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From Policy Takers to Policy Makers

Adapting EU Cohesion Policy to the Needs of the New Member States

Sieps
Swedish Institute for European Policy Studies

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Edited by Jonas Eriksson, Bengt O. Karlsson and Daniel Tarschys

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PREFACE

Preparation for membership of the European Union follows the same procedure for every candidate country. During long and arduous negotiations the *acquis communautaire* of the Union is compared with the relevant national legislation and an assessment is made as to the capacity of the national institutions of the prospective Member State to fulfil the obligations incumbent upon them following accession. In the course of this process, provisions with politically sensitive implications are duly considered and time-limited concessions are sometimes made to allow for a smooth transition in particular policy areas, both in old and new Member States. But it is generally agreed that such concessionary phasing-in arrangements should not entail permanent exceptions imperilling the unity and consistency of Union legislation.

There is little doubt that the recent negotiation round has been fruitful in spurring many institutional and legislative changes in the candidate countries, thereby helping to strengthen the structural conditions for future economic growth. Nevertheless, this transitory stage has been essentially one of *adaptation* to rules initiated and developed in other countries.

Having graduated from this trying preparatory process, the countries in "the class of 2004" are now full-fledged members of the European Union, with equal rights to participate in the policy process shaping its future. This implies a quality leap in their political status. From having been "policy takers", bound to adapt to the policy legacy of EU15, the new Member States will now also be "policy makers", taking full part in the collective deliberations concerning the further development of this *acquis*.

This raises a set of new questions about the future design of Structural and Cohesion Policy. There is a wealth of previous work in this policy area, particularly in the huge body of ex-ante, mid-term and ex-post studies of particular programmes and interventions. This inquiry, however, attempts to present a new and critical perspective of the issue by focusing on the perspectives of the new-comers. In a collaborative effort, researchers from independent institutes in five Central European countries seek to assess the experience of pre-accession support and the official position of each country in the membership negotiations. They also present their own evaluations of the fit between the current policy proposals for the next Financial Perspective and the particular needs and priorities of their respective countries.

The study contains contributions from the following institutes:

- Baltic International Centre for Economic Policy Studies (BICEPS), Latvia
- Center for Social and Economic Research (CASE), Poland
- EUROPEUM Institute for European Policy, Czech Republic

- Institute of Slovak and World Economy of Slovak Academy of Sciences (ISWE SAS), Slovakia
- Institute for World Economics of the Hungarian Academy of Sciences (IWE), Hungary
- Swedish Institute for European Policy Studies (SIEPS), Sweden
- Vienna Institute for International Economic Studies (wiiw), Austria

Each author participates in his or her own capacity. As editors, we introduce the volume (chapters 1 and 2) and seek to draw our own conclusions from the views presented by the contributors (chapter 9).

With the decision on the next Financial Perspective still pending, we believe that it is an auspicious moment to draw attention to viewpoints in the new Member States. SIEPS and the editors would like to thank the researchers and support staff of all the participating institutes for their committed efforts and excellent cooperation.

September 2005
Jonas Eriksson, Bengt O. Karlsson and Daniel Tarschys

NOTES ON THE CONTRIBUTORS

Jonas Eriksson is assistant researcher at the Swedish Institute for European Policy Studies, SIEPS, Stockholm, Sweden, and co-editor of the present study.

Karol Frank is junior research fellow and Ph D student at the Institute of Slovak and World Economy of Slovak Academy of Sciences, ISWE SAS, Department of Macroeconomics, Bratislava, Slovakia.

Veronika Hvozdíková is junior researcher at the Institute of Slovak and World Economy of Slovak Academy of Sciences, ISWE SAS and Ph D student at the Department of World Economy, University of Economics, Bratislava, Slovakia.

András Inotai, Professor, is General Director of the Institute for World Economics of the Hungarian Academy of Sciences, Budapest, Hungary, Visiting Professor at the College of Europe in Bruges and Natolin, and President of the Foundation of European Studies (Europe 2002).

Magdalena Kaniewska is Associate Professor at the Department of Economics, Warsaw University, and Senior Researcher at the Center for Social and Economic Research, CASE, Research Foundation, Warsaw, Poland.

Pavel Karásek works as administrator of EU Structural Funds' grant schemes at the regional authority in Hradec Králové, the Czech Republic.

Bengt O. Karlsson is an independent researcher, formerly Director in the EU Department of the Swedish Ministry of Finance, Stockholm, Sweden, Head of Industrial Studies at UNIDO in Vienna, Austria, and co-editor of the present study.

Zuzana Kasáková is research fellow at the EUROPEUM Institute for European Policy and Ph D student at Charles University, in West-European Studies, Prague, the Czech Republic.

Vladimír Kvetan is junior research fellow at the Institute of Slovak and World Economy of Slovak Academy of Sciences, ISWE SAS, department of Economic Modeling, Bratislava, Slovakia.

Michael A. Landesmann, is Director of Research at the Vienna Institute for International Economic Studies, wiiw, and Professor of Economics at Johannes Kepler University, Linz, Austria.

Julia Pobyarzina is research assistant at the Baltic International Centre for Economic Policy Studies, BICEPS, Riga, Latvia.

Tomáš Pubrle works in the banking industry in the Czech Republic, with a focus on process management and product development of specialised mortgage investment.

Roman Roemisch is staff economist at the Vienna Institute for International Economic Studies, wiiw, Vienna, Austria.

Radomír Špok is Vice-Chairman at the EUROPEUM Institute for European Policy, Prague, Czech Republic. He deals with the broader aspects of the European Union, with a focus on EU Regional Policy.

Tamás Szemlér, Ph D, is senior research fellow at the Institute for World Economics of the Hungarian Academy of Sciences, Budapest, Hungary, and head of the working group on EU budget of the Task Force for European Integration and Development Policy.

Daniel Tarschys is Professor of Political Science at Stockholm University, Sweden, member of the SIEPS Board of Directors and co-editor of the present study.

Alf Vanags is Director of the Baltic International Centre for Economic Policy Studies, BICEPS, Riga, Latvia.

Katarzyna Zawalińska is Adjunct at the Polish Academy of Sciences and Senior Researcher at the Center for Social and Economic Research, CASE, Research Foundation, Warsaw, Poland.

PARTICIPATING INSTITUTES

Baltic International Centre for Economic Policy Studies, BICEPS, is a research centre, web site http://www.biceps.org, aimed at undertaking and promoting high quality policy-oriented economic research in the Baltic States. Recent projects done at BICEPS include: a growth accounting study of the Baltic states, bridging research and policy in the Baltic states, and an Interreg IIIB project on investment strategies for the three Baltic capitals. BICEPS has hosted several international conferences and organises regular academic and applied seminars. BICEPS together with SSE Riga publishes Baltic Economic Trends which reports on new research and policy issues in the Baltic States together with an update of economic developments.

Center for Social and Economic Research, CASE, is an independent, non-profit international research and advisory institute based in Warsaw dealing with European integration, transition countries and the global economy issues. CASE has performed extensive comparative research in the macro- and microeconomic fields, including international trade, financial markets and labour markets, agricultural markets, structural and social policies. A special attention in research has been given to economic modelling and forecasting of diverse market components, including: inflation, growth, investments, raw material prices, agricultural policies and financial markets. CASE publishes on regular basis forecasting quarterlies in Poland ("Polish Economic Outlook – Trends, Analyses, Forecasts"). CASE also carries ut extensive publishing activities through regular series, such as *Studies and Analysis*, *Reports*, two *Book series*, and many other occasional *policy papers*. CASE has in cooperation with other research centres coordinated and completed over 80 research projects and 100 advisory projects, financed chiefly from foreign sources (EU, World Bank, UNDP, USAID, Open Society Institute). The CASE network includes more than 100 highly experienced and qualified researchers and experts from the EU, Central and Eastern Europe and the CIS region.

EUROPEUM Institute for European Policy was founded in 1998 as a civic association on the initiative of the lecturers at the Department of European Studies at the Faculty of Social Sciences, Charles University in Prague. The aim was to provide a platform for young researchers and university students interested in various aspects of European integration to develop their potential and capacity. EUROPEUM was built with a strong support of Faculty of Social Sciences and the Tempus programme of the European Commission. Over the past few years, it has evolved into a full-fledged think-tank that undertakes programme, project, publishing and training activities related to the European integration matters. In this respect, the organisation was re-named into EUROPEUM Institute for European Policy to reflect more on the activities that it deals with.

Institute for World Economics, IWE, as part of the Hungarian Academy of Sciences, carries out research and formulates policy recommendations on an objective, non-partisan basis, since its establishment in 1973 (on the institutional background of the former Afro-Asian Research Centre founded in 1965). During the past decades, IWE has become one of the major policy-oriented international research institutes and economic policy think tanks in Central Europe. Its main task is to study the underlying trends and factors behind global and regional economic developments and their present and future impact on the Hungarian economy. In addition, it sets out to contribute to international research through co-operation with top research institutes throughout the world. Since the beginning of the 1990s, economic integration in general, and that of Hungary into the European Union in particular have been in the focus of its research activity.

Institute of Slovak and World Economy at the Slovak Academy of Sciences, ISWE SAS, conducts basic and applied economic research with particular regard to solving the real economic problems of the Slovak economy. In the field of basic research the institute pursues accumulation and enlargement of economic knowledge in the particular fields, which are relevant for solving the economic problems of Slovakia in the present development period. The institute is forming the theoretical basis for conceptual solving of specific economic problems and tries to contribute to rising of overall economic knowledge in Slovakia.

Swedish Institute for European Policy Studies, SIEPS, conducts and promotes research, evaluations, analyses and studies of European policy issues, with a focus on the following areas: economics and trade, political science and law. The research is conducted within three broad headings: power and democracy; the external dimensions of the European Union; and consequences of EU policies. SIEPS considers it important to broaden and intensify research on matters that are significant for the future development of the European Union. The objective is to develop well-functioning cooperation with institutions in Sweden and other countries that are already engaged in research on European issues. SIEPS is seeking to act as a link between the academic world and decision-makers at various levels. By publishing reports, arranging seminars, as well as through debates in the media, SIEPS hopes to further stimulate research on the future of Europe.

Vienna Institute for International Economic Studies, wiiw, was established in 1973 as an independent research institute and is a non-profit organization. The primary emphasis of wiiw research activities is on analysing and forecasting economic developments in the countries of Central, East and Southeast Europe as well as economic developments in China; analysing structural developments in those countries, such as sectoral patterns of growth, labour market trends and industrial competitiveness; reviews of foreign direct investment and assessments of foreign trade specialization; conducting studies on the integration of the new EU Members; undertaking research into the reconstruction and stabilization in Southeast Europe, providing policy advice, supplying technical assistance and coordinating research networks; and performing comparative analyses of global development.

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LIST OF ABBREVIATIONS

AEBR	Association of European Border Regions
BICEPS	Baltic International Centre for Economic Policy Studies
CAP	Common Agricultural Policy
CASE	Center for Social and Economic Research
CBC	Cross-Border Cooperation
CEEC	Central and East European Country
CEECMS	CEEC Member State
CFP	Common Fisheries Policy
CMS	Candidate Member State
CSF	Community Support Framework
CSO	Czech Statistical Office
EAGGF	European Agricultural Guidance and Guarantee Fund
EBRD	European Bank for Reconstruction and Development
ECP	European Cohesion Policy (Structural Policy)
ECSC	European Coal and Steel Community
EES	European Employment Strategy
EIB	European Investment Bank
EIF	European Investment Fund
EMU	Economic and Monetary Union
EPRC	European Policy Research Centre
ERDF	European Regional Development Fund
ERM	Exchange Rate Mechanism
ESF	European Social Fund
FDI	Foreign Direct Investment
FIFG	Financial Instrument for Fisheries Guidance
GDP	Gross Domestic Product
GDR	German Democratic Republic
GNI	Gross National Income
GNP	Gross National Product
ISPA	Instrument for Structural Policies for Pre-Accession
ISWE SAS	Institute of Slovak and World Economy SAS (Slovak Academy of Sciences)
IWE	Institute for World Economics of the Hungarian Academy of Sciences
NACE	Nomenclature des Activités économiques dans les Communautés Européennes
NCO	National Contingency Reserve
NDP	National Development Plan
NGO	Non-Governmental Organisation
NMS	New Member States
NSRF	National Strategic Reference Framework
NUTS	Nomenclature of Territorial Units for Statistics
OMC	Open Method of Coordination
OMS	Old Member States

OP	Operational Programmes
PHARE	Poland Hungary Aid for the Reconstruction of the Economy
PPP	Public-Private Partnership
PPS	Power Purchasing Standards
R&D	Research and Development
SAPARD	Special Accession Programme for Agriculture and Rural Development
SIEPS	Swedish Institute for European Policy Studies
SMEs	Small and Medium sized Enterprises
SOP	Sectoral Operational Programme
SPD	Single Programming Document
TENs	Trans-European Networks
wiiw	Vienna Institute for International Economic Studies

EXECUTIVE SUMMARY

The accession of eight Central and East European Member States to the European Union (EU) in 2004 added both new participants and a new dimension to the European Cohesion Policy (ECP). While EU membership had been preceded by lengthy negotiations on the terms of accession, the new members' influence on Cohesion Policy was mainly restricted to adjustments and phasing-in and there was little room for questioning the policy as such.

The present study reverses the perspective: having been presented more or less with a *fait accompli* with respect to regional policy prior to accession, full membership in the EU implies that the new members will go from being "policy takers" to becoming "policy makers". In this study we discuss to what extent the present and proposed Cohesion Policy is compatible with their needs and preferences.

Researchers from five research institutes in respectively the Czech Republic, Hungary, Latvia, Poland and Slovakia have been asked to examine their country's experience from the pre-accession support; to describe wishes and controversies that arose during the accession negotiations; to examine the problems posed by the present and proposed Cohesion Policy; and, most importantly, to single out the priorities that would prevail if the Member States themselves had full national control over the European Cohesion Policy.

While the ultimate aim of the Cohesion Policy is to further economic and social cohesion between the Union's regions, economic growth is often concentrated around "growth poles". Ample evidence of such concentration exists, particularly in the fast growing Central and East European Countries (CEEC) where growth is concentrated to the capital city regions. Regional disparities, which are much more pronounced in the new Member States than in the EU15, deepened as economic growth took off in the 1990s. Hence there appears to be an implied contradiction inherent in the Cohesion Policy between national cohesion on the one hand and regional cohesion on the other.

The experience and lessons learned from the pre-accession instruments

Although it is fair to say that the pre-accession support has had positive effects in the new Member States, it is also true that the instruments have had varying impact in the respective countries. For example, the instruments have not prepared Latvia fully for the use of the Structural Funds and in Poland the programmes were inadequate, even though they seem to have had some effect. Another telling example is Hungary, where the emphasis on environmental aspects regarding infrastructural investments under ISPA implied prioritisations that were not in accord with Hungarian preferences: the EU showed reluctance to co-finance major highway projects, preferring railway modernisation instead. However, this was in large part an exception to the rule, albeit an important one, as the overall experience with ISPA in Hungary has been positive.

Another common problem in the five countries was the lack of national influence on the pre-accession programmes. Domestic authorities were consulted rather than playing an active role in the process. The upshot of this was a situation where the main concern became not to forego any of the funds available from the EU.

More importantly, however, the experiences from the pre-accession instruments have revealed a number of institutional, managerial and administrative shortcomings at the receiving end. Moreover, there are clear indications that most of those problems have not yet been resolved and will remain for a considerable period of time. One might therefore draw the conclusion that resources will have to be set aside for continued administrative and legislative reform, coupled with training and education at several levels. Unless these improvements take place the transition from policy takers to policy makers will be very difficult.

The present Cohesion Policy

The conditionality of the present Cohesion Policy – and indeed of the proposed future policy – implies a number of aspects that are particularly problematic for the new Member States. First, there is an obvious goal conflict between the Maastricht criteria – i.e., exchange rate stability, low budget deficits and low inflation and interest rates – and the co-financing requirements. This having been said, this conflict may have a positive side effect in that it can force governments in the new members to carry out much needed budget reforms. Second, there is a conflict between the aim to decentralise management and implementation of ECP-funded projects on the one hand and the required formalities for project preparation, proposals and reimbursement on the other. The amount of documentation attached to a project proposal is immense, creating problems through an extra workload that is further aggravated by the EU disbursement and reimbursement procedures. As funds are reimbursed late in the project cycle severe liquidity crises may arise for small enterprises or municipalities, who may also have difficulties in accessing the banking system.

Moreover, there are also problems that have long accompanied EU regional policy and that are not only visible in the new members today but remain in the European Commission's proposal for the future Cohesion Policy. The complex design of the policy may create a situation with too many instruments for too many objectives, leading in turn to confusion regarding means and ends. Generally, efficiency is achieved when there is one instrument for one goal. The omnipresence and multifinality of the European Structural and Cohesion Policy are largely responsible for the "making sure no funds are foregone" attitude in the receiving countries. EU transfers are a vital factor in successful membership and sustainable modernisation, but at the end of the day they are instruments and not objectives in themselves.

The future Cohesion Policy

The Country studies show that if the wishes of the new Member States would prevail, objectives and priorities for the Cohesion Policy would be quite different from the ones proposed. First, all Country Studies would like to see more national control over the Cohesion Policy and a majority of them have more or less indicated that they would see advantages in a national approach, i.e., where the policy focuses on the least developed countries rather than the least developed regions. According to this line of reasoning, priority should be given to economic growth since the regional imbalances can be seen as temporary and will decrease over time when adequate economic reforms have been implemented. Second, there is an overwhelming need to develop domestic human resources through education and training at different levels. Human resource development is an investment that will not distort markets and will also allow the economy to grow faster in the future without additional subsidies. Third, there is a need for simplification and more flexibility, given the state of many of the regions in the new Member States, both regarding administrative capacity and financially. Fourth, the limited possibilities for "cross-financing" in the Commission's proposal also cause concern. A significant problem is that possible synergy between projects financed under different objectives might get lost.

Another important aspect is the need for cooperation and coordination between the new Member States. Even though this is pronouncedly stronger in some chapters, it is evident that proper infrastructural conditions are absolutely essential to facilitate growth. Furthermore, if the new Member States are to reap the full benefit from their geographic location infrastructural coordination and cooperation are vital.

Conclusions

The study arrives at the following conclusions:

- The pre-accession support has helped to prepare for EU membership, but it has also revealed institutional shortcomings that to a large extent will remain and will have to be dealt with in the future. Resources are needed for continued administrative and legislative reform as well as training and education at several levels.
- Focus should lie on the special needs of the new Member States and more national control over the Cohesion Policy should be allowed. Targeting divergences between Member States rather than between regions would probably both satisfy net payers and give the receiving countries increased control and influence over the policy.

- Human resource development and institution-building should be the overriding priorities. While being one of the most important factors for long-term growth, welfare and cohesion, human resource development implies a considerable and rapid lift in managerial, administrative and technical levels in the short run. Institution-building of course is already one of the main objectives of the European Cohesion Policy and this phase is not yet over in the new Member States. Even if considerable progress has been made and there are many successful projects to report, it is clear that the administrative and managerial capacity, particularly at regional and local levels, still leaves a lot to wish for. This could become a major obstacle for a successful implementation of the future European Cohesion Policy.
- Cooperation and coordination between the new Member States is vital. Investments that emphasise the principle of coordination between Member States would be more efficient than national infrastructure programmes which are often designed and implemented in line with narrow national interests.
- Simplification and more flexibility are desirable, not least because of the conflict in simultaneously fulfilling the convergence criteria and the co-financing requirements. There is a genuine dissatisfaction with what is felt to be unnecessary bureaucracy and mistrust on the part of the Commission and also a perceived lack of understanding for the special conditions of the new Central European Member States. The situation calls for maximum flexibility and provides yet another argument for taking a national approach to the future European Cohesion Policy.

1 ENLARGEMENT AND COHESION: THE ISSUES

Daniel Tarschys and Jonas Eriksson

1.1 Introduction

The accession of Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia to the EU on 1 May 2004 represents an impressive historic achievement but also an unprecedented challenge.

The enlargement is first and foremost a political process, breaking down barriers in Europe and paving the way for an "ever closer union" between its peoples. It is fuelled by the yearning for peace, security and stability. But enlargement is also an economic process, and the prospects for growing prosperity have always been a powerful motive for entry into the Union. Throughout the new Member States (NMS) there are high expectations as to the material returns from the step just taken. This presents a dilemma for policy-makers who are very much aware that many of the effects of memberships are mainly structural and long-term but who also feel the pressure from their electorates to deliver short-term results.

Historically, every national campaign for membership has contained an element of "over-sell" which is likely to generate some disenchantment in the aftermath of accession. In this situation, there is inevitably a strong interest in the size of the specific cash flows between the EU and its Member States. The immediate success of the accession and the dexterity of national negotiators are gauged by their ability to "bring home the bacon". With agricultural policy virtually locked for the next ten years, a lot of attention is paid to Cohesion Policy which every Member State, old and new, tends to examine with an eye to its own net position.

Easy to measure, the cash flows offer apparently precise quantitative indicators of the impact of EU membership. Other sequels are more intangible, or more long-term, or more difficult to attribute to the very accession. Many consequences of European integration are linked to institutional and legal changes, increased mobility and the benefits of expanding markets and foreign investments. All of these developments need to be taken into account when it comes to assessing whether we attain the goal set in 2003, when the European Council stated that "making a success of enlargement remains the key priority for the years to come" (CEU 2003, p. 7).

Enlargement has led to significantly greater disparities within the EU. Even though economic growth on average has been stronger in the Central and East European Countries (CEEC) over the last decade – implying that there is some economic convergence – GDP per capita differences between new and old Member States are still substantial. This situation will be even more accentuated by the likely accession of Bulgaria and Romania in 2007, the very year that the next Financial Perspective will come into force.

In February 2004, three months before the enlargement, the European Commission (henceforth the Commission) presented its proposal for the Financial Perspective for the years 2007-2013. This proposal was accompanied by the Third Cohesion Report, which outlined the Commission's proposal for the future European Structural and Cohesion Policy (ECP).[1] The budget proposal implied an increase in the EU budget by 31 per cent by 2013 compared to 2006, while the proposed new guidelines for Cohesion Policy shift the focus of EU regional policy in important areas. The implications of the two documents and the positions of the respective Member States in the Financial Perspective and ECP reform debate will be discussed below. Needless to say, the future Cohesion Policy and the 2007-2013 Financial Perspective will have important consequences regarding both revenues and expenditures, for new as well as old Member States. Taking into account the fact that EU25 has an additional number of lagging regions and at the same time a lower aggregate per capita income than EU15, the stage is set for an active debate on the future of the European Cohesion Policy.

In the views of Bachtler and Wishlade (2004), there are mainly three aspects that underline the need for a Cohesion Policy reform. First, the enlargement brought with it a doubling of the socio-economic disparities and decreased the average EU GDP per capita by 12.5 per cent (COM 2004) while, at the same time, the economic and social problems remain in the regions that now face a scaling down of assistance from the Structural Funds. Second, the progress made in the Lisbon Strategy, as described in detail in the Kok Report (Kok *et al*. 2004),[2] has thus far been a disappointment. Third, a number of institutional changes are underway which imply a shift of emphasis for the ECP.

A fourth aspect may be added which will constitute the point of departure for this study. When the new Member States negotiated their terms of accession, their influence over the European Cohesion Policy was limited. What was open to discussion was mainly a set of modalities for adjustment and phasing-in, but there was no room for questioning the principal parameters of the policy package. The candidates met a ready-made model which had evolved from earlier stages in European integration. In fact, in several different stages.

[1] We will use the terms Structural Policy and Cohesion Policy interchangeably throughout this study, without making any distinction as regards the meaning of the two concepts. However, the study predominantly addresses the contents of the new budget heading, Sustainable Development, in the Commission's proposal for the 2007-2013 Financial Perspective, in particular the heading "Cohesion for growth and employment" (see table 2.1 in chapter 2).

[2] The report concluded that although external events had been unfavourable to growth in the EU Member States, the Member States themselves were also responsible for the slow progress by failing to act on the Lisbon Strategy. The report also called for greater involvement at the regional and local levels. See also COM (2005a) for the mid-term review of the Lisbon Strategy.

While some elements in the present Cohesion Policy may be traced back to the very first decades of European integration, its most significant parts were developed in the 1980s in conjunction with the key decisions on the internal market and the monetary union. Other important provisions were added in connection with previous accessions, starting with the UK and Ireland and continuing with the entry of first Spain and Portugal and then Austria, Finland and Sweden. Further elements were added with the perspective of Eastern enlargement, particularly the allocation absorption cap of four per cent of a Member States' GDP.[3] Even though the absorption cap applies in all Member States, it is "only likely to bite in the new Member States" (Bachtler and Wishlade 2004, p. 23).

While it is easy to grasp the importance of formulating a successful ECP in the perspective of the new Member States, it is essential that the ECP *promotes* growth rather than alters the natural growth path expected from countries with initially low GDP per capita levels. Taking into account the historic evolution and outcome of the ECP, there is every reason to carefully evaluate the consequences of simply extending the present system to the new Member States, especially the CEEC Member States (CEECMS). By focusing on five of the CEECMS, this collaborative project involving researchers from two old and five new Member States will attempt to give new insights into the expected effects of the ECP in its current shape and form on the respective CEECMS economies. It will also suggest possible modifications of the present policy with the view of making it better adapted to the needs of the new Member States.

1.2 Objective and framework

The ECP purports to make a genuine and positive contribution to cohesion in the EU. As we will see below, however, it has to be recognised that although the ECP may come to play a crucial role in EU27, unresolved issues remain in both its structure and in the formulation of its objectives. As noted, the new Member States landed in a policy framework formulated and decided long before they could assert any influence on its foundations. With the insight that regional disparities widened after the enlargement, it begs the question: how is an optimal European Cohesion Policy designed in the perspective of the new Member States?

The present collaborative project seeks to disentangle this complex problem. In addition to the Swedish Institute for European Policy Studies (SIEPS) and the Vienna Institute for International Economic Studies (wiiw), five renowned research institutes in Czech Republic (EUROPEUM Institute for European Policy), Hungary (Institute for World Economics of the Hungarian Academy of Sciences, IWE), Latvia (Baltic International Centre for Economic Policy Studies, BICEPS), Poland (Center for Social

[3] For a survey of the evolution of EU Structural Policy, see Tarschys (2003).

and Economic Research, CASE) and Slovakia (Institute of Slovak and World Economy, ISWE SAS) have agreed to address a common set of questions. The problem formulation has been designed so that the first three questions give a natural introduction to the last, and most important, question as to how a future European Cohesion Policy should be designed to best suit the new Member States.

First, it is reasonable to assume that some implications of the effects of the European Cohesion Policy on the new Member States can be derived from the experience of the use of the pre-accession instruments.[4] Even though the pre-accession assistance differs from the ECP in important aspects, the similarities between them increased as accession drew nearer. The experience of the pre-accession support can also serve to indicate possible future problems of Cohesion Policy in the new Member States, in terms of its benefits and drawbacks regarding implementation. The first objective of the national contributions is therefore to describe what experience the particular country has had of the pre-accession EU assistance.

A second indication of how the Cohesion Policy can be improved may be derived from the various positions and wishes expressed in the accession process. The entry of the ten new Member States crowned a long period of arduous negotiations about the terms of their accession, closing chapter after chapter in an extensive catalogue of requirements. Even though there may have existed many differences of opinions in each and every candidate country, articulated in a variety of domestic political promises – e.g., due to the influence of internal pressure groups – a reasonable assumption is that the consolidated official positions were based on well founded considerations of how to optimally design Cohesion Policy from each country's point of view. Hence the second objective is to single out and describe which questions and controversies arose in the accession negotiations.

Third, the conditionality of the Cohesion Policy may influence national policies. In particular, the method of "matching funding" may cause modification of policy objectives and, coupled with the amount of red tape involved in European regional policy, give rise to budgetary strain.[5] Regardless of whether this is a serious problem, the pros and cons of the present framework have to be evaluated and balanced against the need for assistance, on the one hand, and the principle of additionality and the need for evaluation and monitoring, on the other. The objective is thus to

[4] The pre-accession instruments are PHARE (strengthen public administration, promote convergence with the *acquis* and promote economic and social cohesion), ISPA (the pre-accession equivalent to the Cohesion Fund) and SAPARD (the pre-accession equivalent to the Common Agricultural Policy, CAP).

[5] Assistance from the Structural Funds and the Cohesion Fund must be co-financed by the Member States. The idea behind this so called "additionality" is that EU regional policy should complement, rather than reduce, a Member State's own regional policy efforts. This presents the new Member States with a specific problem, an issue that we will return to on numerous occasions in this study.

examine whether the policy in its current shape causes problems as regards its design.

This brings us to the essential problem to be examined in this study: the future of the European Cohesion Policy in the new Member States. The institutes have worked along the lines of a scenario where the country under scrutiny may dispose freely of the sum foreseen for it in the Commission's 2007-2013 Financial Perspective. Given its own priorities for national development, how would these resources be used?

This opens up several matters to consider. First of all, an examination of which priorities will prevail has to be undertaken. Second, consideration must be given to relations between different targets and ambitions. Though the European Cohesion Policy is sometimes presented as a single-objective policy intended to promote "cohesion", it has in effect a much more complex goal structure and the relationship between its multiple objectives may be construed in several different ways. To offer but one example: while some measures may promote both growth and intra-national convergence, others (such as investments in transport infrastructure close to the capital) may promote national growth while also leading to greater inter-regional disparities, at least in the short run.

Given the specific needs of the respective countries examined, how should the system be designed in order to function optimally from each Member States' point of view? This will be the main focus of this study.

1.3 Basic outline of the study

The next chapter gives a brief account of the design and impact of the ECP; describes and discusses the causes that underlie the need for a European regional policy; and provides an overview of the present reform debate. The third chapter presents an overview of regional developments of the new Member States and two of the candidate countries, Bulgaria and Romania, with respect to income and growth disparities; compares measures of regional disparities for the NMS with those of the EU15; analyses differences across regions in terms of the distribution of foreign direct investment and of infra-structural facilities; and examines a number of "problem regions".

In chapters 4 to 8, the respective institutes respond to the problem formulation outlined in the beginning of the first chapter. Chapter 4 examines the case of Poland, chapter 5 Hungary, chapter 6 the Czech Republic, chapter 7 Slovakia and chapter 8 Latvia.

Finally, the ninth chapter summarises and analyses the main findings of the respective country studies. On the basis of the results, the chapter will aim at drawing certain conclusions for the future of European Structural and Cohesion Policy.

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2 COHESION POLICY – RETROSPECT AND PROSPECT

Jonas Eriksson

2.1 Regional policy in the EU – need, logic and rationale

The economic and social differences and the territorial imbalances prevailing in the Union today are seemingly sufficient reasons for a European regional policy. However, a number of aspects should be considered before we accept this argument, all of which will be dealt with in the remainder of this section.

First, we need to get a better picture of what is meant by economic and social disparities. The European Cohesion Policy predominantly addresses issues of economic efficiency, income levels and employment, but the choice of indicators to use for measuring regional inequalities is not at all obvious. Second, there is a need to show what constitutes the optimal level – regional, national or supranational – from which to conduct and implement specific factors of regional policy. Finally, and most importantly, sending money into a region may have adverse effects. Obviously, the Structural Policy should not strive toward goals that offset each other.

2.1.1 Regional disparities in the Union

Troublesome as they might appear in reported statistics, disparities between regions may be understated or overstated depending on how they are measured. For example, the indicator used as a basis for assistance from the Structural Funds is GDP per capita in Purchasing Power Standards (PPS). However, further distinctions are desirable. One might argue that the optimal indicator should not only take into account the cost of living in the various regions, but also taxes, transfers and public expenditures, as well as private capital flows (Tarschys 2003a). Emigrants often come to the aid of relatives in impoverished areas by sending them part of their salaries earned in richer areas and remittances make up a considerable part of the resources available for consumption in some regions (and extra-EU countries).[6]

However, although gaps within the EU may be exaggerated, it is certainly clear that significant regional disparities exist and that the disparities have been further pronounced, to say the least, after the most recent enlargement. The accession of Bulgaria and Romania – and the possible future accession of Croatia, other Balkan countries and Turkey – will not improve the picture. The third chapter, which delves deeper into the economic and social situation in the EU25, provides ample evidence of the extent of the problem.

[6] Not surprisingly, these arguments have been brought forward by EUROCITIES, a network that consists of the larger European cities; see, for example, Häupl (2003).

The determinants of regional disparities have been studied from many angles and by scholars in several disciplines. The approaches to it span a wide spectrum from exclusively economic to predominantly cultural. Regarding the economic determinants, it is possible to single out at least four basic, but intertwining, elements (see Begg 2003):

1. There might be a lack of development in many regions because of the existence of large agricultural sectors and the lack of an industrialisation process with large scale industries.
2. Less developed areas tend to be geographically remote and, accordingly, transportation costs are high.
3. As new regions emerge, agents of industries meet competition they are unable to counter and therefore experience a loss of competitiveness.
4. Economic integration may result in the agglomeration of industries, further reinforcing the lack of development when removal of barriers leads to economic concentration in border areas.

There are also factors that add to the problem indirectly such as the aging population in the EU and, particularly in the CEECMS, the marked slowdown in the population growth. The CEECMS are forecasted to experience negative population growth in the future.[7] Since major cities and capitals tend to attract the younger and better educated part of the population, it may further accentuate regional polarization. Thus, as it is clear that all the above listed factors are present in the Union today, the endeavour to reduce regional disparities might be viewed as justified.

2.1.2 The Cs: Convergence, Competitiveness and Cohesion

Although the concept of "economic and social cohesion" is mentioned in the Treaty of Rome, it was practically forgotten until refreshed and put in use by the Delors Commission in the 1980s. As such, "cohesion" is intertwined with the concept of "convergence". Allegedly, the ECP will boost growth and employment, i.e., promote convergence between regions, which in turn will lead to greater cohesion in the Union.

It has to be recognised, however, that the connection between growth and the reduction of real income disparities is complex. Taking into account that, according to the Commission's proposal, the ECP should not only reduce income disparities, but also promote employment, sustainable development and, most notably, increase the EU's competitiveness, further complications are added to the equation. We will therefore devote some space to discuss, in turn, convergence, competitiveness and cohesion. Our discussion should not be seen as an attempt to exhaust the issue, but more as a need to be aware of the pitfalls of the phrases invoked in the discussion of the future ECP.

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[7] See, for example, forecasts from the U.S. Census Bureau (2004).

Convergence
By convergence, according to the standard neo-classical model, we mean a process of higher growth in countries with comparatively lower capital to labour ratios, i.e., countries that have a lower GDP per capita level should grow faster than richer countries. This is in the economic literature known as "β-convergence". However, the relationship between β-convergence and the dispersion of real per capita incomes, or "σ-convergence", is less than clear-cut: it can be shown that σ-convergence is a necessary but not sufficient condition for σ-convergence, i.e., there may be β-convergence but no σ-convergence.

Moreover, different theoretical models produce very different results. According to one theory, initial regional imbalances may be enhanced by the integration process (Myrdal 1957).[8] The idea is that regions with a highly skilled labour force tend to attract more R&D investments while such investments in turn attract skilled labour. Highly skilled workers therefore tend to move away from less productive areas.[9] In the celebrated Heckscher-Ohlin-Samuelson models, by contrast, the integration process will cause convergence through an equalisation of factor returns when barriers to trade are removed.[10]

Arguments that emanate from new economic geography (see, for example, Krugman and Venables 1995) further add to the complexity of the regional policy domain. In these models, economies of scale are a source of concentration of production. If transport costs (real transport costs or artificial transport costs such as customs or other costs of crossing a border) are high, each country will only produce enough to serve its own market. If costs fall, the gains from economies of scale can be realised by concentrating the production. It will be most profitable to concentrate production to the largest market since this minimises total transport costs – and wages may therefore be higher. However, if transportation costs continue to fall, it is less important to produce in the large market and a wage difference between countries will not be sustainable. In the first case, a lowering of transportation costs through integration may lead to divergence in real incomes between countries; in the second case to convergence.

The Commission's Third Report on Economic and Social Cohesion recognises that there may be a trade-off between national and regional converg-

[8] This is called circular and cumulative causation; see Myrdal (1957).
[9] Myrdal (1957) therefore recommended active regional policies to promote "spread effects", for example through FDI or development funds; see also Martin (2003).
[10] It should be noted that this equalisation rests on the assumptions of constant returns to scale, no market distortions and perfect mobility of production factors; see, for example, Markusen *et al.* (1995). Convergence may also result from the "the life-cycle of the product" model; see Molle (2001).

ence in the first stages of catching up, especially because of agglomeration effects. A telling example is Ireland, which has experienced high national growth and a strong concentration of economic activities on Dublin whilst regional disparities in the three other "cohesion countries" have largely remained at the same levels. Even though the third cohesion report points out that "the extent to which a trade-off of this kind exists depends in part on the spatial distribution of economic activity and of settlements across the country in question" (COM 2004b, p. 149), the observation seems less relevant for the new Member States where the spatial distribution of economic activity was often decided by the central planning authority (see, for instance, chapters 6 and 7).

While economists still struggle with the problem of explaining the concept of economic growth, there is agreement that growth is conditional on what is often referred to as "technological progress", that is to say, improvements in the production process that enhance productivity. In other words, supply side factors that improve the production process improve a country's (or region's) long term growth. However, the phrase "technological progress" should be interpreted in the widest sense. It could imply, for example, both methods of production and effects from individual or corporate networks (Eliasson and Westerlund 2003). Similarly, economists have come some way in their search for an environment that facilitates a maximum outcome from different growth factors. Above all, empirical studies[11] point at factors such as investments in physical and human capital (education and research) in the context of a stable political environment, institutions such as property rights, and the absence of barriers to trade.[12]

Competitiveness

A related distinction as made above regarding β-convergence and σ-convergence can also be made regarding "competitiveness". As pointed out by Martin (2003), there is no clear link between microeconomic and macroeconomic competitiveness. In fact, Krugman (1994, p. 41) goes so far as to say that competitiveness in the macroeconomic sense is little more than saying productivity[13] and that the search for macroeconomic competi-

[11] In the sensitivity analyses carried out by Levine and Renelt (1992), only three out of 50 variables survived the tests: initial GDP per capita, physical investments as a share of GDP and human capital. A similar, though less strict, analysis by Sala-i-Martin (1997), gave 22 out of 58 statistically significant variables, among others the three mentioned variables and institutional circumstances such as a country's geographic position. This suggests that regional policy in remote areas may benefit from a focus on reallocation, rather than active measures that aim to promote economic growth.

[12] Barriers in the sense discussed here include barriers to goods, services, labour and capital. One should also mention here that the integration process, which has removed numerous obstacles, may in fact have played the prominent role where convergence between countries and between regions has been observed.

[13] Adding, perhaps, the condition of low inflation.

tiveness is a "dangerous obsession" that "distort[s] economic policies". Furthermore (Krugman 2003, p. 30),

> [t]he idea that a country's economic fortunes are largely determined by its success on world markets is a hypothesis, not a necessary truth; and as a practical, empirical matter, that hypothesis is flatly wrong. That is, it is simply not the case that the world's leading nations are to any important degree in economic competition with each other, or that any of their major economic problems can be attributed to failures to compete on world markets.

If there is any distinction to be made between macroeconomic and regional competitiveness, furthermore, the latter should arguably be the primary concern with respect to European regional policy. Unfortunately, as Martin (2003, p. 7-1) concludes,

> [t]here is no single theoretical perspective that captures the full complexity of the notion of 'regional competitiveness'. The overview of both theoretical and empirical literature confirms the […] notion that competitiveness is a difficult and often confusing term – especially so at the regional level. The term 'competitiveness' often raises more questions than answers, perhaps one reason why the term has only relatively recently infiltrated the language of macro-economic theory and regional economics alike.

The concept of competitiveness rather becomes a question of outcome and, as such, Martin (2003) argues that some lessons can be learned from the empirical exercise carried out in his report. Above all, the report stresses that regional policy makers should adopt measures that take into account the stage of development in a particular region. That is to say, "there is no 'one-size-fits-all policy'" (Martin 2003, p. 7-5). He uses a trisected typology divided into "Regions as production sites" (lower to medium income levels), "Regions as sources of increasing returns" (high and sustainable income levels) and "Regions as hubs of knowledge" (mainly major cities and capitals, with relatively high wages), with different priorities depending on the type of region.[14]

Even though the typology and policy recommendations make sense on many levels, the aftertaste of this discussion is a bit sour; and for two reasons. First, because it is difficult to define regional competitiveness and, second, because it is difficult to single out the factors that promote competitiveness in regions that do not qualify for any of the three above categories, such as the least developed regions in the CEECMS.

Cohesion

The third concept, and the ultimate aim of European regional policy, "cohesion", is one which can be given a multitude of interpretations. As a

[14] In the first category policy makers should emphasise economic governance, internationalisation and accessibility; in the second category innovation and entrepreneurship; and, in the third category, more or less all four mentioned factors; see Martin (2003).

starting point, the Commission's view on cohesion, here provided by Hall *et al*. (2001, p. 5), distinguishes,

> between inequalities between countries, and particularly between the so called Cohesion Four (Greece, Ireland, Portugal and Spain) and the rest of the Union; inequalities between regions within the EU; and inequalities between individuals ("social cohesion"). […] Greater cohesion implies that incomes, employment, and economic opportunities grow faster for groups in weaker areas with low incomes than for groups in richer areas with high incomes.

An advantage of this definition is the exclusion of non-economic factors: cohesion is improved when lagging regions, on all levels in the Union, catch up with non-lagging regions, that is to say, they converge in the traditional sense by growing faster.

However, there are at least three drawbacks related to this line of reasoning:

1. As noted – and the essential point from much research on economic growth – it is not at all clear whether the promotion of regional convergence within Member States (or within the Union) with any certainty will promote economic and social cohesion between the Member States' (or the Union's) regions and/or between the Member States, and vice versa.
2. The definition provided by Hall *et al*. (2001) may be too narrow, in that it leaves out important aspects of the European integration process. We return to this point below.
3. Convergence may also be attained by a decline in growth in higher developed areas and less developed regions may in that sense still "grow faster".

An alternative way of conceptualizing cohesion is to divide it into the four categories *economic*, *social*, *political* and *cultural cohesion* (Tarschys 2003a). The point of departure is the idea that these four categories will capture the essence of what creates, constitutes and maintains a political community such as the nation state, or indeed, the European Union. It can be argued that none will work without the other. That is to say, to achieve the goals of economic and social cohesion, both political and cultural cohesion are of the essence – and while economic growth can create the need for social measures, political and cultural cohesion should be viewed as a precondition for economic development.[15] This perception of cohesion may also be more in line with the perceived benefits (or "added value") of the Structural Funds as they are interpreted by the EU Member States and programme management authorities, a point to which we will return in the next section.

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[15] The list of characteristics in which the four concepts intertwine is long; see Tarschys (2003a). The report also argues that far too little attention has been paid to political and cultural cohesion, particularly the latter.

Even though the regional tension within Member States, with few exceptions, has been accentuated in later years, implying that we have moved farther away from cohesion in some parts of the Union, it would be presumptuous to draw the conclusion that the ECP has failed to promote economic and social cohesion in the EU. Tendencies to even further divergence may have been counteracted. Furthermore, convergence has taken place between the EU Member States and – although to a much lesser extent – between the Union regions. However, the role and the success of the ECP in this respect are unclear.

What the discussion boils down to – with special attention paid to the fast-growing CEECMS, where we today are witnessing emerging growth poles and increased regional disparities, that is to say, an indication of β-convergence without σ-convergence – is that the link between convergence, competitiveness and cohesion is not self-evident. The supposition that the three concepts are mutually supportive is questionable, especially in the short run.

2.1.3 Rationale for policy: European added value

As argued by Midelfart-Knarvik and Overman (2002, p. 349), there is justification for regional policy when market forces move an economy in a "direction that is not desirable in terms of either efficiency or welfare." Thus, the polarization at the regional level in the EU would according to this argument justify active intervention. Notwithstanding the evidence of marked regional disparities, however, a rationale for a regional policy on the *European level* cannot be found in this fact alone. A European regional policy should at the very least produce an outcome that transcends that which can be accomplished at the national level.

Both the Commission and the EU Member States share the view that the future European regional policy should maximise the added value of the Structural Funds, particularly outside Objective 1 assistance.[16] According to one Commission document, regional policy is justified "when the actions of Member States are not sufficient (the criterion of need) and when benefits are generated for the entire Union (effectiveness criterion)" (COM 2004e, p. 1)

All the EU15 Member States have expressed appreciation of at least some of the effects the Structural Funds have had in their respective countries. For example, it has been pointed out that the ECP has improved strategic

[16] The bulk of the present ECP assistance is channelled through the Objectives 1, 2 and 3. Objective 1 supports development in the less prosperous regions; Objective 2 supports the revitalising of areas faced with structural difficulties that lead to high unemployment; and Objective 3 supports the improvement of education, training and employment policies and systems in regions not eligible under Objective 1 assistance; see, for example, http://europa.eu.int/comm/regional_policy/index_en.htm.

planning, development and evaluation at the regional level; that it has facilitated more cooperation between regions and Member States; that it has, in many cases, both improved regional cohesion and increased local and regional employment; that it has made the EU more visible in the respective Member States; and that it has brought added value from its role as a bridge between richer and poorer regions in the Union (Bachtler and Wishlade 2004).

As pointed out by the IQ-net, a network of analysts and practitioners engaged in programme management authorities across Europe (Bachtler and Wishlade 2004, p. 1),

> [a]dded value is not a simple concept. It attempts to capture both the quantitative impact and qualitative effects of the European Community contribution to regional development through the Structural Funds, for example with respect to the 'Community method' for implementing programmes. As such, it entails considerable subjectivity.

The IQ-net has nevertheless made an attempt at summing up the added value of the Structural Funds. The point of departure for their definition is that added value is "something which has been enabled [with], or which could not have been done [without], […] Community assistance" (Bachtler and Wishlade 2004, p. 7).[17]

The concept of added value is in the report classified into five different categories. The first category, *Cohesion added value*, is perhaps the most obvious category: it is the added value that comes from the reduction of economic and social disparities in the Union. We will discuss in some detail the successfulness of the ECP in this respect in the next section.

Political added value concerns the visibility on several levels in the Member States' societies. Allegedly, support from the Structural Funds has increased the support for European integration. However, while regional beneficiaries may have become more positive in their attitudes toward both the political and the economic integration process, scepticism against further integration has remained or even increased in some of the regions and countries that have received least support from the Structural Funds. Increasing assistance from the Structural Funds to these Member States would be difficult since they are among the richest in the EU. Thus, political added value may certainly be considered a positive side-effect of the ECP in supported areas; but any such gains, if weighed, would likely weigh about the same as losses made in other areas.

Policy added value stems from the strategic improvements made as regards regional policymaking. However, there is some disagreement as to whether

[17] One should perhaps go so far as to say that added value is something which has been enabled with, *and* could not have been done without, Community assistance.

the Structural Funds have altered policy priorities for the better or the worse. The UK government in particular has expressed concern regarding the latter (UK Treasury 2003). The argument is that the temptation to receive financial support from the ECP may lead to policy distortions if national or regional funds are diverted to co-financing projects that would otherwise receive low priority.

Another form of added value comes from the partnership principle. This *operational added value* first and foremost gives a better quality to regional interventions. The spoke in the wheel seems to be the sheer amount of bureaucracy involved, which is both costly and demanding. Again, the mentioned position paper from the UK Treasury (2003) has expressed concern of a deficient coordination of assistance at the regional, national and supranational level.

Finally, *learning added value* is the encouragement of "[a]nalysis, reflection and learning […] through regulatory requirements placed on programmes to monitor and evaluate their activities" (Bachtler and Wishlade 2004, p. 4).

The EU Member States differ somewhat in their views on the added value of the Structural Funds. The Greek government maintains the view that "the added value of regional cohesion policies has already proven to be highly significant" (cited in Bachtler and Taylor 2004, p. 4). The UK Treasury (2003, p. 19), by contrast, has criticised the Structural Funds for their "lack of flexibility" and goes so far as to claim that "it is not clear that the use of Structural Funds adds significant value in comparison to domestic initiatives." However, this latter view mainly concerns the effects of the Structural Funds in the UK regions, rather than in the Union as a whole.

To evaluate the perceived added value of the Structural Funds in the respective Member States, the positive effects concern above all co-operation, learning, strategic planning and implementation efficiency. The "detracted value" of the Structural Funds, on the other hand, is allegedly related to distortions to national policy priorities; excessive bureaucracy and costly management and implementation; and poor coordination between supranational, national and regional levels. Even though it is fair to say that, for rather obvious reasons, the net contributors are less positive in their attitudes toward the ECP than are the beneficiaries, judging by its proposal the Commission seems to have listened to the complaints voiced by the former group of countries.

2.2 The impact of the policies in EU15

The ECP has made a number of positive contributions in the EU. As noted, all of the EU15 Member States have expressed appreciation of at least some of the effects the policy has had in their respective countries, even though there remain unresolved issues where the ECP may actually have had a negative effect. There has been a long-standing concern of the burden imposed on recipients through the specific conditionality of the ECP. Moreover, there are many signs that the ECP suffers from goal congestion, in that it strives towards fulfilling too many objectives (Tarschys 2003b). This approach makes it difficult to evaluate and pin down the real effects of the policy. As Wim Kok has said of the Lisbon Process: “Lisbon is about everything and thus about nothing” (Kok *et al*. 2004, p. 16).

An issue that has already been touched upon is the paradox that may result from regional interventions. The gains expected from a deepening of the integration are principally related to a) structural change and a more efficient allocation of resources and b) the accumulation of additional resources (Midelfart-Knarvik and Overman 2002). The role of the ECP has been to aid regions in the Member States to manage the transition process when such structural change has occurred. However, regional measures may also have unintended consequences, such as the distortion of local markets.

Notwithstanding the allegations of policy alterations, excessive bureaucracy and goal congestion, empirical evidence on the outcome of the ECP is mixed. On the one hand, indication of its results is witnessed by those most affected by it. Reports by implementing authorities and organisations that are involved in the programming impress upon us the great success of the Structural Funds. These reports are complemented by evaluations carried out by the Commission, above all the cohesion reports. The Third Report on Economic and Social Cohesion concludes that GDP per capita growth was higher in the Cohesion Four (Greece, Ireland, Portugal and Spain) than the EU average, and that this was in no small part due to Structural and Cohesion Funds assistance. According to the Commission’s simulations, “GDP in real terms in 1999 was some 2.2% higher in Greece than it otherwise would have been, while in Spain the figure was 1.4%, in Ireland 2.8% and in Portugal, 4.7%” (COM 2004b, p. 148).

As regards Objective 1 assistance, which represents the bulk of the support from the Structural Funds, the Commission claims that the assistance is likely to lead to another 700,000 jobs created and that the faster growth witnessed in the Objective 1 regions bears a positive relationship with structural aid. In the case of the Objective 1 regions in Germany and Italy, however, the report concludes that “growth seems to have been depressed by low growth in the rest of the country” (COM 2004b, p. 148).

There are obvious drawbacks with these reports. The micro perspective employed in the studies conducted by implementing authorities and organisations prevents the authors from discovering effects of the policy that cannot be ascertained by examining specific sectors, areas or projects. For example, if the employment level increases in an area as a consequence of funding, a serious examination of the effects will have to take into account possible crowding out effects from higher wages.

The problem with the Commission's reports is rather one of credibility: one would like to express caution to those taking the estimates reported above at face value.[18] For example, in the Sapir report (Sapir *et al*. 2003, p. 60), in which a high-level study group under Professor André Sapir tries to lay down the lines for future growth promoting policies in the Union, the authors claim that,

> [i]n practice, […] there is simply not enough relevant regional GDP data for statistical procedures to distinguish the effects of cohesion policies in the absence of data on other regional characteristics, such as initial income, human capital, local industrial structures, quality of local administration, the peripheral nature of the region, and of random influences. The net result is that it is not possible to establish conclusively what the relative performance of these regions would have been in the absence of EU cohesion policy and other policies.

The same report also examined the empirical outcome of the ECP. The poor data quality notwithstanding, the authors concluded that the ECP had played some role in boosting growth in the regions that had received funding, but that (Sapir *et al*. 2003, p. 146),

> during the catching-up process, increasing regional disparities within the poorer countries may also emerge. However, this phenomenon may be mitigated by national growth and could be eased by national rather than EU policies (such as social transfer schemes, labour market and wage policy, etc).

The recommendation from this report was to focus on low-income countries, rather than low income regions, and it goes on to suggest that the future regional policy in this respect should have two objectives. First, it should promote institution building, thus improving the administrative capacity in Member States and, second, sustain "high investment rates in human and physical capital" (Sapir *et al*. 2003, pp. 146-147).

There has also been research by independent students of European regional policy, examining particularly the effects on industry location from integration. These surprisingly few papers tend to moderate the conclusions on whether the ECP has been successful in its objectives. Midelfart-Knarvik and Overman (2002) examine whether assistance from the Structural Funds has facilitated structural change and whether the EU has been successful in improving the functioning of state aid in its Member States.[19] Their results indicate that the assistance has in fact acted counter to the

[18] For a critique of the assertions in the cohesion reports; see Tarschys (2003a).

[19] Articles 92-93 (Aids granted by States) of the EEC Treaty empower the Commission to supervise state aid in the EU Member States. The purpose is to realise the full potential of the common market and prevent Member States from giving aid that counteract these forces.

first point, even though the Commission has been successful on the latter. They find that the ECP has not been able to prevent regional polarization, i.e., the ECP has been unsuccessful in delivering economic and social cohesion. Furthermore, the most direct result of EU expenditure has been the distortion of the location of R&D industries by attracting them into areas without the proper endowment of high-skilled workers.

The authors argue that there is still a motive for a European regional policy. If the aim is to improve the situation of people in the poorest regions in the EU, they propose a strategy with three objectives. First, it should try to focus support so that the poorer countries are helped in changing endowments and specialise according to their comparative advantage. Second, the policy should seek to ease this comparative advantage dispersion by removing factor price distortions. Third, labour mobility should be encouraged so that the end result is an efficient location of both firms and production factors (Midelfart-Knarvik and Overman 2002).[20]

A report from the Centre for Economic Policy Research (CEPR; Braunerhjelm *et al*. 2000), examines the cases of Ireland and Italy (the Mezzogiorno region). The historic outcome of regional policy in the two countries has differed significantly: where regional policy has succeeded in Ireland, it has been a failure in Italy. What makes the comparison interesting is the relative uniformity of current regional interventions in the two countries. As noted in the CEPR report, one aspect of Structural Policy is the copying of behaviour at the national level. The Italian approach has changed over time to increasingly resemble Irish policies.

According to the authors of this report, the success of Ireland owes to the promotion of two sectors: electronics and pharmaceuticals. The CEPR report argues that the concept that made the Irish government's investments less of a gamble was the fact that it chose to concentrate on these sectors after industries had already been established. Thus (Braunerhjelm *et al*. 2000, p. 89),[21]

> [e]lectronics may not have been an obviously good bet for Ireland before the Intel and Microsoft investments arrived, but once they had done so, Ireland was well advised to promote them for all it was worth. Success was facilitated by their willingness, along with other global companies, to assist actively in the promotion of further investment in the Irish electronics sector. This they did in the interests of developing the electronics agglomeration, while ensuring that there was not excessive poaching of labour from any one company as new plants were established.

[20] Sectoral remedies such as those advocated by Midelfart-Knarvik and Overman (2002) are criticised later in this study (see chapter 8).

[21] The massive inflow of FDI from the US is to a large extent explained by the close ties between the two countries.

Regional initiatives in Italy, by contrast, have been "half-hearted", given too little time, suffered from a lack of consistency and have not had the same concentration on specific sectors as in Ireland.

In order to meet the effects of deeper integration, the CEPR report recommends, among other things, investments in schooling and lifelong learning; the creation of an entrepreneurship friendly tax and regulatory system; endorsing labour market policies that allow wages to adjust according to productivity trends; welcoming international investments; and removing barriers to capital and labour movements (Braunerhjelm *et al*. 2000).[22]

In sum, the ECP seems to have promoted cohesion in the least developed regions, but at a high cost given the meagre results. There is also disagreement as to the size of the effects, as it is difficult to trace the specific effects of funding due among other things to poor data quality. Moreover, the ECP may have had negative effects in that it has not promoted an optimal localisation of R&D industries.

2.3 The present and future European Cohesion Policy

Although this study focuses on the current and future ECP, the debate and negotiations on the 2007-2013 Financial Perspective will have implications for Cohesion Policy. The Commission has taken an expansionistic view as regards the Financial Perspective, proposing an increase in the total budget by 31 per cent in 2013 compared to 2006 (see Table 2.1). However, the June 2005 European Council summit showed that the amounts proposed by the Commission are no longer credible.[23] The numbers in this proposal nevertheless remain the only ones which have not (and will not) change. Furthermore, the shares devoted to the respective headings in the proposal serve as good indicators of the Commission's priorities. Hence we will use the Commission's proposal as our starting point when discussing the future ECP.

2.3.1 The debate on the future ECP

In its proposal for the next Financial Perspective, the Commission has reduced the number of budget headings to five. The first heading in Table 2.1, *Sustainable growth*, encompasses both Cohesion Policy (1b Cohesion for growth and employment) and EU funding for implementing the Lisbon Strategy (1a Competitiveness for growth and employment). The total

[22] Indeed, examples of lingering protectionism are not difficult to find. One example is the Services Directive, which in certain Member States has come under heavy fire. Another much debated element of protectionist behaviour among EU15 Member States concerns the restrictions on labour migration from the CEECMS imposed in all but three of the EU15 Member States.

[23] The final bid from the Luxembourg presidency (which was turned down) was a budget ceiling of 1.06% of EU GNI. The EU budget is thus likely to be dramatically lower than the Commission's proposed budget.

financial resources under heading 1b in the proposal represents €336.3 billion in 2004 prices, or 0.41 per cent of EU27 GNI.[24]

Cohesion Policy (1b) would increase by ca 23 per cent in 2007 and ca 31 per cent in 2013, compared to 2006. By contrast, CAP, which is included under the second heading, would increase by only ca 2 per cent by 2007 and ca 3 per cent by 2013, compared to 2006. In other words, according to the proposal this heading would basically remain fixed throughout the period 2007-2013. Thus, the division of resources in the Commission's proposal is roughly almost a half to Cohesion (and competitiveness) Policy, more than a third to CAP, and the residual, about 15 per cent, for the remaining headings.

As shown in Table 2.1, the Commission has replaced the former three objectives with a Regional Convergence and Employment objective (78.54 per cent of heading 1b in Table 2.1, replacing Objective 1; henceforth Convergence objective); a Regional Competitiveness and Employment objective (17.22 per cent of heading 1b, replacing Objectives 2 and 3; henceforth Competitiveness objective); and a European Territorial Co-operation objective (3.94 per cent of heading 1b; henceforth Territorial objective), respectively (COM 2004b). The three objectives would be supported by the financial resources of the European Regional Development Fund (ERDF), the European Social Fund (ESF) and the Cohesion Fund.

Regions eligible for assistance under the Convergence objective would be, as before, those with a GDP per capita level below 75 per cent of the Community average. However, the Commission has proposed that temporary resources (85 per cent in 2007 and then phased out by steps of 5 per cent) are made available from the Structural Funds for regions in the EU15 that would have received support had the base for calculation been the EU15 rather than the EU25. The aim of the Convergence objective is to "promote growth-enhancing conditions and factors leading to real convergence. Strategies should plan for the development of long-term competitiveness and employment" (COM 2004c, p. 4).

The programmes under this objective would be supported by the resources of all three funds, where support from the Cohesion Fund, as before, would be given to Member States with a Gross National Product (GNP) below 90 per cent of the Community average (i.e., Greece, Portugal and all ten new Member States). According to the Commission's proposal, the Cohesion Fund will have a specific conditionality attached to it, insofar as assistance is conditioned on the convergence programmes and constraints on excessive deficits. Programmes supported by the Cohesion Fund would

[24] An additional €8.6 billion is planned to cover for the new Solidarity Fund and the Commission's administrative expenditure.

