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EU Structural Support: Its Macroeconomic and Distributional Effects and Social Environment

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Abstract

This is a report about the fourth workshop from the seminar series of IIASA's Economic Transition and Integration Project entitled "The Process of EU Accession: Preparation by Learning and Exchange". The workshop was held in Prague on 9-11 November, 2000.

The first section summarizes recent developments in the accession process in the individual candidate countries. The second is devoted to the establishment of regional institutions for managing the structural support funds of the EU. The next section deals with the organization of planning, monitoring and evaluation of EU financed programs as experienced and perceived in the current members states and the candidate countries. The fourth section is devoted to the essence and realization of the principles of EU programs, while the fifth analyzes the macroeconomic effects of past and future such programs. Section 6 deals with the impact of EU funds on national and regional convergence, while section 7 with the issue of program selection. Finally, section 8 is devoted to the special problems of the two heavy weight sectors in EU programs: agriculture, as well as transport and infrastructure.

Foreword

In 1996, the Economic Transition and Integration Project (ETI) at IIASA initiated a seminar series on the accession of the Central and East European countries (CEECs) to the European Union (EU). The title of this series is "The Process of EU Accession: Preparation by Learning and Exchange."

This initiative was a logical one, since in recent years ETI has been active in research and policy advice on the international economic relations of transition economies. Moreover, several recent ETI research projects, such as the one on "Output Decline in Eastern Europe," "Impediments to Exports in Small Transition Economies," and "Catching Up and EU Accession" have had strong implications for the CEECs' integration into the EU.

EU enlargement is a complex process whose importance for the countries concerned can hardly be overestimated. This probably justifies the large number of ongoing academic research projects on the topic. A distinctive feature of ETI's seminar series is that it is intended to promote an exchange of views and understanding among the transition countries aspiring to EU membership. IIASA, with its diverse composition of members from both parts of Europe (among other countries), including older and newer members of the EU, as well as the Central and East European (CEE) candidates for EU membership, is an ideal research institution for realizing this goal.

The organization of the seminar series is supported by an advisory committee with changing composition, in which the most stable and active members have been András Inotai (Director, Institute of World Economics, Hungarian Academy of Sciences, formerly also Coordinator of the Strategic Task Force for European Integration, Hungary) and Danuta Hübner (Executive Secretary, UN Economic Commission for Europe, formerly Head of the Chancellery of the President of the Republic of Poland).

The first meeting in the series was concerned with the "Strength and Advantages of Eastern Europe: EU's Net Gains from Accession," and was held in Laxenburg, Austria, in December 1996. That workshop was intended to help make the CEE applicant countries aware of their strengths and weaknesses in the context of EU membership and build up their self-confidence before negotiations started. The meeting had an interdisciplinary character; in addition to issues of purely economic importance, problems related to the environment, foreign policy, and national security were discussed. A summary of the workshop can be found on the World Wide Web at
http://www.iiasa.ac.at/Publications/Documents/IR-97-019.pdf.

A second meeting was held in Budapest on December 4-6, 1997, on the "The European Union and the Rest of the World: Complements or Substitutes for Central and Eastern Europe?" The seminar investigated the impact that accession will have on applicant countries' relations with the rest of the world, with respect to trade, flows of

capital and labor, research and technology, environment, administration, and culture. A crucial issue discussed was whether an increased focus on the EU region, as manifested in the adoption of the common external tariff and common health and environmental standards, distribution of structural and cohesion funds, and provision of agricultural transfers, will enhance only the applicant countries' relations to EU member-states, or there will also be effects for their interaction with the rest of the world. The seminar in Budapest was characterized by substantive presentations, lively debates, and participation not only from the Visegrád countries, Slovenia and EU members-states, but also from the Baltic states, Bulgaria, and Croatia. A summary of the workshop can be found on the World Wide Web in an Interim Report at
http://www.iiasa.ac.at/Publications/Documents/IR-98-020.pdf.

A third seminar was held in Laxenburg on December 5-7, 1998, on "The Time Pattern of Costs and Benefits of EU Accession." This workshop analyzed the emergence of various costs and benefits in a timeline characterized by the following milestones: the start of the transition, the signing of the Europe Agreements, the start of accession negotiations, accession to the EU, and accession to the euro-zone. The discussion focused primarily on the CEEC side and went beyond the strictly economic factors. Separate session dealt with the lessons from former accessions, the implications of the need to comply with EU's environmental standards, the special issues of agriculture, future adoption of the euro and the results of the relevant computable general equilibrium model calculations. A summary of the workshop can be found on the World Wide Web in an Interim Report at:
http://www.iiasa.ac.at/Publications/Documents/IR-99-015.pdf.

The fourth seminar was held in Prague on 9-11 November, 2000 on "EU Structural Support: Its Macroeconomic and Distributional Effects and Social Environment". This report summarizes that seminar.

The underlying idea of the seminar was as follows. While reforms in the candidate countries have increasingly been geared towards EU accession, the short-term sacrifices of the present period are rationalized by the promise of future long-term benefits of the EU accession. On the list of these advantages one invariably finds the blessing of various kinds of EU transfers before, but particularly after EU membership. Transfers from the union are perceived as assisting the new members in their adjustment to the challenges of the single market, providing relaxation of the foreign exchange constraint of growth, contributing to the broadening of physical and social infrastructures, alleviating regional and national disparities and thereby assisting the real convergence process.

While the enthusiasm for the coming transfers is obvious, there seems to be limited understanding of the mixed blessing of the structural transfers and the administrative burden the acquisition and management of these transfers will require. It seems that without the proper institutional background and political framework there is a danger of distortions and counter-productive effects. Similarly to the effects of any capital inflows it is not sure that the EU transfers will be beneficial for the recipient countries. In addition, theoretically, it is not clear yet that even with the most proper institutional and political framework the transfers would lead to the expected regional and national convergence and cohesion in the union, which is the ultimate aim of these transfers.

The workshop intended to enlighten specific features of the EU transfers, particularly as they appear for the less developed and new members of the European Union.

The mix of participants at the seminar at Prague turned out beneficial both for distributing useful information (including results of scholarly research) and for discussing critical issues of the EU support system. Researchers and government experts gathered from nine candidate countries (all but Slovenia), several EU member countries (among them from those that joined the latest to the union, i.e. Austria, Finland and Sweden), and the European Commission. A relatively large number of government officials were present from various candidate countries, who at the closing session strongly endorsed the usefulness of such seminars, in general, and of this meeting in Prague, in particular.

Accidentally, the IIASA meeting in Prague turned out to be also a special event, because it coincided with the confirmation of the return of the Czech Republic to IIASA as a full member starting January 2001.

The Institute of International Relations affiliated with the Czech Ministry of Foreign Affairs provided a nice, familiar and efficient venue for the meeting for which IIASA is indebted to that institute. The efforts of Karel Zeman and the Association for the Study of International Relations, Prague, as well as Petra Polaskova of the Institute of International Relations were invaluable for the initiation and organization of the meeting for which we are grateful.

This report is structured as follows. The first section summarizes the most recent developments in the accession process in the individual candidate countries. The second is devoted to the establishment of regional institutions as an alleged prerequisite for managing the structural support funds of the EU. The next section deals with the organization of planning, monitoring and evaluation of EU financed programs as experienced and perceived in the current members states and the candidate countries. The fourth section is devoted to the essence and realization of the principles of EU programs, while the fifth analyzes the macroeconomic effects of past and future such programs. Section 6 deals with the impact of EU funds on national and regional convergence, while section 7 deals with the issue of program selection. Finally, section 8 is devoted to the special problems of the two heavy weight sectors in EU programs: agriculture, as well as transport and infrastructure.

The report is based on presentations and discussions that were taped at the workshop, on papers prepared for the meeting, and on background material and related papers that the participants brought with them to the workshop. The speakers at the meeting had no opportunity to check the text of this report, therefore minor misunderstandings may have occurred for which the responsibility rest with the authors of the report.

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EU Structural Support: Its Macroeconomic and Distributional Effects and Social Environment

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1. Latest Developments in the Process of Accession – Updates from Applicant Countries

1.1 Poland[1]

The European Commission's latest Regular Reports were released the day before this meeting, so the presenter naturally reflected her first impressions. Since Poland, Hungary and the Czech Republic received relatively high grades, this implies that most of the implementation of the short- and medium term priorities of the national program for Poland have been assessed positively. There seem to be some inconsistencies in the document as to the expected date of accession: at one place the document mentions that the most advanced countries could join as early as 2003, but at other parts of the report it is indicated that negotiations about the most difficult chapters will start in the first half of 2002 only. Since negotiation on chapters such as agriculture will take substantial time, and after concluding the negotiations the ratification of the terms of accession in the current member states would take at least 18 months, the second information would imply a date of accession in 2004 or 2005, at the best.

At the time of the workshop 11 out of the 29 chapters under negotiation were provisionally closed, however, it is clear that these 11 chapters were the easy ones. The difficult issues for Poland (but also for many other candidates) are agriculture, the free movement of labor, the free flow of capital (more precisely, sale of land), and the environment. The importance of the chapter of agriculture for Poland is clear if we take into account the size of the country, the share of employment in agriculture, as well as the efficiency lag in agriculture behind advanced countries.

The Polish government declared that by the end of 2002 the country would be ready for accession: Polish law will be adjusted to the requirements of EU, except for those areas where Poland will receive transitional periods. Simultaneously with the adoption of laws also the enforcement of these should develop, as it became also an important element of the assessment of the applicant countries. Poland has been asking for a long time for a clear calendar of the negotiations, including the possible closing

[1] This section summarizes the presentation by Elzbieta Kawecka-Wyrzykowska.

date of these. The reason for this has been that Poland wants "to be prepared just in time, not just in case". This is important in order to minimize the costs incurring after some obligations have been assumed, and thus make the adjustment easier.

Another important issue is the question where does Poland stand in terms of the implementation of the association process? In the European Agreement between the EU and Poland the association process consists of two phases, each being five years long. The first such period started February 1994 and already elapsed. Unfortunately, Poland could not move yet to the second stage, due to Poland's own fault: not all domestic laws covered by the European Agreement are yet in conformity with the European law. Here particularly the laws should be mentioned where "national treatment" has not been yet guaranteed to all EU nationals and companies. An example is gambling: according to the Polish law capital invested into gambling in Poland can be only of Polish origin. Since revenues from gambling are high, the Polish Parliament hesitates to give up the revenues collected by the Polish budget or those ones at least being used within Poland. Unlike Poland, Hungary, for instance, already moved to the second stage of the association process.

The reason of improved assessment of Poland by the Commission could be attributed to two developments. First, in the middle of 2000, in the Polish Parliament's lower chamber a special Extraordinary Commission on European Law was established, and it speeded up implementing, preparing and adapting new laws. Second, early 2000 the government realized the danger that the next report would be too negative, and therefore made every effort to avoid this, including speeding up the adjustment of the legal system.

The fields that are still weak in preparing the institutions for EU membership are public administration and the judicial system: for instance, processes at court require very long time to go through. As for the public perception of the EU accession, it is an optimistic sign that following a sharp deterioration several months ago, public opinion on accession is again improving.

The current macroeconomic developments in Poland are in general favorable, but there are some clear challenges for the future, such as the relatively high current account deficit (amounting to about 7% of the GDP), increasing inflation rate, and increasing unemployment.

1.2 Estonia[2]

The presenter listed some favorable and less favorable facts about Estonia's macroeconomic development in 2000. As for output, following a 1.1% decline in GDP in 1999, the growth picked up in 2000 to a forecasted rate of 4.1% (eventually reaching 6.4%). A spectacular expansion of exports (around 32-34%) occurred in the presence of a relatively low inflation (4.5%-5%). Since the government and the parliament decided earlier to have a balanced budget, the deficit of 4.7-5.0% in terms of GDP in 1999 was unusually high, but it was related to the election year. In 2000, however, again, due to not very positive developments in tax revenues, prospects for a balanced budget looked

[2] This section summarizes the presentation by Alari Purju.

dim. In the past years Estonia used to have current account deficits beyond 10% of the GDP, so the expected 6.5-6.8% deficit for 2000 seems moderate. However, its growing tendency starting from 1999 was a cause for concern, because as income was growing in the economy, imports picked up, leading to increasing deficits in foreign trade.

Transition is not yet over in Estonia as the critical parts of economic reform also show it. Here one should mention the particularly low targeted level of taxes. Currently, government expenditures are at 36% of GDP, but the government's target is to reduce this to 33%. Accordingly, the accomplishment of the reform of public administration is of crucial importance. A special government committee deals with this issue. The person nominated to lead this committee served earlier as a chairman of the Privatization Board, which is an indication how important the public administrative reform is considered now in Estonia. This reform is only at its beginning. Discussions about principles are very heated, particularly about the relationship between central and local administrations and the tax bases of the two levels.

Another crucial issue of debate is the new Estonian income tax system that had been introduced on 1 January 2000. The novelty of the new system is that corporate incomes, which are reinvested, are not taxable. Estonia's tax system is uniform across physical persons and companies: both personal income and corporate income are taxed by a flat rate of 26%, and from the latter reinvested revenues are exempt from taxes. In 2000 it was a critical question how, following the changes, tax incomes would develop; but, thanks to the pickup of growth, the tax base is growing faster than forecasted and the target of 1% budget deficit seems achievable.

The next critical issue is infrastructure, particularly the objective of improving transport infrastructure, developing energy networks, and creating conditions for the development of information and communication technology. As for the transport infrastructure, one should mention its important position. According to some estimations, close to 20% of Estonia's GDP is produced by transit trade. The underlying transport infrastructure in Estonia, like in some other East European countries, is in a rather bad shape and in need of substantial investments.

As for energy networks, Estonia is relying on oil-shale based power engineering: about 55% of primary energy and 98% of electricity use in the country is obtained from oil-shale. Two critical issues have to be tackled. First, the electricity network of Estonia, like those of the other Baltic states, are linked to the North-Eastern part of Russia. In order to establish an access to the Nordic countries, substantial investments from the EU are needed. Second, there are environmental problems due to this type of energy base (high emission of CO_2 and sulphur); thus the North-East part of Estonia (where oil-shale mining and energy engineering are organized) has become heavily polluted, and the mitigation of this pollution calls for investments.

At the accession negotiations, Estonia managed to close 14 chapters - the easiest ones. Estonia asked for transitional periods in the framework of several chapters.

Some requests are closely linked to the achieved low level of income. For instance, in services, Estonia asked for a transitional period in the amount of deposit guarantee: the current Estonian level is about one fifteenth of the European requirement. In the agricultural chapter transitional period until 2006 was requested for restructuring of the processing industry, for various aspects of veterinarian inspection, and for a long list of other issues. In transport, Estonia asks for transitional period for levying taxes on heavy trucks.

As for taxation, discussions are currently focusing on various issues, including a transitional period until the end of 2006, for excluding VAT on electricity power generated by wind and hydro-power. Also transitional period is requested for harmonizing excise duties on tobacco and mineral oils, the former due to the quite large black market of tobacco. Another request is to postpone the fulfillment of the minimal level of fuel stock to 90 days, which Estonia would like to fulfill in 2010 only. The discussion is about the possibility that Estonia could account also its oil-shale reserve as part of the fuel stock.

As for environmental transitional periods, there is a long list of requests (as mentioned with regard to energy), a characteristic one is the requests to fulfill the directive on drinking water in 2013 only, because it implies substantial investments.

As for external relations, there are no special Estonian requests, except for two issues related to free trade agreements. Estonia has such an agreement with the other two Baltic states, on the one hand, and with Ukraine, on the other. The possibility to maintain the Baltic free trade agreement in the future depends very much on the EU's attitude to the Baltic states in general, but the agreement with Ukraine seems to be transitional, because according to the current opinion of the EU, this agreement should be abolished in case of Estonia's accession to the union.

1.3 Latvia[3]

Latvia is one of the poorest of the applicant countries: together with Bulgaria and Rumania it stands at the bottom of the list of the candidate countries with per capita levels of GDP 20% of the EU average at purchasing power parity. Visitors of Riga should be reminded that central Riga is far from being representative of the country.

In 2000, the most important development in the accession process was that Latvia was allowed to start negotiations starting at the beginning of the year. Many Latvians, including the presenter, saw no justification for the earlier discrimination between the candidates. However, fortunately, the EU recognized and corrected the mistake. It is important that the Commission stated that the date of the accession would not hinge on the fact which country started the negotiations first. Latvia is eager to catch up with the negotiations and just like Poland (as mentioned by the Polish presenter) Latvia is committed to be ready for accession by 1 January 2003.

Negotiations started with eight chapters in February and March, out of which five were provisionally closed by May. One of the three not closed chapters was on the EU's external economic relations, where the sticking point was the Baltic Free Trade Agreement. According to the information going around this subject, Estonia declared that if the three states join the union in different times, they would scrap the agreement without asking for any transition period. Originally, Lithuania and Latvia wanted to ask for transitory periods, but later Lithuania pulled out, so for Latvia there is no partner for

[3] This section summarizes the presentation by Alf Vanags.

asking transitory period in this free trade agreement. Accordingly, this chapter will also be closed soon.

In October 2000 negotiations started on another set of eight chapters. There do not seem to be any heavy problems with them. The Commission criticizes certain aspects of the Latvian land regulations; in the economic and monetary union chapter the Commission does not like that the Latvian government forces some of its financial institutions to accept some of its own securities. The Commission wants more independence for the central bank of Latvia. This is a curious objection since the constitution of the Bank of Latvia was set up essentially on the constitution of the Bundesbank, one of the most independent central banks in the world. In fact, the Commission does not like that the minister of finance sits on the board of the central bank, so he/she can exert some influence; therefore that should be scrapped as well. In 2001 twelve chapters are hoped to be negotiated, including some of the more contentious ones, such as agriculture. Agriculture is not as problematic as in Poland (due to its smaller dimension), but it is a problem, particularly getting its shape consistent with what is required to be in the EU. But implied restructuring will be very costly, approximately one billion euros, or 15% of Latvian GDP. Obviously this would spread over several years.

Investments needed to fulfill the environmental requirement also amount to a very high amount: 23% of the GDP, of which the Latvians are expected to pay 8% of the GDP. However, this is a longer term process.

Discussion of First Three Country Presentations

A question was addressed to the Polish presenter about the reasons for the favorable turn in public perception of the EU accession in Poland and about the regional pattern of public support. The presenter answered that the government's new information strategy may have played a decisive role: more meetings were organized to discuss special reports on accession, more television debates were conducted about problems of joining the union. In addition, also in the recent presidential election, responding to the opinions of some of the presidential candidates, the voters had to make up their mind about the future of Poland and their attitude to accession. As a workshop participant added, it was favorable that the Polish government's campaign targeted various groups of the population in a differentiated way: separate promotion programs were prepared for peasants, for media people, for teachers, etc. The regional distribution of public support has not been studied in detail yet; the general impression is, however, that Warsaw is leading, followed by the Western part of the country.

A question addressed to the Estonian presenter asked about the rationale of trimming the size of the government (along with the obvious need for increasing efficiency) just in Estonia, the smallest among the candidate countries. It all happens in the perspective that the administrative burden of accession and, subsequently, membership, will place disproportionally high demands on governments of small countries. Purju answered that the administrative reform has several aspects, including increasing efficiency, training, more use of consultancy, computerization, and the reduction of the size of the administration. The government attempts to show new ways of administration: some government meetings have been organized on the intranet of the government; the Ministry of Foreign Affairs reforms its administration in the 'tiger jump' way, computerizing almost everything. In this respect the closeness of the Scandinavian countries is a benefit, since they are leaders, at least in the EU, in improving administrative efficiency through computerization. While these are prospective attempts, the presenter agreed that, with accession approaching, the administrative burden will increase, and according to the latest information, several Estonian ministries had to face such problems, especially in those very complicated areas as energy, and in other technical issues. This shows that the policy of cutting administrative capacities has a high risk. According to his assessment, if the government managed to keep its administrative expenditures at its current level, that would be a big achievement.

The Latvian presenter added that high administrative expenditures are criticized also in the case of Latvia. There is a Soviet legacy here. Although the law "in books" looks already very well, in many cases it looks even better than in more advanced western societies, the problem is the failure of implementation, and this originates in the society. In some sense, implementation was not a problem in the Soviet system. Now there are no mechanisms of the implementation. In addition, the origin of the legal system of Central and East European transition countries is in the continental or German judicial systems, as opposed to the common law style of the Anglo-Saxon countries. In the latter, if in the common law system the public administration is not doing what it should do, the citizen can sue the administration by taking it to court. In fact, ministers in the UK have been taken to court for failing in their expected conduct. But such mechanisms are missing in transition countries, such as Latvia. For instance, some years ago a progressive law on higher education was passed in Latvia, but then nothing happened on this front. What was the solution? The parliament passed a new law about the *implementation* of this earlier law.

To a question whether the European Commission can monitor the performance of the enterprises in the transition countries to evaluate whether they can withstand the competitive pressures emerging after membership, the Latvian presenter answered a strong no. He was not sure whether even the national governments really wanted such monitoring. Moreover, in case even if they themselves could do it, its is a question whether they would want to initiate such an investigation.

He also mentioned that the administrative culture has horrendous problems of language and expression. Critical opinions are verbally presented, but never put on paper, because there is a widespread perception that too original opinions and/or ideas can be easily turned against those that express them. This might as well be a hindrance of monitoring, because a part of the monitoring process should inevitably be summarizing the results of fact-finding in written documents.

In a question a Czech participant from the audience asked whether in the Baltic states, just like in the Czech Republic, the pattern of regions formed due to the need of the coming EU membership is artificial, compared to the original historical regional structure.

The Latvian presenter answered that the territorial reform is both rather complicated and slow in Latvia. In Latvia from the original 16 regions 6 new regions will be formed, and there will be some local elections, possibly in 2001. At the more general level, if the European Union says that they would like the Latvian government to do X, the government would do X, or at least, will pass a law that X should be done.

The Estonian presenter added that Estonia has also 16 regions and there are discussions about merging them to a smaller number (six or nine, or another number). This is, however, only a formal question: the basic issue is the tax base of the new regions and the distribution of functions.

The Lithuanian participant added that in his country there are 10 intermediate units of government at NUTS III level. In its program, the recently elected government proposes to establish 5 self-government units.

1.4 Bulgaria[4]

The presenter concentrated on two topics: recent progress in the negotiation process between the EU and Bulgaria, and the specificities of the Bulgarian economic development that are relevant for the integration. The first round of negotiations took place in December 1999, and during the next year Bulgaria presented altogether 19 position papers and closed 4 chapters (these were SME, R&D, education, and common security policy). New institutions were created (e.g. the Council on European Integration and the Directorate at the Council of Ministers). In fact, the speed of implementing the *acquis* in the Bulgarian legislation was highly appreciated by the Commission. However, its enforcement was lagging seriously behind. Another serious problem emphasized by the Commission concerns the policies fighting against the existing corruption.

In 1997, Bulgaria experienced hyperinflation, banking crisis and exchange rate instability. The stabilization policies in the next two years were very severe. The output in the Bulgarian industrial sector declined by more than a quarter during 1997-99; the present dominance of production depending on low-skill labor is taken more as a barrier to than a ground for improving the industrial structure with increasing specialization. The currency board arrangement is judged as too restrictive, resulting in an extremely low level of loans that hamper further expansion. Mass privatization schemes applied in Bulgaria were also unsuccessful, hitting adversely the restructuring of enterprises, what resulted in a low level of FDI up to 1997. The interest of foreign investors revived only after the financial discipline was reinstalled and the impact of FDI on the economy is currently judged as positive.

1.5 Romania[5]

The Progress Report of the EU from November 2000 put Romania to the last position among the accession countries. It is true that Romania suffered of financial and social problems throughout the last 10 years. Even the growth during 1994-96 was later judged as artificial. It was assumed that it had been caused more by changes in the statistical methodology, than by real events. The permanent instability of the local

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[4] This section summarizes the presentation by Ivanka Petkova.

[5] This section summarizes the presentation by Nicolae Idu.

political system is supposed to be the main factor behind the economic failures and its elimination will be the key to a future progress in Romania. The aim at gaining political stability was initiated in 1999 and the provisional economic results for 2000 signal that Romania may finally break even. At least it was for the first time since 1990 that Romania was able to stand by its macroeconomic commitments agreed with IMF.

The main problems seem to rest on the microeconomic side. Structural reforms in the industrial sector have been opposed by local trade unions, and the fragmented agriculture with hidden unemployment remains a sector that is not prone to a sustained progress. That is naturally a liability for progressing in EU accession negotiations. In 2000, in the accession negotiations only 6 chapters were opened. Additional 11 chapters are prepared for 2001 and the concluding date of most of the negotiations is expected in 2004, with discussions about derogations in the most problematic issues pending until 2006. The ratification of accession is thus envisaged for 2007.

