Regional Diversity and Local Development in the New Member States

Also by Bruno Dallago and Paul Blokker:

YOUTH ENTREPRENEURSHIP AND LOCAL DEVELOPMENT IN CENTRAL AND EASTERN EUROPE

Regional Diversity and Local Development in the New Member States

Edited by

Paul Blokker
Post-Doctoral Fellow, Department of Sociology, University of Trento

Bruno Dallago
Professor of Economics and Academic Director,
Joint European Master in Contemporary Local Development, University of Trento, Italy

palgrave
macmillan

First published 2009 by
PALGRAVE MACMILLAN

Palgrave Macmillan in the UK is an imprint of Macmillan Publishers Limited, registered in England, company number 785998, of Houndmills, Basingstoke, Hampshire RG21 6XS.

Palgrave Macmillan in the US is a division of St Martin's Press LLC, 175 Fifth Avenue, New York, NY 10010.

Palgrave Macmillan is the global academic imprint of the above companies and has companies and representatives throughout the world.

Palgrave® and Macmillan® are registered trademarks in the United States, the United Kingdom, Europe and other countries.

ISBN 978–0–230–21819–2 hardback

This book is printed on paper suitable for recycling and made from fully managed and sustained forest sources. Logging, pulping and manufacturing processes are expected to conform to the environmental regulations of the country of origin.

A catalogue record for this book is available from the British Library.

A catalog record for this book is available from the Library of Congress.

10 9 8 7 6 5 4 3 2 1
18 17 16 15 14 13 12 11 10 09

Printed and bound in Great Britain by
CPI Antony Rowe, Chippenham and Eastbourne

Contents

List of Tables, Figures, Maps and Box vii

Preface xi

Notes on the Contributors xiii

Introduction: Regional Diversity and Local Development in the New Member States 1
Paul Blokker and Bruno Dallago

Part I: Regional Diversity in Central and Eastern Europe

1 **Time Horizons and the Institutional Underpinnings of Local Development** 31
Aleksander Surdej

2 **Regional Development in Central and Eastern Europe** 43
Grzegorz Gorzelak

3 **Local Development in a European Union Perspective: Cohesion and Regional Policies in Central and Eastern Europe** 63
Chiara Guglielmetti

4 **Poland's Great Transformation and the Lessons to be Learnt** 99
Grzegorz W. Kolodko

5 **Regional Labour Market Disparities in an Enlarged European Union** 122
Peter Huber

6 **Regional Development Effects of Foreign Direct Investment in Central and Eastern Europe** 166
Petr Pavlínek

Part II: European Integration, Regional Disparities and Developmental Strategies in New and Prospective Member States

7 Local Development and Local Government in Hungary: Challenges for a New Local Policy 197
Éva Ruttkay

8 Local Government in the Process of Transformation 228
Anna Gąsior-Niemiec

9 How to Avoid the '*Mezzogiorno* Syndrome': The Golden Burden of EU Funds in the Romanian Regions 253
Sorin Ioniţă

10 Multiple Shocks and Changes in the Development Gradient of Croatia's Regions 272
Ivo Bićanić and Vedrana Pribičević

Index 294

List of Tables, Figures, Maps and Box

Tables

1.1 Approaches to local development according to time horizon 33
1.2 Cultural barriers to local development: when certain aspects of TILTs become liability 36
1.3 Types of efficiency in local government 38
1.4 Examples of local public goods (LPG) 40
2.1 Regional differences in GDP per inhabitant, 1998–2003 51
2.2 Regional reactions to the post-socialist transformation 55
3.1 Principal interregional associations tackling social policy with CEE members 69
3.2 The regional policy architecture 70
3.3 Indicative allocation by Member States, 2007–2013 (current prices, € million) 78
3.4 Regions and Member States eligible for Cohesion Policy objective 80
3.5 Structural Funds absorption rates, 2000–2006 (funds paid/funds decided) 86
4.1 GDP per capita by region in 2000 as a percentage of the average 103
4.2 Spatial decomposition of income inequality at the subnational level, 1999 105
4.3 Unemployment in Poland 109
4.4 FDI stocks in Central and Eastern Europe – Spring 2001 (US$ billion) 113
4.5 Regional distribution of FDI in Poland (number of locations) 114
5.1 Development of national employment, unemployment and participation rates and shares of long-term unemployment in the EU27, 2004 and 2006 (in %) 128
5.2 Coefficient of variation of employment, participation and unemployment rates by gender, age and country group (averages 2004–2006) 131
5.3 Factor loadings and descriptive statistics for factors identified in the factor analysis 133