Table 2.1 Financial Framework overview (€ million in 2004 prices)

	2006	2007	2008	2009	2010	2011	2012	2013
1. Sustainable growth	**47 582**	**59 675**	**62 795**	**65 800**	**68 235**	**70 660**	**73 715**	**76 785**
Share of total appropriations for commitments	0.394	0.447	0.453	0.460	0.465	0.470	0.478	0.485
1a. Competitiveness for growth and employment	8 791	12 105	14 390	16 680	18 965	21 250	23 540	25 825
1b. Cohesion for growth and employment	38 791	47 570	48 405	49 120	49 270	49 410	50 175	50 960
2. Sustainable management and protection of natural recources (incl. CAP)	**56 015**	**57 180**	**57 900**	**58 115**	**57 980**	**57 850**	**57 805**	**57 805**
Share of total appropriations for commitments	0.464	0.428	0.417	0.406	0.395	0.385	0.375	0.365
3. Citizenship, freedom, security and justice	**1 381**	**1 630**	**2 015**	**2 330**	**2 645**	**2 970**	**3 295**	**3 620**
Share of total appropriations for commitments	0.011	0.012	0.015	0.016	0.018	0.020	0.021	0.023
4. The EU as a global partner	**11 232**	**11 400**	**12 175**	**12 945**	**13 720**	**14 495**	**15 115**	**15 740**
Share of total appropriations for commitments	0.093	0.085	0.088	0.090	0.094	0.097	0.098	0.099
5. Administration	**3 436**	**3 675**	**3 815**	**3 950**	**4 090**	**4 225**	**4 365**	**4 500**
Share of total appropriations for commitments	0.028	0.028	0.028	0.028	0.028	0.028	0.028	0.028
Total appropriations for commitments	**120 688**	**133 560**	**138 700**	**143 140**	**146 670**	**150 200**	**154 315**	**158 450**

Source: COM (2004a)

as before focus on transport and environmental infrastructures and institution building, strengthening the capacity to manage support from the Structural Funds (COM 2004g).[25]

The Competitiveness objective aims at improving the competitiveness and attractiveness of the regions. The regions eligible for support would be those "currently eligible for Objective 1 not fulfilling the criteria for the convergence priority even in the absence of the statistical effect of enlargement" and "all other regions of the Union covered neither by the convergence programmes nor by the 'phasing in' support…" (COM 2004c, p. 5). The Competitiveness objective would be funded equally by the ERDF and the ESF and interventions supported by the ERDF would be based on innovation and knowledge based economy;[26] the environment and risk prevention; and accessibility of services of general economic interest, while interventions supported by the ESF would become more in tune with the European Employment Strategy (EES) (COM 2004c).[27]

The Territorial objective, building on the INTERREG programme, would promote sustainable development of the EU territory (and beyond). It would support cross-border cooperation actions, for regions located on internal borders or certain external borders; contribute to the cross-border elements of the future European neighbourhood and partnership Instrument and Instrument for Pre-accession Assistance (IPA). It would benefit from trans-national cooperation actions and cooperation and exchange networks.

In response to criticism regarding problems encountered with the management of the funds, the proposal also implies a number of simplifications.[28] Priorities for Cohesion Policy would, in the future, be given in an overall strategic document, adopted by the Council, and in national framework documents worked out by the Member States, based on the Commission's proposal. The documents would then serve as a basis for specific national and regional programmes. The so-called programme complements and management by measure would be abolished, the number of funds reduced from the current six to three (i.e., the ERDF, the ESF and the Cohesion Fund will remain in place) and a mono-fund approach introduced (one fund per programme).[29] There would also be a number of simplifications as

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[25] As we will see, strengthening institutions and the administrative capacity in the new Member States will be crucial in the years to come.

[26] For a critique of the concept of "knowledge based economy", see chapters 8 and 9.

[27] The EES was launched in 1997 as a coordinated effort at the EU level to increase employment in the Union. Since 2002 the EES has become a key component in the Lisbon Strategy.

[28] It should also be mentioned – as pointed out by Bachtler and Wishlade (2004) – that the system has to be in place before it has been proven to be a simplification. See also chapter 9, where we question the assertion that the Commission's proposal as a matter of fact implies a simplification.

[29] This particular feature is criticised in the subsequent chapters; see, for example, chapter 8.

regards financial management and control, such as the elimination of "on-the-spot" audits and payments operated at the level of priorities rather than at the level of measures (which excludes private co-funding) (COM 2004c, p. 8). However, the principle of additionality would still apply for the Structural Funds and the n + 2 rule[30] would not only remain but also be extended to the Cohesion Fund. As we will see in subsequent chapters, they may both have serious consequences for the new Member States.

A number of features in the Commission's proposal have received widespread support.[31] There seems to be agreement on the linking of the ECP and the Lisbon and Gothenburg agendas; the attempts at simplifying the regulation of the Structural Funds; and the three new objectives and their content. In particular, there was general agreement on the importance of concentrating support to the least developed areas of the Union.

Even though there is broad support for the Convergence objective, some Member States have proposed that resources allocated to it should be increased. Unsurprisingly, a number of Member States have questioned the Competitiveness objective and a few Member States have even asked for its elimination. In line with the recommendations from Sapir *et al*. (2003), furthermore, some Member States have asked for support being concentrated on the least developed Member States – i.e., national as opposed to regional convergence – rather than on the least developed regions. Thus, the main dividing lines seem to be the amount of resources that should be devoted to the respective objectives, whether support should focus on regions or countries and whether aid should be directed to all regions or just to regions in the new Member States.

The Commission's proposal has also raised concerns among students of European regional policy. For example, Jouen *et al*. (2005) – while taking a generally positive attitude to the proposal with respect to reducing regional disparities, strengthening competitiveness and combating spatial and territorial imbalances – has questioned whether some of the objectives of the ECP will be reached. The author argues that the improvement of general welfare would be hampered by the "[r]emoval of transversal priorities, such as equal opportunities, …"; that the elimination of Community initiative programmes would act counter to the aim of increasing the sense of European belonging; that "making eligibility rules national" will stop subsidiarity at the national level and thus hinder a modernisation

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[30] i.e., funds get de-committed if not claimed, at the latest, two years after the commitment year.

[31] Position papers from *inter alia* the Member States' governments can be downloaded from the DG Regional Policy homepage on, http://europa.eu.int/comm/regional_policy/debate/reflex_en.htm. See also Bachtler and Wishlade (2004); Jouen *et al.* (2005); and Richter (2005) for summaries of the Member States' positions in the Cohesion Policy debate.

of European governance; and, most importantly so far as our study is concerned, that there is an unfortunate absence of a policy to “accompany future developments of the new Member States” (Jouen *et al*. 2005, pp. 30-31). The main argument, with which this study concurs, as we will see, is that “the actions eligible for the convergence objective are identical for both old and new Member States, although the needs are different” (Jouen *et al*. 2005, p. 31). The extent to which the needs differ will become clear in the next chapter.

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3 REGIONAL DEVELOPMENTS IN THE NEW MEMBERS AND CANDIDATE COUNTRIES OF THE EUROPEAN UNION

Michael A. Landesmann and Roman Roemisch

3.1 Introduction

This chapter presents an overview of regional developments in the new Member States (NMS) of the European Union and two of the candidate countries (Bulgaria and Romania).[32] It first presents in section 3.2 an overview of income and growth disparities at the NUTS 2 and (for the smaller NMS) the NUTS 3 level and compares measures of regional disparities for the NMS with those of the EU15.[33] Section 3.3 develops a taxonomy of regional types identified by the relative representation of different sectors in the overall employment structure: hence we identify, apart from the capital city regions, agricultural regions, mining regions, basic and forward looking industry regions, basic services and tourism regions. It turns out that regional types thus identified differentiate with respect to income levels and income growth and in section 3.4 we also show that the regional taxonomy also captures distinct features with respect to labour market conditions in terms of employment rates (also differentiated by age groups) and employment opportunities for different sections of the labour force distinguished by educational attainment levels. In section 3.5 we analyse further differences across regions in terms of the distribution of foreign direct investment and of infra-structural (particularly transport) facilities and in section 3.6 we focus on particular features of "problem regions" (mostly concentrated in agricultural and traditional basic industry regions as well as those singled out by their geographic peripheral position). Section 3.7 summarises the results and offers some policy suggestions.

3.2 Economic growth and regional disparities in the NMS

The new Member States of the European Union have experienced a turbulent decade and a half. After the sharp recessions in the period immediately after the start of the "transition" in 1989/90, the 1990s were still not an unqualified growth period as growth continued to be interrupted by banking and restructuring crises (Hungary mid-1990s, Czech and Slovak Republics towards the end of the 1990s) often combined with

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[32] We restrict the "new Member States" (NMS) to the eight new EU Member States from Central and Eastern Europe, i.e., excluding Cyprus and Malta. We shall also cover in our analysis the candidate countries Bulgaria and Romania and include these with the NMS in our region-wide calculations.

[33] The Nomenclature of Territorial Units for Statistics (NUTS) is based primarily on the institutional divisions currently in force in the EU Member States. NUTS 1 is defined as an area with 3-7 million people, NUTS 2 to 800 000-3 million people and NUTS 3 to 150 000-800 000 people.

fiscal and monetary policy blunders as well as exchange rate crises (Poland and Hungary in the early 2000s). Overall, however, one can say that from 1993/94 onwards, economic recovery gained momentum in the NMS and their *average GDP growth* began to exceed that of the EU15. Taking the period 1995-2004, we find a growth rate differential between the NMS8 and the EU15 of 1.7% p.a. (NMS grew at 3.8% p.a., the EU15 at 2.1% p.a.). In some countries, particularly in the Baltics, the differential was significantly higher.

Nonetheless, one should not forget that all the NMS are still substantially below the EU25 average in terms of GDP per capita (see Table A.1, Appendix A[34]) and the closure of this gap, while proceeding, will take another few decades to be achieved. Hence, at an aggregate level, the NMS are on a path of "catching-up", with the distance to be covered being quite different across the NMS as their current income levels vary significantly.

What is the pattern at the regional level? Tables A.2a and A.2b present a lot of information on this account. The regions for each country have been ranked by GDP per capita (measured in PPS) in these and all the following tables so that we can look at other characteristics (growth, employment structures, employment rates, FDI. etc.) in relation to this ranking.

The first item which strikes one is that in all countries, the richest region by far in each country is the region which includes the *capital city*; there is no exception to this. The degree to which this is so varies: Prague, Bucharest and Bratislava show income levels more than double the country average, while the regions containing the capital city in the other countries show a somewhat smaller but still very sizeable gap. One of the reasons for this difference across countries, is that the NUTS 2 regions (and the NUTS 3 regions presented in Table A.2b for the smaller countries; see discussion in Box 3.1 at the end of this chapter) are differently defined and might include more or less of the "hinterland" of the capital city, thus reducing or widening the gap in income levels to the rest of the country. Notwithstanding this difference, the gap in income levels between the capital city regions and the rest of the country is very substantial throughout. Two *caveats* should be mentioned here: in calculating the GDP per capita at PPS for the regions, no adjustments have been made to inter-regional price level differences as PPS comparisons so far account only for country-wide differences in price levels. As price levels are significantly higher in capital cities (although we do not have detailed statistical evidence to document this) the income gaps shown here are likely to be a (significant) overestimate. Furthermore, enterprises in particular might record their corporate incomes in the headquarter locations and not always where that income is regionally generated. This creates a further bias in the direction of over-

[34] All tables and figures to this chapter in Appendix A.

estimating the income gaps between capital cities and the rest of the country. In spite of these two caveats, the large gaps in income levels between the capital cities and the rest of the countries should feature as an important stylised fact in the NMS. We shall come back to this issue further below. In this context we should also point to the wide divergence in (GDP) growth between the capital cities and the rest of the economies in all the countries (see last columns in tables A.2) which are very striking. Again we should keep in mind the two caveats from above: it is likely that the very high growth rates recorded for the capital city regions are an overestimate due to the lower GDP deflators used for the country as a whole in a period when price levels would have diverged between capital cities and the rest of the economies and a concentration of (especially foreign companies') headquarter locations has taken place. We come back to the role of the capital cities in relation to regional uneven growth below.

We now turn to the general issue of *regional disparities*: Table A.3 presents information regarding the coefficients of variation calculated across the regions of each of the EU25 economies. The upper half contains calculations at the NUTS 2 level, the lower half at the NUTS 3 level. Furthermore, the coefficients were calculated first for all regions including the capital cities, and second, excluding the capital cities. The table shows some interesting features if one compares levels and changes in regional disparities between the NMS and the old Member States (OMS):
First the *levels*: If one compares coefficients of variation calculated across all regions (i.e., including the capital cities), we find that the NMS show measures of regional disparities at the higher end (the averages for the NMS are around 0.5 at the NUTS 2 level as well as at the NUTS 3 level; for the OMS the values are 0.29 and 0.38 respectively), both at the NUTS 2 and NUTS 3 levels. We find that Poland and Bulgaria and Slovenia and Lithuania are more or less in line with the values measured for the bulk of the OMS. The situation changes strongly if we look at the measures of regional disparity without the capital cities: in this case the NMS are at the very low end of the spectrum for the Czech Republic, Slovakia and Bulgaria, as well as Estonia and Slovenia, and only Hungary, Poland and Romania, as well as Lithuania and Latvia are in line with the bulk of the measures of the OMS.
Second the *trends*: Including the capital cities in the calculations, we definitely measure very substantial increases in regional inequality amongst the NMS over the period 1995-2002 (with the exception of Bulgaria and Slovenia), way above those measured for the OMS (overall there is also an increase in intra-country regional disparities in the OMS over this period, but there are also a few countries where there is a decline). Furthermore, the trends in all the NMS indicate an increase in intra-country regional disparities; there is no decline for any NMS. In the calculations without capital cities, we obtain quite high values for in-

creases in regional inequalities for some of the NMS (particularly Hungary at the NUTS 2 level, and Estonia, Lithuania, Romania, Poland, and again Hungary at the NUTS 3 level) but the size differences compared to the OMS are not as high as in the calculations with the capital cities. For a few NMS, there are even declines in this case for some of the NMS (specifically at the NUTS 3 level for the Czech Republic, Latvia and Slovakia).

Summing up: Capital cities account for a significant part of the gap in overall measures of regional inequalities between the NMS and the OMS. This also very strongly affects the trend increases in measures of regional inequality in the NMS over the most recent period. The two caveats mentioned earlier with regard to the measurement problems of real income levels of capital cities should also be kept in mind when considering these results regarding levels and trends in NMS' regional disparities.

3.3 Economic structure and regional disparities

In the following we want to bring together information regarding economic structure in Table A.4 and the regional development indicators contained in Table A2 (particularly the real income growth columns on the right hand side of the table). As regards structure, we are limited to the data which are available at the regional level: lacking output or value added data by individual sectors, we can only use employment statistics by sector and region.

In the following we shall refer to the following qualitative grouping of regions in terms of their structural characteristics (in particular sectoral employment shares):

- *Capital cities*: as we have seen above, capital cities have a very special position in the NMS in terms of real income levels (and growth). Examining their economic structures we find that they also emerge distinctly – as one would expect – in terms of the share of employees in services in general and – more specifically – in terms of those services which we shall call "modern services" (NACE[35] categories J + K, comprising financial and business services). With regard to the position of these types of services there is a particularly wide gap between the capital city and the rest of the country in the NMS. We shall see later (section 3.4) that this plays a major role in explaining labour market features in capital cities.

As to the other *region types*, they will be defined by the sectoral employment shares which distinguish them most strongly from the national employment structure.

[35] NACE is the statistical classification of economic activities in the European Community.

- *Agricultural regions* are defined as those regions in which the agricultural sector is more prominently represented (relative to the national average) in the employment structure than any other sector. Similarly,
- *Mining industry* regions are those regions where the employment share of the mining industry distinguishes the region most from the employment structure in the country as a whole.
- *Basic industry regions*: these regions show a particularly strong presence of two types of industries: heavy industries such as metallurgy, but also labour-intensive industries such as textiles and clothing. The interest in these types of regions arises from an ex-ante hypothesis that a strong presence of these industries reveals a legacy from the past in which highly capital-intensive industries were supported by communist industrial (and regional) policy and these have – following the transition – become problem regions; on the other hand, the strong presence of labour-intensive branches indicates a potential competitive threat (especially in the more advanced NMS) from countries with even lower wage rates.
- *Forward-looking industry regions*: given the level of classification chosen (NACE 1-digit) we include here the various engineering industries (mechanical, electrical and instrument engineering) as more detailed analysis (see, e.g., Landesmann 2000 and 2003) has shown that these industries in the more advanced NMS experienced the fastest productivity developments, strongest FDI inflows and also growth in exports on EU markets. A strong presence (in 2003) of such industries in a region thus reveals a comparative advantage in a part of the industrial sector which had undergone quite successful modernisation.
- *Basic services regions*: a strong presence of these types of services (comprising wholesale and retail trade, transport, postal services, etc.) are evidence of urbanisation, but it could reflect a relative lack of any other types of employment opportunities.[36]
- *Tourism regions*: it turns out that some regions which have a high share of agriculture and of services in general are also important tourist destinations and hence show some distinct features compared to basic services or agricultural regions. Hence we wanted to identify them separately.

Table A.5 gives a summary of the features of these regions across the whole of the Central and Eastern European region. We have singled out a number of variables: real income levels in 2002, real income growth over

[36] In principle, we also wanted to identify a cluster of regions in which a high representation of "modern services" (financial and business services) was the most distinguishing characteristic. It turned out that this was almost uniformly just the case for capital city regions in the NMS and hence no separate regional cluster of this type was identified.

the period 1995-2002, employment rates in 2003 (also for different age groups), employment growth 1998-2003, the shares of different qualification groups in the population aged 25-64. All these variables have been calculated for the regions relative to the national average (sometimes – when indicated – without capital cities to avoid distortions emerging from the different weights of these in different countries). In this section we shall restrict ourselves to discussing income levels and income growth in relation to the above classification of regions in the NMS; in the next section we shall discuss labour market features.

Let us start with an overview: The differences in the sectoral structure of regions are associated to some degree with differences in economic prosperity and performance. GDP per head is by far the highest in the capital cities, followed by a long way by mining regions and then by the forward-looking industry regions.[37] More advanced industrial structures and the historically high incomes in mining regions shows up in GDP levels more than 10% per cent higher than the average national GDP per capita levels (calculated without the capital cities).

GDP per head in the NMS is lowest in the agricultural regions, followed with some distance by the tourism and basic industries regions. This is in contrast to the EU15 agricultural regions which have partly developed into basic services regions by diversifying into tourism, increasing their GDP per head as a result. A similar tendency is not yet evident in the NMS and, given the geophysical features of most agricultural regions in these countries, there has to be a question mark over their tourism potential (see also Roemisch and Ward 2004). The implication is that economic activity in such regions may advance much more slowly than in comparable EU15 regions.

Even excluding the capital cities, the differences in GDP per head between these region types have become more accentuated in the NMS over recent years. Thus, the average annual growth rates from 1995 to 2002 (relative to the country averages) in the forward-looking industry regions were higher than for other regions. Though the gaps in growth rates to the basic services, the basic industry and the tourism regions were relatively small, disparities amongst regions with a more and a less advanced sectoral structure widened. This is even more true for the agricultural regions that had the lowest growth of GDP per head in this period.

Let us now return to Table A.2 and discuss some of the sectoral features by country: we shall see that in many instances the sectoral structure does

[37] It should be borne in mind that the mining group contains very few regions, so that conclusions from this classification are of a tentative nature.

indeed provide explanatory power for both levels of income as well as for relative growth of real income over the period 1995-02.[38]

In the *Czech Republic*, it is those regions that formerly depended on a relatively large mining sector and developed either into basic industry or basic services regions which experienced the strongest negative growth rates over the period (Moravskoslezko and Severozápad region). Regions with a higher share of industry (either basic or forward-looking) have higher income levels than less industrialized and more services-oriented regions (with the exception of the Strední Morava region).

In *Hungary*, it is the agricultural (at times combined with a high share of basic industries) and former mining and now basic industry regions which are the regions with the most strongly negative growth rates and low real income levels. In addition, one must mention another variable, i.e., the geographical location in the periphery of the country (North and East) which also accounts for these features.

In *Poland* (where we do not have detailed industry data to distinguish between industry in general and basic vs. forward-looking industry regions) the sectoral characteristics as being an agricultural or (basic) industrial or mining region also accounts for a very low ranking in terms of real income growth; however, as in a number of other countries the main mining region, Slaskie, features as one of the highest real income regions reflecting the strong past position of miners in the wage structure of NMS (similar features can be seen in Bulgaria and, see above, the Czech Republic).

In *Slovakia* (although here only a small number of NUTS 2 regions are identified), it is again the basic industry regions which belong to the relatively low income regions, whereby the regional income distribution follows a distinct West to East pattern. Still, growth rates are higher in the more peripheral regions.

Bulgaria follows the same pattern as above, with the agricultural and tourism regions positioned towards the bottom of the list of real income growth and levels. But there are two specific features in that the two regions, Yugoiztochen and Severoiztochen, which developed from agricultural regions into tourism regions, income growth and – as we shall see below – employment growth is considerably higher than in the purely agricultural region (Yuzhen tsentralen). Another specific feature is that

[38] Table A.2 shows the allocation of individual regions to the different types of region (the type of region is indicated in the first column) characterised by the sectoral specialisation features discussed above; this provides a convenient way to analyse to which extent the relative sectoral composition of a region can contribute towards an explanation of a region's ranking in terms of income levels and income growth. The same coding is used in later tables (A.4 and A.5) to analyse employment and other features of economic performance.

Bulgaria's main mining region, Severozapaden, is not only a high income but also a relatively high growth region.

In *Romania* it is clear that the predominantly agricultural regions account for the bulk of the low real income and highly negative growth regions. Again the geographical location variable (periphery) is important to explain the very bad performance of another crisis region, Sud-Est.

3.4 Employment rates and employment growth

The next feature we want to discuss is the employment record of the different regions and also present some information on the "skill structure" of the population in the regions. Skills will be measured by educational attainment levels and we shall distinguish three groups (using the standard international ISCED classification): those with completion of only primary schooling (the "low" skill group), those with completion of some type of secondary schooling (the "medium" skill group), and those with a completed tertiary degree (the "high" skill group). Information on these skill characteristics of the population in the different regions, as well as on employment rates and employment growth have been calculated from national *Labour Force Surveys* (LFS)[39] and are presented in Table A.6.

We start the discussion of the regional employment record by looking at *employment rates*,[40] i.e., the shares of people that are employed in the population aged 25-64.[41] If we plot the employment rates relative to re-

[39] The series of labour force surveys exists for the NMS for the period 1998 to 2003 and have been compiled under the supervision of Eurostat. They therefore follow a common methodology. We consider the quality of the data contained in these statistics and their cross-country comparability as relatively high.

[40] In this article we shall only deal with the employment situation of the total population, i.e., we do not take account of differences in male and female employment opportunities, although these vary greatly across the NMS and also across the EU15 countries (see e.g., Landesmann, Vidovic and Ward, 2004). Yet unequal employment patterns between males and females follow a national rather than a regional pattern. The ratio of female employment to male employment rates is relatively stable across the regions within each country. Given that this chapter focuses on sub-national regional patterns and gender characteristics in employment patterns do not differ that much across regions but rather across countries we shall not follow this feature up any further in this chapter. Nonetheless, we should mention that the one striking difference between female employment rates in the OMS and the NMS is the much lower proportion of part-time employed in the NMS (for details, see again Landesmann, Vidovic and Ward, 2004).

[41] We chose the population 25-64 years old, rather than the more commonly used definition of working age population 15-64 years, as employment rates can be quite low and/or falling in the age group 15-25 years if there is a high rate of further education beyond primary schooling or if such rates are increasing, as has happened in the NMS over the analysed period (for details see, Landesmann, Vidovic and Ward, 2004). As we are interested in using employment rates as indicators of labour market conditions, we prefer to exclude the young (15-24 years) age groups from our calculations of employment rates, as changing employment rates for this age group reflects two things: changes in the years of schooling and labour market conditions and we want to focus on the latter.

gional GDP per capita (see Figure A.1a, Appendix A) we do not see any relationship at all, i.e., there is no evidence that regions with low GDP per capita have lower employment rates than higher income regions. However, if we redefine employment rates to include employment only in non-agricultural activities (see Figure A.1b) we see a strong correlation. Hence we can say that employment rates in non-agricultural activities are high in high income regions and low in low income regions. To make the two pictures consistent (Figures A.1a and A.1b) we can also say that agriculture acts as a "sponge" to absorb people into employment in low income regions who do not find employment opportunities in non-agricultural activities. In other words, one can interpret (at least to some extent) the relatively high employment rates in agricultural regions as "disguised" or "hidden unemployment" (this can be corroborated by the evidence of low productivity levels in agriculture in such regions).

If we return to our summary table regarding the types of regions by sectoral specialisation (Table A.5) we can see the following features with respect to employment rates, employment growth and the educational attainment structure of the working-age (25-64) population:

– *Agricultural regions* have in general a relatively high employment rate (see the discussion above) but it is interesting to see that the employment rates are rather low for the young (25-29 year olds) and very high for the older age groups (50-54 year olds). These regions belong – together with the basic industry regions – to the regions with the most negative trends in employment rates. As to the skill structure of the population (25-64 age group), we find that the agricultural regions are those – together with the tourism regions – with the highest shares of the least qualified with the lowest shares of those with the highest educational attainment levels.
– The *Mining regions* are the regions with the worst employment growth record; they also show the lowest overall employment rates and – in contrast to the agricultural regions – the employment rates are especially low amongst the older age groups (50-54) while being higher for the young (25-29 years). There is one of the lowest shares in this region of people with completed tertiary degrees and the skill structure is very strongly skewed towards those with "middle skills", probably reflecting the training traditions (in non-agricultural activities) in these regions.
– *Basic industry regions* show country average employment growth and low employment rates overall, especially amongst the older age groups. Interestingly, the share of highly educated is relatively high, possibly reflecting an urbanised character of these regions and the availability of institutions of further education.
– *Forward looking industry regions*: the differentiation of industry regions into the two categories gets strong support from the differentiated labour market features which characterise these two types of regions: while the

basic industry regions show a poor employment record, the forward-looking industry regions show exceptionally high employment rates (in fact the highest amongst all the regional types) and also high positive employment rate changes. The share of medium-educated (qualified industrial workers) is rather high.

– The *Basic Services regions* have relatively low employment rates, a high share of the least qualified and a relatively low share of highly qualified, employment growth is below the country average.
– *Tourism regions*: we identified only two Bulgarian regions as “tourism regions”. From a labour market point-of-view they are an example of regions in which the shares of the low skilled is relatively high and nonetheless employment rates are quite high; employment rates for the older age group is significantly lower than for the younger age group, in contrast to agricultural regions, though both groups have a largely similar sectoral structure. However, these regions showed above country average employment growth while agricultural regions in general experienced below country average employment growth.

To sum up the labour market features of the different region types, we can say that:
Employment rates in the NMS are highest in the forward-looking industries regions, though the difference to the other regions is not as pronounced as it was in GDP and GDP growth differentials. This might reflect the well observed phenomenon of job-less growth in the NMS (Havlik and Landesmann 2004), where rising GDP is rather due to increases in productivity than in employment. Therefore, although regions might benefit from an advanced sectoral structure in income terms, high GDP per head is not necessarily associated with a high level of employment. Employment rates are – if only slightly- above average in the agricultural regions, reflecting the tendency for those unable to find jobs in other activities to make a living from subsistence agriculture.

In contrast, the lowest employment rates – despite relatively high levels of GDP per head- are found in the mining and basic services regions. In the mining regions the restructuring and closure of mines and related industries largely contributed to the under-proportionate employment record. In the case of basic services and basic industry regions the relatively low employment rates are due to the failure of basic services to fully offset the losses of jobs in other sectors, particularly in industry.

The sectoral structure of economic activity across regions in the NMS also reflects variations in the educational attainment levels of the working-age population. Agricultural regions, tourism and basic services regions tend to have a larger proportion of people with only basic schooling than other regions (see correlation in Figure A.2), while forward-looking industry regions and also basic industries regions tend to have a larger proportion of people with medium level education (see correlation in Figure A.3). Thus the shares of the low educated in population is about 20 to 30 percentage points higher in agricultural and basic services regions than in industrial regions, while in the latter the share of medium educated is higher than in other regions. Similarly the share of medium educated in the population is larger in the mining as well as in the forward-looking industry regions than elsewhere. This reflects the twin tendency for economic activities to develop in places where the available labour force has the necessary skills required and, at the same time, for people with such skills to move to – or remain living in – areas where they are in demand.

3.5 Distribution of FDI and infrastructural facilities across the regions

3.5.1 Foreign direct investment

Due to their relatively small size the share of the NMS in global or European FDI is marginal – in 2003 the share of the NMS in global FDI inflows was around 3 per cent. Yet, when compared to the size of the economies, FDI in the NMS is slightly above European standards, as the inward stocks of FDI in the NMS amounted on average to 35 per cent of GDP compared to 33 per cent for the EU15 (and 23 per cent worldwide) (UNCTAD, 2004). While already sizable in terms of GDP the role of FDI inflows into the NMS was even greater as far as the restructuring and upgrading of the NMS economies is concerned (see Hunya and Geishecker, 2004). There is clear evidence that FDI inflows strengthened the private sector, introducing new technologies, organisational practices and knowledge, opening new (export) markets and thereby raising the competitiveness of the NMS in general.

In terms of employment FDI inflows had on the whole positive effects: on the one hand, job losses occurred as a result of the restructuring of privatized formerly inefficient state-owned companies; on the other hand, greenfield investments created new jobs, especially in services sectors like banking, retail and real estate. The net effect is estimated to be positive. This was also the case in manufacturing, where – by and large – domestically owned enterprises reduced jobs, while foreign investment enterprises expanded them (Hunya and Geishecker 2004).

However the positive effects of FDI are quite unevenly distributed across the regions in the NMS as the FDI intensity varies across the regions. This is indicated by the data in Table A.7 that show the regional distribution of FDI (measured as FDI per head relative to the country average). Regional FDI data were available to us only for the Czech Republic, Hungary, Poland and Slovakia and hence only these countries are examined.

In the four NMS the – by far – largest FDI stocks can be found in the capital cities, though the actual numbers might overestimate the amount of

FDI pertaining to the capital city regions, as FDI flows are often accounted for by the headquarter of a firm. Nevertheless, given the advantageous position of the NMS capital cities because of their market potential, well educated labour force and agglomeration spillovers, it is clear that these regions were the main target for FDI amongst the NMS regions over the last decade. In part this explains the vigorous GDP growth, the high GDP levels and the good employment situation observed in the capitals; a strong correlation of FDI and GDP per head and employment rates is found for the other regions too. This is shown in Figures A.4 and A.5 where the regional FDI stocks per head are plotted against regional GDP per head and regional employment rates (excluding agricultural employment) – all variables are expressed relative to the respective country average. Given the high correlations in Figures A.4 and A.5 it can be deduced that the uneven distribution of FDI across the NMS regions contributed significantly to the increase in regional disparities, as the prosperous regions located mainly at the Western borders or around larger agglomerations received higher FDI inflows than peripheral and less prosperous regions in the Eastern parts of the four NMS (see also the detailed study by Fazekas and Ozsvald 2004).

3.5.2 Infrastructure

Over the last decade the fast economic development in the NMS was accompanied by marked shifts in the pattern of individual and commercial transport use (the so-called "modal split") towards road rather than rail. Due to increased competition, prices charged for transporting freight by road have fallen markedly, while prices charged for transporting freight by rail tended to increase as subsidies were reduced. The road network was however substantially under-developed in the NMS, since under the (pre-1989) regimes freight transport was concentrated on rail instead of roads, while passenger transport was centred around busses and trains instead of cars (Ward 2002).

Although the NMS started to improve their transport systems in recent years, these are in many regions still underdeveloped and thus potentially impeding regional economic development. Table A.8 presents data on the NMS regions' endowments with motorways, roads, electrified railway lines as well as an indicator on the region's accessibility. More recent data are not available, so that we have to restrict ourselves to using data up to 2001; the actual situation in some of the regions might have improved over the last years.

Up to 2001 the motorway network in the NMS was largely underdeveloped. Thus in Poland there were only around 400 km of motorways, hence less than in Slovenia (435 km), Lithuania (417km), the Czech Republic (517km) and Hungary (448km). In Romania the length of the motorway network is particularly small (given the size of the country) and with 113 km only slightly less long than in Estonia (93km). In Latvia no motorways existed at all.

Although construction of new motorways proceeded at quite a high pace in some countries (as the length of the motorways increased from 1996 to 2001 by 54% in Poland, 40% in Estonia and Slovenia, by around 34 % in Hungary and Slovakia and 22% in the Czech Republic), this is largely concentrated in a few regions mostly around the capital cities or on transit routes to the West. Thus, in Poland motorways are exclusively found in regions bordering Germany, the Czech Republic and also Slovakia, as well as in adjacent regions that connect the border regions with the main regions in the Polish hinterland. The situation is similar in the Czech Republic and Hungary, where motorways exist mainly in the regions that connect these countries to the West as well as in the regions surrounding the capital cities.

Furthermore, the *density of the NMS motorway network,* measured by dividing the length of motorway by the surface, also clearly demonstrates the uneven regional distribution of transport infrastructure. Overall, the average EU15 motorway network density is much higher than that of the NMS countries with the exception of Slovenia, being twice as high in 2001 compared to the Czech Republic and 33 times higher than in Romania. However, in certain NMS regions the density is increasing fast, predominantly on the main routes to the West, though occasionally also in more remote regions where no or only few motorways existed before; this was the case e.g., in the Hungarian regions Dél-Alföld (on the Romanian border) and Észak-Magyarország.

As there are only few motorways in the NMS, the network of roads and their condition are also vital to the regional economies especially for those regions that are most distant from the main agglomerations. To get a notion of the accessibility of roads in the NMS regions, we use the estimates provided by Ward (2002) on the average time that is needed to reach a motorway. The most striking feature of these estimates is that only in 13 out of the 53 NMS regions the time needed to get to a motorway was below the EU15 average of 27 minutes. Not surprisingly these are the regions with the highest motorway density. In contrast to that, the time needed in the most peripheral regions especially in Poland and Romania was three hours or more.

3.6 Problem regions

In the following we focus on a sub-set of regions we call the "problem regions": In almost any NMS employment opportunities vary a lot across the regions. Thus the difference between the regions with the highest employment rates and the regions with lowest employment rates amounted in 2003 10 to 14 percentage points in Bulgaria, the Czech Republic, Hungary and the Slovak Republic.

As far as the differences across Polish and Romanian regions are concerned, they are *prima facie* slightly less pronounced (9.9 and 6.6 percentage points respectively) than in the other NMS. However for both countries, employment rates are blurred by the fact that a large part of those unable to find jobs elsewhere move into subsistence agriculture. Thus in both countries – especially as far as the agricultural regions are concerned – employment rates incorporate a considerable amount of hidden unemployment. Correcting for this – by simply subtracting the agricultural employment rate from the total employment rate – reveals for Poland a gap between the region with the highest and the region with the lowest "non-agriculture" employment rate that is of similar size as in the countries above (11.6 percentage points). In the case of Romania this difference grows to 22.8 percentage points.

Focussing on the regions with the least employment opportunities and prospects, they can be broadly distinguished into one group containing old industry regions and one group containing agricultural regions.

Using the NUTS 2 level regional breakdown, *old industry regions* with over-proportionate labour market problems are: the Moravskoslezko region in the Czech Republic, the Észak-Magyarország region in Hungary, the Východné Slovensko region in Slovakia, the Slaskie region in Poland and to some extent also the Nord-Vest region in Romania.

In contrast to other regions within the respective countries, in many of these old industry regions the restructuring process and industry upgrading was hampered by a comparatively low inflow of FDI. This was partly due to the low attractiveness of privatised objects (as all those regions formerly were centres of heavy industry) but also because of the disadvantageous geographic location at the Eastern borders combined with an underdeveloped transport infrastructure. Consequently the massive loss of industrial jobs that occurred at the early stage of transition was neither compensated for by the creation of new industrial jobs nor by the relatively slowly developing services sector. Hence these regions still rely to a relatively large extent upon the old declining industries and, to a much smaller extent, on forward-looking industries and services.

Agricultural regions with prospective labour market problems are considered to be the Lubelskie, Podkarpackie, Podlaskie and Swietokrzyskie regions in Poland, the Nord-Est, Sud and Sud-Vest region in Romania and also the Dél-Alföld region in Hungary. A common feature of the agricultural problem regions is that, though they have in general a relatively high employment rate, a great deal of employment is attributable to the agricultural sector, while there is an absence of employment opportunities in industry and services. Thus in the Romanian agricultural regions the ratio of agricultural employment to total employment is between 40% and 48%, while in the Polish regions this ratio ranges from 27% to 37%. In the

Hungarian Dél-Alföld region the share of agricultural employment in total employment is slightly above 11 per cent. Though this is low by Polish and Romanian standards, it is more than twice as high as the Hungarian country average.

The high level of employment in agriculture, though at present greatly mitigating (un-) employment problems is a matter of concern once a rescaling of the agricultural sector starts, as hidden unemployment will turn into open unemployment of considerable size.

Low educated: The low employment opportunities in both the old industry as well as the agricultural problem regions have especially severe effects on the lower educated work force. The relatively few available jobs – even those with low skill requirement – are occupied by the highly and medium educated workers, for which there is also an excessive supply in those regions. Thus the substitution of lower educated workers with medium or even highly educated workers led to particularly low employment rates for the lower educated.

Youth employment: Another consequence of the low employment opportunities in the problem regions is that the young age groups of the labour force (aged 25-29) have particular difficulties in finding jobs. Correspondingly, youth employment rates in old industry regions (except for the Romanian Nord-Vest region) are amongst the lowest if not the lowest in the respective countries with the gaps to the average youth employment rates ranging from 3 to 5 percentage points. The situation appears worse again in agricultural problem regions if the absorptive capacity of the agricultural sector is accounted for. Given the low labour demand in industry and services, the youth employment rate (without agriculture) is only around 10 to 15 per cent in Polish and Romanian agricultural regions and thus much lower than in other regions.

Educational attainment levels of working age population: One dilemma of the agricultural problem regions is that, on the one hand, economic activity expands in locations where the workforce has the necessary skills demanded by employers. On the other hand the potential skills of the workforce adapt (e.g., via migration) to the skill-demand at a certain location. With respect to the future potential of regions to attract investors the educational attainment levels of the young age group (25-29 years) deserve special attention. Two things are noteworthy. Firstly disparities in the proportion of the lower educated (and the highly educated) for the young age groups between the problem regions and other regions are smaller than for the total population (except for the Hungarian Észak-Magyarország region). Secondly across all NMS regions the share of lower educated is much lower within the young age population than within total population. Thus over time the average skill level within the NMS regions (including the problem regions) is expected to rise, as the old, less educated groups phase out of the labour force and young and better trained groups enter.

Regional GDP and market potential: The prevailing conditions for economic development – besides being reflected in a region's employment opportunities – are to a large extent measurable through the income a region generates. In fact, not only is a region's income level directly related to the past and present economic performance, but it also relates indirectly to future economic development as it partly reflects this region's market potential, which in itself is an important determinant for prospective future investment.

Regional income differences between the agricultural and industrial problem regions on the one side and the other regions on the other side are, therefore, not only an expression of an unfavourable sectoral structure or of large scale industrial decline. They can also be associated with different potentials for future economic development, especially with regards to the services sector development, given the tendency that higher income regions expand this sector at higher rates than low income regions.

An additional determinant of a region's market potential is its geographic distance to prospering markets. In this respect, too, most problem regions are not favoured because of their peripheral geographic location. Especially the old industry regions in the Czech Republic, Hungary and Slovakia – at least in relative terms – suffered from their geographic location. Being located at the Eastern borders and thus further away from Western markets than the other regions was not only an impediment to large-scale FDI inflows. It also inhibited the development of small scale businesses fuelled by cross-border shopping from Austria and Germany, which happened in Western Hungarian and Czech regions. Similar arguments apply to the four agricultural problem regions in Poland that are located adjacent to or near to the Belarus or Ukrainian border, as well as to the Nord-Est region in Romania, which borders Moldova.

3.7 Summary and conclusions

The following provides a summary of the findings of this study.

- Regional disparities within the 8 Central East European EU new Member States as well as in Bulgaria and Romania are relatively large and more pronounced than in the old Member States.
- The main reason for the size of regional disparities in the NMS is the income gap between the prosperous capital city regions and virtually all other regions.
- Over the last seven years regional disparities in the NMS increased strongly; again, this was mostly due to the capital cities, which experienced high growth whereas in the bulk of the other regions economic development was relatively slow.

- An exclusion of the capital cities from the analysis results in a quite even and relatively stationary distribution of incomes across the remaining NMS regions (with the exception of Hungary).
- Grouping the NMS regions according to their sectoral structure reveals relatively big differences between different types of regions: capital city regions as well as regions with a larger share of more modern industries (or services) show higher incomes and higher income growth than agricultural regions or regions that rely to a large extent on basic industries or services.
- The employment record within the NMS regions is not necessarily connected to their income level. This is because of the absorptive character of the agricultural sector, which is the main source for employment especially in the least prosperous NMS regions. Looking particularly at agriculture though, the analysis reveals a strong correlation of non-agricultural employment rates and income levels; correspondingly (except for the agricultural regions) the sectoral structure is of major importance as far as employment opportunities are concerned.
- Moreover the sectoral structure of the NMS regions corresponds also to the educational attainment level of the population. Thus the share of population having completed tertiary or upper secondary education is higher in regions with a larger share of modern (and skill intensive) industries and services. Conversely, the share of lower educated population is especially high in the agricultural regions, but also in basic services regions.
- Foreign direct investment is unevenly distributed across the NMS regions and has become one of the main sources for regional inequalities, as it tends to locate primarily in the capital cities and in regions close to the capital cities or to the Western borders.
- Furthermore, the infrastructure (especially motorways) is much better developed in regions close to the Western borders and in and around the capital city regions, and thus an additional source for the regional inequalities in the NMS.
- In addition to the general level of regional disparities, one can identify in most of the NMS what we called “problem regions”. Common to these regions is the adverse economic structure and low attractiveness to (foreign) investors, due to a low market potential and a less qualified labour pool, that leads to significant problems on the labour market – especially so for those having completed only primary education as well as for the young age groups in general.

The analysis has presented a picture of uneven regional distribution of economic development across the NMS, which is expressed as significant disparities in income, employment opportunities, educational attainment, involvement by foreign investors and infra-structural facilities. Moreover, latest trends clearly indicate a widening of these disparities, and there is no good reason to believe that this trend will reverse in the near future – without public policy intervention.

Before attempting to formulate any concrete regional policy recommendations, one has to be clear about the challenges such a policy will face. One of the main challenges is the diversity of regions with respect to their sectoral structure, their geographic location, their market potential, etc. A second challenge is of strategic nature, as it comprises a decision whether to support core (or agglomeration) regions, which might generate high growth in some regions (that eventually might trickle down to the other regions), or whether to relocate funds to the least prosperous regions, which might generate lower country-level growth but counteract some of the tendencies towards peripherisation and further agglomeration. A third challenge is – independent of the actual regional policy – the provision of a well-functioning (policy) transmission mechanism, in the form of effective administrative bodies, NGOs, and other institutional facilities.

As the following chapters of this study will elaborate on the above points at the detailed country level and the existing literature offers a wide range of policy proposals (see e.g., Brücker, Trabold and Ward 2004), we restrict ourselves to emphasising three points of relevance to regional policy at the current juncture of development in the NMS:

Firstly, education and training policies i) raise the probability of individuals to become employed, ii) create a pool of qualified labour that potentially attracts investors, iii) facilitates restructuring as it raises peoples mobility between jobs and locations.

Secondly, theory as well as empirical evidence does indicate that "core regions" develop much faster than more remote regions. Thus any policy geared towards the support, creation or revitalisation of core regions (i.e., those with major agglomerations, towns and cities) will lead to higher growth in those regions and stimulate such growth at the country level. Yet, such a policy ought to be accompanied by a supplementary policy that ensures that more remote regions also benefit from this.

Thirdly and following from the above, infrastructure policy is a viable option as it raises the mobility of workers and facilitates commuting from remote regions to (local) centres. It also raises the mobility of consumers and small firms, which is important for the development of local businesses (though increased mobility could also encourage shopping in larger agglomerations). Moreover infrastructure investment (in road and rail) raises the regions' attractiveness for large(r) scale investment, as transport costs and the time required to reach potential markets are reduced. Additionally an enhancement of the connectivity of remote regions should also raise their tourism potential.

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Box 3.1 NUTS3 regional disparities in the Baltics and Slovenia

So far the analysis concentrated on development of NUTS 2 regions, which did not allow assessment of the scale and the development of regional disparities in the Baltic states and Slovenia. Using NUTS 3 regional data for the same period as above allows us to analyse regional disparities in these countries.

The basic result is that much of what has been observed for the NMS/CC NUTS 2 regions also holds for the Baltic and Slovenian NUTS 3 regions. All of the 4 countries experienced high GDP per capita growth between 1995 and 2002, with annual real growth rates ranging from 3.9 per cent (Slovenia) to 6.8 per cent (Estonia and Latvia). Yet, with the exception of Slovenia, it was again the capital city regions that benefited most, as they were the only regions with above national average growth. Additionally though – and unlike other NMS/CC countries – regional disparities increased also within the sample that excludes the capital cities. This was because the least developed regions especially in Estonia and Lithuania grew much more slowly than other regions, leading to an increase of disparities even without taking account of the capital cities. As a consequence, regional disparities in the Baltics which were already high in 1995, increased markedly by 2002. In contrast, Slovenian growth was much more balanced regionally, with most regions showing growth rates around the national average, except for the two least developed regions that lagged behind. Regional disparities, which are the lowest amongst the NMS/CC, therefore increased only slightly from 1995 to 2002.

The Baltic states face overall the same dilemma as other NMS/CC. Despite high national growth, only few regions manage to converge at a decent speed towards the EU25 average – except for Estonian regions where all but one of the regions grew more than 3 percentage points faster than the EU25 on average. Given that the Baltics contain some of the poorest regions in the NMS/CC (together with Bulgaria, Romania and Poland), the issue of regional policy to ensure that cohesion proceeds at an acceptable pace has added relevance.

Map 3.1 NUTS 2 regions

4 POLAND AND COHESION POLICY

Magdalena Kaniewska and Katarzyna Zawalińska

4.1 Introduction

When the European Union was enlarged on 1 May 2004, it gained an additional large Member State and an important player on the European policy arena. Poland, which is the sixth largest EU country with population amounting at 8.5% of the total EU population, will by virtue of its size play a dominant role in future European policies. On the one hand, Poland will have to adapt in the years to come and catch up with more developed EU members, on the other hand it will have to speak with its own voice and switch from having been a policy taker to becoming a policy maker in its own right.

After the accession, there was a question mark whether sufficient preparations had been made for adaptation of the European Cohesion Policy to the enlarged Union and the needs of NMS. As we will see in this and the subsequent chapters, there are a number of features in both the current Cohesion Policy and in the Commission's proposal for the future policy that will still create problems in the NMS. Some of them may be unique to Poland or to a limited number of NMS, while other features may be problematic to all NMS. The one issue that can perhaps be singled out as the most common among them is the budgetary strain. Constraints on public funds are often put forward as a justification for cuts to the cohesion budget, but the complexity of the procedures in relation to the funds available is often perceived as a root cause of inefficiency. There is a clear risk that many NMS, including Poland, will be forced to return funds to the EU budget, which means the funds will not target what they were aimed to target.

Of course, the problems are not restricted to the Cohesion Policy *per se*. We also identify a number of weaknesses in the Polish approach towards EU regional policy, particularly those manifested and criticised in the National Development Plan (NDP) for the years 2004-2006. While the new NDP, which covers the next Financial Perspective 2007-2013, has improved on several issues, some problematic issues remain unsolved.

We argue that the future ECP should strive towards addressing a number of basic challenges that Poland faces in the process of integration with the EU. To mention but a few, regional policy should focus on the upgrading of human capital, help transform Poland to a knowledge based economy through R&D initiatives, help improving environmental standards and support the implementation of institutional reforms.

We also propose the creation of a Common European Education Policy, that is to say, that domestic education policy should be reinforced by an education policy that is coordinated at the supranational level. For the new

Financial Perspective, we propose the reinforcement of the actions on stimulating the quality of education and training in the EU. Since programmes aimed at improving education at post-secondary and higher level as well as vocational training have been already planned, we strongly recommend the establishment of a new fund to finance basic education in the NMS under the "1a" heading: "Competitiveness for growth and employment". The main priority of the fund would be the improvement of the primary and secondary education in the NMS, in order to catch up with other EU countries' educational standards. Since the benefits of human capital upgrading in one country are spread over the EU, common action should be taken to reinforce individual country efforts and take account of "positive externalities".

Last but not least, we also stress the importance of decentralisation of public finance and consider some of its consequences on the effectiveness of regional policies and actions. From the view of managerial aspects of regional policy, we also stress the importance of horizontal programming rather than sectoral programmes, and call for higher competencies of local governments in regional development programming.

4.2 Lessons learned and future implications from the pre-accession instruments

The primary goal of pre-accession support was to prepare Poland for a smooth integration into the EU. At the time, cohesion as such was seen as a secondary goal, even though it was a goal expected to gain importance in the future. The most vital task was rather to learn the logic of Structural Policy and to begin implementing the *acquis*. The EU pre-accession programmes introduced an administrative organisation and a financial discipline that was new to Poland. Polish public administration and Polish policy-makers were totally focused on learning the new rules, such as planning, implementing, monitoring and evaluating the programmes, which implied that they were not in a position to contribute to it or adjust it to the particular needs in Poland: they were all policy takers at that time.

Since the most pending need before accession was to learn the EU's policies, there were no reflections or thoughts on possible changes, or how to adjust the Cohesion Policy. Rather, concerns were geared toward the ability to absorb the resources offered by the funds. At first, therefore, it was quite natural that "simple" projects dominated Polish propositions, i.e., goals tended not to be diversified and although they made absorption easy, they did not necessarily bring the highest possible development in the areas where they were implemented. Good examples are provided by some of the infrastructure projects, which allowed Poland to focus major amounts of funds into one large investment which, however, did not necessarily improve entrepreneurship. To name but one example, a new highway may cause increased traffic at a certain area without the existence of positive effects.

The projects financed from the pre-accession funds were accepted on the basis of the fulfilment of formal requirements, rather than on the justification of their strategic and operational goals. Again, as focus was laid on the ability to absorb all funds available, this meant that practically all projects that qualified were granted support, without any distinction between projects that might have brought higher (or lower) development. However, there was never really a risk that a project was not needed: the Polish infrastructure was so underdeveloped that each euro invested with high probability brought some changes (unless the projects overlapped or contradicted). So, all in all, we may conclude that Commission officials, quite naturally, had much more impact on the content of the pre-accession programmes than did Polish officials, who more or less acted as consultants. In fact, this could be viewed as a natural introduction to a more active future participation in the decision process.

Once the implementation of the pre-accession funds started in Poland, specific problems appeared due to a sometimes inadequate Polish institutional capacity, insufficient human capital and under-developed organisational structures. In order to avoid these problems in the future, the recommendations that resulted from the ex-post evaluations of the PHARE, ISPA and SAPARD programmes, illustrated below, should be taken into account. We can generalise them as follows (see AGROTEC 2003; NIK 2003a and b; and EMS 2003):

1. There is room for simplification of procedures without loosing rigour. For example, business plans and application forms could be simplified substantially while still being based on sound economic indicators. Otherwise, chances are that the rate of uptake will be slow. Furthermore, complexity indirectly benefits larger and wealthier beneficiaries, who can afford to pay for advice and help. A simplified procedure will also allow for a reduction in both the amount of supervision needed and the number of errors to be dealt with.
2. Since infrastructure projects usually have a high uptake but not always assure a positive impact, it is advisable to introduce stronger economic assessments for these projects. A proven “good value for money” and a positive long-term impact from the infrastructure projects should be primary and compulsory requirements.
3. Since it was observed that smaller projects had difficulties in competing with larger projects, a good practice would be to have separate project schemes directed to small projects (firms). It would guarantee that a certain amount of the funds would be reserved for small and medium sized enterprises (SMEs), which are believed to be “engines of growth” in developing countries. It would also allow for simplification of the procedures up to a certain level of the budget.

Different types of calls for proposals could also be considered.

4. In some of the structural projects it seems reasonable to introduce an age limit (requirement) into the qualification procedure. This is especially important in the fields or regions where young people are particularly disadvantaged. A good example is the rural labour market in Poland, where employment opportunities are in short supply. Therefore, as advised in SAPARD, "youth proofing" should be used as a criterion in the ranking procedure of project selection.
5. A common problem for all of the pre-accession funds was delays in starting-up. This problem could possibly be avoided or at least diminished if the programmes were designed in careful relation to the resources that were available to implement them. The common problem of an accumulated workload could be addressed by shortening the lapses between calls for proposals. On the other hand, introduction of some standards for the number of applications checked per person per week or month (e.g., 60 projects per person per month) would allow for planning the sufficient human resources needed to deal with the accumulated workload.
6. It seems important to differentiate the rates of subsidies in the projects in order to give higher priority (higher subsidies) to disadvantaged areas and groups of people and to "public good" types of investments, as well as those creating positive externalities (e.g., knowledge and technology). This can be introduced by specifying accurate conditions for qualification of participants.
7. Pre-accession trans-border cooperation proved to be a very efficient tool of development in the form of economic exchange (trans-border trade), cultural exchange and tourist and environmental cooperation – over the years 1994-2001 Poland had realized 320 such projects, where the main partners were Germany, Czech Republic and Slovakia. Especially in the field of environmental cooperation, physical country borders lower the efficiency of environmental protection since the environment itself is not limited by borders. In that sense the cooperation is a good example of the value added at the EU level of these programmes. There are also positive externalities from learning good practices and exchanging ideas with more advanced "neighbours", at the level of local administration, entrepreneurs and citizens in the regions. Therefore, it would be advisable to further promote the trans-border initiatives, especially in the case of activities that generate externalities, both positive and negative. In the case of positive externalities, cooperation should be based on higher exchange and integration (e.g., in the case of transfer of knowledge and of innovations), while in the case of negative externalities, cooperation should focus on more effective common prevention (e.g., crime, etc.). Incentives should be created to encourage local governments to create a good legal basis for such cooperation for all local societies.

To conclude, it seems that the pre-accession programmes revealed a need for better implementation of the pre-accession programmes rather than the need for a change in their design – although the latter is usually less problematic. The recommendations suggested above may contribute to eliminating some of these problems in the future.

4.3 Controversial accession negotiation issues

The Polish approach to the Structural Funds and the Cohesion Policy has been changing with advancements in integration and by the learning process initiated by the pre-accession aid. At the final stage of negotiations, Poland had a clear view on what was beneficial for it and it also had more political power to execute its position, for the simple reason that Poland was the largest country among the candidates and had a favourable geographical position lying in the centre of Europe and separating the Baltic countries from the EU15 Member States. Besides, during the final negotiations the financial issues became much more important for Poland than it was in the case of the pre-accession programmes. The funds that now were to be negotiated were no longer non-refundable, but would be a part of Poland's contribution to the EU budget.

Then, unsurprisingly, in the final stages of negotiations some controversies appeared, even though in the case of Structural Policy they were not very contentious and were closed quite quickly (long before the final summit) – unlike agricultural issues, which were discussed until the very last minute of the summit. The negotiations in the field of "Regional policy and coordination of the Structural Funds" were opened on 6 April 2000 and closed on 1 October 2002 (RM 2002). Controversies were mainly related to financial issues, rather than to the content of European regional policy.

First, Poland claimed that the absorption of the Structural Funds would be difficult for the country (as the pre-accession programmes revealed), so the negotiated funds might not be fully utilised. Therefore, Poland proposed that its contribution to the EU budget should be gradually phased-in, reaching 100 per cent over a 5-year period, in order to avoid the possibility of becoming a net contributor to the EU budget during the first years as an EU Member State. The EU did not agree: the argument was that Poland had already gained much pre-accession aid and with this aid taken into account, there should not be a problem of Poland becoming a net contributor. It was expected, however, that Poland would not be able to fully utilise the allocated share of the Structural Funds from the start.

Second, the Polish negotiation proposition was to shift some funds from rural development – partly financed from the Structural Funds – to direct payments to farmers. According to the EU proposition, the system of direct income payments would be phased-in in Poland (like in the other NMS) over the period 2004-2013, starting with 25% in 2004 (of the EU-15 level), 30% in 2005, 35% in 2006, 40% in 2007 and then with added 10% every year until reaching 100% in 2013. Such a slow pace in the phasing-in of direct payments was difficult to accept by Poland for both political and economic reasons. Therefore, Poland suggested the possibility of shifting some rural development funds, which were supposed not to be able to be absorbed anyway, to the funds for direct payments. The compromise reached at the European Council in Copenhagen, December 2002 was that Poland was able to top-up direct payments from rural development funds up to the levels of 36% in 2004, 39% in 2005, and 42% in 2006 and even additionally top them up from the national budget up to the limit of 55% in 2004, 60% in 2005, and 65% in 2006.

Third, Poland was in favour of a higher share of the Cohesion Fund within structural support because of its more absorbable form, having more favourable co-financing conditions, quicker procedures, etc. than other funds. Eventually, Poland obtained €1 billion more for poor regions than initially proposed by the EU.

Poland also negotiated the territorial division of the country into NUTS units since the division affects the eligibility criteria of the objectives. All in all, the whole of Poland was classified eligible for Objective 1 support (but excluded from Objective 2 and 3) and it also qualified for INTERREG, EQUAL, URBAN and LEADER.

It is thus clear that the debate during the accession negotiations did not concern the priorities of the ECP or, for that matter, its congruence with specific Polish goals, but rather financial and absorption issues. The Polish government probably followed the logic that overall funds must first be secured and only then, as a second step, could talks on their distribution start. Notably, this sequence of events has also been adopted by the EU. First the budget is given an expenditure (or appropriations) limit and then distributional issues are raised. Should the opposite sequence be implemented – that is to say, if all countries started their negotiations by making individual claims on the budget, according to their specific needs – it would mean that Member States had incentives to maximise their claims. This would in turn mean a risk of costs sky-rocketing, no matter how tough the negotiation constraints. A good case in point was the Common Agricultural Policy (CAP), which substantially increased the EU budget before any limits on the CAP budget had been implemented.

4.4 Polish problems linked to the conditionality of the Structural Funds

It was only after Poland had gained experience from the Structural Funds, that it also gained insight into their full meaning: it thus became clear which conditions were favourable with respect to Polish preferences and limitations which were not. Some problems resulted from economic and institutional differences between Poland and OMS, differences such as a different level of development, specific economic needs related to an unfinished economic transformation, institutional shortcomings, etc. We may divide Polish problems linked to the conditionality of the Structural Funds into at least three categories:

1. problems related to the budgetary envelope and the resources of Cohesion Policy;
2. problems related to the new ECP priorities; and,
3. problems related to the general provision of the Structural Funds, such as concentration, partnership, programming, co-financing, etc.[42]

4.4.1 Conditionality linked to budgetary envelope and resources

In the debate on the size of the overall EU budget, Poland does not in theory perceive any problems, unless the size of the reduced budget affects the transfer of funds for important priorities. However, there is a real threat that the small budget option of one per cent or less of EU GNI would crowd out priorities – possibly important ones – that are not represented by strong lobbies in Poland. This comment stems from a general observation of political processes, which show that budget capping never means proportional cuts. The higher the shortage of funds compared to the needs, the higher the discrimination against certain priorities. Therefore, in order to reserve a sufficient amount of funds for important developmental goals and to avoid crowding out, the one per cent option may be too meagre.

The absorption cap of four per cent of a country's GDP for Cohesion Policy, taking into account co-financing abilities and institutional capacity, seems from the outset to still bring quite enough resources to Poland from the EU budget (Grosse and Olbrycht 2004). However, it would be harmful if this cap were to apply for both rural development and the fishery policies. First, it would in practice imply a trade-off between the goal of cohesion on the one hand and the rural development goals on the other. As they are both crucial, they should not be substituted with each other. According to the Polish National Development Plan, the scheme would mean that at most 3.55 per cent of GDP would be devoted to Cohesion Policy and up to 0.45 per cent to rural development and fishery (MG 2005). This implies a decline in funds devoted to Cohesion Policy as such and a room for manipulation with rural development and fishery funds (because of the trade-off). Second, it seems quite illogical (or the logic is hidden) when rural development funding is eliminated from the Structural Funds and at the same time included into the calculations of the Cohesion Funds' absorption level.

[42] Some of them are already expressed in the proposed National Development Plan for 2007-2013.

4.4.2 Conditionality linked to priorities for the new European Cohesion Policy

As mentioned, the Commission has proposed to exclude rural development and fishing industry restructuring from the Cohesion Policy framework. Although it may be perceived as a step towards management simplification, which in general is desirable, this step has in fact far-reaching consequences for the scope of Cohesion Policy and the hierarchy of priorities supported by it. That is to say, the benefits from simplifying policy may be outweighed by the cost of giving up important goals. As a matter of fact, it weakens the political significance of the new ECP and strengthens agricultural policy, which is already dominating the EU budget.

Poland is a very rural country and most of its structural problems are concentrated there. We agree with Grosse and Olbrycht when they conclude that taking funds intended for the development of rural areas out of regional policy – rather than bringing them closer together – will not contribute to structural improvements in the country (see Grosse and Olbrycht 2004). Nevertheless, the Polish government does not officially reject the proposal to exclude rural development from Cohesion Policy, since it probably expects the EU to compromise in areas deemed more important by the Polish government.

