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NATIONAL AND REGIONAL DEVELOPMENT IN CENTRAL AND EASTERN EUROPE: IMPLICATIONS FOR EU STRUCTURAL ASSISTANCE

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1. Introduction

Eastern enlargement is generally assumed not to take place before the year 2000, with a first accession of at least some of the 10 Central and Eastern European Countries (CEECs) that have association agreements with the European Union (EU). In spite of uncertainties about the time and scope of enlargement, it is not premature to start reflecting on EU structural assistance to CEECs. One reason is that all external assistance has - wanted or not - a regional impact as it is allocated to certain locations and therefore requires some decisions on priority regions and activities. Second, pre-accession aid to CEECs should be designed in a way that allows a smooth switch-over from existing funds (such as PHARE) to the Structural Funds in order to facilitate accession. This means not only to adjust pre-accession aid to the Structural Funds, but may also require - in the opposite direction - to prepare the Structural Funds for the CEECs. Whatever the modalities of transition will be, it is clear that sooner or later there will have to be an equal treatment of old and new Member States after a certain period.

This paper will proceed as follows. After summarising briefly the national development gap of the CEECs relative to the EU (section 2), a more comprehensive view will be taken on the CEECs' regions (section 3). Section 4 presents some theoretical considerations on whether priority should be given to national or to regional development policy. Section 5 discusses several implications for EU structural assistance. Section 6 summarises and concludes.

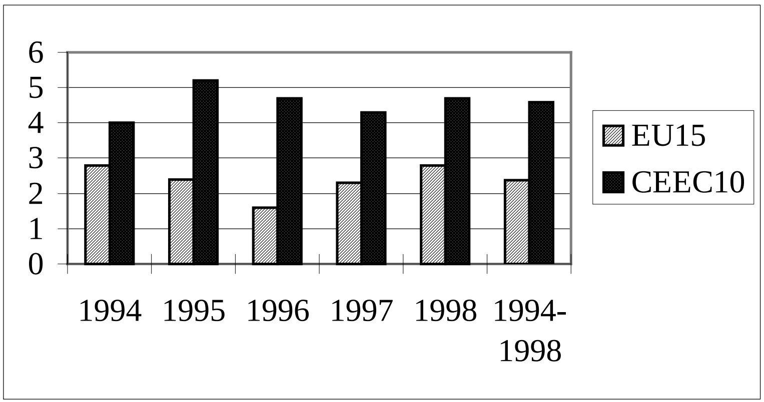
2. The CEECs' development gap towards the EU[1]

The most frequently applied indicator for the level of development, GDP per capita, is difficult to calculate for CEECs. As the socialist systems had a different system of economic accounting, some efforts had to be done on changing it to the international standardised system, and will still involve some problems as, for example, accounting for the black economy. In order to allow for international comparisons, the conversion on the basis of market exchange rates can be misleading if exchange rates differ from purchasing power parities due to international price differences. Therefore, Eurostat and the OECD have calculated GDP on the basis of purchasing power parities (PPPs) for all European countries which take account of these differences. The outcome of these calculations can be seen in table 2.1 in the annex which gives GDP per head in US$ PPP in 1993 for the 15 EU Member States and the 10 associated CEECs.

[1] This section draws mainly from work carried out by DG II-F-1, most of which is published regularly in European Economy Supplement C - Economic Reform Monitor.

The most striking result is that in all associated countries income per capita in 1993 was lower than in the poorest EU Member State, i.e. Greece. Income differences were considerable among the associated CEECs themselves reaching from Slovenia (9,210 US$) to Latvia (3,070 US$). Compared to the EU15 average income (17,118 US$), the 10 associated countries' average was at 29%. Assuming an EU of 25 member states in 1993 increases income disparities as measured by the (unweighted) coefficient of variation which would have doubled from 23% (EU15) to 46% (EU25). The reduced income average from 17,118 US$ (EU15) to 14,412 (EU25) helps distinguishing different country groups. All present Member States would have been above average in 1993, except for the cohesion countries that ranged from 97% (IRL) to 74% (GR) of the EU25 average. The relative income of Slovenia, the Czech Republic, Hungary, Slovakia and Poland varied approximately between two thirds and one third of the EU25 average, whereas all other countries would have been below 30%.
In the meanwhile, these figures have changed slightly since 1993 and will change further in the future due to real GDP growth. Its rate is expected to be at 4.6% for the 10 associated CEECs at the average for the years 1994 to 1998, well above the EU15 average of 2.4% (see graph 2.1). For most of these countries, in particular for Poland and the Czech Republic with growth rates above 5%, this means a process of catching-up raising expectations for a further closing of the income gap to the present EU until the time of accession.

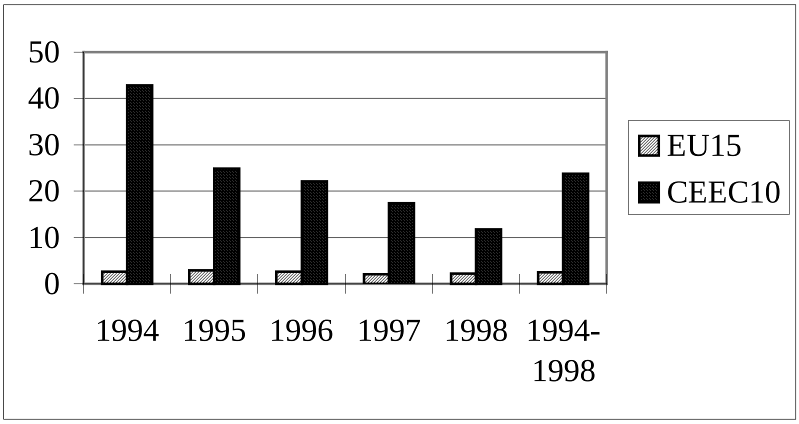
Graph 2.1: Estimates and forecasts on real GDP growth rates in EU15 and CEEC10 in %, 1994-1998



Source: European Commission, DG II forecasts autumn 1996

Other macro-economic indicators are also expected to improve further in the 10 CEECs. The Czech Republic and Slovakia were the first to reach single-digit inflation rates. Forecasts suggest that the differential in inflation rates between EU15 and CEEC10 will be reduced from almost 40 percentage points in 1994 to 10 percentage points in 1998 (see graph 2.2). With the exception of the Czech Republic, unemployment had increased in all countries in the beginning of the transition and started to decline in the last years as more and more new jobs have been created by the private sector. The trade balance, which improved in most countries in 1994 following an improved export performance and low domestic demand, is expected to deteriorate again in the next years due to an increase of domestic demand, in particular for investment goods.

Graph 2.2: Estimates and forecasts on average inflation rates (GDP deflator) in EU15 and CEEC10 in %, 1994-1998



Source: European Commission, DG II forecasts autumn 1996

3. Regional patterns in the CEECs

While local administration has strengthened in most CEECs after 1989, regional administrations at an intermediate level between the local and the national level (comparable to NUTS 2 in the EU) have often lost power as they were regarded as an artificial element in the structure of the state. This tendency has to be seen in a wider historical context which is characterised by the fact that the CEECs' national borders are mostly an outcome of more or less arbitrary decisions after the two World wars. Therefore, several countries - in particular Bulgaria, Slovakia and Romania - have ethnic minorities with a differing historical and cultural background. However, as regional and local authorities had no major role to play in a centralised planning system, but the central administrations still wanted to have a basis for regional planning, they created planning regions that were deviating from the historical regions. But with the political change after 1989 these planning regions lost their legitimisation and were rarely replaced by the historical regions in fear of excessively powerful regions, thus making it extremely difficult to find political consensus for territorial reforms.

Czechoslovakia is a case in point for this aspect.[2] Between 1960 and 1989 there were five levels of administrations: a federal government, two republic governments, ten

[2] For the following cf. OECD-CCET (1996), pp.19ff.

large administrative regions (“kraj”) plus Prague and Bratislava, 114 districts (“okres”) and over 7,500 municipal governments. The two leading objectives in this administrative division were, first, to obscure the traditional division between Bohemia and Moravia and, second, to create economic units with a major industrial complex. After 1989, the “kraj” disappeared due to the spontaneous rejection of regional authority by the lower levels and previously merged municipalities re-established their independence. Within the Czech Republic, a proposal put forward in 1991 suggesting to establish a system of regions such as Bohemia, Moravia, Prague and Silesia “generated a mixed response and was never likely to be implemented”[3]. Similarly, in mid-1996 the Slovakian government has designated eight new administrative regions, which control infrastructure, education and other services, “in ways that will under-represent Hungarians”[4] who are concentrated along the southern border of Slovakia.

