productive investment.

These measures would be cheap in relation to the enormous cost of much basic infrastructure now part-financed by the EC, but they might have a disproportionate impact on the less-favoured regions, particularly if they were to be implemented with the specific objective of attracting more private investment, whether from local or foreign sources.

In conclusion, the Community's cohesion requires a more rapid economic development of its most backward regions. This process depends only in part on public finance: greater attention should be given to the capacity of the private sector for creating jobs and raising living standards. The structural funds and the new cohesion fund will be making an important, indeed essential, contribution to cohesion, but this contribution is less important than the attraction of investment into new economic activity.

ANNEX

A.

FOREIGN DIRECT INVESTMENT IN THE EUROPEAN COMMUNITY
(intra and extra-EC sources) 1985 - 1989 (MRD ECU - current prices)

	1985	1986	1987	1988	1989
SPAIN	2.50 (n.a.)	3.39 (2.31)	3.77 (2.43)	5.59 (3.8)	7.21 (5.08)
PORTUGAL	0.34 (0.22)	0.23 (0.19)	0.37 (0.27)	0.74 (0.53)	1.42 (1.06)
GREECE	0.24 (0.11)	0.34 (0.14)	0.19 (0.10)	0.15 (0.09)	0.34 (0.25)
IRELAND	0.61 (0.28)	0.06 (0.06)	0.49 (0.16)	0.48 (0.30)	1.45 (1.05)
TOTAL EC*	5.7	7.1	12.2	16.1	27.6

N.B. ( ) indicates intra-EC

* Extra-EC only

Source : Eurostat estimates; see especially "European Community Direct Investment 1984-1988", Eurostat, 1991.

B.

EC Structural Funds, 1985 - 1991 COMMITMENTS

Current prices MRD ECU

	1985				1986				1987				1988			
	a	b	c	d	a	b	c	d	a	b	c	d	a	b	c	d
SPAIN	-	-	-	-	0.64	0.35	0.06	**1.05**	0.66	0.51	0.08	**1.25**	0.73	0.45	0.13	**1.32**
PORTUGAL	-	-	-	-	0.38	0.21	0.02	**0.62**	0.39	0.37	0.06	**0.82**	0.43	0.30	0.12	**0.85**
GREECE	0.41	0.12	0.13	**0.67**	0.32	0.14	0.13	**0.58**	0.31	0.20	0.11	**0.61**	0.36	0.21	0.15	**0.73**
IRELAND	0.16	0.27	0.08	**0.51**	0.13	0.23	0.07	**0.43**	0.16	0.25	0.10	**0.51**	0.15	0.18	0.08	**0.41**
TOTAL EC	2.50	2.19	0.85	**5.54**	3.33	2.52	0.85	**6.70**	3.66	3.52	0.94	**8.13**	3.83	2.87	1.18	**7.88**

	1989				1990				1991				1992			
	a	b	c	d	a	b	c	d	a	b	c	d	a	b	c	d
SPAIN	1.22	0.60	0.20	**2.03**	1.80	0.72	0.30	**2.83**	1.69							
PORTUGAL	0.59	0.34	0.18	**1.11**	0.53	0.10	0.24	**0.94**	0.94							
GREECE	0.65	0.30	0.24	**1.18**	0.56	0.34	0.27	**0.93**	0.93							
IRELAND	0.31	0.21	0.12	**0.64**	0.29	0.23	0.12	**0.64**	0.28							
TOTAL EC	4.67	3.48	1.46	**9.61**	5.23	3.50	1.93	**10.71**	5.94	4.03	2.23	**14.37**	6.92	4.69	2.70	**17.59**

