 EN

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 25.6.2009
COM(2009) 295 final

REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

Sixth progress report on economic and social cohesion

{SEC(2009) 828 final}

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1. INTRODUCTION

This report focuses on creativity and innovation because they can help the Union to emerge faster and stronger from the current economic crisis. This is why the European Economic Recovery Plan together with Cohesion Policy targets investments that strengthen the EU long-term competitiveness, such as entrepreneurship, access to finance for SMEs, human capital, ICT, green technology and energy efficiency[1]. This plan reinforces Cohesion Policy's link with the Lisbon Strategy and the stronger focus in the period 2007-2013 on innovation to which € 85 billion has been dedicated[2]. The fifth progress report[3] highlighted the strong role of certain sectors and economic restructuring in regional development. This recession will accelerate restructuring and hit some sectors hard, particularly the financial, construction and automobile sector will face significant employment losses.

Furthermore, this report argues that creativity and innovation have a crucial regional dimension[4]. The OECD[5] emphasizes that because innovation is becoming more complex (with more open innovation models, process innovation and role of absorption and adaptation) no single policy can promote innovation in all regions. Local knowledge needs to be mobilised for regions to design their own innovation systems and use knowledge and technology more effectively. Last but not least, the European Year of Creativity and Innovation inspired the focus of this report.

The main goal of this report is to show which factors can boost creativity and innovation in both developed and less developed regions. The report covers technological innovation, but also many non-technological forms of innovation such as social, artistic, cultural, process and service innovation.

Regional data available for this report does not yet reflect the crisis. Up until 2007, unemployment rates were shrinking and converging rapidly (see Factsheet 1). But they are now increasing dramatically in Spain, Ireland and the three Baltic States, expected to reach between 11 and 17% in 2009, more than double the rate in 2007[6]. These five Member States (MS) are also forecast to suffer economic contractions, bringing to an end a period of sustained growth (see Factsheet 2).

The report also provides a synthesis of the debate on Territorial Cohesion, launched by a Green Paper last year.

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1 COM(2008) 876
2 SEC(2007) 1547
3 COM (2008) 371
4 *Regional innovation Scoreboard 2006*, MERIT
5 Summary of the OECD Ministerial Meeting: Building Innovative Regions March 2009
6 Economic Forecast, Spring 2009, EC

This report is accompanied by 11 factsheets mapping and analysing key indicators related to creativity and innovation.

2. THE REGIONAL DIMENSION OF CREATIVITY AND INNOVATION

This report uses creativity in the sense of generating a new and useful idea[7], and innovation as putting a new and useful idea into practice. The regional dimension means that an idea has to be new and useful in the region. As a result, the analysis covers both activities that push the knowledge frontier and ones that allow regions to come closer to that frontier.

2.1. Creativity

How are new and useful ideas generated? Despite the popular image of the solitary inventor, most new ideas are generated by human interaction especially between different and talented people. This is one of the reasons why patent applications and cultural activities are concentrated in cities. To boost such interaction, regions need to develop their own talent, attract talent and be tolerant of diversity.

2.1.1. Developing local talent

Education and training can help people to develop their talents and creativity. Yet large differences in education levels remain between regions. The share of graduates is almost nine % points higher in the regional competitiveness and employment (RCE) and Transition[8] than in Convergence regions (see figure 1). Also participation in lifelong learning lags far behind in Convergence regions, where the rate is half that in RCE regions.

The *human capital intensity* (HCI) index shows a weighted combination of secondary and tertiary educational attainment by the population aged 25-64 (see Factsheet 3). Most regions in Portugal, Italy, Greece and Southern Spain score low, which implies that may stimulate creativity less. The gap between Convergence and RCE regions is wide at nine points, but has shrunk thanks to a higher increase in secondary educational attainment in Convergence regions.

The HCI increased significantly for the whole of the EU over the period 2000-2007. This will continue as more young and better trained people enter the labour force. Women are increasingly gaining medium- and high-level qualifications. Indeed, young women are now often better qualified than young men (see Factsheet 4).