For these reasons it is not always clear what "regions" in the different CEECs are. Most authors quoted in this paper take a pragmatic approach in looking at statistical regions which are - in order to allow for time series - frequently identical with the regions of the socialist era (see, for example, the old “kraj” for the Czech Republic and Slovakia in map 3.1 in the annex). This is the main reason why the subsequent look at the regional policies and the regions in the transformation process is characterised by insufficient data and by a varying country coverage. Most literature and data is on the four Visegrad countries, while hardly anything could be found on the Baltic states. As a particular case, East Germany has been included in section 3.1 for illustrative purposes because it is already fully integrated into the European Union and the Structural Policies.

3.1 Regional policies in transition

A high degree of specialisation following an inter-industry trade pattern was organised between the member states of the Council on Mutual Economic Assistance (CMEA), which included all CEECs (except Romania): "For example, Bulgaria was chosen as a major centre for mechanical engineering and electronics, Czechoslovakia for machinery and consumer goods, while the USSR provided raw materials and energy in exchange for manufactures."[5] Consequently, dissolving the CMEA required a principal reorientation of trade and production of the CEECs and their regions, shifting trade from eastern to western countries which was one of the reasons for the recession in the CEECs in the first half of the 1990s.

[3] Ibid., p.21.

[4] Economist of 10 August 1996, p.25.

[5] European Commission (1992), No.3, p.15.

More than 40 years of central planning have left their mark on most of the CEECs' regions and is an important starting point for understanding the regional pattern in Central and Eastern Europe. At the same time, it is a necessary background for identifying the present problems of these regions in the process of economic transformation.

In most CEECs, regional policy was essentially the outcome of national sectoral plans which were the basis of decisions on the locations of investment, production and settlement. As the planning process was largely influenced by political power which was largest for the biggest firms and their politically nominated directors, there was a tendency towards concentration and specialisation in few and - from an economic point of view - often arbitrarily chosen locations. This system, in combination with an ideologically based confidence in heavy industry and economies of scale, led to a high degree of regional division of labour and locational specialisation often making regions completely dependent on one large enterprise. In this way, sectoral and regional policies became strongly interrelated.

However, a closer look at the individual CEECs in respect to their regional structures shows some remarkable differences between these countries which can broadly be categorised in two groups: A first group of countries, including Bulgaria, the German Democratic Republic, Hungary and Poland, did not undertake major efforts to reduce inter-regional disparities and allocated industries - although with many exceptions - according to traditional locational advantages as natural resources or agglomerations. The underlying reason is that most of these countries had already established centres of industrial production before the start of the socialist period which could not easily be disregarded by the central planning institutions. In comparison to the west, inter-regional income disparities were however low because the price and transfer system reduced most of the disparities in living standards. A second group of countries, among which Czechoslovakia, Romania and Slovenia, tried to allocate industries to all regions of the country, in this way establishing new industrialised centres which reduced inter-regional disparities but created intra-regional differences between the location of industries, mostly cities, and their rural surroundings. A specific problem of this second group of countries will be the sustainability of firms in locations that are not capable of supplying the necessary inputs at competitive prices because of high transport costs. The opening up of trade with western competitors has already revealed that many locations chosen by planners have often completely disregarded the regional comparative advantages and cannot survive without high subsidies.

Economic transformation had a varying impact on the CEECs' regions. Domestic and foreign investment is mainly concentrated on the capital regions, other urban regions and regions bordering western countries. In spite of these polarisation effects, an implemented regional policy can hardly be found in any of these countries because public spending had to be reduced and policies at the national level had the highest priority. Regional policy is still the outcome of sectoral policies, but now resulting from privatisation, infrastructure investment, foreign investment etc. A major regional orientation can only be found in some countries with active labour market policies for problem regions that were particularly badly affected by recession.[6] A further regional orientation is introduced by programmes and institutions on cross-border co-operation. But in general, regional policies - even where concepts have been developed - are only implemented on an ad hoc basis due to disputes over ministerial responsibilities, the need to reform territorial administrative structures and the lack of financial resources.[7]

In *Bulgaria*, centralised planning was focused on the structure of sectors and branches, territorial plans basically being the outcome of sectoral plans.[8] As high preference was given to the growth of heavy industry, there was little investment neither in infrastructure nor in the preservation of natural resources. In 1982, a system of regional incentives was created to favour enterprises in lagging regions, but it was abolished in 1991 due to its effect of leading to inefficient management of supported firms. During the transition period, regional aspects were given little priority which was largely focused on macro-economic policies and privatisation.[9] Although regional aspects were present in many sector policies, there was hardly any co-ordination or coherence in respect to regional planning. The most important regional policy measure was cross-border co-operation with regions of the neighbouring countries.

The *German Democratic Republic* experienced the same pattern of regional specialisation as other CMEA countries, with a concentration of big firms in few regions (for example, the chemical industry in the Halle region or services in East Berlin). The policy of industrialisation was oriented at the traditional distribution of population and reinforced the traditional disparities between the South and the North of East Germany.[10] After unification, regional policy in East Germany was exceptional for CEECs due to the large transfers from West German and EU funds. Immediate decisions with major effects on regional development in East Germany were to be taken primarily in three policy areas: regional and local administration, privatisation of state-owned firms as well as construction and upgrading of infrastructure. The re-introduction of the Länder and the communes was a very fast process without major political friction because experiences from West Germany and the time before 1952, when the federal structure in East Germany was dissolved, could be used. Privatisation was managed by

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[6] Cf. European Commission (1993), No.4, p.29.

[7] Cf. EPRC/RWI (1996), pp.173f. See tables 3.1 and 3.2 in the annex for the state of play of regional development institutions and territorial administrations in Central and Eastern Europe.

[8] Cf. Spiridonova (1995), pp.81ff.

[9] Cf. Spiridonova (1995), pp.82ff.

[10] Klemmer/Schrumpf (1990), p.123.

the state-owned "Treuhandanstalt" which prepared and negotiated sales of firms to private owners until the end of 1994. For many less attractive enterprises - in particular the bigger industrial ones - this was a difficult task and involved high amounts of state aids to make them attractive for investors. In some cases, discussions raised the issue if a closing down of these enterprises would not be a preferable solution in cases where no private investor was willing to buy them. Due to the high dependence of regions on single enterprises this would have meant to have complete regions hit by high unemployment and out-migration. As a consequence, the Federal Government gave political guarantees for "industrial cores" which were subsequently preserved at high costs. The decision on where to set priorities in the construction and upgrading of infrastructure required - at least to a certain degree - a concept of spatial planning which is in general a competence of the Länder. However, the Federal Government used its co-ordinating competence to adopt orientation guidelines for the Eastern Länder which identified twelve development regions and corridors between regions.[11] The concept was based on the principle of "decentralised concentration" by attempting to develop centres in the different regions and to avoid a "hub and spoke"-type concentration on Berlin. While this concept gave an orientation for infrastructure projects, the main regional policy instrument of investment grants ("Gemeinschaftsaufgabe") did not follow this approach: In contrast to West Germany, the decision to identify focal points ("Schwerpunktorte"), where grants can be higher than elsewhere, was left to the Länder which made very little use of this option. The reasons were the difficulties to identify these focal points during the transition process and the high availability of funds that did not require a concentration.[12] In the recent years some Eastern Länder have started to identify focal points in rural and remote regions, motivated by equity considerations.[13]

In *Hungary*, industrialisation took mainly place in Budapest, which provided 42% of industrial employment in 1960, and some industries along the northern industrial axis.[14] In 1971, aspects of regional development planning and regional priorities were incorporated into the financial distribution of resources and were changed to a quota system in the 1980s. But these attempts for a de-concentration of industry were only partially successful as disparities in infrastructure and human capital remained high between Budapest and the other areas. In 1990, a Ministry for Environment and Regional Development was established and regional incentive systems focused in particular on the north-eastern areas. However, policy initiatives have a short-term perspective on fighting unemployment rather than addressing structural weaknesses of the regions.[15]

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[11] For a graphical illustration see Europäische Kommission (1995), p.196

[12] Cf. Henseler-Unger (1993), pp.63 and 73.