1.6 Czech Republic[6]

The annual evaluation of the European Commission for 1998 and 1999 were quite critical about the progress made in the Czech Republic towards accession. That led to a real change in the approach of the government to these issues what was also reflected in a more favorable report for 2000. The most intensive positive changes occurred in the "hard core" of harmonization of the *acquis.* Significant progress was also reported in the "soft core" of harmonization - in alignments at the level of informal parts of legal codes, values, state administration, judicial reform and economic restructuring. The legislative changes received a high priority both in the government and the parliament, and their intensity was unprecedented since 1993. It is therefore a credible plan that in 2002 the Czech Republic will be fully in line with the EU *acquis* and the remaining requirements of core harmonization will be fulfilled in 2003 – the year that the government set as a target for the EU entry.

Critical comments can be raised, however, to the real progress in such areas like the public administration, education, science, and the performance of the judiciary system. Civil services remain unreformed and the bureaucratic treatment of entrepreneurial activities at the level of small and medium sized enterprises, in fact, worsened. The progress in the pension and the social security systems was very slow and its critical decisions were postponed. Corruption and crime became a very serious issue pending solution.

Economic growth was boosted by two major factors: the activities of foreign investment enterprises and the growth in the aggregate demand from the EU. The restructuring of enterprises is a long way from its completion, especially in large domestic firms subject to mass privatization schemes. The size of their debts goes beyond the means of the state budget. The local public perception of EU membership and the political debates on benefits and costs of the Czech accession show mixed results. The lack of commitment of some political parties to accession is apparent, and the population has not been addressed with visions evoking their interest in the

[6] This section summarizes the presentation by Václav Šmejkal.

European issues. Notwithstanding that, the majority of Czechs remain pro-European, and the economic exchanges with the EU show the fastest growth and stability from all the economic indicators.

Discussion of Previous Three Country Presentations

A participant from the audience was of the opinion that the state of the Romanian and Bulgarian agriculture seems to be a crucial economic and social problem. He asked what ways there are foreseen for its solution in the near future?

The Bulgarian presenter replied that the agriculture in Bulgaria was pressed by two main shortcomings: administrative barriers in developing the market for land, and the lack of financial funding available to farmers. As agriculture does not contribute to the growth of GDP and the market for land is underdeveloped, the banks are not willing to provide credits. At this stage the provision of funds from SAPARD resources seems to be the most plausible way for financing the development in this sector.

The Romanian presenter was of the opinion that the Romanian agriculture faces primarily a structural problem of employment, since officially 35% of inhabitants were employed in that sector. The expected growth in the service and the industrial sectors would change this picture dramatically. The other problem is how to promote the concentration of land ownership. Programs are being prepared offering financial instruments, and new laws would open space to agricultural entrepreneurship. However, in some respects the liberal principles proposed by the government are in conflict with the functioning of CAP – a matter that must be negotiated with the Commission. The negotiations were not easy (the Romanian National Rural Development Plan was rejected twice by the Commission), but the quest for mutual understanding is continuing.

A workshop participant argued that the experience with FDI in Hungary and the Czech Republic showed that transformation could be speeded up significantly if the country were able to attract foreign investors. Can we foresee a similar break-through in Bulgaria and Romania?

Both the Bulgarian and Romanian presenters agreed that even though both Bulgaria and Romania have been relatively successful in attracting FDI in the last four years and both the society and the governments of these countries accepted the existence of favorable effects of FDI on domestic economies, institutional and administrative impediments (e.g. on the side of judiciary and institutions) were so resilient to changes that the position of foreign investors was not satisfactory. The changes in the institutional and behavioral approaches to foreign investments are progressing but relatively slowly.

One of the workshop participants commented that the co-operation in the matters of accession between the Czech Republic, Hungary and Poland became a positive element in the negotiations with the Commission. Can we expect that Bulgaria and Romania will open themselves to more intensive contacts at the level of CEFTA? Both presenters confirmed that Bulgaria and Romania have brought their East European co-operation on the matters of accession to a promising level. Further expansion of working contacts towards CEFTA is progressing. The problem remains on the level of real absorption of foreign experiences on the lower levels in the hierarchy of administration.

There was a question raised from the public that free movement of labor could become a threat to the national development if it would imply human capital outflows. Could the presenters explain how their countries dealt with that problem?

The answer of the three presenter was as follows: Derogations in the free movement of labor, due to fears of brain drain, have not been considered a serious problem in more developed accession countries (e.g. in the Czech Republic). In Bulgaria, however, there was an emigration of more than 400,000 young people just after the start of transition, what posed a threat. The destination countries were not in Europe, but mainly in Canada and the US. Actually the Bulgarian population is rather immobile and permanent emigration is small. Bulgaria is therefore not afraid of the brain drain if the barriers to EU labor market would be liberalized. Romania is in a similar situation, as far as the EU is concerned. The relative decrease in attractiveness of the American labor market in the future is, however, less clear to envisage.

1.7 Hungary[7]

What is the current position of Hungary in the preparation for the EU accession and what is the legacy it brings with itself? It is a general view that Hungary is among those countries that are best prepared for the EU enlargement, even though we should admit that no country among the applicants is fully prepared. There are differences in the level of preparation both among countries and within each of the countries. In Hungary we can distinguish four levels of “maturity” in EU membership preparation. The first is economics, the second is the legal adjustments, the third is the quality of public administration and the fourth is the social adjustments of the process. Regarding the economic issues, Hungary can be already considered the member of the EU. 76% of exports are going to the EU, which is the third highest intra-EU share if we consider the 15 EU countries. Only Portugal and the Netherlands have a higher share. If you look at the structure of Hungarian trade, it is consistent with the EU standards of modern trading. Two thirds of exports are so called technology intensive goods. If compared with other candidate countries, this share is 48% in the Czech Republic, 44% in Slovenia and 30% in Poland.

Hungary is also the only accession country that has a balance of trade surplus with the EU. All this is based on the privatization pattern of the country and on the leading role played by foreign direct investment. The latest World Investment Report of the UN of October 2000 indicated that Hungary belongs among the most trans-nationalized economies worldwide, together with Singapore and Ireland. The trans-nationalization index, which is a composite index, quotes that Hungary’s standing is three times higher than the standing of the second most globalized accession country. Therefore an enormous structural differentiation has taken place in Hungary in the last 11 years – such that concerns the ownership, intra-industry trade, technology transfers, financial contacts, etc.

[7] This section summarizes the presentation by András Inotai.

As far as legal harmonization is concerned, the most important point is the enforcement of the *acquis*. It is a two-way process: one is proceeding from the Parliament to the bottom and the other one depends on the social and institutional acceptance at the roots of the society. In Hungary all these speeded-up due to the early intensive presence of FDI, what is often omitted in the analysis of impacts of FDI. Except for technology, management, capital, know-how and trade, FDI has brought to Hungary also the modern legal system.

The major shortcomings of Hungary can be discovered in some parts of the public administration, similarly like in many other countries. As to the social acceptance of the EU membership, public opinion polls reveal that 68% of the population would like Hungary to become a full member, while the opposition to membership is 8% only. A surprising finding is that the share of the positive votes has been rising, notwithstanding the existence of conflicts of interest that became apparent at the later stages of negotiations.

If we look at the process of EU entry negotiations, all chapters have been opened, although some of them have been opened formally only. Among those more questionable we should mention agriculture, regional policies, free movement of labor, justice and home affairs and also the contribution to the EU budget. Thirteen out of 29 chapters were concluded. The Hungarian official attitude to negotiations is that the negotiations can be finished, provided there is the political will, by the end of 2001. The European Commission thinks that the negotiations can be prolonged until the mid of 2002 mainly due to elections in Germany and France, and to some extent also in Hungary. We can therefore expect that the process of ratification can start in the second half of 2002, which means that the year of accession can be in 2003. In case the process will be unexpectedly delayed and the accession will be in 2004, we do not consider it a catastrophe. What matters is that the EU will stand by the basic rules for accession which have been reconfirmed several times in the past. First, that each country is admitted according to its merits, what implies that no country has the right to take any other country as a hostage. Second, that the process of enlargement is open for all remaining applicants. This is of the most fundamental interest especially for Hungary because of its extensive borders with non-EU members at the expected time of EU membership. Hungary is therefore interested in an uninterrupted strengthening of cooperation in the region.

To conclude, the Hungarian side expects that the enlargement process will be smooth, quick and subject to qualitative criteria. Any delay in the enlargement would be detrimental to Hungary. First, because it will be a threat to the pace of social and economic modernization of the country, that has proceeded to this moment in a sustainable way. Second, many of the transnational companies came to Hungary with a vision that it would become soon a member of the EU with an advantageous location for the production of service activities. They could reconsider some of their investments because they based their strategy on the firm EU membership date in 2002. Third, many scheduled investments, for example into infrastructure, can commence only once Hungary is a member. These investments have large externalities to all economic agents in the region, for example to the potential investors - be they domestic or foreign. Hungary must also maintain momentum in the preparation of public administration and stick to the schedule of its restructuring. Last but not least, if there is a delay in enlargement, it causes a social disappointment that can be abused by the politics of populism, nationalism, internal conflict and cause international instability in the whole region.

1.8 Slovakia[8]

Slovakia has not yet proceeded so far in the integration process as Hungary did, nevertheless, one must say straight from the start that the situation in Slovakia, especially if compared with that of a couple of years ago, is in a much better shape and further progress is in the offing. Slovakia is a young country, having established its independence in 1993. The internal political strife brought many of the forward-looking expectations to a halt. In 1997 the European Commission had a relatively negative opinion about the Slovak accession, mainly because of the nationalist, populist and non-transparent policies of the government that was not offering a clear pro-Western orientation. Though the country was not excluded from the EU's enlargement, it was neither invited for further negotiations after the Luxembourg summit in December 1997. The changes to a more international orientation of the country came in autumn 1998 when a coalition of a wide spectrum of political parties was required to change the local balance of power.

In December 1999 Slovakia was invited to negotiations about the EU accession, to what the new government responded with an intensive preparation for the enlargement. In the following three aspects of the standing of Slovakia in the current negotiations with the European Commission are to be analyzed: legislation, political stability and economic policies.

The negotiations dealing with the switchover to the *acquis* have been dynamic and smooth. In March 2000 Slovakia officially submitted its position documents to 8 chapters. It is expected that at the beginning of 2001 16 chapters will be negotiated, of which 6 should be concluded.

According to the presenter's personal opinion the political stability in Slovakia has not yet reached a sufficient level. Though the government of Mr. Dzurinda looks highly professional, the coalition on which it is based has been subject to cyclical crises. On top of it, the potential government alternative does not offer much continuity. Some observers even expect a subsequent reversal of the present strategic policies.

The past macroeconomic situation in Slovakia is an interesting case to observe. The reservations against the policies of the government of Mr. Mečiar notwithstanding, we could observe a long period of relatively high growth. The growth was fuelled mainly by investment. Unfortunately that is the end of the positive news. We must also add that this investment was backed by government guarantees and by credits granted by state banks what created large macroeconomic imbalances. For example, the external deficit became more than 10% of GDP, if measured on the current account. The second large imbalance – the loose fiscal policy – was indirectly associated with the current account. The annual budget deficit was running on over 5% of GDP.

The process of transition was also marked by the absence of structural reforms. This weakness was particularly apparent as the Slovak real exchange rate was

[8] This section summarizes the presentation by Július Horváth.

appreciating and the exports were losing on competitiveness. Until October 1998 the real exchange rate gained by approximately 25-30%, if measured by relative unit labor cost increases. The new government has put a break on the previous developments by introducing restrictive policies that remind us to a large extent of the recommendations outlined by the Washington Consensus. In assessing their outcome we cannot come up with a simple answer. On one side, the macroeconomic imbalances were to a large extent eliminated. On the other side, the growth of the economy significantly decreased and the unemployment rate became one of the highest in Europe. We can call it a tradeoff of the new Slovak reality. Taken from the point of view of the electorate the former figures of 6% versus the present 1.5% of growth may be calling for a political change, what the populists do not miss to use as an argument.

On the other hand we should mention that the export performance has improved in the last two years and the current account deficit decreased to 5% of GDP. Nevertheless, the stock of FDI at the end of 1999 was a mere USD 2 billion what reveals indirectly that the economic and political instability in Slovakia were adversely correlated with international linkages. The reserves of the National Bank have been USD 3 billion only, which provides little support to the credibility of local monetary stability. The fiscal stability improved significantly and the process of restructuring has been guided by a large wave of privatization in the banking sector. As an outcome of recent prudent policies, the restructuring of enterprises gained on intensity, what is the best signal for the future development. Taking the assessment in general terms, Slovakia has progressed significantly in its convergence to the EU in the last two years. Nevertheless, its lagging in the progress of economic restructuring and the EU accession behind such countries like Hungary and Poland remains still apparent.

1.9 Lithuania[9]

The major accession milestone of Lithuania happened in 1995 when the country placed its application to the European Commission. The National Programme for the Adoption of *Acquis* was launched in 1998 and the negotiations with EU started in 2000. The Lithuanian government schedules the process of preparations so that it should be ready for the accession by 2004. The negotiations with the Commission have been already completed in six chapters. By the end of 2001 all position papers are planned to be ready. The most problematic chapters are expected to concern such fields as energy, agriculture and environment. The public support of EU membership, according to recent public opinion polls, is the lowest among all candidate countries. It is less than 50%, and 33% of the population are undecided. The large part of discord has been caused by the negotiations with the Commission about the viability of the Lithuanian nuclear power program. The issue has escalated recently by the Parliamentary elections when the issue of nuclear energy became a part of local politics.

The co-ordination of the EU accession program is in the hands of the prime minister that chairs the Governmental European Integration Commission. In parallel to that, the Ministry of Foreign Affairs is in charge of negotiations with the EU and it also acts as a national aid coordinator. In addition to these bodies there is a European Affairs

[9] This section summarizes the presentation by Vitalis Nakrosis.

Committee at the Lithuanian Parliament which is responsible for the passing of new or transposed legislation compatible with the *acquis*. In its last progress report the European Commission has given a very positive assessment of the Lithuanian preparation, stressing especially the advances in economic transformation. For the first time it recognized that the local market economy operated reliably. Public interventions and protectionism were reduced, and the macroeconomic stabilization program was successful. Privatization has been completed with the exception of one savings bank and sectors of energy, gas and railways.

There are still problems pending adjustment, particularly concerning the high current account deficit, high unemployment and low private investments. The Commission noticed a gap existing between the transposition of laws and their actual enforcement. Widespread problems with the judiciary system deserve a special attention and a question of reforms in the state administration was opened in order to improve its efficiency. It dealt with changes in the schemes of remuneration, training and co-ordination. What concerns the other sectors, agriculture, fishery, exports and regional policy stood out among those where more efforts would be needed in order to meet the obligations of the membership.

Discussion of Previous Three Country Presentations

A participant from Poland asserted the Hungarian experience with multinational corporations. Poland has received in the last three years a massive inflow of FDI and this trend is expected to continue. There has been reported a growing pressure of multinationals on the EU member countries' governments to speed-up the integration process in Central and Eastern Europe because of the strategic concerns that multinationals have there. It seems that the role of foreign investors in post-transition economies will be more substantial and we should not expect their present response to be limited to a short-run perspective only.

András Inotai responded to questions by stressing that in no case we should accept a policy that some country is taken hostage or punished for shortcomings caused by some other accession country. Of-course, the horizon of something like 12 months between the signing of the Treaty by various countries can lead to an outcome that their actual entry to the EU will happen at the same time. However, waiting for a longer period, let us say 3 through 5 years, cannot be explained as a process of approval procedures. That would create a dramatic deterioration of the international situation in Europe.

Another problem is the general policy of enlargement. The Helsinki decisions of the European Commission, that any country can start negotiations, was very forward-looking and generous. On the other hand, it caused a decline of public support among the EU incumbents, for example, in Germany. There are voices of populists claiming that in the near future the EU can have 25 members what may halt the European integration. We therefore need a clear schedule of procedures and a set of rules for enlargement without labeling which country should belong to which group.

What we did not consider until now is that it is not only the European Union who takes decisions how to tailor the enlargement process, but also the potential developments in the candidate countries. Here we should be cautious. Ten years ago each among the post-Communist countries shared two common values: political democracy and market economy. Though we started from a common baseline, the actual individual developments became very differentiated. Now we are subject to a common effort of homogenization through the accession criteria, especially the *acquis*. The same rules and requirements are laid on all applicants. However, it is a question if the absorption capacity of the *acquis* is the same throughout all these countries. Once it comes to the hardcore of negotiations, there will have to be introduced a process of differentiation responding to specific domestic conditions and different demands for national derogations. A higher flexibility in accession policy should become a part of the European Commission's current negotiation strategy.

As far as the transnational corporations are concerned, they represent most probably the strongest lobby in favor of enlargement. Their impact on decision-making is often stronger than that of the best-prepared governments. But they are not uniform: we should distinguish between three different lobbies they represent. The first lobby is interested in investment in the region because it improves their global market position. It represents the lobbying for a quick membership. The second lobby is interested in trade. But the free trade was already created under the association agreement and its benefits have been utilized. Therefore these companies are not necessarily interested in a quick EU enlargement. Those who are exporters to accession countries are interested in the sustainability of the current trade deficits – a condition that is not so crucially linked with enlargement. The third lobby is represented by those companies, which can lose if the CEECs enter the EU as full members. It is because of the harder social, environmental and safety standards, or because of a loss of their present monopoly position. We should be aware of these pressures and our governments should learn how to play with these lobbies.

Responding to a question about the main strategic decisions behind Hungary's success Inotai emphasized that we can see various factors that call for a reserved attitude towards a sustained successful development of Hungary. The present favorable situation is in the first place a result of economic policies undertaken in recent years. First, there are those very policies that have been highly criticized by some economists and politicians: it is the so-called "Bokros package" and the austerity program. Then we should consider the specific microeconomic conditions and the international orientation created before 1989. As a third element we should consider the policies taken after 1989. They need not have been an outcome of a specific Hungarian strategy but they were shaped under an international pressure, be it privatization or FDI policy. For example, it was so because the country was highly indebted and there was no other way how to get rid of its burden. What we see today is therefore the spillover effect of decisions taken long time ago. It is evident that the sustainability of such multidimensional and gradual processes is not easy to achieve.

We can say in the same logic that the strategy for a successful Hungarian performance as a future EU member must be prepared today. One could be therefore dissatisfied with the developments in Hungary in the last years, as some very important reforms were postponed in the belief that the current favorable developments would be self-sustaining. It will be unfortunate if the burden of adjustment after the EU accession would overlap with the additional burden of adjustments to internal policies that we have now unduly postponed.

A German participant commented on the issue of the German public support of the Eastern enlargement. First it would be good to stress that it was not spread proportionally around all Germany. The support in the Eastern part of Germany has been declining faster than in the other parts of the country. His personal impression is that German authorities have been so intensively associated with the Polish accession that it is hardly imaginable that Germany would give a consent to the first round of enlargements if Poland is not included.

In response to a question about the backwardness and lack of competitive potential of the Baltic countries Vitalis Nakrosis pointed out that according to the latest Lithuanian statistics the GDP per capita accounts to 32% of the EU average. If we consider also the informal sector, we can raise this figure up to 40%. What matters for increasing the local competitiveness is the growth and the quality of production. We should take into account that an important share of Lithuanian GDP is produced in two key enterprises: the nuclear power plant and the oil refinery. Both are expected to remain internationally competitive. Their role across industries is so important that the competitiveness of many other enterprises depends to a large extent just on these two. Also the expected high intensity of the EU transfers to Lithuania is a factor that will positively influence the local competitiveness.

One participant mentioned that the Lithuanian accession negotiations seem to pivot around the nuclear power: its efficiency on the one hand, but also its risks to safety on the other. It would be interesting to know, however, what precautions were taken that this program does not lead to a risk of an accession failure.

One of the Czech participants commented on Inotai's call for a more differentiated approach to the accession and raised the question of Maastricht criteria. These should be unanimously and uniformly satisfied once the countries are considered candidates for the entry into the European Monetary System (EMS) and for the adoption of the Exchange Rate Mechanism (ERM). Here the present macroeconomic outcomes are still heterogeneous among accession countries and a more differentiated approach to their evaluation by the European Commission would reflect the fact that there are other priorities, specific for the particular situation in individual accession countries, than the criteria applied on more advanced countries in their preparation for the adoption of euro. The answer to the problem of trade-off between growth and external balance is still pending solution and many governments are pressed to stabilize their economies by austerity measures without knowing where is the optimal point of reversing the policies in order to get the economy back on a growth path.

A participant of the audience addressed Inotai asking for his opinion about the number of expected waves of enlargement and how the potential hierarchy of membership could look, once there could be in the EU 25 or even more member countries. That raises the issue of homogeneity of the member countries, as far as the intensity of their integration is concerned.

Another participant commented that the present international picture of Hungary in its approaches to EU accession is generally highly optimistic, what may really be the case if Hungary is compared with other accession countries. The snag is that in the EU the test of competence is given in a competition with all other countries, including the incumbents. To this moment we did not have that empirical test. The enormous social risks of a failure in adjustments have been already mentioned. We also know that some crucial areas, such as agriculture and public administration, are lagging behind the EU more than the industrial sector does. Their failure occurring simultaneously in more countries can put the process of further integration and enlargement at stake. Maybe it would be a prudent strategy if the EU would be enlarged first, as a test case, by one among the candidate countries only. The selection can be made among the best-prepared candidates. A more extensive enlargement would follow only after sufficient experiences with adjustments at such working conditions are acquired.

A workshop participant raised the issue that there are numerous studies about the benefits of accession. The cost side, however, is often neglected. Were there elaborated in the various countries analyses of the drawbacks that the enlargement may cause? The adverse impacts can hit a group of population, industries or firms. What is the balance between those who gain and those who lose, and what measures have been taken so far in order to alleviate the situation of the losers?

András Inotai in his final response remarked that the issue of European integration is a part of wider issues – one of them is security. The security of Europe is indivisible and currently there are no forces that would have an explicit interest in the opposite. However, uncertainty can be generated by neglect. For example, if some fundamental decisions are *not* taken at the right time.

As to the importance of macroeconomic indicators, András Inotai admitted that he has been always critical to those approaches for which the macroeconomic figures were the main playfield of decision-making. These figures are reliable and predictable for the mature market economies, for example such as Canada or the Netherlands. But how can we rely on these statistics once the fundamentals of the transformation are not in place? For example, a 3% rate of unemployment can be the result of a highly successful transformation, as well as a consequence of a fact that transformation did not even start and the same can be said about such indicators as the growth heated by expansionary government spending, inflation checked by administered prices, etc. Sooner or later the truth is revealed with a consequence that a lot of effort and human confidence have been wasted in the meantime.

We should support a policy in favor of creating a 10-15 years strategy of the EU enlargement, with clear schedules and rules, but with no firm dates of accessions. The speaker set a hypothesis that we could expect that in the next 10-15 years there will be three accession rounds. One before 2005, the second one 3 to 4 years later and the last one at the beginning of the next decade. The adoption of such schedule would be a clear message, not only to the accession candidates or the general public, but also to strategic investors.

Without a clear long-term vision of the EU we can never get a strong euro. The vision of Europe is dependent on how the EU will integrate and how the enlargement will evolve in the next 10-15 years. With a clear message about the deepening and the widening of the EU, international investors will consider the euro as potential reserve currency. These processes run in parallel and depend on each other. However, the tendencies for creating different "categories" of countries within the EU institutions, such as concentric circles or peripheries of various hierarchies around one pre-defined core of leadership, do not seem to be a lucky solution. We could imagine, however, the existence of countries that are natural leaders is various areas of development – for example, in the security, social, fiscal or monetary policies. That would reflect and strengthen the existence of diversity of European countries. In fact, it is the diversity that can be considered the comparative advantage of Europe and a principle that should guide its development.

We should realistically expect that the enlargement will proceed in groups and not by single countries. The first group will be taken as a test, anyhow. These countries should be therefore very much aware of their responsibility in order to keep the process open and avoid a backlash precluding further enlargements. As a pessimistic scenario, we can envisage an enlargement where all parties, both incumbents and new entrants, would have a feeling of being worse off. That would create a political deadlock in Europe that would be very difficult to overcome.

What concerns the costs of enlargement, they as the benefits, are not spread evenly in time. A lot of costs has been expended up to this moment and there will have to be more of them during the next preparatory stages, while there were much less benefits to come in the short run. We have got to understand that there are also the costs of transformation that must be considered a part of the process. However, they would have to be spent notwithstanding the accession. Similarly, there are many costs of integration within the EU 15 and only a small part of them can be attributed to the Eastern enlargement. There are also the costs of global challenges and we should consider to what extent the risks of enlargement could add to them or whether the benefits of enlargement can moderate their burden.