However, there is an inconsistency in the Polish strategy: on the one hand it is supporting the idea of a single fund, but, on the other, it forces through 16 regional programmes.[43] We believe that both the single fund approach and the exclusion of rural development from Cohesion Policy will be non-beneficial to Poland. We rather support the idea of creating decentralised Operational Programmes, since they would give more power to the regions to decide about their own development. Even the Commission admits that regionalised management is a more effective way of building regional competitiveness and increasing employment than centralised management (COM 2004b).

However, we have to keep in mind that it would require a reform on both European and Polish levels. The EU would have to adjust to deal with 16 representatives of regional administrations – instead of one central administration – while Poland would have to complete a reform of public finances and build a solid regional administration structure with well trained civil servants. Although a step in the right direction, it will take time and require strategic planning.

The Commission's proposal to strengthen the priority of competitiveness within the framework of sustainable development is very much in line with

[43] Poland insists on the proposition to include 16 regional operational programmes into structural policy organisation framework, 50% of the total SF would be spent on these programmes. So far there was no EU acceptance for this change.

Polish development needs, as Poland suffers from high unemployment and an unfinished restructuring of the economy. Therefore, the creation of new objectives, such as the Competitiveness objective and territorial cooperation programmes based on the Lisbon and Gothenburg priorities, seems beneficial to Poland.

However, it appears that OMS, with few exceptions, are to be sole beneficiaries of this new objective (see Bachtler and Wishlade 2004). Although it seems possible to realise some of the activities that are aimed at raising the level of economic competitiveness and innovativeness under the Convergence objective (which is directed mainly toward NMS), experience clearly shows that the financing of these priorities will be marginalised within this objective (Grosse and Olbrycht 2004), as it mainly focuses on infrastructure and environmental issues. So if Poland wants to build an economy based on knowledge and advanced technologies as well as to develop its human resources – which should be viewed as absolutely crucial for creating a competitive economy with well functioning institutions – it should be either a) in favour of a higher participation of the NMS in the new Competitiveness objective, or, b) try to find ways of realising these goals by the resources available through the Cohesion Fund.

As for the first option, it could be done simply by switching from the current qualifying condition – which says that the Competitiveness objective is intended only "to assist all the areas not covered by the Convergence objective" and thus "the current Objective 1 regions no longer be eligible as a result of their economic progress" (COM 2005) – to conditions based on comparative advantages in the Member States' product and labour markets. Thus, the higher the opportunity to utilise comparative advantage through the funds, the more eligible the country should be for participation in the programme.

As for the second option, we have to conclude that the possibilities are limited since the efficiency goals (interpreted as "the utilisation of comparative advantages") are not always in line with the cohesion objectives (interpreted as "achieving higher equality"). Only in cases where those two do not contradict can we say that the Cohesion Fund could realise the policy of higher competitiveness (and in certain cases the employment objectives).

The proposition of including priorities related to urban areas (including public transport) and renewable sources of energy is also very much in line with Polish needs. As pointed out by Kaniewska (2003), increasing the level of available technical infrastructure in agglomerations in Poland adds to positive external effects and makes the effective markets larger. Therefore, regional actions should aim at upgrading the existing transport infrastructure, including public transport in the dominant urban areas. The public transport constitutes the driving force of local development and fast railway networks around the cities should be considered an important priority, as they increase the shuttle migration and thus makes local labour markets more flexible. Second, Poland has a potential to become a significant producer of renewable energy, especially biomass, since it is a major producer of wood, straw, oil and alcohol in Europe (Council of Ministries 2000). In addition, extending the priorities within the Cohesion Fund to include local transport would increase flexibility of measures, such as the possibility of combining the trans-European infrastructure with the transport infrastructure of agglomerations.

At the same time, the introduction of this priority implies an increase in local governments' decision power and financial autonomy, because the scale of the agglomeration projects is local and would not require inter-regional actions. Self-governments would thus be able to programme and finance the policy themselves. So far the programming in the area of transportation within the Cohesion Fund has been much centralised and this proposition would be beneficial from both the viewpoint of Polish development priorities, as well as from an institution building perspective. However, there is a risk that the expected increase in the share of the Cohesion Fund in financing Cohesion Policy (see Table 4.1) may lead to a centralisation of management. Therefore, the advice would be to use more regional initiatives within the framework of the Cohesion Fund.

Table 4.1 Structural Funds and Cohesion Fund
(% of the total funds devoted to Cohesion Policy)

	Financial Framework 2000 – 2006	Financial Framework 2007 – 2013
Structural Funds	91.55	81.3
Cohesion Fund	8.45	18.7

Source: Bachtler and Wishlade (2004)

However, problems will arise if too much priority is given to transport infrastructure investments (as pointed out by Grosse and Olbrycht 2003b). First, it may strengthen the political and programme-management role of the central authority at the expense of territorial self-governments. Second, as experiences with ISPA have shown, the Polish administration has had difficulties with the management of such projects when they have been too large. Third, it is clear from the evaluation of the pre-accession funds that the effectiveness of these investments differed significantly across the country – e.g., the building of a road may not necessarily boost development (the Greek experience too serves as a good example of this insight).

4.4.3 Conditionality linked to the general provision of the Structural Funds

Generally, it seems important to *simplify the provision of the funds* wherever possible, while at the same time preserving their main principles of assuring efficiency and effectiveness of policy. There is a general perception that the procedures and centralisation of the management system caused many delays and constraints in Poland, so there is a postulate to focus management and the provision of the funds more on the results rather than on advancing the procedures (Grosse and Olbrycht 2003c). In this context, the Commission's proposal to include the *principle of proportionality* – which would make requirements toward programming, monitoring and evaluation of programmes proportional to their size, thus reducing the red tape in small projects – should be viewed as a positive element in the proposed ECP reform.

Another problem concerns the proposal related to the n + 2 principle, which has applied so far to the Structural Funds and is now proposed by the Commission to be extended to the Cohesion Fund. Hence the financial resources assigned for a given year must be absorbed by the country in question within the next three years. This may become a problem in Poland, at least during the first years after accession, because of a less experienced administration (as revealed during the implementation of the pre-accession programmes). We can therefore expect to see a situation where a large proportion of granted resources will not be used in the required spending period. Although the unexploited funds would not be wasted, but transferred back to the EU budget and distributed differently, the fact is that they would not be used by Poland and it is therefore in the interest of Poland not to extend the n + 2 rule to the Cohesion Fund, at least in the early stages of its membership.

Some problems may also appear due to the proposal to *exclude VAT from eligible expenditures* in projects co-financed through both the ERDF and the Cohesion Fund (although it would still be eligible expenditures in ESF projects). The proposition to exempt VAT from the country's own contribution makes the co-financing requirements for the beneficiary country harder to fulfil, since the domestic contribution will rise dramatically. For those beneficiaries of the policy that are not registered as VAT payers – that is a large part of public administration e.g., local governments and universities – the domestic contribution for the realisation of projects from the ERDF will increase from the current share of 33.3 per cent of the EU funds to 62.7 per cent and, in the case of the Cohesion Fund, from 17.6 per cent to 43.5 per cent. The problem may also arise in some cases for beneficiaries who are VAT payers (MG 2005). The old system is therefore more beneficial for Poland than the proposed new one.

Furthermore, it is in the interest of Poland to postulate a higher *flexibility in the allocation of the funds*. One step towards achieving this objective would be to let the funds allocated to the country be transferable. The flow between funds within a country would go from operational programmes (or regional programmes) that do not use up the funds to programmes that need more funding. It would create a positive incentive – to focus on high efficiently rather than on absorption capacity (the latter is the case when there is a threat of unused funds being returned to the EU budget). The Commission's proposal to start management and allocation of the funds at the level of priorities rather than measures is a good step towards higher flexibility.

The concept of *matching funding* represents another challenge. However, the problem lies mostly on the Polish side, as the country has an alarming situation with respect to its public finances.[44] This has at least two consequences: first it may result in problems co-financing the programmes (at the required level up to 25%) and, second, even if the funds are set aside for co-financing, there may be little or no resources left for the realisation of a domestic regional policy. So, on the one hand, there is a threat that domestic policy will be marginalised – that is to say, that the ECP will be prioritised at the expense of domestic policy – but, on the other hand, the situation may cause a positive pressure on Poland to make the programmes financed within the EU policy consistent and synergic with those planned within the scope of domestic policy.

The *principle of partnership,* introduced within the Structural Policy framework, is a useful tool for reducing the problem of asymmetric information among different agents involved in the regional development process. Unfortunately, the law on public-private partnership has not yet been introduced in Poland. The current law proposal seems to be quite unfavourable to private entrepreneurs. This threatens the involvement of the private sector in projects and their contribution, as a consequence, may become negligible. The other aspect of the partnership principle, which concerns the relationship between local and central levels of administration, is the strong centralisation of decision making and finances for regional programmes, caused by the delay of the public finances reform and amplified by the government's much stronger position at all stages when negotiating with local representatives. It may result both in conflicts of interests and sector policy domination, rather than the predominance of regional/horizontal perspectives.

The *principle of concentration* of funds also seems to be a good proposal, but should in the Polish case give much more support to priorities related to development of an advanced economy and of entrepreneurship, rather than the transport and environmental infrastructure (as has been the case

[44] To name but two telling examples: the central budget deficit amounts to almost five per cent of GDP, which is above the three per cent threshold that applies for Member States that wish to join the Euro, and the decentralisation of public finances has not been carried out yet.

so far). They ought to be based on a domestic strategy of structural economic development and a domestic regional development policy. While the plan should take into account the evolving ECP, it must nevertheless consider Polish strategic interests, which so far seem to be missing. Concentration causes selection bias towards larger projects and crowding out of smaller and more demanding projects (related to entrepreneurship, knowledge, etc.). This is because investment in infrastructure is less troublesome for public administration than investments in innovation programmes, which to some extent makes it easier to utilise a greater share of the EU's resources.

However, as shown by the experience gained in other parts of the world, the impact of infrastructure investments on economic development is limited, while investments in production based on advanced technologies are much more effective for stimulating local economic network resources. Besides, it can be expected that large infrastructure development contracts will be won by more competitive EU enterprises.[45] However, despite the fact that innovations and technologies are the driving forces of a higher development, it is not certain to what extent Poland would be able to absorb such projects given the current state of human capital. So all in all, a mix of basic infrastructure and innovative projects seems optimal, with a tendency towards increasing the share of the latter over time.

Another challenge linked to the provision of the Structural Funds is *long term planning*. An examination of the projects submitted within pre-accession programmes shows that many potential beneficiaries lacked administrative imagination and long-term planning skills. In particular, there was a deficiency with respect to sequential thinking abilities and strategic planning. Local strategies, often developed just for show, were not helpful in specifying development priorities and creating good business plans. The practice of filling out PHARE project applications showed that the wish to spend the EU's funds, for whatever purpose, rather than use them sensibly and for the benefit of local interests, was more important than their real impact (Grosse and Olbrycht 2003a).

The National Development Plan (NDP) for 2004-2006 also shows a lack of visions and strategic planning as regards development policy and has been widely criticised for the lack of long-term targets. Besides, despite proper definitions of Polish needs, there is no clear list of priorities of development goals. The document only provides an institutional framework for regional spending financed through the Structural Funds and the Cohesion Fund, but gives no clear guidance as to how these goals should be achieved.

[45] This proved to be the case with most contracts on projects that were conducted within the framework of PHARE; see Grosse (2003a).

A lot of attention is given to two specific sectors of the economy: public infrastructures (mainly roads) and environmental infrastructures improvement; it is, however, not clearly justified as to why they are perceived as top priorities. It gives yet again the impression that absorption is the priority, which would explain the focus on large, “easy-to-absorb”, projects. Furthermore, despite the obvious importance of small and medium sized enterprises (SMEs), clearly defined priorities are lacking. In general, there is little evidence of a national development strategy in the NDP, such as actions that stimulate economic growth in the medium and long term: rather, it looks like a shopping list.

The new NDP for 2007-2013 has retained similar deficiencies as regards priorities and the setting of long term targets, even though improvements are visible. The recommendation from this experience is to call for the initiation of all types of learning schemes that would solve these problems, examples of which could be training provided by the Commission, setting up networks of experts between OMS and NMS, as well as between the Commission and NMS, to communicate advice and experience.

4.5 What should be done?

According to some countries’ propositions, priorities within the Structural Policy framework should be given to regions lagging behind, and in particular, the objective of Cohesion Policy should change from reducing disparities between regions to reducing disparities between countries, allowing the countries to reduce territorial imbalances themselves.

From a Polish perspective this sounds reasonable as, firstly, it prioritises CEECs with respect to financial flows; secondly, for countries that have recently experienced a liberalisation process, the territorial divergence may increase in the early stages when the economy faces strong international competition. As transaction costs diminish over time and adequate economic reforms are implemented, regional disparities are expected to decrease. In this case, the efforts should focus on overall economic growth and leave aside territorial imbalances, as they can be seen as temporary or at least influenced by forces outside the scope of Structural Policy, e.g., tax policies.

It also means a gradual re-nationalisation of regional policy, compared to its current shape and form, which should be linked to national priorities and managed on the national rather than the European level. There is still room for action coordinated “from Brussels” when a particular Member State cannot manage some of its regional problems alone, or when they are making others worse off. Concerning the general aim of the regional policy, even though national rather than regional convergence seems to be a reasonable approach to us, the question remains as to which factors stimulate growth and should be prioritised within a growth-oriented Structural Policy. This is true regardless of whether Structural Policy is managed on a regional, national or supranational level.

To answer these questions we start with the official proposals made by the Polish government. They have been presented in many documents on economic strategies, but the most important document is the NDP. The first draft of the NDP for the period 2007-2013 (MG 2005) was approved by the Cabinet in January 2005 and subsequently put for further public discussion. In contrast to the previous Plan for 2004-2006, the document proclaims a diversified and complex set of programmes and actions that target social and economic reforms. Some of the activities have to be covered under the ECP's financial scheme, and some of policy actions are designed to be financed solely from domestic sources (central or local government financing).

The fundamental questions, from the point of view of directions and targets, set out in the NDP, are:

- how to reinforce competitiveness and maintain social, economic and territorial cohesion priorities;
- how to sustain a high rate of economic growth;
- how to transform the regions in economic and social decline into the growth poles;
- what kind of institutional changes should be implemented in order to make Poland a citizenship country with a self-governmental base;
- how to redefine economic and social priorities into goals and strategies which are much more knowledge and information oriented.

The above issues are very broadly defined and need to be followed by more strict and detailed strategies (see Table 4.2 for a detailed distribution of financial means for operational programmes).

Unfortunately, we do not see clear answers to the above problems in the NDP, which lacks a transparent vision on the development prospects for Poland. Grosse showed that the NDP lacks a definition of national priorities and suggested that building a knowledge based economy should become the principal strategic goal for the years to come (Grosse 2005). In this paper, we would like to focus on a number of other aspects of development, which we consider to be the basic challenges facing Poland in the process of integration into the EU:

- to improve human capital through basic education (primary and secondary education), life-long learning opportunities for workers, and socially related initiatives;
- to improve environmental standards;
- to improve transport networks;
- to build a knowledge based economy through R&D initiatives;
- to implement institutional reforms and to restructure the budget.

At first glance there are similarities with the priorities defined in the NDP. However, there are also differences in the details, which we would like to address here. Some of the strategic target areas are closely linked to the orientation of the ECP, such as environmental and transport policies, but others, like institutional reforms, are also related to a wider EU policy framework, since they are crucial for improving the ECP's effectiveness in Poland.

We also provide novel insights with regard to policy on human capital formation, in particular a proposal for a "Common European Education Policy". From the viewpoint of Lisbon Strategy targets, there is a need to set priorities for the EU as a whole in areas in which there is a role for

Table 4.2 Financing the Operational Programmes within NDP for 2007-2013 (€ million)

Horizontal Programmes/Operational Programmes	Total*	Funds from EU
Regional Development and Rural Restructuring	**65446.2**	**33542.0**
16 Regional Operational Programmes	39200.0	21000.0
OP Regional Cohesion	8994.7	4271.0
OP Trans-border Cooperation	469.3	352.0
OP Rural Area Development	14641.1	6772.0
OP Fishery Sector Restructuring	2141.1	1147.0
Technical Infrastructure	**36456.6**	**17787.1**
OP Road Infrastructure	27091.5	13013.3
OP Railway Infrastructure	6171.1	4328.3
OP Power Infrastructure	3194.0	445.5
Natural Resources	**10120.0**	**5715.0**
OP Environment	10120.0	5715.0
Investments in Enterprises	**15120.4**	**7564.5**
OP Development and Modernisation	9193.1	4657.0
OP Research, Hi-tech Technology, Information Society	5927.3	2907.5
Human and Social Capital	**10951.8**	**5963.9**
OP Education and Training	5489.3	2767.0
OP Employment and Social Integration	4689.3	2767.0
OP Citizenship	773.2	429.9
Technical Aid	**594.0**	**445.5**
OP Technical Aid	594.0	445.5
	138689.0	71018.0
Programmes for Target 1a) Regions	3466.7	2600.0
Total	**142155.7**	**73618.0**

* Funds from EU + domestic co-financing + domestic financing of other programmes + private funds

Source: MG (2005)

supra-national authorities to supply European public goods – and basic education is arguably one of the most important public goods which generates positive external effects. Financing basic education should then be channelled through the Structural Funds in order to increase the European Added Value and reduce market failures in the provision of educational services in the EU.

4.5.1 Upgrading skills through education

One of the main factors that influences regional, as well as national, competitiveness in attracting direct investments is the level of skills of the average worker. The higher the educational level in a region, the higher the expected labour productivity in the eyes of potential investors. That is to say, the localisation decisions of R&D intensive industries are strongly linked to the educational level. Furthermore, the literature on economic growth shows a positive and significant relation between education, human capital and growth (see, for example, Mankiw *et al*. 1992). Numerous studies have focused on positive externalities from education, in particular basic education, and its importance in social capital formation (see Temple 2000 or McMahon 2004 for a review of the literature).

The existence of positive externalities calls for public financing in the education sector, as private agents choose a level of education that is regarded as lower than the socially optimal level. While it can be regarded as obvious that public financing or co-financing of educational services needs to take place on the national level, we would like to stress the necessity of supra-national co-ordination of educational services in the EU, especially at the primary and secondary levels as these externalities are spread Europe-wide as barriers to migration diminish. We start with a short presentation of the characteristics of the education sector in Poland, and, to some extent, in other NMS.

The research conducted by Barry revealed that educational attainment – the percentage of persons with at least upper secondary, tertiary B (diploma level), or tertiary A (degree level) – of the population aged 25-34 in the late 1990s in Poland was below the OECD average (Barry 2003). The general opinion that Poles have an insufficient command of foreign languages, such as English, French or German, seems to us to be true. This is partly explained by the fact that Russian was the only obligatory foreign language taught in most primary and secondary schools until the late 1980s. As other studies have shown (see EC COM 2004), foreign language skills among young Europeans are low: in 2000, one and a half foreign languages were taught per student, but the target set at the Barcelona summit in March 2000 was for 2 foreign languages per student.

Furthermore, the situation in NMS is worse than in OMS, as indicated by the overall results of students from NMS, which were much below the OMS average in 2000. PISA studies (OECD 2000) have revealed that 23.2

per cent of students below 15 years of age in Poland showed the lowest level of generic skills, compared to the EU average of 17.2 per cent (in Bulgaria and Romania it was more than 40, in Latvia 30.1, in Hungary 22.7 and in the Czech Republic 17.5 per cent).[46]

When human capital is low, it causes severe constraints on development prospects, particularly in the case of regions that are located outside agglomerations. Limited access to education in rural Poland undermines social cohesion. In the cities the situation is the opposite; a higher level of foreign language courses in schools (i.e., more lessons), better access to private educational services and higher aspirations of inhabitants, increases the gap in human capital level between core (the cities) and periphery.

There is no doubt that Poland and other post-communist countries will have to increase their investments in education (as a share of GDP) and upgrade skills in order to catch up with other European countries and to draw the benefits from integration and the world division of labour. A survey conducted by the World Bank revealed that the levels of public expenditure on education remained broadly stable in 1995-2000 in the NMS. In 2000 it ranged from roughly 3.1 per cent of GDP in Romania, to 6.5 per cent of GDP in Estonia and Latvia (Funck 2002). Bulgaria, Romania, the Czech Republic and Slovakia experienced particularly severe declines in this period.

However, growth in public expenditure for education in Poland is relatively high (the growth in education expenditures has been 36.5 per cent since 1995). Unfortunately, this moderate education sector rise is not accompanied by a rise in efficiency and quality of education, since a major share of the increase can be attributed to a rise in wages. The authors of a report on rural education in Poland proposed a significant reallocation of resources within the education sector, as well as new public spending over the next 5 to 10 years (Golinowska *et al*. 2001). Indeed, because of the already high fiscal burden on Polish taxpayers, they were convinced that over the long term the improvement in Polish education must rely principally on a better use of existing expenditures, in particular the reallocation of resources and also moderation with respect to the new spending proposals.

According to the authors of the World Bank report, decentralisation has had a crucial and often negative effect on the resources available at the local level for education (Funck 2002). The small size of local govern-

[46] Reforming the educational system has been proposed as one of the basic priorities in Joint Assessment Papers signed by all Visegrad Countries in years 2000-2001.The Visegrad Countries are the Czech Republic, Hungary, Poland and Slovakia. The name stems from the Visegrad agreement, taken in Visegrad, Hungary, in 1991, in which the then three (Czechoslovakia, Hungary and Poland) countries agreed to coordinate their policies with a view to apply for EU membership.

ments is leading to mismanagement, as there is less potential for economies of scale and synergy effects. The system also maintains large local differences in access to educational services, since relatively wealthier local authorities can finance basic education more generously than authorities in poorer areas.

There is greater dispersion in student assessment results for CEECs than for the OECD average and the differences are much more linked to *inter*-school than to *intra*-school variation. The greater between-school differences may be attributed to the decentralisation policy within the education sector in all the CEECs. School attendance is falling gradually in rural areas, where families cannot afford to cover the costs of transport if it is not covered by the local communities.

The problem is especially pronounced in the case of secondary and post-secondary education, since remoteness of schools is often a constraint for students and their families. As a result, post-secondary education institutions are often under pressure to operate on a week-end basis and it is in these cases unrealistic to maintain a satisfactory educational quality. The authors of another report estimated that young people from rural areas constituted about ten per cent of daily course students at state universities and about six to seven per cent of evening and weekend course studies – so the number of young people from rural areas who decide to continue their studies at the university level is not enough to meet the needs (FRPR 2002). As the Commission pays considerable attention to the quality of university studies as a factor of regional development, we expect that further actions must be planned and implemented to ensure equal access to universities for all candidates.

It is not only the financing of education – where local authorities are under the obligation to finance basic education – that poses a problem to self-governments in the CEECs: any attempts at increasing the flexibility of teachers' employment status and efficiency of staff management are hampered by a powerful union, The Union of Polish Teachers (Związek Nauczycielstwa Polskiego). A reduction in the number of redundant teachers, at all levels, would improve the efficiency of the system. The student/teacher ratio in basic education is low in all the CEECs; in Poland it was 15.4 per cent in 1997, while the OECD average the same year was 17.1 per cent. However, the downsizing of staff is problematic.

As the share of the schooling-aged population is expected to decrease even further in the future, while at the same time the teachers' unsatisfactory employment situation can be expected to remain unchanged, major inefficiencies within the system will be maintained and the financial situation of local education administration will deteriorate. The process of establishing a regional-level management for schools – i.e., management on a higher level than the existing local level – in order to capture the efficiency gains from economies of scale is now highly recommended. The system of per student financing, which allows the allocation to be easily transferred to students who attend schools in other regions, may also be a reasonable solution. The authors of the World Bank report concluded that it was necessary to reorient education so that it would meet global knowledge needs, on top of an institutional and management reform (Funck 2002).

In Poland, where the decentralisation of education was only part of a broader reform of the education system, mainly implemented by Mr Buzek's right-wing cabinet, the reform of the education system, as in other CEECs, can be seen as a partial success. Local education authorities had to introduce some unpopular changes, such as the closing-down of many local schools that were dispersed in the rural areas and where the class size was below minimum, but other rationalisations of the system have still not been carried out by the central government.

The school rationalisation programme has to this day been limited to the consolidation process. A small reduction in employment has also taken place. Furthermore, the education path has been changed, new institutions have settled and others have been modified. Children are obliged to start school at the age of 6, which is one year earlier than before, follow a one-year preparatory "0-class", then six-year primary school, three-year gymnasium and three-year secondary school, completed by a Matura exam. The system contains an external examination at the entrance of each stage of the education – pupils must pass the exam to enter primary school, gymnasium and secondary school. When secondary school graduates holding the Matura certification decide to continue their education at the university level, they must pass the exams and fulfil other requirements demanded by the universities. The system is under modification in order to introduce the commonly accepted Matura certification, which will replace the examination procedure for entering any institution of the higher education.

The main difficulty in the education sector that governments in the CEECs are struggling with is the increase in differences between schools, especially the gap between schools in urban and rural areas. We therefore opt for a universal financing of primary and secondary education services. The central financing of teachers' salaries and school utilities should be maintained and only part of the expenditures should remain under the purview of local government. It would help reduce national differences in education level, but without a common policy on the supra-national level it would not eliminate the uneven situation with respect to human capital endowments between OMS and NMS. In our view, even if we assume a steady growth of expenditure on education in NMS, national policies fail to tackle the education sector problems correctly.

In sum, we strongly recommend that domestic education policy should be reinforced by a common education policy and that common education policy should be carried out within the framework of Cohesion Policy, with similar financial priorities as in environment or regional policy. For the new Financial Perspective, we propose to reinforce the actions on stimulating the quality of education and training in the Union. As programmes aiming at improving education at post-secondary and higher level, as well as vocational training, have been already planned, we strongly recommend the establishment of a new fund to finance basic education in the NMS under the 1a heading "Competitiveness for growth and employment". The main priority of the fund would be the improvement of the primary and secondary education in the NMS, in order to catch up with the educational standards in other EU countries. Since the benefits of human capital upgrading in one country are spread over the EU, common action should be taken to reinforce individual country efforts.

One of the questions that needs to be answered is how we should deal with the *external effects* produced within the education sector. Furthermore, since local authorities consider spending on education as an investment in human capital, they expect a high rate of return from these investments in the medium term. The probability of attracting new investors into the region, especially R&D intensive FDI, increases, since the region becomes better endowed with high quality workers. However, until a critical mass of well educated workers in a specific region is reached, the region will not welcome new investments, resulting in an outflow of workers. This phenomenon is called the *backwash effect*.

The labour force will be looking for employment at another location, whether it is another region within a country, or, when barriers to international migration fall, abroad. The region will be vulnerable to the process of negative circular causation, even if an internationally comparable level of the region's own resources is spent on public education. Local governments may then be pushed to limit public spending on basic education and reallocate expenditures to less "mobile" assets, such as transport or public health care infrastructures.

On the other hand, a region with a high inflow ratio will benefit from an educated labour force that is well endowed with human capital. At the same time, the inflow region or country benefits from the external effects generated by the newcomers. As the market cannot estimate education costs and the overall external effects of education, it will not be able to deal with it properly. In this sense, the inflow region will not be able to compensate the outflow region for either its education investments or for its own external effects benefits. Therefore, the government, or another central agency, must intervene.

The policies to be implemented must also eliminate the *free rider problem*, which widens national educational differences, and the *prisoner's dilemma*. The latter keeps basic educational expenditure on a low level in the entire country, since no region will voluntarily supply a public good. We must remember that education is a public good and that the government, or the self-government, is under the obligation to ensure high standards in providing education as a universal service in all regions.

The problems described above are not confined to the national level alone – that is to say, to labour flows within a country – they apply to the European level as well, since they concern the labour flows within the EU. Thus, supranational action on the European level should be implemented and a common education policy established within the Cohesion Policy schedule. It seems to us to be a very convincing argument that common action in education should be financed "from Brussels" and that an immigration policy, which may improve the mobility of workers, should be coordinated with the education policies of each Member State. A European immigration policy, which should be viewed as crucial to employment policies, is almost neglected so far as the European agenda is concerned. In the words of Professor Tito Boeri, immigration policy is "a great absentee in Lisbon" (Boeri 2005).

In order to improve the effectiveness of public spending on basic education, strict standards in education as well as in life-long learning procedures and requirements must be established. Countries lagging behind in keeping high standards would benefit from equalisation grants managed under a common education policy. To assure higher efficiency of the programmes, the cooperation between central and local government in managing the education sector must be much closer than it is now.

Conversely, local governments should be more free in choosing the best model for encouraging the entrepreneurs to provide life-long learning opportunities in a region. As life-long learning is not vulnerable to the negative backwash effect, there is no room for actions (national or supranational) under a common policy of all Member States. Increasing labour productivity through life-long education should be both directly and indirectly subsidised by national governments. Policy actions in this field include: tax incentives on training for both employers providing training and for workers or unemployed taking part in training; subsidies to public libraries; and tax exemption on subscriptions to professional papers. Interventions on the European level are not needed. According to Lindley (2003), *generic skills* usually relate to:

- communication – literacy;
- application of numbers – numeracy;
- problem solving;
- working with others;
- improving own learning and performance;
- knowledge of information technology – computer literacy.

As these skills should be acquired during regular basic education (in primary and secondary schools), we believe continuous education would be much more effective if students had a sound basic education, so the priority should be given to the latter, rather than to life-long learning.

There are, however, convincing arguments for managing basic education on a supranational level, as structural problems in this field call for international coordination. Martin (1998b) provides a number of arguments for pursuing a two-level regional policy, namely the European and national regional policy:

- the “financial targeting” argument – the poorer Member States are unable to target their regional problems themselves, thus the EU has to provide the necessary resources;
- the “external effect” argument – solution solving the regional problems (such as environmental and social problems) in one Member State will benefit the Union as a whole;
- the “effect of integration” argument – when benefits from integration are not evenly spread across the EU, a redistribution mechanism is required to minimise the inequalities;
- the “effect of coordination of other policies” argument – similarly to the argument above, some countries benefit relatively less from other policies (in particular from CAP and transport policy oriented towards the Trans-European Transport Networks) and therefore the relative losers should be compensated by EU regional policy tools.

This line of reasoning, i.e., complementing national and European education policies, is similar to Martin’s argument. The authors of this study are deeply convinced that if education policy were to be given a supranational perspective – the *European Education Policy*, within the ECP framework and with its own funds (the “Education Fund”) and supranational coordination – it would provide better European Added Value than were management of education to remain solely under national jurisdiction, since a common coordinated policy would eliminate some of the market failures. If *status quo* is to be retained it will result in further distortion of the labour markets in the EU. In sum, similarities between environmental problems and education problems, which in our view do exist, suggest that both should be treated from a similar supranational viewpoint and with similar financial tools.

The Polish government is rather pragmatically oriented on any aspect of the ECP and there is no room for a more fundamental discussion on priorities. In the NDP for 2007-2013, problems related to education are almost neglected, but the disparities with respect to access to education, in all CEECs, provide a good argument for having a broader discussion on the future of the domestic education policy, which should take place among theoreticians and practitioners. We recommend that the idea of an education policy, managed from both the national and supranational levels, is given consideration in the discussion.

4.5.2 Upgrading human capital through social related initiatives

In general, enhancing human capital within the framework of regional activities is limited to programmes aimed at combating unemployment and social exclusion, since – marginal programmes notwithstanding – not all levels of education fall into the scope of Cohesion Policy. The experience with pre-accession aid showed that discrepancies in targets to be achieved between EC and Polish authorities seemed to be the greatest in the field of social policy. Social problems vary between Member States, as there were different opinions on how to solve some of the most important problems. In other words, there are differences in both priorities and in opinions as to the methods that will achieve specific goals. That is why social policy should be planned and managed under a domestic policy.

We see, however, some room for Community initiatives. Community grants could be obtained by the most successful NGOs in the field of social exclusion in order to make the social organisations more independent from central or local budget financing. In Poland, almost one-third of civil society organisations' income comes from public funds, while the rest comes from a growing amount of contributions and private donations. Nevertheless, a number of the small NGOs that operate in the field of social welfare are faced with substantial financial difficulties, despite using available financial, material and organisational resources very efficiently. Several examples exist of organisations that have been very successful in providing non-governmental safety nets for the very poor.[47] The possibility of obtaining grants makes the pressure on central budget financing less constrained.

4.5.3 Upgrading environmental standards

The NMS are obliged to comply with a number of environment related directives in order to improve the quality of the environment in their respective countries. Roughly half of Cohesion Fund measures and to some extent the Structural Funds (for compliance with the sanitary standards in agricultural production and food processing) will be transferred directly to the regions under clearly defined programs. However, the cost of improving environmental protection standards is a considerable financial burden for central and local authorities alike. This having been said, the benefits from such investments usually overpass the costs. The World Bank report revealed that the benefit-to-cost ratio was usually greater than 1, although not always and not for all NMS (Funck 2002).

[47] Reflecting Polish tradition, social aid organisations tend to be linked to the Catholic Church; see World Bank (2004).

Poland has generally experienced a high benefit-to-cost ratio, but a number of improvements with respect to the implementation of the directives on waste management should be introduced.

The problem of co-financing is experienced by all NMS, including Poland, and further difficulties can be expected until other environmental funds can be established on the same basis as the previous funds (funds receive payments from pollution fees and charges), as their consistency with the EU institutions are not always clear. From the perspective of the World Bank and IMF, outside-budgetary earmarked funds in environmental financing are not encouraging. These institutions have almost always asked for the eco-fund to be part of the consolidated budget (see Funck 2002 for additional policy recommendations).

Additional institutional changes are crucial for improving the efficiency of environmental funding – the consolidation of small ecological funds is but one example – and the privatisation of polluting industries in CEECs are recommended. The obligation that each individual environment related investment should be subjected to a thorough cost-to-benefit analysis should be institutionally implemented. Under the present system, such analyses are very often only a recommendation.

4.5.4 Upgrading transport networks

The quality of the road network in Poland is slightly below the CEEC average. The length of roads with European standards for axle loads (11.5 t/axle) amounts to 637 km, which represents 3.5 per cent of the road density. A lack of major modernisation and maintenance investments in the past, a rapid increase in domestic motorisation and heavy international trucking resulted in higher transportation costs, as transport is slow and unsafe, and congestion on some roads. Rail transport also causes obstacles to rapid growth and development, since almost half of the network only fits a low standard of transportation, i.e., a maximum speed of 60 km per hour.

Concerning the peripherality of the regions, Schuermann and Talaat showed that transport infrastructure plays an important role in calculations of peripherality, where peripherality is measured as the travel costs between two points within the overall region, weighted by the purchasing power that each point represents (Schuermann and Talaat 2000, cited in Barry 2003). According to their paper, the most peripheral regions at present are the Baltic countries, northern Sweden and Finland, Bulgaria and Romania. Hungary, Slovenia, the Czech Republic and Slovakia, and the southwest corner of Poland are no more peripheral than Ireland, Portugal or Spain and less peripheral than Greece.

While deteriorated conditions of the transport infrastructure call for major investments in order to support local development and growth, attempts at expanding the motorway network too rapidly and to standards that are not always economically justified have already diverted funds away from maintenance and development, according to the World Bank report (Funck 2002).

The construction of the highway network in Poland, employing both the Cohesion Fund and the Structural Funds, takes up a major part of the financial budget for the upgrading of the transportation system. With respect to the financing of such investment projects, road and highway construction may not necessarily lead to regional development: it may even cause an economic slowdown if construction is financed by an increase in tax charges. Regional and industrial mismanagement can lead to further economic deterioration, which seems to have been the case in Italy in the 1980s, when regional divergence – the North-South dualism – deepened (Cellini and Scorcu 1995).[48]

Transport costs play a crucial role in influencing industrial location because they constitute a large share of total costs. It is usually assumed that there exists a positive relationship between transport infrastructure and regional development and growth. However, the causation of this relation is not defined and higher productivity from transport investments are in many cases likely to be overestimated. While higher infrastructure investments drive faster growth, higher development is related to a higher rate of spending on infrastructure.

Martin (1998b), using data on infrastructure spending in the EU during the 1980s and 1990s drawn from a project conducted by Biehl, demonstrated a high and positive impact of telecommunications endowments on regional growth. None of the other infrastructure investments had a similar impact on regional growth in the EU. The same relation was tested for data on Polish regions during the period of 1989-1998 by Cieślik and Kaniewska (2004). The empirical results confirmed a positive and statistically significant causal relationship between telecommunications endowments and regional income.[49] However, the impact of transportation endowments, as

[48] The infrastructure investments are considered to lead to a crowding-out effect when public investments are financed from taxes. In Italy regional policies failed and caused even further increase in income differences between northern and southern regions in the 1980s. Cellini and Scorcu tested the relationship between public spending on infrastructure and economic growth in the 1970s and 1980s in Italy and showed that there was a negative correlation between the variables.

[49] The authors proposed that regional income differences could be reduced as a result of government attempts to assure common access to telecommunication services across the country, possibly by means of adopting universal service regulations, or sharing the cost of network expansion in the least developed regions. These actions could be complemented by instituting special programmes for the development of access to advanced telecommunication services in the least developed regions similar to those implemented earlier in the cohesion countries in the 1980s and 1990s with the financing scheme under the Structural Funds arrangements. However, given the rather low effectiveness of the these programmes and the legal problems of the enforcement of universal service obligations, we

represented by the public road network density, on income in Polish regions was not significant and revealed that the role played by the transportation infrastructure in promoting national and regional growth is ambiguous.[50]

The survey conducted by the World Bank revealed that most of the CEECs continue to finance their motorway expansion programmes by public resources, since the public-private partnership in this sector has failed. This failure has in turn been the result of a very weak institutional framework, an almost nonexistent regulatory capacity and local financial market opportunities and a risky and unstable economic situation (Funck 2002). This is especially the case in Hungary and Poland, where road network building poses severe financial constrains on the central budget and worsens the budget deficit. Thus, the continuation of the programme calls for prudent economic evaluation, including traffic projection, impact on environment (with the use of costs/benefit analysis), and analysis of the European Added Value of a specific infrastructure investment.[51]

4.5.5 Building the knowledge based economy – investments in R&D

A detailed analysis of the NDP suggests that the Polish government has not been able to produce a clearly defined growth oriented strategy for Poland. Since economic growth and competitiveness of the cohesion countries Portugal and Ireland depended on a strategy of attracting FDI inflows, this strategy could also prove to be successful in the case of the Polish economy. Ireland succeeded in attracting FDI in high technology industries, but most of the FDI in Portugal flowed into sectors that were not technologically advanced.

Grosse has proposed that Poland should build a "knowledge based economy" and strengthen competitiveness by aiming for a rapid growth in R&D, upgrading education and orient policy towards supporting enterprises in technologically advanced sectors, as well as institutional building in these fields (Grosse 2005). The Scandinavian countries provide a good example of how to become successful in this respect, as they caught up with the most R&D advanced countries in a relatively short period of time.

think now that a liberalisation of the telecommunication market is a much more effective and less costly policy. The improvement in access to telecommunication services in Poland, especially in rural areas, was a result of a reduction of monopolistic power in this sector, and strong competition on the cellular phones market.

[50] Whether it had a negative or positive impact depended on the equation specification.

[51] The Polish Ministry of Transport is going to expand the road network to the eastern undeveloped part of Poland. We think that such investments do not guarantee high European Added Value, as weak economic justification of these investment (road traffic is dramatically reduced going east of Warsaw, its prospects are uncertain as trade with post-soviet countries pose many doubts) and high environmental costs give high cost-to-benefit ratios for both Poles and other EU citizens.

However, since the human capital and average worker skills endowment is very low in Poland, we assume that such a strategy could only be considered as a long term target. The average level of budgetary and non-budgetary spending on R&D in Poland has been falling gradually from the beginning of the 1990s and is roughly 0.7 per cent per annum the last 12 years, far below the EU average. The aim to increase R&D funds up to 1.5 per cent of GDP in 2006, which is the strategy for the next Financial Perspective (MG 2005), seems unrealistic. The falling trend in R&D spending and low competitiveness of basic research areas have resulted in a low number of submitted patents and deterioration of terms of trade in R&D intensive industries. Since Poland is a net-importer of high technology intensive products, a radical decision should be taken to change the existing situation.

In the area of Cohesion Policy in the current Financial Perspective, roughly nine per cent of the funds are dedicated to support sectors related to High Technology (HT). Poland will not build its comparative advantage in HT with such a modest financing. However, the R&D policy presented in the NDP represents a departure from the Commission's official statement on R&D policy. The official explanation to the rejection of the EU's R&D policy is provided on the website of the Polish Ministry of Science and Information Society Technologies (MNiI 2005), where one can read that:

> The Polish delegation, in accordance with an unequivocal instruction from the Government, did not support the draft conclusions only because they were not supplemented by a brief reference that Poland had proposed to ensure equal chances of participating in framework programs for all EU member states. The Polish opposition to potential inequality of chances is in some statements interpreted as opposition to the proposed strengthening of basic research in Europe and to the establishment of the European Research Council (ERC). Taking the above into consideration, I would like to offer the following explanation: 1. Poland has repeatedly highlighted the insufficient adjustment of the current instruments of European science policy to the capabilities of the new member states. The work on the new framework programme provides an opportunity to introduce systemic changes, and that was the origin of the Polish proposal to insert the provision on guaranteeing equitable opportunity for all member states. Since the proposal was rejected and thus did not make its way to the draft conclusions (which constitute general guidelines for the Commission) at a crucial moment in shaping the future research policy of the Union, Poland could not accept the document as a common position of all the member states (Council conclusions are adopted unanimously). 2. Poland supported the theses of the Netherlands Presidency that became the draft conclusions. In particular, Poland has actively and consistently backed from the beginning the expansion of framework programs to include basic research, accommodating also social sciences and the humanities. We have also supported the concept of establishing the ERC, as it is in agreement with the Polish long-standing practice of promoting the best researchers and allocating funds based on the criterion of scientific excellence. Representatives of the Minister of Scientific Research and Information Technology were co-authors of the ERC concept, and their future efforts related to creating this novel instrument of European research policy will be steadfastly supported by the Ministry.

The Polish government wants to increase the Polish participation in the EU Framework Programme. It proposes to make a number of simplifications with respect to application procedures and reductions in project size, in order to build an effective public-private partnership in the R&D area and involve more research institutions. However, we presume that the discrepancy between the Polish and the Commission's views is of a non-financial nature. Even though the Polish government has confirmed its strong support for basic research in the new European research policy, basic research is not even mentioned in the NDP. Priority has instead been given to commercialised research since,[52] according to the document, only close cooperation between research institutions and industry can give optimal results. Certain research fields, such as information technology, must therefore be given precedence.

This line of reasoning seems to us to be incorrect. Research in general and basic research in particular is subject to a high risk of failure: since we cannot programme the outcome, the correct strategy would be to diversify risk by supporting all basic research areas and with the financial tools provided by the ECP and the European R&D Policy, rather than just a few fields chosen for some bureaucratic reason. We are convinced that supporting basic research is a key factor in building future competitiveness based on R&D. However, the considerable differences between the views of the Polish authorities on the one hand and the Commission's priorities concerning the EU's support for research and development on the other, implies that it will be very hard to reach a consensus.

4.5.6 Macroeconomic and institutional reforms: reducing central budget deficit and decentralising public finances

As pointed out by Barry, the Irish success in attracting export-oriented FDI was a combined result of both infrastructure and education investments, financed through Structural Funds channels and a favourable macro-economic environment, above all a low corporation tax, fiscal consolidation and flexible labour market conditions (Barry 2003). In order to increase the effectiveness of Structural Funds investments, Ireland has introduced a set of evaluation procedures that has helped change the way the administration approaches public expenditure – from a bureaucratic perspective to a more rigorous economic evaluation.

The Polish government is focusing on macroeconomic reforms and sees budget restructuring as a major challenge. The budget deficit has structural and permanent imbalance on the expenditure side, above all caused by social expenditures. The demographic trends – with an ageing population, low birth rate, high emigration ratio of young people and the highest

[52] It maintains also the post-socialist system of state-owned institutions with central budget financing. The system has proven to be ineffective, but changes are difficult to implement.

unemployment rate in the EU – put the budget under serious pressure. In order to cope with the accession challenges, such as co-financing and pre-financing procedures, contribution to the EU budget and to other European and international organisations and the Maastricht convergence criteria, the government has postponed the public finance decentralisation process.

However, the Polish government is determined to continue the institutional reforms, which aim at strengthening the self-governmental level of administration. The idea to implement 16 regional programs that correspond to 16 administrative units of NUTS 2 size and managed by local governments within the Structural Policy framework, was the result of a conviction that cooperation between central government and regional self-governments would be the most successful form of governing in Poland. Thus, further decentralisation of the administration, fair division of competencies between central and local government and decentralisation of public finance, in order to provide local authorities with the necessary financial tools to conduct their policies, is the task for central and local authorities.

Poland has proposed to manage, among other operational sectoral programmes (see Table 4.2), 16 regional programmes within the Structural Policy framework with the aim of reinforcing regional authorities, as horizontal programming and management are supposed to favour regional economic development. The general opinion is that sectoral management softens budget discipline, since the government is under permanent pressure from sectoral lobbies, political parties and other interest groups that corrupt public administration representatives. This is especially true for industries with a state-owned dominance, such as coal mining, railways, power industry, roads and public health care system. Thus, further institutional reforms are essential in the process of transforming the Polish economy.

European Cohesion Policy should reinforce national regional policies on the principle of subsidiarity. Governmental authorities responsible for regional development in Poland have been introducing the idea of decentralization of the administration of the domestic regional policy in order to increase the effectiveness of the overall scope of regional programmes financed under the Structural Funds scheme. This has been confirmed by establishing 16 regional programmes within NDP for 2007-2013. The authors of this chapter are also convinced that gradual increase in public spending, managed from the local level and starting from 30% to 50% of Structural Funds spending, would strengthen local governments as decision makers in the regional policy field.

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5 HUNGARY AND COHESION POLICY

András Inotai and Tamás Szemlér

5.1 Introduction

The Structural and Cohesion Policy has for decades been one of the most important fields in the European integration process. This policy area has always been influenced by major changes, especially by enlargements of the European Community/European Union. New members have always meant new challenges in one way or another and Structural Policy was supposed to meet these challenges. This is also true – even more than at any time before – for the enlargement in 2004, when ten new members, among them eight Central and Eastern European countries joined the European Union.

New members have their own specificities and, consequently, new needs vis-à-vis Cohesion Policy. The present paper aims at describing and explaining the needs of one of them, Hungary. The paper is structured into seven main sections.

In section 5.2 we summarise the Hungarian experiences with the pre-accession funds. In section 5.3 we discuss the most important past and present problems and challenges related to Cohesion Policy in Hungary. These problems are discussed in more detail in the following sections: section 5.4 is devoted to the question of additionality, section 5.5 describes the challenges to Hungarian regional policy, while section 5.6 deals with the possibility of involvement of the private sector actors into structural development projects. In section 5.7 we present arguments for a new budget line covering trans-border infrastructure and environment in the new Member States. Finally, in section 5.8, we conclude and summarise the most important Hungarian interests related to the European Cohesion Policy.

5.2 Experiences and background of the use of pre-accession funds

In this section, we briefly summarise the experiences of Hungary with pre-accession EU support – SAPARD, PHARE and ISPA – and we also try to provide background information in order to help the reader to better understand the situation in the given field in Hungary. The order in which we present the experiences with the pre-accession funds does not correspond to the chronological order – PHARE being the first among them – but enables us to get step by step closer to the very heart of the topic of this paper, namely the European Structural and Cohesion Policy.

5.2.1 SAPARD and Hungarian agriculture

The main controversial issue in connection with the pre-accession funds was related to SAPARD, where the establishment and the accreditation of the national agency suffered a long delay. Unfortunately, internal political debates overshadowed the establishment of the National SAPARD Agency and this slowed down the process of preparation. As a result, in the first two years of SAPARD, Hungary was able to access zero per cent of its potential share (€38 million a year in 1999 prices), while in the third year, after essential steps had been taken by the new government, the share of absorbed transfers grew to 40 per cent.

However, the improvement did not result in a rapid catching up in using funds available to the country. The institutional system, although finally in principle corresponding to the requirements of the Commission, was not able to deal with support claims of farmers in the second half of 2004. The slowness of the process resulted in manifestations of agricultural producers, partly also backed by some political parties and movements. In brief, in the early spring of 2005 it seems that the institutions and the communication devoted to facilitate the use of EU transfers in the field of agriculture are still unsatisfactory. This has, of course, long-term explanations as well.

While Polish agriculture, despite expectations to the contrary, seems to have benefited from membership in the CAP, Hungarian agriculture had to face a serious crisis, not so much on the production level as on the political level. Beyond the political and institutional problems the fragmented ownership structure can also be made responsible for the evolving situation. More than 200,000 applications for financial support have been submitted in Hungary (in several cases inadequately filled-out and sometimes even in duplicates), which had to be evaluated by an institution that was clearly understaffed for the task. In contrast, there were only 18,000 applications in the Czech Republic (with a similar population size) and 12,000 in Slovakia, which is mainly due to the fact that the ownership structure of agriculture did not undergo the ideology-driven and past-oriented transformation experienced in Hungary.

The problems surrounding SAPARD (and in the first year of membership) are rooted in the general structural problems of the Hungarian agriculture. The performance level of the related institutions is just the tip of the iceberg. EU funds (also available for rural development) can be helpful in the rapid and future-oriented restructuring process. The key barrier, however, remains the irresponsible behaviour of some domestic political actors and the outdated and partly consciously contaminated mentality on the part of the farmers, most of them with no chance of attaining competitiveness.

5.2.2 PHARE: from multi-objective aid to preparation for membership

At its start, PHARE support was focusing on providing the financial framework for Hungary's solvency, due to the high level of external indebtedness at the moment of systemic change. Later, in the first half of the 1990s, it was aimed at offering technical support in the privatisation process, with the establishment of market-economy institutions and legal background and the training of public administration. The amount of money channelled into the real restructuring and regenerating the growth process, if any at all, was minimal. All PHARE resources were planned on an annual base, which deprived this instrument the possibility of becoming a meaningful factor of sustainable transformation. Moreover, additional international financial resources (e.g., World Bank credits) were not allowed to be combined with PHARE money.

The situation changed substantially in the second half of the 1990s, mainly by means of a prolonging of the planning period and by facilitating the support to multi-annual projects. Also, as a result of internal restructuring of the PHARE resources, more money became available for key economic development objectives (e.g., infrastructure). The change in the PHARE strategy since 1998 – concentrating on issues directly related to EU-accession – has substantially improved effectiveness and also the rate of use of PHARE funding in Hungary. The use of PHARE support in Hungary from 1998 is shown in Table 5.1.

Table 5.1 PHARE resources and local co-financing absorbed by Hungary 1998-2003 (€ million)

Programming year	PHARE and CBC	Local co-financing	Total
1998	93	134.7	227.7
1999	128.6	96.5	225.1
2000	119.7	96.5	216.2
2001	108.8	69.7	178.5
2002	120.7	78.3	199
2003	120.7	73.6*	194.3
TOTAL	**691.5**	**549.3**	**1240.8**

* Indicative figure

Source: http:www.nfh.hu/

5.2.3 ISPA: preparing for the Cohesion Fund

In the case of ISPA, Hungary was able to cover its envelope entirely with projects (the average yearly amount of potential EU support was €88 million in 1999 prices): environment projects concentrated on water and waste water management, water supply and waste management, while in the field of transport infrastructure, the development of main international railway lines and the enhancement of the load-bearing capacity of main roads have been financed.

One negative experience in Hungary with ISPA was the EU's reluctance to co-finance major highway projects, preferring railway modernisation instead. This approach was based on Western European experience but not on the reality in NMS. One can only speculate about the background to this position (environmental lobbies, fear of competition from NMS, etc.). To tell the full truth, the 1998-2002 Hungarian government aggravated the problem by denying public procurement for highway construction according to EU competition rules.

This experience was an important step in the learning process in the phase of preparation for membership. It made clear that EU regulations had to be respected, and that there were no alternative "individual solutions". For most of Hungarian ISPA projects – which, with accession, have been transformed into Cohesion Fund projects – no institutional problems arose. The total value of Cohesion Fund projects – including new projects – for the period 2004-2006 is roughly €1 billion.

The story of the use of ISPA in Hungary is a clear proof of two issues:

1. EU support can be highly successful if it really concentrates on key economic development priorities of Hungary;[53]
2. in such a case, the absorption capacity of the country is very high.

Therefore, when estimating the "absorption capacity" of a country (or region), the nature of the project may have crucial importance, let alone the bureaucratic hurdles on the EU side, which should also be examined, for the "absorption capacity". The EU's "absorption" capacity – or adjustment capacity, i.e., the definition of key areas in the NMS to be supported and the bureaucratic procedures – definitely have a (negative) impact on the absorption capacity in the NMS.

5.3 Past and present problems and challenges

Structural and Cohesion Policy – and especially the financial instruments available for the new members for it – was one of the most debated issues during the accession negotiations. After accession, challenges related to the use of available support came to the foreground.

5.3.1 Debates during the accession negotiations

During the accession negotiations, the most important debates concerning Cohesion Policy in the period 2004-2006 were of a financial nature and were therefore dealt with as part of the final financial package.

[53] The modernisation of transport and environmental infrastructure is clearly an important part of these priorities. We will return to a specific aspect of it – the need for developing trans-border infrastructure in the new Member States – in section 5.7.

Like many other new Member States, Hungary was very much interested in the possibility of elaborating Operational Programmes on the national level instead of regional operational programmes, due to missing traditions and administrative capacity at NUTS 2 level. This approach was approved until 2006, not least because the Commission would have had capacity problems if it had had to work with dozens of new and inexperienced regions. An additional motive for the Commission to agree with the national approach until 2006 was that it really wanted to have a quick success with the absorption of the available resources in the first and really critical years of membership (also due to the low level of resources, the bureaucratic procedures, etc.).

In light of the debate on the 2007-2013 Financial Perspective as well as concerning the problems related to the NUTS 2 level in Hungary (see point 5.5.2 for details), it is especially interesting to see whether this situation will change after 2006. Until now, most Operational Programmes were regional and, in fact, the National Development Plan was also in many cases called National Regional Development Plan. Such an approach – an approach focusing on the regions – was expected to apply also for the new Member States after 2006. But in the recent debates on the future Cohesion Policy the question often asked is whether it would be better to focus on the national level rather than continuing with the present practice.[54]

Potential effects on efficiency of the policy are under heavy discussion. From an administrative point of view, the interests mentioned on the EU side for the period 2004-2006 will probably persist; with the prospect of further countries joining the EU, these arguments will become, in fact, even stronger. For the new Member States, this approach can have different effects. Hungary is surely one of the members in which an expressed focusing on the regional level is hardly conceivable in the present circumstances. It means that for Hungary, the relatively centralised structure of Operational Programmes would be – from a purely administrative point of view – a better solution, regarding the present (under)development of the sub-national entities. This, of course, does not mean that it is the best conceivable solution. With a well elaborated regional policy, with clear responsibilities on the different levels as well as with a reinforcement of the potential (finances, human resources) of the regions, the specific problems of the regions could probably be tackled more efficiently.

Similarly to other new Member States, Hungary was interested in a higher share of the Cohesion Fund within Structural Policy transfers. One reason is the already mentioned weakness on the regional level, another one is the

[54] The suggestion was also present in the first proposal from the European Commission for the 2007-2013 Financial Perspective (COM 2004).

relative overall underdevelopment level of the country, making country-level infrastructure development measures necessary, and the third reason is the more favourable co-financing regulation of the Cohesion Fund. We can also note that ISPA provided a good model for the use of Cohesion Fund support and the experiences with ISPA (mentioned under section 5.2.3.) can make it easier to use than Structural Funds transfers.

5.3.2 Challenges after accession

The restructuring of the national budget will allow Hungary to fulfil co-financing and additionality requirements until the end of 2006. With probably much larger amounts of transfers, the task will be more difficult – but not unfeasible – from 2007. We should seriously consider the additional pressure on the Hungarian budget due to enhanced EU resource flows. Seemingly paradoxically, it will be the presence (and availability) of the EU resources that will force the Hungarian budget to be fundamentally re-structured in the first period of the new budgetary framework.[55]

For the next financial period, the following issues must be tackled in this respect:

1. continued restructuring of the budget in order to meet co-financing and additionality criteria;
2. strengthening human, administrative and financial capacity of NUTS 2 regions;
3. involving the private sector into development projects more intensively, as well as strengthening cooperation with municipalities.

We discuss these three issues in the subsequent sections (sections 5.4, 5.5 and 5.6) of the chapter.

5.4 The need for restructuring the budget

Restructuring the budget is an important task to be done in order to be able to absorb potential EU structural and cohesion support.[56] In this respect, however, the present situation is characterised by poor circumstances for a substantial reform, influencing short and medium term prospects.

5.4.1 Lacking solid background for reform

One of the key challenges not only of absorbing EU resources efficiently, but also of a successful Hungarian membership in the enlarged integration process, comes from the situation and structure of the budget. There is widespread professional consensus concerning the need of fundamental reforms, both on the revenue and the expenditure side of the budget.

[55] A comparison can be made with respect to the experience of Portugal in 1992-1993.

[56] It is important to note here that restructuring the budget is necessary for other reasons as well. The regulations of the Cohesion Policy (notably additionality) can play the positive role of a catalyst in this respect.

Unfortunately, the years of sustainable and high growth following 1997 were not utilised as a way to start this process. Just the opposite, the previous 1998-2002 government did not start any major reform (in turn, even the rules of the game of the previously initiated pension reform were changed). The current government became hostage of its (partly populist) promises, which could hardly have had a positive impact on budgetary reforms. However, they may have increased the pressure on urgent reforms. Still, there are substantial barriers or question marks concerning the timing and viability of such reforms:

1. within one year, Hungary will have parliamentary elections, a rather unfavourable external condition for starting key reforms at this particular moment (even if they were urgent);
2. there is no well-elaborated reform package (benefits and costs, the distribution of both elements in time and across business and social sectors) in the government's pocket;
3. as a fundamental precondition of sustainable long-term reforms, the mutual confidence and cooperation between the fiscal and the monetary authorities is missing (the interest rate policy of the National Bank of Hungary is partly responsible for the level of budget deficit, since a large part of budgetary expenditures covers interest payment);
4. there has not been an honest dialogue with the population, how reforms would affect the society, and why reforms are necessary and, at the end of the day, a positive-sum game;
5. resistance in a large part of the society, mainly generated by demagogy and populism, and in the interest of narrow-minded party politics, is evident (see the story of the partial privatisation of the absolutely outdated, run-down and capital-poor health sector); and, last but not least;
6. the critical (and in this case, relevant) mass of consensus between government and opposition is farther away than at any time in the past.

5.4.2 Short and medium term prospects

Short term budgetary corrections are of no help or may even backfire. Generally those expenditure items will fall victim of the "corrections" where no organized social protests are expected, where the lobbying activity is low and where there is a lack of "demonstration effects" from represented interest (i.e., no strikes, no occupation of roads, etc.). As a result, the only reserves of the country for a sustainable and future-oriented growth, i.e., expenses in human resource development, have regularly been curtailed (education, research and development and partly also health care). The Hungarian budget, as that of other major Central European countries, faces a threefold and "overlapping" challenge:

1. to restructure the budget for its internal unsustainability and reduce the current GDP-related budget deficit from above five per cent to three per cent in a few years;

2. to keep on (or start) financing future-oriented factors of sustainable competitiveness, including the catching-up process to more developed EU Member States;
3. to cope with the criteria of EMU membership and the introduction of the Euro still in this decade (in 2010, according to the current official Hungarian position).

Most probably, major budgetary reforms need a clear sequencing, since not all areas can be addressed at the same time and with the same level of intensity, such as education, health, regional institutions and tax policy, to mention but a few of the most important fields. Moreover, some "holy cows" should be revisited, including the 30 per cent national contribution for direct payments to the farmers. This figure is not carved in stone, it could be even lower if economic conditions allowed. In fact, it could be lower, looking at the requirements of competitiveness of the Hungarian agriculture, but the issue is an eminently political one.

In this situation, a loosening of the co-financing restrictions could, of course, be advantageous for Hungary (although as stated under section 5.3.1, the task is feasible according to present regulations as well). However, it would not mean "non-conditionality". An interesting alternative would be to enhance macroeconomic stability requirements while loosening co-financing regulations. The roots to this idea were present in the original objective of the Cohesion Fund; and this approach could be broadened to all Structural Policy instruments.[57] The possibility to shift financial resources between the Structural Funds and the Cohesion Fund enlarges the room for manoeuvre in this respect.