[13] Cf. Lammers (1994), p.202f.

[14] Cf. Szaló (1994), pp.82ff.

[15] Cf. EPRC/RWI (1996), p.177.

Still, more than half of the foreign investment is concentrated on Budapest and the western part while the northern industrial areas and the eastern agricultural areas are of marginal importance.[16]

Sectoral and territorial planning in *Poland* used to be separated in a way that left regional aspects inferior to the interests of powerful sectors and branches.[17] Industrial-urban-infrastructural complexes have been created in the regions of the major cities that were already well equipped with industries and infrastructure. After 1990, regional policies in Poland have remained weak in spite of the re-introduction of local government.[18] The fastest pace of privatisation occurred in highly industrialised regions by the "capital" way of privatisation and in the city regions due to the change of ownership in retail trade. Accordingly, the inflow of foreign capital has been concentrated on the big urban centres and on the western part of the country. In 1992, 35% of all joint ventures were located in the voivodship of Warsaw and more than three quarters in the 10 leading voivodships. A regional policy is almost non-existent with the exception of labour market policy whose regionally oriented employment support is determined by the level of regional unemployment.[19]

As for the second group of countries, *Czechoslovakian* territorial planning was separated from regional economic planning which led to a highly complex planning system.[20] In 1976, territorial planning started the "project of urbanisation" which was "implemented by imposing a central place-like structure to the Czechoslovakian territory which consisted of seven levels ranging from the national centre down to non-central settlements of lower importance."[21] As urbanisation was closely related to industrialisation, economic activity and population concentrated in the larger cities of the various regions leading "to strong intra-regional differences while the differences between regions were minimized"[22]. New industrial enterprises were frequently established in rural areas in order to create a strong socialist urban working class society.[23] Since 1993, the Czech government has formulated regional development concepts and identified problem areas.[24] In the Ostrava region, an industrial conurbation in North Moravia, a Regional Development Agency has been set up - partly supported by PHARE assistance - which is responsible for promoting regional development, co-ordinating and attracting

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[16] Cf. Losoncz (1994), pp.105ff.
[17] Cf. Gorzelak (1994).
[18] Cf. Gorzelak (1994), p.302ff.
[19] Cf. EPRC/RWI (1996), p.176.
[20] Cf. Maier/Masek (1993), p.38ff.
[21] Ibid., p.39.
[22] Ibid., p.39.
[23] Cf. OECD-CCET (1996), p.13.
[24] Cf. EPRC/RWI (1996), p.178.

investment, and identifying foreign sources of financial assistance.[25] In 1994, districts "affected by economic problems" were designated using a wide range of indicators and financial incentives for regional SME support have been developed. The Slovakian government has developed five strategic priorities to provide the legislative basis for regional development, the promotion of regional aid, infrastructure, human capital and information systems. By mid-1994, a regional enterprise fund and a regional development agency has been established with the help of PHARE assistance.[26]

Romania had a different kind of industrial specialisation as it was not member of the CMEA and implemented a policy of self-sufficiency. But the national diversification did not prevent from high regional specialisation which was seen as necessary to exploit economies of scale and to meet a low demand at the same time: "The normal tendency towards locational specialisation was reinforced by the concentration of production in a small number of large enterprises - in the extreme, in a single enterprise per industry"[27]. In the early 1970s, the policy of "systematization" introduced an artificial hierarchy of settlements which distorted the historical settlement system by developing selected towns and neglecting others.[28] Until the mid-90s, no comprehensive and coherent institutional and legal framework for regional policy had been established in Romania, although several legislative measures with a major spatial impact - such as on local administration, small and medium enterprises, private land ownership or foreign investment - have been adopted.[29]

Slovenia as a republic of Yugoslavia had its own regional policy for the co-ordination of regional development and the promotion of less-developed communes since the early 1970s.[30] As the specific economic system in Yugoslavia, which was characterised by self-management of firms, had a stronger market orientation than other socialist countries, the objective of a special regional fund was to reduce inter-urban differences by implementing a "policentric concept of development"[31]. After 1990, regional incentives were drastically reduced. A new concept for regional development focuses on three types of regions: structurally weak regions, unstable regions with an old industrial structure and border regions. "Action areas" include support for direct investment via soft loans, interest subsidies and grants.

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[25] Cf. OECD-CCET (1996), p.101.
[26] Cf. OECD-CCET (1996), p.76.
[27] European Commission (1992), p.15.
[28] Cf. Anton/Danciu/Mitu (1993), p.9.
[29] Cf. Constantin (1995), p.20.
[30] Cf. EPRC/RWI (1996), p.179.
[31] Cf. Kukar (1993), p.14.

3.2 Regional disparities

Describing regional disparities in the CEECs is constrained by the availability of regional data. Best access to data is given for the labour market, i.e. for unemployment and employment, and some rough estimations on regional income have been made. However, some caveats have to be added as to the reliability of this data concerning the private sector whose SMEs still tend to escape the statistical system.

Unemployment

In the central planning systems, unemployment was politically not accepted and existed only in its hidden form of labour-hoarding within firms. This changed during the reform process when registered unemployment increased to two-digit rates in all countries (with the exception of the Czech Republic). On a regional level, although regular Labour Force Surveys are carried out in most of the CEECs since 1992, there are only registered unemployment rates available which are regularly published by the European Commission (DG V) in the "Employment Observatory Central & Eastern Europe".[32] For this purpose, in most of the countries administrative regions have been merged to larger statistical units in order to have labour market regions with a stronger statistical link between employment and unemployment which is not cut by commuting between regions. The average size of the statistical regions in terms of labour force is still varying considerably from 322,000 in Bulgaria, which is about the average of NUTS 3 regions in the EU, up to 2 million in Poland, which is approximately the average size of NUTS 2 regions (see table 3.3 in the annex). Except for Albania and Hungary, where 51% and 40% of the labour force respectively are concentrated in the region of the capital city, the regional distribution of the labour force is rather even. Due to the differing size of regions and the variety in the definition of unemployment, comparisons of unemployment rates between CEECs have to be treated with care.

Map 3.2 in the annex shows unemployment rates for 1994 above 20% in the north-east of Poland, the north-east of Albania and the north-west of Bulgaria. Rates below 7.5% could be found in all regions of the Czech Republic and in the regions of the capitals (Bratislava, Bucharest, Sofia; the Budapest region was at 7.6%). Apart from these extremes, there are different degrees of homogeneity between the countries: While in Romania (with the exception of North and South Moldova) and the Czech Republic the rates vary only little, there are major differences within Poland, Slovakia, Hungary, Bulgaria and Albania (see table 3.4 in the annex).

The performance of regional unemployment rates from 1990 to the second quarter of 1995 (see table 3.5 in the annex) is less differentiated on the regional than on the

[32] In comparison to the ILO definition of unemployment these rates will be too low in countries with little incentives to be registered as unemployed (and vice versa).

national level, basically reflecting the differing speed of the reform process: In Bulgaria, the Czech Republic, Poland and Slovakia unemployment increased most in 1991/92, while in Hungary and Romania the biggest increase took place in the years 1992/93. Except for Slovakia, Romania and the Czech Republic, unemployment decreased in most of the CEECs' regions after 1994. In general, those regions with the sharpest rise in unemployment at the start of the transition process are also those with the highest rates some years later because the sectoral structure causes continuing problems.[33] New employment opportunities in the private sector have been created mainly in urban and diversified regions with already low unemployment.

Apart from methodological factors, there are several reasons for the variation of unemployment rates between the CEECs such as differences in macro-economic policy, in the reorientation of trade from eastern to western partners as well as in the speed and ways of reform and privatisation. Yet this does not explain the regional pattern of unemployment which is mainly dependent on the structure of employment inherited from the socialist era determining the reduction of old jobs and the creation of new jobs.

Employment by sectors

Data on the structure of employment in CEEC regions are available by broad sectors for the four Visegrad countries in 1991.[34] Although this data may seem out-dated, it expresses more than might be expected. Firstly, it indicates the starting positions of the different regions which do not change too quickly due to the magnitude of regional problems and the slow pace of structural change. Secondly, older data will have a better coverage which corresponds mostly with state-owned firms; a too strong reliance on more recent data could be misleading as it would not take into account the informal status of many new private firms and the importance of the black economy in most CEECs.

