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Boulevard of broken dreams. The end of EU funding (1997: Abruzzi, Italy)☆

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ABSTRACT

EU regional policies aim to push regions into self-sustaining growth. Successful interventions would imply a higher growth rate, not only during the treatment (when the region benefits from the transfers), but also after the expiry of the program (when the financing terminates). We investigate to what extent this happened in the case of Italy's Abruzzi region, which entered into the Objective 1 (Convergence) program in 1989 and exited it in 1996 (without a transitional regime). More specifically we focus upon the post expiry period by implementing a synthetic control approach. Our results indicate that exiting the program had a negative effect on regional per-capita GDP growth. This result is a confirmation of the widespread evidence that during their implementation EU regional policies help boost the economic performance of the treated regions. However, additional evidence suggests that the permanent effect of the treatment is negligible: the policies fail to transfer the treated regions to a permanently higher GDP growth path.

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1. Introduction

EU regional policies are a prominent example of place-based (or location-based) policies, policies targeted to specific areas and aimed at enhancing their economic performance. Whether these policies should be put in place is a topic that has been receiving increasing attention in the last few years among policy makers (see, for instance, OECD, 2009a and 2009b; World Bank, 2009). By and large, economists seem to be mostly puzzled (Glaeser and Gottlieb, 2008; Neumark and Simpson, 2014). Yet, supportive arguments have also been proposed (Barca et al., 2012). Most importantly, and irrespectively of the economists' reservations, policy makers all around the world do implement these policies, spending considerable amounts of public money.

EU regional policies, financed via the so-called Structural funds, mainly target disadvantaged areas and use a significant portion of the EU budget (277 billion euros, 27% of the budget, in the programming period 2007–2013). Expenditures under the structural funds include both investments (transport or telecommunications infrastructures, outlays for innovation, energy, the environment) and labor market programs (aimed at reducing unemployment and increasing skills and social integration). The bulk of Structural fund expenditures (213 billion in 2007–2013) flows to Objective 1 regions (renamed Convergence in the 2007–2013 programming period), which are EU NUTS II regions whose GDP per capita is less than 75% of the EU average. The aim of Structural funds is to increase the long-term growth of the lagging-behind regions.

Recently, credible causal estimates have pointed out the efficacy of the Objective 1 program to spur GDP growth in the European regions (Becker et al., 2010 and Pellegrini et al., 2013), even though a high regional heterogeneity prevails (Becker et al., 2012 and Becker et al., 2013). Giua (2014) confirms this positive result for the Italian case (that we study in this paper) with respect to employment growth. While these findings are very relevant and not obvious on an a priori ground, one can argue that it is not sufficient for supporting EU Cohesion policy: EU transfers may have positive short-run effects on regional economies, without triggering a self-sustaining faster growing path. Our study goes precisely in this direction, trying to assess if the Objective 1 policy enables treated regions to exit poverty traps and/or to trigger endogenous growth mechanisms. On the other hand, the short-run positive effect of the program on growth is not fully unexpected. For instance, back-of the-envelope calculations in Becker et al. (2010) suggest that the multiplier of the program is about 1.2. This figure is broadly consistent with current prevailing estimates on local fiscal multipliers: Acconcia et al. (2014) use Italian data and estimate that the contemporaneous output multiplier of spending contractions is as high as 1.5; Nakamura and Steinsson (2014) estimate multipliers in the range 1.4–1.9 for US regions. Hence, we interpret the positive causal effect of the Objective 1 program as evidence of a *necessary* condition in favor of the policy. The

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key second-step question is: does the intervention deliver a *self-sustaining* growth? This is the question we address in this paper, and the answer will complete the information needed for an overall assessment of the Objective 1 program.[1]

Our research question, besides being interesting from an academic perspective, is also high on the policy agenda. For instance, the World Bank recently underlined this issue by distinguishing between *treatment* and *cure*: "A treatment is an instance of treating someone, say, medically. A cure ends a problem. Sometimes, the treatment is a cure. Other times, it just keeps the problem under control without curing it: if you remove the treatment, the problem comes back" (Ozler, 2014). In this respect, our paper analyzes what happens when the treatment is removed. Therefore, it evaluates whether the program represents a case in which, using Ozler's (2014) words, *the treatment is the cure*. We do so by analyzing what happens when the program vanishes. We study the unique case of the Italian southern region of Abruzzi that is the only EU region which after being treated for a period of time (1989–1996) exited the program (in 1997) *without* transitional support (what is now known as phasing-out).