5.4 Regression results for regional employment, unemployment and participation rates 135
5.5 Results of Anova tests for differences in regional employment, unemployment and participation rates by age and gender 138
5.6 Group means and summary statistics of clusters (aggregate indicators) 140
5.7 Group means of clusters (disaggregated indicators) 141
5.8 Regression results for regional unemployment rates 144
5.9 Regression results for regional employment rates 146
5.A1 Regression results for regional unemployment rates of youths and older 154
5.A2 Regression results for regional male and female unemployment rates 157
5.A3 Regression results for regional employment rates of youths and older 160
5.A4 Regression results for regional male and female employment rates 163
6.1 The percentage share of individual regions on annual FDI inflows to CEE, 1990–2006 170
6.2 Regional distribution of FDI stock and FDI stock per capita in CEE in 2006 171
6.3 Inward FDI stock in CEE countries, 2006 172
6.4 Inward FDI stock per capita in CEE countries, 2006 173
6.5 Inward FDI stock as a percentage of gross domestic product in 2006 174
6.6 Regional distribution of FDI stock in Czechia at the NUTS3 level as of 31 December 2005 175
6.7 Top ten Czech districts (including Prague's districts) (NUTS4 level) according to FDI stock as of 31 December 2005 175
6.8 Regional distribution of FDI according to the NUTS3 regions in FIEs with at least 10 per cent of foreign ownership in Hungary as of 2006 176
6.9 Regional distribution of FDI according to the NUTS2 regions in FIEs with at least 10 per cent of foreign ownership in Hungary as of 2006 176
6.10 Regional distribution of sales and employment of FIEs with at least 10 per cent of foreign ownership according to the NUTS2 regions in Hungary in 2005 177
6.11 Regional distribution of FDI stock in Slovakia as of 31 December 2006 177

6.12 Potential positive and negative effects of FDI in host countries at the enterprise, local and regional scales 182
7.A1 Trends of regional development, 1995–2005 222
7.A2 Distribution of settlements according to population size, 2002 223
7.A3 Income steps by settlement categories, 2000 223
7.A4 Expenses of local governments in the percentage of GDP between 1990 and 2004 (%) 224
7.A5 Settlement size and balloting preferences, 2002 225
7.A6 Number of popular initiatives in the period 1999–2006 225
7.A7 Objectives of popular initiatives in the 1999–2006 period 226
7.A8 Indicative financial allocation plan of the operational programmes 227
10.1 Variety among Croatian counties, 2005 279
10.2 Inequality of county GDP in Croatia 286
10.3 Inequality of county per capita GDP in Croatia 286
10.4 Changes in ranking and development gradient of Croatian regions 289
10.5 Intra-Croatian redistribution of income 290

Figures

1.1 Triangle of local institutions design 40
2.1 GDP growth of selected post-socialist countries, 1990–2005 47
2.2 GDP per inhabitant in NUTS3 of new Member States, 2003, PPS 52
2.3 Growth of GDP in NUTS3 of new Member States, PPS 53
2.4 Relative growth of GDP in NUTS3 of new Member States, PPS 54
3.1 Financial framework for 2007–2013 75
3.2 Cohesion Policy financial resources allocation 77
5.1 National employment rates by age group and gender, 2004–2006 130
5.2 Cluster membership of European NUTS2 regions 139
6.1 Annual FDI inflows to CEE, 1990–2006 168
6.2 The share of annual FDI inflows to CEE on the total FDI inflows to Europe between 1990 and 2006 and the share of CEE regions on total annual FDI inflows to CEE, 1990–2006 169
9.1 GDP per capita in the NUTS2 region 258
9.2 Social problems by region, 2005 260

9.3 Structure of labour by sectors and regions, 2003 261
9.4 Agriculture and public administration, as % of total employment, three Romanian '*Mezzogiorno* counties' 262
9.5 Labour force supply and demand by region, forecast for 2005–2013 262
9.6 The two vectors of regional development: the West–East tidal wave; and the opposing diffusion-draining effects of large cities 263

Maps

2.1 The eastern–western split of Europe 44
4.1 Map of the Polish regions 101

Box

3.1 Administrative Organization of CEE new Member States and Applicant Countries 84

Preface

This book responds to an increased concern among scholars, experts, and policy makers in recent years for regional and local models of development and policies of local intervention, while 'contextualizing' this concern by means of the analysis of regionally and locally existing socioeconomic disparities, which constrain or facilitate such local possibilities for development, and by assessing the impact of EU enlargement and European – in particular, regional - policy.

The book's geographical focus is on the new EU Member States of Central and Eastern Europe (including both 2004 and 2007 enlargement countries and Croatia as an accession country). This is for three particular reasons: (i) in general, they have received considerably less attention in the literature on local development than the countries of Western Europe; (ii) few case-studies of the area exist; and (iii) in some cases dynamic and innovative strategies seem to be emerging, under both the influence of European integration and also the relocation of Western European local economic activities.

The analytical focus of the book is twofold: it offers comparative research of the distinct nature of regional differences within Central and Eastern Europe and offers a comparative and in-depth analysis – through a substantial number of case studies in the region – of regional and local institutional set-ups and strategies of local development.