Such an approach would exercise external pressure on Hungary in order to meet the Maastricht criteria, especially those concerning public deficit and debt ratios measured as a percentage of GDP. Such a pressure is in the long-term interest of the country, even if the steps to be taken in the short run in some cases can be painful. However, the resulting loosening of co-financing requirements could ease this situation, help the use of Structural and Cohesion Funds transfers as well as meeting the Maastricht criteria (a lower rate of co-financing means less burden on the national budget).

5.5 Regional policy challenges and problems of the regional classification

In this section we present the main features of territorial inequalities and regional development in Hungary. Heritage can provide help in understanding actual problems with regional classification in general and one of the most debated concrete issues – the future of Central Hungary – in

[57] Weise (2005) tackles the possibility of using macroeconomic stability criteria as an additional requirement for providing structural and cohesion support for the recipients.

particular (for more details on Hungarian regional policy; see Horváth-Illés 1997; and Horváth 1999).

5.5.1 Regional policy challenges

In order to understand the regional development in Hungary after 1990, it is necessary to know the situation before the beginning of transformation. The territorial changes in the country during the 20th century have influenced the regional development considerably: these changes (after the First World War, then reconfirmed after the Second World War) meant the end of their organic links for several territories near the new borders of Hungary. As a result, these territories have become peripheral, and a centre – periphery problem has emerged: due to its population and its importance as an economic centre, Budapest has become the only outstanding centre of the country.

Emerging regions, as the result of a decade-long sustainable development following 1867, became separated from Hungary (Bratislava, Kosice, Cluj, Subotica, Timisoara, Brasov, even Zagreb), and, as a result, bottom-up regional development and "regionalisation" came to a halt, or was even reversed. The new borders were drawn without taking into account the physical infrastructure, consciously planned and developed for the needs of a large empire (major railways and road connections happened to belong to the neighbouring countries). Key centres of human resource building (universities, technical schools) were separated from Hungary (university of Kolozsvár (Cluj) mainly had to be relocated to Szeged, geological and mining high schools of Slovakia to Miskolc, etc.). Finally, the rationale of division of labour in a rapidly growing and catching-up "market economy" was not only questioned but destroyed. Autarchic, inward-looking development with high economic, social and political costs had to be the consequence. It is the EU membership that offers a new opportunity to link together what belongs together (in the words of Willy Brandt, "es wächst zusammen, was zusammengehört"). Moreover, EU membership is expected to reduce the one-sided (heavy-weight) development of the "centre" and mitigate the contradictions between the "centre and the periphery". Evidently, a reasonable and future-oriented solution to the agricultural problems is a precondition.

During the time of the centrally planned economy, the economic policy (concentrating on industrialisation, especially on heavy industry), could not find solutions to the long-run regional problems. Regional development based on centralised direct methods and often for reasons of a political nature, not leaving space for local initiatives, proved to be unsuccessful in the long-run, as was clearly shown by the economic problems already before the beginning of the transformation process. This kind of development policy was not able to cope with the double challenge of fighting overall underdevelopment and regional inequalities.

Regional economic inequalities remained (and in some cases have become even more accentuated) in the 1990s. For the beginning of the 2000s, in terms of GDP/head, the data characterising the most developed region (Central Hungary) was more than the double of that of the least developed regions (Northern Hungary and Northern Great Plain).[58] The centre-periphery problem has been aggravated in the first years of market economy: the poorer and also infrastructurally underdeveloped territories were not able to compete with the economic possibilities offered by Budapest.

Foreign direct investment, playing a key role in the economic modernisation of Hungary, looking for the best investment possibilities, also contributed to the increase in regional inequalities. Beyond the centre-periphery problem, East-West differences have become stronger. Especially territories lying along the Vienna-Budapest axis or near the Austrian border have experienced a rapid development, partly due to the interest of foreign capital. Among other factors – relatively well developed or rapidly developing infrastructure, availability of qualified and cheap labour force – the neighbourhood of the EU market was an important motivation.

Under market economy circumstances new problems that were unknown in the previous decades of centrally planned economy have surged as well. The most important one is unemployment, where – according to difference in regional development – regional inequalities are considerable. Most of the territories severely hit by unemployment are in Northern Hungary and in the Northern Great Plain region. The problem is aggravated there by the fact that the activity rate of the population is much lower than the already very low national average. Labour market inequalities are reflected in the regional differences in wages as well.

According to official figures, Hungary has the lowest level of registered unemployment among all new member countries. Its figure of slightly over seven per cent is much better than the EU average and is in the range of the old EU countries with the best performance in this context. At the same time, Hungary indicates the lowest level of economic activity of the working age population, according to OECD figures. There are about 1 million persons in the age group between 18 and 65 that have practically “disappeared” from the labour market in the first decade of transformation. The question of how these people can be integrated into the official labour market is a crucial economic and social policy issue. In principle, there are three major groups to be addressed:

1. those who have returned to household activities;
2. those who decided to benefit from – in Hungarian terms – generous early retirement schemes (including “invalids”);

[58] See chapter 3 and Appendix A for empirical data and analysis.

3. those who became "entrepreneurs" (one-person businesses), having no other choice to have a job – whether their activity is/was sustainable or not.

The appropriate labour market policy has to be diversified, since these groups have different motivation to stay in or give up their current position. There is, however, no doubt, that at least the partial reintegration

Table 5.2 Transitions of Hungarian regional policy at the end of the 20th century

The policy's	Bureaucratic (1985 – 1990)	Transitory (1991 – 1995)	Decentralised (1996–)	Degree of EU-compatibility
Aim	Equalisation	Equalisation	Restructuring	Medium
Object	Underdevelopment	Underdevelopment	Moderation of the negative effects of the market	Medium
Target group	Underdeveloped region	Underdeveloped settlement	Problem region	High
Tools	Regional Development and Organisation Fund, planning	Regional Development Fund, projects	Earmarked provision for regional development, additional resources, programming	Medium
Way of financing	Centralised	Centralised	Decentralised	Low
Form of incentive	Automatic	Discretionary	Discretionary	Medium
Dominant element of the implementation	County council	Local government of the settlement	Regional Development Council	Low
Effect on developments	Isolated	Isolated	Integrative	Medium
Dominant favoured sectors	Industry	Infrastructure (gas, telephone)	Manufacturing, business services, innovations	Low
Population concerned	4%	17%	29%	Medium
Scales of direct financing	0,05% of GDP	0,2% of GDP	0,3 – 0,5% of GDP	Low

Source: Horváth–Illés (1997), p. 95 and Horváth (1999), p. 112.

of this “idle” workforce is a basic condition of increasing the Hungarian absorption capacity both of EU resources and of Hungarian instruments.

Beyond persisting or even increasing regional inequalities, (relative) overall underdevelopment has also remained a major problem, especially in light of the prospects of EU accession. National and regional development policy (as in most countries in Central and Eastern Europe) has to deal with both problems.

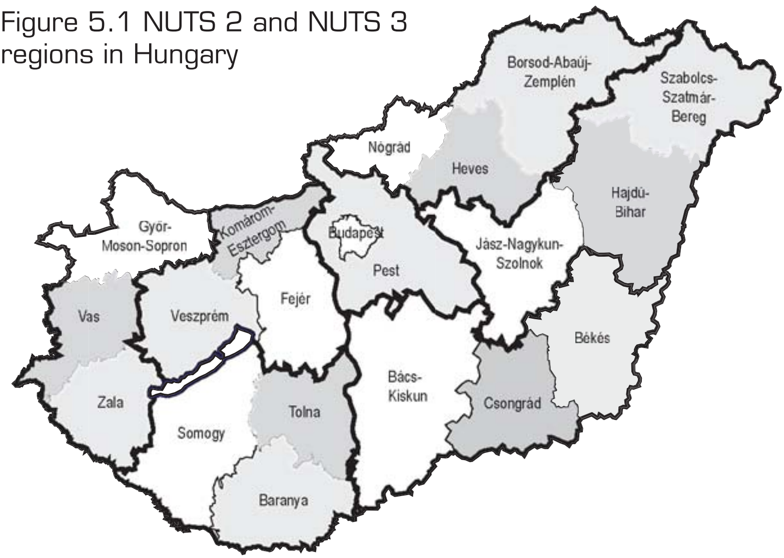
The changes since the beginning of the 1990s pushed regional policy to the foreground in Hungary. This is reflected by several changes presented in Table 5.2. These changes – especially after 1996, with the adoption of the Law on Regional Development and Land-use Planning (XXI/1996) – meant important steps in the direction of being compatible with EU requirements.

Despite the considerable development acknowledged by the EU itself, in a number of aspects – way of financing, scales of direct financing, dominant element of the implementation, dominant favoured sectors – the degree of EU-compatibility remained low. Beyond this, some practical questions, in particular concerning the (re-)definition of the borders, competencies and resources of the NUTS 2 units, are to be solved as well.

5.5.2 The problem of NUTS 2 regions

The definition of regions in Hungary has caused different problems on different levels. The 20 NUTS 3 regions correspond to the counties (+ the capital); this definition has a long tradition in the country. The definition of the 7 NUTS 2 regions – having no historical traditions – has been a much

Figure 5.1 NUTS 2 and NUTS 3 regions in Hungary



more difficult task. NUTS 3 and NUTS 2 regions are presented in Figure 5.1. The distribution of competencies is a difficult task on both levels.

NUTS 2 regions were first defined in 1998 by the National Territorial Development Concept. The regions created were the so-called territorial-statistical regions, as the first objective of their creation was to produce EU-compatible statistics at NUTS 2 level. This is the main reason why the regions consist of 3 (in the case of Central Hungary, 2) counties (NUTS 3 units), and why region borders coincide with county borders: statistics can be obtained relatively easily by aggregating county statistics. It also means that reflections on the internal cohesion of the regions to be created did not have an important role in their formulation (the case is just the opposite in Poland: there the objective was to set up organic regions, but, as a result of the boundaries of the 16 NUTS 2 units, statistics are hard to produce backwards). There were debates concerning Northern Hungary and the Northern Great Plain, but for today, the only big debate is on Central Hungary (we discuss the issue in section 5.5.3).

The introduction of a new intermediary level of public administration – the NUTS 2 regions – is "suspicious" both from the point of view of the central public administration, which is the strongest actor in territorial development and the counties, which fear to lose even the competencies they have now. No wonder that until now the NUTS 2 regions have remained pure territorial-statistical units. Although some administrative bodies have been set up at the new regional level, their competencies and the financial instruments available for them remain very limited. For the next Financial Perspective, it is crucial to change this situation – it is even more important than the question of the borders of Central Hungary, mentioned above.

The 7 NUTS 2 regions have a common feature that they all have external borders. Not taking into account Central Hungary, these borders are relatively long. However, as the NUTS 2 regions created in 1998 are not a result of a traditional regionalisation process, the effects of the borders can be very different in different counties within a given NUTS 2 region. Of course, it is not irrelevant what kind of external borders the regions have. Before 1 May 2004, only Western Transdanubia had a common border with the EU. With the accession of Hungary, the situation changed: the Hungarian-Austrian, the Hungarian-Slovene and the Hungarian-Slovak borders have become internal EU borders. This will probably boost the economy of the bordering Hungarian regions; the effects will probably be different at different borders, but also according to counties within a given NUTS 2 region. The Northern Great Plain and the Southern Great Plain regions will remain – until the EU-accession of Romania – without internal EU-borders (with the exception of a 3km-long fluvial border section of the Northern Great Plain region with Slovakia); this can contribute to accentuating even more the already existing regional differences.[59]

The fact that all Hungarian regions border neighbouring countries, should call attention to the high priority of cross-border cooperation, i.e., how national development plans related to the given region can, from the very beginning, be combined with similar national development plans to be elaborated for the given regions in the neighbouring countries. In this context, it is extremely important to look at the development level of neighbouring (cross-border) regions, since it substantially influences the growth capacity of the whole area and defines the best way of allocating resources. At first glance, three different patterns can be outlined:

1. developed regions on both side of the border (development level can be similar or different, but still "developed" as compared to other regions of the given country);
2. bordering of developed and less-developed region;
3. underdeveloped regions on both sides of the border.

These patterns can be complemented by the growth factor (high- or low-growth developed or underdeveloped regions). As a result, an interesting matrix can be created for further consideration of the potential implications for regional development, cross-border cooperation and "best practice instruments".

5.5.3 The dilemma of Central Hungary

In the case of Central Hungary, the debate's main reason is that Budapest "distorts" the indicators of this region. In 2003, GDP per capita in Central Hungary was about 90 per cent of the EU average. The capital itself was far over this level, while the county Pest – being part of Central Hungary – was still well under the 75% threshold that, without Budapest, would make it eligible for support under Objective 1 of the Structural Funds after 2006.

Leaving Central Hungary as it is could lead to the loss of a considerable amount of Structural Funds transfers for the county Pest after 2006. There are some possible solutions to this problem; the most probable one is to make Budapest – or Budapest with its agglomeration – a NUTS 2 region, and to add the county Pest to an already existing NUTS 2 region (probably to Northern Hungary). However, the question has for long been the subject of political debates and it makes the solution even more difficult. For the future of Central Hungary, three basic scenarios can be imagined.

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[59] In this case, relatively underdeveloped Hungarian regions will cooperate with relatively well-developed (but in absolute terms even less developed) Romanian regions. In such cases, the importance of EU support is more crucial than in general, and the tasks of the regions are more difficult as well: first of all, absorption capacity has to be developed in these regions in order to give them a chance to realise the multiplier effects of development programmes.

Scenario 1: Central Hungary, including Budapest, loses its position as an Objective 1 region after 2006 (due both to growth and statistical effects). As a consequence, big intra-regional differences remain, the under-developed environment of Budapest also hinders the development of the capital and disparities remain or become even stronger, not only between Budapest and Central Hungary, but between rural Central Hungary and other Hungarian regions that will keep utilising EU resources. In this scenario, three positive solutions are conceivable:

a) long phasing-out period for the whole region after 2007;
b) creating a special category (there is interest in such an option in some old member countries, facing similar problems);
c) use a mixed structure of regional fund plus R&D, human resource, etc. baskets.

Scenario 2: taking out Budapest from Central Hungary, making it a NUTS 2 region of its own. In this case, Budapest does not benefit from Objective 1, but the remainder of the present Central Hungary will benefit from it for a long period (provided EU rules remain the same). The solutions to the consequences of such a situation could be the following:

a) rapid development of the regions around Budapest, with indirect but important multiplier effects for the capital;
b) decreasing intraregional cleavages;
c) new sources for the development of Budapest (see Prague);
d) Budapest may have a lower growth path in the first years (it has to be sold politically);
e) stronger reliance on additional money for Budapest (EIB loans to urban transportation and housing rehabilitation);
f) designing Cohesion Fund money to involve Budapest (environment, partly physical infrastructure).

Scenario 3: taking out Budapest, and bring the rest of Central Hungary into another Hungarian region. It is theoretically possible, but the economic rationale for such a solution would be hard to explain.

According to the latest Commission survey, two of the four regions in the enlarged EU with the highest growth prospects are located in Hungary (Central Hungary and Central Transdanubia). It means that what matters is not only the current level of income per head, but also the growth potential of the selected regions.

5.6 Involving potential participants: the private sector and the municipalities

The basic principles of EU structural policies – concentration of financial resources, programming, partnership, additionality and efficiency – have to be applied in the whole process of national regional policy-making. A key issue is to get the most potential actors to become involved.

It is very important to emphasise that while most of the rules of the game are centrally decided – on EU or on Member State level – local initiative is crucial from the point of view of the successful use of the possibilities provided by EU transfers. The attitude of local governments can be decisive in this respect. Local governments as well as NGOs can encourage local initiatives by collecting, disseminating and explaining information on these possibilities. In order to have up-to-date information, they should strengthen their contacts with regional and central authorities. They should continuously follow actual announcements and tenders and disseminate information about them to the potentially interested local partners (for more details, see Szemlér 2001).

The grade of involvement of the private sector in development projects is generally hard to predict (Szemlér 2004 provides some empirical evidence from the former GDR). In Hungary, as in many other countries, public-private partnership (PPP) has become a very fashionable notion. However, there are also debates about the possible extra costs of such solutions: opponents say that, in the long run, investments may be more costly for the state (and thus for the citizens) this way. On the other hand, it has to be seen that private sources must play a key role in assuring the necessary own contribution to the (partly) EU-funded development programmes; if this contribution is not assured, part of the potential EU financing may be lost – costs and benefits of the PPP construction must also be regarded in this respect.

The Hungarian government is conscious of this and supports PPP in a number of fields, where investment requires a high amount of financial resources. A special field where PPPs can play an important role is the accelerated construction of physical infrastructure. In order to be able to realise the potential gains from its favourable geographical location, Hungary needs a modern and well-functioning transport network, and rapid modernisation and development is inconceivable without the involvement of private capital.

5.7 The need for a new budget line: trans-border infrastructure and environment in the NMS

Infrastructure development is a key issue in Hungary, with special emphasis on transport infrastructure. Given its specific geographical situation – at the crossroads between East and West, and also North and South – Hungary needs a highly developed infrastructure in order to be able to realise the potential gains from its location. These gains, of course, could be felt in the whole enlarged EU.

It is also important, especially from the last argument of the previous paragraph, that infrastructure development in the new Member States should be coordinated: from the EU point of view, gains can be realised if actions do not end at national borders. Hungary is therefore interested in an overall Central and Eastern European transport infrastructure development priority of structural operations. The region desperately needs not only the extension of West-East routes, but the creation of genuine "arteries" for itself, both in North-South and Southwest-Northeast directions.

Beyond a number of other "special" features, the EU's enlargement to the East (and the Southeast) has two strategic implications rooted in the geographic conditions of Europe.

1. The most recent (and coming) enlargement did not result in an EU reaching its geographic boundaries to the East (all previous enlargements, with the exception of Austria and Denmark, widened the Union's map up to the clear geographic frontiers of the continent). Moreover, we really do not know where the Eastern border of the EU has to be drawn: geographic, political and cultural considerations may imply different frontiers.
2. All North-East and Central European new members (eight together) have common continental borders.

The above two conditions, with substantial and still not recognized relevance for the future of Europe, urgently need a revisiting of the basic principles of the EU budget. Thus, the budget should immediately create a new item, called "financing of trans-border infrastructure and environmental projects in Central-East-South-East Europe" (for further details on this idea, see Inotai 2004a). Such an approach would have a number of advantages:

1. it would be a clear political message to not-yet-member countries that they are not forgotten, just the opposite, that they may actually participate in some of the projects;
2. it would avoid inefficient use of EU transfers for national prestige projects that have little to do with the priority of trans-border infrastructure development;
3. it would, within a very short period, exert a positive growth-enhancing impact on business, both domestic, regional and all-European, since just the Hungarian case demonstrates that there is a close correlation between the geographic concentration and spread of business activities and the development of physical infrastructure (mainly highways);
4. perhaps most importantly for the EU budget, this approach seems to offer the only instrument that could prevent narrow-minded and selfish "bargaining" in the negotiation process of the 2007-2013 budget. Any meaningful reorientation of the resource flow from old to new beneficiaries needs a separate objective, for its nature and contents, mainly available for new members; and, finally,
5. such an approach would serve the interest of most net contributing countries, since they are, due to their geographic position or economic orientation, interested in better business conditions in the new Member States (Austria, Germany, Netherlands and Sweden, as well as

Finland and Denmark).

It has to be emphasised that the inclusion of a new objective would not necessarily imply a bigger budget and, therefore, more financial contribution by the current net contributors:

1. the money for the new objective should come partly from the national entitlements available for the new Member States;
2. it would be helpful in breaking the deadlock and resistance of the old beneficiaries, and making possible major regrouping of financial resources (this is one of the main arguments of those who do not seem ready to pay more than one per cent);
3. it would ensure higher efficiency and quicker return, not least for private business;
4. the net contributors would be the main beneficiaries in getting orders for designing, construction, technology deliveries related to the implementation of physical infrastructure and environmental projects.

There are two more aspects for further consideration:

1. by implementing the above mentioned concept, an important shift could be produced between Structural and Cohesion Funds that would alleviate the co-financing pressure on the budget of the NMS. This trans-border infrastructure objective would fall into the category of Cohesion Fund;
2. the money available under this heading of the EU budget would not form part of the four per cent capping of EU resources available for the NMS.

5.8 Hungarian interests – some summary remarks

EU membership brings with it a number of tasks, both on the side of the new Member States and of the EU. Of course, the Hungarian domestic tasks have to be addressed adequately. In this context, it is vitally important to develop a comprehensive Hungarian EU strategy that would clearly identify our basic strategic development pattern.[60] They may not fully harmonise with the Commission's priorities, but could offer a good basis for further discussions on the basic objectives of the expected resource transfer. Most probably, the EU would not be able to develop any special programme for Hungary (or for any other NMS), but the EU-created packages could be somewhat softened and special Hungarian priorities (either concerning areas to be financed, or, not less importantly, just the sequencing of the projects) built into the EU-packages. We should also focus more on the success stories (e.g., FDI inflow, exceeding by far the earlier estimations of absorption capacity) in order to prove that the

[60] The issue is at the centre of earlier and current research at the Institute for World Economics of the Hungarian Academy of Sciences. Similar conclusions have been drawn by Inotai (2004b) and Inotai and Szemlér (2004).

absorption capacity of Hungary is higher than believed.[61]

5.8.1 Steps to be taken by the EU

The EU could improve the conditions of having access to the resources and, not less importantly, to enhance the efficiency and speed of using such resources, in many ways:

1. by dispensing with the four per cent ceiling on annual transfers; as has been shown earlier, the absorption capacity is influenced not only by domestic but by external factors as well. Hungary, together with some other countries in the region, e.g., the Czech Republic and Slovakia, demonstrated that it had a high absorption capacity once it started to host foreign direct investment. FDI inflows have reached more than four per cent of GDP in selected years of the nineties. Including reinvested earnings, in itself a clear sign of confidence and sufficient absorption capacity in a "maturing transformation economy", FDI contribution, even today, is likely to be around four per cent of GDP. Moreover, it produces 50 per cent of the Hungarian GDP, controls about 75 per cent of total exports, plays a key role in technological advancement and ensures several hundreds of thousands of jobs;
2. by keeping the four per cent ceiling but, at the same time, reducing the ceiling for more developed net beneficiaries (some of them did not use more than one to two per cent of GNI in a year), such a step could enhance the manoeuvring room of the overall budget and at the same time facilitate redistribution of resources. Moreover, it would take into account the "equal treatment" principle, since four per cent for Spain and four per cent for Poland would in the aggregate be completely different figures, which could hardly be explained on the basis of development levels;
3. by changing the rules of co-financing, i.e., reducing its share in the Structural Funds and/or regrouping part of the Structural Funds-financed projects into the Cohesion Fund;
4. by concentrating, as a common work between EU and Hungarian experts, on such projects that promise not only efficient and quick return, but generate multiplier effects across the economy. In this context, a study of previous experience would be very useful, since Hungary and most other NMS can hardly be compared with other net beneficiaries. The presence or lack of multiplier effects depends on factors such as population density, FDI, economic transformation and competitiveness, educational level of the society, the state of physical infrastructure, telecommunications, cooperation within regional and central authorities, etc. Efficient absorption capacity can be interpreted

[61] A very clear sign of the absorption capacity is that most firms with FDI coming into the country reinvested their profits in Hungary. This means a high level of confidence of the investors in the Hungarian economy, and this is the point where long-term investments differ from the presence of "footloose" capital.

in two different ways. First, the efficient absorption of the resources available within the framework of one single project. Second, and more importantly, in the multiplier (spill over) impact of the project. We would strongly prefer the second scenario, whenever possible;

5. by defining the new objectives in a way that would not exclude any NMS that is automatically benefiting from the regional fund (cohesion objective), from other programmes (e.g., research and development, innovative capacity-building, etc.). The access to other financial resources involved into other objectives is also a must in order to reach the Lisbon goals. Some of the NMS are better off in this context than some of the OMS. Therefore, it would be not only unjust but detrimental to the future development of Europe if they remained deprived of such sources. Access of NMS to EU resources aimed at achieving the Lisbon goals is important for additional reasons as well: equal footing in an enlarged community and ensuring the rapid generation of multiplier effects in the economy;
6. by stressing the importance of cross-country projects (mainly physical infrastructure and environment), so that the priority of this effort is adequately reflected in the new 2007-2013 Financial Perspective.

5.8.2 Steps to be taken by Hungary

For a successful integration, of course, there is much to do on the Hungarian side as well. The most important issues can be summarised in the following:

1. Domestic absorption capacity needs:
   a) constant improvement in the public administration (on governmental, regional and local levels alike);
   b) speeding up the process of application, evaluation and payment;
   c) strengthening the monitoring and controlling functions;
   d) making the whole process more transparent and freeing public servants from the widespread fear in getting into unjustified and artificially created scandals and being accused of maltreatment or misuse of money.
2. Most importantly, a new political culture is needed, based on cooperation as opposed to conflicts, on transparency and not "assumptions" and scandal mentality, on the stability of institutions and public servants working in them, instead of firing professionals in each new electoral period.
3. There have already been identified interesting local and regional initiatives that would not have been possible a decade ago. In fact, money, or even the hope for money, is a very important integrative factor. Let us hope that a large part of the society is able, ready and willing to learn and, sooner or later, discover its own interests (enlightened self-interest behaviour). Western Hungarian counties that a decade ago did everything to establish unique (closed) contacts with neighbouring Austrian regions and used most of their energy to

prevent the other county from doing anything, have learnt that they could achieve much more if they developed a common position. Also, there are encouraging examples of local initiatives in small regions (e.g., local water treatment projects, human resource building, etc.). Here, the main bottleneck is the rather limited co-financing capacity of the municipalities.

4. An additional budgetary constraint may emerge once it turns out that successful projects will need additional (although provisional) financing. Namely, at the beginning of the implementation of the project some money will be made available from EU sources. The second slice of financing is expected to come from national co-financing. Later, another part of EU money may become available. However, the total amount of EU contribution will be disbursed after finalising the project, and sometimes with a substantial time gap (1 to 2 years, which is needed for final controlling of the financial items, etc.). However, the project leader and the participants (subcontractors) can hardly be asked to wait for their money for such a long period. Most potential participants in Hungary are and will remain undercapitalised, they do not dispose of huge financial resources in order to pre-finance their services or activities. As the number and financial volume of successful projects tends to increase, which represents a positive development, more and more money may be needed to overcome the liquidity gap. It should be investigated to what extent the disbursement rules of the EU funds can be changed in order to shorten the transitional period and mitigate the liquidity pressure (and, *ceteris paribus*, the budgetary constraints) in the NMS.
5. Communication policies have to be substantially improved and an active dialogue has to be established, not only between those who have already applied for or those who belong to the potential applicants for EU resources, but in the society as such. Not only the potential amount of money (following 2007) has to be publicised (which, in itself, is a high-risk undertaking; see the next paragraph), but the conditions of having access to the resources and the obligation the applicant is assuming when signing the project. Wrongly or deficiently filled-out application documents, loose accounting, "innovative bookkeeping" and incorrect bills, all of them widely spread and in part deeply rooted in past practices, have to be abandoned. If the local, regional or central government and/or EU authorities identify such cases, it should not be taken as a good chance to blame the government or the EU and defend "poor Hungarian/Slovak/Czech, etc. (so-called) entrepreneurs".
6. Finally, the current Hungarian strategy towards EU funds has to be fundamentally revised, since, quite frankly, Hungary does not have a strategy. Integration strategy has been largely replaced by concentrating on the highest possible absorption of potential EU funds (above

€20 billion for the next seven-year budgetary period). This, however, means that objectives and instruments have been confused. EU transfers are a vital factor of successful membership and sustainable modernisation. However, at the end of the day, they are instruments and not objectives in themselves. A one-sided concentration on money may backfire for two reasons. First, if the money is not available or, for different reasons, becomes available only with a delay, potential beneficiaries will turn against the administration and, more likely, against the government. Second, such an approach may foster the image of Hungary in the old member countries in general, and in the net contributing countries in particular, as Hungary being in it only for the money (which, of course, is far from the truth!). Consequently, a comprehensive integration strategy is badly needed, because,

a) Hungary's successful membership in the EU needs the definition of interests, the seeking for strategic or tactical alliances in the enlarged community and the implementation or protection of basic interests;
b) the EU consists of much more than just a budget – more importantly, several high-priority and high-intensity areas are not covered by the objectives of the budget as defined by the Commission (justice and home affairs, common foreign and security policy, where fundamental Hungarian interests are at stake);
c) Hungary has to define its longer-term place and role both in the rapidly changing global environment and within the enlarged/ enlarging EU – only by using this as a fundament can the country's room for manoeuvre be determined (most probably along different scenarios) and the main objectives that the country would like to achieve with the financial support of the EU be defined;
d) it is not ruled out that these objectives will largely coincide with the basic objectives formulated by the Commission and with those that will become the pillars of the coming EU budget – however, differences in priorities may not be a priori excluded, either concerning the areas, the instruments, the timeframe or the sequencing of different policy goals and means;
e) automatic acceptance of the EU-defined goals is a consequence of the lack of a national strategy, and may generate serious consequences both for Hungary, the EU and for the image of the EU in a Member State. Even assuming the (not unlikely) fact that, at the end of the day, Hungary (and other countries) has to subscribe to the priorities of the Commission and could hardly change them (the trans-border infrastructure objective could and should be an exception), the negotiations on the modalities of EU transfers after 2007 and the composition of the Second National Development Plan should (have) start(ed) from a different approach. At least some special high-priority interests of Hungary could (have) be(en) included into the package at an early stage of preparing the final document.

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6 THE CZECH REPUBLIC AND COHESION POLICY

Radomir Špok (ed.), Pavel Karásek, Tomáš Pubrle and Zuzana Kasáková

6.1 Introduction

In this chapter we examine the European Cohesion Policy with a view to adapting some of its aspects so that they become more in line with the particular needs of the Czech Republic. We claim that the role of the European Union, in creating the right conditions for economic growth, should not be underestimated.

The challenges the Czech Republic is faced with ranges from structural unemployment to an unsatisfactory state of transport infrastructure. Many of the problems visible today can, to a great extent, be said to be the legacy of the former Communist regime. The major income redistribution that this regime undertook, together with a centrally planned relocation of industries, led on the one hand to narrower regional disparities in the Czech Republic than in the former EU15, but, on the other hand, laid the foundations for the structural problems we still see today in some parts of the country.

The Czech Republic has benefited, on many levels, from being an EU Member State, both from having access to the internal market and from the ECP. At the same time, it has also benefited from the pre-accession assistance. Above all, the pre-accession programmes made it possible to invest in areas which otherwise would have been neglected or at least received less attention, they have improved the institutional and administrative quality and they have also made possible the utilisation of the Structural Funds and the Cohesion Fund once the Czech Republic joined the EU.

In this chapter we argue that a successful ECP should primarily focus on the enhancement of a good entrepreneurial environment and the promotion of economic growth based on innovation, R&D and new technologies. This economic growth, furthermore, should be anchored in the development of human resources.

The chapter is divided as follows: in the next section we examine the pre-accession instruments, PHARE and ISPA, with respect to their respective strengths and weaknesses. In section 6.3 we look briefly at controversies in the membership negotiations. Section 6.4 looks at various aspects of the Commission's proposal for a new Cohesion Policy, which is followed by a discussion on Czech priorities for the period 2007-2013. Before concluding the chapter we provide the reader, in section 6.6, with the expert's views on how European regional policy should be conducted in the future and which priorities should prevail.

6.2 The Czech Republic and the pre-accession instruments

This section will attempt to assess the impact of the two pre-accession funds PHARE and ISPA – leaving out the third major instrument, SAPARD – on the Czech Republic. However, in order to evaluate PHARE and ISPA, we must first establish the goals of the programmes or, rather, what the Czech Republic wanted to achieve with these programmes.

Besides the political effort to use as much of financial support as possible, the main objective was to invest in sectors and regions that would otherwise have been left out of the main objectives of the Czech government, such as border regions and certain large infrastructure projects. Another important and basic aim of the Czech Republic with the pre-accession funds was of course to prepare for the future accession to the EU.

Hence we shall focus on how the aims and priorities of PHARE and ISPA were fulfilled; how successfully they were implemented through different types of projects; and how important these programmes were for the transformation of the Czech Republic in its endeavour to join the European Union.[62]

6.2.1 PHARE

The Czech Republic joined PHARE as early as 1990 when still part of Czechoslovakia (Pravda 2002). After the dissolution of the federation, both the Czech Republic and Slovakia became, without delay, participants of the PHARE programme.

Administration of PHARE

The adoption of the Accession Partnership in 1998 led to a more decentralised administration of PHARE, which emphasised the demand for enhancement and formalisation of Czech institutions. A position of National Aid Coordinator was established, with responsibility for the coordination of preparation, implementation and monitoring of all EU aid programmes. This post was assigned to the deputy of Minister of Finance – the Centre for Foreign Assistance was set up to administrate his agenda. In addition, another deputy Minister of Finance was designated National Authorizing Officer, responsible for the management of all financial allocations coming from the EU and after 2000 also all financial resources intended for co-funding of the EU's aid programmes. The National Fund was created at the Ministry of Finance as an administrative instrument of the National Authorizing Officer (CFA not dated b).

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[62] The sources used in this chapter are mainly official documents of the Czech government or governmental web sites and the European Commission's Regular Reports on Czech Republic's Progress towards Accession. Other publications and journal articles were also consulted.

Moreover, specialised implementation agencies were established – mostly within Czech ministries – in order to administrate projects in particular areas.

- The Central Financing and Contracting Unit (Ministry of Finance) implements institution-building projects.
- The National Educational Fund (Ministry of Labour and Social Affairs) is responsible for human resource projects.
- The Centre for Regional Development (Ministry of Local Development) administrates investment projects in the area of economic and social cohesion and cross-border cooperation.
- CzechInvest (Ministry of Industry and Trade) manages projects in the field of business development including business infrastructure.
- The Civil Society Development Foundation is responsible for the grants supporting NGO activity (MLD 2004a).

The European Commission described the implementation of PHARE as "generally satisfactory" in its 2000 Regular Report. However, it also criticised the functioning of the National Fund, in particular that it had been slow in handling requests and distributing the funds (COM 2000, p. 12). Although the implementation of PHARE had improved in time for the next report, the Commission recommended in the years that followed that the Czech Republic improve the capacity of public administration by providing "adequate human resources and efficient and effective organisational structures for all relevant bodies" (COM 2001, p. 12).

Even though the improvement of public institutions became a permanent and important priority of the PHARE programmes after 1997 (CFA 2001; and CFA 2003), project implementation was still not optimal. The Accession Partnerships had meant that the implementation of PHARE became decentralised, but all projects still had to undergo ex-ante monitoring by the European Commission or by the Delegation of European Commission in the Czech Republic. In order to accelerate the process of approving projects, the European Commission decided to introduce the so called Extended Decentralisation Implementation System, which – according to the Commission's 2001 Report – should have been fully operational in 2002 (COM 2001).

However, the Czech Republic was unable to secure satisfactory administrative bodies even by the time of its accession to the EU and thus the Commission refused to grant its accreditation. Therefore, the flow of financial resources from PHARE was suspended in August 2004, but restored only four months later in December 2004 when the shortcomings had been dealt with (EurActiv 2004a; Euractiv 2004b).

Types of programmes

The PHARE programme consists of several types of programmes. The most important in terms of financial allocations is the National Programme. Then there is the Cross-border Cooperation Programme, which is the counterpart of EU's Community initiative Interreg. The administration of these programmes is decentralized. In this chapter we do not deal with Multi-country Programmes which are proposed directly by the Commission for all countries participating in PHARE.

National Programmes

During the first phase of PHARE, the aim of the support under the National Programmes was to promote certain sectors in their transformation to market economy. When the multi-annual indicative plans were introduced in 1994, each candidate country became responsible for determining its own long term priorities. The areas prioritised in the Czech Republic were really very broad including public administration, agriculture, civil society and democratisation, education, infrastructure, environment and nuclear safety, private sector, social affairs, employment and healthcare. The adoption of the Accession Partnership in 1998 meant that almost a third of the allocations under the National Programmes were assigned to institution building projects and the remainder to investment projects (CFA not dated a). In 2002, the National Programme was even divided into two parts, where the first part was entirely devoted to institution building (CFA not dated c).

The institution building projects were focused on six priority areas: finance, justice, home affairs, agriculture, environment, and economic and social cohesion (CFA 2003). The priority status of institution building was also stressed by the introduction of a new project type, twinning, which supplemented existing projects such as consulting, training and studies. Under the twinning projects, different bodies of public administration in the Czech Republic accepted long- or short-term advisors from the EU15 Member States in order to benefit from their knowledge, experiences and contacts, thus improving the preparedness for the accession to the EU (CFA 2001).

Between 1998 and 2001 more than 60 twinning projects were carried out in the Czech Republic, in co-operation with EU Member States. There were problems reported with respect to communication between the visiting consultants and hosting institutions. This was partly caused by lack of helpfulness on the Czech side and partly by the fact that the quality of the consultants was not always satisfactory (CFA 2002). The twinning projects were applied in a number of areas, such as legal business environment, pension reform, public procurement, integrated pollution prevention and control, sanitary and phyto-sanitary[63] administration, healthcare and

[63] EU and national standards to protect health, of humans, plants, and animals.

work safety and the combating of organised crime (COM 2001; and COM 2002).

The aim of the investment section of the National Programmes was primarily to foster economic and social cohesion, which included projects in the area of support for small and medium sized enterprises (SMEs), employment policy, protection of human rights and minorities, human resources development and business infrastructure (CFA 2002).

As for the overall distribution of the resources of the PHARE National Programmes among particular sectors in the Czech Republic during 1993-2001, the largest share was allocated to transport (€71 million), followed by regional development (€54.4 million), employment, human resources, social policy, and education (€47.6 million), and technical assistance, public administration reform, standards, statistics, legislation, industrial property, and telecommunications (€38.8 million). Significant resources were also aimed at support of business, export and foreign direct investment, agriculture, finance and many other areas (CFA 2002).

Cross-border Cooperation

The second significant component of PHARE was the Cross-border Cooperation programme. This programme was launched in 1994 and represented about 50 per cent of the PHARE resources in the period 1995-1999.

When the Cross-border Cooperation was launched, it only concerned the Czech-German border, which in 1994 was the only Czech border with an EU Member State. When Austria joined the EU in 1995, the CBC programme was extended to the Czech-Austrian border. In 1999 the Cross-border Cooperation programme was introduced also on the borders between the Candidate Countries. The Czech Republic has thus cooperated with Poland under this programme since 1999. There was also a one-off cooperation with Slovakia in the same year (MLD 2004b). However, the Czech Republic also cooperated with Poland and Slovakia under two trilateral cross-border cooperation programmes (Czech Republic-Germany-Poland and Czech Republic-Austria-Slovakia) in 1995 and 1996 (CFA 2001).

The primary aim of the CBC PHARE programme was to support the economic development of the regions disadvantaged by their border position. This was to be achieved by supporting competitiveness of Czech businesses, improving infrastructure, dealing with common problems such as environmental degradation and fostering cooperation between residents in neighbouring regions (MLD 2004b; and CFA 2001).

The process of decentralising the CBC programme started in 1996, which further enhanced cooperation and contacts between people and institutions in the border regions. The CBC PHARE programme converged towards the Community Initiative INTERREG after 2000 with respect to its rules, methods and administrative procedures, in order to prepare the candidate countries for INTERREG participation after accession (MLD 2004b; and MLD 2005).

The CBC originally supported a large number of smaller projects, but subsequently changed with the introduction of ISPA in 2000 to favour instead a small number of large infrastructure projects. At the same time, grant schemes were also introduced, first tested in the two pilot NUTS 2 regions Moravskoslezsko and Severozápad. The most successful fund was the Small Projects Fund, which was launched in 1996 and supported small non-investment projects[64] based on cooperation between municipalities, schools, and NGOs in the area of culture, education and tourism (Horáček 2002; and MLD 2004b).

Although the tangible outcomes of the CBC PHARE infrastructure projects could be seen in the form of roads, sewage systems or sewerage plants, these projects sometimes failed to demonstrate a direct cross-border impact.

Table 6.1 Phare support by sector 1993-2001

Sector of support	Allocation (€)
Cross-border cooperation	221,250,000
Transport	71,000,000
Regional development – investment	54,350,000
Employment, human resources, social policy, education	47,550,000
Technical assistance, public administration reform, standards, statistics, legislation, industrial property, telecommunications	38,800,000
Support for business, export, FDI	32,850,000
Agriculture	24,680,000
Community programmes	24,457,308
Finance, banking, customs	22,600,000
Home Affairs	22,200,000
Environment	20,750,000
NGOs and minorities	16,770,000
Justice	13,650,000
Preparation for Structural Funds and Cohesion Fund	9,900,000
Energetics (including nuclear)	9,790,000
Healthcare	1,600,000
Total	**632,197,308**

Source: CFA (2002), pp. 4-5

[64] Amounts allocated ranged between €1,000 and €50,000.

This fact was also criticised in the 2000 assessment reports by the Association of European Border Regions (AEBR 2000a; and AEBR 2000b). The problem was solved in the following years, especially by the means of the grant scheme of the Small Projects Funds, which focused on a people-to-people approach. Nearly half of these funds were as early as 1995-1999 allocated to cross-border cultural exchanges (AEBR 2000a; and AEBR 2000b). However, it is still questionable whether the aim of overcoming cultural differences and rooted prejudices was achieved, since support for EU Membership in the 2003 referendum was below average in nearly 85 per cent of Czech districts bordering Germany and Austria (CSO 2003). One can only guess what support of EU in these regions would be achieved without any visible PHARE projects and their outcomes.

6.2.2 ISPA

Since ISPA supports large infrastructure projects with a budget exceeding €5 million, particularly thorough and elaborate preparation is required. Although there were special programmes under PHARE for the preparation of ISPA projects, the Czech Republic was unable to obtain even the average allocation from the possible range in the years 2000 and 2001 (COM 2002).[65] This changed quite dramatically in 2002, however, when the Czech Republic's allocation equalled €80.5 million, which was nearly 90 per cent of the maximum achievable allocation (MLD 2004c).

We have already mentioned that the process of project documentation approval was rather lengthy, which subsequently put pressure on project implementation. This was in no small part due to the approval procedures of the Delegation of European Commission, but there were also serious shortcomings on the Czech side. The most important factor was the inability to guarantee sufficient co-funding of the projects. The EU contribution should ideally be 75 per cent of total eligible costs, but the typical EU contribution was not so high and there were also substantial ineligible costs. Thus, the average EU contribution amounted to 50-60 per cent of the overall costs, requiring sizeable resources to be provided by the Czech side (CFA 2002; CFA 2003; and MLD 2004c).

The above mentioned obstacles occurred much more often in the area of environmental projects. This led to a slight imbalance between the allocations for the transport and environmental project. In the end, 55 per cent of the ISPA allocations were used under the transport branch and the remainder under the environmental branch (EU Information Centre and DEC 2003). Since the accession of the Czech Republic to the EU, all ISPA projects were transformed to the Cohesion Fund (MT not dated).

[65] The Czech Republic could obtain between €57.2 and €83.2 million; see (MLD 2004c).

The projects in the area of transport all aimed at improving the connection between the Czech Republic and its EU neighbours through the Trans-European Networks (TEN), in total of €260 million.

Under the environmental part of ISPA, there were three main target areas: securing quantity and quality of water, air quality and climate protection, and waste treatment. Altogether, 14 projects were supported in the Czech Republic (ME not dated; and MLD 2004c).

6.2.3 Conclusions

Under the PHARE programme, more than €1 billion was allocated to the Czech Republic prior to its accession to the EU. The total ISPA allocation in 2000-2003 exceeded €500 million (CFA not dated b; and COM 2004a). The various branches in the Czech Republic were indeed successful in contracting and implementing these resources. In both the PHARE and ISPA programmes, more than 95 per cent were, or are expected to be, contracted. The reason for not contracting the entire allocation was that the least expensive offer has to be chosen during the selective procedure. Although some projects were cancelled and the contribution had to be reimbursed, more than 95 per cent of the contracted resources were already paid out (DEC 2001; and CFA 2002).

Table 6.2 Phare and ISPA allocations 1990-2003

Phare	ISPA
€1,034 million	€244.297 million‡

‡ By September 2003
Source: CFA, not dated b

Thus, we can conclude that the Czech Republic took full advantage of the assistance offered by the European Union. We can also claim that the pre-accession funds inspired and supported investment in sectors and regions that would otherwise have been omitted, or at least much more modestly addressed. In this regard, we can for example mention the success of the CBC PHARE programme (regardless of the various shortcomings mentioned above) or the amounts invested in transport and environmental infrastructure.

Furthermore, the pre-accession funds contributed partially to the success of Czech accession to the EU. In other words, this particular aim of both PHARE and ISPA was fulfilled. Both administrative bodies and different final beneficiaries have improved their knowledge and skills in how to prepare, implement and evaluate the individual projects or administrate the programmes. These facts imply that the Czech Republic is now better prepared for participation in both the Structural Funds and the Cohesion Fund. However, there are still some imperfections, as the suspension of the PHARE fund in 2004 suggests. This particular situation shows that ongoing reforms and constant endeavour is needed if the Czech Republic is to be as successful within the EU Regional policy framework.

6.3 EU regional policy in the negotiation process

The negotiations on the accession of the Czech Republic to the EU were officially initiated in March 1998. One of 31 negotiated chapters consisted of EU regional policy and structural instruments coordination. From the very beginning, the Czech government declared its preparedness to fully adopt and implement the whole *acquis* in the field of EU Structural and Cohesion Policy. The Czech government did not expect any serious obstacles in this field during the negotiations and was convinced that the respective laws and rules would come in effect in time for the date of Czech accession to the EU. Thus, the Czech government did not request any transition periods in this chapter (Position document of Czech Republic to the Chapter 21).

With regard to the pre-accession instruments in previous years, the Czech Republic had created the administration system in accordance with EU regulations. Although both the pace and the quality of these administration and monitoring structures were often criticised by the Commission, the public administration in the end managed to guarantee that the entire process of preparation and implementation system would be granted accreditation.

During the negotiations the Czech Republic faced a specific problem which called for immediate handling. Due to the strong tradition of state centralism in the country, a reform of regional self-governance was postponed several times in the 1990s,[66] which significantly influenced the preparation of public administration on the territorial level. Since regional authorities (including elected assemblies and regional councils) started working only in the beginning of 2001, not being fully involved in the pre-accession instruments, they could not gain sufficient administrative experience as regards EU programmes and projects. Perhaps this is the reason for the initial mistrust on the part of the Commission towards regional operational programmes in the Czech Republic.

Based on the National Development Plan, six sectoral and seven regional operational programmes were proposed by the Czech government under objective 1 (excluding Prague). The Commission was however reluctant to "inflate" the programming documents, which led to a substantial reduction

[66] Constitutional law on the creation of territorial self-governance was approved at the end of 1997 and came into effect on 1 January 2000. The first elections for regional assemblies took place in November 2000.

in operational programmes – in the end one joint regional operational programme and four sectoral operational programmes were approved. In light of weaker administration capacity at regional authorities, a more centralised (national) control over the Cohesion Policy can be seen as a better conception.[67] The government can thus easily enforce national priorities; management is less complicated and cost savings can also constitute a significant factor for this approach. However, representatives of individual regions should be involved as much as possible in constituting the content of Cohesion Policy, including the setting of priorities and measures in the Czech Republic.

In order to conclude this part it is important to note that no serious controversial issues appeared during the negotiation process. However, there were several opinion clashes between the Czech government and the Commission regarding the preparation of the programming documents.

6.4 Czech stance towards new regulation drafts on regional policy

Generally speaking, the Czech government considers the proposed structure of Structural Policy objectives – Convergence, Competitiveness and Territorial cooperation – as sufficient and holds the view that these objectives cover all needed areas of the least developed regions and states in compliance with Lisbon objectives. However, there are a number of aspects in the Commission's proposal that representatives of the Czech Republic should strive to modify. In this chapter we will discuss the most important topics, which are either emphasised by the Czech government or should not be neglected in our opinion.

It is essential to ensure sufficient flexibility of regional interventions in order to respond adequately to the needs of regions or states. It would be beneficial to bring activities supported within the Competitiveness objective into the Convergence objective. With regard to the Cohesion Fund, it is desirable to allow for a flexible use of resources for projects in both the supported areas of transport and environment.
The proposed reorganisation of the rural development policy – from the ECP to the Common Agricultural Policy (CAP) – is regarded as a significant step that will substantially influence the future rural development. The priority is to prevent possible overlaps or the existence of gaps in covering problematic areas.

According to the Czech government, lifelong education should be explicitly set as one of the priorities supported by the European Social Fund for both the Convergence and Competitiveness objectives. It also wants to create a more precise definition of horizontal themes necessary for the

[67] We return to this particular question in section 6.5.1.

programming documents. To name but one example, a reference to the information society is today missing.

The Czech government favours the emphasis on the urban dimension of the ECP. It is certainly in line with the current political debate on the deterioration of large prefabricated blocks of flats located especially on the city suburbs. The threat of lower living standards for inhabitants in these quarters, which could easily cause social-pathological phenomena (higher criminality, drugs distribution etc.), explains this pro-urban stance. In this context the government intends to increase the role of the cities and to clarify their involvement into the implementation and preparation of individual operational programmes.

6.4.1 Proposed costs for EU Structural and Cohesion Policy

As noted in the first chapter, the Commission has proposed a total of €336.1 billion to finance the ECP in the years 2007-2013. Regarding the ongoing negotiations, the figures in the Commission's proposal should not be considered as definite. It would be probably better to connect the total budget to indicative calculations for each Member State. The Commission's proposal should be regarded as a good base for further negotiations, but the Czech government considers the proposed share of resources for regions and countries lagging behind as not being optimal and, on the contrary, the allocations for phasing-out regions as very generous. We do indeed agree with this position.

6.4.2 Mono-fund v. Cross-financing

According to the Commission's proposal, each operational programme should be financed by a single Fund (a so-called mono-fund system). The only exception to this rule would be operational programmes financing environment and transport together where the Cohesion Fund and the ERDF may be used simultaneously. This simplification is welcome, since it can significantly reduce bureaucracy and save costs. However, the mono-fund approach seems in many respects to complicate rather than to simplify matters.

According to the proposal, the flexibility for cross-financing would have a ceiling of five per cent as a general rule, implying that each fund in each operational programme could fund up to five per cent of its budget actions that usually fall under the scope of the other fund. The Czech government has expressed an intention to raise this ceiling by several per cent in order to secure synergy between the ESF and the ERDF. For example, human resources development requires both infrastructure investments and training.

6.4.3 Eligibility rules on VAT

Under the current provisions on eligible costs, non-reimbursable VAT is eligible for financing from the Structural Funds and the Cohesion Fund. In the draft for new regulations this is to be changed, since VAT would no longer be eligible for financing from the ERDF and the Cohesion Fund in all cases, regardless of whether it is reimbursable or not (although the provisions on eligibility of VAT for financing from the ESF would remain unchanged). Since some of the final recipients, especially municipalities, do not have to be VAT payers (i.e., they are not entitled to get VAT re-funded) this rule threatens to negatively influence the absorption capacity of those beneficiaries. The Czech government should therefore try to maintain the current rules on eligibility of VAT for the next programming period.

6.4.4 Operational Programmes

Another debatable question concerns the creation of a special operational programme to be used as a national reserve. The Commission has proposed that each Member State should create a national contingency reserve, amounting to one per cent of the annual contribution from the Structural Funds for the Convergence objective and three per cent for the Competitiveness objective, in order to cover costs from unexpected crises. The proposed special Operational Programme should partly help to respond to such crises. On the other hand, unexpected crises logically imply unexpected risks, which can hardly be fully covered by a specific Operational Programme.

The draft for regulation also lacks the definition of a precise period for the fulfilment of the Commission's obligations concerning the procedure for the submitting, approving and revising of programming documents. It is unclear why the Commission should have the right to adjust operational programmes on its own initiative. In compliance with the principle of subsidiarity we are convinced that the Commission should only have the power to express non-binding recommendations for the Member States.

6.4.5 Maximum level of co-funding

If the Commission's proposal was to be adopted, it would mean that some islands, mountain areas and sparsely populated areas would be faced with a higher rate of Community co-funding, such as the outermost regions as well as regions that no longer have external EU borders (compared with the situation on 30 April 2004). There is a possibility to increase this level up to 85 per cent compared with a maximum 80 per cent for cohesion countries. Moreover, the latter level is expected to be used only in exceptional and duly justified cases. We are convinced that such differences neglect the specificities of the new Member States. In regard to the lower level of economic development, higher convergence gap and the less developed infrastructure, the Czech government should require the same level (i.e., 85 per cent) of financing for convergence regions in cohesion countries as for remote regions.

It is quite strange that the Commission's draft requires co-funding to be related to the total eligible costs and not just to public costs. Such an approach would exclude the opportunity to involve private resources in financing and thus reduce the strain on public budgets.

6.5 Priorities of the Czech government in 2007 - 2013

On 1 March 2005 the Czech government approved the priorities of the Economic and Social Cohesion Policy for the 2007-2013 period (Government resolution no 245 on progress in preparation of the Czech Republic for EU Structural Funds and Cohesion Fund in budget period 2007-2013). The priorities are as follows:

- enterprising;
- human resources and tertiary schools (including universities);
- innovations and knowledge-based economy;
- infrastructure (including environmental infrastructure);
- regional disparities reduction (horizontal theme).

The Ministry for Regional Development in the Czech Republic has been given the task of updating the current National Development Plan (NDP) by 30 September 2005 and to prepare the National Strategic Reference Framework for the 2007-2013 period by 30 November 2005.

According to a survey organised by this Ministry, the needs of individual ministries expressed in costs, potentially funded from the Structural Funds, exceed €6.7 billion per year. These figures (and the absorption capacity arising there from) seem to be overestimated.[68] Bearing in mind the capping principle of four per cent, a maximum estimation of transfers corresponds to €4.2 billion per year. This amount significantly exceeds the current transfers from the Structural Funds to the Czech Republic (€2.3 billion in the 2004-2006 period). Moreover, if we add national co-funding (approximately 25 per cent of total funding), we conclude our estimations at €5.4 billion per year, which represents more than six times the volume of the financial resources in 2005.

There are some problems which negatively influence the absorption capacity in the Czech Republic. First, problems are apparent on the side of the final beneficiaries. In particular, the smaller municipalities may face obstacles, both on administrative and financial levels. Smaller municipalities do not have enough experience to meet all the requirements set by the respective regulations and rules and, at the same time, they are often not so financially strong to pre-finance and co-finance the projects. On the

[68] Many ministries included in these figures all investments and development projects that they wanted to implement regardless of the main rules of EU Structural Policy.

other hand, exclusion of smaller communes and the limitations of final beneficiaries could lead to a lower overall absorption capacity.

Second, the Czech government has to clear away duplicities with respect to national development priorities. Thus far, the National Development Plan has been perceived as a tool through which additional funds can flow from the EU budget to the Czech Republic. Apart from the NDP, there are still many other national funds supporting many areas and identifying many other priorities than those defined in NDP. Such duplicity and overlapping of funds has to be dealt with properly.[69] The approximately €1.34 billion per year which would probably be needed for co-funding represents around five per cent of the state budget. Regarding the current general government deficit[70] and the necessity of complying with Maastricht fiscal criteria, the Czech Republic cannot afford on the one hand to further deepen budget deficits and on the other use in an inefficient way the resources available from the Structural Funds; that would simply not be politically sustainable.

The Czech government will have to realise that the NDP and the National Strategic Reference Framework should be based on long-term goals combined with clearly defined priorities and strategies. In compliance with the principle of additionality, a national development policy has to walk hand in hand with the rules of the ECP. Interventions carried out in the framework of this policy will be financed both from public budgets and the Structural Funds.

Last but not least, in preparing the new operational programmes the Czech government should focus on defining crucial priorities. As regards the current budget period, the Czech Republic has been criticised by the Commission for having too many priorities and measures in the individual operational programmes. Such an approach naturally leads to a conflict with the principle of concentration. The impact of individual projects, as well as the overall outcome of the operational programmes, will not be as strong if too many priorities are built into the policy formulation. The Czech government should therefore avoid this approach and define fewer priorities and measures. A less voluminous approach would better influence the situation in particular areas.

The above mentioned priorities arise from the Economic Growth Strategy, which is one of the most important strategic documents and it is currently[71] being prepared and developed by an expert team led by the Czech deputy Prime Minister Martin Jahn. This document seems to be the first attempt

[69] This topic is further developed in the next section.
[70] The general government deficit consists of the central government deficit, which forms the most significant part of the overall deficit, the local government deficit and non-budgetary funds and state agencies' balances.
[71] April 2005

in the Czech Republic to formulate a coherent and clear mid- and long-term strategy for economic growth. Each of the five chapters (human resources, research and development, infrastructure, financial sources, institutional environment; see Table 6.3) is further divided into several objectives, which will be measured and monitored in detail.

Table 6.3 Priorities and topics in Economic Growth Strategy (draft mid-March)

Chapters - Priorities	Topics*
Human Resources	Quality of Human Capital Quantity of Human Capital Labour Market and Employment Human Resources for Modern Society
Research and Development	Public Private Partnership in R&D, Innovation From R&D to Innovation National Innovation Policy Involvement of Regions to Innovation Policy
Infrastructure	Transport Infrastructure Telecommunication Infrastructure Environmental Limits Investment Sources
Financial Sources	EU Structural Funds and Cohesion Fund Foreign Direct Investments Public Private Partnership Public and Alternative Sources
Institutional environment	Taxes Legislative Environment Public Services Quality Stimulation Tools

* Only selected objectives

Sources: working material – Euro 11/2005, p.29

This ambitious document is expected to fight at least two crucial battles. First, it has to be approved by the Czech government, which could be paralysed by the conflicts inside the coalition government. A second and probably more dramatic battle will take place after the general elections in the summer of 2006. The civil democrats (ODS), currently the strongest opposition party, are predicted to win. Despite the fact that the Economic Growth Strategy is a well elaborated document according to independent analysts, there is doubt whether the ODS – which have scored political points mainly by criticising the coalition government – will be courageous enough to adopt a document prepared by their political opponents. Another question which deserves to be raised is whether a new government will have enough time to modify the programming documents, especially the operational programmes that are to be prepared for the next budget period. We are convinced that it will not.

6.5.1 How to set priorities

The question of how to optimally use the resources available through the Structural Funds and Cohesion Fund has been discussed in the Czech Republic since 1998. The Czech administration has been preparing for the Structural Funds primarily through PHARE, which enabled responsible officers to administer and monitor individual PHARE programmes.

The first draft of the National Development Plan – a complex and far-reaching strategic document – was prepared in 1999. The Czech government had to tackle the problem of a high number of priorities identified first in the NDP and then in operational programmes. As noted, the Czech Republic has been criticised for not being able to limit the number of prioritised problems to be solved through the ECP and was consequently forced to reduce the number of operational programmes. The changes were incorporated into the final version of the NDP only in February 2003 and the delay significantly reduced the time frame in which the concerned actors could prepare for and develop priorities and measures as set out by the NDP.

In the current programming period, EU subsidies are distributed through five Operational Programmes for the Objective 1 (Industry and Enterprise, Human Resources Development, Infrastructure, Rural Development and Multi-Functional Agriculture and the Joint Regional Operational Programmes); two Single Programming Documents for Objective 2 and Objective 3 and the Community Initiatives Equal and Interreg. Projects under the Cohesion Fund for the areas of transport and the environment are prepared on the NUTS 1 level.

However, the number of priorities has remained high and in order use effectively the financial resources available through the EU funds, more emphasis should be placed on the principle of concentration. The supported priorities should be further reduced and be more specific since this approach can help to set up clear strategies and targets. The focus should be put on long-term concepts and targets, especially on human resources development, research, enterprise and infrastructure.

As we have already indicated, one of the potential problems is the overlapping of priorities. The government should clearly divide the priorities into those that are to be supported under the ECP and those that are to be covered only by national sources. The explicit definition of such priorities could prevent the government from using national finances on programmes similar to those co-financed by Structural Funds resources. It should thus concentrate on areas which cannot be supported from EU sources but which are important from the national perspective.

6.5.2 How to assure co-financing

The problem of setting ECP priorities is closely related to the economic situation of the country. In order to receive funding, the government must ensure co-financing from national sources (state budget, state funds, and regional or municipalities' budgets). Naturally, it would be a great advantage if the Czech government was able to ensure sufficient national finances for co-financing and thus use as much financial resources from the EU budget as possible.

For the years 2004-2006, the Czech Republic allocation from the Structural Funds and the Cohesion Fund is about €2.8 billion. For the next programming period it is estimated that the Czech Republic could get about €26.4 billion from the Structural Funds and it therefore has to provide co-financing from national public resources in the area of€8.9 billion. Additionally, almost €13.4 billion is allocated from the Cohesion Fund and thus about €2.3 billion would be required for co-funding. In comparison with the current (reduced) programming period, the amount of financial transfers will thus grow substantially. This in turn implies much stricter requirements in order to assure co-funding from national public sources.