Vitalis Nakrosis turned in his response to the question on the Lithuanian nuclear power plant. According to the recent EU safety standards the Chernobyl-type of reactors are hazardous and should be closed down. However, the Lithuanian nuclear plant consists of three units and only Unit-1 should be closed. Its dismantling, the upgrade of Unit-2 and the building of Unit-3 will require billions of euros in investments. Negotiations are being held how the international community (including the EU) and international capital will finance such a development.

Július Horváth replied to a question concerning the Slovak privatization program addressing the privatization of the banks. Subject to the changes in time and in governments during 1992-98, the attitudes to privatization in Slovakia have also changed dramatically. The former policy of creating “domestic capitalist class” and the ways how its members were selected, was abandoned and the new government of wide coalition adopted a strategy that became more recognized internationally. Nevertheless, the whole change is still in a preliminary stage that commenced with the privatization of banks. Though consolidating the classified loans is in progress, the solution will take much longer time and its costs will be also large.

As to the question of trade-offs between growth and macroeconomic stability, we seldom have information telling us the exact causes of recourses to a cycle, especially if the cycle is combined with stabilization policies. It is only historical analysis that could reveal whether the past policies were justified and/or sensitively used. Horváth would disagree with András Inotai that macroeconomic data for economies in transition are not generally credible. Though the macroeconomic policy instruments are far from being perfect, we do not have so far an alternative that would perform evidently better.

2. The Role of Regionalism in the System of EU Transfers – Necessity to Create Institutions and Channels for Transfers, or Establishing and Pursuing New Regional Policies

2.1 EU-Induced Changes in a State-Centrist Regime: Lessons from the First Program Period of Finland [10]

The presenter started distinguishing two concepts of regional policies used in the Nordic domestic debates: small and large regional policies. Small regional policies (or regional policies in the narrow sense) refer to measures earmarked for upgrading designated areas (such as investment grants, tax relief). Large regional policies (or regional policies in the broad sense) refer to the regional development implications of the operation of the welfare state. For example, there can be some sectoral policies (for instance in education or health service), which are implemented according to common criteria, and that imply income transfers from the richer regions to the less prosperous ones. It is worth mentioning that the latter income flows have been, as a rule, much larger than those related to the narrow domestic policies, or those related to the EU's structural funds operations.

Turning to the tradition of regional policies in Finland, one must refer to the first specific regional legislation in the middle of the 1960s. Since then many changes happened. Program-based domestic regional policies were initiated in the 1980s, i.e. many years before the EU membership. In fact, the history of regional development policies is much longer, since they played a major role in the construction and internal integration of the nation state. This is a relevant point here because the nation building policies since the early years of independence strengthened the unitary state, which has been characterized by a strong central administration and strong local administration, but without much influence in the intermediate level. There are around 450 municipalities in the country, which are not only areas of local democracy, but also bear main responsibility for the provision of welfare state services.

When Finland applied for the EU membership in 1992, it underwent a very serious economic crisis, including a 10% decline in output. In fact, with some exaggerations, at that time Finland could well have been regarded as one of the transition countries. The resulting "crisis consciousness" has probably contributed to the subsequent profound changes both in the political system and the economic base. As regards regional policies and structural funds operations, it is an indisputable fact that the learning curve has been swift and steep. Nevertheless, a closer look shows that the state-centrist tradition deriving from the legacy of state building policies and the welfare state has been relatively resistant to change.

Finnish reforms in the institutions and the practice of regional development policies can be taken for an example how a national policy regime could be adapted to the European policy framework. However, it is important to state that the European requirements, as a rule, are not straightforward in the sense that it would be necessary to

[10] This section summarizes the presentation by Heikki Eskelinen.

squeeze the national regime into any strictly designed “European model”. Finland's example also showed that national governments have a final say in the arrangements, and the adaptation to EU norms shows a wide variety. For instance, one of the main principles of EU regional policies is *partnership*, which has been interpreted in widely different ways, and in different countries has led to different arrangements.

In the following the presenter described what institutional and procedural reforms were actually made. In Finland, for some 15 years, the responsibility for internal regional policies lies with the Ministry of Interior. While the preparation of legislation, promotion of regional policy in different policy areas, coordination of regional policy administration, including overseeing municipalities, are among the responsibilities of this ministry, the actual regional policy measures are implemented by sectoral ministries, especially the Ministry of Trade and Industry. This division of labor has not undergone any dramatic upheaval since the EU membership, despite that a number of reforms have been made for the purposes the EU membership, or in the name of such purposes.

While programme-based policies were initiated at the end of 1980s, regional policy measures were not organized in terms of programs until 1994 (one year before the membership). Both the internal conditions (e.g. the economic crisis) and the external ones (e.g. the anticipated EU membership) conditioned these to be changed into programs. In addition, the reform was also supported by the developments in the theoretical and conceptual bases of regional policies. The theory of endogenous growth was one of the most important among them. Finland was no latecomer in this field.

The direct impact of the EU membership was most obvious in the institutional reforms, primarily in the intermediary level. It was in those levels that Finland had been very weak for about a century. As part of the pragmatically oriented swift preparations for the membership, a partial solution for the distribution of responsibilities was found in 1993. 19 *regional councils*, which are bottom-up organizations of representatives elected by the municipalities, were established, and they were made responsible for regional development and planning. Simultaneously, the state-led top-down provincial governments lost their coordinating role in the regional planning and their number was reduced from 11 to 5 a couple of years later. Two strands of spatial polices in Finland - land use planning and spatial development - were also brought to the intermediate domain of the regional councils.

These changes took place before membership, and interestingly, the regional councils were not granted a leading role in the implementation of the structural fund programs from 1995. In fact, due to the fast preparations and a political decision, Finland started implementing structural fund operations much earlier than for instance Sweden. It was even before the referendum on the EU membership took place. Since the councils were not involved in the structural funds operation, a dual system of governance emerged in the intermediate level in the mid-1990s.

At the central level nothing changed. So it was with the responsibility of the Ministry of Interior for administrative tasks, and the sectoral ministries for their implementation and main national financing. At the regional level, the state regional administration was reformed in order to comply better with the new situation. Starting from 1997, there are 15 *Regional Employment and Business Development Centers* that include regional offices of the Ministries of Trade and Industry, Labor, and Agriculture and Forestry. One specific feature of the organization of structural funds operations of Finland is that there is only one program for each EU objective: this feature is naturally supporting the central level administration of regional policies.

The regional councils, when established, were required to provide an avenue for democratic regional participation and an integrated approach for spatial development. However, they were not granted resources and they lacked the proper decision-making competence. In this dual system, the resources and competence was granted to the Regional Employment and Business Development Centers, but they lack the mandate from the population to decide on either policy guidelines or concrete measures. That means, that they suffer from a democracy deficit. It is no surprise that it is difficult to live with this dual model, a model which is very different from those prevailing in other EU countries, for instance the one used in Denmark.

Nevertheless, this unique model has been accepted by the EU. It is worth to emphasize that the complexity of this model is clearly a domestic achievement, not dictated by the EU and, as such, it reflects a long-standing Finnish tradition of being a small unitary state.

The question arises that why was the role of regional councils kept weak? The standard argument is that Finland’s regions are small (19 regions for 5 million people) and they lack the capacity and ability to negotiate directly with the Commission. In another words, they were not established as appropriate institutions with full powers at the intermediate level.

In fact, this complex administrative machinery is used for structural funds operations and remains in place (with relatively small modifications) for the next programming period of 2000-2006 as well. As far as the community initiatives at lower levels are concerned, for example such as INTERREG, the councils became important local and regional actors and their role has been increasing.

The logic of the institutional development in Finland can be summarized as follows:

In the past five years, when EU’s regional policies were applied in Finland, ECU 1.7 billion was received from the structural funds, and about half of these funds were directed at regional objectives. Finland experienced “the necessity to create institutions and channels for transfers” (see the title of this section), and the greatest shortcoming here was the weakness of the intermediate level of the government. In short, the problem was how to create regionalism almost from scratch, how to respond to increasing and legitimate demands for democratic participation in regional development, and how to apply these in a unitary state, where intermediate regions (whatever defined) are small in terms of population and other resources, and where regionalism as a political and cultural phenomenon is not strong?

This problem is not unique, other countries have faced and will face the same phenomenon in Europe. It reflects the diversity of the European territory, and came up particularly in the Nordic countries in connection with the Objective 6 funds (applied for the sparsely inhabited Northern areas of Finland and Sweden) in the years 1995-1996.

Finally there are some additional concrete experiences from Finland in a summary:

EU regional policies required skills at the central, regional and local levels. The latter seemed to have been able to face this challenge: about 90% of the 450 municipalities have participated in various EU projects, and most regional councils established information offices or lobbying organizations in Brussels. However, the guiding principles of the EU policies (innovativeness, additionality and partnership) tended to favor institutions with stronger resources, and this tendency has undermined the very target of reducing regional disparities.

Domestic regional policies have decreased in importance and have been streamlined mainly for the purpose of co-funding structural fund operations. This has raised criticism and became a controversial issue of the otherwise all-embracing consensus of the Finnish political life.

The key targets of national development strategy in Finland at the macro-level are R&D, knowledge, innovation, and information technologies. These initiatives, however, have no clear regional guidelines. In fact only a few of the biggest city regions have grown in recent years as a consequence of this national strategy. While Finland has shown a strong industrial development and a modest progress in learning the rule of the game in the EU, regional disparities have been *growing* in recent years.

Finland's example shows that even a small country may raise new issues to the EU's political agenda. The entry of Finland and Sweden implied that the EU had to pay increased attention to the Baltic Sea region, the Barents Sea region and the Russian border. Similar new issues are bound to emerge with the Eastern enlargement and will call for institution building for regional transnational cooperation.

2.2 Experiences from the Swedish Accession – Strengthening Regional Institutions and Internationalization[11]

The Swedish case is very similar to the Finnish example, partly because Finland and Sweden are very similar. The background is that Sweden is one of the oldest centralized nation states in the world. It has been very stable, its boundaries have been the same for centuries. The very strong state has a major role in the life of the population. Sweden might be a world champion both in taxing and homogeneity: there is very little regional variation in the income levels and the level of social services. As in Finland, the regions in Sweden are very weak, while communes, that supply most of the services, are strong. The turbulent 1990s, with their economic crisis, led to a major rethinking of the system. Part of the rethinking was the turn in Sweden's relation to the EU: following 30 years of negative attitude to the European Community the Swedish government, after a very short discussion, applied for the membership.

The Swedish regional system was not only weak concerning its power, but also poorly adapted to the EU framework. Many of the Swedish counties have only a hundred thousand inhabitants, and they are not based on elected assemblies. In fact, in the past decades the power on the country level has become less and the communes gained more influence.

[11] This section summarizes the presentation by Stefan Anderberg.

To the question that what change occurred following the EU accession in the governance system, there is a legitimate answer that no important changes happened either at the regional or the local levels. But one may answer also that, nevertheless, quite important changes took place in terms of mobilization of regions, internationalization and general vitalization of the local and regional levels.

In accordance with the preferred attitude of the Swedish government there has not been any constitutional change: the powers of communes and counties were virtually untouched. Some limited changes occurred due to EU legislation, mostly in the field of procurement, competition and environmental legislation. The state held the foreign policy in its hands, outside and above the influence of the competence of regional and local authorities. This setup is based on the logic of the nation-state, with a clear separation of the country and the EU. In this system the government wants to keep EU politics outside of the national scene, partly because it has a generally anti-federalist standpoint, and wants to defend the traditional Swedish system.

However, from the point of view of development of networks, and organization on the regional level, as well of certain single issues, one finds dramatic changes. The EU brought in a 4th level of government and it implied new relationships and new opportunities (particularly in the form of EU funds) for the lower levels. The international contacts of the lower levels increased dramatically: in fact, the communal policies started to occur on a larger, international scene. We saw considerable local and regional mobilization, mostly on an inter-communal basis. This means that it is now the communes that drive the creation of regions in Sweden and not the other way round that used to be the normal procedure. For example, when the state is making all the reforms all over the country, it is characteristic that the new structures are not well–organized and they have no formal base. Nevertheless, the communes are quite successful in creating networks, getting the EU funding for various projects, and launching new initiatives often within the various EU frameworks, such as the INTERREG.

The Swedish state has also recognized the need to look at the formal structure of the regional system. What we had at the counties, it was transferred to the EU NUTS III regions. For making the NUTS II regions, certain counties were put together; but these are just statistical units. Nevertheless, five regions were selected as test regions with stronger governments. In two of these (Scania and Western Gotland) there have also been elections, and regional parliaments, called councils, were formed. The test regions have got increased authorities in some areas, such as culture, employment and development policies. The “test” runs for 5 years, after which the results are evaluated and a general reform will be introduced.

Swedish regions, usually the larger ones, due to the need of closer relations to the EU regions, have set up their offices in Brussels. Presently there are 9 such permanent regional offices in Brussels. It is interesting that these offices represent the stronger part of Sweden and not those regions that normally receive most of the structural funds.

Cross-border cooperation, particularly in the Southern part of Sweden where the main partner is Denmark, is an important aspect of strengthening regional institutions. The new bridge between these two countries is a prime example of such co-operation. Finally, regional interests have become much more pronounced in national interest group organizations. They, just like the government, strive to achieve national consensus and avoid regional differences.

The presenter ended his account with the following concluding remarks:

In formal terms the direct effect of the accession on local and regional governments was limited. But the indirect influence was important. This change was particularly driven by the opening opportunities brought about not only by the accession, but also by the pressure of the preceding economic crisis where many areas experienced factory and industry closures. Taken from this point of view, market opportunities, the need of information available in the union, the opportunity to influence developments in the EU, and the access to EU funding – these all played a role, but also some moral support by other regions in the Union were important.

Studies analyzing Nordic regional relations to the EU point out that there are two distinct approaches: the East Nordic (Finnish and Swedish) one, where communes make more and more direct contacts to Brussels and circumvent their governments, and the Western (Danish and Norwegian) approach which builds more on the process of forming national priorities on regional policies.

The local levels have undoubtedly been vitalized by the feeling of greater independence due to the opportunity of questioning national approaches by regions or communes based on practices established elsewhere in the EU. It is interesting that these developments have made Sweden *a lot more heterogeneous*: regions have become stronger in the Southern part of Sweden, in city areas, in regions with export-oriented industries, and in border regions.

The Swedish government has a somewhat mixed attitude to these developments: it encourages regions to attract external funds and to launch faster development, but it also wants to guard national unity and homogeneity. This naturally leads to tension about competencies and policies such as the approach to privatization, foreign relations and future visions, particularly in the test regions. Especially border regions in the south want a lot of more flexibility within the uniform national system and they strive to become more integrated with Denmark.

Sweden has a similar problem as Finland, as was mentioned by the previous presenter. It is a typical problem of many centralized countries: how to form regions in a country where there are only few natural regions, and where regions with identity are, in fact, not very functional.

2.3 Structural Policies, EU Transfers and Regionalization in Eastern Europe[12]

The presenter had the opportunity to work as a consultant in Bonn for an INTERREG II/C project of the EU that aimed at elaborating a regional development strategy for the whole Central and South East European area. Based on his experience in this field therefore he deals with the whole East European region, rather than just Hungary. Three topics are to be touched upon: 1) the relationship of regional allocation

[12] This section summarizes the presentation by Iván Illés.

of funds and the absorption capacities of these countries; 2) the interrelationship between the eligibility rules of the Structural Funds and the specific demarcation of regions in the accession countries; and 3) (an intentionally provocative question) would the allocation of Structural Funds survive the year 2006?

Absorption capacity

By now all accession countries have established their system of regional NUTS units according to the requirements of EUROSTAT. Since GDP per head figures are below 75% of the EU average in all candidate countries, the most important NUTS level for them is NUTS 2, since they are eligible for the EU support. In six of the accession countries the whole of national area represents one NUTS 2 unit (in Estonia, Latvia, Lithuania, Slovenia, Cyprus and Malta), in the other six countries there are more than one. It is, however, only Poland, where NUTS 2 units are administrative territorial units with elected decision-making bodies. In Bulgaria NUTS 2 units host some sort of central government organization; but in all other countries NUTS 2 units represent merely a grouping of smaller territorial-administrative units without own administrative functions; they have been established to meet EU requirements concerning planning, programming, financing and controlling the implementation of future structural funds.

Based on past experience, the Commission introduced a new condition into the handling of structural funds, *the absorption capacity:* it established that the limit of an efficient absorption of external investment support is 4% of the GDP of the respective country.

According to the presenter, however, that absorption capacity has at least three important aspects:

(a) Macroeconomic absorption capacity defined in terms of GDP.

(b) Managerial-administrative absorption capacity, meaning the ability and skill of central and local authorities to prepare acceptable plans, programs and projects in due time, to decide on programs and projects, to arrange the coordination among the principal partners, to cope with the reporting paperwork by the Commission, and to finance and supervise implementation properly, avoiding fraud, as far as possible.

(c) Financial absorption capacity which means the ability to co-finance the EU supported programs and its projects and to collect national budgetary contributions from several partners interested in the program or the project.

As for the *macroeconomic absorption capacity*, the question is what measure of the GDP should be taken into account? Is it the total GDP of the country (as is the usual interpretation), or can it be interpreted as the GDP of the eligible regions only? In Hungary, for instance, by the time of accession the Central Region around Budapest may surpass the eligibility threshold (of 75% of per capita GDP) and the rest of the country makes up only 57% of Hungary’s GDP. Accordingly, if the EU support is compared to the GDP of the rest of the country, the same amount of support may easily surpass the 4% cap. Moreover, if the absorption indicators would be calculated for single regions, low regional GDP per capita may become a serious constraint to receiving structural support just in the least developed regions, especially in countries where regional disparities are high, i.e. in Hungary, Poland and Slovakia.

As for the *managerial-administrative capacities*, we have to acknowledge that in the case of EU's PHARE support, even when the overwhelming part of transfers would be managed by central ministry units, the timely utilization and spending of these relatively small sums may cause serious difficulties. The regional management units, which are just being established, are much less experienced and have less professional skills than the central ministry units. For the sake of truth one has to admit that bureaucratic procedures and procrastinated decision making in the EU aggravate these difficulties significantly.

The presenter asked whether it is worth to establish all the new regional structures now when the time of accession is rather far and uncertain. A simple calculation on ISPA[13] funds shows that in the pre-accession phase, in each of Hungary's seven NUTS 2 regions, regional development councils and regional development units would have the opportunity of making decision about one single ISPA project each two years. Accordingly, it is justified to ask whether these bodies would not be frustrated by the lack of work before the time of real tasks and challenges will come?

It is clear that the administrative-managerial absorption capacity of the regionalized support system is more difficult to organize and more competitive than a system based on national quotas. Regional program documents will be prepared more slowly and would certainly need more corrections and amendments than a single national document. The availability of the few consulting firms that will be entrusted with the preparation of the regional documents will be a bottleneck and thus lead to further lengthening of the preparation period and limiting the absorption capacity of the recipients.

The *co-financing*, that means the matching *capacity of the recipients*, is not equal to the overall financing capacity of the country. In addition to the national financing capacity it largely depends on the willingness of the concrete participants of the projects to contribute and on the technical and institutional possibilities to pool those contributions together. The willingness to contribute to projects managed by other organizations is rather low in the accession countries. Both ministries and governments are reluctant to transfer budgetary resources – once allocated to them – to other organizations. Horizontal transfer has been unusual in these countries in contrast to the usual resource transfer along vertical lines.

In sum: the regionalization of the EU structural policies is an important driving force for more decentralization and for bringing decisions closer to the citizens. Nevertheless, at least in the first periods, the cost of decentralization might exceed the benefits in economic terms, and it might limit the absorption capacity of the accession countries in several respect.

Eligibility rules and the demarcation of the regions

In the accession countries the regionalization was carried out mainly in order to fulfill the requirements of the EU accession. Therefore, it is no wonder that in this process tactical considerations concerning the regulations of structural funds were taken into account. Due to traditional development patterns and the most recent structural

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[13] The acronym is used for the Instrument of Structural Policies for Pre-Accession, used in the past mainly for financing the structural adjustments in environment and transport).

changes, capitals and regions around them have reached the highest development level in the accession countries. Therefore, they are most likely the regions that surpass the eligibility threshold of Objective 1 support. In the case of larger countries, two strategies are used to maximize the eligibility area within the country. First, one can define the capital city as a separate NUTS 2 region (this method was chosen by the Czech Republic, Slovakia, Romania and Bulgaria). Second, enlarge the region of the capital city sufficiently to counterbalance the high development level of the city (this pattern was followed by Poland). Therefore even the rich parts of the country become eligible. Interestingly, Hungary has chosen neither of these: the Central Region with Budapest and the surrounding area is larger than the capital, but still has a too high level of per capita income to be eligible for Objective 1 support. The unfortunate consequence of this strange option may be that an area inhabited by 30% of the population may be excluded from this kind of EU support. Since Hungary has taken seriously that regionalization is not jut subsidy-shopping, it will lose a lot.

Will the regionalized allocation system of Structural Funds survive the year 2006?

Before 1988, when the regionalized allocation of the Structural Funds was introduced, structural funds were allocated according to national quotas, and the regional allocation of these funds within the countries was basically left to the national governments with the obligation to observe the aims, competition rules, and further requirements of the European Commission. Regionalization served several aims, including that the more developed members managed to have a share in the funds for their own less developed regions.

In recent years more and more critical opinions could be heard concerning the management and utilization of Structural Funds, in general, and their regionalization, in particular. The following arguments could be heard:

- From 2007 on the few regions of the more developed countries, which were eligible for Objective 1 support, will certainly not be eligible for such support, not even for the so-called “transitional support” granted to those countries which drop-out from the Objective 1, 2 and 5b categories. This means that the relevant countries (the Netherlands, Belgium, Austria and Britain) will lose their interest in regionalization.
- After finishing the full enlargement, altogether 51 new Objective 1 regions will have accessed to the EU. This means a doubling of the number of such regions, and it can seriously threaten the administrative capacity of the European Commission.
- The Commission seems to believe that in the time of their accession the new members will be unable to establish skilled and reliable planning and programming, implementing, financing and supervising structures at the regional level.
- Regionalization was introduced at a time when the sum of structural funds grew very dynamically. Even if the minimum requirements of enlargement are to be met, the allocations to old member states are to be reduced. Reduction of funds and the number of eligible regions is not a popular and pleasant task, as the example of Objective 2 regions has showed.
- In recent years a certain tension emerged among national regional policies, EU regional policy and EU competition policy. Eligible areas for national regional policies turned out to be not identical, but usually larger than areas eligible for the

EU support. The General Directorate of Competition Policy enforced a substantial reduction of the upper limit of the national support and also the extent of the regions that could be supported by the national governments. One of the consequences of this tension can be that in the next budgetary period, as a revenge, national regional policies will "integrate" EU support, rather than the other way round. This means a return to some form of the former national quota system.

- The example of the EU agricultural policy might signalize a policy direction that treats the new member countries differently, i.e. a policy that invents a new support scheme for the new members which is not, or only partly, comparable to the system applied by the present member states. One form of this differentiation would be retaining the regionalized support scheme for the present members and offering national quotas for the new ones. Another strange proposal that emerged in unofficial and semi-official documents is that leading regions, not eligible for support according to their per capita GDP, would receive the support funds, on the assumption that the development of these regions is vital for the catching up of the respective countries.

Plenty of proposals of reform for the structural policies and funds are flowing around currently, and according to the presenter's experience about half of these propose the discarding of the regionalization of structural funds. Keeping this in mind, the candidate countries should be cautious not to raise expectations too early in their regions, expectations that could be impossible to fulfill later.

Discussion of Previous Three Presentations

A discussant from the Commission expressed his conviction that there is no basis whatsoever to apply the 4% absorption capacity limit to the regional level: according to the conclusions of the Berlin summit it applies to member states. He sympathizes with the view that the candidate countries should not focus on the development of the poorest regions only, and thus neglect the regions around the capitals that are crucial in pulling the countries towards to EU level. According to his personal view (as distinct from that of the Commission) it was not easily understandable why the candidate countries so readily accepted the suggestion of the EU to follow the regional approach to structural funds. In fact, the *acquis communitaire* is pretty weak to enforce on the member states the establishment of the NUTS 2 regions.

A discussant from Hungary found that the question addressed in the three presentations were that to what extent the EU requirements on regional administration and policy, so far as they exist, affect the national systems of public administration. On the one hand, the two Nordic presentations stated that there was not much coming from the Commission in terms of requirements, and Finland and Sweden did not have to adapt to a common system too much. The presentation from Hungary (by I. Illés), on the other hand, suggested that we are running after a mirage of the so-called European regionalized territorial development, which might not exist, and might not even be justifiable on an objective criteria. The discussant acknowledged that in many Hungarian regions its is believed that regions were set up merely for subsidy shopping. But he was sure that policy makers in the central government do not think like that and they have a longer term vision: there is a strong belief in stronger regional autonomy and decentralization of the state. It is a problem that there is no public debate, the visions are discussed inside the executive organs. The real problem is how to channel funds of billions of euros to the right place in a democratic manner. In other words: what changes are necessary to put through in the institutional system to be eligible for the structural funds, because simply establishing NUTS 2 administrative levels is clearly not one of these.