The volume has its origins in an international seminar, promoted by the Unidea UniCredit Foundation in collaboration with the OECD/LEED Programme, CoDe Joint European Master in Comparative Local Development (University of Trento), EUROREG – the Centre for European Regional and Local Studies (Warsaw University), the Corvinus University of Budapest, the University of Ljubljana, the University of Regensburg and the Regional Studies Association – Polish section, and held at the University of Warsaw in November 2006. The seminar, in which a good part of the contributors to this volume participated, discussed regional diversity and local development in Central and Eastern Europe, the opportunities for both public and private actors to actively contribute to the improvement of local realities, and the regional and European context of such local strategies. The greater part of these chapters consist of revised versions of the contributions to the international seminar, while a number of contributions have been added on invitation by the editors (the chapters by Chiara Guglielmetti, Grzegorz W. Kolodko, Peter Huber, and Anna Gasior-Niemiec). We would like to thank the latter authors for their willingness to contribute to the volume, the various above-mentioned organizations that helped to realize the original seminar in Warsaw, most prominently the Unidea UniCredit Foundation, without whose support this volume would not have been possible, and, finally, Helen Licata for her valuable language assistance.

Paul Blokker
Bruno Dallago
Brighton and Trento, June 2008

Notes on the Contributors

Ivo Bićanić is Professor at the Faculty of Economics, University of Zagreb and Recurrent Visiting Professor at the Department of Economics, Central European University, Budapest. Following a degree from Zagreb University he completed his postgraduate studies in economics at St Antony's College, University of Oxford and a doctorate at Zagreb University. After research in the early 1990s on the break-up of Yugoslavia, his research interests shifted towards growth theory and the growth prospects of Croatia and Southeast European economies. His most recent publications include 'The Economic Lag of Transition Economies', in Vojmir Franicevic and Milica Uvalic (eds), *Equality, Participation, Transition: Essays in Honour of Branko Horvat* (2000); and 'Poverty and Development in Southeast Europe', *Journal of Southeast European and Black Sea Studies*, vol: 1 (2001).

Paul Blokker is currently a Post-Doctoral Fellow, University of Trento, Italy. Until 2009, he was a Marie Curie Research Fellow at the School of Social and Cultural Studies, University of Sussex. He holds a PhD from the European University Institute, Florence. He is a sociologist, interested in political and social theory, as well as issues of modernity, transformation and social change, democracy and democratization, and culture, and has undertaken extensive research on modernization in Central and Eastern Europe, in particular the case of Romania. His current research focus is on democratic political cultures and constitutionalisms in the region. Blokker is a member of the Centre for Social and Political Thought and the Sussex European Institute at the University of Sussex, and the Europe in the World Centre (EWC) at the University of Liverpool. His recent publications include: 'Rights, 'Identities, and Democracy in Post-Enlargement Europe', in: *Perspectives on European Politics and Society* (2008); 'Romania at the Intersection of Different Europes: Implications of a Pluri-Civilizational Encounter', in Johann Arnason and Natalie Doyle (eds), *Unity and Diversity in European History* (2008); 'Multiple Democracies: Political Culture and Democratic Variety in Post-Enlargement Europe', *Contemporary Politics*, 14(2) (2008); 'The "Unity in Diversity" of Enlarged Europe: From Central Europe to Post-nationality', *European Journal of Social Theory*, 11(2) (2008); Paul Blokker and Bruno Dallago (eds), *Youth Entrepreneurship and Local Development* *in Central and Eastern Europe* (2008); 'Post-Communist Modernization, Transition Studies, and Diversity in Europe', *European Journal of Social Theory*, 8(4) (2005): 503–25.

Bruno Dallago, PhD, is Professor of Economics at the University of Trento, Italy, and the University of Bologna. He is director of the School on Local Development at the University of Trento and Academic Director of the Erasmus Mundus Joint European Master in Comparative Local Development. He was President of the European Association for Comparative Economic Studies and visiting professor at various universities, including the University of California at Berkeley, USA, Hitotsubashi University, Tokyo, Japan, Tschwane University of Technology, Pretoria, South Africa and the University of North Carolina at Chapel Hill. He is the author and editor of several scholarly books and journal articles and has acted as a consultant to various international organizations, including the World Bank and the OECD. His research interests include comparative economics, the transforming economies of Central and East Europe, SMEs and entrepreneurship, and local development.

Anna Gąsior-Niemiec, a sociologist, graduated from Central European University/Lancaster University (MA) and Polish Academy of Sciences (PhD). Currently, she is a research associate at the European Studies Unit at the Institute of Philosophy and Sociology, Polish Academy of Sciences in Warsaw and holds the position of Assistant Professor at the Department of Political Science, University of Rzeszów, Poland. Her academic interests include governance, discourse, new regionalism, and local and regional transformation in Poland. Here recent publication have included 'Regional Development: the Role of Regional Governance, Social Capital and Cultural Endowment', in Patrycja Jakubowska, Antoni Kukliński, and Piotr Żuber (eds), *The Future of European Regions* (2007); 'Civil Society and New Modes of Governance in Poland', *Polish Sociological Review* 1 (157) 2007; "Polish Traditions of Self-organization, Social Capital and the Challenge of Europeanisation', in: Frane Adam (ed.), 2007, *Social Capital and Governance: Old and New Members in Comparison* (Münster: LIT Verlag, co-author: Piotr Gliński), and 'Regional Studies. A Practical Exercise in Transgressing Disciplines and Paradigms', in A. Gąsior-Niemiec and J. Niżnik (eds), *The Individuality of a Scholar and Advancement of Social Science* (2008).