Czech public finances are characterised by a growing general government deficit and a relatively low but rapidly increasing public debt. The state budget is afflicted by permanent deficits driven mainly by high mandatory expenditures. Mandatory expenditures (e.g., social transfers, debt service, state contributions to the health insurance system, etc.) represent 55 per cent of overall public expenditures. Together with quasi-mandatory expenditures (i.e., the army and public administration salaries) it represents about 81.4 per cent of total expenditure.

A public finance reform was implemented in 2003 in order to improve the fiscal position of the Czech Republic. The main task of the reform was to ensure a gradual reduction in the budgetary deficit and a slowdown of the growth of public debt. The government has committed itself to a general government deficit that will not exceed four per cent of GDP by 2006 and a year later it should not be higher than 3.5 per cent of GDP. In comparison with the level of general government deficit in 2004, this represents an annual reduction of 0.7 percentage points. The government (late 2004) plans to cut expenditure by €6.7 billion (CZK 200 billion) during the 2005-2007 period and to raise an additional €2.3 billion (CZK 70 billion) in tax revenue.

Within the framework of the public finance reform the question of public private partnership (PPP) has been vigorously debated. The adoption and development of the PPP principle could significantly contribute to the required level of co-funding. The government approved this approach in January 2004 and the first pilot projects have already been started. However, no legislation has been adopted so far in this area.

In the current programming period co-funding is possible also from private sources. However, this condition is not included into the Commission's proposal for the next programming period. This could cause problems for the government to guarantee sufficient financial sources for the co-funding requirement. Additionally, it would be convenient to maintain this feature in light of the importance to enhance public private partnership. Therefore, the Czech government needs to push the idea of involving private sources in order to make it part of the new ECP.

The Czech government should also focus on mistake-free administration of individual operational programmes. It has recently come under strong criticism due to changing rules and conditions during the preparatory phase of projects, such that the applicants were sometimes unable to adapt to modified rules in time. The unsatisfactory state of the knowledge and lack of experience of civil servants in several cases complicated the process of preparing individual projects.

In order to receive money from the Structural Funds it is also important to be able to develop quality projects. Despite the use of financial sources within the PHARE programme, the applicants in many cases had poor or no experience of how to prepare projects and fill out application forms.

It seems that both civil servants responsible for the Structural Funds and potential applicants have gone through a learning process. Experience, skills and knowledge gained from the current programming period could fundamentally contribute to a more efficient use of the funds.

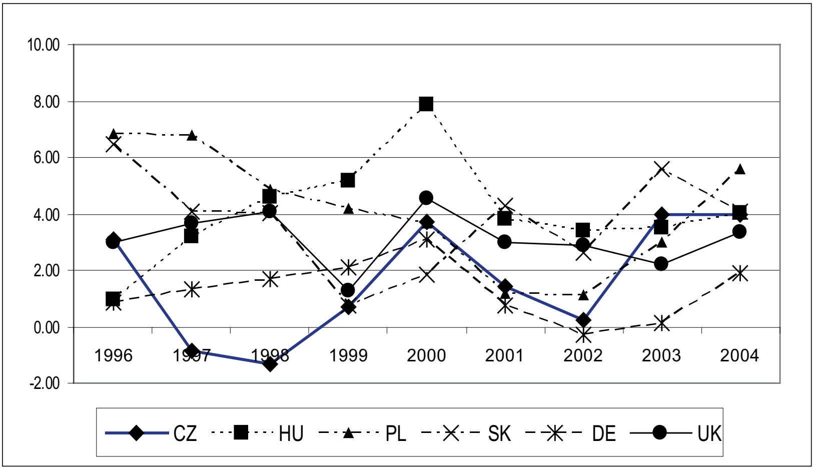
6.6 Expert view on the situation in the Czech Republic

The challenges faced by the Czech Republic, ranging from structural unemployment, unsatisfactory state of transport infrastructure and environment, to low mobility of the labour force, to mention but a few, to a great extent can still be attributed to the legacy of the centrally planned economy under the former Communist regime. In the hope of narrowing regional disparities and securing balanced regional development, the Communist regime chose to engage in major income redistribution and centrally planed relocation of industries, resulting in, for example, strong concentration of mining and heavy engineering industries in certain regions (especially in North-West and Moravia-Silesia).

Even though the redistribution efforts led to narrower regional disparities in the Czech Republic than in the former EU15,[72] the approach laid strong and undeniable foundations for the structural problems we see today in some parts of the country. The past era stands as an important example of what Tsoukalis calls "the risk of government failure" (Tsoukalis 1997). Despite major progress in the Czech Republic during the past fifteen years of putting right the wrongs of the past regime, the legacy of the former system still mirrors itself in the country's structural problems.

From a macroeconomic point of view, economic growth in the Czech Republic is higher than in the former EU15. However, in comparison with the other CEECMS, the Czech Republic rates as average, if not below average (see Graph 6.1). As a relatively small, open and trade-dependent economy, the Czech Republic and its future growth perspectives are to a large extent dependent on the performance of the European economy, especially that of Germany.[73]

Graph 6.1 Rates of growth of GNI at market prices in real terms (%)



Source: Eurostat and own calculations

We would like to begin our discussion of the issues that are important for sustained future economic growth by listing some of the most urgent challenges the Czech Republic is faced with. Even though the following list does not give an exhaustive picture (see the National Development Plan) it should however provide the reader with an elementary view of the current situation of the country.

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[72] As measured in terms of unemployment and GDP per capita levels.
[73] We return to this issue below.

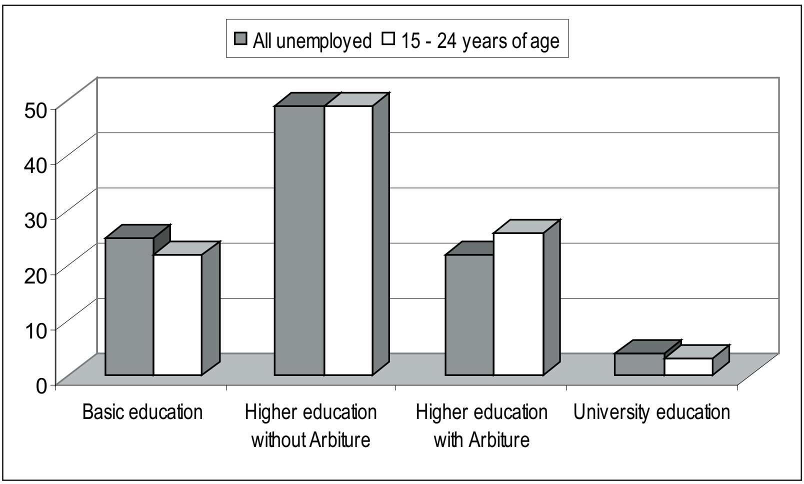
6.6.1 Public finances

The most critical question with respect to Czech economic policy is the question of public finances. As noted, the general government deficit has been rising in recent years and public debt has increased rapidly. Rising deficits and high mandatory spending result in a situation where there is little room for "productive public spending". Especially worrying in this regard are the possible consequences of this situation, should the issue receive less attention than it rightly deserves. The above consequences would certainly include a major decrease in, or complete halt to, investment policies as well as potential destabilisation of the macroeconomic environment.

6.6.2 Labour market and regional disparities

The unemployment rate in the Czech Republic reached 9.65 per cent in February 2005 (CSO). Despite the fact that the employment rate is relatively high and the unemployment rate is close to the EU average, the Czech labour market displays a number of structural shortcomings. First, there are marked regional disparities with respect to unemployment. The unemployment rate in structurally weak regions is more than four times higher than in Prague and in some areas exceeds 20 per cent. This is particularly the case in the northern regions, where structural unemployment has become a chronic problem with many negative consequences, not only for the unemployed but also for the welfare system. Second, the share of long-term unemployed can be regarded as high, reaching 37 per cent of

Graph 6.2 Educational structure of unemployed in the Czech Republic (2004, 3rd quarter)



the total number of unemployed in 2002. The increase in the number of long-term unemployed is a major negative phenomenon. Third, youth unemployment (people under 25 years old) is very high. In 2002, the average share of people under 25 registered as unemployed was almost 17 per cent of the total number of unemployed. Here, too, there were substantial regional disparities. The structural shortcomings in the Czech labour market mirror a low occupational flexibility and a low geographical mobility of the labour force.

It is interesting to consider the composition of the unemployed, particularly with respect to their educational background. Graph 6.2 (data form CSO 2004) clearly shows that job seekers without "arbiture"[74] make up nearly half of the total number of unemployed, regardless of their age. The above only underlines the importance of higher and university education and the need to engage in active education policies.

6.6.3 Employment composition

In comparison with the former EU15 the employment in the secondary sector remains relatively high in relation to the tertiary sector.[75] We should be able to expect that the continuing structural changes in the secondary sector (where a large proportion is still made up of industry) may release more workers, creating additional pressure on the tertiary sector. It can be argued that the absorption capacity of this sector is almost exhausted, due to its level of saturation.

6.6.4 Secondary and tertiary sectors

The most acute challenges of the secondary and tertiary sectors are arguably the relatively low value added of the production in the secondary sector; the relatively low export ability of SMEs; insufficient investment resources; and insufficient development and transfer of new technologies, as well as a lower level of productivity than needed.

6.6.5 Transport infrastructure, technical infrastructure and environment

The qualitative characteristics of the transport infrastructure network do not correspond to the conditions of the former EU15. This has a negative effect on the environment, the development of entrepreneurial activities and on the mobility of the labour force, especially in regions with structural problems. Some parts of the transport infrastructure embodied in the TENs can be regarded as unsatisfactory from the point of view of both current requirements and future needs. The quality and quantity of the

[74] Or what is known as the A levels in the UK.

[75] The secondary sector represents the part of the economy that is devoted to the processing of basic materials extracted by the primary sector and the tertiary sector represents the part of the economy that is devoted to service activities.

technical infrastructure is also being tested to its limits in many parts of the country. The above, together with an unsuitable waste industry, the high energy demands of industry and households in general, a past environmental legacy as well as the low ratio of renewable energy resources, presents a great challenge to the environmental situation of the country.

6.6.6 In the "middle" of the debate

Without prejudice to the fact that this paper focuses on the future of European Cohesion policy from the point of view of the new Member States, what must not be disregarded is the fact that the Czech Republic and its future growth perspectives are closely tied to the performance of the European economy as such. This does not necessarily imply that what is good for Europe is *a priori* good for the Czech Republic, but it does imply that the economic developments in Europe will have a strong impact on the Czech economy. A general view that takes this into account must be put forth before we can adequately discuss the future Cohesion Policy.

In particular, we would like reiterate the conclusions of the Sapir report, which stated that "the EU system has failed to deliver a satisfactory growth performance" (Sapir *et al*. 2003, p. I). The report points out that "growth must become Europe's number one priority" (Sapir *et al*. 2003, p. I) and that growth is pivotal in achieving the economic, social and environmental objectives of the enlarged Union and crucial in helping to fulfil the Union's political objectives. To a great extent the same can be said about the Czech Republic. The most important documents in this regard, the National Development Plan and the CSF, seem to recognise this fact. The National Development Plan states that the "long term aim of the Czech Republic is to reach sustainable growth, which will enable continuous convergence towards the economic level reaching the EU average" (NDP 2003, p. 117). The global objective of the Czech Republic in this regard is then defined as "sustainable development based on competitiveness" (NDP 2003, p. 117). To reach these objectives the Czech Republic has set itself three specific objectives, namely:

1. creating conditions for a business environment;
2. increasing labour market flexibility;
3. improving the quality of the infrastructure.

These objectives are then developed into the following priority axes:

- increasing the competitiveness of industry and business services;
- development of transport infrastructure;
- human resource development;
- protection and improvement of the environment;
- rural development and multi-functional agriculture;
- development of tourism.

The rationale behind the strategy for the shortened period 2004-2006, but no doubt also for the longer term, is to "develop a range of key interventions in a limited number of core areas which will support the strengthening of the competitiveness of the Czech economy by creating the conditions for higher productivity growth while addressing structural problems in the labour market" (CSF not dated, p. 6).

If the above is the goal of the Czech Republic, it is important to note its position in the so-called post-Berlin debate, that is to say, to the debate regarding the reform of the European Structural and Cohesion Policy. First of all the Czech government fully supports the policy's goals embodied in the Treaty and wants to see a continuation of the Cohesion Policy in the future. In this sense it can be argued that the Czech government leans towards the values of social market economy as defined by the Commission in 1996,[76] that is to say, towards the objective of creating a system of European liberal democracy capable of regulating markets, redistributing resources and shaping partnership among public and private actors in the European arena (Hooghe and Marks 2001). One could argue that this view is to a certain extent coloured by the fact that the Czech government has been dominated by the Social Democratic Party since 1998. However, were the system entirely left to the mechanisms and logic of the market forces, there is arguably a grain of truth to the argument that it would take too long to secure a socially desirable equilibrium.

The Czech position in the post-Berlin debate closely corresponds to the goals and objectives of the country's National Development Plan. What is interesting to note is that the Czech Republic does not take a clear stand in the ECP debate. Arguably, the Czech Republic, while agreeing with the need of retention of the Cohesion Policy on the one hand, seems to support certain attributes of what has been called a re-nationalisation of the Cohesion Policy. It will become clear that the Czech government does not protest in principle to a certain level of open method of co-ordination (OMC), also titled a "framework for devolved regional policy" by the UK (Rawlins 2003), or what Austria titles the "light governance approach" (Austria 2003). The Czech position should be divided into three parts.

1. *The philosophy of the policy* (or the underlying principles). As stated previously, the general view is strongly leaning towards solidarity and, which will become clear later, also arguably towards the New Growth Theory. Particularly the need for retention of the principle of concentration, or, so to speak, a philosophy of "positive discrimination" (concentrating funds into the least developed regions), is frequently signposted.

[76] This model "seeks to combine a system of economic organisation based on market forces, freedom of opportunity and enterprise with a commitment to values of internal solidarity and mutual support which ensures open access for all members of society to services of general benefit and protection" (COM 1996, p. 13).

2. *The objectives of the policy*. On the level of objectives of the Cohesion policy an intrinsic link is made to the Lisbon Strategy. The need to support the innovation processes in the economy is strongly emphasised, including support for the implementation of information technology, thus enhancing competitiveness. Furthermore, it has been suggested that the Cohesion Policy should primarily take into account the goals of sustainable territorial development, adaptation of human resources to labour market conditions and infrastructure development. Obviously, a strong link to the Czech National Development Plan can be detected here. Moreover, it is arguably fundamental that the Cohesion Policy instruments regarding employment and social integration should be developed on the basis of the national action plans and not the other way around. This represents a clear move towards the notion of proportionality.[77]
3. *The delivery principles*. Here too we can see a move towards proportionality. First of all, a definition and clarification of the role, relations and powers between the European Union, Member States and individual regions are believed to be key issues. It can be also argued that the need for a certain level of OMC is proposed in many ways, shapes and forms, as the need for decentralisation in the enlarged Union is viewed as acute. It is further suggested that different levels of co-funding should be used and that more developed Member States should be capable of providing more national resources for their underdeveloped regions than poorer Member States.[78] In addition, more emphasis on OMC is implied with respect to the use of Structural Funds and the Cohesion Fund in the Member States receiving assistance from both, as it is suggested that the ration between the above instruments should be decided on the basis of the priorities of the given Member State. Joining a long cue of countries, the Czech Republic has made it clear that a simplification of the regulation of the Structural Funds and the Cohesion Fund is desirable. In this regard the Czech Republic does not shy away from suggesting directions. For example, it has pointed at the need to simplify administration and implementation procedures, reduce the number of program-

[77] As defined in the draft of the Treaty establishing the Constitution for Europe. Title III, Article 9(4) states that "under the principle of proportionality, the content and form of the Union action shall not exceed what is necessary to achieve the objectives of the Constitution".

[78] This view arguably correlates with that of Germany, Netherlands, Austria, Sweden, Denmark and the UK. Nevertheless, the proposals supported by the above Member States would with some certainty mean a decrease in funds for the ECP, which is clear from the UK position (the UK government stresses the necessity of a fair budgetary deal for the UK taxpayer; see UK, 2003b) and Sweden (who views the 0.45% threshold of the EU GDP on the Structural Funds budget as unacceptably high; see Sweden, 2003, p. 1). Interestingly, the Czech government has stated that the volume of EU funds for the Cohesion Policy should be sufficient to allow for the goals of the new ECP to be fulfilled, but does not provide any further details.

ming documents, and the need to find a solution to the demanding financial management, or to at least provide a clearer definition for recognising costs. Finally, the Czech Republic proposes to create a single fund in the future.

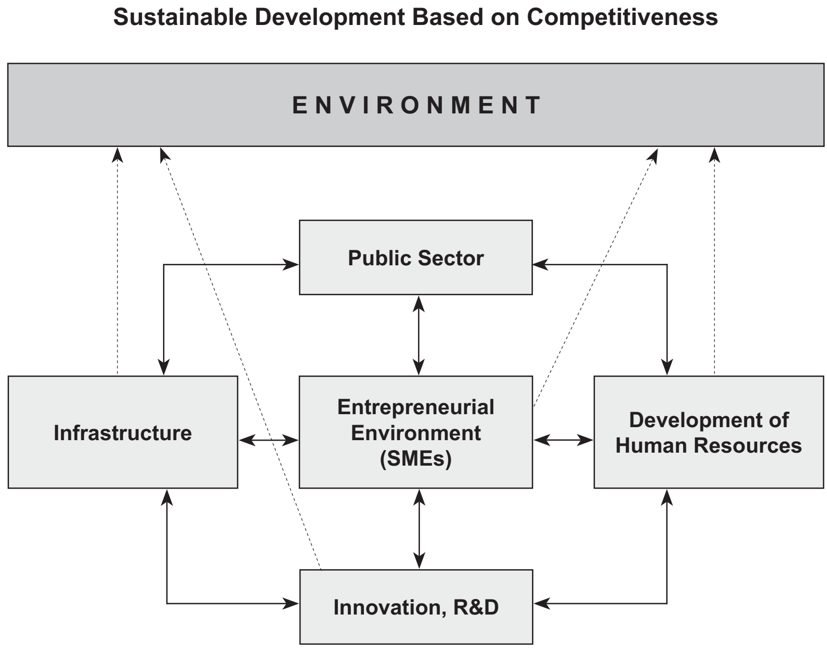
6.6.7 Sustainable development based on competitiveness

As noted, the problem of the public finances in the Czech Republic is the most critical issue as regards its economic policy. The current situation may have far-reaching consequences and the reform of public finances should be the number one priority; not only for the government, but for the whole political spectrum. The imminent question to ponder is whether the European Cohesion Policy can play a valuable role and provide added value in this regard.

Clearly, the large government deficits and public debt must be stabilised. Furthermore, cuts may also have to be made in mandatory expenditures. The current situation seems to "strangle" what the National Development Plan calls a "productive public spending" (NDP 2003). On the other hand, the result of a reform that has not been meticulously planned may be equally disheartening. A cut in the national budget could endanger the application of the National Development Plan and put into question the Czech ability to co-finance assistance from the Structural Funds and the Cohesion Fund. It can therefore be argued that in the long term, public finances can be improved through five intrinsically linked directions (or priorities). Furthermore, it can be argued that, although it may not be apparent, the ECP has a fundamental role to play.

Let us therefore return for a moment to the Sapir report. The argument put forward by Sapir, stating that economic growth should be viewed as the means of achieving the economic, social and environmental objectives and should be understood as an underlying principle of the Czech Republic's economic and structural priorities. Furthermore, it is clear from the Czech position regarding the post-Berlin debate that the country hopes to choose an approach that does not promote "growth at any cost". Rather, it should promote sustainable growth based on competitiveness (NDP 2003), conscious of the fact that market failures do exist and should be (to a certain extent) addressed. While by no means denying the global and specific objectives of the National Development Plan, Figure 6.1 attempts to "renegotiate" the priorities and objectives into a form that could be seen to be intrinsically linked to the short as well as the medium term needs of the Czech Republic. Notwithstanding applicability and logic, it can be argued that some parts of the NDP have been designed to fit with the Cohesion policy's objectives and could be approached, at least from the Czech point of view, through different ways and means. What springs to mind is, for example, priority axes 5 and 6, titled Multi-functional Agriculture and Development of Tourism.

Figure 6.1 Renegotiated priorities of the Czech Republic



The public sector

What seems to be fundamental as regards the situation with the public finances, bearing in mind the need to secure "productive public spending", is the need to reform the public sector. Institutional failure undoubtedly contributes to the weakening of positive motivation of economically active entities. The competitiveness of an economy – and, indeed, the quality of the development of the whole society – is conditioned on the quality of its institutions, which helps to create the basic framework for the activities of the different spheres of society.[79] Institution building, institution capacity and institution learning have played and continue to play a crucial role in the risk of government failure (Tsoukalis 1997). If it is argued that, on the basis of the quality of institutions, "the prospects for effective use of Structural Funds in the (then) accession countries are limited" (Ederveen, de Groot and Nahuis 2002, p. 17), then this line of reasoning implies that the quality of institutions in the new Member States (including the Czech

[79] This view is supported by *inter alia* Sapir *et al.* (2003); Ederveen, de Groot and Nahuis (2002); and Bailey and De Propris (2000).

Republic) is far from satisfactory. This problem has been recognised by the Commission (COM 2002). According to the proposal for the future ECP, the Commission wants the "adaptation of public administration to change through administrative and capacity building" (COM 2004b, p. XXVIII). This still seems to be an important place for the Cohesion Policy.

The policy can help in what can be paraphrased as the "adaptive efficiency" of the public institutions (North 1990; and Cortright 2001). From a practical point of view, the primary focus should lean towards personnel and process audits of the public sector. Furthermore, IT and language proficiency must not be forgotten. Arguably, more use of information technology, e-government and the creation of "one contact points" are also fundamental. In addition, continued institution learning[80] based on the exchange of experience and OMC should not be underestimated. Even though it is a long term goal, increased effectiveness of public institutions is arguably a pillar prerequisite for a well functioning society and economy, as these institutions can be said to "draw the rules of the game". The above contribution should – in the sense of the Sapir report's proposals – be conducted on the basis of an increased conditionality approach, through the "output logic" (goals reached) rather that "input logic" (money spent). Finally, it should be underlined that what is generally needed is a more proactive approach from the public sector towards those who have the potential to become the beneficiaries of the Structural Funds. What we mean by this is that one should attempt to go beyond information campaigns and follow them up with what could be called a qualitative, rather than quantitative, approach. It is thus important to engage in a dialogue prior to the application stage.

Innovation, R&D, technology and human resources development

The need to support innovation, R&D, technology and the need for a continued development of human resources do not only stem from the premises of the New Growth Theory, which claims that knowledge and innovation, as well as investment in human capital, drive economic growth and that an economy that "rewards" innovators will grow faster. Similarly, the need not only stems from the goals of the Lisbon strategy. Arguably, the underlying need is also more basic, but equally valuable. The Czech Republic does not possess many natural resources. The only way for the country to secure growth is through a continuing reorientation towards a knowledge based economy while trying to increase the value added of its output. This can only be secured through focusing on the above objectives. In this regard a much stronger connection must be established between the private sector and educational institutions. Thus, education could take on a more practical and project oriented form and structure. The content of

[80] On all levels: state, region and municipality.

education, especially in industry orientated schools and universities, should focus on broadening the practical skills of its students, ranging from project management, teamwork and communication skills to the implementation of solutions in industrial environment and the involvement in real problem solving. The opening of departments in education institutions from other EU Member States should be actively supported.

It is important to note that there may be a possible risk related to innovation, R&D and technology, which is the so-called "cumulative gravitation mechanism". The cumulative gravitation mechanism results in regional growth clusters, which Hitiris, on the basis of Myrdal (1957), titles "poles of development", causing "intra-country polarisation" (Hitris 2003, p. 222). In other words, already developed regions continue to grow at the expense of relatively backward regions, which are experiencing cumulative economic decline and become further handicapped. The implication of this line of reasoning is that funds should be directed to regions that need to undergo structural change. In practical terms, investments should foster or attempt to lay the foundations for the creation of new growth poles and their potential spread effects, rather than be directed towards the current growth poles (e.g., Prague), potentially magnifying what Myrdal (1957) called "backwash effects". This indicates in turn a need for further enforcement of innovation centres through venture funds and PPP. The plan by the Czech Ministry of Industry to establish a special venture capital fund therefore seems particularly promising (Bautzova and Hrstkova 2005). It goes without saying that the promotion of innovation centres in the structurally weakest regions must be accompanied by with investments in human capital and infrastructure. Projects based on the OMC approach, aiming at knowledge and experience exchange by creating the so called "flexible education system" (NDP 2003, p. 123) should be increasingly encouraged. An attempt at promoting the mentioned "output logic" should be strongly emphasised. Some of the indicators of success could, for example, be the following:

- Output value added
- Increase of export output (composition of export output)
- The ration of high-tech sector employment
- The number of unemployed per one job offer

Infrastructure and environment

Both transport and technical infrastructure play a pillar role for the future development of the country; for many different and intrinsically linked reasons. Not only will the quality of the infrastructure help to intensify economic activities, it will also help to promote greater mobility of the labour force (especially in a relatively small country as the Czech Republic). At the same time the quality of infrastructure has an immense impact on the environment. For example, the unsatisfactory state of the Czech transport infrastructure, in every sense of the word, shows that there is a clear link to the state of the environment. This link has been further accentuated after the accession of the Czech Republic to the EU, as the transit transport has risen by 50 per cent between May 2004 and May 2005.

The TENs cannot be the only priority with respect to transport infrastructure in the future. The creation of a quality transport infrastructure to and within structurally weak regions must also be regarded as an immensely important priority. Furthermore, trans-border infrastructure in and between the border regions must be supported. As regards the technical infrastructure, waste policy and energy consumption are arguably the key elements. For example, Structural Funds in conjunction with private capital might successfully cooperate to revitalise ageing housing stocks, which has proved to be unsatisfactory with respect to energy consumption. This approach could secure energy savings of as much as ten per cent of total household consumption. Once again, the need for "output logic" and increased conditionality is apparent. It can be argued that the "output logic" approach can secure the value added of the Structural Funds and the Cohesion Fund.

Entrepreneurial environment

The support of an entrepreneurial environment and of SMEs must be viewed as essential. The development and expansion of SMEs have a great impact on the overall stability and performance of the economy. Furthermore, SMEs poses a great level of adaptability regarding market demands, and has proven to be an important engine in the creation of new employment opportunities. In this regard the emphasis must be put on the enhancement of a good entrepreneurial environment, an environment where legislation and the concerned public administration motivates rather than demotivates entrepreneurship, that is to say, an environment where the playing field is levelled and just. To this end the Structural Funds can, in the future, play an immensely important role. As Figure 1 suggests, the enhancement of a good entrepreneurial environment, as well as the support of SMEs, should be a key priority, but only as a part of intrinsically linked and mutually supportive activities and priorities., such as connection between education, research and business activities, investment into transport and technical infrastructure, support of lifelong learning, to mention but a few.

6.7 Conclusions

It is important to note and underline that the Czech Republic undoubtedly has benefited from its year-long membership in the European Union – and on many levels. With relatively strong growth and exports, low inflation and low interest rates, the country has the potential to sustain its promising growth path. In addition, the general course set by the National Development Plan, which seeks to "develop a range of key interventions in a limited number of core areas which will support the strengthening of the competitiveness of the Czech economy by creating the conditions for higher productivity growth while addressing structural problems in the labour market" (CSF not dated, p. 55), also seems to be the right course to take. Nevertheless, major challenges lay ahead. The problem of how one should create the conditions for higher productivity is the most fundamental challenge of all and there is no simple solution to this problem.

European regional policy has an immense role to play in helping to create the right conditions for economic growth. As noted, the support of an entrepreneurial environment and of SMEs is essential. In this regard the emphasis must be put on the enhancement of a good entrepreneurial environment, an environment where legislation and the concerned public administration motivates rather than de-motivates entrepreneurship; an environment where the playing field is levelled and just. But this must not be the sole focus of the policy. If economic growth is to be sustained, especially in the Czech Republic, it has to be based on innovation, R&D and new technologies. First and foremost, it must be an economic growth that is anchored in the development of human resources. To this end, what is arguably needed is more "output logic" in the whole policy rationale and more OMC approach with regards to the priority setting.

From a broader point of view, it is certain that EU regional policy has its place in today's Europe. The post-Berlin debate made it clear that some of the fundamental issues, namely those centring on the philosophy, scale and spread of the policy, may be a source of severe tensions when the future ECP is up for its final deliberation in the Council. After nearly half a century of European integration the respective Member States' governments seem to be deeply entrenched in positions that can only be titled *juste retour*. Thus, the time has come when we ought to reflect on the past and begin to debate the underlying and fundamental question of the European integration: Is the European Union a Union of Member States or a Union of peoples? Such a debate would in turn undoubtedly reflect on the future European regional policy.

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7 SLOVAKIA AND COHESION POLICY

Karol Frank, Veronika Hvozdíková and Vladimír Kvetan

7.1 Introduction

Regional development in the European Union is constantly changing and it is a process that poses a number of challenges to the new Member States. Most of them have undergone an economic transition that has represented a tremendous challenge, unparalleled in their modern history. European integration and the Cohesion Policy combined are therefore seen as a possibility to accelerate and successfully catch up with the market economies of the EU15.

Slovakia began its transition process in 1991 as a part of the Czech and Slovak Federative Republic (ČSFR). The new federal government, formed after the collapse of the Communist regime, started to prepare for a legislative, economic and administrative reform in the beginning of 1990 (Morvay 2005). By the end of 1990, the economic reform was presented to the public. The main tasks of this reform were fast and massive privatisation; price liberalisation and liberalisation of foreign economic relationships; macroeconomic balance; and the establishment of a social security system. The reform also carried with it a restrictive monetary and fiscal policy regime; a mechanism of internal convertibility of the currency; exclusion of the circulation of foreign currencies in the economy; and a depreciation of the Czechoslovak Koruna of more than 80 per cent. Furthermore, the basic goals of Structural Policy were also specified.

With the formation of Slovak Republic on 1 January 1993,[81] the process of building the necessary institutional framework for an independent state took off. However, lack of experience, insufficient human capital, various structural problems, controversies as regards the transition method, inadequate administrative capacities, a low level of law enforcement and other problems seriously hampered this process.

During 1994-1998 Slovakia underwent the so called “Own way of transition” as a reaction to the federal transition strategy, which it opposed. In 1995 Slovakia applied for EU membership. Although becoming a part of the European integration was one of the most important priorities of the government, the actual outcome was quite the opposite. At the Luxemburg Summit in December 1997, the European Council decided not to open

[81] The unsolvable situation as to the competencies between national and federal levels was one of the crucial factors that led to the split. Another important reason was the different impacts of the transition process on the social situation on the national level. Conversion of heavy military industry, deep structural problems of the Slovak industry and the so-called “radical” way of transition had a severe impact on the economical and social situation in entire regions. The necessity of a deeper social consideration thus became an important topic.

accession negotiations with Slovakia. The main arguments provided in Luxemburg were the instability of constitutional institutions and the democratic deficit.

After the 1998 parliamentary election a new government with a different policy orientation (as compared to the 1994-1998 government) brought with it a change in the Slovakia-EU relations. Slovakia was persistent in its efforts to fulfil the Copenhagen criteria, which eventually paid off as it led to an invitation to open accession negotiations in December 1999 in Helsinki.

After 1999 Slovakia underwent a substantial shift in economic policy and political development and has since implemented substantial economic reforms, including reforms of the tax, pension, healthcare, welfare and social security systems. Although the reforms have created the necessary conditions for overall macroeconomic stability, substantial regional disparities still exist in Slovakia.[82]

Our contribution strives to present a Slovak perspective to the discussion about the future ECP and present our vision of this policy on the premise that it should form a forceful regional policy in the EU in general and in Slovakia in particular.

7.2 The experience of Slovakia with pre-accession support

The pre-accession instruments have played an important role in the integration process. The availability of pre-accession assistance for economic development (PHARE), for environment and transport (ISPA) and for agricultural and rural development (SAPARD) has paved the way for the substantial increase in funding that has taken place since accession in 2004.

7.2.1 PHARE

At the present time, four PHARE Implementing Agencies are in operation.[83] The PHARE support was based of Financial Memorandums 1998-2002. The pivotal fields for the use of PHARE support have been the pre-accession activities and infrastructure building. The key objective of the PHARE support has been to enact and strengthen transparency in the process of gaining and using the resources to avoid dispersion of funds. Significant progress in the fields of programming, coordination and improving administrative capabilities has been achieved in recent years.

[82] See chapter 3 for empirical data.

[83] The Central Financing and Contracting Unit (CFCU), the Slovak Post-Privatization Fund, the National Agency for Development of SMEs (NADSME) and the Regional Development Support Agency and the Civil Society Development Fund (CSDF).

The Central Financing and Contracting Unit (CFCU) has proven to be effective in handling the financial administration of PHARE's "Institution building" projects. CFCU was the main consumer of the PHARE funds in the years 1999-2003 (nearly 75 per cent of PHARE resources).

The Regional Development Support Agency (RDA) was responsible mostly for implementing Cross-Border Cooperation programmes, building the infrastructure for Roma communities and also for most of the economic and social cohesion projects. The main problem of Implementation Agency (IA) RDA had mainly to do with a relatively low rate of contracting. Enormous efforts have been made to strengthen the administrative capacity within the Agency, but progress is still needed in management capabilities and in project implementation in order to pave the way for an optimal utilisation of future cohesion assistance.

The largest infrastructure projects were related to highway network development (Bratislava-bypass Mierová), while the most tangible project based on Cross-border Cooperation (CBC) was the construction of the bridge over the Danube River (connecting ?túrovo in Slovakia with Ostrihom in Hungary). The PHARE community programmes were mostly oriented towards research (the 5th Framework Programme), education and culture. Only a small share was used to supporting SMEs. One of the weaknesses in the utilisation of the funds was timing, because a lot of sources were only tapped at a very late stage in the process, which was mainly due to problems in public procurement.

7.2.2 ISPA

There were substantial difficulties as regards ISPA environment projects in Slovakia. It took two years to start the environmental projects, mostly because of a lack of suitable projects. In 2002 the number of projects in force allowed Slovakia to obtain more than its average allocation. The programming improvements have also been matched by a steady improvement in implementation.

Almost all funding of environment projects has been channelled to heavy investments in the water sector. The active involvement of regions' and municipalities' water companies was crucial for the technical and environmental preparation of the 18 ISPA drinking water and waste water projects. Only one non water sector project was launched in 2003, namely an air pollution project.

The transport sector was performing well right from the start, mainly because of the good preparation of infrastructure projects in the years 1996-1998. During these years, substantial infrastructure construction took place, financed by government expenditures. In 1998 the government changed and so did the attitude towards government investments in transport infrastructure. The necessity to reduce the budget deficit led to a decrease in the number of government investment projects. After the introduction of ISPA, however, “old projects” could be used to obtain “new” resources.

The most important impact of the ISPA programmes as regards the rail sector was the renovation of a substantial part of the important international TINA/TEN corridor V.a between Bratislava and ?ilina. Concerning roads, the financing of the city motorway between Vienna and the Riverport Bridge (bypass in Bratislava) closed an important strategic gap, at the same time linking the TINA/TEN corridors V.a (Venice-Trieste/Koper-Ljubjana-Uzgorod-Lvov) and VI. (Gdansk-Grudziadz/Warsaw-Katowice-Žilina).

The administrative staff has increased in the implementation agencies established in the relevant ministries. While the increase was higher than the Commission’s recommendations, the low salaries made it difficult to recruit staff with adequate knowledge, experience and background and the substantial turnover has continued to pose a threat to efficient programming and sound implementation. In particular, young staff have often left the Ministries for the private sector shortly after gaining sufficient experience.

7.2.3 SAPARD

Slovakia obtained accreditation in only five objectives on 15 April 2002 based on the SAPARD programme on 15 April 2000.[84]

The most significant problems with respect to the implementation of projects concerned the poor accessibility to free resources, difficult conditions for basic industry and unfortunate climatic changes (floods in 2002, freezing spring and dry summer in 2003). Insufficient compensation for these climatic changes affected the number of proposed projects mostly in the objective No. 1 Investments to agriculture enterprises.

7.2.4 Main achievements of the pre-accession support

The pre-accession assistance for economic development (PHARE), environmental and transport (ISPA), and agricultural and rural development (SAPARD) has paved the way for the increase in funding from the Structural Funds in 2004-2006, essentially in the same sectors. Some of the positive achievements to date – bearing in mind that programmes are still being implemented and results are still coming in – are the improvements as to the administrative capacity and the increase in experience that the pre-accession instruments brought with them. They will be vital in-

[84] No. 1 – Investments in agriculture enterprises, No. 2 – Improvement in manufacturing and marketability of agriculture and fish products, No. 4a – Diversification activities in rural area and non-infrastructure investment, No. 5 – Forestry, No. 7 – Land adjustments. Accreditation for the remainder of the objectives (3, 4b, 6, 8, 9) was obtained on 14 August 2003.

gredients in the utilisation of the Structural Funds and they will hopefully help Slovak institutions overcome the obstacles that we describe later in the text.

Regarding the absorption capacity, Slovakia has so far been able to draw approximately 95 per cent of the resources available through the PHARE and SAPARD programmes and 120 per cent of the resources available through ISPA.[85] The case of ISPA proved that it was possible through special effort to draw support at the end of the programming period, despite contracting problems. However, the overdrawing of ISPA support owed more to huge transportation infrastructure projects than to a radical qualitative change in managing and contracting.

That having been said, there has been no evaluation of the pre-accession instruments by either government officials or independent researchers in Slovakia[86] and it is therefore not possible to state with any certainty their *real economic impact* on overall economic development.[87]

7.3 Cohesion Policy in the accession negotiations

Slovakia started accession negotiations in March 2000, two years later than the other Visegrad Countries. The delay was mainly due to political reasons and it meant that Slovakia was placed in a disadvantageous position in the negotiation process from the very beginning. The main problems related to negotiations were mostly of an internal nature. When negotiations were opened, Slovakia had not elaborated a coherent regional policy strategy that could have served as a basis for the negotiations. Also, the preparation and drafting of the National Development Plan was both inadequate and delayed.

In addition to these complications, there were also other internal problems. Above all, uncertainty about the territorial and administrative division of Slovakia; negotiators with poor experience who did not have all the relevant information; struggles over competence between regional bodies, central government and municipalities; and the obligation to press the schedule in the negotiation process, produced an outcome that was not optimal. In many cases Slovakia accepted statements and proposals from the Commission and, from our point view, applied a quite passive approach during the negotiations that concerned Slovakian economic priorities. Examples of specific restrictions that discriminated the efforts and require-

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[85] The figures reported here are estimates made at the end of 2004 by the Ministry of Construction and Regional Development of the Slovak Republic.

[86] The ex-post evaluation of PHARE projects in 1997 and 1998 (which was published in 2001) focused on 16 selected projects. The overall economic impact of PHARE support was not evaluated.

[87] Evaluation of the NDP for 2004-2006 and the ex ante evaluation of the National Strategic Reference framework for 2007-2013 is currently in progress in Slovakia.

ments of Slovak applicants were certain restrictions in agricultural and rural development, where the food sector was excluded from EU funding (eligible applicants for the Sectoral Operational Programme Agriculture and rural development were only agrarian-processing subjects in accordance with the rules of the ECP). Some very important industries in Slovak regions were also excluded from support (such as mining and the steel industry).[88]

The Ministry of Environment had from the very beginning serious problems exploiting the ISPA financial limit for environmental projects. As late as 2000, none of the environmental projects submitted to Brussels had been accepted, six of them because they lacked the necessary documentation (such as the lack of a financial plan). The Ministry of Environment was unable to provide in time the basic information on ISPA criteria to the municipalities in time. Moreover, there has been no tradition of large environment infrastructure projects in Slovakia. In the year 2000 Slovakia lost ISPA environmental support worth of €4 million, money that was instead transferred to Slovenia.

The described problems are mainly explained by the nature of ISPA, as its priorities are centred on projects in large agglomerations. For instance, in the field of water sewage purification, the recommended costs for ISPA projects are a maximum of €500 per capita. However, since environmental liabilities in Slovakia are the greatest in the field of canalization and sewage plants building – especially in small settlements and villages – projects have often exceeded the maximum recommended per capita cost.[89] Even though the Slovak delegation has asked for a more flexible approach on several occasions due to the specific conditions of the country, the rules of ISPA have remained the same for all participating countries. The low-water mark for ISPA projects in Slovakia was reached in 2001, when only one environmental project was accepted and Slovakia lost approximately €20 million worth of ISPA resources as a consequence. After 2002 the situation has changed. Despite the initial problems, however, the situation changed in the following years and Slovakia has since been able to utilise the ISPA resources to approximately 120 per cent, as measured over the entire pre-accession period.

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[88] The National Development Plan of the SR (NDP SR) for the period 2004-2006 introduces four programming documents, one Operational Programme (OP Basic Infrastructure) and three Sectoral Operational Programmes (SOP Industry and Services, SOP Human Resources and SOP Agriculture and Rural Development) for Objective 1. As regards Objectives 2 and 3, NDP SR determines one Single Programming Document (SPD) for each of them.

[89] The high per capita cost in ISPA projects were in most cases caused by the low urbanisation level in Slovakia. There are only two agglomerations in Slovakia (Bratislava and Košice), in specific cases other regions had to form so-called “microregions” in order to be eligible for ISPA support.

As regards the positive features of the negotiation process, the opening of negotiation chapter 21, “Regional policy and coordination of structural instruments”, at the end of March 2000 had a very positive effect on the adoption of legislation related to the implementation of EU regional policy in Slovakia. At the end of 2001 the Act on the Regional Development Support, the Act on Financial Control and Internal Audit, the Act on the State Statistics and the Act on the State Treasury, were adopted. At the same time, the National Monitoring Committee was established and in January 2002 the ex ante evaluation of the SR National Development Plan by independent experts was completed and submitted to DG Regio and DG Enlargement. The legislative steps for the implementation of European regional policy invoked by the accession negotiations served as a base for the accession process. Negotiations on chapter 21 were preliminarily closed in July 2002, which meant that Slovakia fulfilled the basic legislative conditions of the ECP.

7.4 Selected problems, barriers and obstacles related to Cohesion Policy in Slovakia

This section is thematically divided into two contiguous parts. The first part describes the situation with respect to regional policy, public administration and management of the regions at the time when pre-accession support was launched. The second part outlines some concrete provisions of the ECP that have created considerable obstacles in EU-funding in Slovakia, with a special emphasis on the problems in lagging regions.

7.4.1 Background – Regional division of Slovakia

A special situation regarding EU pre-accession support was caused by an ongoing regional reform, which brought about a complete change in the regional structure in Slovakia. Three Slovakian regions (Western, Central and Eastern Slovakia) were revoked and the country was instead divided according to a new territorial architecture. The result was a new self-government structure,[90] where the newly formed municipalities required new regional offices, new administrative capacities and new management. However, due to a lack of management experience in the regions in the regional self-governing bodies, along with a weak partnership between these bodies, the new agenda has continued to be a source of substantial delays and problems with respect to EU funding.

7.4.2 Decentralization of public administration

Administrative capacities with the appropriate competence at the local and regional levels are essential to correctly prepare for support from the

[90] Since 2002 Slovakia is territorially divided into 8 upper-tier territorial units, so-called VÚC.

Structural Funds and the Cohesion Fund. Furthermore, they need to be sufficiently equipped so that they are able to prepare and implement development projects in partnership with national bodies. Like the other CEECMS, Slovakia has been characterized by a high level of centralisation and, as a consequence, there has been a total absence of any regional structures from the very beginning of its existence as an autonomous country. The basic principles of an integrated regional policy were defined in 1991 (as part of the federal transition strategy), but the first *Integrated plan of regional development* – which was necessary to enable the country to apply for pre-accession support – was adopted by Parliament only in 1999. The *National plan of regional development* required for programming of post-accession support was adopted in 2001, the very year when the decentralisation of the public administration was initiated. However, the municipalities obtained competencies for regional planning only in 2002[91] and they still did not have enough time for building up efficient administrative capacities for implementing the *Principle of Partnership* (Vojteková 2004).

In addition to insufficient experience with programming and planning at the regional and local levels, there were also delays when the methodology of regional planning for municipalities were prepared and released. This did not exactly strengthen the partnership between national and local levels in creating a strategy of regional development. The methodology handbook for elaborating the *Plan of regional economic and social development* was prepared by the Ministry of Regional Development and Construction and adopted only in 2004.

7.4.3 Fiscal decentralisation

The concept of Decentralisation and Modernisation of Public Administration that introduced the principles of fiscal decentralization in Slovakia, *Conception of Decentralization and Modernization of Public Administration*, was prepared within the framework of the process of the above mentioned regional reform in Slovakia. The document (Conception) determined two phases of fiscal decentralisation[92] and outlined the new legislation on budgetary principles for regional governance.[93] However, the launch of the fiscal decentralisation, primarily planned for 2004, has been delayed one year.

[91] The process of competences transfer from the national level to the new self-governing territorial units was planned for the period 2002-2004.
[92] During the transition period 2002-2003 the activities of VÚCs and municipalities had to be financed by grants from the State Budget.
[93] The list of taxes in the competence of regional governance bodies, the structure and principles of sources redistribution, principles of financial management, budgetary process of municipalities, etc.

Although the new legislation was adopted in 2001,[94] regional self-governing bodies still dispose of limited possibilities for putting their competence into practice. As mentioned, moreover, the fiscal decentralisation has been initiated only in 2005. Since the financial tasks are still rather centralised, serious questions have arisen after the launch of the fiscal decentralization process, especially regarding the cooperation between regional (VÚC) and local self-governing bodies (municipalities). The experience of the municipalities in the Trenčín region (VÚC Trenčín) serves as a good example. In accordance with the decentralisation process, the responsibility for preparing the *Economic and social development plan*[95] falls on the municipalities on the local level, but the financial resources are allocated to the regional lever (VÚC). Unfortunately, the VÚCs do not perform this duty in a satisfactory way. The financial coordination between local and regional levels is thus rather deficient.

The delay in implementing the decentralisation reform caused problems as regards the preparation of regional structures (mostly at the municipality level) for the process of EU Funds exploitation in the period of 2004-2006. Without fiscal decentralisation and the completion of the public administration reform, formation of public resources on the local and regional level necessary for supporting the socio-economic development of regions is impossible. Thus, an initiator and coordinator of endogenous development of the regions is absent (Benč *et al.* 2004).

7.4.4 Delays in preparation of strategic documents

In addition to the above mentioned caveats, the insufficient administrative capacity – such as problems in inter-ministerial coordination, long-lasting lags in legislative adaptation and other problems – delayed the preparation, coordination and adoption of the necessary strategic Cohesion Policy documentation. As noted previously, the first national plan for regional development for pre-accession support was adopted in 1999, for post-accession funding in 2001, but the actual National Development Plan only in March 2003. Individual ministries were late in preparing the grant schemes for smaller projects and compared to neighbouring countries they were approximately a year behind schedule. Consequently, the delayed process of documentation and legislative preparation hindered accreditation of the implementing agencies. However, the lag observed during the pre-

[94] A portion of the competencies regarding regional development has been moved from the national level to the competence of VÚCs, such as preparing regional development plans and programmes; participating in the preparation of the National Development Plan; approving and implementing the Cross-border Cooperation programmes; monitoring the socio-economic development of the regions; ensuring that the financial resources for overcoming regional disparities are adequate; coordinating the activities of municipalities, etc.

[95] This document represents an important strategy for exploiting future EU funds and also serves as a base for elaborating the development plan on the national level.

accession period was adjusted at the final phase of preparation for the Structural Funds. After the Commission had adopted the basic documents required for initiating Structural Funds exploiting in December 2003, Slovakia launched the first call for a Local Infrastructure priority (Operational program Basic Infrastructure) on 19 January 2004 (it was a second call from all acceding countries).

7.4.5 Obscurity and complexity of strategic documentation

The National Development Plan that was adopted in 2003 was designed in too complicated a way and even though it was reduced from an initial 11 operational programmes to 4 in the final concept (Basic infrastructure, Industry and Services, Agriculture and Human Resources) it remained quite obscure. Also, the structure of other documents in their final form has often been unintelligible for the applicants, which has led to formal mistakes in project preparation. The reduction of elementary documentation types[96] and the simplification and unification of rules in the next period 2007-2013 will be very welcome.

7.4.6 Administrative and capacity building

The huge administrative and human capacity problem was observed in both the state authorities and in the regional and local public bodies and agencies, as well as on the side of the applicants. It is indeed hard to build an appropriate administrative capacity when the experience of such processes is lacking and finances to motivate already trained personnel are absent. A noticeable fluctuation of ministerial human resources can therefore be observed in Slovakia. Also, poor coordination between ministries at the beginning of the process caused additional administrative confusion.

The administrative requirements in project preparation represent great obstacles for potential applicants. In general terms, one might conclude that; the smaller the project, the greater the abundance of administration. In other words, the cost-benefit ratio will be excessively high in smaller projects, since administrative costs will not be matched by the benefits drawn from the projects, especially when compared with larger projects. Administration thus represents a substantial barrier for small entrepreneurs. The question is whether the principle of proportionality in the new ECP will help solve this problem. The idea of proportionality with regard to audit controls and administrative requirements is definitely a positive feature in the Commission's proposal, but the principle is extended only to a limited number of programmes and administrative requirements. In our opinion, the proportionality should to be extended to a larger number of

[96] Regional, Sectoral Operational Programmes for Objective 1, Single Programming Documents for Objective 2 transformed into Operational Programme for each Objective; no programme complement.

programmes and projects. One example concerns management costs in accepted projects, which could either be reimbursable or, possibly, included into eligible costs. Also, the reform of the evaluation process – whereby in the first stage of the evaluation process no complete project proposal will be required – may be very helpful with respect to Slovak conditions.

7.4.7 Experiences with programming and regional planning

The lack of necessary experience to successfully prepare and implement projects, along with almost no previous experience of regional planning (due to the Slovakian history of being a centralised economy), resulted in a situation where Slovak applicants were not only ill-informed, but where some of them did not even understand the principle of EU funding. Some of the projects at the beginning of the pre-accession period were prepared with the sole aim of gaining financial support; there was neither any estimation as to the real impact of the project on the region, nor were there considerations of whether the projects had even the slightest chance of becoming profitable.

7.4.8 System of project evaluation

The evaluation process was demanding, not only in terms of exhausting the administrative capacities, but also because of the inexpert composition in the evaluation committees. The lack of specialists slowed down the evaluation process. At the present time, the decentralisation of the evaluation process is underway in some sectors, which could further complicate matters. Since the regional self-governing bodies try to solve the problem by inviting external evaluators – when participation in the project assessment process is not compensated – the inexpert composition of the regional committees together with the unwillingness of external evaluators could weaken whole process.

7.4.9 The co-financing criterion

Co-financing implies serious pressure on the state budget. For example, in this year alone, €373.8 million will have to be drummed up for financing Slovakia's EU membership, while an additional €249.2 million is required to cover the "matching funding". The lion's share of the resources is spent on public sector projects. Most of these projects are co-financed according to a 75:25 intervention rate, only seven projects are financed according to a 80:20 intervention rate and projects oriented toward SMEs are carried out with an intervention rate of 65:35 of eligible costs.[97] This represents a way to give preference to large public projects. Applicants from the private

[97] Note that the 80:20 model refers to projects supported by resources from the Cohesion Fund, whereas the state budget has to cover for a quarter of the costs in projects financed by the resources of the European Regional Development Fund.

sector (especially SMEs) do not enjoy this privilege and in most cases their demand for resources from the state budget is refused.

The financial weakness of many applicants (especially in lagging regions) along with – on occasions – the distrust of banks, low profitability, and the fact that contributions from EU funds only comes in the form of reimbursements for already paid invoices and bills, the principle of co-financing *per se* represents a tremendous obstacle, especially for SMEs and sole proprietors.[98] In the updated evaluation of the *Convergence programme of Slovakia* in February 2005, the Commission warned Slovakia that it would probably not be able to deplete the whole amount of the Structural Funds resources allocated for the period 2004-2006 and for that reason will ease the pressure on the state budget. However, from the year 2007 and onwards the situation may change and the pressure on the state budget may therefore increase.

7.4.10 Privileged position of large public projects

There are several reasons why in the Slovakian context large public projects and industrial parks are in a better position. The Slovak government decided early on to support such projects, mostly because of the social and economic impact in the respective regions. Being one of the criteria for measuring the success of a project, the impact can be much more predictable and visible, as regards the benefit of the sector or target group, in such projects. A second reason has to do with the fact that administration is much more efficient in large scale projects. Moreover, it is easer for the public finance administrators to assign financial resources to large industrial parks and thus satisfy the responsibility taken for the development of rural regions. The question is whether this strategy has been the right one.

The government's strategy of attracting foreign direct investment (FDI) and concentrating them into new industrial zones has also been evident in areas which did not involve EU funding. The formation of large industrial clusters can for example be seen in the automobile industry in south-western Slovakia (Volkswagen, PSA Peugeot, Citroen and their suppliers) with the future cross-connection to north-western Hungary (Audi and Ford); in the consumer electronics industry in the Prešov region in the eastern Slovakia (Embraco, Whirpool, Alcatel and their suppliers); and in the prepared silicate zone in the south of central Slovakia. The role of the government and regional self-governance bodies has been to identify potential clusters and to support them actively, e.g. by the strengthening of investment impulses through sub-suppliers programmes, by supporting

[98] There is a possibility of advanced payments, but only in special cases. The financing of most projects is based on the reimbursement principle.

R&D, by supporting cooperation between universities and industrial sector and by developing the local infrastructures. Such activities can be co-financed by EU resources, which may give rise to an acceleration of the mentioned processes (Šikula *et al*. 2003). To name but a few examples of large public projects and industrial parks that have been co-financed by EU resources, there is the Industrial park Spišská Nová ves and Humenné; the Highway by-pass Mierová-Viedenská cesta in Bratislava; the Industrial Park Snina; the Industrial park žiar nad Hronom and the business incubators in Banská Bystrica and Martin.

A fourth reason for preferring large scale projects is the so-called liquidity rule. The small economic entities in Slovakia had grown accustomed to the support of fading-out or "dying" industrial sectors and businesses. With EU funding the situation has changed. The Slovak entrepreneurs meet a support that is directed toward profitable businesses. The applicants have to prove that they have stable and sufficient financial resources to ensure the continuity of their activities throughout the project and, if necessary, to take part in financing. They also have to show that they have fulfilled the obligations of social security contributions and taxes. However, taking into consideration indebtedness and undercapitalization of many businesses and municipalities, this particular rule represents a serious obstacle for many applicants from the poorer regions, since they simply cannot fulfil the liquidity criterion.

7.4.11 Ineligible costs

Another barrier for smaller businesses is the rule of ineligible costs. Among the most disputed are the cases of VAT and administration/management costs. If the applicants are able to ensure financial resources for co-financing (co-financing by 50 per cent is not an exemption) they may be not able to cover, additionally, VAT by themselves. The administration costs for the preparation of a project represent a special problem in the Slovakian context. Most entities are not able to prepare successful projects and they are furthermore dependent on paid support from private consulting companies. The costs involved in preparing projects are seen as excessively high and so is the requirement for administrative capacity. This fact discourages not only small businesses but also many cities and villages from undertaking the necessary steps for using the EU funds. They are aware, first, that every single project cannot be accepted and, second, that it is not possible to receive reimbursements for excessively high management costs (since they are ineligible costs). This usually turns off potential applicants. As noted above, since administration costs are much the same for the preparation of larger and smaller projects alike, larger projects, as a consequence, are in a better position. A solution as to how one could lessen this problem would perhaps be a new evaluation process structure, where the first evaluation step would be given immediately after a strategy and impact proposal, leaving out the necessity for elaborating a final version of a project.

7.4.12 Formal requirements of EU funding process

The submission of proposals has proven to be a problematic process. Many of the projects were refused because of formal mistakes.[99] In addition, other formal requirements necessary for EU funding may also aggravate the process. Applicants have to open a special account for the financial flows from the EU budget and there are in some cases special requirements for a double-entry accounting. Furthermore, there are also meticulous requirements on the project budget.

7.4.13 Actual task – implementation

A new challenge has been caused by the parallel use of the pre-accession instruments and the Structural Funds. During the period 2004-2005 there are still many pre-accession projects in the implementation phase and at the same time the Structural Funds projects are already up and running. We have seen that the institutional and administrative capacities were deficient during the pre-accession period and this implies that the problem has been further aggravated. Preparing and implementing two system-different programmes at the same time is very time consuming and leads to serious administrative pressure. The duplicity of rules, documents and programming is confusing for both the involved authorities and implementation bodies and for the applicants. Moreover, an insufficient evaluation process in the previous period and a poor expert quality, together with inflexible institutional structures, also complicate the implementation process.

7.5 A Slovak perspective

7.5.1 Priorities of Slovakia in 2007-2013

The preparation for the utilisation of the Structural Funds in Slovakia in the next Financial Perspective (2007-2013) is already underway. In accordance with the Commission's proposal for new regulations of the Structural Funds, the Slovak government is obliged to elaborate a National Strategic Reference Framework (NSRF). The word on NSRF is currently in progress. The NSRF represents the integration of the Community priorities, on the one hand, and the national and regional priorities of Slovakia, on the other.

The basis for preparing the NSRF and other documents for the next Financial Perspective will be provided mainly by the mentioned proposals

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[99] With respect to, for example, the organisational budget, statutes and/or the articles of association, annual reports and accounts, official registration certificate and the financial plan. However, the document that has most often been missing is the bank account report, or some form of statement that proves the ability to co-finance a project.

for regulations of the Structural Funds, by the philosophy of the new ECP designed in the third cohesion report and by the existing strategic and conceptual documents of Slovakia. The Ministry of Finance prepared the strategic docment *Competitiveness Strategy of Slovakia until 2010 (Lisbon strategy for Slovakia)*. For fulfilling of the basic objective of the Strategy – increasing competitiveness of the Slovak economy – the strategy defines four priority development areas with their main objectives. (Slovakia 2004a).

Table 7.1 Comparison of the priorities declared in the latest SR strategic documents

Lisbon Strategy for Slovakia	National-economy strategy
Human resources and education	**Human resources and education**
• Modern education policy • Achieving high employment rate • Coping with demographic changes	• Modern education policy • High rate of employment • Reverse the negative demographic tendencies
Information society	**Information society**
• Information literacy • Effective e-government and modern on-line public services • Wide internet accessibility	• Development of knowledge-based economy • Support for innovative processes • Transparent economic environment and support of e-commerce, e-government and e-learning • Prevent "digital isolation" of specific social groups and regions
Business environment	**Business environment**
• High efficiency of law enforcement • A high-quality physical infrastructure and services in the network industries • Public institutions as a partner rather than a burden • Effective access to capital market for all enterprises	• Improving and simplifying of business environment (reducing of administration requirements…) • Conditions for development of e-commerce • Improving of evaluation process of the legislative impacts on business environment • Reducing of state support and its targeting towards horizontal objectives
Science, R&D, innovations	**Innovation policy: science, research and innovations**
• Education and support of expert scientists • Research comparable with international standard and appropriately interconnected with the business sector • Effective public support of business activities aimed at research and innovations	• Education and support of high-quality researchers • Research at the international quality level with the adequate connection to business sector • Effective public support of business activities oriented at research and innovations

The second strategic document at the national level – *National-Economic strategy of Slovakia for the period 2005-2015* – was elaborated by the Ministry of Economy. This document has not yet been adopted by the government but will represent (together with the previous document) the base for developing the future strategy in the field of regional and economic development in Slovakia. Moreover, the document emphasises that the only way to ensure long-term competitiveness in Slovakia is to create favourable conditions for development of the so-called knowledge based economy. The priorities defined in the National-economic strategy and the Lisbon strategies for Slovakia are compared in Table 7.1.

The structural reforms that have already been implemented in Slovakia (pension, tax, healthcare and social system reforms) have made Slovakia an attractive location for FDI. The main advantages are the favourable conditions for industrial production (particularly the automobile industry). However, Slovakia can count on this advantage only for a short period of time, since the key to sustaining the present positive economic trends lie in the ability to increase the sophistication of the production. Hence economic growth must be based on the ability of Slovak citizens to work with new information, develop new knowledge and effectively exploit them in real life. The role of the government in this process is to define the strategic objective, content, principles and principles for each area and to coordinate and implement them.

The third conceptual document that will have a strategic position in preparing the National Strategic Reference Framework for the 2007-2013 period is *Conception of Territorial Development of Slovakia*. The document establishes the main priorities for the present policy of territorial development as follows (Slovakia 2001):

- supporting economic development and strengthening competitiveness and efficiency;
- supporting a balanced regional development, including rural development;
- ensuring equal regional access to infrastructures;
- protecting the environment and the natural and cultural heritage;
- supporting cohesion and integration;
- maintaining sustainable development.