Maps 3.3 a-c in the annex show the regions by their shares of employment in agriculture, industry and services. For statistical reasons, comparisons between the countries might be difficult and suggest to compare the regions in relation to their national average. This is given in table 3.6 in the annex by classifying the regions according to sectoral employment shares above the national average. On this classification of regions several observations can be made:

- Regions with the severest problems will be those that are highly specialised either in agriculture or in industry (categories A and I). Most Polish and Hungarian regions are extremely mono-structural with the exception of the capitals and major cities.

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[33] Cf. EPRC/RWI (1996), p.60.

[34] Source is a study from the European Policies Research Centre (EPRC) carried out for DG XVI in 1993.

Some Polish regions have employment shares in agriculture of more than 50% and some Hungarian regions of up to 30%. Industrial employment is higher than 60% in two Polish regions (Katowice, Lodz) and in several Hungarian regions. Many of these industry regions are specialised in a few industries such as engineering, metals as well as textiles and clothing.[35] In the Czech Republic and Slovakia - corresponding to the former policy of decentralised urbanisation - there is a wider spread over all categories of sectoral employment with only few regions being clearly either agricultural or industrial which might also face problems where industrial sites have been established regardless of transport costs.

- Lagging regions with a certain development potential will be those that have - in spite of a high importance of agriculture - a considerable share of employment in industry or services. These are mostly regions of the Czech Republic and Slovakia (category A+I) as well as some Polish and Hungarian regions that have high employment in agriculture and services (category A+S). In most of these regions, development potentials are connected to locational factors such as proximity to western countries or natural conditions making them favourable locations for industry or tourism.
- Some regions are highly developed in relation to the rest of their country and have a rather diversified sectoral structure (categories I+S, S). These are the capitals of the four Visegrad countries (Warsaw, Prague, Budapest and Bratislava) and other Polish regions with a considerable industrial base and/or located at the Baltic Sea (e.g. Gdansk, Krakow, Lodz, Poznan, Szczecin or Wroclaw). Most of these growth poles are well equipped with basic infrastructure and production-oriented services, but face extremely high congestion, housing and environmental problems due to their level of economic development and to a high population density. They have been the most attractive locations of investment in the recent years causing bottlenecks within these regions and increasing regional disparities between these growth poles and the rest of the country.

This pattern of sectoral employment is basically in line with the regional distribution of unemployment which has the lowest rates in "the area around the capital city or the most industrialised parts" and the highest rates in "regions dependent on agriculture or on basic industries in decline".[36] It also corresponds with other typologies of CEECs' regions as, for instance, the ones given in studies carried out for the European Commission (DG XVI) which differentiate problem regions with predominantly agrarian struc-

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[35] Cf. European Commission (1992ff.), No.3, pp.15ff.

[36] European Commission (1994), No.6, p.9.

tures, mono-structural industrial regions and prospering regions.[37] A similar typology divides CEEC regions into "leaders of transformation" (capital cities and other major centres), "newcomers" (western regions), "losers" (old industrial regions) and "backward peripheries" (eastern regions).[38] These typologies are essentially consistent with the ones frequently applied in western countries which found their expression in the structure of the regional Structural Funds objectives: Objective 1 for lagging regions, Objective 2 for regions in industrial decline and Objective 5b for rural regions (supplemented in 1995 by Objective 6 for regions with extremely low population density). In spite of these structural similarities of western and eastern European typologies of regions, however, there are considerable differences in the dimension of problems.

The potentials of the regions within the categories might vary considerably depending on locational factors such as infrastructure equipment, environmental pollution, human resources and dependence on sensitive sectors whose trade with the European Union is exempted from the Europe agreements and will be restricted for a longer period of time. Nevertheless, the typology gives a first idea of the future objectives of regional policies in the CEECs: diversification of the economic structure in mono-structural problem regions, development of the locational advantages in regions with development potential and removal of bottlenecks in the growth poles. However, it is not straightforward if these objectives - and which of them - should be targeted by EU structural assistance.

Regional income

Regional data on GDP in CEECs are even less available and of lower quality than those on the national level. Starting from the national data from Eurostat/OECD as presented above in section 2 (see table 2.1 in the annex), CEPR/RWI (1996, pp.92ff.) have calculated regional GDP per capita for the six larger transition countries by applying regional data that were available in national statistics: in the Czech Republic, Poland, Hungary and Romania the data approximated to GDP, in Slovakia gross value added and in Bulgaria gross material production. In some cases, when income data at regional level were not available, artificial indices on the basis of sectoral output or employment were constructed. The territorial units were grouped into larger regions in analogy to those presented above on unemployment data (see map 3.2 and table 3.3 in the annex). The outcome of this exercise is presented in table 3.8 in the annex and should only be regarded as an indication for existing regional income disparities within the CEECs rather than as

[37] Cf. European Commission (1996a), p.26ff. and EPRC/RWI (1996), pp.61f. See also Scarpetta/ Huber (1995) who differentiate into agricultural, heavy industrialised and diversified regions categorised by developed and residual areas respectively.

[38] Cf. EPRC/RWI (1996), p.171.

exact statistical data. However, they will exaggerate regional disparities because the regional breakdown of national figures expressed in purchasing power does not take regional price differences into account.

Some interesting results appear from calculating indicators on the basis of the national average, the EU15 average and the EU25 average. The most striking result is the leading position of the capital city regions exceeding the national average by 25% (Bucharest), 50% (Prague), 70% (Warsaw), 80% (Budapest) and 150% (Sofia). Compared to the EU 15 average, these regions already have higher income levels than the poorer regions of the present EU. According to this data, Prague and Budapest which are the most important growth poles of their countries would already be in danger of being ineligible to Objective 1 assistance of the Structural Funds in a EU 25 if the indicator of 75% were strictly applied to the regional level.

In some countries, apart from their capitals, income seems to be quite evenly distributed across the regions. In the Czech Republic, income is the lowest in Mid Bohemia (87% of the national average) and the highest in East Bohemia (99%). Most Romanian regions vary around the national average, except for North and South Moldova (87% and 88%). In Slovakia only the central part is significantly below the national average (87%), although disparities might be higher if a more detailed breakdown were taken. In the remaining countries, regional differences are much wider with income levels below 70% of the national average in several Bulgarian regions and in the north-east of Hungary. In Poland, all eastern regions vary around 80% except for the Warsaw region (excluding Warsaw city) whose low value of 73% is probably partly a statistical phenomenon as a consequence of commuting.

Trends in regional income are difficult to identify due to a lack of comparable data. Taking indicators within countries, regional disparities seem to have widened since the beginning of the 1990s as is evidenced by average wages in Poland, industrial production in Hungary and industrial income in Bulgaria.[39] New firm formation and FDI inflows tend to favour capital city regions but are subject to major statistical uncertainties.

4. National versus regional development policy?

Before the implications for EU structural assistance can be discussed, some of its constraints have to be taken into account. Rough calculations on the application of Structural Funds to CEECs comparable to the volume of assistance to present Member States have come to differing results saying that the Union budget would have to

[39] Cf. EPRC/RWI (1996), p.95.

increase by amounts up to 40 billion ECU per year. The results vary with the assumptions on the number of acceding countries, their assumed level of GDP and the indicators of comparison to present beneficiaries. These orders of magnitude for increasing the Structural Funds from one year to the next have to be seen as unrealistic for several reasons. Firstly, net contributing Member States seem to have little willingness to increase their contributions to the Union budget substantially. Therefore, it has been suggested to maintain the own resources ceiling for the Union budget of 1.27% of GDP and spend a constant percentage of the Union GDP on Structural Policies, in this way having the Funds increase in line with GDP growth in the Union.[40]
With the working hypothesis of maintaining the expected share of 0.46% of Structural Funds relative to the Union's GDP in 1999 for a possible programming period 2000-2006, structural spending could increase from 28 bn. ECU per year in the present programming period to 37 bn. ECU per year in the future period.[41] This would allow for an increase in funds available for assistance in CEECs while consolidating the efforts in favour of the present Member States. Secondly, the Member States who are main beneficiaries of the Structural Funds related to GDP already show problems concerning their absorptive capacity due to the limited capacities of their administrative system. While it is difficult to estimate an upper limit of absorption capacity, this suggests at least a slow phasing-in of assistance in CEECs rather than a front-loading. Thirdly, the political margin for a concentration of the Funds in the present Member States in order to re-allocate to new Member States will be limited. "Soft landings" for regions that will cease to be eligible have to be planned, not only for political reasons, but also for economic reasons to avoid negative shocks.