In particular, we compare the GDP per capita in Abruzzi after the funds associated with the Objective 1 program lapsed with those which would have been observed had the treatment continued. The counterfactual pattern is estimated with the synthetic control method proposed by Abadie and Gardeazabal (2003) and Abadie et al. (2010) for comparative case studies. The donor pool includes the other treated Southern Italian regions for which the intervention was not interrupted. The within-country perspective largely mitigates the role of unobserved confounding factors and makes treated and control units much more comparable to each other than in a cross-country framework.[2]

According to our results, after the end of the program the GDP per capita in Abruzzi showed a weaker growth pattern: 7 years after the end of the program, the GDP per capita in Abruzzi was more than 6% lower than the counterfactual, while the difference equaled 0.7% before the funds were withdrawn. This finding is statistically significant (as far as the synthetic control approach mimics confidence intervals) and robust to a number of sensitivity checks. However, this result might not be enough to state that the policy has not generated endogenous growth: if the intervention implies both a contemporaneous impact and an endogenous (or permanent) growth effect, our exercise sheds light only on the former because the latter is shared by both Abruzzi and the donors. A straightforward answer would be comparing Abruzzi with never-treated regions before and after entering the program. Unfortunately, this is not possible because before 1989 Abruzzi benefited from another large-scale financial support scheme (see Section 2). However, we can disentangle anyway the two components by proposing two additional simple pieces of evidence. First, we show that our estimated effect for the end of the treatment is of the same order of magnitude as those estimated in the literature on the *overall* (i.e. contemporaneous impact + permanent component) effect of the policy, thus indicating that the reversal is likely to be complete. Second, we show that after exiting the program, GDP per capita in Abruzzi does not follow a steeper path with respect to comparable control regions, as might have been the case if the Objective 1 policy had triggered endogenous growth mechanisms. All in all, we conclude that *the treatment has not been the cure*.

This study follows the strand of literature that addresses the counterfactual evaluation of place based policies, using the EU Cohesion policy as a case study. As stated above, a general consensus has emerged over the effectiveness of the Objective 1 program as a means to promote economic growth. We complement such evidence by examining what happens to a treated region after the treatment ends. To the best of our knowledge in the European context this research question has not been answered yet.[3]

The paper is structured as follows. The next section gives some institutional details on EU Structural funds and describes the case of Abruzzi. Section 3 illustrates the main features of the synthetic control method, while Section 4 presents the baseline results and an extensive robustness analysis. Some concluding thoughts are provided in Section 5.

2. Institutional setting

As stated in the EU Treaties, the European Union promotes a harmonious development by pursuing the goal of economic, social and territorial cohesion among its member states. In this setting the Union takes actions aimed at reducing disparities between the most developed regions and the lagging ones. The European regional policy is financed mainly via the so-called Structural funds: they include the European regional development fund and the European social fund. The first one addresses major regional imbalances mainly through infrastructural investment and firm incentives; the European social fund pertains to education, training and employment policies.

The European regional (or cohesion) policy has been in operation, in its current form, starting from the reform of the Structural funds in 1988. Since then the policy has been organized in multi-annual cycles and the investment priorities (the so-called "Objectives") are set up according to European regulations. Financial resources have grown up across programming periods – reflecting also the Union's enlargement – currently absorbing more than one fourth of the EU budget. Objective 1 (renamed Objective Convergence in the 2007–2013 cycle) has represented the core of the European regional policy: it aims at supporting the development of NUTS II regions whose per capita GDP is less than 75% of the EU average. Other regional objectives are Objective 2, which concentrates on areas facing industrial decline and Objective 5b, which refers to rural areas (starting from the programming period 2000–2006, Objective 5b has been included in Objective 2). As described in Table 1, in all the programming periods, and in particular in those more relevant for our analysis (1994–1999 and 2000–2006: see Panel B), Objective 1 regions received on a per capita basis from 4 to 5 times the financial support transferred to Objective 2 areas.

In Italy, the EU regional policy has mainly addressed the Southern regions (the so-called *Mezzogiorno*). In the first cycle (1989–1993) all the eight Southern regions[4] belonged in Objective 1. During the 1994–1999 programming period, one Southern region, Abruzzi, whose per capita GDP slightly exceeded the 75% threshold before the cycle started, was assigned to Objective 1 only for the sub-period 1994–1996, as a form of compensation for the absence of any transitional support.[5] After 1996, Abruzzi lost EU support until the new cycle (2000–2006) started. In the 2000–2006 cycle, while the rest of the *Mezzogiorno* remained in Objective 1, Abruzzi was included among the Objective 2 regions together with central northern Italian regions. By moving from Objective 1 to Objective 2, Abruzzi faced a large drop in EU financial support: according to our estimates, the endowments (as a percentage of GDP) more than halved. On top of that, national public resources (the so-called co-financing), also dropped by a similar degree.[6] As to our empirical exercise, it is important to note that the causal effect we

[1] Needless to say, evaluating Structural funds also entails distributive and equity considerations that we do not discuss here.

[2] In the Appendix A we show that our results are confirmed if we enlarge the donor pool to all European regions in the Objective 1 program.

[3] Kline and Moretti (2014) have a similar research question. They examine the long-run effect of the Tennessee Valley Authority and show that gains in agricultural employment were eventually reversed after the program terminated while, in the manufacturing industries the positive effect of the policy persisted. See also von Ehrlich and Seidel (2015) for the German case.

[4] Abruzzi, Basilicata, Calabria, Campania, Molise, Apulia, Sardinia and Sicily.

[5] Starting from the 2000–2006 cycle, the compensation has taken the form of the so-called phasing-out regime.

[6] Besides the large decrease in funds, moving from Objective 1 to Objective 2 also implied an indirect reduction in funds to businesses because under Objective 1 the EU ban for State aid to firms is less stringent.

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