Grzegorz Gorzelak is a professor of economics, specializing in regional and local development and policies. He is Director of the Centre for

European Regional and Local Studies (EUROREG) at the University of Warsaw, and president of the Polish Section of the Regional Studies Association. He has conducted research on multivariate statistical comparisons, the regional and local development of Poland and Central Europe, and post-socialist transition. He was advisor of the Polish government during the local government reform in 1990, manager of the PHARE programme for local government (1991), consultant to several local and regional authorities on development strategies, in Poland and in Ukraine. He has worked in collaboration with international organisations and institutions, including: the European Comission, the OECD, the World Bank and UN agencies. He has also been a member of several advisory councils to the Polish government, and of two committees of the Polish Academy of Sciences. He has coordinated several Polish and international research programmes on regional development, regional policy and post-socialist transition, and published (as author and editor) more than 30 books (several of them in English) and over 200 articles. He is Editor-in Chief of a scientific journal *Studia Regionalne I Lokalne*.

Chiara Guglielmetti is a post-doctoral researcher at the School on Local Development at the University of Trento. She completed her PhD in Law and Economics at the University of Bologna in 2007. Her research interests are human and local development, European regional policies, entrepreneurship and SMEs, the economics of inequality and welfare systems.

Peter Huber is a senior researcher at the Austrian Institute of Economic Research where he is a member of the research group on regional development and structural change. He studied economics at the University of Economics and Business Administration in Vienna and at the Institute for Advanced Studies, Vienna, where he also worked as a research assistant. His research interests include migration and regional development in transition. His publications include: 'Did Previous EU-Enlargements Change the Regional Distribution of Production? An Empirical Analysis of three Enlargement Episodes', forthcoming, *International Journal of Public Policy*; 'Regional Labour Market Developments in Transition: A Survey of the Empirical Literature', *European Journal of Comparative Economics*, 4(2), 2007, 263–98; 'Introduction' (with Jan Fidrmuc), *Empirica*, 4, 2007, 281–6; 'Who is Willing to Migrate in the CEECs? Evidence from the Czech Republic' (with Jan Fidrmuc), *Empirica*, 34(4), 2007, 351–69.

Sorin Ioniţă is the research director of the Romanian Academic Society (SAR, an independent think-tank), and associate lecturer at the National

School of Government (SNSPA), Bucharest and the Babes Bolyai University, Cluj; he also serves as a board member of the Romanian Social Development Fund. His main interests are decentralization, regional development, public sector reform and the evaluation of local development projects. He has worked as consultant for several EU-funded programmes and in various World Bank, OECD, and USAID regional assistance efforts, in Romania and other East European countries. Among other publications, he co-authored the textbook *Public Policies: Theory and Practice* (2002); and contributed to the textbook *Handbook of Administrative Reform: An International Perspective* (2008), with a chapter on public administration reform in the post-Communist world. Mr Ionita has an MSc in Engineering from the Bucharest Polytechnic School, an MA in Political Science and Public Policy from the Central European University (CEU), Budapest, and a PhD in Political Science from the National School of Government, Bucharest. In 2000–01 he was a Fulbright Fellow at Georgetown University, Washington DC.

Grzegorz W. Kolodko is a key architect of Polish reforms, and a world-renowned expert on economic development, emerging markets and post-Communist transition. He is the author of numerous books and research papers published in 24 languages. While Deputy Prime Minister and Minister of Finance (1994–97) he led Poland into membership of the OECD. Holding the same positions in 2002-03 he played an important role in Poland's integration with the European Union. He is the founder and Director of TIGER (www.tiger.edu.pl) – Transformation, Integration and Globalization Economic Research at the Kozminski Business School in Warsaw.

Petr Pavlínek is a Professor of Geography at the University of Nebraska at Omaha, USA and at Charles University in Prague, Czechia. His research and publications deal with the regional development effects of the post-socialist transformation in Central and Eastern Europe. His recent work has focused on the automobile industry restructuring and on the regional development effects of foreign direct investment in Central and Eastern Europe. He has published three books: *Economic Restructuring and Local Environmental Management in the Czech Republic* (1997), *Environmental Transitions: Transformation and Ecological Defence in Central and Eastern Europe* (with John Pickles, 2000), and *A Successful Transformation? Restructuring of the Czech Automobile Industry* (2008). His papers have been published in a number of academic journals, including *European*

Urban and Regional Studies, *Eurasian Geography and Economics*, *Environment and Planning A*, *Regional Studies*, *Europe–Asia Studies*, *Post-Communist Economies*, *The Professional Geographer* and *Tijdschrift voor Economische en Sociale Geografie*.

Vedrana Pribièeviæ is a collaborator and tutor at the Faculty of Economics, University of Zagreb.