An outcome of these constraints will be a limited access for the CEECs to EU funds in the next years. Whatever the institutional framework of assistance may be - PHARE, pre-accession aid, Structural Funds - decisions on priorities will have to be taken. One of the most crucial decisions will be on the regional allocation of funds, in particular whether to promote primarily national or regional development objectives in the CEECs.

This issue of national versus regional development policy can be dealt with by asking several questions:

- Why at all should a regional policy be carried out? (section 4.1)
- In a "multi-layer state" with different layers like the European Union, who should be responsible for regional policy? (section 4.2)
- Is there a trade-off between national and regional development policy so that both policies can hardly be followed at the same time? (section 4.3)

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[40] Cf. Wulf-Mathies (1996).
[41] Cf. ibid., pp.4ff.

4.1 The case for regional policy

In principle, regional policy can have two objectives: improving efficiency and providing more regional equality. A discussion of the first objective is prevalent in economic theories on regional policy. The second objective is not necessarily only achieved by transfers to individuals, but can also be followed by providing equal supply-side conditions of growth; in this context, growth theory is relevant.

Efficiency arguments for and against regional policy can be found in the context of static economic models of foreign trade theory. In the standard neo-classical model there is almost no need for a regional policy, not only for the reason that space does not exist in most models because there are no transport costs. But even if two regions are assumed as points, the reduction of barriers either to trade or to factor movements will immediately lead to factor price equalisation caused by an adjustment process without cost and time. Assuming economies of scale and transaction costs changes the model radically: Bigger markets and lower transaction costs create a competitive advantage of agglomerations that may become a self-perpetuating process of cumulative causation, in which trade and factor movements cause relative advantages of competitiveness in the centre and relative disadvantages of competitiveness in the periphery.[42] The final outcome of this process may be agglomeration diseconomies (like negative externalities) in the centre that will be an impediment to further growth, creating a necessity to make other locations attractive to factor flows. Some of the costs for recovering the competitiveness of the periphery (e.g. for rebuilding infrastructure) could have been economised on, if a regional policy would have contributed to a regionally more balanced development. However, this efficiency argument for regional policy is more relevant to the more industrialised economies where public investment in the periphery had already been undertaken and where there is a risk of losing this capital.

The most important factors for providing equal conditions of growth are discussed within the context of growth theory. Neo-classical growth theorists would hardly see the necessity for conducting a regional policy because - other things being equal, in particular the production technology and the speed of technological change - decreasing marginal returns to capital productivity will lead to higher returns, investment and growth rates in the low productivity regions and in this way to an equalisation of productivity. All that is to be done is a reduction of barriers to trade and/or factor mobility by a liberalisation of goods and factor markets. As empirical researchers could not find a tendency for (unconditional) convergence on an international level, "new" growth theory made the causes of technological change endogenous to the models. This was done by assigning special characteristics to human or public capital, in particular positive

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[42] See Myrdal (1957), Hirschman (1958), Kaldor (1970) and Krugman (1991).

externalities or economies of scale, so that marginal returns to capital productivity are no longer decreasing. A regional policy based on new growth theory should therefore concentrate on promoting infrastructure, technology and human resources.

To sum up, the static and dynamic models of the standard neo-classical approach see regional policy mainly as liberalisation policies. New approaches in economic geography and growth theory present some additional arguments in favour of public support for infrastructure, technology and human capital formation.

4.2 The assignment of responsibilities in a "multi-layer state"

Once the general need for regional policy is accepted, the subsidiarity principle suggests to ask what level of government in a "multi-layer state" like the European Union should be in charge of which activities. The economic theory of (fiscal) federalism gives some help by discussing the optimal division of labour in a federal state.[43] The diversity of preferences and the reduction of transaction costs being the main cases for the lowest possible level of responsibilities, there are three main cases for assigning responsibilities to a higher level of government:

(1) inter-regional redistribution,

(2) inter-regional externalities (or spillovers) and

(3) economies of scale in the provision of a public good.

From an economic point of view there is not much to be said about an "optimum" of *inter-regional redistribution* which is mainly depending on the political willingness of richer regions to direct transfers or capital to poorer regions. In this way efficiency gains (e.g. from economic integration) are separated from - rather than prevented by - distributive objectives. However, it must be taken into account that there will be some efficiency losses as the incentives to provide for one’s own income decrease with increasing redistribution. Once the volume of redistribution is fixed, a decision must be taken between a concept of purely inter-regional transfers (like the German "Finanzausgleich") or a concept of some kind of regional policy. While both concepts require a certain activity of the higher level, the first concept is suffering from the possibility that recipient regions might use the transfers for purposes which were not intended by the donating regions. In particular, consumptive uses will give the donating regions a perspective of permanent transfers, while investive uses open up a perspective of only temporary assistance for catching up. This is the main rationale for financing and controlling regional interventions on a centralised level.

Inter-regional externalities (or spillovers) distort the allocation of resources because activities with negative (positive) externalities are higher (lower) than preferred by the recipient regions. For example, as regards growth effects of public infrastructure "... the

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[43] See Walsh (1993) for an overview on fiscal federalism theory in a European perspective.

estimates tend to be larger at the federal level than at the state level, and larger at the state level than the municipal level."[44] This is basically due to positive network externalities which are received by all participants of a network if it is enlarged anywhere. But the need to internalise externalities to improve allocation does not necessarily require an intervention of the higher level, if the involved regions can agree on compensatory schemes. Because this is a spatial application of the so-called “Coase theorem”, this will only be the case if property rights are fully assigned and if transaction costs are negligible. In practice, however, transaction costs are often prohibitively high suggesting that the higher government level should take over responsibilities with a degree of intervention to be discussed from case to case.

Economies of scale in the provision of public goods can be realised when co-operation between regions or countries reduces average costs because of high fixed costs or the avoidance of double work. In particular, some industries and R&D activities have these characteristics, which do not necessarily require state interventions, but might do when major positive externalities (e.g. technological progress) can be expected.

Summarising, inter-regional redistribution, internalisation of externalities and realisation of economies of scale are the main arguments for regional policy at a centralised level. For the European Union as a community of nation states, this would imply to transfer funds from rich to poor Member States (and to non-members), to reduce externalities between Member States and to finance large-scale projects, i.e. very little direct intervention at the regional level with the exception of activities for which transaction costs of trans-national co-operation may be too high, such as for inter-regional co-operation. At the national level, this would include, for instance, allocating money to the regions, constructing infrastructure and providing large-scale public goods. The regional and local level should particularly carry out policies that need to take into account the diversity of preferences (e.g. education) and that have potential for reducing transaction costs (e.g. administration).

4.3 The Williamson hypothesis

Countries in a process of catching-up usually have not only a development gap towards industrialised countries, but also major disparities between the regions within the country. In this regards, an important issue is a possible trade-off between national and regional cohesion in the process of national development. Williamson (1965) has presented the hypothesis that the typical pattern of national development creates an inter-regional divergence at the early stages of development and an inter-regional convergence in the later stages: "The expected result is that a statistic describing re-

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[44] Aschauer (1993), p.18.