B. (continued)

EC Structural Funds, 1985 - 1991 PAYMENTS

Current prices MRD ECU

	1985 a	1985 b	1985 c	1985 d	1986 a	1986 b	1986 c	1986 d	1987 a	1987 b	1987 c	1987 d	1988 a	1988 b	1988 c	1988 d
SPAIN	-	-			0.31	0.17	0	**0.49**	0.35	0.31	0.02	**0.68**	0.54	0.40	0.09	**1.04**
PORTUGAL	-	-			0.19	0.11	0	**0.30**	0.22	0.19	0.03	**0.44**	0.33	0.20	0.10	**0.63**
GREECE	0.31	0.08	0.08	**0.47**	0.31	0.11	0.09	**0.50**	0.29	0.15	0.08	**0.52**	0.31	0.15	0.13	**0.59**
IRELAND	0.12	0.17	0.07	**0.36**	0.08	0.20	0.06	**0.35**	0.13	0.25	0.09	**0.47**	0.14	0.20	0.08	**0.40**
TOTAL EC	1.62	1.41	0.69	**3.73**	2.48	2.32	0.73	**5.53**	2.54	2.72	0.86	**6.11**	3.09	2.30	0.11	**6.53**

	1989 a	1989 b	1989 c	1989 d	1990 a	1990 b	1990 c	1990 d	1991 a	1991 b	1991 c	1991 d	1992 a	1992 b	1992 c	1992 d
SPAIN	0.98	0.47	0.17	**1.62**	1.41	0.63	0.27	**2.32**								
PORTUGAL	0.40	0.22	0.15	**0.76**	0.45	0.07	0.25	**0.77**								
GREECE	0.42	0.22	0.21	**0.55**	0.54	0.30	0.23	**1.08**								
IRELAND	0.19	0.19	0.10	**0.48**	0.25	0.20	0.13	**0.59**								
TOTAL EC	3.92	2.68	1.35	**7.95**	4.55	3.21	1.83	**9.59**	5.57	3.90	1.91	**12.85**	6.72	4.51	2.46	**16.04**

a = ERDF
b = ESF
c = EAGGF - Guidance
d = Total (a + b + c)

Sources : Annual reports of the Court of Auditors

C.

GROSS FIXED CAPITAL FORMATION, 1985 - 1991

Current prices and exchange rates MRD ECU

	1985	1986	1987	1988	1989	1990	1991*
EC-12 of which:	635.73	673.66	720.75	811.65	913.11	990.37	1,030.96
Ireland	4.74	4.63	4.31	4.69	5.69	6.38	6.53
Spain	41.87	45.81	52.87	66.11	83.41	95.42	103.83
Greece	8.33	7.41	6.88	7.87	9.45	10.23	10.69
Portugal	5.90	6.64	7.69	9.48	10.87	12.39	14.60

Source : SEC1-CRONOS, EUROSTAT
Production : European Parliament/Statistical Service

* provisional

D.

FOREIGN DIRECT INVESTMENT AND GROSS FIXED CAPITAL FORMATION FOR THE FIVE YEARS 1985 TO 1989

	(i) FDI (MRD ECU)	(ii) GFCF (MRD ECU)	(iii) FDI/GFCF %
SPAIN	22.46	290.07	7.74
PORTUGAL	3.10	40.58	7.64
IRELAND	3.09	36.97	8.36
GREECE	1.26	39.94	3.15

Source: Tables A. and C.

E. **Inward direct investment: Shares of OECD countries in OECD total and shares of inward investment in their GDP**

Per cent

	1975-85		1986-89		1989	
	Share in GDP	Share in OECD total	Share in GDP	Share in OECD total	Share in GDP	Share in OECD total
Australia	1.2	5.9	2.2	4.8	2.6	4.6
Austria	0.3	0.6	0.3	0.4	0.4	0.4
BLEU	1.2	4.3	2.2	2.9	3.7	4.3
Canada	-0.1	-0.3	0.6	2.5	0.6	2.2
Denmark	0.2	0.3	0.4	0.4	0.9	0.7
Finland	0.2	0.3	0.4	0.4	0.4	0.3
France	0.4	7.8	0.6	5.2	0.9	6.0
Germany	0.2	4.3	0.2	2.2	0.5	4.2
Greece	1.3	1.5	1.4	0.7	1.4	0.5
Ireland	1.6	0.9	0.2	0.0	0.3	0.1
Italy	0.2	2.9	0.4	2.8	0.3	1.6
Japan	0.0	0.8	0.0	0.1	0.0	-0.7
Netherlands	0.7	3.3	1.6	3.2	2.7	4.2
Norway	0.7	1.3	0.9	0.8	1.6	1.0
Portugal	**0.7**	**0.5**	**2.0**	**0.7**	**3.7**	**1.1**
Spain	0.9	4.7	1.7	5.3	2.1	5.3
Sweden	0.1	0.4	0.5	0.8	0.5	0.6
Switzerland	..	..	0.9	1.6	1.2	1.4
United Kingdom	1.2	17.9	2.2	14.4	3.4	17.7
United States	0.4	42.0	1.2	51.1	1.4	44.5