Anderberg answered to the question what regional policies can really do: he accepted that regional policies can reduce income disparities, however, they can not able to cure the illness. Just like now in the transition countries, also in Sweden there is a hot debate about the effects of regional policies on the capital area.

Eskelinen commented on the question whether the system of regionalized structural fund allocation will survive 2006. One of the options is that more prosperous countries will lose the support from the EU. Another possibility is that the structural fund support will focus on various cooperation efforts, such as INTERREG, or inter-regional cooperation in general. A document prepared by the national governments and the Commission on the European Spatial Development Perspective outlines a potential for funding spatial and regional development. This scheme assumes money also for the more prosperous regions.

In his comment Illés emphasized that the present member countries had already some regions before policies for regional development support from the EU were developed, and therefore they did not have to make much about it later. In the accession countries, however, partly under the EU pressure, regions are being formed just for the management of structural support in the future. Perhaps there is a political aim behind this endeavor on the side of the EU assuming that this regionalization and decentralization is necessary for further democratization in these societies. In a recent discussion with a senior Hungarian official responsible for regionalization in one of the ministries, it was mentioned that for years the representatives of the Commission liked to reiterate the same guideline: decentralize, decentralize, and decentralize! In 2000, however, in a moment when the accession is coming closer and the utilization of the funds becomes necessary, they switched to a suggestion: centralize, centralize, centralize! The question arises then that what had been the logic behind encouraging the decentralization campaigns in the previous years?

A British participant recalled that the UK has been a highly centralized West European member country struggling with the concept that it had to create regions. It was also partly in response to certain internal nationalistic pressures from countries like Scotland and Wales. The EU structural funding system in fact assumes a regional set up, but the problem is that how to develop regions when there is neither clear economic perspective, nor regional political perspective to doing it. If there is only an insufficient bit of either of these identities, then we are left with a mess, rather than with a clear regional system. In the past the EU had probably used regions in order to weaken national governments, and that might be in fact a good thing at that moment. But the problem remains how to create a region which has neither a clear political-cultural identity, nor a clear economic identity. In Britain Regional Development Agencies were created with a business function, but in the case of some regions with no functional identity those business functions could not operate. And lastly, the problem of monitoring arises. The discussant’s recent involvement in a project looking at the new

INTERREG 3-I had the impression that the only thing that one can monitor in such regional projects is the number of documents that have been produced. This may be important, but it does not necessarily reflect what you want to achieve with the regional projects.

Several discussants acknowledged that the message of the Nordic presentations was that it is better to utilize natural, historically developed regions for the allocation of structural funds, than artificially create new regions. One participants added that running ahead with the creation of a new regional administrative system may turn out not only unproductive (if eventually structural funds will be allocated across nations), but also costly. In Hungary there are already regional councils and related regional agencies and they are already working on regional development programs. The danger is that there will be programs and projects elaborated which are very EU-conformed, but perhaps not really necessary for the regions themselves. Since many of the regions have no funds, the implementation of the required co-financing will imply much tension.

Eskelinen commented that apart from the EU related purposes there could be further motives for increased regionalization and local involvement of people in various development efforts, in support of local dynamics. If one asks which regions are relevant for these additional purposes, the answer is probably that quite different regions in the various European countries, due to different spatial structures, networks, identity of regions, etc. This has much more to do with path dependency and historical processes, and less or nothing with NUTS 2 level regions.

2.4 Building the Institutional Framework of EU Structural Funds in the Czech Republic within the Context of Decentralization of Public Administration[14]

The Constitution of the Czech Republic (CR), which came into force on January 1, 1993, envisages dividing the state territory into an unspecified number of regions or counties. These regions should play the role of the intermediate level of public administration, as well as represent a part of the system of self-government in the CR.

During the first five years of independent existence of the country there was no sufficient political will to fulfill some parts of the Constitution. Not only that the intermediate level of administration was not developed, but the establishment of the upper chamber of the Parliament (*Senát*) was also delayed for 5 years, and the introduction of an act about referenda has not been fulfilled yet. In all these cases the Parliament initiatives were blocked by the aversion of the former strongest coalition party – the Civic Democratic Party (*ODS*) – to those themes. Their politicians considered these changes only as a pure and unnecessary expansion of the public sector. Finally, the *Constitutional Act on the Formation of the Regions* was adopted by the Parliament in December 1997. However, the coming into force of this act was delayed by two years (i.e. self governing regions were not to be introduced before January 1, 2000). Regardless of this delay, the subsequent Czech governments have not been able

[14] This section summarizes the presentation by Jan Hřích.

to fulfill the constitutional act about the formation of the regions yet, mostly due to fact that the fulfillment of this act requires about 14 concomitant acts to be adopted.

The historical first elections in the regional Assemblies in the CR were to take place on 12 November 2000 (just some days after the workshop). It was to happen in each region except Prague, where the regional Assembly is identical with the already existing representation of the city. Subsequently, the higher territorial units, their assemblies and offices are to be set up on January 1, 2001. The progress of regionalization of the CR was already acknowledged in the 2000 November report of the Commission.

According to the *Constitutional Act on the Formation of the Regions* the whole territory of the CR was divided into 14 self-governing regions. This division is based mostly on the existence of significant urban centers and their links to their surrounding peripheries. The final pattern of regions is a result of compromises of various particular interests. Especially the city centers were able to push through their interest. Also historical traditions played some role.

The size of the counties varies significantly according to their area and population. According to population the biggest region has about 1.3 million inhabitants (and the second biggest – the capital city of Prague 1.2 million), the smallest one has only 305 thousand. The average size of the regions is 736 thousand people.

For the regional policy reasons the most important levels of the European system of regions is NUTS-2 (this level is decisive for Objective 1 of EU's structural policy) and to a certain extent NUTS-3 (for Objective 2). We can expect that the whole territory of the CR will be eligible for Objective 1. The NUTS-classification is quite important already in the pre-accession period because of drawing funds from the so-called pre-accession financial instruments.

The average size of EU NUTS-2 regions in the present member countries is 1.8 million people, more than twice as large as the average size of the Czech higher territorial units. Due to this difference the counties were unacceptable for the EU bodies, particularly for Eurostat, and accordingly, the Czech NUTS-2 statistical regions had to be created by grouping the 14 higher territorial units into eight larger regions. Out if these there are two special NUTS 2 regions that correspond to counties: these are the capital city Prague, and Central-Bohemia (see Table 1).

According to the *Regional Development Strategies,* which have been already elaborated as a basis for pre-accession funds, the main tasks for the future development of the various NUTS-2 regions are more or less similar. These are: the stabilization of existing economic activities, support of small and medium-sized enterprises, improvement of infrastructure and utilities for tourism. These tasks represent no principal interference with the existing economic structure in the regions. Exceptions here are the Ostrava and North-West regions, where the main tasks are completion of a radical economic restructuring (especially of mining and heavy industry) and mitigation of unemployment. The remaining special case is the capital city Prague, where the main tasks are improvement of the environment and a comprehensive solution of the transport problems.

Table 1: Dividing of the Territory of the Czech Republic into NUTS-2 Regions

Name of Region	**Associated Counties**	**Population**	**Surface Area (in km^2)**	**GDP per Capita, % of Average of EU-15**
Prague	Capital City Prague	1 209 855	496	113.9
Central-Bohemia	Central-Bohemia	1 106 738	11 013	49.0
South-West	Budějovický and Plzeňský	1 182 277	17 618	60.2
North-West	Karlovarský and Ústecký	1 130 160	8 649	57.0
North-East	Liberecký, Královéhradecký	1 492 873	12 440	55.1
South-East	+Pardubický	1 664 018	13 992	58.9
Central-Moravia	Jihlavský and Brněnský	1 246 421	9 104	51.1
Ostrava region	Olomoucký and Zlínský Ostravský	1 289 002	5 555	57.0
Czech Republic		**10 321 344**	**78 867**	**62.5**

Source: Terplan, Prague, 2000.

The 14 higher territorial units were declared to be the NUTS-3 regions in the CR (compared with EU-average they are relatively big), while the NUTS-4 level represent the 77 existing administrative districts. It is to be expected that this level will be changed within the framework of the second stage of public administration reform (2001 – 2002), when the existing 77 districts are to be replaced by the so-called small districts (about 170 of them), to be administrated by the so-called entrusted municipalities. Similarly to all EU-countries, the NUTS-5 level is reserved for the municipalities. There are more than 6,200 municipalities in the CR at present. This number is generally considered too high. The gradual voluntary integration of existing municipalities is therefore considered desirable for the future.

2.5 Adapting to EU Transfers: the Case of Lithuania[15]

The message of the Lithuanian experience from adapting the domestic economy and the public administration to EU requirements for the usage of transfers is very illustrative. It deals with the general efficiency of public procurement, selection of competing projects, their co-financing, evaluation of individual stages of implementation, adjustment of domestic institutions, changes in the hierarchies of organization, conflict resolution and many other problems of modern public administration. In 2001 Lithuania competes for EU funding for its projects in the programs of PHARE (institutional convergence), SEC (social and economic cohesion), SAPARD (agriculture and rural development) and ISPA (environment and transport). Expected EU funding (including CAP, structural and cohesion funds) at the time of EU

[15] This section summarizes the presentation by Vitalis Nakrosis based on a paper by Vitalis Nakrosis and Ramunas Vilpisauskas.

enlargement is estimated to reach up to 4% of the Lithuanian GDP (or approximately 1000 million EUR in absolute terms). The problem is that the effective commitments of the EU depend on the accession country's ability to compete for funds by developing the capacities for their successful absorption. This requires a long way of learning, adjustments and changes in the management of public investments and policies.

At the beginning Lithuania was particularly unsuccessful in attracting financial support from the EU. For example, it contracted only 19% of the PHARE commitments for 1998 while on average the accession countries succeeded to receive over 40%. The problems appeared on all sides of the management of support schemes: bureaucracy, clash of interest between the domestic side and the EU side, negative distributional effects related to domestic decision making (e.g. rent seeking, politicized project selection, corruption), market distortions, displacement of domestic private investments by public investments, lack of monitoring and periodic evaluation, limits of competition, rigidity of factor movements and false expectations. The reforms of institutions and policy procedures were superficial and the old communist administrative reality was hiding behind the "modernized" institutional façade.

Thus the Lithuanian government stood in the late 1990s before a crucial decision: either resign from a revamping of its support policies and get in the first year of EU membership only 30% of the expected structural and cohesion funding, or initiate the deep changes that are targeted at gaining the full potential funding. What also mattered for the acceptance of the latter strategy was large expected positive externalities that the compliance with the EU requirements had on the functioning of the public expenditure and investment policies. On the other hand, large inflows of the EU support funds would require greater demands on domestic co-financing (both public and private) that may divert domestic expenditures from being channeled to their traditional beneficiaries and cause conflicts of interest. In the meantime, after 1997 the European Commission also changed its policies to accession countries: from the soft "demand-driven" provision to a more austere "accession-driven" support, where efficiency and public returns, judged to a large extent from the EU's viewpoint, became the decisive criteria.

The process of adaptation to the EU's pre-accession financial policies should commence with a systems analysis and an audit of the mismatch between characteristics of national public investment procedures and the EU's objectives and requirements. The analysis should unveil areas of major tensions ("mismatches"). In Lithuania the list was divided into major areas of potential conflicts:

- Vaguely defined and non-transparent domestic development policies whose implementation could not be supported from the EU funds. Here one could find e.g. intervention schemes that were in conflict with the market operation, subsidies that had their history in the communist planning, and vested interests of private businesses embedded in the public spending. Many of these policies were targeted on welfare objectives while EU funds are aimed at investments that should reduce development disparities.

- Existing public finance programs that could be (partially) supported from the EU funds, but whose existing implementation was not compatible with the EU's procedures. Such programs were found e.g. in the development of SMEs, exports, quality management, business innovation, information technologies, tourism, R&D, etc.

- Methodological differences in the management of funds, such as representing the techniques of multi-annual programming, budgetary control, private and public co-financing, personal accountability, etc.

The intensities of the level of mismatch and the pressures for adaptation were assessed against six criteria. At the same time each item was assigned to a particular EU support scheme. The criteria were as follows:

(1) Programming requirements of development plans.

(2) Implementation structures (such as paying and managing authorities) and their procedures.

(3) Co-financing requirements and their sources.

(4) Institutional requirements and co-ordination (including both central and the regional co-ordination).

(5) The division of responsibility for public interventions and monitoring of projects funded by the EU.

(6) Experience in public investment management and the requirements for their upgrading.

Though the implementation of the above rather technical agenda is important, it is not a sufficient condition for the efficient management of EU funds measured by both benefits for the domestic development and fulfilling the EU policy aims. One must also comply with the "art" of the EU fund raising, the guiding principles of which can be best explained on the *Irish experience*:

- The applicant country must address its real needs and build on the real potential for improvement.
- The development strategy should be open to co-ordination at the communitarian, national and regional levels that also implies periodical monitoring and effective control. There should be effective partnership between governments (central and regional), trade unions and businesses.
- The management of national and EU funds and the policies that they require is centralized.
- The largest part (36% in the Irish case) of EU investments should be channeled into human capital development, followed by productive environment improvements (27%) and infrastructure (25%). Investments into the so called "sunrise industries" (e.g. the information technologies) should expand significantly at the expense of subsidies into agriculture. (A comment should be added that this policy did not weaken the rural sector.)
- Negative distributional effects of EU and government funding and their market distortions must be strictly controlled. Public financing and interventions are legitimate only if they provide public goods whose benefits are widely distributed and transparent. The positive externalities should be accountable and assessed in the long run. Public finance should not interfere with the functioning

of the markets. The policies of the government should be aimed at reducing entry barriers, imperfect information flows and uncertainty. Compliance with EU public investments must go along with creating entrepreneurial environment that motivates economic agents to productive activities that are competitive on international markets. The public administration therefore must not abuse its role as a co-coordinator and an institution guaranteeing the rules, and should refrain from expanding its power into areas that belong to private initiatives.

Discussion of Previous Two Presentations

A discussant pointed out that the problems experienced by Lithuania were in many aspects similar in other countries. It seems very difficult to estimate the future inflows of EU funds after accession, such as the estimated 1 billion euros of gross EU transfers to Lithuania (e.g. for 2006). First, we do not know what rules will be applied; second, we cannot assess the relative competitiveness of bargaining of individual countries for the funds.

Another discussant emphasized the uncertainties concerning agriculture related transfers. For Hungary and Poland (the most agriculture intensive countries of the first group of candidates) the Berlin Summit estimates for future funding do not include compensation payments, and a discussion about the future role of compensation was postponed. In the present EU member countries these transfers are huge. Until this particular issue is solved we cannot have any serious expectations about the future total transfers from the EU. The estimation of EU subsidies to Lithuania looks justified, even if the funds received could go above the 4% of the GDP.

A workshop participant commented on the support of the “sunrise industries”. Such a selection of supported areas by the government implies judgments, or a “long-term vision” of the government. However, let us ask: are such approaches compatible with successful economic policies, once comparative advantages depend on much more complicated determining factors?

A Swedish participant expressed his view that in the Scandinavian countries 15 years ago hardly anyone could be certain about telecommunications becoming their leading industry. The risks were, however, taken and the combined vision of the private and the public agents really changed the economic structure of countries like Sweden and Finland. No country can lose on supporting the human capital development, though its particular local implementation cannot be commanded exclusively by the government.

A discussant agreed that the problem of EU institutions dominating the process of funding provisions was extremely important. The atrophy of a partnership to a one-way communication can be detrimental to both sides as the experience from the PHARE programme shows. Therefore it may not be just the lack of internal commitment in accession countries that makes the institutions and programs inefficient. The arbitrary and fluctuating priorities of the EU, whose representatives act in a role of principals, also point out that there may be present other systemic problems to be solved than just the domestic problems.

Vitalis Nakrosis replied that he did not associate himself with the pessimistic view presented by some of the commentators. His experience shows that the dominant bargaining position of EU directorates (DG) has been generally a result of the inability of association countries to become qualified opponents. The EU procedures are open for local maneuvering and they offer the candidate countries a potential for local initiative, provided these countries are ready for it. The Lithuanian government first decentralized the EU support schemes to the level of target regions. Only later it was discovered that this move deteriorated the quality of projects and a central surveillance authority is needed in order to keep the process of negotiation with centralized EU authorities in balance.

3. The Sequence of EU Programs: Planning, Monitoring and Evaluation

3.1 Structural Funds Programming – A Retrospective Assessment [16]

This presentation gave an overview of trends in the implementation of the Structural Funds in the EU over the past decade including a review of the institutional arrangements across Member States, and discuss strategy development, program management and partnership.

The implementation of the Structural Funds is a highly complex process superimposed onto the individual constitutional and institutional frameworks of individual Member States. In each Member State, national authorities, the Commission and sub-national actors have different degrees of influence, reflecting factors such as the existence of regional institutions, the allocation of competencies to different levels, the scale of EU funding and administrative experiences of economic development. To further complicate the picture, implementation structures do not stay static but are affected by new approaches to economic development, shifting national balances of power and regulatory change. Further, the implementation of the Funds differ even *within* countries and this regional level divergence appears to be on the increase. While these differences make it very difficult to generalize on *implementation structures*, some overall comments can be made.

First, it is a feature of virtually all EU Member States that established government authorities play a dominant role in Structural Fund implementation. This involves the national governments in most cases, although regional authorities have also gained an increasing role, including in more unitary countries. Overall, most Member States have sought to limit the impact of EU regional policy on their systems of governance.

[16] This section summarizes the presentation by Ruth Downes based on a paper with the same title written together with John Bachtler. It is based on comparative research undertaken by the European Policies Research Centre at the University of Strathclyde, Glasgow (see www.eprc.strath.ac.uk/eprc/ and www.eprc.strath.ac.uk/iqnet).

Second, the relationship between national and EU regional policy is very variable. In some cases, EU regional expenditure has been channeled rigidly through the already existing funding circuits of regional policy (Germany, Austria), while elsewhere the implementation systems for the Structural Funds are more distinct (UK, Sweden). Over time, there is some evidence of convergence – in particular, the administrative lessons of the Structural Fund implementation are influencing the delivery of national regional policy.

Third, implementation of the Funds over the past decade has been characterized by management deficits at every level, especially during the early programming periods. At *regional level*, initially it was often anticipated that program management could be accommodated within government departments or agencies, many of which had no experience or frame of reference for designing regional strategies or managing multi-annual programs. At *Member State level*, many national regional policy officials were often suspicious and critical of the policy objectives and implementation requirements of the Structural Funds and, in some cases, showed resistance to these. It usually took 4-5 years for the respective officials to appreciate the terminology and procedural requirements of the Funds and introduce appropriate management and monitoring systems. Institutional inflexibility hindered integrated approaches to implementation and this is still widely the case. And at *Commission level*, the management and resource capabilities of Commission services were inadequate to deal with the administrative complexity of the Funds, resulting in the familiar litany of complaints – endemic delays, complicated decision-making processes, bureaucracy, lack of co-operation between DGs, inconsistent advice, etc. Unfortunately, these problems are not yet wholly behind us. The management of the Funds has improved greatly – at all levels over the past decade – but problems still remain.

Within this broad institutional context, the approach to *programming* has been highly differentiated. A common feature is that the programming process is one of incremental learning, with considerable improvements usually resulting as time progresses. This is clearly illustrated in the *regional development strategies*. The early programs, launched in 1989, were often viewed as mechanisms for simply drawing down EU funding and exerted virtually no strategic direction over the program. Single projects were assessed on a project-by-project basis with little overall strategic orientation and they were dovetailed to fit pre-existing organizational plans, programs, strategies or schemes.

Over the past decade, however, the concept of multi-annual programming has become more firmly embedded and is widely viewed as more conducive to efficient and effective planning than annual 'wish lists'. Most of the recent programs provide more explicit strategic objectives (employment commonly being the main focus) that have better links to the specific priorities and measures for implementation. In the best cases, clear and targeted strategies are rooted in detailed analyses of the local economy, provide concise mission statements around which organizations can unite and bring a coherence to practical regional development which was often previously lacking

Compared to the first programming rounds, the more recent strategies cover a wider range of priorities, with increased attention being given to business development, R&D, technology transfer and environmental issues. This is mainly at the expense of physical and economic infrastructure projects – although these still play a more prominent role in the larger Objective 1 programs.

Sectoral or thematic targeting has become more common. Training measures are now appearing, for example, which are tailored to the requirements of different groups (e.g. the employed workforce, the unemployed or disadvantaged, or specific sectors and skills) and business development measures distinguish between the needs of different types of firm (e.g. new entrepreneurs, craft firms, firms in declining sectors, high growth enterprises and inward investors).

These examples are drawn from the particularly good programs, but many other programs do not show this level of sophistication. A key criticism, which has been leveled at the majority of programs, is the difficulty of integrating the priorities of the European Regional Development Fund and the European Social Fund within single strategies. This is largely related to the separate institutional structures for implementation found in most of the Member States, as well as in the European Commission.

The ‘horizontal priorities’ of *sustainable development* and *equal opportunities* have been increasingly pushed by the European Commission throughout the 1990s. The more explicit incorporation of both these priorities has been evident in more recent programs, the full horizontal integration of these is, however, still a longer-term goal in most cases.

At the start of the 1990s, institutional deficits meant that programs were disjointed in management and administration. The administrative culture of the EU was very different, and adaptation of national practices was initially slow. Management and delivery systems have matured significantly since then. Departmental barriers are being broken down with more integrated relationships, and greater strategic planning has often drawn otherwise disparate actors together. A key factor is the leadership of the programs: key individuals are crucial in leading programs with ‘strong, clear-sighted leadership’ needed for effective strategic management and also partnership.

Partnership is one of the most disputed and difficult principles of the Funds, basically because it means people from different organizations and institutional cultures, with different interests, priorities, expectations and ambitions, having to co-operate and work together in pursuit of shared goals. At the start of the 1990s there was very little partnership, and it was generally characterized by vertical and horizontal tensions between institutions and the exclusion of key groups. The process of preparing development plans and managing programs was dominated by the major partners, often national government authorities. As the decade continued the partnership principle has become more embedded and the preparations for the most recent 2000-2006 programs have seen the greatest level of partnership participation and consultation yet.

There are several distinct developments in this area: First, the membership of partnerships is expanding, and regional level representation has significantly increased. Further, more social partners, voluntary and community groups are becoming involved – although this is not a universal trend. Second, there is evidence that communication and coordination between actors at regional level has improved. Especially in unitary states, collective regional strategic thinking, planning and co-ordination has been introduced for the first time or rediscovered. The Funds are promoting better contacts between the public and private sectors, economic development organizations, voluntary organizations and other bodies.

What are the *lessons learnt for the future*? Drawing all these comments together, there is clear evidence through the 1990s of an overall improvement in strategic direction, program management, project delivery and partnership in the Structural Fund programs. However, wide differences between programs remain and the dissemination of good practice, or at least potential practical solutions to common problems, is not always widespread. The programming requirements of the new 2000-06 period are, if anything, more demanding and complex and concerns already exist among program managers about the associated administrative burden.

The fact that effective programming is a learned process, sometimes over a considerable length of time, emerges very clearly from the experiences with the Structural Funds during the last decade. The challenge is how to use this expertise in light of the future accession of Central and East European countries to the EU.

The accession of the candidate countries implies that this will be the last period of assistance for many of the current Structural Fund regions. This calls for embedding structures, systems and initiatives to ensure that they will benefit longer-term efficiency and effectiveness. Therefore many of the current Structural Fund programs will be focusing on supporting projects, or experimenting with instruments, that are self-sustaining in an attempt to ensure durable economic structures for the future.

The exact framework and regulatory requirements, which will govern future EU structural and cohesion policy in the current candidate countries, is not yet known. There have been calls for a fundamental re-think of EU policy in the light of the economic situation of the candidate countries and the new patterns of regional disparity, which will result from enlargement. The outcome is far from clear. However, a key lesson of the past ten years of Structural funding in the current Member States is that the effective and efficient preparation and administration of Structural Fund programs is not a process that can either instantly or easily be introduced. Rather, the learning curve is steep and presents different challenges depending on the particular institutional make-up of each country.