2.1.2. Attracting talent and visitors

A region can boost its share of talent by attracting talented people to move there or to visit. Although movements within a country can help some regions and cities, only attracting talent from abroad increase the national pool of talent. The share of foreign-born graduates is only 2% in the EU, compared to 6% in the US, a level only eight EU regions match. The proposed EU Blue Card[9] will help to attract more foreign graduates.

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7 *On creativity*, 2008, Ernesto Villalba, JRC.

8 Phasing in and Phasing out regions are grouped as Transition regions since both receive transitional support

9 COM(2007) 637

The share of working age population born in another country follows the same pattern as the foreign-born graduates, with high shares in London, Luxembourg, Brussels and Vienna, where more than one in three are born abroad (see Factsheet 5), and many very low shares in most of the Central and Eastern MS (CE MS). In Convergence regions, it is only 3%, whereas in RCE regions it is four times higher.

Fortunately, for countries and regions with high levels of outmigration, most citizens do not cut their ties with their country of birth. Some MS, for example, receive substantial inflows of remittances. This provides a strong inflow of capital, the equivalent of one or more % points of GDP a year[10], but this could decline due to the crisis.

Many EU citizens have already gone back to the CE MS due to improving employment opportunities and wages, in part due to Cohesion Policy, and increasing unemployment in some of the major destination MS. This reduces remittances, but they take their international experience, increased business acumen and contacts with them. In the past, Ireland and Spain lost population due to higher out- than in-migration, but in recent years they have gained population through intra-community mobility and migration thanks to high economic growth and a more open attitude.

Business travel also boosts interaction and the exchange of ideas. Despite more and better opportunities to connect and cooperate online, face-to-face meetings are still in heavy demand. Business and scientific conferences continue to draw large crowds from all over the globe Business travel is a significant source of growth and employment for many cities and regions. The goal of leisure travel is not the exchange of ideas, but it can contribute to enriching social life in cities thus stimulating creativity. The number of arrivals per capita in hotels (see Factsheet 6) shows some of the most successful business destinations and the very low number of arrivals in the CE MS.

2.1.3. Tolerance

Tolerance of different backgrounds and lifestyles helps not only to retain and attract talent, but also to create the open environment in which creativity thrives and diversity is valued. In some countries, however, residents are not very comfortable with a neighbour or someone in the highest elected political position with a different ethnic background, religion or belief, sexual orientation or with a disability (see Factsheet 7). Discrimination on these grounds is prohibited[11] in the EU. Nonetheless, in contrast to the US and Iceland, in eight MS over half the respondents were not comfortable with someone from a different ethnic background in the highest elected political position and in nine MS they were not comfortable with a homosexual leading the country.

Although overall, respondents said they thought discrimination had become less widespread in their MS, in 17 MS at least one type of discrimination was seen as more widespread than five years ago. In almost all MS this included ethnic discrimination, but also on the basis of religion, homosexuality or gender. Although the more developed MS tend to be slightly more tolerant, some of these still score low and increasing unemployment could lead to more acts of discrimination.

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10 *Remittance flows to and from the EU*. 2007. Eurostat

11 Art. 21 EU Charter of fundamental rights

Unemployment rates amongst residents born abroad are often higher in EU MS, up to double or triple the rate of people born in the country. These high rates are in part due to insufficient knowledge of the local language and lower education levels, but also due to discrimination. As migration from outside the Union will be the only way to stem population decline, ensuring that migrants and their children can find a job or set up a business[12] will become even more important in the future. Better access to appropriate training and higher education will help to improve their integration in the labour market[13].

The core creative class (see Factsheet 8) is particularly important for an economy as its members generate more ideas and are more likely to set up new companies, creating both growth and jobs in the process[14]. Analysis has shown that in the USA[15] this class is attracted to talented, tolerant and high-tech cities. Core creative class professions include engineers, writers, architects, scientists, professors and artists and other professions which entail creating meaningful new products, processes or services.