It could be useful to compare the priorities designed for the future development in Slovakia in the represented three strategic documents with the main objectives and priorities defined in the present official documents – especially in the actual National Development Plan for the period (2004-2006).

Table 7.2 National development plan of Slovakia

NDP Strategic objective	Specific objective	Priority
To support, by respecting the principle of balanced sustainable development equally across the regions, such GDP growth that the Slovak Republic by 2006 achieves a level exceeding 50% of the GDP per capita average in the EU countries	Growth of competitiveness of industrial production and services, and development of growth potential	1. COMPETITIVENESS
	Employment growth based on qualified and flexible workforce under conditions of improving labour market efficiency	2. EMPLOYMENT
	Growth of efficiency of agricultural production and quality of life of the rural population	3. AGRICULTURE AND RURAL DEVELOPMENT
	Development of transport, environmental and local infrastructure supporting balanced regional development	4. BASIC INFRASTRUCTURE

The strategy for 2004-2006 focuses on four development priorities: increasing competitiveness, promoting employment creation, fostering balanced regional development and agricultural and rural development (see Table 7.2). It is implemented through four operational programmes (Slovakia 2003):

- *industry and services*: supporting the development of industrial production, creating better conditions for efficient integration of research and development into industrial production, improving energy efficiency and promoting tourism;
- *human resources*: increasing labour market flexibility, reducing unemployment and reducing the risk of social exclusion of the most vulnerable groups, in particular the Roma community;
- *basic infrastructure*: fostering balanced regional development by improving transport accessibility, improving the environment and renovating local infrastructure;
- *agriculture and rural development*: increasing the efficiency of agricultural and aquacultural production, modernising the processing of agricultural and fisheries products and improving the quality of life of the rural population.

The comparison reveals a noticeable shift towards knowledge economy, information society, research and innovations and the inclusion of sustainable development. From our point of view, the strategic documents are in full compliance with the needs of the Slovak economy. However, the implementation of these strategic objectives represents a substantial challenge.

The strategies and the identified priorities seek to promote a competitive and sustainable knowledge based economy by including the objectives of the Lisbon and Gothenburg agendas into the national strategic documents. The convergence between Slovak and EU strategic priorities becomes more clear when the above documents are compared with the priorities outlined in the third cohesion report.

Although the priorities of Slovakia and those of the Cohesion Policy show noticeable convergence – and we agree with most of them – there are still some comments given by the Slovak representatives, introduced in the *Draft statement of the Slovak Republic on the Proposal for a Council regulation laying down general provisions on the EU funds*, which will be presented in the section below. In this statement Slovakia stresses the importance of the development of the transport infrastructure and the enhancement of the transport infrastructure system, the support of investments in the TEN-TINA networks and local infrastructures and investments in information society development. Slovakia supports the projects oriented towards reducing long-term unemployment and the integration of cross-border labour markets. Support of these projects could lead to a more efficient integration of the long-term unemployed into the labour market and help reduce the high regional and structural unemployment in Slovakia, especially in regions that are still affected by structural problems. On the other hand, the Commission has recommended a reduction of the strategic priorities to three, at the most four, priorities. The main (and correct) idea behind this is to concentrate resources on areas that are the most relevant to the main objective, that is to say, to reduce regional disparities. As noted, the priorities were reduced from 15 to 4.

7.5.2 Controversial issues in the proposals on the new regulations for the EU Funds from a Slovak perspective

The new Cohesion Policy is currently discussed in Slovakia. *Draft Statement of the Slovak Republic on the Proposal for a Council Regulation Laying Down general provisions on the EU funds,* Slovakia (2004b), constitutes a negotiation framework and provides the priorities of Slovakia with respect to Cohesion Policy in the years 2007-2013. The most relevant proposals are summarised below. This document is not yet adopted, but it provides a complex view on the most controversial issues of the Commission's proposal from a Slovak perspective.

Considering the fact that there is a low probability of the four per cent absorption cap being abolished, Slovakia supports a more flexible approach towards the limit on structural operations and proposes to use up-to-date macroeconomic data separately for each Member State (mainly exchange rates and GDP growth data).

According to the draft statement, a more flexible approach should be based on:

- The exemption of specific expenditures from the four per cent cap, for example territorial cooperation and financial allocation for rural development. Some of these expenditures are currently part of the EAGGF guidance section.
- The use of up-to-date economic growth rates for each new Member State, instead of an average for the group of ten new members (EU10), taking into account the exchange rate development in each Member State.
- A dynamic development of absorption capacities and levels of co-financing in the respective countries.

Slovakia strongly supports the proposal that changes in operational programmes be realised retroactively in relation to commitments (at the end of the n + 1 year) and not on 30 September of year *n*. The main idea behind this proposal is simple. In some cases, it is difficult to predict the future development as regards the implementation of operational programmes with respect to the n + 2 rule. This modification would allow more effective and flexible utilisation of the Structural Funds and it would have a positive impact on the Slovak absorption capacity.

The responsibilities of the Commission and the Member States should be precisely specified – in terms of time schedule – when adopting the operational programmes. The current situation leads to a prolongation of the time the Commission needs when adopting individual operational programmes (according to a recent Slovak experience made in 2003-2004). The Commission's proposal fails to take into account the precise time schedule for adoption after the operational programme has been submitted to the Commission. There are several precisely defined schedules for the EU Member States, but the responsibilities of the Commission are only vaguely specified.[100]

According to the Commission's proposal, furthermore, expenditures would be eligible for reimbursement from the Funds if already incurred by the beneficiary for an operation carried out between 1 January 2007 and 31 December 2015. Operations that are co-financed do not have to be completed before the starting date for eligibility. Slovakia strongly disagrees with the proposed deadline for eligible expenditures. The complexity of the long-term planning needed to realise Cohesion Fund infrastructure projects

[100] The Commission shall adopt each operational programme as soon as possible after its formal submission by the Member State; see COM (2004).

may prove to be unsuitable for Slovakia. The application of the n + 2 rule should be excluded from the rules of the Cohesion Fund, as applied in the present Financial Perspective, in order to improve the absorption capacity of Slovakia. Higher contributions from the Cohesion Fund at constant national budgetary constraints could result in severe and unfortunate pressure on Slovakia's absorption capacity.

One of the most criticised principles of the new Cohesion Policy is the "one programme – one fund principle" (mono-fund approach). It seems rather impractical that individual programmes would only be given support from one fund, which is especially true for the regional operational programmes. An application of this rule would lead to a doubling of the regional programmes and in turn imply more administrative pressure in Slovakia. Hence we are unable to see in what way this proposal constitutes a simplification. The rule has its advantages only at the level of sectoral operational programmes. In case this proposal is not accepted, the Slovak stance will be to seek an increase of the upper limit for cross-funding in the ERDF and the European Social Fund (ESF).

There is also controversy regarding the establishment of a National Contingency Reserve (NCR). This new proposal does not show any sign of flexibility or simplification. The intention of the Commission to cover for unforeseen local or sectoral crises linked to economic and social restructuring, or to consequences of trade opening, is tied to the creation of an additional special operational programme with a one per cent allocation for the Objective 1 and 3 per cent for Objective 2. These allocations are part of the four per cent capping calculation. However, if no crises occur, there is a high probability that the reserve remains unexploited. Consequently, the country in question will lose the financial resources of this contingency reserve. The question of how one creates and links a special operational programme to an unexpected event is quite unclear and it will in our opinion only lead to more red tape.

The proposal to include action in order to strengthen the administrative efficiency in the Member States that are eligible for support under the Convergence objective represents an element of discrimination. The need to increase the administrative efficiency should logically result from a consideration of the administrative conditions of each Member State separately, not from the criterion of economic development.

Operational programmes related to territorial cooperation should be created on the NUTS 3 level. For Slovakia, there are four operational programmes to be designed with the participation of the NUTS 3 regions:

1. Košický kraj, Banskobystrický kraj, Nitriansky kraj, Trnavský kraj a Bratislavský kraj for operational programme Slovakia-Hungary,
2. Prešovský kraj, Žilinský kraj for operational programme Slovakia-Poland,

3. Žilinský kraj, Trenčiansky kraj, Trnavský kraj for operational programme Slovakia-Czech republic,
4. Bratislavský, Trnavský kraj for operational programme Slovakia-Austria.

Trans-national support, network support and information exchange will be part of the regional operational programmes and of the Operational programme under European territorial cooperation. The respective programmes of economic and social development on the regional level will be in accordance with the three levels of programming. It is also necessary to solve the problem of urban areas within the scope of National strategic reference framework, or in future regional operational programmes.

7.5.3 Position on the new European Cohesion Policy

Concerning the question of the criteria for qualifying for Structural Funds support under the Objective 1, we propose to keep the present limit of 75% GDP per capita in PPS in NUTS 2 regions. This should help lagging regions converge toward the average EU GDP per capita level. Increasing the limit will lead to supporting regions that may not need it and it will also imply a decrease as to the amount that can be allocated to the least developed regions. A lowering of the limit, on the other hand, will restrict the use the funds in regions that already have made efforts to prepare themselves for Structural Funds support. Furthermore, it should also be taken into account that only Member States with a PPS GDP per capita lower than 100 per cent of EU25 PPS GDP per capita can acquire the support. This mechanism will decrease the redistribution (recirculation) of funds between more developed countries. Consequently, Member States' contributions to regional policy will not rise.

7.5.4 The Cohesion Fund

The completion of the transport infrastructure is a key priority in the Slovak regions. As noted in an official document (Slovakia 2004c, p.14).

> The quality of Slovakia's basic infrastructure varies across the country. Regions to the east are poorly served compared to the more developed centres of economic activity closer to the capital, Bratislava, in the extreme west of the country. The geographic position of the country in Europe confirms the importance of its transport infrastructure in the Europe-wide transport network. The main cross border routes, both road and rail, have been designated as TENs routes, all of which are a priority for upgrading. In the road transport sector an ambitious motorway network has been designed for the TENs routes, with approximately 50% already completed, supported in the pre-accession phase by ISPA. However alongside the high priority of completing the TENs routes, particularly the "Northern corridor" D route; there is a need to upgrade certain other primary routes of national importance to expressway standard to ensure efficient intra-regional access, and in particular to facilitate regional development, especially through growth pole linkage. The challenge therefore is to complete the motorway network on the TENs routes with support from the Cohesion Fund and continue upgrading to expressway standard the other key routes. The topography of the country with its mountainous terrain in the centre

of the country means the completion of the whole network will require heavy investment.

Due to a substantial need for investment in the transport infrastructure, the rate of intervention from the Cohesion Fund has had to be decreased (e.g., in railroad project from 85 per cent to 75 per cent) because of the lack of resources for other potential projects. If the 50:50 rule could be modified, more resources would be available for the transport projects that are needed in Slovakia.

We assume that the effects of the Cohesion Fund will remain the same after the accession of new countries. The Cohesion Fund should hereafter offer financial support to projects in the field of environment and to the Trans-European networks of transport and technical infrastructure. From our point of view, it could be favourable to keep the 50:50 proportion, but we also propose to allow for more flexibility so that the 50:50 rule is allowed to change in legitimate and substantiated cases. The possibility of a nonparallel draw could, for example, be tied to a division in the road and the railroad transport infrastructures respectively.

We also hold the position that the present conditions for a country's eligibility for Cohesion Fund support (a GDP per capita lower than 90% of the EU average) and the existence of programmes leading to economic convergence should remain. The definition signifies a real example of solidarity between developed and lagging Member States. At the same time there is no unnecessary mutual redistribution of resources between developed countries at present. Despite initial doubts that Slovakia would not be able to use all the resources available through the ISPA instrument, those resources were overdrawn and as a result became part of the Cohesion Fund resources for the period 2004-2006, in order to cover for ISPA obligations. Slovakia has already contracted 91 per cent of the amount that remained in the Cohesion Fund (€408 million) in the 9 projects that were adopted by the Commission at the end of 2004 (Slovakia 2005). Out of these 9 projects, 7 of them are environmental projects (water sector) and two are transport infrastructure projects (1 railroad transportation project and 1 expressway project converted from an ISPA project to a Cohesion Fund project). The numerical imbalance was caused by the high costs and long-term character of the transport projects. If the principle of 50:50 between transport and environmental projects is preserved, a smaller number of transport projects will be accepted.

We propose to keep the present allocation of general structural operation resources for the new Member States also in the period 2007-2013. This means the share of resources offered, i.e., a third from the Cohesion Fund and two thirds from the Structural Funds, should be preserved.

7.5.5 Management

The process of implementing projects supported by the resources from the Structural Funds needs more flexibility and less administration. While the controlling and anticorruption mechanisms should remain in place, the process should be significantly decentralized with adequate connection of top-down and bottom-up approaches. It should be also more focused on the activation of internal regional resources. The crucial role in this process is the improvement of human capital on the respective levels of public administration with the support from the ESF and the involvement of citizens in greater participation on the economic development of their respective regions. A key question is the transparent demarcation of competencies on particular levels of regional policy structures, as well as interactions of these levels (supranational, national, regional and the municipality levels).[101]

7.5.6 Financial Perspective

Since the European regional policy constitutes approximately one third of the total EU budget, the decision on the 2007-2010 Financial Perspective has to be perceived in a wider sense and in relation to the financial resources of other Community policies. EU regional policy is the tool for convergence between the economies of EU's Member States. On the other hand, the principle of additionality may have a negative impact on public finances and may indirectly influence the new Member States' path towards joining the euro. EMU membership will thus be threatened, or at least delayed, due to the fact that the general government deficit according to the Convergence Criteria should not exceed three per cent of a country's GDP.

At the same time we may assume that under current political development in the EU, it would seem unrealistic to increase the share of Structural Policy on overall EU Budget and therefore it is necessary to keep and fully use the given limit (0,41 % GNI of EU27). The enlargement of the Union meant that EU GDP increased in absolute terms, which in turn meant that the resources available for the ECP also increased.

7.5.7 Cross-border Cooperation and Community Initiatives

Similar to other Member States, Slovakia has had positive experiences from the Cross-border Cooperation programme. Not only do we therefore support a continuation of cooperation based on the Community Initiative Programme INTERREG, we would also like to see it strengthened financially. At the same time we would like to point out that an evaluation of the

[101] Clear and transparent demarcation of competences is one of the most important tasks in Slovakia due to constant legislative changes. It is necessary to stabilize the legislatory environment in the field of regional governance to achieve a predictable and transparent framework which will allow more consistent and coherent regional planing.

successfulness of other Community Initiatives, such as EQUAL, LEADER and URBAN, would be welcome. Actions based on these programmes could be included into the framework of priority targets supported by the Structural Funds and contribute to a general simplification.

The enlargement of the Union meant that the eastern external EU borders were shifted to the boundaries of new Member States and countries of the Balkans, the Ukraine, Belarus and Russia. These borders represent an important part of EU surface frontiers and probably also the future frontiers of the Schengen Area. Under these circumstances it is necessary to emphasise the need for a coordination of the present cross-border co-operation tools (PHARE CBC, TACIS, MEDA, CARDS a INTERREG) at external boundaries and to introduce one common tool (NEIGHBOURHOOD).

7.6 Conclusions

The new European Cohesion Policy is faced with a tremendous challenge, which at the same time should be seen as an opportunity: to increase the support of lagging regions and to assist in the effort of reducing regional disparities in Slovakia.

The pre-accession support created the necessary foundations for these efforts, especially regarding the administrative capacities and, to some extent, economic development. It is difficult to measure the real effects of the pre-accession support in Slovakia, since no extensive evaluation has been made either by national authorities or by independent researchers.

Slovakia started its accession negotiations on 15 February 2000, which was two years later than the other Visegrad countries. This put Slovakia in a difficult position from the very start in the membership negotiations. Slovakia accepted, in many cases, statements and proposals from the Commission without any substantial objections and the Slovak government officials, from our point view, adopted a quite passive approach during these negotiations. This, along with other domestic factors, influenced in a substantial way the shaping of the Slovak negotiation position and resulted in an outcome in several areas that were not optimal. Negotiation chapter No. 21 on Regional policy was preliminarily closed in July 2002, which meant that Slovakia fulfilled the basic, mostly legislative, conditions necessary to conclude the accession negotiations.

Although the legislative preparations for the EU membership and the question of Cohesion Policy in Slovakia were successfully completed, practical problems and obstacles have since emerged. The first obstacle was caused by the domestic situation with respect to regional policy and the preparedness for the implementation of the ECP principles, e.g., problems related to the regional division of Slovakia, decentralisation of public administration, fiscal decentralisation, delays in the preparation of strategic documents, administrative and capacity building and the lack of the necessary experience to successfully handle project preparation and implementation. There was also lack of relevant information as to the principles of EU funding. The second problem was built in the concrete provisions of the European Cohesion Policy as regards the difficulties in the less developed regions in Slovakia.

At present, the necessary preparation for the implementation of Cohesion Policy during the next Financial Perspective (2007-2013) is already underway. We may assume that most of the priorities of the Slovak government, as formulated in preliminary statements and official strategic documents, are in accordance with the Lisbon and Gothenburg objectives. We can conclude that this convergence of priorities is the result of the significant influence of the European Cohesion Policy on policy making in Slovakia, but we can also see a positive trend with respect to Slovak priorities, on the one hand, and the priorities of the ECP, on the other. In our opinion, this convergence can be seen as a favourable condition to strengthen regional development in Slovakia.

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8 LATVIA AND COHESION POLICY

Alf Vanags and Julia Pobyarzina

8.1 Introduction

For Latvia the road to the European Union (and beyond) has been and continues to be a major learning process. Unlike most other new Member States and candidate countries Latvia, as a former Soviet republic, had no experience of operating as a nation state after 1940. This meant that at the start of the 1990s neither its politicians nor administrators had experience of operating in the international arena – international relations, including the EU accession process, was very much a learning-by-doing experience. Mistakes were made, and disappointments were endured – most notably when Latvia was excluded from the so-called Luxembourg group, the six countries initially chosen as the "first-wave" of countries to commence accession negotiations.

This learning process is very much evident in the experience of Latvia with both the pre-accession funds, the Structural Funds for the 2004-2006 programming period and also now in the negotiations for the 2007-2013 programming period. This will come out in the discussion below.

As a background to this chapter it is worth noting some basic facts about Latvia in the EU context:

- Latvia is currently the poorest country in the EU in terms of GDP per capita.
- In discussions of regional policy the whole of Latvia is a NUTS 2 region – this perspective hides the fact that at NUTS 3 level Latvia has severe regional disparities, containing some of the poorest regions of the EU at this level (see Table 8.1).
- At the same time, Latvia has the highest real GDP growth in the EU25. This was 8.5 per cent in 2004 and cumulatively is up by more than 60 per cent since 1996.
- Latvia is one of the EU's smallest countries with a population of 2.35 million (Central Statistical Bureau 2005).

These facts serve to define the heart of Latvia's problems and also the constraints it faces in the EU arena.

The remainder of the chapter is ordered as follows: the next section offers a short overview of Latvia's experience with pre-accession funds; this is followed by sections on issues relating to Cohesion Policy in the accession negotiation process and problems linked to the conditionality built into EU Structural Policy. There follows a forward looking part of the chapter that considers what Latvian development and structural policies look like on the basis of the current system of rules and also of how an unconstrained scenario might look. The concluding section examines Latvia's interests in the outcome of the negotiations on the Commission's proposals for the 2007-2013 programming period

8.2 Latvia's experience with pre-accession support

Latvia like every candidate country has had access to the three pre-accession funds – PHARE, ISPA and SAPARD, whose aim was to facilitate the integration of the accession countries into the EU and to prepare them for future use of the EU Structural Funds. In Latvia the Ministry of Finance was the main institution responsible for implementing and administering EU pre-accession funds.

8.2.1 PHARE

In the early years the main aim of PHARE was to support transition to democracy and to a market economy. However, as of 1998 when it was clear that relatively early EU enlargement was on the cards the programme was exclusively reserved for EU accession preparation. As of 2000, most of the PHARE resources supported an ongoing process of "Institution building" by which the Latvian public administration and its institutions were strengthened. The aim was to put Latvia in a position where it could effectively apply and enforce the *acquis*. A smaller part of the PHARE funding was devoted to strengthening "Economic and Social Cohesion" in Latvia. The economic and social cohesion measures were clearly an attempt to address Latvia's specific regional problems in the form of special measures for Latgale and Zemgale – Latvia's two poorest regions.

The 2003 PHARE Programme was the last PHARE support for Latvia and funds were allocated to the following:

- the National Programme;
- Cross-border Cooperation in the Baltic Sea Region;
- the Nuclear Safety Programme.

The National Programme continues to address key political issues, such as the integration of society, civil society and anti-corruption measures. It has also provided support for the strengthening of the administration with a view to EU accession. Priorities have included improvement of the capabilities of the Justice and Home Affairs ministries, especially in the areas of border management, free movement of goods, company law, agriculture, social affairs, employment, public health, energy, customs union and public finance management as well as in regional policy matters including European Regional Development (ERDF) and the European Social Fund (ESF) type actions concerning economic and social cohesion. Since the 2003 budget was the last PHARE support for Latvia. there was a need to ensure continuity of institution building support for issues not covered by the Structural Funds. Accordingly, a "Transition Facility" has been set up, which will continue to co-finance institution building actions until the budget year 2006.

8.2.2 ISPA

ISPA started as of the year 2000 and can be regarded as a forerunner of the Cohesion Fund. It has financed major environment and transport infrastructure projects. In Latvia, the priorities for environment infrastructure development concern the following: drinking water and wastewater treatment and waste management. The upgrading of the Via Baltica (Road Corridor I) and of the East-West railway link are transport priorities.

8.2.3 SAPARD

SAPARD was set up in 2000 to assist candidate countries in preparations for the implementation of the Common Agricultural Policy and for addressing in a sustainable way agricultural and rural sector problems. Revenue generating investments (mostly projects proposed by enterprises) require 50% co-financing from the project owner. The agreed goals have been:

- development of sustainable agriculture;
- integrated rural developments and improvement of the environment.

Projects financed have included:

- investment in agricultural holdings;
- improvement of agricultural and fisheries product processing;
- marketing, development and diversification of economic activities providing alternative income, including tourism;
- improvement of general infrastructure;
- environmentally friendly agricultural methods.

8.2.4 Impact of the pre-accession funds

In general the pre-accession funds have contributed much to the Latvian economy and have generated many successful projects: a good example is the pilot regional development plan in Latgale, which created the Latgale Development Agency, trained more than 200 people and had many spin-offs in regional development planning throughout the country. The full quantitative effect of the pre-accession funds on the Latvian economy and society requires a comprehensive impact analysis which has not yet been undertaken.[102] However, an important goal of the pre-accession funds has been to prepare Latvia for the use of the Structural Funds and, arguably, this goal has not been fully achieved. The main problem has been an overly individual attitude to each project and rather loose terms and deadlines for submitting projects. This has negatively affected the discipline of submitters and as a result there are ISPA projects that may remain un-

[102] The "PHARE country ex-post evaluation and capacity building. Country report – Latvia" http://europa.eu.int/comm/enlargement/phare_evaluation_pdf/latvia_country_report_english.pdf has a detailed evaluation of 5 projects. However, the valuation is not a comprehensive economic and social impact analysis

finished for some time. SAPARD has had the strictest terms and deadlines, and this has significantly increased the speed with which projects have been approved and funds disbursed. As a result SAPARD went beyond its original financial limits and Latvia already has used more than 100 per cent of the allocated funds.

8.3 Issues relating to Structural Policy in the accession negotiation process

In Latvia the whole accession negotiation process, including decisions on the amount of pre-accession funds allocated to Latvia, has appeared as a rather unilateral decision – prosperous EU member countries simply decided how much money they could afford (or perhaps more accurately wished) to contribute to the acceding countries and then implemented these wishes without any meaningful consultation with the recipient countries. Latvia was in an especially difficult position to be pro-active – it had been excluded from the Luxembourg group of first wave accession countries which meant that it was psychologically and politically important for Latvia to catch up and join the EU together with the first wave countries. Accordingly Latvia did not press for increases in the amount of pre-accession funds. Therefore it got only €1.2 billion instead of the maximum 1.6 billion which it had grounds to receive. Thus, this compliance cost Latvia €400 million.

In addition, there were disputes about priorities. In the first stages of the accession process the European Commission already wished to define in detail how the pre-accession funds should be implemented and administered. However, Latvian civil servants did not have sufficient knowledge, or experience to be able to take a strong position on these issues. Thus, in order to speed up the accession process and generally comply with the wishes of the Commission, the necessary documents were signed and the obligations were undertaken. Only when the funds came on stream, did Latvian civil servants understand that they might not be in a position to meet all the contracted obligations

A further issue of conflict was the twinning programme which was introduced in the later stages of institution building. Arguably, the European Commission used the potential new member countries to experiment – changing conditions and rules for receiving funds. That was a factor behind the relative failure of the twinning programme. Also, the twinners saw that the needs and conditions (including the economy) in new member countries were very different from those in their home countries. Thus, the twinners found that their experience was not easily and effectively transferred to Latvia.

8.4 Problems with current Cohesion Policy

The negotiation process between the Commission and the Latvian civil service on the current National Development Plan which then became the Single Programming Document (SPD) was fraught with difficulties. As mentioned in the introduction, developing the SPD was a learning process for Latvia and early versions of the SPD were severely criticised by the Commission on various grounds such that it was merely a "shopping list" or that there was insufficient foundation for what the Latvian side was proposing. A number of disagreements of substance emerged. Sometimes the Commission was unwilling to take into account the Latvian legal system, its political preferences and various historical issues. For example, the Commission tried to promote projects concerning minority and nationality issues in Latvia. This was not acceptable politically, because what was proposed was in conflict with the main statutes of the leading political parties. This led to active and emotional negotiation between representatives of Latvia and the Commission.

Furthermore, some of the economic areas that the EC sought to make priorities in Latvia were inconsistent with the priorities as perceived by Latvian civil servants. For example, the Commission wanted to emphasize tourism and social issues, but home officials took the view that some other areas were more important and financing them would lead to more sustainable development.

The generous time allowed for planning and programming of the priorities within the pre-accession financing framework was very favourable for Latvia and contributed to improving decisions on priorities. However, there were rather strict conditions about the areas, where funds could and could not be invested. Moreover, these conditions did not always consider the particular characteristics of the Latvian economy. For example, Latvia had to work hard to convince the commission that its healthcare system needed urgent attention. The arguments worked, and as a consequence, Latvia is the only country in the Baltics to receive support for its healthcare system. This support has enabled a start to be made on health sector capacity building.

Here could also be mentioned the problem of "rent-seeking" generated by the Structural Funds. It is rather clear that support from the Structural Funds, e.g., the Rural Development Fund or the ERDF, can make business ventures supported by the funds very profitable – even projects that would be hardly viable commercially can be very profitable if subsidised. If evaluation of projects is confined to ensuring that projects satisfy the technical eligibility requirements then this generates a significant incentive to commit resources to ensure successful application. This can result in considerable socially unproductive activity.

Finally, there is a potential "success problem". In recent years Latvia has experienced the fastest growth in Europe, with real GDP up by more than

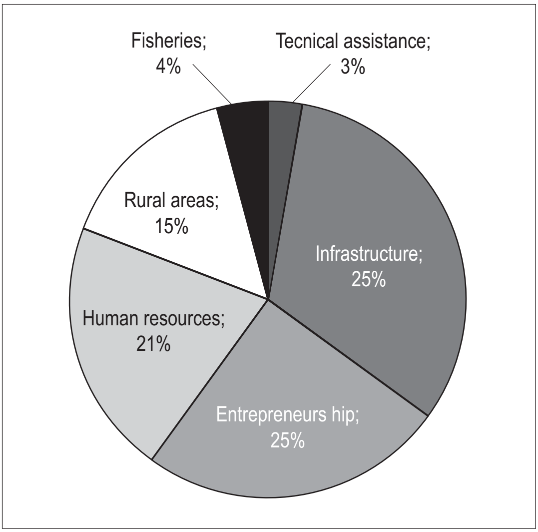
60 per cent since 1996. If this trend continues then Latvia could well reach the 75 per cent of the EU average per capita threshold in a measurable number of years and will no longer qualify for support under Cohesion country rules. The danger is that after the Latvian economy no longer receives the positive external shocks generated by the Structural Funds, which can be viewed as a kind of financial doping, it may no longer be able to maintain the same growth rates. Perhaps Latvia could adopt the Irish "solution" and divide the country into two regions one of which remains an Objective 1 region.

8.5 Latvia's development and Cohesion Policy: actual vs optimal?

8.5.1 Cohesion Policy under current rules

The National Development Plan for the next programming period is currently in the process of preparation so we do not yet know how it will look. However, the expectation is that the priorities for the next period (2007-2013) will not differ much from those defined for the existing financial period. After all, the current SPD is for the three year period 2004-2006 and it cannot be expected that Latvia's structural problems will have changed radically in that period.

Figure 8.1 The priorities of Latvian National Development Plan and available financing distribution for 2004-2006

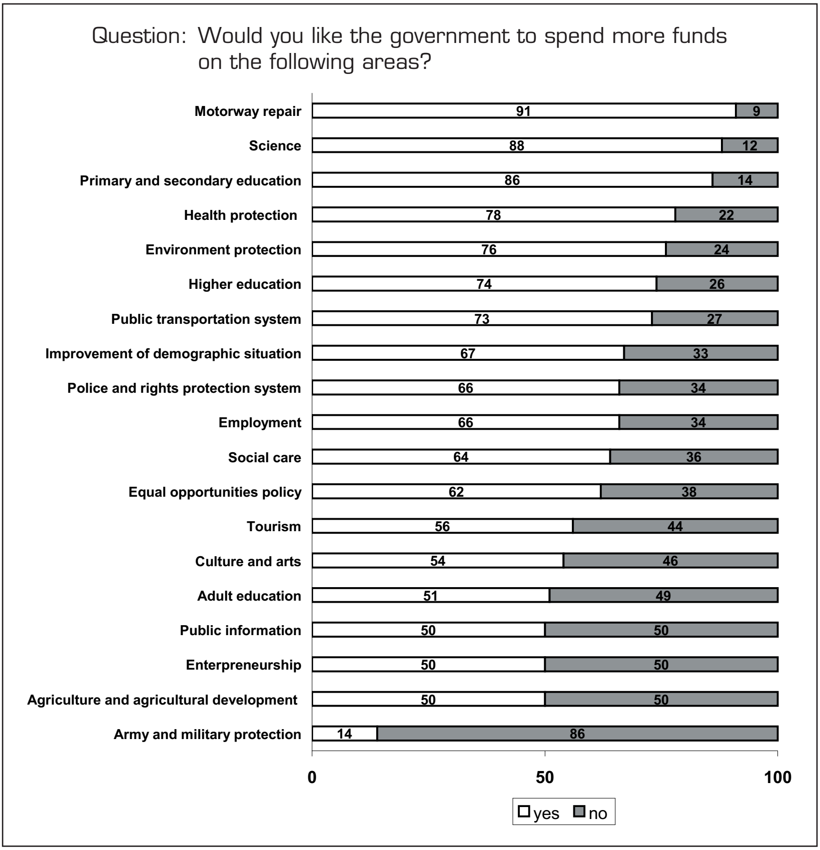


Source: http://www.esfondi.lv

Figure 8.1 shows the current allocation of all EU Structural Funds among priorities together with domestic co-financing funds. The biggest share of financing is devoted to infrastructure which receives 32 per cent of total available funds. This is followed by entrepreneurship which receives 25 per cent with human resource development in third place with 21 per cent.

Thus Latvia has adopted a position somewhere between the so-called Greek model in which support for business and infrastructure is emphasised and the Irish model where human resource development is given a more prominent role.

Figure 8.2 Survey "What kind of national development would you favour?"



Source: http://www.politika.lv

It is of interest to see how these priorities compare with what the Latvian public thinks. Although we do not have large scale surveys on this the Soros Foundation of Latvia conducted an online survey on the Latvian public policy portal http://www.politika.lv at the beginning of 2005. This exercise was done in order to inform the working group responsible for elaboration of the National Development Plan for the next financial period (2007-2013) (Soros Foundation-Latvia 2005b). Thus the survey can be seen as redressing the widely criticised lack of consultation with NGOs in the 2004-2006 exercise.

Figure 8.2 represents the opinion of respondents as to the sectors of the Latvian economy which should receive additional financing (there was an assumption that such action might increase the tax burden).

It is clear that the first priority of the public is infrastructure and in particular, motorway repair, with 91 per cent of respondents stating that the government should pay more attention to this issue and increase financing. Here it seems that the policy makers and public are singing in tune.

The second priority is science – 88 per cent of respondents believe that an increase in investment in science is necessary for successful development of Latvia. Next comes funding of primary and secondary education with 86 per cent positive responses. Most respondents would also allow increased financing for health and environment protection, as well as for higher education, public transport and measures to improve the demographic situation.

There are some interesting divergences between public opinion and official priorities. For example, in practice support for entrepreneurship receives 25 per cent of available funds, but public opinion views it somewhat neutrally with half of the respondents opting for increased financing and half being

Table 8.1 Regional income disparities in Latvia 2002

	% of country	% of EU25
Latvia	**100**	**38.9**
Riga	181.7	70.8
Kurzeme	82.9	32.3
Pieriga	65.7	25.6
Vidzeme	57.9	22.5
Zemgale	55.7	21.7
Latgale	48.4	18.8

Note: These are indices of real income per capita at PPS by planning region

Source: Eurostat

of the opinion that entrepreneurship is already financed enough. However, education and science that is rated highly in the survey actually receives just five per cent of available Structural Funds

Although a key aim of EU Structural Policy is to promote income convergence, this relates to the EU level, i.e., country level or at least NUTS 2 level. Lower level regional disparities are left to Member States. The problem for Latvia is that there are particularly severe regional disparities within the country. These are illustrated in Table 8.1 (Tables 8.2 and 8.3 show the same for Estonia and Lithuania).

Table 8.2 Regional income disparities in Estonia 2002

	% of country	% of EU25
Estonia	**100**	**46.6**
Põhja-Eesti	153.2	71.4
Lääne-Eesti	72.6	33.8
Kesk-Eesti	70.2	32.7
Lõuna-Eesti	66.6	31.1
Kirde-Eesti	58.6	27.3

Note: These are indices of real income per capita at PPS by planning region

Source: Eurostat

Table 8.3 Regional income disparities in Lithuania 2002

	% of country	% of EU25
Lithuania	**100**	**42.4**
Vilniaus	143.3	60.7
Klaipedos	108.5	46.0
Kauno	94.2	39.9
Panevezio	86.6	36.7
Telsiu	83.6	35.4
Utenos	82.7	35.1
Alytaus	77.2	32.7
Siauliu	74.0	31.4
Marijampoles	66.5	28.2
Taurages	57.8	24.5

Note: These are indices of real income per capita at PPS by county

Source: Eurostat

In the current Latvian priorities (2004-2006) the regional dimension was added as something of an afterthought and there is very little in the SPD that explicitly addresses regional issues. Rather it has been left to agents themselves, e.g., municipalities or businesses to make project applications. This has led to fears that partly because of co-financing requirements and partly because of inadequate capacity to prepare projects, the less developed regions would be unable to get a "fair share" of projects. These fears seem to have been realised. According to the first information on implemented Structural Fund projects published in March 2005, of 178 accepted projects Riga and the Riga region (including Jurmala) received 99 projects worth a total of nearly €24 million, whereas Latgale, Latvia's poorest region, has just had 7 projects approved worth €2 million. If such an outcome is repeated in the future, including for the next programming period, then far from promoting convergence the Structural Funds may even exacerbate internal regional disparities.

8.5.2 An unconstrained scenario

What would represent an optimal scenario for 2007-2013 from the point of view of Latvia? A quick and cheap answer would be unlimited funding without conditionality. Unlimited funding is of course not feasible though as will be argued below that the four per cent cap penalises the poorest countries. However, conditionality is another matter. The main form of conditionality comes in the shape of various co-financing requirements. In general the point of Member State co-financing is that by having a financial stake in the project there are incentives to deliver a good project. However, there are some problems with co-financing issues in Latvia. Firstly, the applicants for many ESF and ERDF projects are expected to be local authorities and in Latvia there are more than 500 local authorities, many of them rather small – 70% have a population of less then 2000 (Central Statistical Bureau of Latvia 2005). This means that they have very limited scope for co-financing. In an ideal scenario there would be incentives for local authorities to merge, as has been the wish of the central government for some time. However, in practice issues such as the promotion of territorial reform are outside the scope of Structural Policy.

There is also the problem that a small and relatively poor country such as Latvia cannot afford on its own to implement some large projects, which do not qualify under EU requirements. For example, a current problem is market failure in the building sector, where there are no projects for building public sector housing. A number of factors such as the problem of what to do with the tenants of denationalised houses together with recent developments in the real estate market suggest that public housing projects are rather desirable and socially justifiable.

What can one say in general about an optimal Structural Funds policy for Latvia? One route is to try to identify regional comparative advantages and support sectors that have such advantages. Another is to identify particular sectors – "high-value added" or "knowledge based" are popular buzzwords. Such approaches are entirely misconceived. Production according to regional comparative advantage will emerge quite automatically in a market economy unless governments intervene to obstruct it. High value added is an entirely non-operational concept and is there any activity that is in some sense not knowledge based? In a modern economy value added consists of wages plus profits and it is of course good to have more profits, higher wages. High profits are generated by good projects and high wages are earned by people with marketable skills. What meaning can be attached to a "high value added sector"? In truth not very much – one needs a denominator i.e., value added per "something". One option is value added per worker, but then the high value added per worker sectors are all traditional capital intensive sectors such as refining, steel or car making and not at all the so-called high tech sectors. Indeed Paul Krugman has pointed out that one sector with the highest value added per worker is the making of potato chips (crisps) since it is very highly mechanised.

In general, unless some specific sectoral market failure can be identified policies that select particular sectors should be avoided. Thus if one believes that the market is not generating enough "knowledge based" activity the correct approach is to implement horizontal rather than sectoral remedies. Here horizontal policies are ones that are available equally to all sectors of the economy e.g., support for innovation – innovation in a traditional or "low-tech" industry is potentially just as valuable as innovation in a so-called "high-tech" industry.

Another approach to defining a good Structural Policy is to consider the experience of other countries. This is the approach of Alasejeva (2003), who has looked at the historical examples of Greece, Portugal and Ireland. The experience of Greece and Portugal shows that it is a mistake to treat the Structural Funds money as a free lunch. By contrast Ireland was able to achieve a long term positive effect from the EU Structural Funds by concentrating on developing human resources.

European funds have two main effects. First they represent a boost to economic activity through the demand side and secondly they can improve productive capacity through supply side effects. Demand side effects occur automatically with the appearance of EU Structural Funds. Thus implementing large infrastructure projects, using EU funds, automatically increases demand for building sector services. But the demand effects are transitory and they disappear together with Structural Funds. However, if the infrastructure project is a good one it can be expected to contribute to increased productive capacity in the future.

However, a subsidy to business has a supply effect while the subsidy is in place but vanishes when the subsidy is removed. On the other hand resources devoted to human resource development i.e. increases in skills and human capital in general, allow the economy to develop faster also in the future without additional subsidies.

The question is how to create the right mix between demand or supply side effects? Alasejeva reports that for the Irish economy the total impact of the funds has been the equivalent of between 2.7 per cent and 3.5 per cent of GDP (Alasejeva 2003). From this overall effect the demand oriented part constituted 1.9 per cent. That means that the supply effects were almost as big as the demand effects. Moreover the supply effects persist over future years.

Ireland has differed from Greece, Portugal and Spain in its priorities for the use of EU funds. Around a third of all available EU money in Ireland has been devoted to the development of human resources. In the other countries less than one fourth of available funds were devoted to this priority, but more was invested in physical infrastructure.

From Ireland's experience it can be concluded that the most effective investments are in those areas that can give highest supply effects. In Ireland's case investment in human resources has been a key factor with higher labour quality at all the levels increasing productivity in all sectors i.e. in both existing industries and in new ones, including the high-tech industries that are much sought-after in Latvia.

8.6 A Latvian perspective on the Commission's 2007-2013 proposal

8.6.1 Co-financing requirement

One important issue is precisely that in the new proposal the eligible private expenditures for projects will be cut in half – this effectively cuts the implicit subsidy in half. Motivating this decision is presumably the view that current levels of support for the private sector are more than generous enough However, the Latvian government view is that private funds as a source of co-financing play an important role as a guarantor of the success of structural projects. Involvement of private financial funds as a source of co-financing structural projects is regarded as a powerful instrument to motivate entrepreneurs to contribute more to planning and monitoring of structural projects because they risk their own money in addition to money from the Structural Funds. Therefore, the new co-financing limitation is regarded as unfavourable for the effectiveness of structural projects.

At the same time the Commission wants 25 per cent of the costs of structural projects to come from national co-financing (government and municipalities' budgets). In a poor country such as Latvia it is difficult to generate such resources from the public sector. Latvia cannot exceed the ceiling for government budget deficit to qualify for membership of the

Exchange Rate Mechanism 2 (ERM2) and generally needs to maintain satisfactory macroeconomic indicators. Thus, the government faces a dilemma, on the one hand it wants to and is asked to invest more, but on the hand it needs to practice fiscal prudence and to maintain economic stability. As a possible solution of this problem the Commissions suggests public-private partnership (PPP) as a way to replace government financing. However, PPP is really a method of substituting government financing by private. The Commission position has created incomprehension and confusion in the Ministry of Finance of Latvia as to the direction to which to point. On the one hand the Commission suggests the use of PPP, but on the other hand Structural and Cohesion Funds are trying to reduce private initiative. If it is clear that co-financing is not possible then a whole department in the Ministry of Finance, created to increase and to attract private co-financing, should be closed and a new information centre should be created to stimulate PPP. The main official position of Latvia is that it is necessary to keep private co-financing and to maintain current rules.

8.6.2 The 4 per cent cap

The main goal of the Structural Funds as proposed by the Commission is convergence between the member countries and cohesion within the union. Convergence according to neoclassical growth theory may be defined as a long-term process of higher growth in countries with low capital to labour ratios, in other words, countries that have a low GDP per capita level should increase growth rates to "catch up" with richer countries. Such a development should lead to an increase in the level of economic cohesion within the Union. However, the existing method of allocation of Structural Funds is not fully compatible with GDP per capita levels within the cohesion and convergence framework.

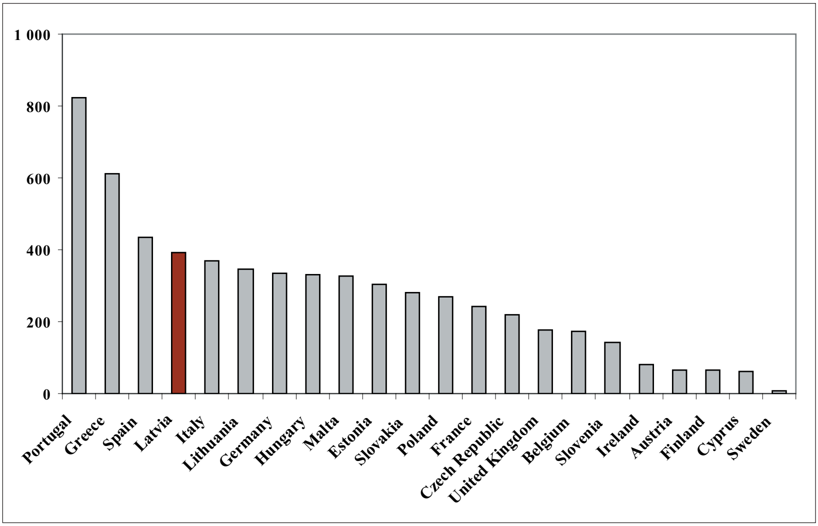
The current financial period is the first when the so called Berlin Method and four per cent cap GDP criteria applies to the amount of aid from Structural Funds that is allocated to recipient countries. This Method states that the maximum total amount of aid each country can receive from all 4 Structural Funds and the Cohesion fund is four per cent of its GDP. There was no need to apply such method before the enlargement because the amounts of money to be reallocated were not so big and the poor countries were not as poor as Latvia is now. However, now it is obvious that the demand for Structural Funds significantly exceeds supply and that the Berlin Method is supposed to solve the problem of allocation of resources.

However, from the Latvian perspective this approach seems to be somewhat unfair. This system fundamentally discriminates against poorer countries (with lower GDP) relative to richer countries (with higher GDP).

First, the amount of financial assistance per capita Latvia receives seems low taking into account macroeconomic conditions and the level of development of Latvia in comparison with other recipient countries. Latvia, as one of the poorest countries in the EU (if not even the poorest if we look at GDP per capita), receives less aid per capita than countries that are much more wealthy and economically developed.

Figure 8.3 shows the distribution of total structural aid per capita in the next (2007-2013) financial period[103] one can see that Latvia is not last in the amount of aid available per capita for all member countries, but is nevertheless behind Greece, Portugal and Spain which are much richer.

Figure 8.3 Total aid per capita for each Member State in the 2007-2013 Financial Framework (€)



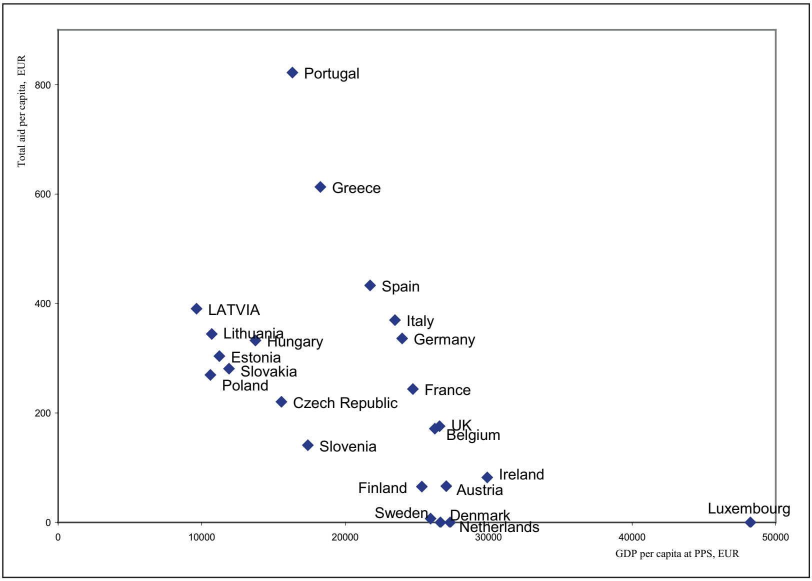
Source: University of Strathclyde, Glasgow, Scotland.

However, it important to look at the need for aid for each country. For example, Latvian GDP per capita is only around 43 per cent of the EU average, but Greece, which is much more developed and prosperous, has this measure around 83 per cent. However at the same time Greece receives much more aid than Latvia does. Portugal, Spain, and Italy are other examples.

[103] The data on total amount of aid per capita in each country for the period 2007-2013 used in the analysis comes from the latest analysis in the University of Strathclyde in Glasgow, Scotland, and was provided by the Ministry of Finance of Latvia.

A different picture appears when we take into consideration GDP per capita at PPS for each country (2004 data).[104] This is shown in Figure 8.4.

Figure 8.4 Disparities in per capita aid intensity. Correlation of total aid per capita for period 2007-2013 and GDP per capita at PPS in 2004 in existing Member States (€)



Source: University of Strathclyde, Glasgow, Scotland; Ministry of Finance of Latvia; SIEPS.

Latvian GDP at PPS per capita in 2004 was only 43 per cent of the EU average and actually from Figure 8.4 it is obviously the smallest in the whole Union. The total aid per one person granted to Latvia exceeds the EU average by 61 per cent. However, at the same time Portugal, with twice as big a GDP per capita as Latvia had in 2004, is expected to receive from the Structural Funds *more than twice* as much as Latvia or 339 per cent of the EU average.

Figure 8.4 shows GDP per capita against the amount of aid given. The differences between old and new Member States are quite substantial. From the diagram one can notice that GDP capping criteria distributes Structural Funds in a way that is inconsistent with GDP per capita and, thus, the need. There is some negative correlation between the variables – the correlation coefficient is equal to -0.55. However, it is not large enough to define a strong relationship between the variables. Such alloca-

[104] The data on GDP per capita at PPS was provided by SIEPS.

tion of funds obviously discriminates against the new member countries and does not provide aid according to need. Countries are substantially different in their levels of development, for example the standard deviation in GDP per capita at PPS for all member countries in 2004 constituted 41 per cent of the EU average. Using the GDP capping method with such initial differences will lead to even larger disparities in the long run. Thus, it can be argued that this method is inconsistent with the main goal proposed by the EU, namely convergence.

Second, there is a difference in the conditions for Latvian contributions into the EU budget and the aid it receives. Latvia contributes to the EU budget according to its existing GDP, which grows at a rate of around eight per cent annually. However, the amount of Structural Funds Latvia qualifies for in the existing financial period was calculated using the assumption of only four per cent annual GDP growth for developing countries (like Latvia) and two per cent of annual GDP growth for developed countries. Thus it seems that Latvia receives aid that is inconsistent with its contributions. The Latvian Minister of Foreign affairs Artis Pabriks has agreed with the Ministers of Foreign Affairs of Lithuania and Estonia that the Baltic countries receive too little foreign aid and that aid is not proportional to their contributions to the EU budget. Possible solutions to this problem may be:

1. That theoretical calculations should be replaced with real economic indicators to match contributions with aid. The amount of aid each country is eligible for in the EC is based on Eurostat official statistics (latest available are for year 2003) and divides countries into "old" (with two per cent GDP growth) and "new" (with four per cent GDP growth). However, real existing indicators for 2004 look much better than those assumed by the Commission, with a Latvian GDP growth at a rate around eight per cent annually (instead of four). Thus, our contributions to the EU budget are calculated according to our existing GDP (with annual growth around eight per cent), however our reception of aid from Structural Funds is calculated from approximated GDP (with assumed annual growth of four per cent);
2. To put emphasis on environment protection and infrastructure projects that may benefit not only Latvia, but also other countries. Such an emphasis would make other countries more interested in financing such programmes and may persuade contributors to exclude environmental and infrastructure projects from the four per cent of GDP limitation;
3. To cancel the four per cent of GDP regulation. Latvia is not yet ready for such a move because of political considerations. Countries which benefit from the existing system will lose a lot if it is cancelled.

The limitation of financial aid with four per cent of GDP per year is motivated by the Commission as the maximum amount a country is able to spend and absorb and not harm its economic stability. This is mainly a political argument. There are no theoretical or empirical findings which justify such a measure. Furthermore, there is evidence that investment in richer countries (which can be classified as structural investments) very often exceeds this limitation. For example the UK, which has always invested more that four per cent of GDP in the projects that could have qualified as structural and has not faced any economic problems regarding these investments and overall stability.

8.6.3 Cross-financing

The Commission suggests a mono-fund approach, which states that every type of programme should be financed from a different fund and that every type of programme is under the authority of a different ministry. It is planned that in the future there will be two managing authorities: a Regional Development Fund, which will deal with infrastructure projects and a Regional Social Fund, which will deal with soft investments. Currently the only managing authority for the use of structural aid is the Ministry of Finance of Latvia, which coordinates both types of projects and guarantees synergy. There is a plan that in the future the Latvian Ministry of Welfare should deal with social projects and the Ministry of Finance with regional and infrastructure projects. However, the Ministry of Finance of Latvia believes that there is a big share of projects in each sector that "overlap" with each other. As a result of the proposed division the necessary synergy achieved by the Ministry of Finance between all "overlapping" projects will be lost. Coherent projects will be difficult to manage because there will not be one common institution responsible for administering and implementing such projects.

The Commission suggests that one should fix a cross-financing level that will state maximum volumes of cross-financing for each foundation. For the Regional Development Fund it suggests a five per cent ceiling from the overall budget to be devoted to social projects, for the Regional Social Fund the suggested ceiling is ten per cent devoted to infrastructure. However, the actual level of cross-financing in both types of investment substantially exceeds these measures. Thus, such a rule creates the risk of losing this synergy between the two types of projects with corresponding losses in efficiency.

A possible solution is to accept the mono-fund approach, but the ceilings for cross-financing for each fund should be increased. Based on the experience of the Ministry of Finance, the ceiling for cross-financing should be raised to 20 per cent for each budget. Thus, without rejecting the mono-fund approach it will be possible to maintain the necessary synergy and the level of cross-financing.

However, larger and more developed countries where administration of

Structural Funds is less centralised, in many cases do not understand such a problem and the necessity for synergy in a small country like Latvia. Thus, they do not support an increase in the maximum level of cross-financing. However, their position does not seem to be constructive because a higher level of cross-financing does not create an obligation to use its full potential and at the same time it allows it where it is needed. Currently the Ministry of Finance is engaged in negotiations concerning an increase in cross-financing levels. Even other countries that are indifferent on this issue support the Commission in its view in order to speed the progress of negotiations.

If the small countries are not be able to achieve an increase in the maximum ceiling for "overlapping" structural projects, they will be constrained to use the government budget to maintain the necessary level of synergy. Such an implication may cause fiscal strain with possible harm to macroeconomic stability.

8.6.4 The n + 2 rule

This rule states that the Commission must automatically decommit any part of a commitment for which it has not received an acceptable payment application by the end of the second year following the year of commitment. The application of this "n + 2" rule forces Latvia to increase the speed of Structural Funds' administration in Latvia. According to estimates of the Ministry of Finance, if Latvia continues to use funds with the same speed, then money supposed to be used up to the year 2007 might be already spent by the end of 2006. Since Latvia will not have any access to additional financial means before January 2007, this may create a one-year period of slow down unfavourable to the stability of the Latvian economy.

8.7 Conclusions

For Latvia the new programming period from 2007 to 2013 represents an opportunity to build and improve on what has been achieved in the current period. What has to date been achieved includes the demonstration that Latvia does have the capacity to administer the funds as well as to absorb them. Judgement on the quality of implemented projects awaits detailed evaluation.

The most important problem in the current period appears to be that the priorities of the funds have insufficiently addressed the problem of internal convergence i.e. regional disparities. Indeed lack of resources and capacity in disadvantaged regions may mean that the Riga region will receive a disproportionate share of Structural Funds with the consequence that regional disparities may actually worsen. This is an issue that urgently needs to be addressed for 2007-2013.

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9 FROM POLICY TAKERS TO POLICY MAKERS

Bengt O. Karlsson

9.1 The stage set

The basic goal of this study was to investigate some of the past experience of pre-accession support and European Structural and Cohesion Policy in new Member States as well as issues that might have transpired during the accession negotiations. Further, we wanted to study how the present system of conditionalities on the ECP would affect the future development in those States and, lastly, to get some ideas on how a more liberal system, in which the new Member States had a freer hand in managing available support funds and in defining priorities would differ from present proposals. On the basis of information from 5 national case studies an attempt would be made to suggest an outline of a new framework for the ECP which might in a better way correspond to the needs and objectives of the Member States. Four specific questions, corresponding to those issues, were put to the participating research institutes.

The Country Studies, each one of which has been devoted a special chapter, must be read against the backdrop not only of the actual situation with respect to income differences between countries and regions but also of the present system of ECP and the proposed changes that are presently under negotiation. This section 9.1 reviews briefly some of the more important aspects which were fully covered in chapters 1 and 2.

We have discussed at great length the present proposal by the European Commission for a new ECP to be included in the Financial Perspective for the period 2007-2013 (see chapter 2, section 2.3). Even before the breakdown of the negotiations in June 2005, it was clear that in addition to the opposing positions of net payers and net receivers, there is also a lack of consensus on the proposed structure of the objectives of the Structural and Cohesion Funds. The Convergence objective is generally endorsed and several new Member States wish to see a larger share of the funds under this objective whereas the Competitiveness objective does not have the same support. The third objective, Territorial cooperation, is, perhaps, somewhat vague but met with interest. Some countries wish resources to be allocated to the least developed Member States rather than to the least developed regions (see chapter 2, section 2.3.2).

That standpoints differ may to some extent reflect the fact that the new Member States had very little influence over the design of the ECP during the accession negotiations. Basically the system was already in place. It had been developed by and for the old Member States and has been modified to accommodate new Member States at every earlier accession (Tarschys 2003, chapter 2). What the candidate countries in the Eastern enlargement round could influence was only some modalities for adjustment and phasing-in and, to a certain extent, the amount of funds to be allocated (see chapter 1, section 1.1.1). Accordingly, it is a relevant question to ask how Structural and Cohesion Policy in the new Member States has been affected by the conditionality inherent in the system and what would happen if this conditionality would be relaxed.

Ample empirical evidence of the regional imbalances in the new Member States is presented in chapter 3. The regional divergence was from the outset generally larger than in the old Member States, yet it is clear that regional imbalances have increased considerably[105] between 1995 and 2002, mainly due to the expansion of the capital city regions. When excluding the capital city regions, the regional differences seem to have remained basically at the same level as before the start of the integration process in the Czech Republic, Latvia and Slovakia but have increased in other new Member States even if not so strongly as when the capital cities are included. Furthermore, there are big and increasing differences between regions due to their sectoral structure, educational level and ability to attract foreign investment. Those differences do not always show up in the employment records since the agricultural sector, at least in some countries, serves as a “sponge” that can absorb superfluous labour in subsistence farming. Employment has generally developed more favourably in so called forward looking industry regions[106] but not as strongly as their GDP. This might reflect the well-observed phenomenon of jobless growth in the new Member States where rising GDP is mainly due to increases in productivity rather than employment (see chapter 3, section 4).

It can be argued that the regional differences are somewhat exaggerated: differences in cost of living are taken into account, but only at the national level. Further adjustment could be made for taxes, transfers and public expenditure, maybe also for private capital flows.[107] A hypothetical measure of divergence expressed in terms of *equality of consumption* might show considerably smaller regional divergences than we normally assume (Tarschys 2003a).

In the period under consideration the process of convergence between countries did take off in an impressive manner (see chapter 3). During the period 1995-2004 the growth rate of the eastern European new Member States surpassed that of the old Member States by 1.7 percentage points annually. In certain countries, notably the Baltics, the growth differential was even higher. We might say that increased national convergence was

[105] Except in Bulgaria and Slovenia.
[106] See chapter 3 for a definition of this term – those regions have a large share of various engineering industries.
[107] For a discussion of various measures of human resources development and international competitiveness where the new Member States generally come out better than when measured by GNI statistics, however adjusted, see Karlsson (2002), section 9.2.

accompanied by strongly increasing regional differences within countries – leaving the casual connection aside for the moment.

We have discussed in chapter 2 the definitions of the concepts convergence, competitiveness and cohesion as well as their possible overlapping and potential goal conflicts. As has been shown in the Sapir report, there is very likely a conflict between achieving regional convergence within a country and economic growth.[108] We may look at this as a possible conflict between the objectives of Lisbon and Gothenburg on the one hand and the convergence goal on the other. The creation of growth centres or industrial clusters is one of the main engines for growth.[109] As we have seen from chapter 3, the expansion of the capital city regions in all new Member States may well be an expression of this fact. The Sapir report states explicitly that "It is obviously possible that, during the catching-up process, increasing regional disparities within the poorer countries may also emerge. However, this phenomenon may be mitigated by national growth and could be eased by national rather than EU policies (such as social transfer schemes, labour market and wage policy, etc)." This is also one of the reasons why the Sapir report recommends an ECP that is directed towards countries rather than towards regions. The Commission recognises this conflict in the Third Report on Economic and Social Cohesion but wards it off by saying that the trade-off will depend on "the spatial distribution of economic activity and of settlements".[110]

While groping for an optimal design of the ECP for new Member States we can, then, immediately discern two fields of tension of great consequence: one between the conditionalities of a system originally designed for EU 15 and the national constraints of the new Member States, the other between the Lisbon objectives of growth and competitiveness and the regional divergences within a country. In addition, the deficient capacity to manage and administer support funds transcends those fields of tension in the new Member States, albeit to a varying degree. This capacity is sometimes further hampered by remnants of old political structures.

Against this somewhat troubled background, we will now proceed to sum up what the national contributions have to say about their past experience of ECP and their thoughts about the future policy, on the one hand if present conditionalities prevail, on the other if they were to be given a

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[108] For a review of discussions on this issue see Richter (2005), section 1 p.24 ff

[109] The concept of industrial clusters is mainly connected with the work of Michael Porter. See the seminal work in Porter (1990). For an updated bibliography and references to European conditions; see Kethels (2004).

[110] As noted in chapter 2, this observation seems less relevant for the new Member States where the spatial distribution of economic activity often was decided by the central planning authority. See, for instance, the Czech Country Study, section 6.6.

freer hand in forming the implementation of the ECP in line with their own priorities.

9.2 Summary of national contributions

9.2.1 Experience drawn from the pre-accession support

The refocusing of the PHARE programme and the creation of the ISPA and SAPARD programmes in 1997/98 made important financial support available to the candidate countries for preparing for the accession. Whereas SAPARD aims at rural development, PHARE supports institution building and cohesion and ISPA large scale environment and infrastructure projects. Although 2003 was the last programming year for the new Member States, pre-accession support is still very much a living issue: contracting continues in 2005 and payments until 2006.[111] In the course of the present study, it seemed reasonable to assume that the experience from the pre-accession support would throw some light on the possibilities as well as on the difficulties that the new Member States would face, once included in the ECP.