3.2 Structural Funds in Poland – Challenges and Options[17]

The presenter drew his observations from his hands-on experience from managing the PHARE Programme funds during the mid 1990s, as he was responsible for managing more than 200 million EUR passing annually to Poland. Since 2000 the annual EU funds for Poland increased to 920 million what made it an important item in the local public finance. The funds will further increase. At the Berlin summit it was agreed that 3750 million EUR would be allocated to the 10 candidate countries for spending for 2002. The problem is that at that time, most probably, none of these countries will be able to use them as EU members. Another problem is with the absorption capacity and the efficiency of allocation in given countries.

[17] This section summarizes the presentation by Jacek Szlachta.

The *pre-accession funding* has two priorities that are not compatible: on the one hand it aims to bring the accession countries to a full membership as fast as possible; on the other hand, it aims to prepare these countries for a prudent implementation of the EU structural policies. The problem of co-ordination of these priorities is very difficult to accomplish. While Poland has been able to introduce successfully the ISPA Fund, negotiations about the introduction of SAPARD Fund have been at a deadlock. The main weight of the preparation for the structural funds rested in the meantime on the PHARE-2 scheme and its three projects – Social and Economic Cohesion, Institution Building, and Cross-Border Co-operation.

It became a principle in the recent Polish policies that decentralized decision-making play an important role in fund allocations. The problem is that the EU financial instruments are allocated to different ministries, so the sectoral and the regional approaches to management are at conflict. The Polish regional organization was created with an aim that their regional governments should take responsibilities belonging to NUTS. Brussels first did not agree that all 16 regions would become automatically the agents of structural funds. A partial participation was later agreed for some of them with a potential widening of the scheme in the near future. Thus in 2001 11 regions are involved in the preparation for the structural and the cohesion support. The problem of matching funds was solved by amalgamating the domestic resources from central budgets with those of the regions with the provision that the role of the regions would grow in the meantime.

Another important agenda deals with assigning a leading managerial role in the structural funding to only one of the ministries. The Ministry of Economy seems to be the winning candidate, though the positions of the Ministry of Finance and the Ministry for Regional Development have been also strong. The danger of politicization and changing the process of management into an arena of a struggle for power is extremely large and the governments should avoid it. Another decisions deals with setting a programming system that would allow for a smooth transition of the pre-accession conditions to the different post-accession conditions. The strategy of the National Development Plan has therefore to be adjusted to four structural funds plus to two priorities of the cohesion funds. The plan was broken down to 16 regional parts, however, transport infrastructure and environment will be kept at the sectoral level.

The outlined system should become fully operational before 2004 when the EU accession is expected. That is a demanding task, which will be controlled from three sides. First, it is the efficiency of the public administration that must be improved. Second, it is the financial dimension. For example, the matching domestic funds were upgraded from 25% to 37% (and potentially it can be even more) in order to keep up with the level of efficiency of cohesion projects; this implies a large domestic fiscal burden. Third, there is the structural dimension that deals at the level of localities and industries.

As to the traps of an efficient use of structural funds, one should mention attempts for re-centralization of regional policies or an excessive concentration on infrastructural projects. Bureaucratic approaches that fail on programming, monitoring and evaluation of the efficient absorption of EU funds may result in serious economic losses that will keep the whole economy at low stages of development, and at the same time undermine the future success in competing for EU support.

3.3 Management of Pre-Accession Instruments and Preparations for the Structural Funds[18]

The presentation touched not only on the Hungarian experience but also more on general issues that were relevant for national success in the usage of the EU structural support. The currently existing pre-accession funds are temporary and soon they will have to be transformed in the following way: PHARE to ERDF and ESF, ISPA to Cohesion Fund, and SAPARD to EAGGF/FIFG. The funding will be not only more than doubled but also the existing procedures in these instruments will have to be upgraded to more demanding standards valid in the successor schemes. The deadline for transition is 2006, at the latest. By that time the total EU budget for these instruments will be 108 billion EUR, with the net increase being nearly completely dedicated to the new members. Thus in 2006 the incumbents will actually get the same amount as they did in 2000, notwithstanding their growth. Hungary is expected to get 1.5–3 billion EUR from the cohesion and structural funds around 2006 when the 4% limit relative to GDP will be reached. Compared to the present level, Hungary will spend up to 12 times more, what presents a challenge to the administrative and institutional parts of the programs.

The question is if the PHARE programme contributed to the ability of the candidate countries to cope with the structural funds. Here one should be rather critical. Mind you that the relationship between the association countries and the Commission has been unequal. On the programming side the donor dominated the agenda. In the requirements for co-financing the EU had a strong leverage on domestic policies of the beneficiaries. On the side of implementation PHARE worked on artificial, arbitrary and inefficient principles that had little common with how the structural policies are used. For example, the EU was not flexible and enforced the same implementation principles on all association countries irrespective of their national procedures, getting thus their initiatives into a sort of straightjacket. On top of it, the enforced principles have been separated from the policies and financial mechanisms applied both at the EU and at the national levels. As a result, PHARE could even block the internal domestic developments that aimed at the priorities of harmonization and cohesion. Thus it created parallel structures, confusion and bureaucracy. Reports of such institutions like the OECD pointed out that there exists a prolonged mismanagement in this respect. Contrary to expectations, the managerial techniques of the Commission cannot be compared with up-to-date approaches of project management. For example, the techniques of program performance or the project cycle management techniques have been only currently introduced. Not surprisingly, evidently weak projects were approved while potentially successful projects were declined.

It should be mentioned that, with approaching the stage of a switchover to structural funds, improvements are under way what includes decentralization and integration of programs for sectors and regions. Further changes are required in the institutional aspects, such as the building of partnership on both the horizontal and vertical levels of management where autonomy for decision-making is important. The centralized powers should be redistributed and they should follow the pattern of the

[18] This section summarizes the presentation by Péter Heil.

funding structures. This process will have an impact on the increase in competition that would require a revamping of the competition rules.

One message is certain: in Hungary the regions showed the will and the ability to cope with demands for an efficient system of public structural investments. There still exists a large space for improvements on both sides of the project management, but the development policy has been showing recently encouraging results.

Discussion of Previous Three Presentations

A discussant asked about the management structure of funds in Poland. It was mentioned that Poland had worked out more than 20 operational programs (16 of them are regional). Does this imply that there were established as many management authorities? Would it not be better to centralize the programs and have fewer management institutions? Another question referred to the experience of the East German accession. If we compare the extent of resources invested into cohesion in East Germany with the real results, then we cannot do else but have doubts whether the much more limited EU structural resources could strike a difference and bring results that are expected.

Jacek Szlachta responded to both questions. For a large country, such as Poland, the center must rely on both the regional and the local level. The role of the latter is crucial and in Poland it controls approximately 22% of the budget. The majority of the projects are co-financed also at the local level. The dispersion of users at the local level is a disadvantage, thus the regional bodies must co-ordinate their activities and represent them in the negotiations with the centrally positioned organizations. In Eastern Germany there was an excessive belief in the ability to manage the allocation of structural funds from the center, but the results were not satisfactory. We think that in Central Europe the funds can be allocated more efficiently. If Poland joined EU in 2003, we expect up to 22 billion euros for EU assistance in four years, plus 8-9 billion from public national funds and 5-6 billion euros raised from the private sector. Such amounts cannot be spent on few projects managed from the center. We must therefore expect that the initiative will come from the regions and the local authorities. The EU authorities often do not understand this Polish specificity and try to apply on us a model that fits smaller countries.

Péter Heil responded very critically to some comments. It is an inadmissible simplification to argue that the problem of funds is a central political issue of accession. The misunderstanding is on both sides of the negotiating parties. First, for claiming that funds are crucial for making the accession attractive enough for poorer candidate countries. Second, for resisting the admittance of new members from transition countries on grounds that it would be too costly for the incumbents. We must see beyond the lobbyist bandwagons hidden behind such statements. In fact, we should argue that the Eastern enlargement does not represent only costs on the EU side. Firstly, there is a condition agreed in Copenhagen that the transition countries could join only if they are transformed and the cost of that must be borne in principle by themselves. The annual cost of EU through PHARE represents in this case a mere 10 EUR per capita! That is much less than what were the costs of EU for the accession of the four cohesion countries, estimated to be 400-500 EUR per capita. The cumulated FDI inflows to

Hungary have been 2000 EUR per capita – this all makes the discussion about the EU costs of transition less relevant.

Secondly, we should not expect any major shock to occur after accession. For example, today the share of high-tech sector products in Hungarian exports to Germany is higher than the same share in Austrian exports. The industrial and financial sectors are internationally competitive without interventions. The transfer of funds after accession will not be a crucial condition for the further development in the majority of accession countries. It is simply the interest of the EU to follow its regional cohesion policies in order to expand the potential of the single market as a whole and bring benefits to all EU members. Based on the Ceccini Report, the impact of approximately 100 million new consumers from the accession countries will bring the EU countries as a whole on a higher growth path. That would imply that for the period of mere 8 years the benefits of enlargement could finance the whole EU budget and not only the additional transfers to accession countries. It is also in the interest of the current candidate countries that the EU transfers are used efficiently because otherwise they would waste the local funds used for co-financing. Heil emphasized that he believed that the regional management of the EU financing was both more efficient and more compatible with democracy than the alternative approaches.

Ruth Downes responded to the discussion with an idea that structural funds are not a panacea for fostering growth in member countries. The decisions at the national framework and the national strategy of development play a much more important role than the structural funds, and the EU funding does not have a potential that could reverse or significantly improve the internally generated pace of restructuring. The EU structural funds should be therefore looked at as an additional leverage on speeding-up the existing development in some of the less fortunate sectors.

The decentralization of management of funds depends on the conditions and traditions of the country. In federal countries, where the existing regional bodies have been for a long time used to operate on various public investment programs (e.g. in Germany or in Austria), the situation is different from the originally centralized countries where the regional management had to be newly established. For example, in the Swedish case the implementation of funds was completely regionalized at the county level. In some unitary countries (Portugal, Spain) there still remains the central control mainly in Objective 1 programs. In Britain (particularly in Scotland) semi-private executive bodies were set-up that were entirely responsible for the selection of projects, discussion with the project applicants and tailoring those to positions required for a successful financing and implementation of the project.

4. The Rationale, Importance and Effectiveness of Principles of EU Programs: Subsidiarity, Additionality, Concentration and Co-financing

4.1 Some Reflections on Costs and Benefits of EU Programs: The Austrian Experience since 1995 [19]

The division of competences between Brussels and the national or regional authorities has always been a moot point. Why should Brussels know better than national capitals or regional authorities about their own development needs and priorities? The EU level depends naturally to a very high degree on member-state administrations and on the expertise of local private businesses.

The small staff and the internal organization of the Commission do not keep the with the growing amounts of money and the width of programs, which the Commission has been asked to administer. The Commission is in fact a small player. The EU budget amounts to only 1.2% of GDP in EU countries (out of it a half is spent on agriculture), while public expenditure in the member states amounts to 40-60% of GDP. Therefore 80-85% of the annual EU budget is channeled through member states' administrations whose efficiency and cultures differ a lot. Thus the unified legislation and procedural techniques are being designed for the less perfectly working administrations. This results in detailed legislations and extensive informative feedbacks in all the member countries, even in those countries that consider it excessive. Procedures applied are overly complex and bureaucratic. The smaller the program, the higher the share of administrative and transaction costs. There is also an information asymmetry by which the units closer to the implementation level could gain advantage and dominate the center.

There are certain managerial rules that are used to overcome the conflict of interest at various hierarchies of the EU decision-making. Firstly, there is the principle of *subsidiarity* that reflects the fact that the solution to problems and the control of costs should be undertaken at that level of hierarchy, which has the best information. If the relevant information exists at the grass roots, then the decision-making should be decentralized to the local levels. The central level therefore should intervene only in case of large deviations from the aims and retain the control over strategy and rules. However, the most powerful institutions remain in the middle – with the governments and the parliaments of the member states. They also demand a share in decision-making. Thus the principle of subsidiarity is complemented by the principle of *partnership* that is addressed to all potential parties concerned – the Commission, the central and the regional governments, the local authorities, NGOs, social partners, etc.

The presenter of this paper expressed her opinion that the notion of partnership under such circumstances is in fact an attempt to use the principle of partnership as a substitute for the real subsidiarity where the initiative from below is too strong. The hierarchical communication at the level of subsidiarity could be thus converted into a horizontal communication at the level of partnership. The decision-making becomes

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[19] This section summarizes the presentation by Silvia Zendron.

spread over a too wide field and its transaction costs rise. It reveals the existence of some problems in the administration of the EU regional policy, especially in the management of structural funds. It may be interpreted as an attempt of the center (the Commission) to weaken the national level by communicating directly with the regional authorities where the center can still dominate the field. One can have doubts whether the new procedures for 2000-2006 will lead to a reduction of the overall administration costs at all levels. Or rather, the burden of day-to-day implementation has been partially shifted from the EU onto the national level, while the strategic decision-making and possible sanctions remained with Brussels.

The principle of *co-financing* has its rationale: the European Commission wants a high leverage and a multiplier effect of EU money. Subsidized programs shall attract additional public and private resources, which would otherwise not be made available by the member state. Thus the EU shares the risks, the costs and the expertise in decision-making with the host countries, regions and localities. But there is also a burden sharing between the federal and the regional levels. The latter try to maximize the federal level's commitment. In Austria, the shares in total national co-financing until 1999 were 1/3 EU against 1/3 at the federal level and 1/3 at the regional level. For 2000-06 the rules changed according to the type of programs:

Regional programs:	0% EU, 4-6% federal, 5-6% regional, 70% private;
Inter-regional:	50% EU, 20% federal, 20% regional, 10% private;
Objective 3 (unemployment)	50% EU, 50% federal funds.

Austria's contribution is approximately 2.5% of the EU budget, while its share in the structural funds' receipts is 0.71% representing 260 million EUR annually. That means, for each euro received, Austria must pay 3.5 euros. In addition, each euro invested from the EU funds is matched more than proportionally by domestic co-financing. For Austria the structural funds are the most expensive form of subsidies. From the economic point of view the EU subsidies suffer from the same inefficiencies as the national subsidies. In fact, they are biased to even higher inefficiency. They are considered by investors (as the users of funds) as a windfall gain that does not count. Thus the providers hedge and try to earmark the funds, so that they are used "appropriately". That helps to avoid the most flagrant abuses but, on the other hand, it decreases the flexibility of the highly entrepreneurial inventive investments.

Politicization of the structural programs is another serious problem. Politicians tend to consider the EU subsidies as money that widens their room for maneuvering. Thus they introduce into the decision-making also their own criteria related to their political ambitions and/or expected impacts of funds on re-election of their parties. They support projects giving them good image in the media and projects where they have their electorate. The time horizon of politicians is short, so they prefer short-run effects.

The improvement in the performance of investments through EU funding is expected to come if the system of grants is superseded by financial engineering. That means, by a technique that has been successfully applied in the private corporate sector. Higher involvement of the private co-financing, private guarantees, seed capital and development-capital funds in the projects that are supported by structural EU funds, is very important. Such improvements, like the guidelines introduced by the "programming system", have been an innovation in investment management for many of the member states. After looking at the developments from the perspective time horizon, one can discover that the EU's new approaches to investments are often more innovative than the national aid schemes.

Table 2: Structural and Cohesion Funds: Annual Average Receipts of the Member States – data for past 5 years and expected future developments**

Member states	EUR million, at 1999 prices		Percent of national GDP of 1999	
	1995-1999*	2000-2006	1995-1999*	2000-2006
Austria	234	262	0.12	0.13
Belgium	343	291	0.15	0.13
Denmark	127	118	0.08	0.07
Finland	260	299	0.21	0.25
France	2245	2238	0.17	0.17
Germany	3644	4252	0.18	0.21
Greece	3171	3555	2.70	3.03
Ireland	1313	568	1.57	0.68
Italy	3718	4237	0.34	0.39
Luxembourg	11	13	0.07	0.07
Netherlands	443	469	0.12	0.13
Portugal	3154	3251	3.03	3.13
Spain	7477	8036	1.34	1.44
Sweden	251	312	0.11	0.14
United Kingdom	2270	2371	0.17	0.18

Source: Austrian Ministry of Finance, Division II/4, 2000.
* Commitment Appropriations
**Adjusted for transfer of EAGGF-Guidance expenditures shifted to category 1 in 2000-06.
Cohesion Fund: average for 1993-1999

The phasing-out of funds for some regions or for some countries is a serious political issue that will be challenged by the present receiving incumbents. Table 2 gives an overview of data for 1995-99 and compared it with the expected appropriations for 2000-06. The cohesion funds are more important as a vehicle of politics of the EU than as an economic instrument. It would be administratively much simpler if the net payers would not have the right to receive the structural support at all. However, such an arrangement would be extremely difficult to defend politically.

4.2 The Poor, the Unemployed and the Naughty – Some Good, Some Bad and Some New Ideas on Allocating Structural Funds Among the EU Members[20]

This presentation aims at being more analytical than the rest, by focusing on the behavioral characteristics of the system, rather than on empirical facts. It emphasizes the

[20] This section summarizes the presentation by Christian Weise.

existing conflict between the economic and the political aspects of the EU support system. Politics seem to be an impediment to the continuation of the whole system in the long run and it also weakens the economic efficiency of the structural funds. The current system has some elements that allow the management to meet the economic objectives: program planning, the principle of co-financing, speeding-up the adjustment of the poor, concentration on the human capital, infrastructure and productive investment, and the control over the absorption capacity.

If we turn to the critical aspects of the structural policies, we have to look first at the focus on fighting unemployment, a target that politics in general, and policies of national government, in particular, prefer. The structural funds, however, fail to address the inherent economic causes of unemployment. The incentives offered by the Structural Funds may therefore be wrong. At the same time there seems to be little evidence that by defining the eligibility criteria by low relative GDP per capita levels would provide a link for addressing also the high level of unemployment.

The second questionable idea is whether it is rational to follow blindly the Agenda Approach where all members are expected to get the same treatment. According to this scheme the position of beneficiaries is not symmetric, because incumbents would receive too much, while the accession countries too little of the available funds. Bargaining for the funds has showed a mentality that the structural funds are subsidies, and fighting for these funds included too many “bazaar” elements. In an enlarged union this would mean insufficient concentration of funds to meet the objectives of the structural funds system.

In order that the transfers to the Eastern accession countries achieve a sufficiently large scale to have a visible impact, we can ask the following question: how can the present 15 EU incumbents save in order not to inflate the required total budget? There are various approaches that would lead to different results. For example, the scheme for inter-governmental compensation will hardly save any resources. The rule that the accession countries should get the same amount of funds that the cohesion countries received in 1999, would result in an annual saving of 20-25 billion EUR. The rule that the transfers should be higher, the poorer is the country (and lower, the richer is the country), could lead to a saving of 40-45 billion EUR. If the absorption capacity of the recipients is objectively measured, and accordingly, the first wave accession countries get a transfer of approximately 3% of their GDP measured at the present PPP, and if we assume that their GDP would grow by 4% annually, then we come to 20 billion EUR of transfers per year (provided that the same rules are applied on them as were applied on the cohesion countries).

The problem with the Pre-In Support seems to be that the later it is applied, the more costly it may be in the future. Optimally, the accession countries should enter only after their structural problems (i.e. real economic adjustments, adoption of the *acquis*, sufficient development of human capital, etc.) are solved. Thus the more is done in the pre-accession time, the lesser costs will be incurred by the EU after the accession. Solidarity in this respect pays out. The presenter was of the opinion that an overstated projection of the annual growth rates in the EU incumbents at 2.5% made the future financing of the transfers look easier for the EU. However, mixing up of projections of the growth rates for the accession countries (usually put at an annual 4%) in nominal and PPP terms also make the predictions dubious.

Three new elements have been introduced to structural funds financing recently: the *national approach*, the *allocation based on rules*, and the principle of *taking into account the economic policy of the recipient member states*. The first element is based on subsidiarity what also implies regionalism. But the inclusion of growth poles and the GDP criteria at that level (as an outcome of the Lisbon agenda) means that there will arise the danger of less reliability of the data. The second element, concerning the allocation based on rules, is a reaction to the present situation when the allocation is based on the negotiation power. If the number of member states increased, for example, from 15 to 27, the former system would become very complicated. The new approach is based on the national GDP per capita related to the EU average. The individual investment ventures, however, will be still constrained by the local absorption capacity, which reflects also the efficiency and returns to investments. The recipient countries therefore must also build their Community Support Framework for these purposes.

What is crucial for the final approval of the EU support is the consideration of the parallel support from the national economic policy. The criterion used is the orientation of the national policies of the recipient countries on growth rather than on distribution. The problem here is which policies are growth-enhancing and how to measure their outcomes. One could consider looking at the *ratio of public expenditures to GDP*. Economists generally agree that a too high ratio of taxes (or public expenditures) to GDP is an impediment to growth. Therefore if in a country the public expenditure quota of GDP were above the EU average, the country should be called to revise its policies and certain sanctions applied by the union. In the second step the *ratio of unproductive expenditure* (e.g. on public servants and transfers to enterprises and households) *to total expenditure* could be considered. If it is above the EU average, a policy revision should be demanded. Full support to the planned development should be granted only if both the ratio of public expenditures to GDP and unproductive expenditures to GDP are below the EU average.

Discussion of Previous Two Presentations

A discussant expressed his doubt if the indicator of public expenditure to GDP would be useful for the EU to use as a benchmark to evaluate proposed funding for the new EU members. The candidate countries, in fact, can easily exceed the EU average when trying intensively restructure their economies. For example, their public budgets can invest heavily into infrastructure, or help with the restructuring of the industrial sector. Similarly for the other indicator (unproductive expenditures per GDP) pensions can be counted as unproductive. Would the conclusion be to cut on these expenditures correct?

Christian Weise's reply was positive. Yes, one must ask why the pensions relative to GDP are so high in that particular country and if these funds collected by the government could not be used better in some alternative way. It is also true that if the share of public expenditures on GDP has been generally rising in time, we can ask if the accession countries have chosen a correct policy, particularly if the level of these expenditures in absolute terms was also high. Therefore later this share should be decreased in order to receive additional EU funds.

Another participant expressed his view that the fiscal policy indicators are not the best ones to evaluate support to be granted for development policies because there are large differences between the frameworks where they are used. Some wage policy indicators could be used instead, particularly the unit labor costs. For example, in East Germany or in South Italy the EU funds were spent on activities where the wages were far away from the productivity.

A discussant asked about the Austrian experience. What were the reasons that in the first years of membership Austria did not use all the funds that were available and to which Austria was entitled?

Silvia Zendron replied to this question: The programs Austria proposed for the usage of the structural funds were approved very late and thus the funding was just postponed for later years. In the more recent period the rules changed and the funds are available for spending in a firmly stipulated period. The creation of a status of pure net recipient in any country is not recommendable, be it regions or sectors. The principle of participation in the costs and sharing of risks has proved to be a more efficient strategy.

A workshop participant commented that the so much criticized bargaining among the members of the EU about the extent and the conditions for the usage of structural funds is in fact a constitutive element for the existence of these funds. Each enlargement and each major policy change (e.g. the EMU) offer new potentials and new challenges that require a new structure and new ways of operation. The widening of this scope is also reflected in the increases in the amount of structural funds. The discussant also pointed out that the rule that the intensity of the EU support should be higher, the lower is the GDP per capita contradicts the principle of co-financing. If a country is poor and needs more EU funds, it is less capable to support large inflows of funds by its own co-financed resources. What are the solutions to this dilemma if the rules of the game should be the same for all countries? Would it not be better if the rate of co-financing would be lower (e.g. by 25%) for the less developed countries?

Christian Weise responded to the latter questions with an argument that the percentage of co-financing is a relative term, as is also the maximum amount of the structural funds in terms of GDP. Therefore the latter indicator ensures that the support funds, even for a poor country, do not present a risk that the domestic co-financing would not be able to provide sufficient matching. The problem is in the absorption capacity that can be higher in some poorer regions than the limit up to which these countries were eligible for receiving funds from the EU.

5. Macroeconomic Effects of EU Financed Programs: Demand Side Effects, Supply Side Effects and Problems of Absorption

5.1 Macroeconomic effects of EU Financed Programs[21]

The aim of this presentation was to inform the participants about the macroeconomic experience of the so-called “cohesion countries” with the EU financed

[21] This section summarizes the presentation by Sarantis E. G. Lolos.

structural programs. The impacts are evaluated from the point of view how the policies succeeded in fulfilling the objectives of the EU support. The methodology proposed should also allow for comparing the efficiency of alternative investment decisions.

The structural funds are targeted in accordance with the following objectives:

- Promoting the development and structural adjustment of regions whose development is lagging behind (Objective 1);
- Supporting regions affected by industrial decline (Objective 2);
- Combating long-term unemployment (Objective 3);
- Facilitating the occupational integration of young people (Objective 4);
- Speeding up the adjustment of agricultural and rural development (Objective 5).