Éva Ruttkay is an expert on Hungarian regional science and regional policy, and local policy and local development. Currently, she is a member of the advisory body of the Hungarian Settlement Association. Between 1992 and 2003 she took part in the negotiations of the integration process to the European Union in different positions as a high-ranking civil servant. In the past few years she turned once again to the academic field, and is lecturer at the Education Centre for the Hungarian Public Servants and the Modern Economies of Business High School, (Tatabánya, Hungary). She teaches a course in local development at the University of Babes-Bólyai, Cluj-Napoca (Romania). She took part in the foundation of a new high school for Public Finance and Public Administration. As a person committed to human rights, she participated as an expert in the European Programme devoted to increasing egalitarianism in EU countries. Her recent main fields of interest include the following: theoretical questions of regional science, financial aspects of regional policy, the problems of local economies, factors contributing to local development, regionalism and decentralization, the social and human factors of regionalism, and the connections of local democracy and local development. She has numerous publications and research papers on the above topics.

Aleksander Surdej is Professor of European Public Policies at the Cracow University of Economics. His research interests focus on the methods of public policy analysis and on the political economy of post-Communist transformations in Central Europe. He is the author and co-author of many articles, book chapters and policy reports published in English, Italian and Polish in academic publications and the publications of policy research centres such as the World Bank or UNU WIDER. He was a fellow of the Royal Institute of Advance Social Studies in the Netherlands, a Jean Monet Fellow at the EUI Florence and a grant holder of the CEU. Recently he has published a book in Polish on the subject of 'The Determinants of Efficiency of Administrative Instruments in Regulatory Policies'.

This page intentionally left blank

Introduction: Regional Diversity and Local Development in the New Member States[1]

Paul Blokker and Bruno Dallago

1.1 Introduction

The conventional view that holds that the post-1989 economic transformations in Central and Eastern Europe are in *grosso modo* about the convergence of these societies towards a western or Western European economic standard can in many ways be seen as still informing many studies on the issue (see, *inter alia*, Cernat, 2006; Lane, 2007; cf. Hay, 2004). One corollary of such a vision of convergence is the idea that the successful transformation from a communist economic system to a capitalist market economy is about the adoption of western models and institutions by the former communist countries – in other words, about 'innovation through imitation' (Keune *et al.*, 2004: 586). In the period of capitalist restructuring in the wake of mass production in the West ('post-Fordism'), the emphasis has often been on turning away from centralized approaches towards more flexible, decentralized ones, including in this a renaissance of cities and regions.[2] A similar focus on models of decentralized and regional economic development and small and medium-sized enterprise development is endorsed for the countries of the East. Such a focus positively relates to those reforms – mostly economic in nature – that were implemented in various countries and on different occasions before 1989 (cf. Bateman, 2000; Dallago and McIntyre, 2003; Hardy and Smith, 2004). A model of regionalism and local development seems to make sense in the context of such recent historical experiences. These include the failure of the excessive centralism or *dirigisme* of various Eastern European countries, but also the (uncertain) performance of reforms towards decentralization in some other countries, including Poland and Hungary, as well as Khruschev's *sovnarkhozy* and Gorbachev's *perestroika* in the Soviet Union.

Reconsidering local development is therefore of importance in the late transformation period, also due to the often negative and biased consequences of centralistic and macro-economic approaches to transformation that were based on unified blueprints and approaches that cut across-the-board economy and society, such as in the 'Washington consensus'. Based on the consequences of such a narrow circumscribed approach in economies and societies that were internally differentiated and included branches and areas artificially supported by centrally allocated resources, market and decentralized forces – such as the uneven localization of FDI and the activism of local governments to attract them – led to the polarization of transformation outcomes. As a consequence, some localities and social and economic strata and parties boomed while others lagged considerably behind or simply de-developed, with negative consequences for economic performance, social stability and political sustainability.

Local development is clearly equally relevant in the wider 'capitalist culture' of globalization-cum-localization that understands the regional and municipal levels as the strategically most effective level for restructuring and change (Hardy and Smith, 2004: 147–8; Macleod, 2001). Here, we also need to consider the locally asymmetric shocks that new institutional constellations – such as those related to globalization and EU membership – and policy undertakings – such as the international coordination of macroeconomic policies or the adoption of the *acquis communautaire* in structurally different countries – have caused. These very facts have led to highly differentiated consequences and different adaptation and evolution paths not only in specific countries, but also increasingly so in singular entities such as regions and localities within individual countries.

While in general a focus on regional and local development in the emergence of new capitalist systems can be highly rewarding and can critically correct approaches that conflate the macro level with internal homogeneity, we argue here that three aspects should not be lost sight of when analysing regional disparities and forms of local development in the transition economies of Central and Eastern Europe. First, while in general regional diversity and disparities, not least in the Central and Eastern European region, as well as the explanatory and normative failure of macro-level and statist approaches, justify an approach that prioritizes the meso level of economic development, the existence of multiple levels of policy making and economic activity that have a bearing on the local situation, and their mutual entanglement, should be recognized explicitly. In other words, decentralized approaches tend in some cases to overestimate the local potential for autonomous development, to the relative negligence of external forces and influences. We will elaborate on the complexity of local development in terms of multiple levels of governance in the first section below.