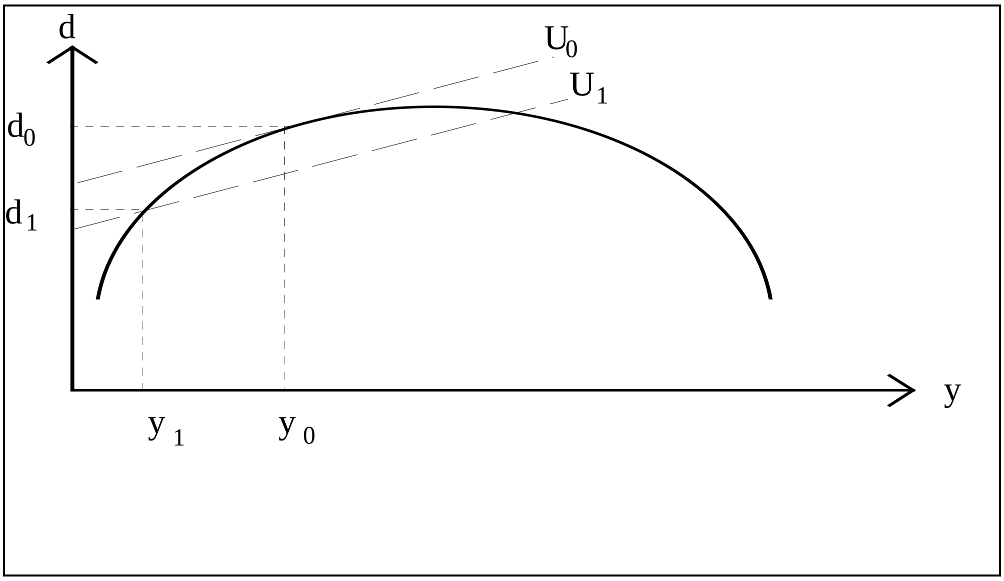
gional inequality will trace out an inverted 'U' over the national growth path."[45] Mainly based on arguments of Myrdal and Hirschman, he maintains that inter-regional linkages, factor movements and central government policies are selective in favour of the centres in the early stages of development, while a higher income level in the later stages of development allows a reversal of this tendency. This relation between regional equality and national development is illustrated in graph 4.1, with *d* representing income dispersion and *y* income per capita. Accordingly, in high-income countries the two objectives of growth on a national level and convergence of the regions are not conflicting, but in low-income countries they are. Williamson presents some cross-sectional and historical data to prove his hypothesis.[46]

A normative interpretation of this hypothesis leaves policy-makers in low income countries only the choice between a higher level of national income and a higher degree of regional equality. In graph 4.1, social preferences U_0 are assumed whose tangential point with the Williamson curve is an optimal combination of per capita income and regional disparities (y_0d_0). Assuming a better articulation of social preferences on a decentralised level (e.g. Member States or regions) than on a centralised level (e.g. European Union), a centralised decision in favour of more regional equality (y_1d_1) might lead to a loss of welfare (U_1). This situation is rather plausible: Confronted with high needs and scarce means, poorer countries often have a preference for promoting national development and creating good conditions for private investment by a concentration of public investment on a few growth poles rather than spreading a low level assistance all over the country and in this way loosing relative attractiveness for private investment in the whole country.

Graph 4.1: Williamson's hypothesis on the relation between national development and regional inequality

[45] Williamson (1965), pp. 9f. This is more or less a spatial version of the Kuznets hypothesis saying that income distribution is becoming more unequal in the beginning of industrialisation and more equal in later stages because of the sectoral distribution of income.

[46] For a summary of criticism on the Williamson hypothesis see Richardson (1978), p.23.



Note: d_t = regional disparities; y_t = income per capita; U_t = social welfare.

However, some critical remarks on this normative version of Williamson's hypothesis should be noted. Part of the explanation for the U-type relation was the orientation of central government policies towards the centres; a normative interpretation then simply gives an ex post justification for these policies. Furthermore, not all regional policy projects are beneficiary either to the centre or to the periphery; for example, given they have access, both types of regions usually benefit from constructing infrastructure networks. Finally, some scepticism on the ability of regional policy to direct the process of regional development should be added because other regional location factors, such as peripherality, which can only be changed to a certain degree, might be more important than policy measures.

The trade-off between equity and efficiency in cohesion countries is far from purely theoretical. De la Fuente (1996, pp.17ff.) has simulated this trade-off for Spain in the period 1981 to 1990 on the basis of an estimated production function including public investment. The result compared to the baseline is that an extremely redistributive policy of public investment would have reduced regional disparities by 13.54% at the expense of a 1.62% decrease of Spanish GDP. The alternative extreme policy oriented towards efficiency by allocating public investment according to rentability would have increased GDP by 1.58% and regional disparities by 18.29%. In a regional breakdown this means that for most Spanish regions the expected rentability is above national average in the wealthier regions and below national average in the poorer regions. These results indicate the conflict for decisions on the regional allocation of public investment in Spain whether to promote convergence of the whole country towards the European average or to promote the convergence of regions towards the national average.

5. Implications for EU structural assistance in CEECs

Theoretical arguments and empirical evidence outlined above will have several policy implications if one assumes that EU structural assistance to CEECs will either move from a system of PHARE assistance towards a scheme similar to the Structural Funds or that the Structural Funds will adapt to the needs and conditions of the CEECs. In any case, one will have to consider both schemes of assistance by taking the PHARE assistance as a starting point (section 5.1) and looking at the appropriateness of the Structural Funds (section 5.2).

5.1 The present situation: PHARE assistance

Apart from EIB loans with a total volume of 3,449 MECU from 1991 to 1995 mostly for infrastructure and global loans,[47] grants from the PHARE programme were the most important source of financing for EU structural assistance in CEECs. PHARE was launched in 1990 to support economic and social restructuring in the CEECs in transition according to the countries' needs.[48] A major change in the programme was introduced after the European Council meeting in Essen in December 1994 had adopted a pre-accession strategy for CEECs which included the Europe agreements, the structured dialogue and the programme PHARE as its financial instrument. The main role of EU financial assistance under the PHARE programme was to be re-oriented to "help the associated countries to absorb the 'acquis communautaire' and to complete market reforms and medium-term restructuring of their economies and societies so as to create the conditions required for future membership"[49]. Priority objectives were decided to be measures to promote the approximation of laws and standards as well as the economic reform process and the development of adequate infrastructure. As regards the latter, the limitation of infrastructure as a percentage of total financing by PHARE was increased from originally 15% to 25%.

An indicative multi-annual planning was introduced, allocating a total of 6,693 MECU for the period 1995-1999 and rising in annual terms from 1,154 MECU (1995) to 1,634 MECU (1999). The new approach of programming started with four country operational programmes for the period 1996-1999 (for the Czech Republic, Hungary, Poland and Slovakia) which define objectives, priority sectors, activities, calendar and the respective funds. Due to their indicative character, an annual budgetary procedure on the

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[47] Cf. European Investment Bank (1996).

[48] In budgetary terms, PHARE consists of five budget lines: B7-5200 (democracy), B7-6000 (economic restructuration), B7-6020 (cross-border cooperation), B7-6310 (NGOs), B7-6330 (access to Community programmes).

[49] European Council (1994).

operational programmes for each country - referring to the programmes in a flexible way - is still necessary. The proposals from the partner countries are scrutinised by the PHARE Management Committee in Brussels, made up of representatives of the Member States of the European Union, and form the core of the respective financing memoranda signed by the European Commission and the partner countries. The implementation of the programmes is organised by a shared responsibility of the Commission in Brussels, its local delegation and the partner country. Evaluation and monitoring is i.a. carried out by three regional offices with independent consultants who are to examine more than 400 projects each year.

Looking at PHARE assistance between 1990 and 1995, total commitments of 5,417 MECU have been made with a clear concentration on infrastructure as the most important priority sector (see table 5.1). Defining infrastructure in a narrow sense, i.e. by transport, energy and telecommunication, it absorbed almost a fifth of the total, whereas in a wider sense, including environment, public institutions and health, it absorbed more than a third. Infrastructure financing by PHARE is subject to certain rules among which the principal are:[50]

- the project must be a stated priority on which the partner country has decided in its own responsibility;
- PHARE's contribution must have a clear additional benefit to the project which is particularly given when several countries are involved i.e. in trans-European networks;
- the PHARE contribution has to be complementary and should not compete with other sources of financing;
- the project must be in line with the Union standards.

A second focus of assistance was the productive sector in order to support restructuring of state enterprises and private sector development, agricultural restructuring and the financial sector. Thirdly, other "soft" measures were funded by projects in education, training and research, emergency aid, social development and employment, consumer protection as well as the promotion of the civil society and democratisation.

A major part of these projects is implemented in the context of cross-border co-operation jointly financed by INTERREG (in EU border regions) and PHARE (in CEEC border regions). Initially, funds were concentrated on infrastructure but have been expanded to "soft actions" (such as tourism, human resources and culture) in 1995. However, this is not necessarily to be seen as an instrument of regional policy since most of the CEECs' regions involved in these programmes are already in a privileged position given their proximity to the West which is a major advantage to them since the opening of the borders.

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[50] Cf. European Commission (1996b), p.7.