The management of community structural policies includes the setting up of Community Support Framework (CSF) aiming at promoting growth in its regions and the Operational Programs that are co-financed by EU transfers and national sources (public and/or private). The intensity of the CSF spending is illustrated in Table 3.

Table 3: The Size of CSF Spending in the Cohesion Countries

Indicator	Greece	Spain	Ireland	Portugal	Four countries total
1989-1993					
Total interventions (1994 ECU bn)	17.5	30.3	11.4	21.7	80.9
Total interventions in % of GDP	4.4	1.5	5.8	6.0	2.8
Community interventions in % of GDP	2.6	0.7	2.6	3.0	1.4
National interventions in % of GDP	1.8	0.8	3.3	3.0	1.4
1994-1999					
Total interventions (1994 ECU bn)	34.8	82.2	13.1	31.8	161.9
Total interventions in % of GDP	6.9	3.1	4.2	6.6	4.1
Community interventions in % of GDP	3.5	1.6	2.4	3.7	2.2
National interventions in % of GDP	3.4	1.5	1.8	3.0	1.9

The above Community funds, coming as capital inflows of the CSF, plus the matching domestic commitments of co-financing, have certain effects on the national economies. Their estimation requires the measurement of impacts in the following transmission mechanism:

Demand side:

- Public investment spending (e.g. infrastructure and investments of public enterprises), as registered in the Public Investment Program;
- Improvement of human resources and skills that implies additional personal incomes (secondary transfers to households) and additional profits of enterprises.
- Changes in the structure of productive capacities and the competitiveness in trade that have impacts on the aggregate demand structure.

Supply side:

- Long-run improvements in the productive capacity of the economy due to investments into physical and human capital in various sectors.

CSF evaluation methodology is based on traditional cost-benefit analysis (usually at the microeconomic level) or on macroeconomic structural modeling and its empirical testing by using alternative development scenarios. In the past, the CSF impacts on cohesion countries were modeled by a variety of macroeconomic models such as: computable general equilibrium (CGE), input-output and various econometric models. The presenter concentrated on explaining the latter approach. There the demand side was described by behavioral equations for consumption, private investment, government expenditure, exports and imports. The supply side of the model included the determinants of the productive potential, such as infrastructure, labor, human capital and investments (physical capital) as well as their impacts on the output. The analysis of employment effects required the data on the labor market (labor demand and supply, including labor migration). The government sector had to be broken down into various types of expenditure and the types of goods and services provided.

The empirical ex-ante estimation of the CSF effects (estimated for Objective 1 support) revealed that the impact on growth could vary by economies. For example, for Portugal the average annual growth rate in 1989-1993 was estimated to increase by 0.7 percentage points - from 3.4% (without CSF) to 4.1% (with CSF). For Greece it was by 0.5 points, while for Spain, Italy and UK it was by only 0.2 points. The impacts on GDP for 1994-1999 were even higher in all of these countries, ranging between 0.6 and 1 percentage points. The expected impact on job creation, albeit lower in terms of growth rate than for the GDP, was also significant.

There are three conditions for a successful estimation of the CSF effects on the economy:

- that the model describes the economic conditions for development correctly;
- that the CSFs are fully absorbed in the amounts committed (what influences the demand side of the economy);
- that the CSFs are efficiently implemented (what influences the supply side and the managerial capacities responsible for investment).

The obvious next question is: how the estimated impacts have been actually realized in the real economies? It was assumed that the real effect should be lower than the hypothetical effect because not all CSF expenditures could be absorbed under ideal conditions modeled ex-ante. Some of the funds were not absorbed, or the marginal efficiency of the additionally provided production factors (mainly in the fixed capital formation) could have diminishing returns. The shortfalls in the real effects can be thus further analyzed by the model and unveil the causes for such frictions. Economic policy can therefore react and deal with the impediments.

Conclusions:

- The quantitative assessments of the CSF on recipient economies show that its effects are significant, especially for the less developed economies.

- The effects have been increasing in time, as the CSF was larger and the management of funds was improving.
- In case we assume that the co-financing domestic funds were not be invested without the CSF, then the impact on growth should be taken as double of the results we have estimated for the CSF alone.
- The learning of the participants at all levels (EU, central national, regional and local) and the improved governance of CSF has positive effects on the global efficiency of CSF.
- CSF has an externality effect on the economic policies in the recipient countries, since the management of CSF reveals various local leakages, frictions and inefficiencies and exerts a pressure for their removal.
- The Euro-solidarity towards the South European regions has been particularly important for their real economic convergence to the average EU levels of income. Without it the closure of their development gap would most probably not be possible.

5.2 EU Transfers for Poland: Problems with their Absorption[22]

The presenter declared her position in the analysis of the EU transfers as that of an observer detached from both the policy-making and the management of respective funds. According to her observation, the aim of various national agents to maximize the volume of support fund commitments from the EU is missing the point of economic substance, or at least it is stressing a point of secondary importance. The essential thing is how effectively these funds can be used. We can also ask if the proper absorption means to use all the funds available and what policies should be used for their management. The ambiguity in practical approaches was apparent immediately after the publication of the document Agenda 2000. In Poland discussions were characterized by two different approaches: whether the funding proposed will be sufficient for the country, and whether the existing procedures for administering and managing the funds properly are adequate.

According to the Agenda 2000, the - by then - new member states should receive 5830 million EUR in 2003 from various EU support funds. The Polish share is expected to be 3600 million, what is, without doubt, a significant amount. One of the practical approaches to its efficient absorption is "learning by doing" what, in fact, could be appropriate for the case of PHARE support. Unfortunately, the future EU funding will be significantly larger than what PHARE used to be and the national losses caused by their improper use could become too hazardous. The Polish problem now is how to disperse the specific knowledge that was acquired so far in the five poorest regions that were the recipients of EU structural and development programs. This transmission of the know-how will certainly bring Poland more value added, than the fight for more EU commitments. Provided that Poland received as much from the structural funds in 2003

[22] This section summarizes the presentation by Elzbieta Kawecka-Wyrzykowska.

as calculated in Agenda 2000, there could be a serious problem with their absorption and efficient allocation if local procedures and governance would not be changed.

Co-financing must not be treated as an additional cost of using the structural funds. We can not rely solely on Brussels for financing our regional adjustments. It is domestic regional investments that should be efficient in the first place. The other problem of co-financing is to have it available in sufficient volumes when the national budget deficits lead to expenditure cuttings in general, or when fiscal and monetary stabilization policies become restrictive prior to the commitment of the exchange rate pegging in the framework of the EMS. The national governments should assign this agenda a high priority and build the working principles and policies in advance. Poland should learn from the Spanish experience when during the first year of structural support Spain paid more to EU budget than what it received because of the local inability to generate projects that could meet EU requirements. Generating appropriate projects, however, rely not only on the local capacities. The procedures for acquiring, implementing and completing the structural projects require an enormous paperwork that does not seem to be related to the substance of efficient investment. It would be rational to press the EU for simplifying the procedures of the support programs .

Because the Polish government has doubts that the structural funds could be absorbed at the volumes outlined, the present accession negotiations aim, among others, at derogations on a part of the budget contributions. If we analyze the effects of the EU assistance on the accession countries' economies, the demand-side effects turn out to be short-run, while the supply-side effects are those that influence the long-run developments. The problem is what policy instruments should be introduced into the governance of EU funds so that the former effects do not dominate the latter ones. In fact, the productive competitiveness of the regions should be the main criterion for making strategic decisions. Surprisingly, it is also a quite recent development in the discussion among incumbent EU member countries that the distributional aims of the support schemes should not dominate the productive aims. As a consequence, an eligible region that is not the poorest but that is able to propose an efficient project, should receive a priority over a less efficient project from the poorest region. The presenter suggested that it would be more suitable to help the poorer but less efficient regions with assistance schemes that aim at education and human capital development.

Discussion of Previous Two Presentations

A workshop participant referred to the problems of estimation of CSF impacts. The presentation of Sarantis Lolos has shown an optimistic picture, especially in the Greek case. We can often hear a different message from other sources where the Greek experience is depicted as less forward looking. Namely, that it took longer to learn how to use the CSF efficiently and how to solve the problem of deep initial deficits. Is there an advice what the accession countries could learn from Greece in order to avoid falling into the same pitfalls?

Another participants remarked that the Greek co-financing of 50% looks too high, once only 25-40% would be sufficient for running the project. Why was there decided about that excessively high national contribution?

A discussant turned to the methodology of macroeconomic modeling of the effects of economic assistance. As there are so many different models with different results, there are also questions asking which model offers the correct estimations? In fact we should consider them as a whole. Some models, such as the input-output models, illustrate very well the effect of the industrial structure and the demand-side spillovers. The HERMIN model shows nicely the differences between the demand and the supply sides, while the QUEST2 model, based on forward-looking expectations, provides feedback on crowding-out, real interest rate and exchange rate effects. The applications of the HERMIN model have received recently a particular attention. The expected developments in the majority of accession countries have been already tested through its simulation exercises.

If we consider the three most standard absorption problems – those related to administration, co-financing and the macro-economy – the first ones are not so difficult to solve if the institutions are set up correctly. The last one is more resilient. For example, there may arise the so-called "Dutch disease" problem when the massive inflows of capital boost a part of the economy, but the real exchange rate appreciation destroys the competitiveness in other sectors. The discussant was not aware of any macroeconomic model that would provide information to what extent the accession countries were liable to such adverse effects.

One workshop participant expressed his view that in measuring the effects of EU support funds the single criterion of GDP growth may not be sufficient. What also matters, for example, is the change in investment and the impact on inflation. A higher inflation with the presence of funds than the inflation expected in the basic scenario leads to a conclusion that some of the investments were not used in an efficient way and the domestic supply response was not very flexible.

Another workshop participant emphasized that the development of regions and the co-operation over investment programs in organizational hierarchies are associated with the development of democracy and the support of social stability. It means that national decision-makers (e.g. the governments) should have a long-term vision, let us say for 10-15 years, that goes beyond the scope of the "electoral political thinking". That would require establishment of institutions that are able to safeguard the continuity of the "vision". The European Commission and its structural funds are (or should be) a part of such an institutional arrangement.

A discussant said that it would be important for the regional development to accumulate a critical mass of structural investments that could ignite a sustained growth even for the period when the EU financial injection would be withdrawn. The policies applied for this objective can vary by countries. In some cases it may be just to provide sufficient financing, but in other cases one needs investments into knowledge and human capital in addition to given financial commitments.

The discussant raised the question of coherence of the EU transfers and the Maastricht criteria based on an hypothetical situation. Let us assume that the capital inflows from the EU are 3.5% of the GDP, and originally the state budget is fully balanced, and its size is of 50% of the GDP. Then the additional European Commission funds will represent 7% of the budget and lead to a net public deficit. How shall we consider the relevance of the Maastricht criteria and criteria for adopting the euro under such circumstances?

Another participant added to the conclusions of both presentations that there are two sides to be considered if we judge the non-private inflow of foreign capital to a country: first, how much effort and expenses both in cash and in kind it requires to administer the inflows and second, what are the effects of such inflows. If 25% of the money is used just for administration and if it requires the brightest minds of the country to back up the administration procedures – it may be worth considering whether would not be better if the resources were used in private activities, outside of the bureaucratic schemes of public financing.

An Austrian workshop participant replied that that 25% of administrative overhead cost is too much. The majority of EU projects, at least from the Austrian experience, require much lower overheads. Co-financing, however, is quite a complicated concept and goes into a combination of grants, loans, partnerships, etc., so that a word "co-financial engineering" was invented to describe its procedures. The level of co-financing, in fact, can be in conflict with the budget constraints, especially in transition countries with prudent budgetary policies.

Another discussant pointed out that here the problem is if the EU funding ventures selected are really effective for the domestic economy: if this is the case, then the co-financing may go very high and the administration is simple. If, however, the effects are low, or they are visible from the EU side only, then the forced national participation can have serious problems. It would be then better if the funds are not absorbed, but used in some other country.

Sarantis Lolos in his reply to the above discussion concentrated first on the exchange rate effect of the CSF inflows. For long time, at least 30 years, Greece has used to act under private capital account surplus. Thus the whole Greek balance of payments has adjusted to such imbalances. We do not know how the part representing the EU's investments affected the exchange rate of the drachma. We know that there were three depreciations in the last 15 years. It is theoretically correct to expect that capital inflows result in an exchange rate appreciation, but we must also expect the existence of various adjustments that may not direct the economy to the contraction of the GDP or employment. Let us leave this problem to be judged by international markets.

This relates to the argument about the Dutch disease when a (seemingly positive) exogenous shock causes that the economy becomes less efficient and its growth stalls. The shock can be caused in some cases by a large foreign aid. Is such an aid worth accepting? Most probably we never get an ex-ante signal about the adverse global macroeconomic impacts of an aid. Then the only strategy remaining is to be efficient at the project management level. In that respect the Greek experience is positive, and the evolution from inefficient project management to an improved performance had taken place. In addition, we know that the supply side of the economy has received injections and incentives that increased its performance through the EU transfers. The transfers were materialized mainly in the industrial sector where they improved the quality of both physical capital and labor. The latter had also wide spillover effects. For example, in Greece 25% of EU funds go into the improvement of the human capital.

As for the estimation of effects of EU transfers, the models used give us relatively reliable estimation of the effects on the demand side. The supply side is much more difficult to estimate. It depends on the model implemented because there can be a wide choice between various theoretically expected impacts. For example, one can consider or disregard the existence of crowding-out of private investments, or assign it various weights. The vision behind the CSF is to provide opportunities to the economy that would otherwise not come. It is not a vision for picking up of winners or for decisions about the future structure of the economy. It aims at improving the conditions and the functioning of the whole economy, especially the functioning of the markets.

In the last 10 years, investments in the Greek and Portuguese economy increased faster than consumption, and the growth was also led by imports. We cannot say what was the exact share of CSF in these developments. In all cases they played a positive role. Under such circumstances the existence of domestic co-financing above the required standards (i.e. the 50:50 ratio) is not surprising. It shows that this investment was worth investing and additional domestic funds were spent on meaningful projects.

Elzbieta Kawecka-Wyrzykowska in her response to the comments explained that the process of learning by doing is especially important in the EU structural schemes. Unfortunately it takes time to have the system adjusted to a high level of performance. The accession countries are therefore in a position where inexperience, risks and uncertainty are large. Under such circumstances the possibility (and necessity) of co-financing does not attract private investors. Therefore we should expect that the domestic participation would come at the beginning mainly from public budgets.

6. The Long-Term Effects of EU Transfers: National Catching Up and/or Regional Convergence

6.1 Empirical Evidence of Regional Convergence and the Role of Structural Funds in the EU[23]

This presentation deals with questions centered round the income convergence of regions, their catching-up dynamics and the experience of cohesion countries. What kind of predictions on the likely impacts of structural funds can we make? Are the results compatible with the policy objectives? When one addresses the various schemes of structural fund spending areas and assesses both their macroeconomic and local (or regional) effects he/she has to be aware that a large part of the impacts are indirect.

It is an inherent characteristic of growth that it is not distributed evenly among regions. There are various impediments to a uniform growth by all regions and the efficiency of their elimination by policy measures also varies significantly. The empirical approach of the presenter to these questions was mainly econometric, where the hypothesis about growth factors is formulated and later estimated. The main intervention areas, targeted at the growth convergence, included investment aid, build-up of public infrastructure, and education. If we look at the convergence dynamics in Western Europe, we can observe that up to the energy crisis in 1975 the catching-up of

[23] This section summarizes the presentation by Gabriele Tondl.

poorer regions was proceeding through a natural reallocation of factors – such as labor and especially physical capital – that moved from developed to lagging regions where the yields were higher. During 1975 through 1986/1988 there was observed a period of regional divergence where the growth was endogenous and subject to innovations that were concentrated in already developed regions. Thus rich regions got richer, while the poor regions stagnated. The neoclassical equalization mechanism collapsed, and the mobility of factors from rich to poor regions either ceased or was even reversed.

After the mentioned period of divergence, the convergence of countries in Western Europe was again present since at least 1988. The incentives came mainly from the escalating integration effect, as the new export markets opened up in Europe, and FDI and other investments brought a wave of spillovers. Also the EU support policies played a new role since the Structural Funds doubled after 1987 and reached 1.7-3.6% of GDP in countries with GDP per capita lagging behind the EU average most. However, not all regions responded in a uniform pattern. Some lagging regions received new incentives and became dynamic (with growth above 3.5%), while many did not react sufficiently and had even a negative growth.

If we analyze the factors that were important for high growth in the lagging regions of the EU, we come to a conclusion that business investment, infrastructure and human capital played the most pronounced role. Therefore also the policy instruments were predominantly targeted to these fields. The presenter has shown the results of her panel data estimations where the growth of GDP in regions was regressed on changes in the accumulated private capital, public capital and human capital. The time series were up to 20 years long. The closest positive correlation was received for the enrolment in upper secondary education. Also the impact of public investment was significant, even though one had to consider a time lag for real effects of these investments to take place. On the other hand, the correlation between private investments and growth was weak.

The following conclusions can be made on policies that aim at the growth promotion in the lagging regions:

- Promotion of human capital formation is the least risky investment, especially in the new skills training programs and the upgrading of the educational systems.
- Spending on public capital formation, either directly or through its assistance programs, has generally positive yields, especially in the build-up of regional infrastructure.
- At the same time the danger of crowding-out is there, when public funding replaces the otherwise successful private activities.
- Not all physical capital investments and incentive schemes have guaranteed regional effects on growth. A part of such activities may miss the objective. Either its spending is not used efficiently or the investment goes into sectors that do not promote growth.
- On the other hand, there are lagging regions where the EU support is not essential, even though its yields can be high. For example, some metropolitan areas can attract sufficient private capital that would provide at least the same service as public investments.

6.2 The Trade-off between National Development and Regional Disparities[24]

This presentation deals with the link between national development and regional disparities measured mainly by the indicator GDP per capita. This relationship is not a linear one. It should be mentioned that this hypothesis was actually formulated first in 1965 by Jeffrey G. Williamson (see Figure 1 and the comments underneath). High national growth in modern economies is often concentrated in few regions ("growth poles") enjoying agglomeration effects caused by innovation spillovers. Thus, in the early stages of catching-up, regional disparities among regions rise. Over time, however, diseconomies (such as congestion or rising factor costs) force the capital to move to other regions that were formerly at the periphery of innovation. Developments in information technology, human capital improvements and knowledge spillovers can speed-up this process. There is also a political pressure to eliminate the inequity by economic policy measures. As the country becomes richer, regional disparities are therefore reduced. The relationship between income (national GDP convergence in time) and regional disparities can be described by an "inverted U" graph. Some further steps of the presentation are based on this hypothesis.

If we assume that all countries converge to the same "steady state" income per capita in the very long run, the late entrants must get certain "bonus" on their growth path in order to catch-up. This can happen without or with the help of the regional policy. In the latter case the richer countries (regions) are taxed and the poorer countries (regions) are subsidized. As an effect, the regional policy decreases the dispersion of average incomes among regions and facilitates an earlier "take-off" of the late entrants. The adaptation of technology and growth in lagging regions are thus speeded-up.

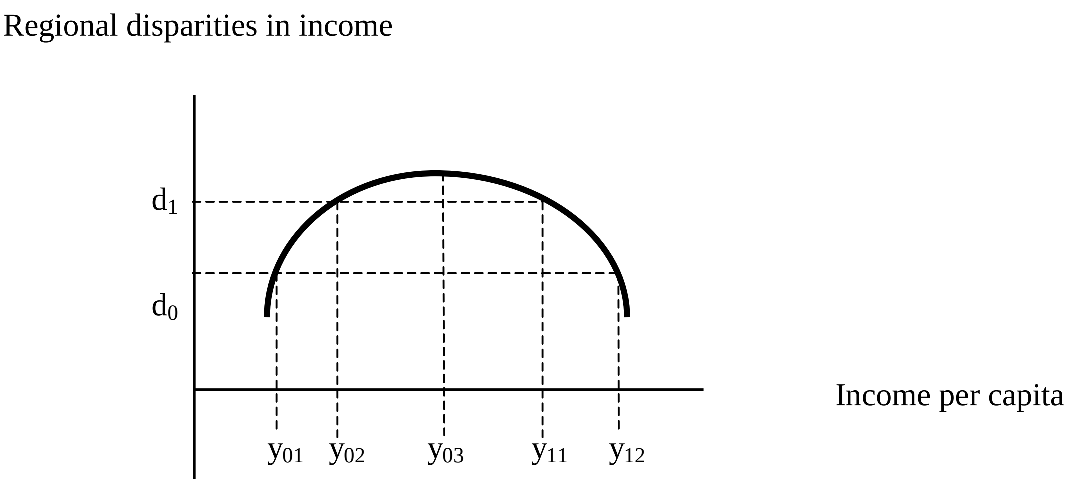


Figure 1: Trade-off between national and regional convergence – the Williamson hypothesis.

Source: Davies, S., Garnier, C., and Hallet, M. (2000). Real convergence and catching-up in the EU, *EUROPEAN ECONOMY*, No 71, 2000, p. 198

[24] This section summarizes the presentation by Martin Hallet.

The so-called "Williamson hypothesis", depicted in Figure 1, says that regional disparities in catching-up countries follow the shape of an inverted-U curve over the national growth path measured by income. Thus the same forces, which drive high growth in such economies, are seen to generate first a widening and then a narrowing of regional disparities in the per capita distribution of income. The important thing here is that the growth in this case must be accelerated, otherwise the catching-up would not be possible. The higher national rate of growth in catching-up economies tends to be generated by the emergence of a limited number of growth poles, i.e. growth leaders located in regional centers of development. They draw their advantage for growth from the development of modern industries based on "agglomeration economies". These economies are characterized by knowledge spill-overs and economies of scale. Private capital and skilled workers are attracted by the new opportunities proliferating in the growth pole regions, leading to cumulative rises in productivity and growth. Therefore the ascending side of the curve is determined by the positive externalities in the growth poles due to agglomeration (linkages, spill-overs, consolidated labor markets, etc.), while the descending side is determined by the negative externalities from agglomeration (rising factor prices in growth poles, congestion, etc.). The developing communication networks support the dislocation of enterprises from the rich centers to the underdeveloped peripheries.

It follows from the model that a more rapid growth of certain regions (e.g. from y_{01} to y_{02}) leads to a widening of interregional disparities from d_0 to d_1. The regional disparities are temporary. As the average income per capita goes beyond y_{03}, the disparities diminish due to spill-overs from growth pole to other regions. At the income of y_{12}, when the catching-up is complete, the disparities return to the original level d_0. It also follows from the model that it is rational to give the development of the growth poles a policy priority and support the lagging regions at the later stages only.

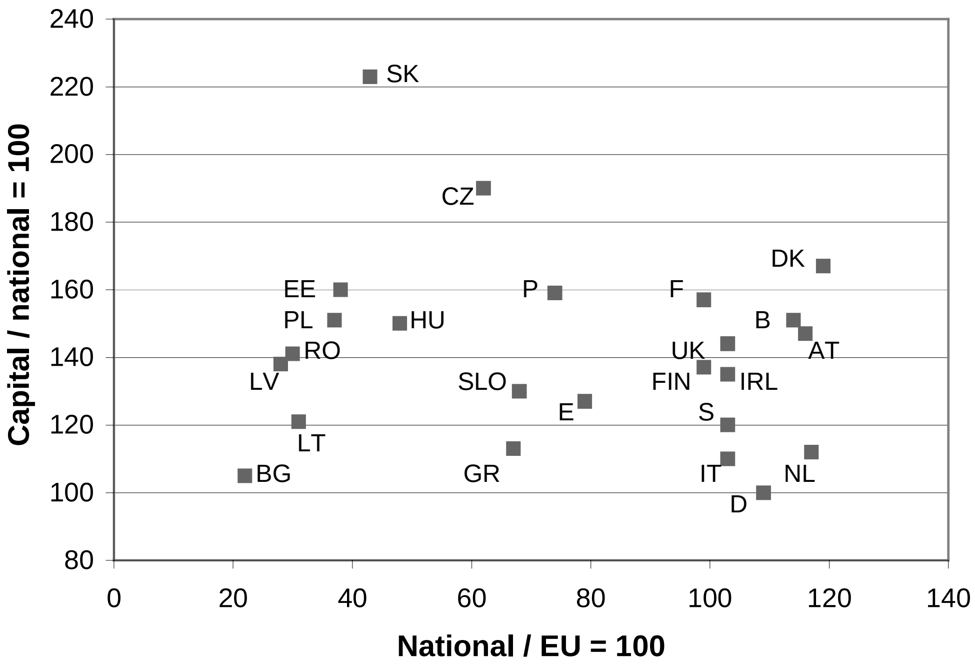
However, there may be costs to the global development caused by such policy interventions because the richer regions have to bear the burden of regional transfers and their development and innovation leadership is impeded. At the end, all economies can have lower income than what could have been achieved without the regional policies. We can see that there is a trade-off between the objectives of high income and unimpeded growth on one hand, and equity and cohesion, on the other.