In the EU, the core creative class is highly concentrated in and around capital regions and in the Benelux and Nordic countries, Ireland and the UK. These regions have a high share of foreign-born graduates, broadband access and often large cities, confirming this preference. These regions and metropolitan areas are increasingly recognised as powerful engines of innovation and many cities are taking action to become more creative by attracting highly skilled, creative people and offering a good environment for innovative occupations and for ideas to be realised[16]. Convergence regions have a lower share of core creative class 5%, compared with 8% in RCE regions, which may be due to their lower shares of graduates and foreign-born, and lower ICT use. For example in 2008 broadband access in Convergence regions at 32% remains well below the 57% in RCE regions but much higher than in 2004 when it was only 8%.

Figure 1: Creativity Indicators by type of region

Indicator	Period	Unit	Convergence	Transition	RCE
Tertiary education attainment *	2007	% of population 25-64	17	25	26
Participation of adults aged 25-64 in education and training *	2007	% of population 25-64	5.1	8.1	11.5
Population aged 15-64 born in another country *	2007	% of population 15-64	2.8	10.3	12.5
Unemployment rate	2007	% of active population	9.2	8.4	6.1
Unemployment rate trend	2000 - 2007	% point change	-4.6	-3.0	-0.5
Arrivals in hotels *	2006-07	Arrivals per capita	0.7	1.4	1.4
Core creative class *	2006-07	% of population 15-64	5.4	6.9	8.3
Broadband Access**	2008	% of households	32	43	57

** excl. FR9 ** excl. FR9, DE5, DEC, UKD1, UKE1, UKK3, UKM5*

12 COM(2008) 394
13 *Jobs for Immigrants*, 2008, OECD
14 *Creative class and regional growth*. 2007 R.A. Boschma & M. Fritsch
15 *The Rise of the Creative Class*. 2002 Richard Florida.
16 *Competitiveness of European Metropolitan Regions* www.acre.socsci.uva.nl/

2.2. Innovation

The focus of this report is on the regional dimension, but there is also a global dimension to innovation. Research[17] shows that the EU lags behind the USA, but has started to close this gap. Notably, the EU has higher growth of graduates, researchers, public R&D, venture capital, broadband access and knowledge-intensive services employment[3] and it leads on S&E graduates, trademarks, technology balance of payments flows and medium-high and high-tech manufacturing employment[3].

A new and useful idea can be put into practice in the social, cultural or economic sphere. Social innovation can create better models of childcare, improve healthcare delivery at home and promote sustainable transport. Cultural innovation can lead to new art forms. In the economy, it can reduce energy use, streamline processes and improve the design of products and services, which all tend to boost productivity. Many regions have witnessed a significant productivity growth (see Factsheet 9). The regions with the highest productivity growth tend to be in the CE MS. Since 2000 productivity in industry and services has grown by 2% a year in Convergence regions, double the RCE rate. This growth has been supported by increases in education, better and wider use of ICT and of high FDI inflows.

FDI is a crucial source of investments for almost all CE MS (see figure 3), where net FDI flows reaches the equivalent of more than 3% of GDP a year between 2005 and 2007. FDI, however, does not necessarily mean the creation of a new firm. Most of FDI involves a foreign investor taking a controlling stake in a company. The high productivity growth in Convergence regions is the main reason why the gap in GDP per head has narrowed substantially. The gap in employment rates has remained above ten % points since 2000 (see figure 4). GDP per head relative to the EU average increased by six points between 2000 and 2006, bringing the Transition regions within four points of the EU average, and the Convergence regions, at 59, closer to, but still well below, the 75% threshold (see Factsheet 2).

2.2.1. New firms

New ideas are often put into practice by new firms. These can either be a start-up created by a local entrepreneur or by foreign direct investment (FDI). Start-ups are the key to innovation. Innovative new firms can conquer a niche market and grow rapidly (the so-called gazelles). But it is not always easy to create a start-up. The World Bank[18] indicates that it is easier to start a business in at least one hundred other countries than in Germany, Austria, Greece, Spain and Poland (see figure 2). Only Ireland and the UK make it into the top ten.