Table 5.1: PHARE commitments by sectors in MECU, 1990-1995

Infrastructure (transport, energy, telecommunication)	1,044.7
Private sector development and enterprise support	863.1
Education, training and research	746.3
Other sectors	543.0
Environment and nuclear safety	483.4
Agricultural restructuring	441.1
Critical aid	392.7
Financial sector	249.2
Public institutions and administrative reform	233.9
Social development and employment	177.5
Public health	101.5
Integrated regional measures	81.8
Civil society and democratisation	45.7
Consumer protection	11.0
Approximation of legislation	2.0
Total	**5,416.9**

Source: European Commission (1996b), pp.40ff.

Funds explicitly devoted to support less favoured regions are almost negligible. Only 82 MECU have been spent on integrated regional measures, 47 of which in 1995 (see table 5.2). This increase might indicate a recent tendency in favour of regional development which is among the long list of priority objectives of all new multi-annual programmes. Another regional orientation is implemented by projects of inter-regional co-operation between cities and regions of EU and CEECs - not limited to border regions - in the context of the sub-programme ECOS/OUVERTURE whose modest support is however of low significance in terms of total PHARE assistance. A further PHARE pilot programme with a regional orientation, called “Struder”, is on the regional development of selected conversion regions in Poland.

To sum up, structural assistance by the PHARE programme has changed from an “ad hoc”-instrument to an instrument of the pre-accession strategy partly based on principles such as programming, partnership, subsidiarity, monitoring and evaluation. Given that the partner countries’ priorities are respected in the design of programmes and projects, the limited efforts regarding regional development objectives can only be seen as an indication of its presently low priority for CEECs’ governments.

Table 5.2: Integrated regional measures of the PHARE programme in MECU

	1990	1991	1992	1993	1994	1995	total
Albania	0	0	0	0	0	8.5	8.5
Hungary	0	0	10	0	0	5	15

Slovakia	0	0	0	0	0	1.5	1.5
multi-country	0	4.3	6.5	10	4	0	24.8
other	0	0	0	0	0	32	32
total	0	4.3	16.5	10	4	47	81.8

Note: Excluding cross-border co-operation; countries not mentioned have no expenditure in this sector.
Source: European Commission (1996b), p.43.

5.2 The appropriateness of the Structural Funds

The four operating principles which were introduced in the reform of the Structural Funds in 1988 - concentration, partnership, programming and additionality - are their constituting elements. The appropriateness of the Structural Funds for CEECs is thus best to be discussed by these principles.

Concentration

EU structural assistance for economic and social cohesion within the Union - including Structural Funds, Cohesion Fund and Community Initiatives - had an annual average of 14.7 bn. ECU in the period 1989-93 (in current prices) and is planned to have an annual average of 27.9 bn. ECU (in 1994 prices) in the period 1994-99.[51] In order to better target this assistance, the Structural Funds concentrate on six priority objectives, of which 70% are allocated to lagging regions whose per capita GDP is less than 75% of the Union average (Objective 1). Further regional Objectives are those for areas affected by industrial decline (Objective 2), rural areas (Objective 5b) and very sparsely populated areas (Objective 6).

A question that arises is whether a new objective for transition economies should be introduced. An argument in favour could be the specificity of the economic situation of CEECs and their regions that might require very specific policy instruments completely different to the present Member States. However, the typology of regions outlined above has already shown that the differences in regional problems are quantitative rather than qualitative. Mono-structural regions depending on few industries can also be found in western Europe. The existence of a large state sector is nothing specific to CEECs as, for instance, also in the two poorest Member States, Greece and Portugal, large parts of industry and services were owned by the state when they acceded the European Community, although the pace of privatisation after the accession was much slower than in the CEECs in the last years. The lack of the peculiarity of transformation problems is also reflected by the fact that economists did not feel the need of constructing an "economic theory of transformation" because most of the issues could well be covered by already existing theoretical approaches addressing problems of market economies.

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[51] Cf. European Commission (1996c), p.144, table 24.

For the time being, it will hardly be possible to identify eligibility for the existing Objectives on a regional level because of a lack of reliable regional data for CEECs. Even if it were possible, the segmentation of a CEEC's territory by the different Objectives would increase co-ordination costs and would reduce the synergy effects of projects, such as for example for trans-European networks. If the territories of CEECs were to be considered as a whole, the criterion of eligibility for Objective 1 would probably be fulfilled for all CEECs even if a reduced EU25 average GDP per capita is taken into account.

An issue that arises from applying Objective 1 to CEECs is if a new eligibility criterion will be needed, given that the application of the present criterion would make all of their territories eligible due to missing or unreliable data on regional GDP. This would give CEECs a wide margin of decision in allocating funds to their regions and to different measures on public infrastructure, human resources and productive environment. But apart from financial constraints, there should be no reason to narrow this margin. And in spite of various deficiencies, GDP per capita is still the most frequently applied indicator of wealth. Other available indicators, such as regional unemployment rates, reflect not necessarily development needs and could even be a disincentive for reducing unemployment figures.

The theoretical arguments presented in section 4 might be extremely relevant for decisions on the regional concentration of EU structural assistance in the CEECs. In the light of the financial constraints of EU assistance, priority should be given to the removal of bottlenecks in growth poles, which will promote faster convergence of the national income per capita towards the Union average but might increase regional disparities, rather than giving assistance primarily to lagging regions, which might allow them to catch up to the national average to the possible detriment of national income growth. In the long-term perspective of the lagging region of a poorer country, regional development could even be slower if funds are directly allocated to the lagging region because of a slow-down of national development, and could be faster if funds are allocated to the growth poles subsequently creating positive spill-overs to the lagging regions.

However, the above discussion suggests also to avoid a degree of urbanisation where agglomeration diseconomies become prevalent. But as to the assignment of responsibilities there is hardly any economic argument why the European Union should intervene directly into the regional policy of its Member States. The possible trade-off between national and regional development in less developed countries suggests rather to leave decisions on regional policy priorities to the national level.

In the past, the Structural Funds programmes have avoided to take a clear-cut position by financing all types of regions in cohesion countries. In Portugal, for instance, Structural Funds are highest in absolute terms in the wealthiest regions (Lisbon, Norte), but are highest in per capita terms in the poorest regions (Alentejo, Azores, Madeira). In the CEECs, however, the low level of national income and the financial constraints of public expenditure might increase pressure to give priority to the growth poles and to pursuit regional equality only as a secondary objective.

Moreover, the institutional setting in the CEECs' regions might still be inadequate to have measures carried out directly on the regional level. Given the political sensitiveness of restructuring territorial administration, for historical and ethnic reasons, hardly any of the CEECs has so far assigned considerable power to the regional level. Connected to this, regional statistics will hardly give an adequate basis for the clear identification of regional problems on which concentration of funds is mostly needed.

Partnership

The principle of partnership involves close collaboration between the Commission and the relevant authorities at national, regional or local level appointed by each Member State, at all stages of programming. In 1994 it was extended to "competent authorities and bodies" including the economic and social partners. The principle is to ensure that no decision is taken without consulting the involved partners.

There will be several problems in applying the principle of partnership in the CEECs due to the lack of administrative and social partners in particular at the regional level (not always on the local level). As outlined above, the regional level is still in a process of restructuring and not yet well established in most CEECs. The same is true for the economic and social partners because, in the socialist era, organisations of managers and workers were closely connected to the political system and "their adaptation to the new market conditions has been stalled by financial problems (as potential members can often not spare the necessary contributions), their limited range of services and lack of credibility in their independence"[52]. Due to the importance of trade unions in the transition process, Poland seems to be the most advanced in this respect, as Voivodship or local employment councils have been created which represent employees and employers as well as state and local administrations.[53]

While partnership on a regional level might involve high co-ordination costs or might sometimes even be impossible in most CEECs, the obligation of partnership on the national level in the context of EU structural assistance could give incentives to speed up the process of institution-building and democratisation. This has often been the case in the more centralised EU Member States in the past and can already be observed in the context of programmes on cross-border co-operation in CEECs. Nevertheless, it might

[52] EPRC/RWI (1996), p.109.

[53] Cf. Kwiatkowski/Janusz/Steiner (1995), p.282f.

take some time to build up and stabilise these organisational structures which will certainly go through changes for a considerable period of time. This might raise some problems - certainly soluble in the medium to long run - in establishing fixed organisational structures as, for example, monitoring committees.