There is also empirical evidence from the EU cohesion countries that confirm that high growth is associated with growing disparities among regions. For example, in Ireland the less developed regions have been losing relative to the Irish average throughout 1991-1997. Nevertheless, the fast Irish average growth caused that even the "poorer regions" were catching up with the EU 15 average in terms of gross value added per person. We can therefore say that on the ascending side of the growth the less developed regions may gain from the spill-over from the faster growing regions, even though their relative position vis-à-vis the national growth poles gets weaker. Similar evidence is provided by regional statistics from European transition countries, where the capitals are leading centers of growth and their positive deviation in income relative to the national average is higher the closer is their national GDP per capita to the EU average. Figure 2 illustrates how the incomes per capita in the capital cities in Europe differ from the national averages. With the exception of Bratislava, Prague and Copenhagen, the dispersion between zero and +60% can be considered as normal, irrespective of the GDP per capita of the country. Nevertheless, it is evident that capitals are among the most important growth poles in the majority of countries.

We can hardly draw a similar conclusion for the more developed EU countries, which are the objects to be caught-up. West Germany can serve as an evidence that can illustrate the descending side of the catch-up. If we relate the income growth in various regions with the average German growth, we can see that there was a tendency throughout 1976-1996 to have faster growth in the urban fringe and the peripheral regions than what was achieved in the agglomeration centers. We can pose a question whether the European patterns of regional development are automatic, caused by pure market mechanism, or whether they are caused by policy instruments following the objective of regional equity. Some empirical evidence points to the latter. For example, the analysis of the decentralized political system of Germany revealed that local authorities had an impact on decentralized economic decisions and transfers. We can generally assume that in the developed countries of Europe regional policies aiming at achieving economic cohesion among regions have certain tradition and the trade-off between high growth and regional cohesion was inclined for the support of the latter.

Therefore we can conclude that Europe is not offering much evidence on the descending side of the Williamson curve that would point to the existence of automatic processes towards regional cohesion as the countries become developed. The role of regional policy is secondary in early stages of development. However, its importance is rising in later stages. As the European countries grow richer, we can expect that their regional policies aiming at higher cohesion will gain weight.

Figure 2: Relative income of European capital cities



Source: estimations of the author
Remark:
The income values are GDP at purchasing power parity per capita estimated for the EU, national and municipal incomes

Discussion of Previous Two Presentations

A discussant referred to Tondl's presentation in which the importance of the human capital development was emphasized, especially through the upper secondary education. In several candidate countries, however, this is not a priority and the tertiary education is promoted instead. Is there some more specific evidence that would point to a crucial importance of the secondary versus tertiary education on the development of human capital and its competitiveness?

Another participant asked if there is some evidence that would explain the persistent lagging of Southern Italy (Mezzogiorno) behind the Italian average.

A discussant asked Gabriele Tondl for more evidence about her statement that EU structural funds provide incentives for private investors in such a way that in their decision-making they may be biased to accept participation even in cases where the efficiency of the projects is low. Was this just a logical assumption to be further tested, or did that conclusion come on grounds of empirical evidence?

Another participant expressed his doubts if we can measure the real convergence in an objective way. The present methodology relies preponderantly on the income per capita and its distribution by regions. However, is this a reliable indicator of the phenomenon tested? Would it be valid uniformly for all societies and their objectives?

The idea of structural policies, as mentioned by Gabriele Tondl, is that there should exist a combination of three interdependent factors of development – education, public investment and private investment. A failure in proper sequencing bears risks. For example, the preconditions for catching-up of the most backward regions are such that they cannot rely on private investors, be it foreign or domestic. The burden of taking-off must be therefore borne by public spending mainly on education and skills training. If the accession countries have the most backward regions from the whole EU, then their pattern of catching-up should rely primarily on these two factors.

The divergence of certain areas can be a normal process in all countries and we should distinguish between relative and absolute losers. Since we do not live in a closed society, the comparison can be done in relationship to numerous alternative benchmarks. A phenomenon perceived originally as a "lagging behind" can be also interpreted as an "overtaking", if we change the point of reference. Thus a region can be losing relative to some extremely fast growing country (or even to a domestic average), while it is catching up relative to EU average. Similarly, one cannot interpret the position of some very rich regions as leaders, once the tax burden brings their international competitiveness to a halt.

A commentator added that the perceptions of lagging behind and the motives of the individual actors should be considered. Does any authority, positioned in the top of administrative hierarchy, have rights to force a certain part of the population that revealed their preferences in abstaining from GDP growth, to an activity of catching-up? Especially it should be the case when a widening gap in the GDP per capita in one region does not have negative externalities on the more "prosperous" regions. The decision about the policies directed on higher "cohesion" should therefore remain exclusively on the local community. As a follow-up of this principle, the distribution of the EU structural funds should be decentralized as much as it could be technically possible. Similarly taxing of the rich can be vindicated only on grounds that the tax revenues will be used for the financing of public goods that can have externalities improving the future position of the taxpayers. Otherwise the support of the policies aiming at gaining a balanced growth among regions should be left on their private philanthropy and solidarity.

Gabriele Tondl answered some of the questions. The enrolment in the upper secondary education was taken as a useful proxy for the estimation of the human capital. First, it was the statistics best available that could cover all compared regions. Second, its correlation with the indicators of development was the highest among all other alternative variables of education.

With respect to the problem of low efficiency of private investments in some regions, one has to look at the data and single out those regions where the private capital had high share in total investments and at the same time low returns. Speaking generally, it was found in South Italy and Central Spain. These findings were closely correlated with the occurrence of high incentive schemes. It is very probable that without these schemes the investments would not have been undertaken. Also other research results (e.g. those of the World Bank) confirmed that in some areas there is no evidence for a positive relationship between private investment and high growth. The explanation rests on the distortions caused by subsidies.

One could agree that the GDP per capita is not a perfect measure for decisions about the structural policies. The real studies use therefore a complex system of indicators, including for example the index of social inequalities or unemployment.

The theory of endogenous growth stresses that the interventions should address the supply side of the economy and support the development in those fields that have wide externalities. These conditions are best satisfied by public investment into infrastructure and education. Though some of them can fail and miss the objectives, it is not an argument that all such schemes should be renounced completely.

The divergence among regions should be measured in relationship to a very wide set of countries and regions. For the purposes of decision-making about the EU structural funds, it should be optimal to measure it across all Europe. On the other hand, the policies of national convergence should be based on information at lower levels than the EU.

A discussant questioned the relevance of the Williamson hypothesis presented by Hallet for the recent developments in Central and Eastern Europe. The present situation in these countries is also a result of sharp decline of production, while the catch-up process for the majority of them is ambiguous. For some of them lagging behind the EU average has actually increased and the disparity among their regimes has widened.

One of the participants was of an opinion that there was certain logical inconsistency between the results of empirical observations by Martin Hallet and his policy principles outlined by the theory. Namely, that the real policy interventions in the European Communities were aimed at the speeding-up of the take-off of the poor regions already in the very early stages of development when, by his theory, the interventions were not supposed to be important. Then, in the later stages, the convergence would be more automatic, requiring less the policy support.

A workshop participant mentioned that as to the functioning of the agglomeration effect, in both of its periods – expanding and contracting – the presentation of Martin Hallet did not mention the importance of labor migration and its changing flows in time. This is all the more surprising that the whole theory of national and regional disparities (developed, among others by Jeffrey Williamson) relies on the presence or possibility of migration.

Another participant referred to the final conclusion of Martin Hallet's presentation where he posited that the role of regional policies would rise as the countries develop and the lagging regions would catch-up with the previous leaders. In the original literature this hypothesis was assumed only. Was Hallet's statement supported by more specific empirical evidence that would not contradict the hypothesis tested? One could have also tested the following reverted hypotheses for the period of "taking-off": first the authorities would provide incentives for the development of the growth pole in order to build-up strong leaders of innovation in the agglomeration centers. Then, in the later period, they would let the market do all adjustments to a higher regional cohesion, as the spillovers from the leading regions divert the flow of factors to lagging regions.

A commentator mentioned that in our debates we have somehow forgotten about the importance of the Common Agricultural Policy (CAP) on the structural developments. The question is to what extent the CAP has contributed to a balanced regional development and what was its impact on reverting that trend, especially due to its subsidy mentality, towards enhancing disparities and conserving the social inflexibility.

Martin Hallet apologized that, due to his concise presentation, he caused some misunderstandings among the audience. For example, it would be a mistake to assume that the presented figure showing disparities between the European capitals and the countries' average incomes was pointing to significant behavioral differences between the western and eastern economies. It would be also a biased inference to say that once the capitals reach the double of the national average per capita income, the optimal policy would be to invest in the poorest regions and not to the capital. Maybe the opposite policy would be more efficient for bringing the whole country on a more balanced and a higher growth path.

As to the importance of the labor mobility in the Williamson's hypothesis, we should make the things right by admitting that factor mobility should be in the core of the problem. The condition that technologies should be available to all regions can be satisfied only if the human capital development or migration are not impeded.

In Mezzogiorno, and also perhaps in East Germany, there are regions where the catching-up cannot rely solely on market automatism. What is specific in these regions is that they are in the neighborhood of highly developed domestic regions. But we can doubt that it is their revealed preference for backwardness, what is the reason of their lagging behind. There are other explanations. For example that the gap is so wide, particularly if combined with fiscal policies causing a rent-seeking mentality, that the spillovers find it difficult to cross it over and take roots.

There was a comment on the appropriateness of regional policies in the early stages of catching-up at the expense of fast growing regions. In fact, the problem should be exposed to a wider context of the national development strategy that deals with public investments, infrastructure, education, R&D and institutional incentives, among others. From that point of view regional policies at the early stages will become of a secondary issue. Creating bottlenecks in the main growth poles and promoting the low growth regions may not be an optimal policy for achieving a high global growth, since the foregone investment in the center may result in an opportunity cost that is not Pareto efficient.

The CAP has various objectives. Though it is not its main target, it has also a stake in the objective of a balanced regional development. Unfortunately, there were only few studies that analyzed it from this point of view. It seems to be apparent that the CAP is not a suitable instrument to address the problem of the regional cohesion properly. The CAP promotes the development of large-size agricultural firms located mainly in developed northern regions (for example in Germany, Denmark, the Netherlands and France). Actually it may pursue just the opposite strategy that is followed by the cohesion funds.

One of the workshop participants added that policies aiming at the reduction of disparities split our societies into two groups: the so far winning majority that supports the policies and the opposition. There are various reasons why the structural policies should not be used. First, we should use the advantages of a unique location and attract the people from less favorable regions to those regions that got on a path of high growth. We should refrain from trying to shape all locations to a similar pattern, what is often an activity going against the substance of naturally developed dissimilarities. In some cases it is the specific local environment that rests behind the "disparity". Many areas with economic disadvantages can then find their comparative advantages in other activities than production. For example, they can become natural or historical reserves, the main business of which is in tourism.

Another participant pointed out that the macroeconomic explanation of certain policies could be misleading. For example, an aggregate relationship between growth and public investment statistics, that seems to offer a plausible correlation in general, is often used as a justification that a whole set of individual projects, often taken as a program, should be undertaken. The causality in that case is flawed, since each project has its specific factors and therefore should be evaluated to that extent separately. The constraints to the local growth can vary by localities and the cost of their removal can be also very different. The availability of a skilled staff for project analysis and programming is therefore the most important precondition for any investment. Unfortunately, many regions and projects lack just this crucial factor for their development, what they try to hide under the fig leaf of general statements.

A discussant agreed that the role of capital cities in generating growth in Central and Eastern Europe is large and their promotion is important. Unfortunately nearly all of the regions of capital cities will not be eligible for a support from the structural funds because the average GDP per capita in EU will decrease after the EU Eastern enlargement and already now some of these cities have income above 70% of the present EU average. That is a strange new situation harming the new entrants. In the past, Dublin, Lisbon and Athens have been for long the active players of the structural support game and their contribution to the local growth was acknowledged. The newcomers from Central and Eastern Europe, with their even less developed economies, will now be excluded from these highly efficient investments.

A discussant was at the opinion that the speakers up to now commented extensively on the real factors that they found essential for the convergence. However, we should not forget about the monetary factors that may become a part of the structural policies. For example, a premature adoption of the common European currency can make the domestic cohesive policies less efficient. Speaking purely theoretically, would it not ease the problems of South Italy to stay away from the euro-zone? The same question, dealing with the optimum currency area, can be raised for the accession countries.

Another participant returned to the policy recommendations that were mentioned by Gabriele Tondl. The structural fund interventions should always use sector-neutral and competition-neutral instruments. In selecting the projects these instruments should not act against the market signals. The incentives to education and infrastructure are consistent with the first two principles. Nevertheless, there were observed investments in the Mediterranean region, which were inefficient, that could happen due to a disregard of the market principles. What other instruments, except for subsidies and grant schemes, the EU can apply in order to minimize the risk of cost inefficiency? For example, should not the funding be rather directed to the usage of refundable instruments, such as credits or risk-capital funds?

Gabriele Tondl in her answer to the comments responded first to the problem of causality and reasoning for a good investment. We can argue that the high income in a country was caused by investments into education, or alternatively, that the latter was rather an effect of the high income. TO identify the causality one has to rely on sophisticated statistical instruments where the role of time factor and lags can be estimated. However, it is a general problem of human perception that is not easy to solve.

Monetary factors definitely play their role in the process of convergence, even though it would be excessive to refrain from a fixed exchange rate regime (or even euro-zone) only on grounds of structural objectives in some region. What was more important for the promotion of regional convergence was the monetary and fiscal macroeconomic stability, as we can observe it from the time series data for the South European cohesion countries.

As far as the usage of selective investment incentives is concerned, she supports the instruments that would be compatible with the market economy and neutral to the competition among sectors. In the past we could observe a process of learning when at the beginning there were not used structural instruments in Southern Europe that would allow for selectivity. Recently we could hear voices recommending the introduction of the principle of conditionality. For example, if the investment would not be profitable, after some period some refunding could be considered as a part of the incentives.

Martin Hallet in his reply disagreed with the view that disparities do not represent a problem for an economic concern. For example, the descending side of the Williamson curve reflects the negative externalities of agglomeration and congestion. The markets, due to the public good nature of the problem, need not solve the resulting deadweight losses efficiently.

The eligibility or non-eligibility of capital-city regions for EU structural funding is a very serious issue and the candidate countries should care much more about the status of policies of these regions. The monetary policy and the exchange rate have not proved to be efficient instruments for the governance of structural policies. Currently the problems of EMU and the criteria for optimum currency area are not at the forefront of discussions in that matter. One must agree, however, that stable macroeconomic conditions are crucial for a balanced development, what concerns also the efficiency of public investment spending.

7 Options of Program Selection: Supporting Losers or Winners, Enhancing or Correcting the Market Mechanism

7.1 Supporting Losers or Winners in the Latvian Context[25]

The presentation started with a comparison of the GDP per capita levels at purchasing power parity for EU candidate countries in 1998 with similar statistics for the EU. In ranking, Latvia is at the bottom, just behind Lithuania and Bulgaria (or close to the bottom, if one adjusts the statistics to differences in methodology). It means that in catching-up Latvia will require certain efforts in order to get at some proportion of the EU average in a stipulated time. For example, starting from a position of 17.1% [26] to reach 50% of the EU average would require an annual growth of 5.7% in 50 years, if the EU's annual growth were 2%. It looks like a big task – but, if taken in historical context, it need not be an achievement which is exceptional. It may be enlightening what the Hungarian economic historian Iván Berend recently showed: countries in Central and Eastern Europe have been standing for more than 125 years at the average of 40% of GDP per capita of the countries in Western Europe. They neither outperformed the Western countries, nor converged to their average level, though there were some fluctuations in time. What is even more surprising, their best relative standing was during the first stage of state socialism.

Though the task of transition economies is just a partial catch-up with the EU countries, it is evident that the EU structural funds will have only a small impact on the whole development. It was therefore interesting to learn from the presentation of Gabriele Tondl (see the previous section) how a combination of EU funds and domestic funds could improve the provision of public goods and have externalities on the production in the private sector. One of the basic problems in poorer accession countries is the lack of effective domestic resources for co-financing, as the expenditures are pre-assigned to certain politically binding ventures whose yields may be lower than the yield of projects supported by structural funds. Therefore a serious approach to accession implies that accession become a government task of top priority. In Latvia the pre-accession funds were finally linked with the National Development Plan (NDP). The first was published in November 1999, and the second one is in the process of submission to the cabinet. The objectives of the NDP were defined as: "Identification of those sectors of national economy which would be eligible for support from the Structural Funds in the future and which can contribute to the development of the economy and to the narrowing of the gap in economic development between Latvia and the EU".

We could hear at this workshop from Ruth Downes that there was much confusion about the structural funds and about the evolution of ways how they were

[25] This section summarizes the presentation by Alf Vanags.

[26] According to more recent revised statistics, the Latvian GDP per capita was 22% of the EU average. As can be seen, the methodology of the GDP estimation at purchasing power parity also evolves and the new estimations give generally higher figures for the transition countries, than in the past.

prepared and implemented in EU countries. A similar situation happened in Latvia where the national authorities had inadequate expectations how the pre-accession and structural funds could have been acquired and used. The list of tasks in the National Development Plan of 1999 could be characterized more as an ideal “shopping list” than a project for investments under budget and absorption constraints. The Plan identified six economic policy goals, which corresponded to six separate investment programs:

- Promotion of entrepreneurship;
- Regional development;
- Tourism development;
- Agriculture, forestry, fishery and rural development;
- Economic infrastructure;
- Human resources development, including employment promotion.

The Plan was subject to criticism from various sides and subjected to a profound revision.

The Plan worked out in 2000 offers more information and also its form has improved. It presents a list of strategic policy goals and a time frame for 2000-2002, even though it does not contain a detailed financial plan. It is expected that the financing will combine funds of domestic private and public sectors, plus the contributions from the World Bank, EBRD and the EU pre-accession funds for projects in infrastructure, as well as the aid to the private sector (subsidies) and the aid to the development of human capital.

There are five strategic objectives outlined in the new NDP:

- Sustainable national development;
- Regional development - elimination of regional disparities while preserving “valuable differences”;
- Education, cultural growth and “competitiveness” of the population represented by the human capital;
- EU accession;
- Improvement of public administration system and development of democracy.

The investment projects are classified according to priorities. For example, one of the highest priorities can be received if a project will “diversify and re-orient the production to high value added products”. That may sound more like a task of picking-up the winners than enhancing the market mechanism. The problem is also to find out what is a product with “high value added”. It is not certain whether it is a value per ton of the product, share of profits per price, the value added per labor, or simply a synonym for hi-tech products. Other criteria for priority are “the development of healthy business environment and funding resources”, “economic infrastructure”, and such tasks like “improvement of workforce qualifications in line with market needs”, and “impacts on the efficiency of public administration”. As a supplementary priority we can find there “social integration”, “social infrastructure” and “regional development”.

The NDP is expected to receive a financial support equal to 6.1% of GDP in 2001 and 7.1% in 2002. A half of it will come from domestic public funds and two fifth from the EU pre-accession funds. The rest will be provided from private co-financing.

What is the role of economists once there is an attempt to set up an NDP? Their objective should not be picking the winners, because this should be done be the entrepreneurs who are the professionals qualified especially for that purpose and who risk their own property if they fail. The economists could maximally strive for identifying the areas in which the market fails and suggest ways for a correction. For example, there may be cases where financing of small businesses fails and public intervention may aim at improve the situation. They should also support the creation of conditions, environment, infrastructure and institutions for private activities to act better as the market signals become more pronounced.

The presenter concluded by commenting on the Irish model for development. Surprisingly, we can find a large number of Irish consultants operating in the Latvian ministries. However, transplanting certain experience mechanically to a situation where the local conditions are different may be hazardous. In Ireland the structural funds were used widely and successfully for the improvement of human capital. The Irish educational reform started in the 1970s, well ahead of the rest of EU, and its focus was on training (especially married) women that were outside of the labor market at that time. The EU structural funds were able to build on that base. But a similar policy may not be as successful, if adopted in Latvia. Another policy that was behind the economic success in Ireland was the creation of a culture of accountability and incentives to reward those who create wealth. In this respect the Irish experience is of a paramount importance and the structural funds could be used most efficiently in Latvia if they could contribute just in that direction.

Discussion of Previous Presentation

A discussant asked how the three Baltic countries are going to co-operate both in the fields of transformation and in the policies aiming at EU accession and how Scandinavian financial capital, public administration and industrial know-how can be used for the benefit of the Baltic?

A Polish participant asked about the process of preparation of the National Development Plan of Latvia. Namely who were the social partners in that process and how intensively have they been involved? The discussant also commented on the goals of the Plan and the structure of expenses. While we could agree with the objectives as set out in the Plan, the financial tables, however, indicate that two thirds of outlays went into infrastructure and very little was provided for the development of human resources. In the long term this may be a great mistake. For example, it was found out in Poland that its eastern regions had weaker absorption capacity of the funds for structural development. Therefore it was decided that this capacity should be enhanced by investments into its human resources.

Alf Vanags replied that the Baltic states are not very much like each other, and the idea of them co-operating in some kind of a collective endeavor is a fantasy. If we take the Central European countries as a yardstick, the Baltic states are definitely neither more flexible and, in a similar fashion like the former, nor they would be able to negotiate the EU accession together. The Nordic countries are important partners for the Baltic states, though. Especially much of the FDI comes from these countries. Finland became a crucial ally for Estonia because of their ethnic and geographical closeness, and a part of Estonia's success should be attributed to that alliance.

The main responsibility for getting all kinds of social partners "on board" rests with the ministries. They have been very reluctant to open their network for the NDP development to a national-wide discussion, but it is true that they were under strong time pressure.

A discussant pointed out that his earlier analysis of the role of education in Europe indicate that Finland could be considered a country with a particularly intensive orientation to education. Giving the young people the chance for a high quality of education has been one of the local highest moral values for centuries. Especially in time when the country was relatively poor the access to education was considered the best investment. Turning to the recent Irish success we should not forget that Ireland had the youngest structure of population in Europe because of the highest fertility rate for the last 30 years. Otherwise Europe is a rapidly aging continent. Therefore the investment into information technologies was much attracted by the structure of the population in Ireland.

A discussant, based on the experience of Lithuania, remarked that to judge a national plan is very difficult on the mere definition of goals and criteria on one the side, and how the actual process of selection for the support to losers and/or winners is implemented, on the other side. Both sides can be, to a large extent, independent.

A Hungarian participant commented on the level of development and growth in transition economies. The Latvian slow growth in the first period of transition cannot be taken as a representative sample. Growth can become much faster in the later period of transformation. For example, in Hungary the growth suddenly accelerated and showed a cumulative 20% during 1995-98. GDP in transition countries has been grossly underestimated, for example in the housing sector, among others. The methodology of the GDP estimation, as it approaches the standards of Eurostat, has had to be adjusted, and the prospects for catching-up suddenly became more optimistic. Another discussant added that the recent statistics coming from EU about the level of GDP per capita in candidate countries relative to the EU had been upgraded and they are different from the figures provided in the past by other institutions. The difference can be more than 13 percentage points in some cases.

Alf Vanags replied that the usual measures of education and its achievements are problematic to define. In Latvia there is a high enrolment in both secondary schools and universities. The problem is in the attainment of quality. The teachers are badly paid and the universities are generally not very good. As there is a big institutional inertia and a low mobility of teachers, the schools are very difficult to reform. The legacy of the Soviet approach, which inclined to provide mass low quality education, is still visible in Latvia.

As to the process of selection of projects in the NDP, which should be funded from domestic or international public resources, we can see the structure of aggregate spending only (e.g. 29 million lats for agriculture, 40 million to the support of small and medium enterprises, etc.). The NDP does not yet offer instruments for monitoring a competent and competitive project appraisal.

8 Special Institutional and Policy Tasks in Sectors: Agriculture and Transport and Infrastructure

8.1 Experience of Preparation of the SAPARD Operational Program for Poland[27]

The presenter has spent the last two years in the Polish Mission to the EU and therefore his message reflects his personal experience from the negotiations for accession. He specializes in the problems of agriculture and therefore he talks about the pre-accession support to that sector – mainly through the "SAPARD" framework. It is expected that the issue of Polish agriculture and its rural areas will be the most difficult problem to overcome before the negotiations for accession could be concluded.

A couple of years ago both the Commission and the Polish government have changed their approach to this problem. Originally the evaluators concentrated mainly on the issue of an over-sized potential capacity of the Polish agriculture. The agricultural land per capita is twice as large in Poland than what is the EU average. Would the Polish agriculture be developed more, as was assumed, it might threaten the stability of the EU markets. In the meantime, however, the Polish side has shown that Poland was also a big importer of agricultural products. Actually it became a net importer, and not only in tropical and subtropical fruits, but also in products produced domestically. Though it may be a result of present domestic structural deficiency, the changes cannot be expected to be solved soon.