[17] *European Innovation Scoreboard 2008*, 2009, MERIT
[18] *Doing Business 2009 Report*, World Bank

Figure 2: Ease of Doing Business Ranking, 2009

Economy	Ease of Doing Business Rank	Starting a Business
Ireland	7	**5**
United Kingdom	6	**8**
France	31	**14**
Denmark	5	**16**
Finland	14	**18**
Belgium	19	**20**
Estonia	22	**23**
Romania	47	**26**
Hungary	41	**27**
Sweden	17	**30**
Portugal	48	**34**
Latvia	29	**35**
Slovenia	54	**41**
Slovakia	36	**48**
Netherlands	26	**51**
Italy	65	**53**
Luxembourg	50	**69**
Lithuania	28	**74**
Bulgaria	45	**81**
Czech Republic	75	**86**
Germany	25	**102**
Austria	27	**104**
Greece	96	**133**
Spain	49	**140**
Poland	76	**145**
Rank out of 181 countries.		
Source World Bank Ease of Doing Business Report 2009		

In 2006, the Spring European Council set three clear objectives to make it simpler, cheaper and faster to register a new company, but by 2008 only nine MS reached all three objectives[19].

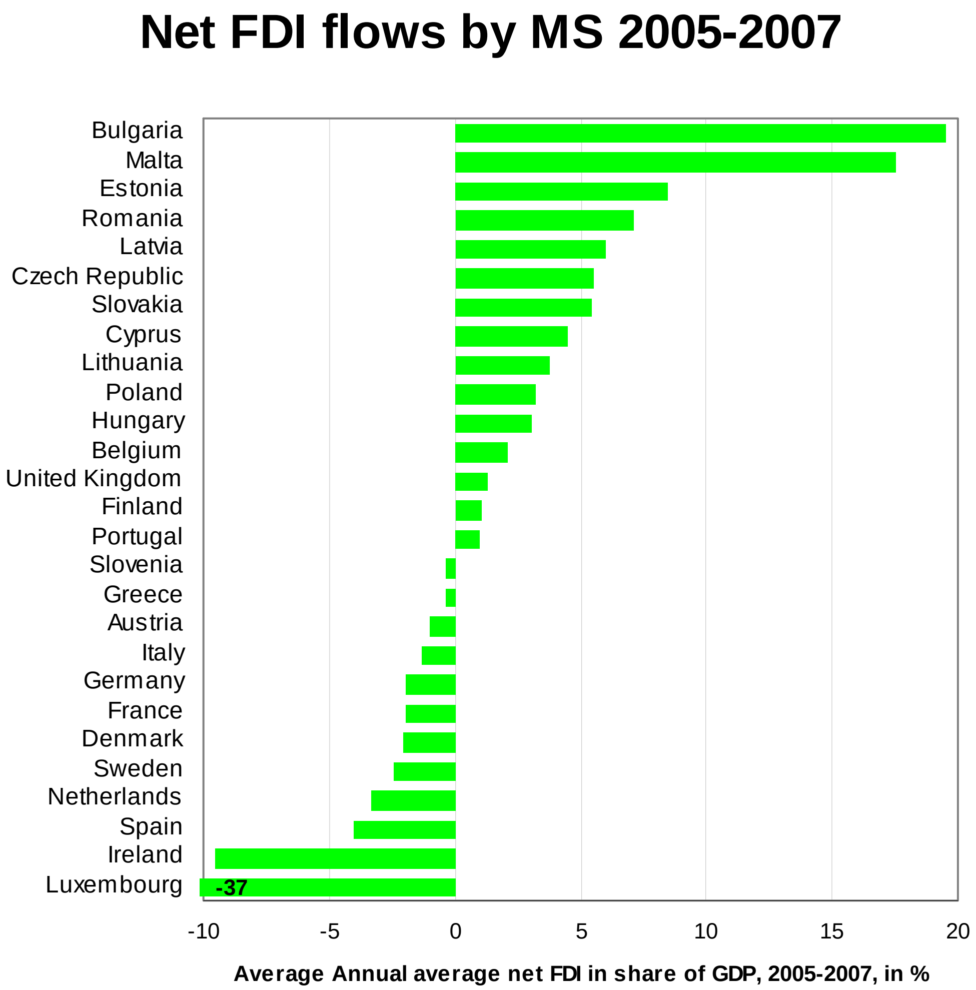
Another important way to boost entrepreneurship is to actively promote it as a career option, especially in regions with a high (youth) unemployment rate. Entrepreneurship education could convince more young people to turn ideas into action.