All Country Studies generally make a favourable assessment of the implementation of the pre-accession programmes, although to a varying degree and with several modifications. The Latvian Country Study says that the main goal to prepare for the use of the Structural Funds has not been fully achieved and the Polish study indicates that the programmes were inadequate even if the funds in several respects contributed to the economy. Other Country Studies show a much more positive attitude towards the pre-accession programmes. It is a common experience that the various programmes have revealed a large number of institutional, managerial and administrative shortcomings on the receiving side – shortcomings that, perhaps, have not yet been fully overcome but which must be addressed in the nearest future. Several instances of unfinished projects and of funds that had to be returned are reported. The Slovak Country Study claims that pre-accession support has increased administrative capacity and experience which, in the words of the Study, hopefully will help to overcome the obstacles to the use of ECP funds that still exist. The Czech contribution goes even further and states that the Czech Republic has taken full advantage of the pre-assistance support and succeeded to stimulate investments in sectors or regions that otherwise would have been neglected. The Czech Country Study also says that the programmes made a contribution to the success of the accession negotiations but admits that the first aim was to secure as much financial resources as possible. The strongest reaction comes from the Polish Country Study which emphasises that the domestic authorities could not influence content and priorities of the programmes –

[111] The Slovak Country Study expresses concern that the simultaneous implementation of projects financed by preaccession funds and the preparation for the funding through regular ECP funds might create institutional and administrative difficulties.

they were consulted rather than playing an active role. All in all this led to a situation where the main concern became not to lose any of the funds available from the EU.

The lack of national influence on the pre-accession programmes is also stressed in the Latvian Country Study and certainly in the Hungarian contribution. The latter makes a favourable overall assessment but emphasises the problems caused by discrepancies between the Commission and the national authorities: sectoral priorities were seen quite differently and bureaucratic hurdles made the use of funds difficult. A special feature in the Hungarian Country Study relates to agriculture and the SAPARD programme: through fortunate circumstances Hungary had already succeeded in building up a relatively successful agricultural sector. The system change meant that well functioning cooperatives were broken up and the SAPARD programme had to serve, instead, a fragmented sector with a large number of small landholders. These problems remain for the future, according to the Country Study.

The Country Studies do not reveal any striking differences between the three programmes except that one Country Study (Latvia) mentions SAPARD as the most successful programme, this in contrast to others. There seems to be satisfaction also with the infrastructural investments financed under ISPA. The Hungarian Country Study states that the experience gained from ISPA is a good model for the use of the Cohesion Fund – probably also with respect to tackling the bureaucratic and other hurdles from the side of the Commission that the Country Studies elaborates on. The attitude towards the environmental projects is more ambiguous even if in Slovakia important improvements in the waste water treatment sector seem to have been achieved.

There does seem to be a certain inconsistency in the Country Studies (with the exception of Hungary) between the overall assessment of the pre-accession support and the identified problems and obstacles. When all is said and done, the general assessment is positive, except, perhaps, in the Polish Study but even there available funds seem to have been absorbed. This must be contrasted with the overwhelming number of problems, shortcomings and failures that have been identified: particularly the Slovak Country Study contributes an impressive list. The Polish Study also lists a number of difficulties but they appear to be different in nature and mainly concern the mode of implementation (procedures must be simplified, more emphasis should be placed on SMEs and on the participation of young people, etc.) With some exception, Country Studies seem to indicate that most of those problems have not yet been resolved and will remain as policy obstacles for a considerable period of time. Adequate legislation is not in place, managerial and administrative capacities are lacking, project identification and preparation deficient and costly. At least in some countries, internal political problems and pressure from special interests make reforms difficult or impossible. All this is compounded by a certain unease about the proverbial Brussels bureaucracy and a feeling of being in a weak negotiating position vis-à-vis the Commission.

Obviously the flip side of all this is that crucial bottlenecks have been identified and even to some extent eliminated and that work on reform and new structures has started. But it is difficult to get rid of the notion that the positive assessment of the pre-accession programmes to a large extent is based on the fact that considerable financial resources thereby have flown into the country. The uncertainty remains as to whether the pre-accession support really has been able prepare the new Member States for a successful participation in the ECP. A first, tentative, conclusion would be that also in the coming years much resources will have to be concentrated on continued administrative and legislative reform, coupled with strong measures for training and education at several levels.[112]

9.2.2 Controversial issues in the accession negotiations

In the design of the study it was assumed, as outlined in chapter 1, that the various national positions and requests in the access negotiations would provide a good indication of how each country perceived that an optimal future ECP should be formulated. Accordingly, the cooperating partners were asked to outline the divergences that might have appeared in the negotiation process between the national positions and the position of the Commission.

Country Studies show clearly, however, that the divergent views – and they existed – arose along quite different lines and did not so much relate to the very objectives of Structural Policy or to the optimal use of funds. Instead, purely operational issues were in focus, at least according to the Country Studies. In two cases, Hungary and Poland, overall financial issues were particularly contentious. Both countries demanded larger allocations than those proposed by the Commission. In Poland's case, concerns about a slow inflow of funds during the first years of membership led to a request for a phasing in of the payments to the EU budget – something which was promptly rejected by the Commission. (Poland, however, gained certain other financial concessions, largely, it appears, as last-minute compensations or a way out of a negotiation deadlock.) In all countries, with the possible exception of Hungary, a weak negotiation position, unfamiliarity with procedures, a fragile administrative structure and, perhaps, a general lack of negotiation capacity were perceived as the main obstacles to a more successful outcome of the process. Several countries, however, seem to have pressed for a larger share of the Cohesion Fund because of its simpler procedures of administration.

[112] For a concurring assessment, albeit with a slightly more positive slant, see Richter (2005), section 7.

Latvia may have been an exception according to the Country Study, where sectoral and thematic priorities were at the centre of attention and sometimes led to "emotional negotiations between representatives of Latvia and the Commission" in the words of the Study.

A special – and important – aspect of the shortcomings relates to the decentralisation of government and public finances. In some cases, a rather artificial regional structure was imposed on a country which had had no experience of decentralised decision-making for many decades. Brave attempts to apply this structure to the required planning process sometimes led to distrust from the side of the Commission and to unilateral changes in the planning structure. An example in the same vein, but with different result, is given by the Hungarian Country Study: national negotiators were finally allowed to elaborate Operational Programmes at the national rather than at the regional level which greatly enhanced the absorption capacity. The Hungarian concern is now whether this will be allowed to continue over the next planning period.

Again, very little guidance for the design of an optimal ECP for the future seems to be given by the reports on the negotiation process in the Country Studies. It can of course be inferred that a strengthening of the administrative and managerial capacity on the receiving side will be an essential prerequisite for a successful ECP. Likewise, that the use of and access to the Structural Funds should be as unbureaucratic and easy as possible, with as few conditions as possible for the receivers. But those are extremely general conclusions and give little advice on how an ECP should be designed to best suit the new Member States, given the overall objectives of that policy. For this we have to turn to the inventory of the main challenges for the future given in the Country Studies as well as to their own look at the proposals currently on the negotiation table.

9.3 The starting position

As this is written, the new Member States have had experience of pre-accession support at least since 1998. They have successfully concluded the accession negotiations in which the amount and composition of the structural support funds for the period 2004-2006 were agreed and they have started the process of implementation. Together with all other Member States, they are in the middle of a new negotiation process: this time to agree on the Financial Perspective for the period 2007-2013 including the amounts to be allocated as well as the objectives and goals of the structural and cohesion support. In this section 9.3 we try to draw some conclusions from the previous experience of the new Member States, as it has transpired not only from the preceding section but also from other parts of the analysis in the Country Studies. Section 9.3.3, in particular, attempts to formulate the problems that the future ECP would meet if the difficulties and issues, identified in the Country Studies, would not be given sufficient attention in the formulation of the policy for the upcoming period. Those problems and issues relate both to the ability of the new Member States themselves to reap the benefits of the ECP and to the various components of the ECP system.

Even if all Member States share the goal of an increased cohesion within the EU, the financial interests of the net payers and the net receivers create natural areas of friction. Whatever the final outcome of the negotiations on the future finances, it is obvious that financial resources will be limited and that available funds must be used in a judicious way in order to further growth and cohesion. To create the conditions for this to happen is now the immediate common task for all Members States as well as for Commission and Parliament. How well prepared, then, are the new Member States in this situation, after almost a decade of experience? And are there obstacles inherent in the proposed system which will make it difficult for the receivers to use funds in the way it is intended by the EU? The Country Studies give a number of indications. We will start by looking at the national issues as identified by the Country Studies and then identify some legacy of the previous system that is perceived as particular obstacles for the new Member States.

9.3.1 Urgent domestic issues

Need for improved strategy and planning

The Country Studies unanimously stress the need for elaborating a better long-term strategy for the national Structural and Cohesion Policy and for the use of support funds from the Union. The Hungarian and Polish Country Studies clearly state that the present strategy has been mainly limited to ensuring that no funds are lost, in other words, to make sure that available support possibilities are used to the utmost. The same can quite easily be inferred from the other Country Studies as well as a clear awareness of the inadequacy of this situation. The Slovak Country Study points out that their strategic documents have been late, particularly in comparison with neighbouring countries. Even if this has now been corrected, the documents are often, in the words of the Country Study, obscure and difficult to understand for the potential users – not the least for those that may apply for funds. According to the Czech Country Study, improved planning documents are under way but have little chance of survival given the political situation in the country.

Some Country Studies make the point that national priorities and EU priorities are confused or overlapping. Necessary budget restraint may lead to cuts being made in the wrong areas (for instance education – Hungary). Countries should see the ECP supported priorities as long-term investment, necessary for growth and convergence, which should not be affected by short-term budget considerations. Budget cuts should be made in areas outside the development plan (the Czech Republic).

Some Country Studies underline that the national development plans lack strategy and vision and rather display the character of a “shopping list” (The Polish Study). The Hungarian Country Study makes a particularly interesting point: the relatively primitive strategy that has been prevailing and which mainly consists of ensuring that all possible support funds are taken advantage of so that no money is lost (which, nevertheless, has happened in several countries and instances) risks creating the opinion that the new Member States are in the European game just for the money. The Hungarian Study warns for a confusion between instruments and objectives and points to the necessity of defining a sustainable long-term strategy for the member country in the European context instead of just aiming at “the highest possible absorption of potential EU funds.” Well thought out national strategies may or may not coincide with the Commission strategies but will at any rate form a sound basis for negotiations and for making the case in Brussels and vis-à-vis the net payers.

Lack of administrative and managerial capacity

It is clear from the Country Studies that there are still great shortcomings when it comes to the ability of national authorities to act as effective counterparts in the ECP, despite intensive training and institution building activities. The highly centralised system of the centrally planned economies was obviously not conducive to building up regional and local capacities. Reforms also have to address the political culture says the Hungarian Country Study and Slovakia laments that it is sometimes difficult to get understanding even for the basic principles of cooperation within EU. Much of the planning work is in the hands of municipalities, without much experience and hampered by lack of cooperation with regional authorities. The Country Studies of Poland and Hungary emphasise the need to encourage local initiatives and initiative for promoting SMEs but have to admit that the capacity to do so is largely lacking. The Slovak Study points out that the fiscal decentralisation has not been implemented which means that the regions have no financial resources to stimulate endogenous growth. Slovakia has tried to use unpaid external advisors for project assessment but found that very difficult – lack of financial incentives seldom leads to a good job, apart from special cases where a more idealistic attitude might prevail.

Particularly in Hungary, Poland and Slovakia the above issues have been aggravated through regional reforms which have been less than optimal. The Hungarian Country Study is most outspoken on this point: The NUTS 2 regions have been created by artificially grouping NUTS 3 regions (termed “counties” in the Country Study) together but they have no or little political relevance or administrative capacity. A special problem concerns the region of Central Hungary which includes the capital city: a huge *hinterland* of Budapest is excluded from Objective 1 assistance because of the weight of the wealthy capital city. The Country Study argues in favour of a split of this region in two, one of which would be the capital city. There is a somewhat similar situation in Slovakia: the three administrative areas which existed under the old regime have been split up in 8 regions of doubtful relevance and with glaring shortcomings in capacity, facilities and experience. The decentralisation of public administration and fiscal policy is painful and hampered by lack of cooperation between the central and regional levels of authority.[113]

In the Hungarian Country Study the lessons seem clear: the experience from the pre-accession period shows that an efficient use of available resources could only be secured when planning and decision-making is made centrally. Operational Programmes were elaborated on the national level due to the missing tradition and administrative capacities at the NUTS 2 level. According to the Country Study the national approach has permitted quick access to and absorption of resources during the first critical years of membership. The Country Study argues for a continuation of this approach and rather worries at the thought that the Operational Programmes would have to be regionalised after 2006. The Polish Country Study, on the other hand, presents quite a different point of view and argues strongly in favour of the official position which is to organise the national Cohesion Policy in 16 regional programmes, corresponding to the NUTS 2 regions, against the Commission proposal to work mainly with sectoral programmes. The Polish approach would require a considerable amount of further decentralisation of administration and public finance in order to provide the regional and local authorities with the necessary instruments. Sectoral programmes, in the eyes of the Polish Country Study, would be subject to pressure from sectoral lobbies and political parties, particularly from industries which are still dominated by state ownership. The Polish Country Study is convinced that management of the Structural Funds at the regional level is the only way to strengthen local government in a situation of a permanent budget deficit and thereby ensure that EU Cohesion Policy will take predominance over domestic interests.

Co-financing requirements in a period of structural budget deficits

All Country Studies point to the obvious conflict between the need to reduce the budget deficit and the co-financing requirements. It would appear that this is perhaps the largest problem relating to the present European Structural and Cohesion Policy. But the assessment of the situation – as well as of what needs to be done for the future, varies from country to country.

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[113] This is also an effect of an old way of thinking and is a part of the political "culture". Those issues can probably only be resolved through the passing of time and generations. This should be borne in mind when formulating the rules for the implementation of the Cohesion Policy.

The Hungarian Country Study states explicitly that future co-financing requirements will be met but that a restructuring of the budget would still be necessary to comply with the ERM-criteria and allow for an introduction of the Euro by 2010. Both expenditure and revenue reforms would be necessary; for political reasons opportunities of such reforms have been missed in the past. Like the Czech Country Study, the Hungarian one points out that it is necessary to see the resources used for co-financing of EU-supported projects as long-term growth oriented investments which should not be curtailed by short-term considerations. Also the Polish Country Study emphasises the positive role that the co-financing requirements could play in pushing necessary budget reforms.

Nevertheless, a general tenor in the Country Studies is the need to change or relax the co-financing requirements. The Slovak Country Study mentions that Slovakia has been warned by the Commission that it might not be able to use all the funds allocated for the period 2004-2006. The Country Study relates this to co-financing problems but also to the EU disbursement procedures which sometimes are considered as very inadequate because of the liquidity pressure that can arise between the end of a project and the final disbursement of EU funds. This is a recurrent theme in the Country Studies: since payments are made very late in the project cycle, particularly smaller entities (municipalities and enterprises) fall into a liquidity trap. This has also a negative impact on their willingness and ability to participate in future ECP-financed projects.

Several Country Studies point out that it is at the lower levels of administration, regional and municipal ones, that the co-financing problems become really acute, often due to disastrous financial and budgetary circumstances. The Slovakian Country Study mentions that this leads to a preference for larger projects at higher levels where the situation might be easier to handle (see chapter 7, section 7.4). The Latvian Country Study takes a particularly pessimistic view of the co-financing possibilities at the local level and points out what it finds to be an inconsistency: on the one hand private financing is no longer eligible for EU contributions to the same extent as before, on the other hand the EU encourages so called public-private partnerships as a way of overcoming the difficulties with co-financing.

9.3.2 Removal of obstacles in the present and proposed system

The proposal by the European Commission for the ECP 2007-2013 was described in detail in chapter 2 (see section 2.3). The Commission has replaced the former “objectives” with 3 new priorities: Cohesion for Growth and Employment, Regional Competitiveness and Employment and European Territorial Cooperation. “Cohesion policy in all its dimensions must be seen as an integral part of the Lisbon strategy” (COM 2004, section 2) and also integrate the Gothenburg objectives. The Commission has proposed a considerable increase in the amount of resources for ECP, distributed via three funds. A general aim has been to simplify the system, among other things by having each operational programme financed mainly from one of the three funds, with limited possibilities for "cross-financing." Furthermore, support for rural development and restructuring of fisheries industry has been transferred to the heading Common Agricultural Policy.

The proposal was under negotiation until the failure to reach a general agreement on the future Financial Perspective became apparent in June 2005. Although a broad generalisation, it may be fair to say that the negotiations so far focused on the total amount of funds for ECP and on the criteria for allocation between countries, in particular between the old and the new Member States. We shall revert to those fundamental issues later. Here we will take up some features of the proposal which so far seem to have had a lower priority in the negotiation process but which nevertheless are fundamental for the receiving countries. The Country Studies show clearly that the experience of the pre-accession support has led the new Member States to identify a number of issues related to *the system itself* which they consider as obstacles for an efficient use of funds in the present system. A discussion of those obstacles will indicate some answers to the third question of our study outline: whether the ECP in its current shape, including the proposed changes, causes problems due to its design.

Simplification of procedures

There is an inherent conflict between the aim to decentralise management and implementation of ECP-funded projects on the one hand and the required formalities for project preparation, proposals and reimbursement on the other. Whereas this may be little more than an annoyance in old Member States, it can become a real obstacle in the new Member States. The Slovak Country Study bears witness to this when it enumerates the documentation that has to be attached to a project proposal: detailed budget of the organisation, articles of association, annual report, accounts, official registration certificate, and a bank statement which certifies the ability to co-finance the project. A special account has to be opened for EU financial sources and very strict requirements are imposed as to accounting, budgeting and monitoring. "Many of the projects are refused because of formal mistakes", says the Slovak Country Study.

The matter is not made easier by the nature of the EU disbursement and reimbursement procedures. Normally, funds are paid out very late in the project cycle with final payment sometimes one or two years after the finalisation of the project when all formal requirements have been met. Obviously this can lead to a severe liquidity crisis for small enterprises or municipalities which also have difficulties in accessing the banking system. Yet, as the Hungarian Country Study says, "local initiative is crucial from the point of view of the successful use of the possibilities of EU transfers."

One step in the direction of simplification is the introduction of the *proportionality principle* according to which the complexity of the system of monitoring will be weighted against the size of the project. This is explicitly welcomed in the Polish and the Slovak Country Studies even if the latter offers the opinion that the principle should be applied to more programmes and areas than has been proposed by the Commission.

More flexibility in the use of available funds

For the receiving countries the ability to make maximum use of allocated or available funds is obviously close to the heart. The Country Studies contain a plethora of proposals and ideas of how to eliminate some of the obstacles in this respect; obstacles which are easily perceived as exaggerated or “bureaucratic” but which may be differently assessed by net payers or by the Commission.

Some of those observations relate to the method of assessing the project costs that are eligible for EU-financing. It was stressed above that small entities have difficulties in participating actively because of the liquidity squeeze caused by the EU reimbursement rules. This problem is compounded by the fact that costs for *project preparation* are not eligible for EU-financing. The Slovak Country Study tells a compelling tale about having tried to have unpaid volunteer experts help in assessing project proposals but, obviously, without much success. Likewise the new proposal of excluding VAT from EU-financing will have a negative impact according to the Polish, Czech and Slovak Country Studies since it will substantially increase the domestic contribution.

The alleged simplification of funding procedures – that each programme in principle would be financed from one fund only with limited possibilities of “cross-financing” – has generally got a negative reception in the Country Studies. Rather than simplifying, this proposal complicates matters, says the Czech Country Study. The Latvian Country Study discusses the problem at length from the particular perspective of synergy between projects financed under different objectives in a small country, for instance between social and regional projects. One way out, according to the Latvian Study, would be to greatly increase the amount of permitted cross-financing. Basically, the Study says, the establishment of the mono-financing rule shows a lack of understanding of the special circumstances in a country like Latvia.

A foreseeable reaction is the criticism of the strict application of the so called n + 2 rule[114] as well as a general wish to soften the co-financing requirements whereby the required budget restraint in view of the Maastricht criteria is a frequently used argument. The Czech as well as the

[114] This abbreviation refers to the so called “sunset clause” according to which funds get decommitted if not claimed at the latest two years after the commitment year.

Slovak Country Study also express their opposition to the proposal of earmarking some of the funds for a National Contingency Reserve.

9.3.3 Conclusion: Status quo ante bellum?

The review of the Country Studies made above gives the impression of a situation where the new Member States, eager to make the best possible use of the new sources of finance that the EU Membership has put at their disposal, are in the middle of an embarrassing double-fronted conflict. On the one hand they face rules, formalities and detailed regulations imposed by Brussels, on the other hand they suffer from a grave deficiency in the domestic ability to absorb those funds and to manage and implement the corresponding projects. The question we had originally formulated for this part of the study can be summarised as: *What will the future ECP look like in the new Member States if present conditionalities will be retained in the next Financial Perspective?* Even though we may not have received an explicit answer to this question in the respective contributions, it is not all that hard to find the answers that are implied in the Country Studies as they have reviewed the shortcomings both in the national system and in the current ECP proposal. Our conclusions as to the answer to the question posed are, then, as follows:

1. If there are no internal and EU-reforms, ECP will continue to limp along, particularly in the first part of the period. The main concern of new Member States will be to ensure as much funds as possible with little strategic planning. The main concern of the Commission will be to make sure that funds are not squandered (continued actuarial control).
2. Among other things this might cement the opinion, both in the EU 15 and the new Member States that the EU mainly serves as a source of financing. This will be absolutely contrary to the idea of increased cohesion in Europe. An unchanged ECP would therefore be counter-productive with respect to improving cohesion.
3. There is a severe incongruity between the convergence criteria for budget deficits (ERM) and co-financing requirements. This will also hamper ECP – there will be more cases of new Member States returning funds to the Commission or for being included in the Growth Adjustment Fund.[115]
4. The difficulties connected with the formalities and the inflexibility of the system are mainly felt at the regional and local levels. At the same time a continued decentralisation or regionalisation is a central feature of the ECP. There is a risk that this may aggravate the problems for the new Member States of making full use of available funds, particularly at the beginning of the financial period.

[115] The Growth Adjustment Fund under Heading 1a in the proposal for new Financial Perspective is intended to be financed partly by non-utilised ECP funds!

5. The situation might even give net payers good arguments for wanting to be restrictive since ECP funds may be considered as a sub-optimal way of using scarce funds.[116]
6. Many problems and issues have been well identified and good experience gained since 1998. Reform work has started. It is quite possible that this process will continue and even accelerate in which case the problems discussed may be at least partly resolved some time into the next financial planning period. (The Hungarian Country Study says explicitly that EU policy will enforce budgetary reform in the country and that that is good. Also the Czech Study replies in the same vein.) However, in many new Member States the political situation is unstable and special interests and old political culture could delay the reform process.[117] It is difficult to see which tendency will prevail.
7. Realistically, it is not very likely that a significant increase in regional convergence will take place, at least not in the first part of the period, since to a large extent the old problems remain. (See again chapter 3). This is not to say that convergence at the EU level, between countries, would not happen – there are growth centres and production capacity in all the new Member States and probably good chances to attract FDI. If anything, this might further increase the regional divergences within the countries. This could be mitigated through an effective transfer system but that might, in its turn, affect the competitiveness of the growth regions in a negative way.

9.4 The system adapted: country preferences revealed

In this section the preferences and priorities for the future ECP, as expressed in the five Country Studies, will be described. Since these priorities have been identified by independent researchers, they may or may not coincide with those expressed by their governments in the official negotiations. In the concluding section, 9.5, we will try to summarise the main conclusions that can be drawn for the future ECP on the basis of the studies but we will also contrast those with the approach that the actual negotiation work seems to be taking.

9.4.1 Objectives and themes

The objectives and themes proposed by the Commission generally find

[116] A similar point is made by Richter (2005, section 7).

[117] This is sometimes masked as a discontent with the willingness of the EU to take "historical facts" and "special circumstances" into account. But the Copenhagen criteria are clear (relatively speaking) and cannot be modified on such grounds. We might compare with the current discussion with Turkey where there are, obviously, very critical "historical facts" and "special circumstances" that are at odds with the basic community values but where the position of the EU is, and should be, absolutely firm. The same must go for minority rights and similar issues.

acceptance in the Country Studies. The embracement of the Lisbon and Gothenburg objectives is also welcome: it provides the new Member States with a strategy for transforming their economies, dominated by agriculture or basic industries into what is generally labelled as “Knowledge Based Economies”.[118]

This being said, emphasis on the various objectives and priorities seems to vary. A general theme seems to be that a larger share of the Structural Policy resources should be allocated to the Cohesion Fund. The reasons for this are easy to understand: This fund is mainly earmarked for the new Member States,[119] its handling and implementation is easier than for the other programmes, generally good experience has been gained from the ISPA programmes and, last but certainly not least, co-financing requirements are lower. Another reason for the emphasis on the Cohesion Fund is that it lends itself to larger projects in transport infrastructure as well as the environmental area.

The assessment of the large transport infrastructure projects seems to vary a bit between the Country Studies. The Polish Study warns that large transport infrastructure investments may be difficult to manage and lead to centralisation. They stress the need for good local or regional transport systems as does the Slovak Country Study. The Hungarian Study has another view: here the field of tension is between the Commission’s insistance on transport by rail and the national needs which are rather to develop the highway system. (See the reasoning on “highway density” in the new Member States vs. the old Member States in section 3.4.2 of chapter 3.) This reflects an interesting difference of views: environmental and energy concerns in the old Member States have led to a general acceptance of the need of a transfer from road to rail which is not necessarily the priority of the new Member States where the road network to a large extent is underdeveloped or dilapidated. The question that can be asked is whether the “western” view represents an enlightened long-term sustainable development strategy or whether it is more a question of impressing certain values on countries where conditions are different?

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[118] This moniker has become a catch-all that generally seems to indicate a highly developed industrial or post-industrial economy but with very little stringency in definition or clear ideas of the strategies required to reach this goal. We might well ask the question: should the whole of Europe become a “knowledge based economy”? Well, maybe, but in what time perspective? By focusing on the concept of “knowledge base” there is an apparent risk that more mundane development strategies will get less attention than they would deserve.

[119] This, of course, is one of the main negotiation points: the Country Studies generally carefully avoid discussing this issue although it would be very much in the interest of the new Member States if this principle would be accepted, particularly if the overall size of the EU budget were to be curtailed along with the wishes of some of the net payers. With a reduced budget and important ECP money being siphoned off to old Member States, the situation of the new Member States could become precarious. New Member States have, nevertheless, been unwilling to side openly with the net payers on this particular issue so far.

The Gothenburg objective of environmental sustainability of course gets the obligatory reverence in most Country Studies. It is somewhat concretised in the Czech and Slovak ones, where the need to focus on the waste water treatment is emphasised along with a report on the good progress made under the pre-accession arrangement (The Slovak Country Study). The Polish Study emphasises the need for upgrading environmental standards but underlines the need for thorough cost/benefit studies as well as the difficulties in coordinating with other institutions (the World Bank and IMF).

The objective of regional competitiveness and employment is an interesting one because it is, among other things, defined as helping "regions and the regional authorities to anticipate and promote economic change in industrial, urban and rural areas by strengthening their competitiveness and attractiveness" and also to support "policies aiming at full employment, quality and productivity at work, and social inclusion." Unfortunately this objective excludes most of the regions that qualify for the convergence objective. It is obvious that countries would also like to have greater access to funds under this objective. The Hungarian Country Study is of the opinion that automatic exclusion from this objective would work against the Lisbon objectives and the Czech Country Study goes so far as to suggest a merger of the Convergence and the Regional Competitiveness objectives.

The Latvian Country Study identifies certain large priority projects, for example in the housing sector, which need to be realised but which do not qualify under the EU requirements.

9.4.2 National or regional management of the ECP?

One of the major, and principally most important, conclusions of the Sapir report was that "There is a solid argument for the new EU convergence policy to focus on countries, rather than on regions, using national GDP per capita (measured in Purchasing Power Parity) as an eligibility criterion. However, individual countries may decide to delegate implementation and monitoring of this policy to their regions." This recommendation was not accepted by the Commission. Furthermore, while the principle of national management of the ECP had been tolerated during the 2004-2006 period, the proposal for 2007-2014 is aimed at transferring the responsibility for the management and implementation of the ECP to the regional level.

Against this background, it is interesting to note that a majority of the Country Studies have more or less indicated that they would see advantages in a national approach. The Hungarian Country Study is most outspoken. It puts the question whether focusing on the national level would not be a better solution than the one presently being proposed. "Focusing on the regional level is hardly conceivable under the present circumstances", says the study, with reference to the underdeveloped regional and sub-regional administrative structures. Despite its heavy insistence on a number of regional programmes, the Polish Country Study also indicates acceptance of the "country approach" saying that priority should be given to growth since the regional imbalances can be seen as temporary and will decrease over time when adequate economic reforms have been implemented. The Slovak study emphasises that the public administration reform and the fiscal and administrative decentralisation has not yet reached the stage necessary for supporting the socio-economic development of the regions. The Czech Country Study calls attention to the need for clearly defining horizontal themes, an idea which is mainly compatible with a national approach to ECP. It also explicitly endorses the recommendations of the Sapir report even if that would lead to a "certain re-nationalisation of Cohesion Policy" (see in chapter 6, section 6.6.6).

9.4.3 The amount of funds and the co-financing issue.

Regarding the total amount of funds to be allocated for ECP in the Financial Perspective 2007-2013, the Slovak Country Study says that they would be happy with maintaining what they see as the present allocation, which represents 0.45 per cent of GNI. The Polish Study states that they could accept an overall budget of one per cent of GNI provided that this did not mean that funds for ECP would be "crowded out". The Czech Country Study believes that this would be the case, however, and expresses a mild dissatisfaction with the assessment method: the total amount of the ECP allocation should be decided through a bottom-up approach and estimated according to the objectives of each new Member State.

As was mentioned above, the conflict between the needs to implement budgetary reforms and restructuring of public expenditure in order to meet the Maastricht criteria and the co-financing requirements transcends all the Country Studies. Whereas the Country Studies of Hungary and Poland admit that they would be in a position to meet the requirements also in the future despite the "alarming" (Poland) budgetary situation, they, as well as the other studies, advocate a loosening of the co-financing regulations. This could take the form either of moving more resources to the cohesion fund or by allowing private financing to be counted as national co-financing or by otherwise changing the proposed rules for estimating the requirements (see above).

A more dynamic proposal is contained in the Hungarian Country Study which suggests a direct coupling between the macro-economic criteria and the co-financing requirements. The larger the extent to which a country would meet the Maastricht criteria, the easier would be the co-financing requirements.

All Country Studies, except the Czech study, discuss the so called four per cent cap. The most common approach is to propose that certain policy areas should be excluded from the cap: environmental and infrastructure investments says the Latvian Country Study, territorial co-operation and rural development says the Slovak Study while the Polish one opts for both rural development and development of fishery industries to be excluded.[120] The Latvian Study argues that the rule is unfair towards poorer countries where the needs are correspondingly larger. National divergence will thus be maintained, argues the study, which admits that a complete cancelling of the four per cent cap rule is impossible for political reasons. The Latvian as well as the Slovak Country Study argue in favour of using more realistic GDP growth data when estimating future allocations.

9.4.4 ECP priorities as defined in the Country Studies

Development of human resources

All country studies unanimously stress the overwhelming need to develop domestic human resources through education and training at different levels. This is no doubt the strongest tenor through all the studies even if the proposals vary in detail and concretisation.

The Latvian Country Study points to human resource development as an investment which will not distort markets and will allow the economy to grow faster also in the future without additional subsidies. The Hungarian Country Study blames, at least partly, the "educational level of the society" for the lack of multiplier effects and absorption capacity and emphasises the need to strengthen the human capacity at the NUTS 2 regions which, as we have seen above, remain mainly a statistical construction. The Czech Country Study notes that almost half of the total number of unemployed are job seekers without secondary education and that it is necessary to adapt the human resources to the labour market conditions and infrastructure development. The necessity to improve IT and language skills in the public sector is mentioned. But the core of the consideration in the Czech Study is that a much stronger connection between the private sector and the educational institutions must be established (see chapter 6, section 6.6.7, subsection on Innovation, R&D and technology). There should be a focus on practical skills, including project management, teamwork and communication skills as well as problem solving and implementation of solutions in an industrial environment. To this effect educational institutions from other Member States should be encouraged to establish departments within the Czech Republic.

Human resources and education is one of the four priority areas defined in the "Competitiveness Strategy of Slovakia until 2010". The intention is to increase the flexibility on the labour market, to reduce unemployment and

[120] It would seem that both the Slovak and the Polish Country Studies have a good point: it seems illogical to transfer the rural development funds to from ECP to CAP but still count them against the four per cent cap on Structural Funds!

the risk of exclusion of the most vulnerable groups. The Roma community is explicitly mentioned.

The Polish Country Study discusses the theme of human resources, education and training at great length (see chapter 4, sections 4.5.1 and 4.5.2). After stating the necessity to improve human capital through improved primary and secondary education, life-long learning and social initiatives, the study goes on to discuss shortcomings in and proposals for reform of the educational system. Differences in access to educational opportunities and in their quality between rural and urban areas would increase regional divergences since regions with a better educated population have a greater growth potential, among other things because they are more attractive for foreign investors. Those regional differences would worsen rather than improve because of the secondary and multiplier effects. Financing remains the greatest constraint on improving the educational system. The study supports a certain centralisation of the system. The authors also point to the risk of a *backwash effect* (or brain drain) and emphasise that life-long learning procedures are less susceptible to such negative effects. The Polish Country Study explicitly recommends that the ECP framework should be strengthened with a Common Education Policy objective with the same priority and financial resources as environmental or regional policy.

The issue of *social exclusion,* which is mentioned under objective of regional competitiveness and employment in the Commission's proposal (COM 2004, section 2.2), has to some extent been successfully handled by Non-Governmental Organisations (NGOs) in Poland. Since those NGOs to a large extent are dependent on government subsidies they have been hit by budget cuts. The Polish Country Study sees those NGOs as suitable agents for ECP financed projects under this objective (see chapter 4, section 4.5.2).

One item which is not discussed under this heading in the Country Studies, but which, nevertheless, belongs in the field of Human Resources, is what we might call *political culture.* This concept is discussed in the Hungarian Country Study but permeates implicitly the discussion of administrative and managerial capability as well as the absorption, implementation and monitoring capacity in most of the other contributions. We do not think that this is the place to define and discuss this particular issue except by noting that most Eastern European Member States have a heavy heritage from previous regimes in this respect. An item *pro memoriam* should, without doubt, be entered on the agenda for the design of the future ECP.

Research and Development
All country studies have endorsed the Lisbon objectives and expressed their intention to move towards a "knowledge based economy"[121] and the need to focus on investment in research and development in this perspective. The Polish Country Study regrets that its Government does not actively support basic research (apparently, it is not even mentioned in the development plan for 2007-2013) but puts all emphasis on applied, "commercial", research with the argument that only close cooperation between research and industry can give optimal results. Information technology is thus given a clear preference. The Country Study argues that there must be a balance between basic and applied research and that all opportunities to receive ECP support for both should be exhausted.

The link between industry and research is also stressed in the Czech Country Study. This study appears very conscious of the risk that the creation of high technology growth poles may aggravate regional imbalances. The backwash effect that was mentioned above is also discussed. The Slovak Country Study points to the formidable challenge of the national strategy plan, which advocates a shift towards a knowledge-based economy and an information society with emphasis on research and innovation. The Strategy document wants to achieve this through education and support of scientists, internationally competitive research in cooperation with industry and effective public support of business activities aimed at research and innovations.

Cross-border cooperation
Both the Slovak and the Hungarian Country Studies underscore the importance of cross-border cooperation and projects. For Slovakia this would be an instrument for combating long-term unemployment and it is the cross-country integration of labour markets that is in the centre of interest. The Hungarian Country Study goes much further and proposes a new objective for the ECP, namely *Cross-border infrastructure and environment protection* for the new Member States (chapter 5, section 5.7, "The need for a new budget line: Trans-border infrastructure and environment in the new Member States"). Hungary and all the Eastern European Member States will need a highly developed infrastructure in order to reap full benefit from their geographical location. But it is important that those investments be coordinated between the new Member States. Transport arteries should not be confined only to the east-west direction but also within and between the new Member States, thus also in the north-south direction.[122] According to the Hungarian Country Study a new

[121] See our reservations expressed in footnote 118.
[122] Given the rather westward location of the Czech Republic those expressions should be seen metaphorically rather than as exact geographical signs of direction…

European policy objective could help to prevent national prestige projects and have a great and expedient impact on growth. Such an objective could become an instrument for avoiding what the study calls “narrow-minded and selfish bargaining”. In the opinion of the Hungarian study the introduction of this objective would also send a political message to the not-yet-Member countries that they are not being neglected by the Union – they could even participate in some of the projects. Financing should, at least partly, come from other national fund allocations and the projects under this objective would have a considerable European Added Value[123] which would benefit also the net payer countries. According to the Hungarian proposal, this objective would fall under the Cohesion Fund, thus easing the co-financing burden for the new Member States.

Regional convergence as a priority?

Regional convergence is an established part of the EU policy and goes way back to the Treaty of Rome. It must, in this quality, always be at the heart of the common Structural and Cohesion Policy of the Union, irrespective of how particular objectives are formulated and specific instruments designed. Against this background, it is striking that only the Czech contribution explicitly mentions regional convergence as a priority for the future and, even there, it is set in the context of increasing occupational and geographical mobility of the labour force. The importance of the regional convergence objective is self-evident but it is also clear that the Country Studies emphasise horizontal, growth stimulating, themes as development of human resources, research and development, institution building and even trans-border cooperation.

9.5 The conclusions: a simplified and growth oriented Cohesion Policy for the new Member States

So far, this chapter has summed up the experiences of five new Member States in their participation in the various forms of European Cohesion Policy, both before and after accession (Section 9.2). We have tried to identify the dangers and risks for the future that are imminent if the present system remains unchanged, even taking the proposed reforms into account (Section 9.3). Finally we have summed up what the Country Studies have identified as the most urgent priorities for the ECP if current structures and conditionalities were relaxed: section 9.4 shows that those priorities to a significant extent deviate from those of the current proposal which is being negotiated between all Member States. We underline, once more, that this is the result of an analysis made by independent experts which may or may not be identical with the official positions of the governments in question.

[123] For an in depth analysis of this concept; see Tarschys (2005).

In this section we go one step further and try to list certain elements that could be discussed for inclusion in a revised ECP framework, better suited to the particular needs of the New Eastern European Member States. It should be stressed that whereas those elements are derived from the five Country Studies, the participating institutes are not individually responsible for this summary assessment of the present ECP or for the suggestions for a reformulation. We offer these proposals, however, as an input to the discussion of the Cohesion Policy in the new Member States which we are convinced will continue for a long period to come.

9.5.1 Too many goals for the Cohesion Policy?

In a study from 2003, D. Tarschys discusses the *omnipresence* and *multi-finality* of Structural Policy. Structural policy has been present in the policy areas transport, environment, research, employment, agriculture, competition, urban affairs and even peace. Structural Policy has also been very rich in goals, for instance, the well-known 7 objectives,[124] later "simplified" to 3 objectives and 4 Community Initiatives. Transcending this structure of goals and policies, according to Tarschys, are 3 "layers of purposes", the first one of which is the *compensatory* motive (Structural Funds used as a resource to "buy out" countries in a negotiation situation), the second motive relates to *convergence and cohesion* and a third one which relates to *institutional and attitudinal side-effects*. The latter motive includes institution and capacity building as well as involving greater parts of the society in the European integration project.

This multidimensional structure of the policy itself has led to a congestion of goals, that is to say there are many instruments for many objectives (Sapir *et al*. 2003, section 1.3, *et passim*). Normally, maximum efficiency is considered to be attained when there is one instrument for one goal. Obviously, this can never be achieved in a political context as complicated as the EU. But the Commission is aware of the problem and views its proposal for 2007-2013 as "a simplified and more transparent framework" (COM 2004, section 2) that would lead to increased efficiency in the Cohesion Policy. The proposal states: "The pursuit of the priority themes would be organised around a simplified and more transparent framework with the future generation of programmes grouped under three headings: convergence; regional competitiveness and employment; territorial co-operation."

After this courageous statement of intention, politics obviously kicked in. Figure 9.1, which utilises the original wording of the proposal, shows that the goal congestion is very far from being eliminated. It is not easy to orient oneself among these objectives, key themes, headings, priorities,

[124] Objective 5 was split into two sub-objectives.

focus, responses and key principles. The modalities for financing the policy from three different funds is yet another dimension which is not included in the schematic presentation in figure 9.1.

Figure 9.1 Goal congestion in the proposal for European Cohesion Policy

- Cohesion policy needs to incorporate **Lisbon and Gothenburg objectives**
- **Core list** of **key themes** for **operational programmes**
- **Priority themes** and operational programs to be organized under **three headings** (**objectives**)
- ERDF financed programmes under **three priority themes**
- ESF-financed programmes under **four policy priorities**
- Territorial co-operation **focus** on **integrated programmes**
- **Integrated response** to territorial characteristics
- **Key principles** of cohesion policy

Despite the ambitious attempts to simplify the ECP system we seem to have ended up with a proposal that is at least as multi-faceted as the old one. This in itself is the result of a long development process, practically since the initiation of the European Union where every enlargement has led to modifications of the system in order to accommodate both the new and old Membership (Tarschys 2003a). With the Eastern Enlargement, however, new Member States were more or less faced with a *fait accompli* and a very entangled one at that.

9.5.2 The goal congestion leads to policy taking – fund maximisation as an objective

The five Country Studies must clearly be seen against the backdrop described in the preceding sections. The participating institutes have, to a considerable extent, focused on *different* dimensions of the proposed ECP. Some discuss obstacles raised by modalities and procedures, others focus on difficulties to get access to available funds and in utilising them, yet other themes are the conditionalities, notably the co-financing requirements, and the design of the operational programmes: should they be "horizontal" or rather perhaps "regional"? The various objectives, themes and priorities proposed are somehow taken for granted: one or two studies discuss at great length *how* to use the allocated ECP-funds with much less emphasis on *what* the funds should be used for. With some exceptions, the attitude is one of *policy taking* rather than *policy making*. This has pointedly been summed up by one of the studies as a strategy of "making sure that no money is lost". One study concludes with great insight: "Integration strategy has been largely replaced by concentrating on the highest possible absorption of potential EU funds… This, however, means that objectives and instruments have been confused. EU transfers are a vital factor of successful membership and sustainable modernisation. However, at the end of the day, they are instruments and not objectives in themselves" (chapter 5, section 5.8.2, point 6).

It can easily be derived from the Country Studies that the *omnipresence* and *multifinality,* to borrow the terms of Tarschys, of the European Structural and Cohesion Policy are largely responsible for this attitude in the receiving countries. All through the Country Studies the call for simplification and flexibility is strong and impossible to ignore. We can also draw this conclusion from the sections of the Country Studies that discuss priorities for the future which could be implemented if current conditions and conditionalities were relaxed. The goals of strengthening human resources, increasing the level of Research and Development, continued institution building, particularly at the regional level, and cross-border cooperation appear as overall and common objectives. These are sub-goals of the overall objective to achieve growth according to the Lisbon principles and would accelerate the process of national convergence within the EU. The results should be achieved through more national control over policy and resources.

To achieve a true simplification of the goal structure of the ECP is probably impossible, at least in the short and medium term, due to the great number of interests involved and the character of *policy formulation by bargaining.* If this is so, the aim of all concerned must instead be to allow for maximum flexibility and concentration within the existing policy structure.

9.5.3 Focus on the neediest countries. More national control over the Cohesion Policy

Some of the receiving countries, and some of the net payers, favour a national approach to the Cohesion Policy instead of a regional one. A couple of Country Studies express that a cohesion policy focusing on the poorest countries, instead of the poorest regions, would be acceptable. This is also one of the recommendations of the Sapir report which points out that individual countries could delegate the responsibility for programme implementation to regions wherever possible. From the Country Studies we can, for instance, infer that this might not be a good idea in Hungary with its artificial NUTS 2 classification but on the other hand be exactly in line with the intentions in Poland, both as expressed by the government and in the opinion of the experts.

A strong caveat appears, nevertheless, in the studies that speak favourably of a possible national approach: since the strongest advocates for such an approach are to be found among countries that also encourage heavy budget restrictions, there may be a risk that it will be used as an excuse for reducing the resources allocated to Structural Policy in the new Member States.

A policy that focuses on income divergences between the Member States rather than between the regions would seem to satisfy net payers at the same time as it would give the receiving countries an increased control and influence over the Cohesion Policy. It would also be in line with various theoretical considerations[125] and with the conclusion of the Sapir report.

It seems somewhat prejudiced to label a policy focusing on national growth as "re-nationalisation", as has sometimes been done. An old term from development economics "redistribution with growth" immediately springs to mind. But it would be the responsibility of the individual Member States to take the measures for internal redistribution – measures that surely would be different from country to country depending on the special circumstances. The wish for such flexibility is also something that very clearly emerges from most Country Studies.

As was shown in chapter 3, all new Member States have some specific *problem regions* created mainly by historical causes. A special ECP programme for those problem regions might be considered.

9.5.4 Human resource development and institution building – the overriding priorities

The development of human resources takes pride of place in most Country Studies. There are two different aspects to this. On the one hand, such a development is one of the most important factors for long-term growth, welfare and European Cohesion. On the other hand, in the short run a considerable and rapid lift in managerial, administrative and technical levels is required in order to ensure an optimal use of the resources made available through the ECP and other EU-programmes. It may be left to the responsibility of the Member countries to find the right mix between basic and higher education, life-long learning and vocational training, presumably monitored by the Commission.

In the Commission's proposal for a Financial Perspective 2007-2013, education and training is mainly covered by Heading 1a "Competitiveness and growth of employment" which is allocated around ten per cent of the EU budget according to the proposal. The possibilities to finance human resource development through the ECP are limited to projects financed by the ESF and subject to higher co-financing requirements than the Cohesion Fund. Part of the ESF is also used for the Regional Competitiveness

[125] For a review of current theoretical as well as policy making discussion see Richter (2005), section 1, p. 24 ff.

Objective and hence out of reach for those regions that qualify for Cohesion assistance. The Country Studies bear overwhelming evidence that a re-orientation of the ECP so that Human Resource Development would become a major priority would be a substantial step towards meeting the Lisbon objectives as well as towards national convergence.

The other theme which clearly emerges from the studies is Research and Development. It is important that a balance between basic and applied research be found. Research and Development are covered under Heading 1a in the present proposal. Other items under this heading are, in addition to education and training, promotion of the competitiveness of enterprises, EU networks and management of change. It is not considered as a part of the Cohesion Policy.

Some net payers strongly insist on the co-called "excellence" criterion for support to R&D projects, that is to say funds should not be allocated as national envelopes but be used where their impact is the greatest. While this may seem a reasonable approach, it might mean, together with other considerations mentioned above, that the scope for Research and Development projects, particularly with respect to basic research, may become very limited and unevenly distributed between the Member States.[126]

Institution building is already one of the main objectives of the ECP. Perhaps the most telling conclusion from the experience from the pre-accession support is that by no means is this phase over in the new Member States. Even if considerable progress has been made and there are many successful projects to report, it is clear that the administrative and managerial capacity, particularly at regional and local levels still leaves a lot to wish for. This could become a major obstacle for a successful implementation of the future ECP.

The Sapir report recommends the ECP to continue the institution building activities. They go hand in hand with education and training, particularly short-term efforts to improve managerial and administrative capabilities at the regional and local levels. It is not mentioned in the Country Studies, but the obvious difficulties for small entrepreneurs to participate in the ECP due to formal requirements at all stages of the project cycle would make support to Chambers of Commerce and Entrepreneurial Associations and other service organs an area of high priority in the institution building.

Whereas the actual existence of institutions and regulations in the new Member States can be measured relatively easily, their intrinsic quality and

[126] Before the breakdown of the negotiations on the future Financial Perspective there seems to have been a general tendency to squeeze out funds proposed under heading 1a, that is to say to further reduce the possibilities of financing HRD and research thus underlining the arguments of this chapter.

efficiency is much harder to assess. This transpired very clearly from the strategy papers and screening reports that were issued before the accession.[127] The Country Studies confirm that those problems remain important obstacles for cohesion even if much progress has been made, particularly through the pre-accession support. Institution building and development of human resources therefore remain perhaps the most important condition for the success of the future ECP in the new Member States.

9.5.5 Cooperation and coordination between the new Member States

European Added Value has become a guiding principle for deciding which programmes or projects should be supported by EU resources. This can in a sense be seen as the mirror image of the subsidiarity principle, but whereas that principle defines in a negative way what should not be done at the European level, the European Added Value concept defines, in a positive way, what could or should be done at that level.[128] Intuitively, one would feel that the proposal for cross-border cooperation, particularly when it comes to coordinating the construction of transport networks in the new Member States would be well qualified according to this criterion. Some Country Studies also echo this observation. A proposal has been made for setting-up of a new community priority for cross-border infrastructure and environment protection investments, targeted explicitly at the Central European region. In the words of another study, those investments would be more efficient than national infrastructure programmes which are often designed and implemented in line with narrow national (domestic policy or simply prestige driven) interests.[129]

9.5.6 Simplification and more flexibility

We let the wealth of proposals and observations concerning simplifications and other changes in the system stand as they have been voiced in the Country Studies. Many of them are expressions of a natural desire to obtain as much funds as possible at as easy conditions as possible. But many others indicate a genuine dissatisfaction with what is felt to be unnecessary bureaucracy and mistrust on the part of the Commission and also a perceived lack of understanding for the special conditions of the New Eastern European Member States. There is an obvious goal conflict between the need to progress towards the ERM criteria on the one hand

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[127] For a discussion of the risks of an erosion of the Union connected with the enlargement, see Karlsson (2002), section 9.3.

[128] A recent Sieps study entitled "The Enigma of European Added Value: Setting Priorities in the European Union" suggests how the concept can be used as a tool for policy choices; see Tarschys (2005).

[129] See Inotai, A. (reference 2004b in chapter 5) as quoted in Richter 2005. See also chapter 5, particularly section 5.7.

and the co-financing requirements on the other.[130] There are no easy ways out of this dilemma except to say that the situation calls for maximum flexibility. It provides yet another argument for taking a national approach to the future ECP and, to the extent possible, leaving it to the receiving countries to decentralise and delegate the responsibilities for regional implementation of the ECP.

9.5.7 An adaptation of the ECP to the needs of the new Member States

A re-definition and re-orientation of the ECP along the lines that emerge as desirable from the Country Studies and which we have tried to summarise and concretise in this chapter would go a long way towards meeting the stated ECP objectives of merging the Lisbon, Gothenburg and Cohesion objectives. We also believe, and that is perhaps the most important thing, that it would greatly facilitate the move of the new Member States from being policy takers to becoming active participants in and developers of the true European Cohesion Process. EU transfers are a vital factor of successful membership and sustainable modernisation, says one Country Study and continues to underline that each Member state must define its longer term role in the rapidly changing global environment and within the enlarged and enlarging EU. Only so can the main objectives be defined for which financial support from the Union should be sought.

However, to formulate the essential priorities that have emerged from the Country Studies as ECP objectives in their own right, might require a fundamental restructuring of the present goal and implementation structures. A focus on human resource development, institution building and research and development might require a regrouping of items between headings in the current Commission proposal as well as – and this is obvious – a shift in the distribution of available resources between different objectives. Basic questions such as whether the focus should be on national or regional convergence or the relation between co-financing requirements and macroeconomic stabilisation may find answers that differ from those presently given.

This is being written after that the negotiations on the future Financial Perspective broke down during the Luxembourg Presidency. The UK has expressed its ambition to reach an agreement during its Presidency, that is to say, before the end of 2005. At this moment it is impossible to form a well founded opinion as to whether this might succeed or not. So far, however, the most important areas of conflict appear to have been the agricultural policy as well as the system of financing with the UK rebate

130 For an overview of the various co-financing requirements, see Richter (2005), chapter 1, p. 9 ff.

as a major bone of contention. Much less attention seems to have been devoted to the Structural and Cohesion Policy.

A recent study (Richter 2005, published in May 2005; see in particular chapter 6) gave us an overview of the negotiation positions of a number of Member States, based on what is officially known. As pointed out in that study, the bulk of the negotiation documents are not available to the public or for research purposes. But, together with what is commonly known about the negotiations, it would seem quite fair to characterise them as having been fully focussed on the amount of funds, the methods for allocation of funds between countries (for instance the so called "Berlin method"), the periods and eligibility for phasing out regions from cohesion support and, certainly not the least, the existence, abolishment or modification of the four per cent cap on cohesion support.

As far as the European Cohesion Policy is concerned the postponement of an agreement offers not only an opportunity but poses a necessity to open up a fundamental discussion of the objectives and instruments of the policy. In that discussion the needs and priorities of the new Member States as they have been illustrated in this study should be placed at the centre of attention.

We might add another, more short-term consideration. Should a financial agreement be delayed, the question of the inflow of resources to the new Member States and of their net positions may become an acute problem. We can assume that this would lead to a renewed discussion of the ECP system and strong demands for immediate simplifications and more flexibility. Even in such a scenario, the conclusions of the present study, based on the experience of a number of Member States and on the opinion of independent country experts, could play a role in the deliberations.

Finally: Our conclusions also open up a much wider question: how should we really conceptualise cohesion at the European level? In chapter 2 we discussed an attempt to widen the perspective of the concept from the strict economic and social aspects to include also a political and a cultural dimension (see chapter 2, section 2.1.2). We do not have to discuss here the so politically sensitive issue of the deepest purpose of the international cooperation within the framework of the European Union but can refer to the Charter of Fundamental Rights, which, according to Tarschys (2005) "was a quality leap in the direction of converting the union into a community of values. 'Die Union ist nicht nur Wirtschaft und Währung, sondern auch Werte' – that was how this idea was expressed in German, with better alliteration than any other language could offer." Maybe the future Cohesion Policy should contribute more to this community of values by giving more weight to the political and above all cultural dimensions of European Cohesion. Were this to be achieved, much else would follow.

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APPENDIX A TABLES CHAPTER 3

Table A.1 GDP per head at PPS (EUR)

	GDP per head at PPS Euro				GDP per head at PPS in percent of the EU25 average			
	1995	1999	2003	2004	1995	1999	2003	2004
EU25	**15214.7**	**18487.3**	**21363.6**	**22283.2**	**100.0**	**100.0**	**100.0**	**100.0**
EU15	16843.9	20320.4	23321.2	24250.6	110.7	109.9	109.2	108.8
NMS10		9243.3	11271.5	12092.3		50.0	52.8	54.3
Austria	19677.7	23507.2	26118.0	27040.5	129.3	127.2	122.3	121.3
Belgium	18307.1	21450.5	25165.0	26256.0	120.3	116.0	117.8	117.8
Germany	18187.0	20995.4	23101.1	23967.2	119.5	113.6	108.1	107.6
Denmark	19024.6	23593.9	26202.4	27307.1	125.0	127.6	122.7	122.5
Spain	13331.5	17016.7	20896.9	21744.4	87.6	92.0	97.8	97.6
Finland	16113.2	20678.7	24149.6	25336.0	105.9	111.9	113.0	113.7
France	17549.6	21173.2	23716.3	24713.3	115.3	114.5	111.0	110.9
Greece	10989.6	13298.3	17280.7	18270.4	72.2	71.9	80.9	82.0
Ireland	15107.1	22628.4	28303.6	29899.4	99.3	122.4	132.5	134.2
Italy	17574.6	20763.5	22839.7	23466.8	115.5	112.3	106.9	105.3
Luxembourg	27203.7	38505.8	45882.2	48242.7	178.8	208.3	214.8	216.5
Netherlands	18319.4	22348.3	25845.0	26642.5	120.4	120.9	121.0	119.6
Portugal	11139.1	14302.3	15889.0	16317.1	73.2	77.4	74.4	73.2
Sweden	18017.1	21936.0	24618.7	25948.7	118.4	118.7	115.2	116.4
United Kingdom	16828.1	20965.2	25326.8	26578.5	110.6	113.4	118.6	119.3
Czech Republic	10663.7	12171.3	14689.6	15559.3	70.1	65.8	68.8	69.8
Estonia	5415.3	7617.4	10361.3	11236.6	35.6	41.2	48.5	50.4
Hungary	7550.5	9732.0	12928.6	13748.1	49.6	52.6	60.5	61.7
Lithuania	5196.8	6979.9	9783.1	10702.9	34.2	37.8	45.8	48.0
Latvia	4544.8	6339.9	8757.2	9643.3	29.9	34.3	41.0	43.3
Poland	6209.0	8453.9	9824.0	10616.9	40.8	45.7	46.0	47.6
Slovenia	10424.5	13695.7	16410.6	17396.2	68.5	74.1	76.8	78.1
Slovak Republic	6782.5	8739.2	11130.8	11908.7	44.6	47.3	52.1	53.4
Bulgaria	4749.0	4893.4	6342.7	6855.1	31.2	26.5	29.7	30.8
Romania		4757.4	6315.3	6941.5		25.7	29.6	31.2

Source: Eurostat, NewCronos Database, PPS from wiiw.