Secondly, while a convergence-induced approach seems often to imply an apparently irrevocable diffusion of the liberal market model (in the sense of Hall and Soskice, 2001), also as a result of the pressures of globalization, what we in reality seem to be witnessing in the transformation societies is the emergence of a complex variety of capitalist trajectories. Even when showing important overlap with more familiar western models, these can be said to differ in a number of significant respects (King and Szelenyi, 2005; Lane and Myant, 2007), and to portray significant disparities and variety also on a subnational level. We will elaborate on such different trajectories below, and elucidate the relevance of a 'varieties of capitalism' approach for the regional and local level.

It can be argued that one of the reasons that variety emerges is due to the fact that globalization works on a dual level. First, by opening and integrating markets and other forms of social interaction, it limits the role and scope of traditional local niches and pushes local constituencies to open to international interaction and competition. Secondly, due to this very fact of the opening up localities and including them in the broader global context, globalization offers new and advantageous opportunities for local development. In this context, the success of local actors depends upon their ability to utilize and properly combine local idiosyncrasies – and hence to specialize – in such a way that they can communicate and interact with other actors outside of the local context. This is particularly important when local actors enter global processes and global value chains. Indeed, in order to prosper globalization requires differences. At the same time, it requires that traditional local idiosyncrasies are combined, proposed and contextualized in novel ways to find new opportunities and uses and that new local competences are developed. New forms of ecological sensitivity, sensibility for cultural and ethnic identities, new demands for variety arising from increased levels of income and the conscience of new rights combine and strengthen the above processes and reinforce the failure of transplantation of institutions (Djankov *et al.*, 2003), and in turn tend to increase variety.

A further push to local development also comes from the enterprise policies in developed countries, including multinational companies, of investing in and delocalizing according to their choice of partners endowed with particularly attractive or advantageous features and local idiosyncrasies (Andreff, 1996). This in turn requires that local actors find a new position and role in the global economy – perhaps identifying and exploiting new agglomeration and network economies and upgrading local systems of innovation – and that localities succeed in re-contextualizing their idiosyncratic, often in particular tacit knowledge. These facts highlight the central role of local institutions as well as capacity building. The outcome, then, is one of integrating the global and the local, giving local roots to the global and global perspectives to the local.

In this perspective local policies, the local effect of national and global policies and the coordination among the different policy levels have particular importance. Local policies are fundamental to compensate for and foster local adaptation to asymmetric shocks that global policies cause and create in locally differentiated contexts and situations and opportunities (Buti and Sapir, 1999; Sapir Report, 2004). At the same time, local policies are fundamental in supporting and governing the specific adaptation mechanisms of value chains and core competences of enterprises, including the local partners of multinational companies.

Thirdly, while a local approach to capitalist development can shed important light on the premises of successful economic transformation, it should not result in relatively simplistic and decontextualized policy guidelines, or what Macleod calls 'policy prescriptions drafted for the purposes of renovating downbeat regions, … which are derived from theoretical investigations based on the selective experiences of ideal-typical hotspots' (Macleod, 2001: 809). In other words, apart from an overall hesitance to engage in ready-made policy prescriptions, a sound analytical approach to local development should avoid an analysis that is biased by a theoretical framework ultimately derived from a small number of successful experiences in capitalist contexts that differ from the ones being studied. Instead, and although placed in a global perspective, the approach should be contextual, historically grounded and 'interpretive' in the sense of being open to different capitalist trajectories, distinct combinations of modes of governance and strategies of development, and engaging in bringing out the complexity as well as both the negative and positive sides that such trajectories bring with them. In the third section below, we will expand on such a view in our proposal for an analytical framework grounded in a variety of modes of governance.

1.2 Multiple levels of economic governance

The processes of economic transformation in the post-Soviet world started in a world-historical and political-economic context in which the state as the dominant or 'natural' macroeconomic agent is perceived as in retreat or at least as subject to profound restructuring. In the post-Second World War era, the role of the state included an important distributive and also allocative function, even in market economies. In the Central and Eastern European countries, the role of the state was more expansive in that it also included the central planning of production and the allocation of resources and the distribution of income according to political and administrative ends with little concern for market processes. Although the economic reforms implemented in a number of Soviet-type societies since the 1960s, decreased – sometimes substantially so – the role of central planning, the distributive and allocative role of the state budget remained prominent while the financial discipline of organizations, including industrial enterprises, remained loose. This led to general shortage being the basic syndrome of those economies (Kornai, 1980, 1992).

In the post-1989 context, the state is subject to profound transformation, which is also a result of the increasing importance of institutions at the supranational level (most conspicuously so in the form of the European Union) and of those at the subnational level. These vertical shifts entail the (partial) transfer of significant elements of economic sovereignty and prerogatives of socioeconomic policy making from the state to the aforementioned levels. It can at the same time be argued that important changes are taking place not only in a vertical sense, but also on the horizontal level – that is, the boundaries between the public and the private sectors are shifting, leading not only to a greater role for civil society in policy making (cf. Bruszt, 2007; Keating, 2003: 9), but also to the emergence of complex forms of public–private entanglements, in that both business as well as civil society increasingly play a role in governance.