New foreign firms are often concentrated in the capital region for example in the Czech Republic, Slovakia, Finland and Portugal (see Factsheet 10). They also often locate in border regions, particularly along the borders closest to the rest of the EU, for example in Western Poland and Hungary, North-Western Romania, and Eastern France. In 2005-07, Convergence overtook RCE regions in terms of new foreign firms per inhabitant. The crisis will lead to a drop in FDI and fewer new foreign firms. Research[20] shows that regional policies are better at encouraging knowledge spillovers from foreign firms than national policies..

19 http://ec.europa.eu/enterprise/entrepreneurship/support_measures/start-ups/startups2008.pdf

20 Final Report, 2009, DYNREG http://www.esri.ie/research/research_areas/international_economics/dynreg

Figure 3: Net Foreign direct investments as % of GDP, 2005-2007



One of the goals of the services directive is to facilitate start-ups in services in other Member States by the end of 2009. This could lead to an increase in FDI, particularly in border regions. A prompt and complete implementation of this Directive by national, regional and local authorities will ensure the highest impact on jobs and start-ups across Europe.

2.2.2. Existing firms

Existing firms innovate with the aid of R&D and other methods[21], such as technology adoption, non-technological innovation and combining existing knowledge in new ways. Studies[22] highlight that large firms invest more in R&D and do more in-house innovation, while SMEs have less access to finance and tend to innovate less and outsource their innovation needs. High-growth SMEs, however, can have an even bigger impact on innovation, but they can be hindered by protected markets and other obstacles.

R&D is highly concentrated both in certain sectors – manufacturing accounts for 80% – and regionally, for example 30% of business expenditure on R&D (BERD, see Factsheet 11) is

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21 Neglected Innovators, 2008, MERIT.

22 Ex. *Innobarometer 2007*, 2008, Flash EB213, and *R&D in Europe*, 2009, K. Uppenberg, EIB.

located in just ten regions. Only in 29 regions do businesses invest more than 2% of GDP in R&D. In most the share is below 1%. Overall, the EU spends far less on R&D than the USA, but some MS equal the US level in certain manufacturing sectors. R&D, however, covers only a small share of innovation related expenditure.

In RCE regions, BERD stands at 1.3%, which is four times more than in Convergence regions. In less developed regions, technology diffusion is likely to play a more decisive role, which is illustrated by the stark difference in the number of patents per head, with RCE producing 13 times more patent applications than Convergence regions.

Figure 4: Innovation Indicators by type of region

Indicator	Period	Unit	Convergence	Transition	RCE
Productivity in industry and services (PPS)	2006	index EU27=100	63	90	113
Productivity trend in industry and services	2000-2006	Average annual real productivity growth	1.9	1.3	0.9
Employment rate	2007	% of population 15-64	59	64	69
GDP/head (PPS)	2006	index EU27=100	59	95	122
GDP/head (PPS) trend	2000 - 2006	index point change	5.4	5.9	-4.4
New foreign firms per million inhabitants	2005-07	Total new foreign firms per million inhabitants	268	62	225
Change in new foreign firms per million inhabitants	2001-03 - 2005-07	Total new foreign firms per million inhabitants	118	-34	-18
R&D expenditure in the business enterprise sector	2006 *	% of GDP	0.36	0.42	1.36

* excl. UKM5 UKM6

2.3. Conclusion

The financial crisis and recession reinforce the role of creativity and innovation. This analysis has shown that creativity and innovation have a distinct regional dimension. On most indicators RCE regions score high, such as core creative class, R&D and human capital intensity. On others, such as FDI and productivity growth, however, Convergence regions score higher. What conclusions can be drawn from these trends?