Table A.2a NUTS2 Regional GDP per capita at PPS, GDP per capita real growth, NMS/CC, 1995-2002

		GDP per capita at PPS					GDP per capita growth in real terms		
								difference	
Cluster	Country/region	1995	2001	2002	% of country	% of EU25	average 1995-2002	to national average	to EU25
	EU25	**15,232.6**	**20,454.6**	**21,171.6**		**100.0**	**2.1**	**0.0**	**0.0**
	EU15	**16,869.1**	**22,411.5**	**23,163.9**		**109.4**	**2.1**	**0.0**	**0.0**
	Czech Republic	**10,660.4**	**13,526.2**	**14,314.6**	**100.0**	**67.6**	**1.8**	**0.0**	**-0.3**
CAP	Praha	19,568.8	30,652.0	32,348.4	226.0	152.8	4.9	3.1	2.7
ENG	Jihozápad	10,138.7	12,255.7	12,935.7	90.4	61.1	1.1	-0.7	-1.1
BIND	Jihovýchod	9,525.1	11,876.4	12,662.9	88.5	59.8	1.7	-0.1	-0.5
BIND	Moravskoslezko	10,051.0	11,295.2	11,952.3	83.5	56.5	0.1	-1.8	-2.1
ENG	Severovýchod	9,190.2	11,242.5	12,004.0	83.9	56.7	1.4	-0.4	-0.7
BSER	Strední Cechy	8,231.4	11,013.2	11,710.4	81.8	55.3	2.6	0.8	0.5
BSER	Severozápad	10,133.2	10,754.4	11,412.0	79.7	53.9	-0.7	-2.5	-2.9
ENG	Strední Morava	9,032.1	10,632.8	11,094.5	77.5	52.4	0.5	-1.3	-1.6
	Estonia	**5,413.1**	**9,154.5**	**9,868.3**	**100.0**	**46.6**	**6.8**	**0.0**	**4.7**
	Hungary	**7,548.0**	**11,545.9**	**12,398.2**	**100.0**	**58.6**	**4.2**	**0.0**	**2.0**
CAP	Közép-Magyarország	10,898.5	18,308.7	20,323.2	163.9	96.0	6.1	1.9	3.9
ENG	Nyugat-Dunántúl	7,774.0	12,194.0	12,866.7	103.8	60.8	4.3	0.1	2.1
ENG	Közép-Dunántúl	6,833.2	10,870.8	10,963.8	88.4	51.8	3.8	-0.3	1.7
AGR	Dél-Dunántúl	6,163.4	8,507.5	9,060.8	73.1	42.8	2.5	-1.6	0.4
AGR	Dél-Alföld	6,280.1	8,164.8	8,546.6	68.9	40.4	1.4	-2.8	-0.7
BIND	Észak-Alföld	5,382.9	7,641.2	7,988.0	64.4	37.7	2.7	-1.5	0.5
BIND	Észak-Magyarország	5,494.5	7,501.9	7,899.4	63.7	37.3	2.2	-2.0	0.1
	Lithuania	**5,195.0**	**8,338.3**	**8,974.9**	**100.0**	**42.4**	**5.5**	**0.0**	**3.4**
	Latvia	**4,543.1**	**7,656.0**	**8,246.3**	**100.0**	**38.9**	**6.8**	**0.0**	**4.7**
	Poland	**6,206.9**	**9,382.6**	**9,661.3**	**100.0**	**45.6**	**4.1**	**0.0**	**2.0**
CAP	Mazowieckie	7,823.1	14,523.6	14,713.7	152.3	69.5	7.0	2.9	4.8
MIN	Slaskie	7,568.1	10,197.6	10,700.0	110.8	50.5	2.7	-1.4	0.6
ENG	Wielkopolskie	6,070.4	9,971.8	9,964.3	103.1	47.1	4.9	0.8	2.8
BSER	Dolnoslaskie	6,432.0	9,516.7	10,021.9	103.7	47.3	4.1	0.0	1.996
BSER	Zachodniopomorskie	6,448.5	9,355.3	9,550.3	98.9	45.1	3.4	-0.7	1.2

BSER	Pomorskie	6,331.4	9,261.3	9,621.2	99.6	45.4	3.8	-0.4	1.6
BIND	Kujawsko-Pomorskie	6,160.8	8,528.8	8,812.0	91.2	41.6	2.9	-1.3	0.7
BIND	Lódzkie	5,689.5	8,506.5	8,744.5	90.5	41.3	3.9	-0.2	1.8
BSER	Lubuskie	6,116.6	8,391.2	8,441.0	87.4	39.9	2.4	-1.8	0.2
REST	Malopolskie	5,470.6	8,058.2	8,350.7	86.4	39.4	3.8	-0.3	1.7
REST	Opolskie	6,056.0	7,751.8	7,915.1	81.9	37.4	1.6	-2.6	-0.6
AGR	Swietokrzyskie	4,870.5	7,224.1	7,555.2	78.2	35.7	4.1	-0.1	1.9
AGR	Podlaskie	4,721.2	7,218.3	7,433.1	76.9	35.1	4.3	0.2	2.2
REST	Warminsko-Mazurskie	4,933.4	6,894.9	7,215.5	74.7	34.1	3.2	-0.9	1.1
AGR	Podkarpackie	4,749.3	6,725.7	6,889.3	71.3	32.5	3.1	-1.0	0.9
AGR	Lubelskie	4,793.4	6,637.1	6,762.4	70.0	31.9	2.7	-1.5	0.5
	Slovenia	**10,422.6**	**15,290.1**	**15,936.9**	**100.0**	**75.3**	**3.9**	**0.0**	**1.7**
	Slovakia	**6,779.8**	**10,006.3**	**10,854.2**	**100.0**	**51.3**	**3.8**	**0.0**	**1.6**
CAP	Bratislavský	14,366.6	22,805.4	25,343.9	233.5	119.7	5.2	1.4	3.1
ENG	Západné Slovensko	6,496.6	9,160.8	9,774.6	90.1	46.2	2.8	-0.9	0.7
BIND	Stredné Slovensko	5,568.7	8,263.6	8,990.5	82.8	42.5	3.9	0.1	1.7
BIND	Východné Slovensko	5,127.0	7,612.7	8,198.2	75.5	38.7	3.7	0.0	1.6
	Bulgaria	**4693.0**	**5868.8**	**6119.7**	**100.0**	**28.9**	**1.9**	**0.0**	**-0.3**
CAP	Yugozapaden	6357.0	8191.4	8863.2	144.8	41.9	2.8	1.0	0.7
MIN	Severozapaden	3965.4	5342.3	5417.0	88.5	25.6	2.5	0.7	0.4
BIND	Severen tsentralen	3986.2	5051.2	5299.7	86.6	25.0	2.1	0.3	0.0
TOUR	Severoiztochen	4118.1	5118.5	5157.2	84.3	24.4	1.3	-0.6	-0.9
TOUR	Yugoiztochen	3978.4	4984.5	5033.9	82.3	23.8	1.4	-0.4	-0.7
AGR	Yuzhen tsentralen	4294.2	4896.2	4938.1	80.7	23.3	0.0	-1.8	-2.1
	Romania	**4701.3**	**5467.2**	**6055.2**	**100.0**	**28.6**	**3.7**	**0.0**	**1.5**
CAP	Bucuresti	7770.6	14733.5	12559.0	207.4	59.3	9.7	6.1	7.6
BSER	Vest	4972.9	5393.2	6590.8	108.8	31.1	4.4	0.7	2.3
ENG	Centru	5087.6	5302.1	6544.4	108.1	30.9	3.7	0.0	1.5
BIND	Nord-Vest	4464.2	4693.2	5723.7	94.5	27.0	3.6	-0.1	1.4
AGR	Sud-Est	4710.9	4347.0	-5196.6	85.8	24.5	-0.2	-3.9	-2.4
AGR	Sud-Vest	4204.2	4271.9	4865.1	80.3	23.0	1.0	-2.7	-1.2
AGR	Sud	4034.4	4014.1	4850.9	80.1	22.9	1.9	-1.8	-0.2
AGR	Nord-Est	3567.5	3627.8	4335.3	71.6	20.5	2.2	-1.5	0.0

Notes: Cluster codes: CAP: Capital Cities; AGR: Agricultural regions; MIN: Mining regions; BIND: Basic Industry regions; ENG: regions spezialised in engineering; BSER: Basic Services regions; TOUR: Tourism regions; REST: Regions that could not be allocated. Romania: Data in column "1995" refers to the year 1998.
Source: Eurostat, NewCronos Database, own calculations

Table A.2b Regional GDP per capita at PPS, GDP per capita real growth, Baltic States and Slovenia, 1995-2002

		GDP per capita at PPS					GDP per capita growth in real terms		
							average 1995-2002	difference	
								to national average	to EU25
		1995	2001	2002	% of country	% of EU25	real	real	real
eu25	**EU25**	**15232.6**	**20454.6**	**21171.6**			**2.1**	**0.0**	**0.0**
eu15	**EU15**	**16869.1**	**22411.5**	**23163.9**			**2.1**	**0.0**	**0.0**
Ee	**Estonia**	**5413.1**	**9154.5**	**9868.3**	**100**	**46.6**	**6.8**	**0.0**	**4.7**
ee001	Põhja-Eesti	7694.2	13946.1	15115.5	153.2	71.4	8.0	1.1	5.8
ee004	Lääne-Eesti	4275.3	6777.8	7164.5	72.6	33.8	5.6	-1.3	3.4
ee006	Kesk-Eesti	4121.6	6362	6923.4	70.2	32.7	5.6	-1.2	3.5
ee008	Lõuna-Eesti	3868.4	6118.2	6577.1	66.6	31.1	5.8	-1.1	3.6
ee007	Kirde-Eesti	3923.1	5521.3	5787.7	58.6	27.3	3.7	-3.2	1.5
Lt	**Lithuania**	**5195**	**8338.3**	**8974.9**	**100**	**42.4**	**5.5**	**0.0**	**3.4**
lt00a	Vilniaus	6045.8	11384.6	12857.8	143.3	60.7	8.7	3.2	6.6
lt003	Klaipedos	5702.5	9192.1	9733.9	108.5	46.0	5.4	-0.2	3.2
lt002	Kauno	4964.3	8159.5	8451.6	94.2	39.9	5.3	-0.2	3.2
lt005	Panevezio	5295.3	7420.6	7771.8	86.6	36.7	3.1	-2.4	1.0
lt008	Telsiu	4572.1	7228.9	7501	83.6	35.4	4.8	-0.8	2.6
lt009	Utenos	5232.2	6942.2	7421.1	82.7	35.1	2.6	-2.9	0.5
lt001	Alytaus	4515	6676.7	6932.2	77.2	32.7	3.8	-1.8	1.6
lt006	Siauliu	4765.6	6188.3	6643.6	74.0	31.4	2.4	-3.2	0.2
lt004	Marijampoles	4332.2	5630	5966.4	66.5	28.2	2.2	-3.4	0.0
lt007	Taurages	3490.4	5046.6	5187.2	57.8	24.5	3.3	-2.2	1.1

Lv	**Latvia**	**4543.1**	**7656**	**8246.3**	**100**	**38.9**	**6.8**	**0.0**	**4.7**
lv006	Riga	6531.2	13082.9	14983.8	181.7	70.8	10.5	3.6	8.3
lv003	Kurzeme	4990.8	7123	6833.4	82.9	32.3	2.6	-4.2	0.5
lv007	Pieriga	3670.9	5197.6	5413.7	65.7	25.6	3.7	-3.1	1.6
lv008	Vidzeme	2880.7	4260.8	4773	57.9	22.5	5.4	-1.4	3.3
lv009	Zemgale	3177.6	4394.3	4592.8	55.7	21.7	3.4	-3.4	1.3
lv005	Latgale	3033.4	4462.5	3989.8	48.4	18.8	2.0	-4.8	-0.1
Si	**Slovenia**	**10422.6**	**15290.1**	**15936.9**	**100**	**75.3**	**3.9**	**0.0**	**1.7**
si00e	Osrednjeslovenska	14361.5	21511.8	22603.6	141.8	106.8	4.3	0.4	2.2
si00c	Obalno-kraska	11281.5	15882.9	16471.7	103.4	77.8	3.2	-0.7	1.0
si00b	Goriska	10187.3	15100.5	15406.4	96.7	72.8	3.7	-0.2	1.6
si00d	Jugovzhodna Slovenija	9319.1	14034.8	14362.3	90.1	67.8	4.0	0.1	1.8
si004	Savinjska	9695.3	13534.6	14193.5	89.1	67.0	3.2	-0.6	1.1
si009	Gorenjska	9370.7	13511.7	13991.4	87.8	66.1	3.5	-0.4	1.4
si006	Spodnjeposavska	8541.7	13053.8	13373.3	83.9	63.2	4.2	0.4	2.1
si002	Podravska	8467	12644.6	13365.9	83.9	63.1	4.3	0.5	2.2
si003	Koroska	8285.9	12464.8	12742.6	80.0	60.2	4.0	0.1	1.8
si00a	Notranjsko-kraska	8287.2	11953.8	12446.7	78.1	58.8	3.6	-0.3	1.5
si005	Zasavska	8777	11485.7	11594.7	72.8	54.8	1.7	-2.1	-0.4
si001	Pomurska	7886.6	10762.6	11000.3	69.0	52.0	2.5	-1.4	0.4

Source: Eurostat, NewCronos Database, own calculations

Table A.3 Coefficients of Variation – Regional GDP per capita at PPS, NUTS2 & NUTS3 regions

	inclusive capital citiy regions			exclusive capital city regions		
	1995	2001	2002	1995	2001	2002
			NUTS2 regions			
cz	0.32	0.47	0.47	0.07	0.05	0.05
hu	0.25	0.34	0.37	0.13	0.19	0.19
pl	0.16	0.22	0.21	0.14	0.14	0.14
sk	0.48	0.53	0.54	0.10	0.08	0.07
bg	0.19	0.21	0.24	0.03	0.03	0.03
ro	0.25	0.59	0.42	0.11	0.13	0.15
NMS	**0.43**	**0.51**	**0.50**	**0.31**	**0.32**	**0.30**
OMS	**0.29**	**0.30**	**0.29**	**0.25**	**0.24**	**0.24**
at	0.23	0.21	0.21	0.16	0.15	0.15
be	0.37	0.38	0.37	0.16	0.18	0.18
de	0.25	0.26	0.26	0.25	0.26	0.26
es	0.20	0.20	0.19	0.20	0.18	0.18
fi	0.18	0.25	0.24	0.20	0.27	0.26
fr	0.17	0.18	0.17	0.08	0.08	0.07
gr	0.19	0.18	0.18	0.20	0.19	0.18
ie	0.18	0.19	0.19	.	.	.
it	0.27	0.25	0.25	0.27	0.25	0.25
nl	0.15	0.17	0.17	0.14	0.17	0.17
pt	0.22	0.23	0.23	0.10	0.14	0.15
se	0.13	0.16	0.17	0.04	0.04	0.04
uk	0.30	0.36	0.36	0.16	0.19	0.19

NUTS3 regions

	1995	2001	2002	1995	2001	2002
cz	0.26	0.40	0.40	0.07	0.06	0.06
ee	0.31	0.40	0.41	0.04	0.07	0.08
hu	0.28	0.37	0.39	0.16	0.21	0.20
lt	0.14	0.24	0.26	0.14	0.24	0.26
lv	0.32	0.49	0.56	0.22	0.21	0.19
pl	0.28	0.32	0.43	0.28	0.32	0.32
si	0.18	0.20	0.20	0.10	0.11	0.11
sk	0.42	0.47	0.49	0.15	0.14	0.13
bg	0.24	0.27	0.29	0.16	0.16	0.16
ro	0.24	0.46	0.34	0.21	0.33	0.28
NMS	**0.43**	**0.52**	**0.52**	**0.36**	**0.43**	**0.40**
OMS	**0.37**	**0.38**	**0.38**	**0.34**	**0.35**	**0.35**
at	0.27	0.26	0.25	0.25	0.25	0.24
be	0.32	0.33	0.33	0.23	0.25	0.25
de	0.41	0.43	0.43	0.41	0.43	0.43
dk	0.25	0.25	0.25	0.25	0.25	0.25
es	0.21	0.21	0.21	0.21	0.20	0.20
fi	0.17	0.22	0.22	0.15	0.19	0.18
fr	0.30	0.35	0.34	0.21	0.27	0.27
gr	0.33	0.32	0.31	0.33	0.32	0.31
ie	0.19	0.21	0.22	0.12	0.16	0.16
it	0.26	0.25	0.24	0.26	0.25	0.24
nl	0.20	0.21	0.21	0.18	0.19	0.19
pt	.	.	0.28	0.12	0.14	0.21
se	0.10	0.13	0.13	0.05	0.06	0.05
uk	0.38	0.46	0.46	0.20	0.27	0.27

Source: Eurostat, NewCronos Database, own calculations

Table A.4 Sectoral shares in employment, 2003

Cluster	Country/region	Agri-culture	Mining& Utilities	Manu-facturing	Basic Industry	Fuel, Chemical	Engi-neering	Con-struction	Services	Basic Sev.	Tourism	Advanced	Healt& Education	Public Admin
	Czech Republic	**4.5**	**2.8**	**28.0**	**19.2**	**1.0**	**7.8**	**9.5**	**55.2**	**25.0**	**3.5**	**8.1**	**12.4**	**6.3**
CAP	Praha	0.4	1.7	10.5	6.6	0.7	3.3	10.0	77.4	33.9	4.3	18.8	13.8	6.6
ENG	Jihozápad	6.3	2.0	30.0	19.6	0.4	10.1	9.4	52.3	22.8	3.6	6.1	12.5	7.4
BIND	Jihovýchod	6.5	2.2	29.9	21.2	0.7	8.0	9.4	52.0	23.1	2.3	7.4	13.0	6.2
BIND	Moravskoslezko	3.2	6.4	30.9	23.1	1.0	6.8	8.7	50.9	22.5	4.0	5.1	12.9	6.3
ENG	Severovýchod	5.3	1.7	34.4	23.1	1.1	10.2	8.9	49.7	22.4	3.0	6.6	11.8	5.8
BSER	Strední Cechy	5.5	1.5	26.9	15.9	1.8	9.2	9.3	56.8	27.6	3.5	8.0	10.9	6.7
BSER	Severozápad	3.5	6.4	24.4	18.2	1.9	4.4	11.0	54.7	26.3	4.5	6.6	11.4	5.9
ENG	Strední Morava	5.0	1.5	35.8	25.0	0.9	9.9	9.1	48.6	21.7	3.4	5.8	12.6	5.2
	Estonia	**6.2**	**2.7**	**22.3**	**18.8**	**0.4**	**3.1**	**6.8**	**62.0**	**29.1**	**3.2**	**9.3**	**14.6**	**5.9**
	Hungary	**5.4**	**2.1**	**23.8**	**15.3**	**1.3**	**7.2**	**7.8**	**61.0**	**26.4**	**3.7**	**8.6**	**15.1**	**7.1**
CAP	Közép-Magyarország	1.7	1.1	17.2	10.0	1.8	5.4	7.8	72.3	32.9	3.5	14.7	14.5	6.7
ENG	Nyugat-Dunántúl	4.6	2.2	32.5	19.1	1.2	12.2	6.9	53.8	23.1	5.4	6.3	13.6	5.4
ENG	Közép-Dunántúl	4.6	3.4	30.9	17.6	1.4	11.9	8.9	52.2	23.3	3.7	7.1	12.7	5.4
AGR	Dél-Dunántúl	9.3	2.3	21.5	14.9	0.3	6.3	7.4	59.6	23.5	4.6	5.7	16.5	9.2
AGR	Dél-Alföld	11.4	2.1	24.1	19.1	0.8	4.2	8.3	54.1	23.9	2.9	5.1	15.2	7.0
BIND	Észak-Alföld	7.6	1.6	25.7	18.2	1.0	6.5	7.5	57.6	22.9	3.0	6.2	17.7	7.8
BIND	Észak-Magyarország	4.7	3.5	24.6	15.9	1.6	7.2	7.9	59.3	24.7	3.9	5.2	16.5	9.0
	Lithuania	**18.3**	**2.0**	**18.4**	**15.0**	**1.0**	**2.4**	**7.3**	**54.0**	**26.0**	**2.2**	**5.1**	**16.0**	**4.8**
	Latvia	**14.2**	**2.8**	**16.6**	**14.7**	**0.3**	**1.6**	**7.8**	**58.6**	**30.4**	**2.7**	**5.8**	**13.5**	**6.2**
	Poland	**17.3**	**3.8**	**19.7**	**0.0**	**0.0**	**0.0**	**5.7**	**53.5**	**24.4**	**1.7**	**7.4**	**14.0**	**5.9**
CAP	Mazowieckie	16.0	1.5	15.1	0.0	0.0	0.0	4.7	62.7	27.1	1.5	13.0	14.0	7.1
MIN	Slaskie	2.8	14.6	20.7	0.0	0.0	0.0	6.4	55.6	26.5	1.8	7.1	15.3	4.8
ENG	Wielkopolskie	17.8	2.6	24.8	0.0	0.0	0.0	5.4	49.4	23.8	1.3	6.8	12.8	4.7
BSER	Dolnoslaskie	10.0	5.4	19.7	0.0	0.0	0.0	8.7	56.1	26.4	2.2	8.1	13.9	5.5
BSER	Zachodniopomorskie	11.7	1.9	20.8	0.0	0.0	0.0	6.4	59.2	29.1	2.7	8.5	13.4	5.6
BSER	Pomorskie	9.8	2.0	21.4	0.0	0.0	0.0	7.0	59.8	28.8	2.3	6.5	14.4	7.8
BIND	Kujawsko-Pomorskie	17.9	0.8	24.4	0.0	0.0	0.0	4.9	52.0	21.7	1.8	7.6	14.3	6.6
BIND	Lódzkie	17.7	3.3	23.5	0.0	0.0	0.0	4.5	51.0	23.5	1.3	7.4	12.7	6.2
BSER	Lubuskie	11.0	1.4	21.8	0.0	0.0	0.0	3.8	62.1	29.9	2.1	6.8	15.5	7.8

REST	Malopolskie	19.7	3.7	17.4	0.0	0.0	0.0	7.1	52.1	24.1	3.0	6.1	13.9	4.9
REST	Opolskie	16.4	3.1	21.2	0.0	0.0	0.0	6.6	52.6	24.8	2.2	5.1	14.9	5.6
AGR	Swietokrzyskie	31.6	3.2	15.2	0.0	0.0	0.0	7.2	42.9	17.7	1.0	5.8	14.2	4.1
AGR	Podlaskie	32.0	0.9	15.7	0.0	0.0	0.0	4.2	47.3	21.4	0.9	4.6	13.9	6.4
REST	Warminsko-Mazurskie	17.2	1.7	17.9	0.0	0.0	0.0	5.5	57.7	26.5	2.1	4.8	16.9	7.3
AGR	Podkarpackie	26.9	2.1	21.3	0.0	0.0	0.0	5.4	44.2	18.7	1.7	4.9	11.8	7.2
AGR	Lubelskie	36.9	1.8	14.0	0.0	0.0	0.0	3.8	43.5	18.8	0.6	4.2	14.6	5.2
	Slovenia	**6.8**	**1.6**	**30.3**	**21.1**	**1.7**	**7.5**	**6.0**	**55.3**	**24.7**	**4.1**	**8.6**	**12.5**	**5.3**
	Slovakia	**6.0**	**2.9**	**26.4**	**18.2**	**1.3**	**6.9**	**9.0**	**55.6**	**23.6**	**3.6**	**6.9**	**14.2**	**7.3**
CAP	Bratislavský	1.7	2.6	14.9	9.6	1.3	4.0	7.0	73.8	28.4	5.0	17.7	13.3	9.5
ENG	Západné Slovensko	7.1	3.4	30.5	19.7	1.5	9.4	8.7	50.3	22.0	3.4	5.0	12.4	7.4
BIND	Stredné Slovensko	7.2	2.8	27.1	20.7	0.7	5.7	9.5	53.3	22.7	3.2	5.2	15.6	6.7
BIND	Východné Slovensko	5.9	2.6	26.2	18.5	1.7	6.0	10.1	55.2	24.0	3.7	5.0	16.0	6.4
	Bulgaria	**10.0**	**3.5**	**23.9**	**18.7**	**1.4**	**3.8**	**5.5**	**57.2**	**26.8**	**4.7**	**4.9**	**13.2**	**7.6**
CAP	Yugozapaden	4.9	3.0	21.7	18.1	0.8	2.8	5.9	64.5	29.5	4.8	9.5	13.4	7.3
MIN	Severozapaden	7.5	8.6	21.5	19.5	0.4	1.5	3.1	59.3	24.6	2.5	2.5	15.9	13.8
BIND	Severen tsentralen	9.1	2.8	30.8	23.5	1.6	5.7	4.1	53.3	23.8	3.4	2.6	14.6	8.8
TOUR	Severoiztochen	12.8	2.1	19.9	15.0	1.6	3.3	7.4	57.8	28.3	6.0	3.3	13.6	6.6
TOUR	Yugoiztochen	12.4	3.4	21.6	14.9	3.9	2.8	6.0	56.5	27.0	6.1	3.0	12.0	8.5
AGR	Yuzhen tsentralen	14.4	4.3	26.3	20.2	1.0	5.0	5.0	50.1	24.8	4.6	2.8	11.7	6.1
	Romania	**33.5**	**3.9**	**22.4**	**16.4**	**1.0**	**5.0**	**4.8**	**35.4**	**17.1**	**1.3**	**2.7**	**8.9**	**5.3**
CAP	Bucuresti	1.8	3.1	22.6	16.2	2.1	4.2	7.8	64.7	30.2	1.7	7.8	13.7	11.2
BSER	Vest	25.9	6.1	24.9	18.1	0.2	6.7	4.7	38.4	20.3	0.6	2.9	9.1	5.6
ENG	Centru	25.3	3.3	33.6	22.5	0.8	10.2	5.0	32.9	15.8	1.4	1.7	10.0	4.0
BIND	Nord-Vest	30.6	3.2	26.6	23.3	0.2	3.1	5.0	34.5	16.3	2.0	2.3	9.1	4.8
AGR	Sud-Est	35.5	3.2	18.7	15.3	0.0	3.4	4.8	37.7	19.7	1.3	2.8	7.9	6.1
AGR	Sud-Vest	45.0	7.7	14.3	8.6	1.3	4.4	4.7	28.3	13.2	1.5	1.2	8.3	4.1
AGR	Sud	40.1	3.3	23.4	14.2	1.5	7.7	3.6	29.6	15.2	0.9	2.9	6.4	4.0
AGR	Nord-Est	48.3	2.7	17.8	14.5	1.6	1.7	4.2	27.0	11.9	1.3	1.5	8.3	4.0

Notes: Cluster codes: CAP: Capital Cities; AGR: Agricultural regions; MIN: Mining regions; BIND: Basic Industry regions; ENG: regions spezialised in engineering; BSER: Basic Services regions; TOUR: Tourism regions; REST: Regions that could not be allocated. Agriculture refers to the NACE rev.1 groups A+B, Mining and Utilities to C+E, Manufacturing to D, Basic Industries to DA+DB+DC+DD+DE+DH+DI+DJ+DN, Fuel and Chemicals to DF+DG, Engineering to DK+DL+DM, Construction to F, Services to the groups G-Q, Basic Services to G+I+O+P, Tourism to H, Advanced Services to J+K, Health and Education to M+N and Public Services to L+Q.

Source: LFS, own calculations

Table A.5 Main indicators by regional types

	Capital city regions	Agricultural regions	Tourism regions	Mining regions	Basic Industry regions	Forward looking industry regions	Basic Services regions	Rest
GDP per head								
at PPS, 2002	172.6	76.6	83.5	108.5	84.3	95.6	97.7	82.4
real growth	6.4	1.8	1.3	2.7	2.9	3.1	3.3	3.2
real growth, relative to country average	2.9	-1.9	-0.5	-1.2	-0.6	-0.2	-0.3	-0.9
real growth, relative to country average (excl. capital)		-0.8	0.2	-0.5	0.3	0.7	0.5	-0.2
Employment rate								
population aged 25-64	106.5	102.5	94.3	92.3	96.3	103.2	94.1	98.6
population aged 25-29	106.2	99.0	97.2	104.5	98.9	103.5	93.2	93.1
population aged 50-54	108.4	105.5	93.0	86.3	93.3	101.5	93.7	105.0
changes, difference to country average (population aged 25-64)	0.1	-0.6	1.7	0.6	-0.4	1.9	-0.8	-1.5
Employment growth (population aged 25-64), difference to country average	-0.5	0.4	1.0	-1.1	0.0	0.8	-0.7	-0.6
Population by education (relative to country average)								
low educated	72.2	111.0	122.4	80.0	108.1	96.7	108.1	100.6
medium educated	97.2	98.7	94.4	108.1	99.1	103.6	100.2	100.6
highly educated	166.7	84.4	82.5	88.0	91.0	84.7	91.3	96.1

Figure A.1a Correlation of regional GDP per capita (relative to country average) and regional employment rates (relative to country average), NMS 2002, capital city regions excluded

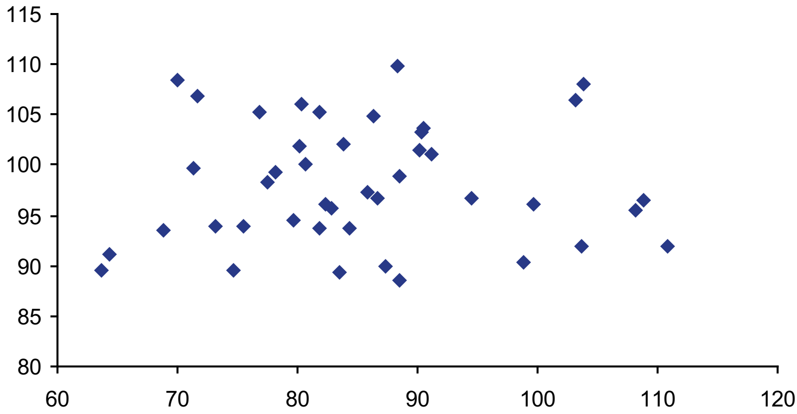


Figure A.1b Correlation of regional GDP per capita (relative to country average) and regional employment rates without agricultural employment (relative to country average), NMS 2002, capital city regions excluded

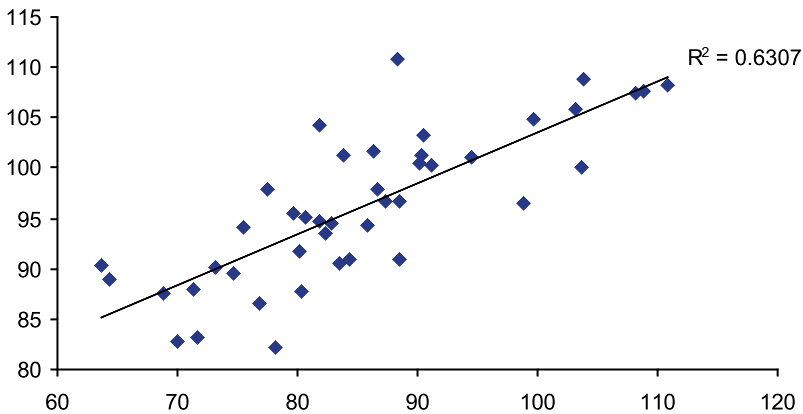


Table A.6 Employment rates, shares of skill groups in employment, 2003, by age groups

		working age population 25-64					population aged 25-29				population aged 50-54			
		change in Employment rate	Employment rate	share of skill groups in population			Employment rate	share of skill groups in population			Employment rate	share of skill groups in population		
Cluster	Country/region	2003-1998	2003	low	medium	high	2003	low	medium	high	2003	low	medium	high
	Czech Republic	**-2.0**	**73.3**	**7.1**	**78.9**	**14.1**	**74.6**	**4.0**	**83.5**	**12.5**	**81.2**	**12.1**	**76.2**	**11.7**
CAP	Praha	-2.2	80.5	3.8	68.4	27.8	81.6	1.8	76.8	21.5	85.7	8.2	66.4	25.5
ENG	Jihozápad	-0.6	75.7	7.5	81.0	11.5	74.4	4.0	83.5	12.5	86.1	12.5	78.1	9.3
BIND	Jihovýchod	-2.2	72.8	6.7	78.0	15.3	73.5	2.0	81.5	16.5	81.8	12.9	75.2	11.9
BIND	Moravskoslezko	-4.6	66.2	6.4	80.6	13.0	73.5	2.4	85.5	12.1	73.9	12.5	73.9	13.5
ENG	Severovýchod	-1.5	74.6	6.5	81.7	11.8	73.2	4.1	85.4	10.5	84.0	11.8	79.4	8.8
BSER	Stredni Cechy	0.2	75.5	9.0	80.0	10.9	73.3	5.6	87.3	7.1	83.2	13.0	78.1	8.9
BSER	Severozápad	-4.0	68.2	11.0	80.9	8.1	73.4	10.1	84.8	5.1	75.1	14.8	79.9	5.3
ENG	Stredni Morava	-1.3	72.9	6.6	81.2	12.1	75.3	3.9	84.1	12.0	78.9	11.7	78.5	9.8
	Estonia	**-0.9**	**72.2**	**8.4**	**58.0**	**33.7**	**72.5**	**7.2**	**63.5**	**29.3**	**70.2**	**10.8**	**52.6**	**36.7**
	Hungary	**5.3**	**64.4**	**15.2**	**65.2**	**19.6**	**66.1**	**11.1**	**69.4**	**19.5**	**67.2**	**19.5**	**61.9**	**18.6**
CAP	Közép-Magyarország	4.6	68.7	10.7	61.7	27.6	69.1	8.5	66.3	25.2	74.5	14.1	60.6	25.3
ENG	Nyugat-Dunántúl	1.9	69.4	17.3	66.5	16.2	73.7	10.1	74.3	15.6	75.1	22.7	62.1	15.2
ENG	Közép-Dunántúl	10.8	70.9	17.8	66.0	16.2	69.0	15.9	67.3	16.8	75.1	20.9	64.1	15.0
AGR	Dél-Dunántúl	3.4	60.4	16.9	67.3	15.9	63.6	11.6	71.7	16.7	59.3	22.6	60.5	16.9
AGR	Dél-Alföld	1.3	60.4	17.8	67.4	14.8	64.8	10.3	75.1	14.5	63.7	22.6	60.9	16.4
BIND	Észak-Alföld	8.2	59.5	17.8	64.5	17.7	59.4	13.3	66.5	20.2	56.3	23.1	61.5	15.4
BIND	Észak-Magyarország	6.8	58.2	14.8	69.8	15.3	61.8	12.2	71.3	16.5	60.0	20.0	65.8	14.2
	Lithuania	**4.0**	**73.9**	**9.3**	**63.7**	**26.9**	**76.2**	**15.9**	**49.4**	**34.6**	**74.6**	**10.1**	**68.0**	**21.9**
	Latvia	**3.2**	**69.9**	**12.7**	**66.2**	**21.1**	**74.4**	**16.5**	**60.7**	**22.7**	**74.4**	**18.7**	**63.8**	**17.5**
	Poland	**-7.5**	**60.5**	**11.2**	**69.8**	**19.0**	**72.9**	**5.1**	**66.8**	**28.0**	**54.1**	**17.8**	**67.0**	**15.2**
CAP	Mazowieckie	-6.7	65.3	9.5	66.7	23.7	73.2	4.2	60.9	34.9	62.0	19.7	68.6	11.7
MIN	Slaskie	-7.3	56.2	6.5	75.8	17.7	76.7	2.4	70.3	27.3	46.8	12.7	72.0	15.3
ENG	Wielkopolskie	-3.3	64.8	10.3	73.3	16.5	76.2	5.8	69.6	24.6	54.6	15.5	72.9	11.6
BSER	Dolnoslaskie	-9.7	55.2	8.3	72.2	19.5	72.7	4.6	72.8	22.6	45.6	12.8	72.5	14.8
BSER	Zachodniopomorskie	-10.5	55.5	11.7	68.5	19.9	70.4	6.3	61.9	31.7	46.5	11.4	70.7	17.9
BSER	Pomorskie	-5.6	58.0	9.8	69.8	20.4	69.6	3.0	70.9	26.1	60.4	12.7	72.6	14.8

BIND	Kujawsko-Pomorskie	-5.9	60.1	10.4	72.0	17.7	70.9	5.9	73.1	21.0	48.2	14.7	71.0	14.3
BIND	Lódzkie	-6.7	61.7	14.5	66.1	19.4	70.7	6.5	61.7	31.8	52.4	21.6	60.5	18.0
BSER	Lubuskie	-14.3	54.1	9.6	72.4	17.9	70.6	5.6	78.6	15.9	48.5	17.9	64.0	18.0
REST	Malopolskie	-7.7	63.3	10.0	70.8	19.1	73.8	5.1	65.7	29.2	61.5	16.1	65.9	18.0
REST	Opolskie	-11.4	57.1	10.2	72.7	17.2	66.6	3.1	72.0	24.9	51.0	16.7	69.7	13.6
AGR	Swietokrzyskie	-8.9	60.3	15.6	66.7	17.7	70.0	7.0	64.3	28.7	58.0	25.9	60.1	14.0
AGR	Podlaskie	-6.3	64.3	16.2	64.9	18.9	70.8	9.8	55.1	35.1	62.7	23.8	58.1	18.1
REST	Warminsko-Mazurskie	-10.0	54.2	15.6	65.5	18.8	67.8	7.8	61.7	30.5	51.2	22.7	56.1	21.2
AGR	Podkarpackie	-9.6	62.9	13.2	70.9	15.9	74.4	5.5	69.2	25.3	60.8	21.9	64.1	14.0
AGR	Lubelskie	-6.6	65.6	17.9	63.7	18.4	75.0	7.2	62.7	30.2	57.4	25.0	60.0	15.0
	Slovenia	**0.0**	**71.0**	**16.2**	**62.5**	**21.3**	**82.4**	**7.8**	**66.7**	**25.5**	**67.6**	**20.2**	**59.8**	**19.9**
	Slovakia	**-1.5**	**67.6**	**5.7**	**79.2**	**15.0**	**72.8**	**1.6**	**80.4**	**17.9**	**72.0**	**11.8**	**72.2**	**15.9**
CAP	Bratislavský	-2.1	78.3	5.6	64.7	29.6	87.3	1.5	67.1	31.4	86.2	10.1	58.0	31.8
ENG	Západné Slovensko	-1.1	68.3	6.5	81.2	12.3	74.4	1.3	81.8	16.8	72.9	13.6	72.5	13.9
BIND	Stredné Slovensko	-4.5	64.9	5.6	81.3	13.1	72.1	2.7	81.2	16.2	70.9	10.8	76.9	12.3
BIND	Východné Slovensko	0.9	64.5	4.8	82.5	12.7	66.2	1.1	84.4	14.5	64.7	11.4	76.8	11.9
	Bulgaria	**1.4**	**61.0**	**17.6**	**55.4**	**26.9**	**59.3**	**14.9**	**56.9**	**28.3**	**65.4**	**23.9**	**50.3**	**25.8**
CAP	Yugozapaden	-0.1	67.1	11.9	53.1	35.0	64.6	9.4	52.3	38.3	73.9	16.3	46.5	37.2
MIN	Severozapaden	5.7	53.7	15.9	57.1	27.0	51.0	12.9	53.7	33.4	54.0	15.9	64.1	20.1
BIND	Severen tsentralen	0.9	58.5	13.5	58.5	28.1	59.6	13.3	58.6	28.1	61.2	18.1	56.9	25.0
TOUR	Severoiztochen	1.6	56.9	22.7	54.6	22.7	56.6	20.0	56.7	23.3	61.5	29.2	50.0	20.7
TOUR	Yugoiztochen	5.5	58.5	20.0	57.0	23.0	50.8	14.9	56.7	28.4	59.9	29.7	52.0	18.2
AGR	Yuzhen tsentralen	0.3	61.6	23.3	55.8	20.9	61.0	19.3	62.3	18.4	67.0	32.1	47.7	20.2
	Romania	**-7.2**	**67.7**	**25.2**	**62.9**	**11.9**	**76.6**	**20.0**	**63.4**	**16.6**	**65.8**	**37.8**	**50.0**	**12.2**
CAP	Bucuresti	-5.7	64.9	10.3	61.6	28.1	73.4	11.8	55.0	33.2	56.6	10.4	55.9	33.7
BSER	Vest	-5.1	65.2	22.5	64.7	12.8	69.5	19.7	64.6	15.7	62.1	32.1	53.9	14.0
ENG	Centru	-4.9	66.3	20.9	69.8	9.4	76.8	18.8	68.5	12.7	61.3	36.6	56.4	7.0
BIND	Nord-Vest	-12.0	64.3	28.4	60.3	11.3	81.5	20.1	62.8	17.0	62.8	44.4	46.2	9.4
AGR	Sud-Est	-6.6	65.7	26.4	63.3	10.3	74.2	16.4	67.6	16.0	67.8	38.8	49.6	11.6
AGR	Sud-Vest	-11.3	72.0	27.8	62.7	9.6	78.7	19.3	68.3	12.5	74.8	45.7	45.7	8.6
AGR	Sud	-7.5	69.1	26.1	65.2	8.7	78.4	20.3	64.5	15.2	66.8	35.8	55.2	9.0
AGR	Nord-Est	-5.0	72.3	32.5	58.1	9.4	78.3	28.7	59.4	11.9	71.0	46.9	42.6	10.5

Notes: Cluster codes: CAP: Capital Cities; AGR: Agricultural regions; MIN: Mining regions; BIND: Basic Industry regions; ENG: regions spezialised in engineering; BSER: Basic Services regions; TOUR: Tourism regions; REST: Regions that could not be allocated.

Source: LFS, own calculations

Table A.7 Regional Distribution of FDI per capita (in percent of country average)

Cluster	Country/region	1999	2002*
	Czech Republic	**100.0**	**100.0**
CAP	Praha	417.1	463.0
ENG	Jihozápad	69.1	65.9
BIND	Jihovýchod	43.9	41.3
BIND	Moravskoslezko	31.9	35.4
ENG	Severovýchod	51.5	42.5
BSER	Strední Cechy	107.7	89.3
BSER	Severozápad	93.2	70.9
ENG	Strední Morava	28.2	40.8
	Hungary	**100.0**	**100.0**
CAP	Közép-Magyarország	248.1	231.0
ENG	Nyugat-Dunántúl	113.1	121.2
ENG	Közép-Dunántúl	50.5	76.2
AGR	Dél-Dunántúl	18.8	22.5
AGR	Dél-Alföld	24.5	22.6
BIND	Észak-Alföld	25.4	34.9
BIND	Észak-Magyarország	32.9	37.7
	Poland	**100.0**	**100.0**
CAP	Mazowieckie	185.4	223.9
MIN	Slaskie	106.9	117.8
ENG	Wielkopolskie	133.9	103.4
BSER	Dolnoslaskie	108.3	102.0
BSER	Zachodniopomorskie	86.4	80.1
BSER	Pomorskie	129.7	94.6
BIND	Kujawsko-Pomorskie	75.0	76.8
BIND	Lódzkie	86.3	87.7
BSER	Lubuskie	81.7	89.4
REST	Malopolskie	67.1	62.5
REST	Opolskie	64.3	63.3
AGR	Swietokrzyskie	66.1	59.6
AGR	Podlaskie	49.3	42.7
REST	Warminsko-Mazurskie	61.1	57.2
AGR	Podkarpackie	45.8	42.2
AGR	Lubelskie	48.7	38.4
	Slovakia	**100.0**	**100.0**
CAP	Bratislavský	519.7	642.9
ENG	Západné Slovensko	55.9	27.3
BIND	Stredné Slovensko	33.8	26.3
BIND	Východné Slovensko	44.1	42.4

Notes: Cluster codes: CAP: Capital Cities; AGR: Agricultural regions; MIN: Mining regions; BIND: Basic Industry regions; ENG: regions spezialised in engineering; BSER: Basic Services regions; TOUR: Tourism regions; REST: Regions that could not be allocated.

Source: National Banks of the Czech Republic, Hungary and Slovakia, PAIZ for Poland, Polish data is for the year 2003

Methodological notes: For Hungary and Slovakia FDI include equity, reinvested earnings; for the Czech Republic FDI include equity, reinvested earnings & other capital (loans); for Poland FDI data refers to the number of FDI project bigger than 1 mn €.

Figure A.2 Correlation of agricultural specialization and the share of low educated in working age population (aged 25-64), NMS regions excluding the capital cities

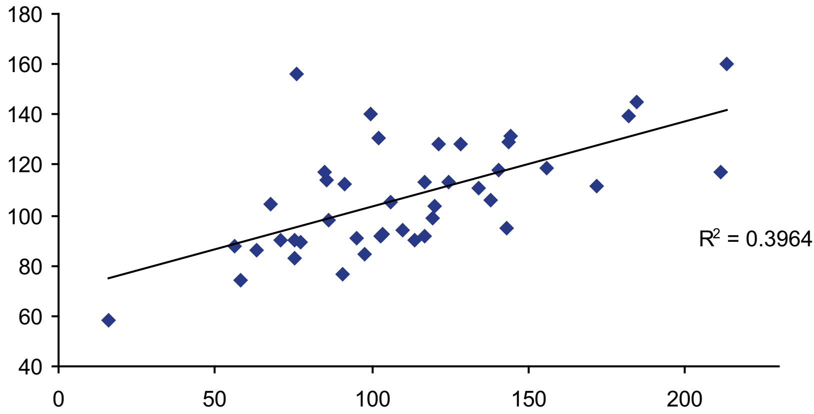


Figure A.3 Correlation of industrial specialization and the share of medium educated in working age population (aged 25-64), NMS regions excluding the capital cities

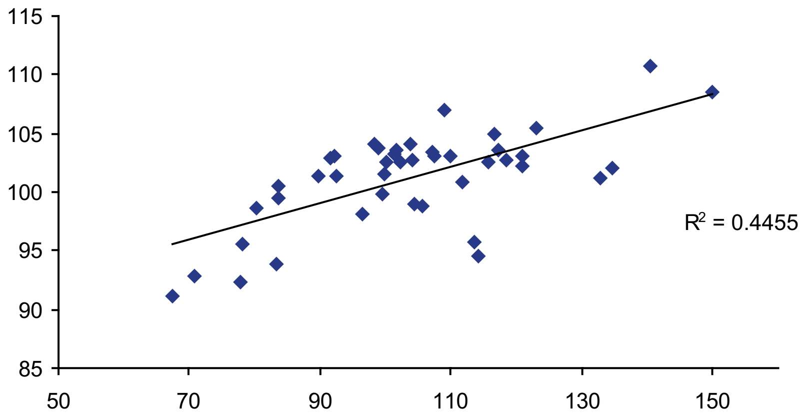


Table A.8 Infrastructure: Motorways and accessibility

		motorways				Average. minimum time to motorway
		km		density per 1000km^2		
Cluster	Country/region	1996	2001	1996	2001	2001
	Czech Republic	**423.0**	**516.5**	**5.4**	**6.5**	**49.9**
CAP	Praha	10.0	10.0	20.2	20.2	3.6
ENG	Jihozápad	26.0	88.0	1.5	5.0	60.0
BIND	Jihovýchod	217.0	217.0	15.5	15.5	3.9
BIND	Moravskoslezko	.	1.2	.	0.2	81.6
ENG	Severovýchod	.	.	.	.	114.8
BSER	Stredni Cechy	166.0	166.0	15.1	15.1	15.0
BSER	Severozápad	4.0	34.3	0.5	4.0	39.6
ENG	Stredni Morava	.	.	.	.	81.0
	Estonia	**66.0**	**93.0**	**1.5**	**2.1**	**51.0**
	Hungary	**336.0**	**448.0**	**3.6**	**4.8**	**61.1**
CAP	Közép-Magyarország	109.8	122.0	14.9	16.6	3.3
ENG	Nyugat-Dunántúl	72.0	72.0	6.2	6.2	50.0
ENG	Közép-Dunántúl	134.7	135.0	12.8	12.8	17.8
AGR	Dél-Dunántúl	.	.	.	.	139.2
AGR	Dél-Alföld	.	56.0	.	3.0	47.6
BIND	Észak-Alföld	.	.	.	.	107.6
BIND	Észak-Magyarország	19.4	63.0	1.5	4.7	62.0
	Lithuania	**404.0**	**417.0**	**6.2**	**6.4**	**34.8**
	Latvia	**.**	**.**	**.**	**.**	**37.9**
	Poland	**258.0**	**397.6**	**0.8**	**1.3**	**101.9**
CAP	Mazowieckie	.	.	.	.	144.8
MIN	Slaskie	25.0	30.2	2.0	2.5	31.0
ENG	Wielkopolskie	45.0	48.0	1.5	1.6	77.3
BSER	Dolnoslaskie	111.0	150.0	5.6	7.5	27.6
BSER	Zachodniopomorskie	6.0	14.0	0.3	0.6	55.8
BSER	Pomorskie	.	.	.	.	172.0
BIND	Kujawsko-Pomorskie	.	.	.	.	180.0
BIND	Lódzkie	19.0	17.6	1.0	1.0	31.0

BSER	Lubuskie	.	.	.	.	68.1
REST	Malopolskie	52.0	52.7	3.4	3.5	51.2
REST	Opolskie	.	85.1	.	9.0	14.4
AGR	Swietokrzyskie	.	.	.	.	99.0
AGR	Podlaskie	.	.	.	.	180.0
REST	Warminsko-Mazurskie	.	.	.	.	157.2
AGR	Podkarpackie	.	.	.	.	161.4
AGR	Lubelskie	.	.	.	.	180.0
	Slovenia	**310.0**	**435.0**	**15.3**	**21.5**	**15.4**
	Slovakia	**218.9**	**295.7**	**4.5**	**6.0**	**64.8**
CAP	Bratislavský	74.2	94.8	36.2	46.2	2.0
ENG	Západné Slovensko	85.7	131.1	5.7	8.7	19.8
BIND	Stredné Slovensko	34.9	45.7	2.1	2.8	57.0
BIND	Východné Slovensko	24.1	24.1	1.5	1.5	180.0
	Bulgaria	**314.0**	**324.0**	**2.8**	**2.9**	**33.8**
CAP	Yugozapaden	100.0	100.0	4.8	4.8	28.6
MIN	Severozapaden	.	.	.	.	86.8
BIND	Severen tsentralen	16.0	21.0	0.9	1.2	33.7
TOUR	Severoiztochen	67.0	72.0	3.4	3.6	21.2
TOUR	Yugoiztochen	.	.	.	.	8.8
AGR	Yuzhen tsentralen	131.0	131.0	4.8	4.8	23.8
	Romania	**113.0**	**113.0**	**0.5**	**0.5**	**138.8**
CAP	Bucuresti	11.0	11.0	6.0	6.0	9.0
BSER	Vest	.	.	.	.	173.9
ENG	Centru	.	.	.	.	180.0
BIND	Nord-Vest	.	.	.	.	180.0
AGR	Sud-Est	1.0	1.0	0.0	0.0	159.3
AGR	Sud-Vest	.	.	.	.	159.6
AGR	Sud	101.0	101.0	2.9	2.9	68.3
AGR	Nord-Est	.	.	.	.	180.0
	EU15	**46522**	**52277**	**14**	**16**	**27.4**

Notes: Cluster codes: CAP: Capital Cities; AGR: Agricultural regions; MIN: Mining regions; BIND: Basic Industry regions; ENG: regions spezialised in engineering; BSER: Basic Services regions; TOUR: Tourism regions; REST: Regions that could not be allocated.

Source: New Cronos Database, Ward, T. (2002) Needs of Objective 1 regions in the accession countries and in existing EU15 Member States in areas eligible for Structural Funds, Study commissioned by DG Regio

Figure A.4 Correlation of regional FDI per head and regional GDP per head (relative to country average), excluding the capital cities

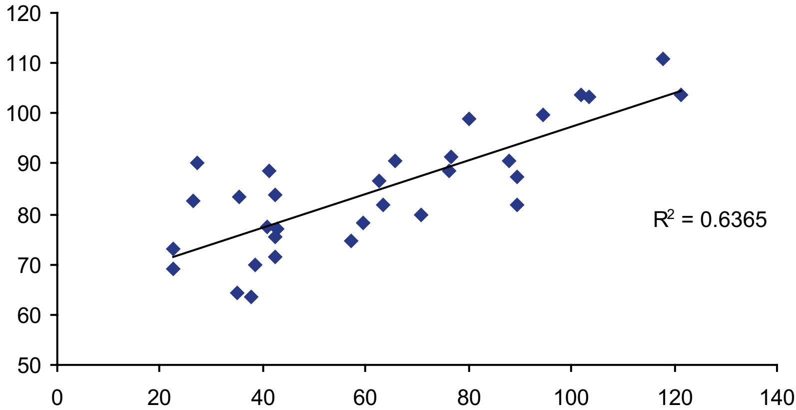
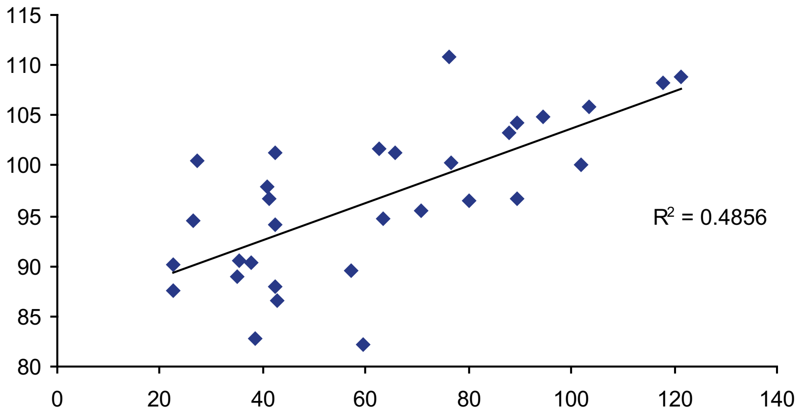


Figure A.5 Correlation of regional FDI per head (relative to country average) and regional employment rates (relative to country average), excluding the capital cities



SVENSK SAMMANFATTNING

Utvidgningen av den Europeiska unionen (EU) 2004 innebar att en ny dimension lades till den europeiska struktur- och sammanhållningspolitiken. Medlemskapet hade för dessa länder föregåtts av långa förhandlingar om anslutninsvillkoren, men det fanns litet utrymme för dem att påverka politiken som sådan.

Föreliggande studie vänder på perspektivet: även om de nya medlemsländerna presenterades inför fullbordat faktum avseende struktur- och sammanhållningspolitiken, borde medlemskapet ha inneburit att dessa länder gick från att vara *policy takers* till att bli *policy makers*. Denna bok diskuterar i vilken omfattning den nuvarande och föreslagna sammanhållningspolitiken är kompatibel med de nya medlemmarnas behov och preferenser.

Forskare från fem forskningsinstitut i Lettland, Polen, Slovakien, Tjeckien och Ungern har ombetts att undersöka och beskriva; erfarenheterna från föranslutningsstöden i deras respektive länder; de problem och kontroverser som uppstod i samband med medlemskapsförhandlingarna; vilka problem som är förenade med den aktuella och den föreslagna sammanhållningspolitiken; samt att skilja ut vilka prioriteringar som skulle råda om landet ifråga kunde styra politiken på egen hand.

Målet för den europeiska sammanhållningspolitiken är att frambringa ekonomisk och social sammanhållning mellan unionens regioner. Men ekonomisk tillväxt är ofta koncentrerad kring tillväxtregioner. Empiriska data ger stöd för att så är fallet, i synnerhet i de snabbt växande ekonomierna i central- och östeuropa, där tillväxten är koncentrerad kring huvudstadsregionerna. De regionala skillnaderna, som är större än i EU15, ökade dessutom i samband med att tillväxten tog fart på 1990-talet. Vi kan därför se att det finns en implicit motsättning i sammanhållningspolitiken; mellan nationell sammanhållning å ena sidan och regional sammanhållning å den andra.

Erfarenheter av föranslutningsstöden

Föranslutningsstöden har överlag haft positiva effekter i de nya medlemsländerna, men de har också medfört problem av varierande grad. Till exempel har stöden inte lyckats förbereda Lettland tillräckligt väl för mottagandet av stöd från struktur- och sammanhållningsfonderna och i Polen var programmen ofta otillräckliga, även om de tycks ha haft en viss effekt även där. Ett annat problemexempel var ISPA-stöden i Ungern, där betoningen på miljömässiga aspekter innebar att EU var motvilliga till att satsa resurser på en modernisering av det ungerska vägnätet och istället ville satsa på rehabilitering av järnvägsnätet. Det senare exemplet är dock ett undantag eftersom ISPA generellt sett får gott betyg i de olika länderstudierna.

Ett gemensamt drag i de fem länderstudierna är att föranslutningsstöden sällan kunde påverkas nationellt. Inhemska myndigheter blev konsulterade snarare än att spela en aktiv roll i processen. Resultatet var att mottagarna huvudsakligen bekymrade sig om att se till att inga resurser från EU:s fonder gick förlorade.

Den viktigaste slutsatsen av användandet av föranslutningsstöden är emellertid att en rad institutionella och administrativa tillkortakommanden har avslöjats hos mottagarna. Det finns också indikationer om att dessa svagheter finns kvar och kommer att bestå under en avsevärd tid framöver. Den slutsats detta föranleder är att resurser måste föras till för att kontinuerligt reformera administration och lagstiftning samt att satsa på träning och utbildning på flera nivåer i de nya medlemsländerna. Om dessa förbättringar inte kommer till stånd kommer övergången från *policy takers* till *policy makers* att bli svår och den praktik som för närvarande råder – det vill säga att säkra så mycket av EU:s resurser som möjligt – att fortsätta en bra tid framöver.

Sammanhållningspolitiken idag

De villkor som finns inbyggda i den samtida – och även den föreslagna – sammanhållningspolitiken implicerar flera problem för mottagarna av strukturfondsstöden. För det första föreligger en uppenbar målkonflikt i att samtidigt behöva uppfylla villkoren för medfinansiering i struktur- och sammanhållningsfonderna och att möta de krav på budgetdisciplin som följer av Maastrichtkriterierna. Denna målkonflikt kan dock ha positiva sidoeffekter, eftersom den kan tvinga fram budgetreformer i de nya medlemsländerna. Vidare är det också problematiskt att decentralisera ledning och förvaltning av projekt finansierade genom struktur- och sammanhållningsfonderna och att samtidigt tvinga stödmottagarna att uppfylla de krav som finns inbyggda i förberedelser, förslag och utbetalningar av och inom ett projekt. Den mängd dokument som är förenade med varje projekt, tillsammans med EU:s ut- och återbetalningsregler, sätter press på framför allt mindre företag och kommuner och kan leda till svåra likviditetskriser.

Ett annat problem, som under lång tid har följt struktur- och sammanhållningspolitiken, riskerar att särskilt drabba de nya medlemsstaterna. Det anses generellt att maximal effektivitet uppnås genom att ha ett instrument för varje mål, men i och med att EU försöker agera på för många områden har man landat i en situation med för många instrument för att uppnå för många mål. Detta är sannolikt också förklaringen till den nu rådande attityden, där mottagare av strukturfondsstöden framför allt agerar så att man inte går miste om bidrag. Problem tycks kvarstå trots de förenklingsförsök som kan ses i förslagen till framtida sammanhållningspolitik. Transfereringarna inom EU är kritiska för ett framgångsrikt medlemskap och hållbar modernisering, men det är viktigt att påpeka att struktur- och sammanhållningsfonderna är instrument och inte mål i sig.

Den framtida sammanhållningspolitiken
Länderstudierna visar att önskemålen i de nya medlemsstaterna skiljer sig avsevärt från de mål och prioriteringar som anges i förslaget till den framtida sammanhållningspolitiken. För det första finns samstämmighet om att man i framtiden bör tillåta en högre grad av nationell kontroll. En majoritet av kapitlen ställer sig dessutom välvilliga till att låta politiken vara nationell snarare än styrd på EU-nivå. I praktiken innebär detta att sammanhållningspolitiken i framtiden skulle koncentrera sig på de minst utvecklade länderna snarare än de minst utvecklade regionerna. Därmed skulle prioritet ges åt den ekonomiska tillväxten eftersom regionala klyftor kan ses som temporära och kan lindras genom omfördelningar på nationell nivå. För det andra finns det ett mycket starkt behov av att satsa på så kallad HR-utveckling (human resource development), det vill säga att satsa på träning och utbildning på olika nivåer. Denna typ av investering är särskilt fördelaktig då den inte snedvrider marknader och dessutom tillåter att ekonomin växer utan ytterligare subventioner. För det tredje finns ett stort behov av att förenkla regelsystemet i sammanhållningspolitiken samt att göra den mer flexibel. Detta är inte minst viktigt mot bakgrund av tillståndet i många av de nya medlemsstaternas regioner. För det fjärde kan förslaget att endast tillåta en fond för varje mål innebära att möjliga synergieffekter av att kunna finansiera ett program med flera fonder går förlorade.

Ytterligare en aspekt som kan läggas till denna lista, även om den betonas olika starkt i olika kapitel, är behovet av samordning och samarbete mellan de nya medlemsstaterna. Även om det är uppenbart att det krävs en bra infrastruktur för att möjliggöra hög och kontinuerlig ekonomisk tillväxt, skulle en koordinerad ansats innebära att de nya medlemmarna kunde dra större fördel av deras geografiska läge.

Slutsatser
Följande slutsatser dras i studien:

- Föranslutningsstöden har fungerat väl när det gäller att förbereda de nya medlemmarna inför EU-medlemskapet, men de har också avslöjat institutionella tillkortakommanden som till stor del kommer att finnas kvar framöver. Resurser krävs därför för kontinuerlig reformering av administration och lagstiftning samt utbildning på flera nivåer.
- Fokus bör ligga på de speciella behoven hos de nya medlemsstaterna och en högre grad av nationell kontroll över politiken bör införas. Om fokus skiftade från skillnader mellan regioner till skillnader mellan medlemsstater skulle detta sannolikt både tillfredsställa EU:s nettobetalare och ge nettomottagarna ökad kontroll över politiken. Det skulle också vara i linje med olika teoretiska hänsynstaganden.
- HR-utveckling och institutionell uppbyggnad (institution building) bör prioriteras. HR-utveckling är en av de viktigaste faktorerna för långsiktig tillväxt, välfärd och sammanhållning. Institutionell uppbyggnad

är förvisso redan ett prioriterat område i sammanhållningspolitiken, men det är viktigt att påpeka att denna utvecklingsfas är långt ifrån passerad i de nya medlemmarna. Även om betydande framsteg har gjorts står det klart att den administrativa kapaciteten, i synnerhet på lokal och regional nivå, ofta är otillräcklig. Detta kan i sig bli ett hinder för en framgångsrik framtida sammanhållningspolitik.

- Samarbete och samordning mellan de nya medlemsstaterna är viktigt. Samordnade investeringar är mer effektiva än nationella investeringar, som ofta sker med snäva nationella hänsynstaganden.
- Förenklingar och en högre grad flexibilitet är önskvärda, inte minst på grund av målkonflikten mellan att samtidigt medfinansiera strukturfondsstöden och att uppfylla Maastrichkriterierna. Det finns ett utbrett missnöje över vad som upplevs som onödig byråkrati och misstro från Europeiska kommissionens sida och också en upplevd brist på förståelse för de speciella villkor som råder i de nya medlemsländerna. Detta är ytterligare ett argument för att ha en nationell ansats i sammanhållningspolitiken.

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Contributors

Jonas Eriksson
Karol Frank
Veronika Hvozdíková
András Inotai
Magdalena Kaniewska
Pavel Karásek
Bengt O. Karlsson
Zuzana Kasáková
Vladimír Kvetan
Michael A. Landesmann
Julia Pobyarzina
Tomáš Pubrle
Roman Roemisch
Radomír Špok
Tamás Szemlér
Daniel Tarschys
Alf Vanags
Katarzyna Zawalińska

Sieps
Swedish Institute for European Policy Studies

Universitetsvägen 10 F
SE-106 91 Stockholm
Office: Stockholms universitet,
Frescati, House F, 6th floor
Tel: +46-(0)8-16 46 00
Fax: +46-(0)8-16 46 66
E-mail: info@sieps.se
www.sieps.se