Programming

The principle of programming is carried out by setting timetable and scope for the allocation of assistance in a programming document. It is to ensure that the different projects are coherent with the overall development objectives. Again, this might face some difficulties at the regional level in the CEECs due to the lack of administrative capacity and organisational structures. While programming should in general be no problem at the national level, there might be insufficient information to programme the regional allocation of funds.

The Cohesion Fund takes a more pragmatic approach in financing projects or groups of projects on trans-European transport networks and environment. In the course of an eastern enlargement, an option for reform could therefore be to give Member States - according to their income per capita - access *either* to a Cohesion Fund-like scheme *or* to a Structural Funds-like scheme. Applying the present criteria of eligibility for the Cohesion Fund, the Member States with a GNP per capita less than 90% of the EU average would be supported by the Cohesion Fund-like scheme, while the other Member States' regions would be given assistance by the Structural Funds-like scheme. A Cohesion Fund-like scheme would provide assistance in cohesion countries and broaden its scope of assistance beyond transport and environment, in particular towards assistance for human capital and the productive fabric, following a medium-term strategy as defined by a national development programme. The main rationale of the proposal is to define the cohesion objective clearer: The Cohesion Fund-like scheme would provide for the real convergence of poorer Member States towards the Union, then being the main instrument for re-distribution of funds from wealthier to poorer Member States, while the Structural Funds-like scheme would provide for social and regional cohesion in the wealthier Member States.

The clearer division of objectives between the cohesion of Member States on the one hand and regional and social cohesion within Member States on the other hand would allow a better targeting of programmes, projects and instruments. The Cohesion Fund-like scheme could finance measures to address problems of catching-up which are specific to cohesion countries and would be similar to present PHARE assistance: infrastructure, education and training, institution-building, privatisation, financial markets, transfer of technology. The decision on the allocation of assistance to lagging regions could be left to the national governments and would not require the prior establishment of regional administration. This decision could also take into account that investment in infrastructure - as mentioned above - has a higher impact on the national level than on the regional level.

A Cohesion Fund-like scheme targeting at the cohesion of Member States would comply with Article 130a of the EC Treaty which specifies that "the Community shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the less-favoured regions, including rural areas". This requirement would be fulfilled even if regions were not interpreted as Member States, but as sub-units of Member States because the development of less-favoured regions in cohesion countries will be more favourable - at least in the medium to long run - in an economy whose process of catching-up is faster with the help of the most efficient use of EU structural assistance.

The Structural Funds-like scheme could be much better targeted to the adjustment needs of regions and labour markets in the wealthier countries. A further advantage would be an improvement in the transparency of the Cohesion/Structural Policies and in that way a strengthening of public support for redistribution between Member States.

Additionality

The principle of additionality aims to ensure that financing from Community funds is not used to replace national structural aid. Each Member State has to prove that it has maintained its public structural or comparable expenditure in eligible regions as a whole at least at the same level as in the previous programming period.

The verification of this principle for the present Member States is a difficult exercise, in particular concerning the identification of public structural or comparable expenditure. In CEECs, the problem of identifying the performance of eligible expenditure would be even more difficult due to the fact that public and private investment can hardly be distinguished in socialist and post-socialist systems which will be reflected in the lack of reliable statistical data. For this reason (and the obvious high level of public investment), the application of the additionality principle in the eastern German Länder was derogated during their initial period of Structural Funds' assistance (from 1991 to 1993).

In theory, it is in the own interest of beneficiary countries to maintain a high level of growth-enhancing public investment and to use the Structural Funds as an additional support. In practice, however, governments tend to reduce investive rather than consumptive expenditure when budgetary problems occur because the short-term impact is less perceived by the population. For political reasons, it is therefore difficult for some countries to maintain structural expenditure at a high level and to conduct a sustainable fiscal policy at the same time. Nevertheless, present assistance from the Cohesion Fund is even conditional on having no excessive government deficit as set out in Article 104c of the Treaty and allows for the suspension of financing new projects if the government deficit is higher than recommended by the Council.

There might be some specific problems for CEECs to comply with the additionality principle and to avoid excessive deficits at the same time. The main reason is that the tax base is still low because the fiscal administration system is not yet fully established making it easy for new private firms to evade taxation. In combination with a weak statistical system to provide reliable forecasts, tax receipts can be subject to major changes from one year to the next. On the expenditure side of the budget, special risks may arise from state-owned or even private firms - as e.g. banks - for which the state bails out in case of problems to avoid their bankruptcy mostly for reasons of national or regional stabilisation. In view of these risks for revenues and expenditures in CEECs, maintaining structural expenditure at a stable level without allowing for variations in public deficits will be extremely difficult.

6. Summary and conclusions

The gap of national development compared to the EU15 average income as measured by income per capita in 1993 was considerable, the 10 associated CEECs' average being at 29% of EU15 average.

Regional policies and the regions in CEECs are characterised by a missing level of regional administration and statistics. Regional policy in the socialist era was essentially the outcome of national sectoral plans and can broadly be categorised into two country groups: A first group of countries, including Bulgaria, the German Democratic Republic, Hungary and Poland, did not undertake major efforts to reduce inter-regional disparities and allocated industries - although with several exceptions - according to traditional locations. A second group of countries, among which Czechoslovakia, Romania and Slovenia, tried to allocate industries to all regions of the country, in this way creating intra-regional differences and locations that have problems to survive in a competitive environment.

Although economic transition caused polarisation effects, an implemented regional policy can hardly be found in any of these countries due to disputes over ministerial responsibilities, the need to reform territorial administrative structures and the lack of financial resources. A major regional orientation can only be found in some countries with active labour market policies for problem regions as well as in the context of programmes on cross-border co-operation.

Describing regional disparities in the CEECs during the transformation process is limited by insufficient regional data. Unemployment rates in Romania and the Czech Republic vary only little across the regions, while there are major differences within Poland, Slovakia, Hungary, Bulgaria and Albania. Classifying the regions in the four Visegrad countries according to sectoral employment shares in 1991 above the national average suggests a typology of regions as mono-structural problem regions, lagging regions with a development potential and growth poles. This typology of regions is essentially in line with the ones frequently applied in western countries and gives a first idea of the future objectives of regional policies in the CEECs: diversification of the economic structure in mono-structural problem regions, development of the locational advantages in regions with a development potential and removal of bottlenecks in the growth poles.

Given the financial constraints of implementing EU structural assistance in CEECs, one of the most crucial decisions will be on the regional allocation of funds, in particular whether to promote primarily national or regional development because a trade-off between national and regional development policy could force governments to decide whether to prioritise either national development or regional equality. The institutional setting in the CEECs' regions, i.e. the lack of regional administration and statistics, as well as subsidiarity considerations suggest not to have structural assistance carried out directly on a regional level.

Implications for EU structural assistance bringing together PHARE and Structural Funds assistance were discussed following the four operating principles that were introduced for the reform of the Structural Funds in 1988: concentration, partnership, programming and additionality. In respect to concentration, no new objective for countries in economic transformation should be introduced because the differences in regional problems are of a quantitative dimension rather than of a qualitative one. The basic problem in applying the principle of partnership would be a lack of administrative and social partners at the regional level, but could be an important leverage for democratisation and institution-building at the national level.

While programming should in general be no problem at the national level, there might be insufficient information to programme the regional allocation of funds. In the course of enlargement, an option for reform could be to give Member States access either to a Cohesion Fund-like scheme or to a Structural Funds-like scheme in order to allow for a better targeting of projects and instruments. The Cohesion Fund-like scheme would provide for the real convergence of poorer Member States towards the Union, based on a national development programme, while the Structural Funds-like scheme would provide for social and regional cohesion in the wealthier Member States.

There might be some specific problems for CEECs to comply with the additionality principle and to avoid excessive deficits at the same time. The main reason is that the budgets of the CEECs still face some risks for revenues and expenditures. Therefore, maintaining structural expenditure at a stable level without allowing for temporary public deficits will be difficult for CEECs.

To sum up, several arguments suggest not to target EU structural assistance exclusively at the reduction of regional disparities within CEECs. Doing so would not only face problems due to missing administrations and statistics at the regional level, but might also be at the expense of national economic growth and extend the process of catching-up. A Cohesion Fund-like scheme could be developed into an adequate instrument for assisting the real convergence of cohesion countries towards the Union.

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Annex