Convergence regions can obtain greater benefits from foreign firms by embedding them in their regional economy and improving their absorption capacity. Strong links between foreign firms and local suppliers increase efficiency, local employment and knowledge transfers. These regions should improve the educational attainment and participation in training, which will add to their capacity to absorb new ideas and practices and help them sustain their high productivity growth.

In addition, these regions should increase their appeal to leisure and business travellers by, for example, stimulating cultural and creative activities. This would boost exchanges of new ideas and possibly increase the appeal of the region to new residents and returning migrants.

Transition regions are closing the gap with RCE regions, but still score lower on many of the economic indicators including productivity and employment. Indicators related to innovation such as R&D, patents and human capital are still substantially lower. To move from a focus on cost-effectiveness to an economy fuelled by innovation[23], these regions will need to improve their business environment and invest more in R&D, education and training and the development of core creative skills.

[23] *Global Competitiveness Report 2008-2009*, 2008, World Economic Forum

RCE regions should make sure that they obtain the maximum benefit from the high share of residents born in another country, by ensuring that they are integrated into the labour market and making it easier for them to set up their own business. To continue to compete on a global scale, these regions need to increase their investment in creativity and innovation and accelerate the transition from a new idea to a new product, service or process.

Creativity and innovation thrive in an environment where new ideas and approaches are accepted and encouraged. A region in which people are discriminated against on the ground of their ethnic origin, belief, gender, disability, age or sexual orientation will not only be less just but also less competitive. Therefore, all regions should endeavour to reduce discrimination, promote intercultural dialogue and more openness towards people with different backgrounds or lifestyles.

3. TERRITORIAL COHESION: THE STATE OF THE DEBATE

In its article 3, the Lisbon Treaty makes territorial cohesion an explicit Objective for the future of Cohesion Policy. Moreover, the current crisis with its asymmetric territorial impacts has increased the importance of territorial cohesion within the EU, and the discussion about the concept has gained momentum.

In October 2008, the European Commission adopted a Green Paper on "Territorial Cohesion"[24] launching a broad public debate on territorial cohesion and its policy implications. The Commission was pleased to receive 391 responses[25], including contributions from all Member States, from nearly 100 regional authorities, from more than 150 regional and local associations as well as from cities, economic and social partners, civil society organisations, research institutions, and individual citizens. The European Parliament, the Committee of the Regions, and the European Economic and Social Committee have all adopted their opinions on the Green Paper on Territorial Cohesion.

This section briefly summarises the key outcomes from the consultation.

3.1. Definition, scope and scale of territorial cohesion

The Green Paper on Territorial Cohesion did not propose a definition, but asked for one. The European Parliament, in its reaction, expressed the concern that without a "commonly agreed, shared and understood definition" it would be difficult to discuss the policy implications. Some respondents shared this concern, but others argued that demanding a precise definition would needlessly delay the discussions. Fortunately, a broad agreement on the goal and basic elements of territorial cohesion emerged from this debate.

The goal of territorial cohesion is to encourage the harmonious and sustainable development of all territories by building on their territorial characteristics and resources.

The three basic elements proposed to achieve this goal were broadly supported:

- concentration (achieving critical mass while addressing negative externalities),

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24 COM(2008) 616

25 http://ec.europa.eu/regional_policy/consultation/terco/consultation_en.htm

- connection (reinforcing the importance of efficient connections of lagging areas with growth centres through infrastructure and access to services), and

- cooperation (working together across administrative boundaries to achieve synergies).

The replies highlighted that territorial cohesion complements and reinforces economic and social cohesion and underlined that the three basic elements were already implicitly present in Cohesion Policy. For some, territorial cohesion essentially serves social and economic cohesion, while for most it is a wider, horizontal concept underpinning all policy areas at all administrative levels.

Many contributors underlined the solidarity dimension of territorial cohesion; some as a territorial dimension of the European social model. This implies that economic and social disparities between territories at all levels (from the EU to the regional and local level) need to be taken into account. Many replies stated that a good quality of life, equal opportunities and access to services of general interest in all territories are crucial both for solidarity and competitiveness.