The whole problem has later acquired a different dimension. Polish agriculture is over-populated and the income earned there is low. Therefore there is a danger that, following accession, the rural inhabitants will try to find jobs abroad and threaten the labor market in the EU. There may also arise problems in Poland as the poorly paid peasants become unemployed, they could burden the social security net with high costs and threaten the social stability in the country. We should be aware that a part of the Polish successful transformation happened thanks to the existence of private plots. Labor dismissed from contracting industries after 1989 could find job in family agriculture businesses and survive there the most dramatic years of transition.

In the meantime, the standard of living in the Polish non-agricultural sectors improved significantly and the gap between them and the agriculture was widening. The government, in order to support domestic agriculture, impeded the import of competing products from abroad and provided various subsidies to the farmers. Approximately 3 billion euros are used annually as state budget support to the farming social security and pension system, what became a too heavy burden to future fiscal developments. Given the protection and the ensuing inefficiencies, local prices of agricultural products increased above the EU level. Therefore also the demand has been artificially restrained. However, the problems with pent-up imports became apparent: they are not only cheaper than the domestic production, but pressure by foreign suppliers and their governments on international negotiations was also rising. Another consequence was that Polish agricultural production lost a lot from its international competitiveness. The

[27] This section summarizes the presentation by Wladyslaw Piskorz.

domestic farmers are also dissatisfied and their collective protests against the government raised wide public attention.

It has become evident that the degree of domestic protection got to a point where no further intervention is possible. The main way for improvement rests in restructuring and improvements in productivity. In difference to industry, restructuring in agriculture was being postponed. Neither the number of farmers nor the number of farms has decreased in the past years of transition. The farming sector should reduce its labor force and by decreasing the excessive labor costs it could again become competitive both at home and abroad without the need of a special protection. The problem is that there is no demand for the expected surplus of less skilled labor in the industrial sectors. Neither we can see much potential in absorbing that part of the population by the cities, nor in their migration abroad. Therefore the only logical solution is that the excess agricultural labor remains in the rural areas and find new working opportunities there.

It is without doubt that this very ambitious plan is not without problems. Presently 50% of income in the rural areas depend on farming. Fortunately, the transition in Polish agriculture can be spread over a generation. The government strategy is to balance the support for the transition of the rural areas between the agrarian incumbents and the new opportunities outside agriculture.

The expected role of the EU structural support to Polish agriculture, namely through the SAPARD program, should be viewed in this context. The preparation of the program has started just recently, even though there was a delay from the expected date of 1st January 2000. The signing of the Financial Memorandum with SAPARD Agency was expected to be at the end of 2000 and the first projects could receive the funds in 2001. In the meantime we should solve the accreditation of the paying agency and establish the proper institutions that would manage the projects. The amount of funds to be disbursed to Poland is EUR 168 million. Most of the money will be spent on improvements of food processing and the infrastructure in the rural areas, though the farmers preferred direct investments into their own production. That was not accepted on ground that the chosen alternative would provide them more benefits indirectly. Poland’s cooperation with the SAPARD Agency has been very fruitful and businesslike so far. We were also glad to hear that our proposals and projects were not considered worse in their standard than what the agency was accustomed to receive from the member states.

8.2 Transport Infrastructure in EU Enlargement and Integration[28]

The issue of infrastructure was raised many times at this workshop, what often implied that its role in the decision-making about the use of structural funds had one of the highest priorities. The presenter raised a somewhat skeptical view of this because it simplified the matters too far. His research was originally undertaken on demand from British authorities with an objective on “trunk road assessment”. Its aim was to test the link between transport growth and economic growth, in order to find an answer to the question if we could sustain the level of economic growth without investments into

[28] This section summarizes the presentation by Roger Vickerman.

transport infrastructure. This is also a problem that has relevance for the economic integration of accession countries with the EU. The message of his research is as follows: do not get carried away with infrastructure in general, but remember the importance of developing the markets for transport services. Transport itself is an industry that depends on markets whose development increases its efficiency. Thus an investment into a better market intermediation can be an efficient alternative for a constant enlargement of existing infrastructure.

What is the role of EU in transport and transport infrastructure? The problem is a multi-dimensional one. First of all there is the fact that the traffic growth in Europe has been greater than the growth of GDP. Secondly, there was an important model switch to road transport that has become pronounced recently in the Central and Eastern European countries. Motorization and the importance of car ownership is a phenomenon that has been running at an alarming rate. The extremely high income elasticity of the demand for cars in accession countries is worrying. There is a political message that the mistakes made in the West in the transportation policy should not be repeated. The congestion and environmental costs are not an inevitable price that must be paid for the development. A new policy initiative should be required for a change. Unfortunately, in many countries the politicians are vulnerable to popular opinion and protests against such measures like the taxation of fuel.

If we look at the transport growth in EU 15 during the period of 1985-1998, we can see that the transport of both persons (in passenger kilometers) and goods (in ton kilometers) grew faster than GDP. What is crucial, is that since 1993 the growth of the transport of goods has accelerated significantly. The explanation can be found in the deepening of integration due to the implementation of the Single Market in the EU. Quite characteristically, it was the distance transported that grew faster, while the weight of transport in tons grew less fast or fell. On the other hand, trade grew mainly in intra-industrial commodity exchanges, so that similar commodities were transported across Europe in opposite directions.

What concerns the levels of motorization, the United States achieved the level of saturation in the early 1980s. Since 1990 the number of passenger cars per 1000 persons has been decreasing, what was not the case in Europe, and especially of Central Europe. The transport policy of the EU is enshrined in the Rome Treaty where it has an important place together with agriculture. Unlike in agriculture, very little was done in the transport policy until 1990. Since that time various initiatives commenced. In 1992 a White Paper on the Future of the Common Transport Policy was published. It contained two main contributions:

- Outline of needs for greater coherence in transport policy at the EU level, particularly sustainability, safety, inter-modality and inter-operability.
- Call for a common approach to pricing to ensure fair competition between modes and compatibility of national systems.

But then there was another set of documents that came as a reflection of the Maastricht Treaty and the White Paper on Growth, Competitiveness and Employment where the stress was put on:

- Competitiveness and cohesion
- Keynesian public works therapy of unemployment

- All-embracing transport policy going up to an obsession with infrastructure.

The real issue came across later when Neil Kinock became the commissioner for transport and raised the idea that the existing transport pricing was inefficient. That concerns the ways how the long-term financing of infrastructure was arranged and how the long run and the short run marginal prices were calculated. It revealed the obsession with the high-level trans-European network, while the real issue was the way of transporting people to work what makes the labor market more efficient. The studies also turned to the analysis of transport intensity related to the growth of GDP and the way how it contributed to the competitiveness of trade in both directions.

There are various myths about the infrastructure that should be debunked. For example, the lobbies for an expansion of infrastructure stress its importance for exports, but omit that the same pays for imports. There is also an argument that transport promotes automatically the economies to scale, concentration and industrial restructuring. The other naïve presumption that people are inclined to make is that transport is (nearly) the only industry where competition is not perfect. Thus there are expectations that the price of transport should be regulated and made equal to the marginal cost, what can be a very costly intervention. Also we must reconcile with the fact that transport cannot be made available everywhere and all the time. Therefore some additional value of output, that transport might potentially mediate to some locality (that represents the marginal increase in demand for transport), would never materialize because the actual state of the market does not allow such a response on the supply side. On the one hand, the absence of transport is used by firms to sustain their spatial monopoly. On the other hand, the improvement of transport can increase a rent-seeking behavior. For example, firms do not include the cheaper transport into their cost by lowering the prices. Therefore the global impacts of transport development can be both positive and negative.

One of the presumptions over-simplifying the argument is that there are wide spillovers (both positive and negative) that can be interpreted as public good effects from the transport. The conclusion is then made that it therefore does not matter so much what the cost-benefit analysis says, because one can always add something positive or negative in order to revert its results. The uncertainty about social costs and social benefits is so large that it can be abused. It may be particularly dangerous in areas where there are sensitive industries which are subsidized. For example, because of the risks and uncertainties, the roads should not be built just in order “to improve the local agriculture”. The diversified relationship between transport development, economic competition, and the costs and benefits to production are quite complicated. We should not forget their impact on restructuring (that is generally positive) and on externalities that can contain many negative feedbacks, such as those of congestion and deteriorating environment.

If we look at the effects of the transport on growth, we should look at the relationship between the investments into the stock of transport infrastructure that acts as a public good and the productivity of private capital in the rest of the economy. Taken statistically, we can find a high positive correlation between them. The problem is that we cannot be certain what is the cause and what is the effect. There are also other effects that are not easy to capture, such as the labor market impacts working through time savings and improved performance of the labor market, or the restructuring effect that includes relocation impacts. The overall impact can be therefore ambiguous and difficult to consolidate, although it is assumed to be positive.

In the analysis of transport investment programs we could assess separately the cohesion effects (making Europe more integrated and balanced) and the competitiveness effects. It is assumed that they go hand-in-hand, but that may not be always the case. The net benefits arising from investment into infrastructure usually omit the existence of various long-run fiscal burdens. For example, roads must be maintained from local taxes what burdens the local enterprises. It is also difficult to identify the beneficiaries of benefits. Often it is a different set of economic agents than was originally planned and their location may be even outside of the region. The global benefit to EU can be very different from the benefits received locally.

Project analyses usually have a tendency to give too much emphasis to the macroeconomics of employment creation that is easy to estimate but difficult to prove, while little attention is paid to microeconomic impacts on individual sectors and their competitiveness and cohesion. There is an increasing evidence that new infrastructure may lead to employment losses. If we look at the recent initiatives at the EU level, we should mention TINA (Transport Infrastructure Needs Assessment) and its proposed creation of 10 Pan-European "Helsinki" corridors and 4 Pan-European transport areas, what includes 20.000 km of rail and 18.000 km of road networks at a cost of 90 billion euros. The proposal reflects more the pragmatic political need to extend European network to CEECs, that are still poorly integrated with the EU, than the specific needs of these economies and the impacts on their regions. The problems with long-haul corridors are that in some cases only a fraction of the total welfare effects fall into the regions (or countries) in which they were built. On the other hand, there could be cases where the wealth is actually transferred (e.g. via subsidies) from abroad into the regions. That means, the regions can earn all the benefits while the contributing regions bear only the costs.

The condition that financing for the most of the 90 billion euros should be found internally places another burden on the project, because of the expected fiscal burden at a time when accession would place excessive demand on public spending also in other areas. The policy makers will have to make a decision whether the funds should not be rather invested into alternative ventures, for example into human resources.

In sum, if we assess the process of setting policy objectives for the transport infrastructure, and their real implementation and achievements, we can see confusion of various kinds:

- The performance of the transport sector is analyzed separately from the needs of the wider economy.
- Local competitiveness can develop differently from the objectives of cohesion.
- There is an emphasis on large prestigious projects of EU interest (such as road corridors or high speed rail) to the exclusion of local projects which could have wider local significance.
- A common appraisal framework is either absent or there is no co-ordination authority that would make it applied.

- Alternatively, countries or regional authorities are reluctant to allow EU authorities to take strategic decisions.

Discussion of Previous Two Presentations

A discussant remarked that the delays in providing the SAPARD program to Poland did a bad service to the general perception of the EU support to accession countries. Even though both negotiating partners are partly guilty, the exceptionally cautious policy of the Commission to this matter was not justified. Another element that harmed the image of agricultural aid was a cut in the budget. Originally the Agenda 2000, that has been known since 1997, offered a very optimistic view of the potential of aid to be mediated by SAPARD. Polish expectations for the restructuring of agriculture, however, could not be later satisfied.

Another participant mentioned that if we compare the funds provided by SAPARD with the extensive cost of transformation that Polish agriculture must solve, the ratio between them is very small. The key element for future development and strategic policies rests on the expected changes in the productivity of agriculture. The present productivity is estimated around 20% of the EU average. That does not sound like a comparative advantage. If Poland enters the EU without a dramatic increase in productivity in agriculture, the farming sector will remain very poor and its market competitiveness would be at a margin of survival.

The other problem linked with the former is the concentration. Polish farms are too small for modern farming techniques. Though the collectivization of agriculture damaged that sector in other countries during the Communist period, the existence of large plots is now recognized as an advantage. For example, the competitiveness of agriculture in the Czech Republic seems to be now in a much better situation than in Poland just because of that factor. The role of the Polish government in solving this issue is therefore paramount, while the role of the EU and its SAPARD Program is of minor importance.

Another discussant stressed that the problems of the Polish agriculture have been in the past underestimated and improperly analyzed. There is no foundation to a belief that Polish exports might undermine the EU markets for agricultural production. The real key factors of market penetration are not hidden just behind productivity. An important role is played by the access to marketing mechanisms and contacts to main distributors in the West that are apart from production. This should be made clear and in advance – before the problem explodes. Once there is a strategy in the domestic policy that the rural population should not move elsewhere, there will arise an enormous pressure for both local and EU subsidies. A detailed co-ordination plan should be prepared for the viability of such a policy. Without such a plan we will face serious social problems and/or the need for even much more money to be spent later than what could otherwise be the cost.

Wladyslaw Piskorz in his reply to the discussants said that because of the demand of one member state during the final preparation of the Council regulations of SAPARD a strange solution was decided upon which, to make it feasible with the procedures of SAPARD, caused sufficient delay. Nevertheless, it would not be fair to blame mainly the EU for these delays. The unfortunate true outcome of the negotiations is the disappointment among Polish farmers. There was another positive aspect associated with SAPARD, namely the revision of some views of Polish authorities on the rural development program. The prevailing strictly sectoral approach was modified by giving preference to the development of businesses outside the farming sector.

What concerns the low productivity in Polish agriculture, we should be aware that in this sector there exists a dual economy. Approximately 20% of the land belongs to large-scale farming which is already competitive. Nevertheless, the EU experts are not unanimous in their views that all small farms operate under the optimum size. There are various externalities of the small-scale farming that make it sustainable. In developing the rural sector we should combine the infrastructural improvements with the programs on education and the labor market.

The average age of the owners of farms in Poland is now 51 years, what is quite high. However, it was in fact declining after 1990, as the young workers employed in industry had to return to the countryside. As we can see, the problem is not so much with the age, as it is with the education of the children of farmers. The statistics says that while 40% of the Polish population are residents in rural areas and 25% of total employment is in agriculture, only 2% of university graduates come from farms. If the young farmers lack education, they are not mobile enough to move out of farms and thus they are deprived of opportunities. If this lack of mobility is combined with a loss of competitiveness, that becomes a real danger.

By turning to the discussion of the presentation on the transport infrastructure one workshop participant commented on the mercantilist obsession that was mentioned several times at this workshop and also in the presentation – that the support for exports is more important than the benefits that may come with improved import supplies. In fact, the main reason for exports is that we want to have access to imports. Therefore also the improved quality of import provision due to better transport is that what should be counted.

Another discussant mentioned that recently, some less developed accession countries had a very high spending on infrastructure. What could be the key recommendations for the accession countries that intend to enlarge their infrastructure by using the EU funds?

A workshop participant commented on the observed obsession with infrastructure. During the previous discussions it was discovered that in EU programs EUR 10 billion has been approved for infrastructure development while, comparatively to that, a negligible amount was assigned for the promotion of small and medium-sized enterprises. Paradoxically, such disproportions in investments may originate not from the higher levels of decision making, but from the lower levels of the hierarchy. For example, if we look at the functioning of Regional Development Councils, their preference for more projects for infrastructure development can be attributed to the fact that such projects bear a low level of risks, even though they may actually fail. Public roads usually do not go to bankruptcy. On the other hand, more efficient projects into enterprises may involve higher risks because the cost-benefit accounting in them is much more transparent. The risk of moral hazard in public decision-making and lobbying at the local levels should be therefore considered, while the structural decisions are made at the level of countries or the EU.

Roger Vickerman in his reply agreed that modern mercantilism is not a credible argument. The pressure on competition, increased efficiency and reduced prices, that we can get as a result of the opening-up of regions through better infrastructure, may be coupled with a short-term loss of employment. It must be recognized that we cannot get both objectives at the same time – high employment and welfare effects of greater competition. The trade-offs between the global and local improvements involve some strategic questions. The top-down approach would stress the competitiveness gains at the level of the EU (or at the level of the countries) through concentrating resources in certain areas to the exclusion of others. The excluded areas then do not get their transport improved, because the overall effect is assessed to be greater. At present the preference is given to the bottom-up approach, where every region has the right to demand that its infrastructure should not be below the average standard. That may result in a wastage of common resources.

As to investments into infrastructure we see that these investments in developing countries reveal very high rates of return in the early stages. The rates are then declining. If we consider for example the Baltic republics, they have invested heavily but they are still at a low stage of development and the potential returns could be therefore still high. The next point is how the investments were selected and designed in order to improve the efficiency of the local private economy. For example, if the improved roads help the labor market to operate more efficiently, then the returns to infrastructure is higher than if the investments were used for high-level infrastructure that has no local impact. Speaking in general terms, it is more advantageous for the less developed countries to invest into the local infrastructure than get involved in megalomaniac projects that remain underused. You must always look at the specific needs of the specific sectors that you want to be developed and the mode of transport should be tailored to that. Therefore, if we speak about the future of Polish agriculture and if we expect that, in search of employment, people will move from rural areas to local little towns, that has definitely significant transport implications that must be tailored to these needs. On top of it, you must look at the specific skills of the people and at the specific requirements of industries that are to be developed. There are two alternatives to the strategy of commuting from rural areas to towns: either to bring the industries to the villages or to develop the local agriculture only. The latter decision is very often the least efficient solution.

9 Final Discussion

This final part of the workshop intended to discuss issues that were insufficiently covered in the previous sessions of the meeting and also provide opportunity to summarize some general lessons.

Martin Hallet presented a short reminder concerning the main determining factors of convergence and catching-up.[29] There are three groups of factors that should be considered separately: macroeconomic stability, structural reform of markets, and

[29] See also Davies, S., Garnier, C., and Hallet, M. (2000) Real convergence and catching-up in the EU, *EUROPEAN ECONOMY,* No 71, 2000.

development of physical and human capital. When analyzing the first group of factors, one should disagree with the idea that there is a trade-off between stability and growth. Maybe such a view can hold in the short run when an expansionary policy of the government leads to some sort of disequilibrium. However, in order to have a sustained growth and convergence at the same time, we must have macroeconomic stability first. Nevertheless, the countries in transition are subject to many other specific circumstances and their macroeconomic stability need not be of a primary concern. For example, they do not have to comply with the Maastricht criteria immediately from the early stages. For them there should be left a longer time for adjustment.

As far as the reform of the markets of goods, services, capital and labor is concerned, this is an issue of paramount importance for the decision making about an optimal allocation and/or displacement of resources. The third group of factors comprises both private and public investments. The latter includes the development of infrastructure, education and training, and the EU structural funds are directed to a large extent to these areas. Each of the three determinants is not sufficient to act on its own, as well as we cannot expect that the structural funds alone could solve the problems of cohesion.

Heikki Eskelinen pointed out that the Finnish case has been used a couple of times in the discussion about how to turn structural policies into a success. The problem is whether the Finnish model is transferable to countries where the economic fundamentals are different. Though the direct applicability of the Finish experience is limited, there are still some specific lessons that can be learnt, similarly like from the Irish case. One of such lessons concerns the possibility of hi-tech based developments in a small country. There are obviously serious obstacles to that because the hi-tech is a very risky business. Before the production starts there must be built a network for the supplies of special inputs, access to labor force qualified in narrowly defined fields, the existence of spillovers from other countries, etc.

You may ask how could Finland succeed in circumventing these obstacles? The Finish approach was different from the Irish experience in many respects. In Finland, the main initiatives came from firms that only later received a consistent support from public policies. It is a paradox that in the Finnish case the legacy of long separation to peripherality played a role in these decisions. There evolved a mentality to adapt innovations very quickly and refrain from building institutional obstacles to their development. That is very different from the environment in many accession countries where the institutional barriers are very large.

Appendix I: Workshop Program

EU Structural Support: Its Macroeconomic and Distributional Effects and Social Environment

Institute of International Relations, Nerudova 3, 118 50 Prague 1 – Malá Strana

9-11 November 2000

Thursday, 9 November

14:00 Introduction of the Workshop: ***János Gács***
Introduction of IIASA: ***Arne Jernelöv***
Opening Remarks: ***Josef Kreuter***

14:20 Latest Developments in the Process of Accession — Updates from Applicant Countries

Poland: ***Elzbieta Kaweczka-Wyrzykowska***
Estonia: ***Alari Purju***
Latvia: ***Alf Vanags***

14:50 Questions and Discussion

15:20 *Coffee Break*

15:50 <u>SESSION 1: The Role of Regionalism in the System of EU Transfers —</u> Necessity to Create Institutions and Channels for Transfers, or Establishing and Pursuing New Regional Policies

Heikki Eskelinen: EU-Induced Changes in a State-Centrist Regime: Lessons from the First Program Period in Finland
Stefan Anderberg: Experiences from the Swedish Accession – Strengthening Regional Institutions and Internationalization
Iván Illés: Structural Policies, EU Transfers and Regionalization in Central Europe

16:50 Questions and Discussion

17:30 <u>SESSION 1 (continued):</u>

Jan Hřích: Building of the Institutional Framework of EU Structural Funds in the Czech Republic within the Context of Decentralization of State Administration
Vitalis Nakrosis: Adapting to EU Transfers: the Case of Lithuania

18:10 Questions and Discussion

18:40 End of Discussion

19:00 *Social Event*

Friday, 10 November

8:30 Latest Developments in the Process of Accession — Updates from Applicant Countries

Bulgaria: ***Ivanka Petkova***
Romania: ***Nicolae Idu***
Czech Republic: ***Václav Šmejkal***

9:00 Questions and Discussion

9:30 SESSION 2: The Sequence of EU Programs: Planning, Monitoring and Evaluation

Ruth Downes: Structural Funds Programming – A Retrospective Assessment
Jacek Szlachta: Structural Funds in Poland – Challenges and Options
Peter Heil: The Management of PHARE, ISPA and SAPARD Assistance and the Transformation to the System of Structural Funds

10:30 Questions and Discussion

11:00 *Coffee Break*

11:30 SESSION 3: The Rationale, Importance and Effectiveness of Principles of EU Programs: Subsidiarity, Additionality, Concentration and Co-financing

Silvia Zendron: Some Reflections on Costs and Benefits of EU Programs: The Austrian Experience Since 1995
Christian Weise: The Poor, the Unemployed and the Naughty – Some Good, Some Bad and Some New Ideas on Allocating Structural Funds Among the EU Members

12:10 Questions and Discussion

12:40 *Lunch*

14:50 SESSION 4: Macroeconomic Effects of EU Financed Programs: Demand Side Effects, Supply Side Effects and Problems of Absorption

Sarantis-Evangelos G. Lolos: Macroeconomic Effects of EU Financed Programs
Elzbieta Kawecka-Wyrzykowska: EU Transfers for Poland: Problems with Their Absorption

15:30 Questions and Discussion

16:00 *Coffee Break*

16:30 SESSION 5: The Long-Term Effects of EU Transfers: National Catching Up and/or Regional Convergence

G***abriele Tondl:*** Empirical Evidence of Regional Convergence and the Role of Structural Funds in the EU
Martin Hallet: The Trade-off Between National Development and Regional Disparities

17:30 Questions and Discussion

18:00 End of Discussion

Saturday, 11 November

9:00 Latest Developments in the Process of Accession — Updates from Applicant Countries

Hungary: ***András Inotai***
Slovakia: ***Julius Horvath***
Lithuania: ***Vitalis Nakrosis***

9:30 Questions and Discussion

10:00 <u>SESSION 6: Options of Program Selection: Supporting Losers or Winners, Enhancing or Correcting the Market Mechanism</u>

Alf Vanags: Supporting Losers or Winners in the Latvian Context

10:20 Questions and Discussion

10:40 *Coffee Break*

11:00 <u>SESSION 7: Special Institutional and Policy Tasks in Sectors: Agriculture and Transport and Infrastructure</u>

Wladyslaw Piskorz: Experience of Preparation of the SAPARD Operational Program for Poland
Roger Vickerman: Transport Infrastructure in EU Enlargement and Integration

11:40 Questions and Discussion

12:10 Concluding General Discussion

13:00 End of Workshop and *Lunch*

Appendix II: List of Workshop Participants

LIST OF PARTICIPANTS FOR THE WORKSHOP

EU Structural Support: Its Macroeconomic and Distributional Effects and Social Environment

Institute of International Relations
Prague, 9-11 November 2000

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