The process of restructuring of the state is strictly bound up with both the phenomenon of globalization as well as with the crisis of the Fordist-Keynesian model, both of which directly affect the nature of the state. But apart from an apparent loss of state prerogative, the transformation of the role of the state has been proposed and implemented in two alternative ways: the market failure approach, particularly in the market supportive sense in which the intervention of the state is called to correct for failures of the market, and the market-replacement approach, in which the state takes up production and other functions that the market would be theoretically able to perform.

Regarding the local level, it has often been argued that, in a globalized world, the subnational level acquires a more direct relation to the global economy, partially bypassing the state (Keating, 2003;

Macleod, 2001: 814). This upgrading of subnational economies regards, for instance, exposure to the global market, but also capacities to attract foreign direct investment, and the provision of institutional support for such investments, the clustering of firms in particular economic sectors in order to enhance competitiveness, or the management of local processes of restructuring. The latter is also the apparent outcome of a qualitative change in capitalism from a highly integrated economic system based on stability and large-scale economic agency, to one of 'reflexive capitalism' where flexibility and market coordination are widespread, and to which smaller economic units sometimes seem more adaptable. An alternative, more critical reading would be that, most of the time, regional economies are simply more exposed to global pressures than before (cf. Macleod 2001: 814–15). In this, one should take into careful consideration the effect of such factors as the level of development and the nature of competition and innovation, including the features and effects of local systems of innovation, on production factors, capabilities, tastes, consumption models and consequently on the features, role, and fate of regional and local economies and societies.

Below we assess various levels of governance – including the firm level, and the national and supranational levels, in their specific and complex relations with subnational governance.

1.3 The firm level

The success of organizations depends critically upon the solution given to a dual level of governance: defining the type of firm most capable of pursuing its goals in the given context; and protecting critical investments representing internal interests in order to have a well-coordinated form of decision making (Dallago, 2008). A successful organization is in fact one which is structurally streamlined to its role and goals and one in which those who invest in it see their investment protected and their efforts rewarded. If this is the case, decision making can be based largely on well-established routines (Nelson and Winter, 1982), is effective and efficient and is supported by the internal and external stakeholders of the firm.

Under normal circumstances the set of institutions relevant to the firm is stable. This makes long-term forecast and calculation by organizations possible and eases interaction within and among organizations and between these and other actors (particularly government offices and social representation bodies). Quite distinct is that of those organizations that, as the result of to external circumstances such as the transformations in Central and Eastern Europe, are operating in a rapidly transforming institutional context and consequently have to make drastic changes to their internal structure and organization. In this case, the issue of governance in firms is radically different from – and more complex and uncertain than in – standard situations.

In fact, in this case there is a dramatic and rapid change of external circumstances including the features of the economic, political and social systems and the variables that these determine, such as the nature and features of external stakeholders, taxation, industrial relations, competition and international relations, the state budget and the budget constraint, the participation in the division of labour and branch specialization. Such a change requires, as a first level governance, new types of firms with different boundaries. Following from this, internal (corporate) governance must be the one most suitable to support firm activities in a transforming and competitive context.

One important problem for firms during the process of transformation is that they simply lack the routines needed to simplify the analysis of problems and make reasonable decisions. As a consequence, firms are left without the coordinates necessary to take effective decisions. The pervasive uncertainty that this situation creates may drastically shorten their time horizon and may favour the use of opportunistic strategies of a distributive nature. Under these circumstances, governance has to solve particularly difficult problems: to learn the new context and internalize the new rules, in order to develop new routines, survive and prepare to operate profitably in the new context. This requires that individuals and organizations invest substantial quantities of valuable resources and that governments at different levels and other collective actors (such as associations) support firms in finding a proper solution to the double governance problem.

1.4 The local and regional level

It has often been argued that, in the wake of the capitalist era, in which Fordist capitalist production based on scale economies was dominant, i.e., large-scale firms structured and operating according to the logic of mass production, a modified, flexible form of capitalism has emerged that favours smaller, more flexible units, operating on a regional and local scale (Amin and Tomaney, 1995). In the post-Fordist era of diversified capitalism and global networks, local and regional systems of production have re-established a more prominent role and are focused on flexible and 'lean' forms of production, and are more adequately structured with regard to specialization and diversification than the large-scale, hierarchical, and vertically integrated firms of Fordism (Le Galès and Voelzkow, 2001). It is clear that the predominantly small and medium-sized enterprises (SMEs) that populate most local and regional economies are significantly different from the traditional, Fordist mass-production enterprises in that, mostly pertaining to their small size, these SMEs have vital necessities that transcend their own in-house capabilities and resources. But in those cases where regional cooperation has come off the ground successfully, such necessities have been provided through inter-firm collaboration, regional institutional procurement, associational provision, active local governments or a combination of all of these (see Le Galès and Voelzkow, 2001). Subnational economies can then offer both flexibility and competitiveness.