A minority of respondents proposed to link territorial cohesion to a small number of geographical features which may influence development. They also proposed specific EU policies and funding or even comprehensive EU strategies for these territories. However, the majority of replies, including a clear majority of MS, argued that these features do not in themselves determine success or failure, nor take account of the capacities of Member States and regions to provide appropriate policy responses, and therefore do not require specific treatment, let alone compensation. These reactions confirm that the socio-economic situation of territories should be the basis for policy intervention and design. In addition, they emphasized that Cohesion Policy already provides sufficient flexibility to tackle different problems in different territories.

Many reactions argued that different issues (e.g. social exclusion or urban sprawl, accessibility to services or the risk of flooding) require policy responses at different territorial levels. These may vary from deprived urban neighbourhoods to metropolitan areas, from river basins to mountain areas. The need for European support and desired flexibility to address problems in a functional manner should be considered in the light of the subsidiarity principle.

3.2. Better coordination and new territorial partnerships

The majority of contributions associate territorial cohesion with an integrated approach, multilevel governance, and partnership; all three appreciated assets of Cohesion Policy. In particular, Community Initiatives such as URBAN and rural development's LEADER were mentioned favourably. Yet, many replies argued that territorial cohesion should lead to a further improvement of the territorial dimension in the design and implementation of Community policies. For example, many reactions asked for a better coordination and coherence between different EU instruments and funds.

A clear consensus emerged that public policies at different levels need to take into account their territorial impact to avoid contradictory effects. This is particularly true for European policies with a territorial impact, such as cohesion, transport, energy, agriculture, environment, employment, competition and research policies. Several contributions stressed that also the territorial dimensions of Lisbon and Gothenburg strategies should be considered.

Taking the territorial impact into account during the phase of policy formulation would improve synergies and effectiveness. That is why a better understanding of the territorial impact of public policies is needed. Most reactions requested the EU to play a key role here, for example by testing ways to strengthen the territorial dimension of existing impact assessments.

All contributions agreed that coordination can also be improved through more multi-level governance. For the vast majority, this does not change the distribution of competences, especially as regards spatial planning. The important role of regional and local actors – including representatives from the cities and towns, private sector and civil society – in formulating, implementing, and evaluating policies was emphasized by many replies. Contributions invite the EU to facilitate territorial governance across borders (e.g. urban-rural partnerships, city-regions, networks of towns) so as to reach critical mass in providing public services or to develop projects of common interest. A number of contributions stated that the EU has a role in supporting institutional capacity at various spatial levels through Cohesion Policy, which also increases the efficiency of non-EU funded policies.

3.3. Better cooperation

The three strands of territorial cooperation are almost unanimously recognised as key for territorial cohesion and clear examples of EU added value. There is a strong demand for reinforcing territorial cooperation by making it more strategic, but – at the same time – more flexible and simple. In this regard, the European Grouping of Territorial Cooperation (EGTC) is welcomed and its potential recognised.

Cross-border regions are regarded as laboratories of European integration. Stakeholders from cross-border agglomerations or natural areas, for example, could test integrated development plans and service delivery.

The majority of contributions underline the importance of coordinating national and regional strategies, regulations and funding in favour of the sustainable development of whole transnational areas, as was done in the Baltic Sea Strategy.

The EU should facilitate exchanges of experience and best practices. There is wide support for strengthening inter-regional cooperation (in particular INTERREG C and URBACT), especially networking and benchmarking on solving problems regardless of administrative borders.

Finally, contributions call for better coordinating cohesion and external policies; strengthening the European Neighbourhood Policy; and using the EGTC on the external borders as well.

3.4. Improving understanding of territorial cohesion

All respondents agreed that better tools for territorial analysis and indicators to understand territorial trends are needed. Improved analysis at NUTS3 level, development of thematic analyses on migration or climate change, improvement of territorial impact assessment instruments, can all improve policy design. The ESPON programme and the Urban Audit are regarded as key assets in this respect.

The Commission is urged to complement for analytical purposes GDP per head with other indicators of quality of life (e.g. human development, sustainability, vulnerability, accessibility of services).