1. OECD less Iceland, New Zealand, and Turkey.
Source: OECD.

Source: "Portugal", OECD Economic Survey 1991/92, Organisation for Economic Cooperation and Development, Paris.

F. Obstacles to investment

Obstacles to improving private investment rates may also be seen as the priorities expressed by firms in a particular region for "improvement of the determinants of regional competitiveness".

The following table is reproduced from the Commission's Fourth Periodic report on the social and economic situation and development of the regions of the Community. It is in based on a study for the Commission by the IFO institute of Munich which itself emphasises the connections between investment, innovation and competitiveness (see page 10).

It is noteworthy that, although the study draws attention to the need for prior public investment in regions where this is deficient, the company replies from the lagging regions (Objective 1) on priorities for improvement put the transport network only in seventh place, the supply and the cost of energy in eighth place and the communication system in seventeenth place.

For Objective 1 regions, higher priority is given to the "Cost of credit" (1), "Income/corporate taxes" (2), "Supply of qualified labour" (3), "Indirect labour costs" (4), "Regulation of the labour market" and "Rate of economic growth" (5=). Public investment in infrastructure is therefore seen as important but less so than these other factors.

It should be remembered that this survey investigated companies already located in the regions concerned. Improvements to the competitiveness of Objective 1 regions depends also on attracting new investment from companies currently located outside the region. For such companies the cost of credit is unlikely to be such a constraint.

Firms' priorities for improvement of determinants of regional competitiveness [1]

Determinants of competitiveness	Lagging regions	Regions in industrial decline	Favoured regions
Financial markets			
1. Cost of credit	1	6	6
2. Income/corporate taxes	2	5	3
3. Exchange rates	10	8	8
4. Availability of risk capital	20	19	23
Educational system			
5. Supply of qualified labour	3	1	2
6. School facilities	15	26	26
7. Proximity of training facilities	28	33	33
8. Supply of unskilled labour	30	15	11
9. Proximity of third-level education	34	33	29
Labour market			
10. Indirect labour costs	4	1	1
11. Regulation of the labour market	5	8	6
12. Wages and salaries	13	4	5
Macroeconomic outlook			
13. Rate of economic growth	5	3	4
14. Sector medium-term outlook	12	10	9
Infrastructure			
15. Transport network	7	11	10
16. Supply and cost of energy	8	12	18
17. Industrial sites	14	17	25
18. Communication system	17	23	14
19. Supply and cost of waste disposal	26	21	14
National policies and institutions			
20. Industrial policy	9	18	12
21. Administrative procedures	16	25	20
22. Other national determinants	25	28	32
23. Legal regulations	29	22	19
Regional policies and institutions			
24. Regional policy incentives	11	14	20
25. Cooperation of local authorities	24	20	24
26. Other regional determinants	31	32	31
27. Local taxes	33	7	12
Regional economic structure			
28. Servicing machinery	18	31	27
29. Proximity of suppliers	19	23	28
30. Proximity of customers	21	15	22
31. Banks, insurance, lawyers	22	30	33
32. Business culture	26	26	30
33. Advertising and consulting	36	36	35
Social facilities			
34. Social climate	23	12	17
35. Cost of housing	31	29	16
36. Cultural and social facilities	35	35	36
37. Leisure facilities	37	37	37

[1] Ranking according to the frequency of company replies in response to the request to list the three determinants of competitiveness with the highest priority improvement.
Source: IFO, *An empirical assessment of factors shaping regional competitiveness in problem regions*. Study financed by the European Commission, Luxembourg 1990.