As the new age of capitalism is characterized more than anything else by the 'nexus of knowledge, information, and innovation' (Amin and Tomaney, 1995: 32), subnational economies will be able to benefit from the globalized economy and exploit development opportunities. These concern those economies that are, on the one hand, able to offer the flexible capacities and resources that correspond to this nexus (such as high skills, well-developed and flexible labour markets, R&D, institutional interdependence, local agglomeration of resources, knowledge and skills), and, on the other, that are, or manage to become, integrated into transnational, industrial networks in which information, skills and technological competencies circulate. As confirmed by statistical data on regional development in Europe (see, for example, EC, 2007), regional and local economies that are exploiting such opportunities are normally networked metropolitan cities and specialized industrial districts.

It seems, in this sense, clear that the primarily market- and competitiveness-based nature of the European economy tends to favour those subnational regions and localities that are favourably endowed by characteristics that correspond to the necessities of the global economy and, further, that attract highly skilled labour and other important resources, while those subnational economies and local systems that do not dispose of the right properties – regions and localities normally referred to as 'less developed' or 'less favoured' – are mostly excluded. And what is worse, there is a real risk of an increasing developmental and competitiveness gap between advanced and less developed subnational entities. In fact, in the post-1989 period, regional disparities have increased in Central and Eastern Europe (cf. Abrham, 2007). The less favoured regions are often dependent upon traditional industries, or primarily based on agriculture, and lack the institutional density and synergies of industrial clusters. Without public support from either the state or supranational institutions, they have severe difficulty in developing the flexible, knowledge-based capacities of the more successful regions and localities. Investment by multinational corporations that do dispose of the demanded requirements in the form of high skills, R&D resources, services, and managerial capacities invest in lesser developed subnational areas not only for reasons of cost reduction, but also because of other strategic considerations (including those regarding the market, skills and natural endowment), although they may not stimulate subnational competitive and learning potential (cf. Amin and Tomaney, 1995: 34).

The transformation of the Central and Eastern European economies has shown a decisive move away from the Soviet centralized model to a market-based model. In addition, as will be mentioned below, the European integration process has involved a 'push' towards regionalization (cf. Abrham, 2007; Bruszt, 2007). It can be said that the transformation from a macro-level oriented, statist economy to a market-based, regionally and locally oriented one has not been favoured by the Soviet legacy, which was characterized by a lack of substitutive social institutions (Smith and Swain, 1998: 38), weak subnational institutions (Bruszt, 2005) and perhaps more important pervasive soft budget constraint (Kornai, 1980). The marketization of the formerly communist economies has therefore consisted of the search for suitable models as well as for a mode of insertion into the world economy (Smith and Swain, 1998: 39).

It can be argued that the transition economies were experiencing three trajectories in their 'modes of extrication' from the communist system. First, the changes entailed the dissolution of socioeconomic networks, the isolation of institutions, and, in some cases, the outright adoption of market forms and integration into transnational networks, mostly bypassing subnational networks. Secondly, some subnational economies were able to construct new networks and reconfigure old ones, building on past legacies and creating new, locally embedded economies. And, thirdly, some networks, in a highly defensive vain, insulated themselves from the wider processes of marketization, leading to closed, over-embedded local economies that have not adapted to the new capitalist context (Smith and Swain, 1998: 40–3, 44–6).

1.5 National level

In the globalized era, the state was initially seen as being in a phase of irrevocable demise as a result of its 'rolling back' or 'dismantling' by various forces, including emerging global players (such as MNCs as well as the increasing importance of IFIs), as well as a re-emerging civil and economic society, demanding increasing autonomy. This situation was further supported by the widespread perception of a legitimacy crisis of the state and the emerging consensus in politico-economic circles on neoliberalism. Later on in the globalization debate, however, it was increasingly recognized that the state was not so much 'withering away' as it was in a phase of structural change. The state not so much cleared the field, but rather was turning from an interventionist and paternalistic player into a regulatory, mediating actor. This new role of the state has been variously described as the 'entrepreneurial state', 'strategic state', 'competition state', or 'Schumpeterian workfare state' (Jessop, 1994), or – particularly in underdeveloped countries and countries with severe transitional depression – the 'developmental state' (Lazonick, 2008). In this view, the state still plays a crucial role in guaranteeing the competitiveness of national and subnational economies, thus promoting development, and as a mediator between the global and the local levels.

The latter view, which sees the state as in a moment of qualitative restructuring, seems to correspond more neatly to European reality, and also to the particular situation of the newly capitalist societies in Central and Eastern Europe. For instance, in the Polish case, a country that has been often invoked in reference to neoliberal, shock therapy kind of economic policies, the state has not merely been significantly downsized in the wake of the regime change in 1989, but its role and functions have also been crucially redistributed among national, regional and local governmental levels, in particular with the reform of local governments in 1999: '[o]wing to the transfer [of policy competences from the central to the regional tier of government], the regional tier has been made responsible or at least co-responsible for both economic growth and welfare in regions' (Gasior-Niemiec, 2007: 65-6). Leaving aside whether or not such reforms have actually led to more efficient and economically successful policy making, and whether or not the principle of subsidiarity has been applied satisfactorily (see Poplawska, 2002), it is evident that the Polish state plays a highly important role in the national economy. The post-communist state is not so much to play the role of a proprietor of the means of production, and performer of managerial as well as productive functions in the economy (as was the case during communist times). Rather, the state is to provide the context for business activity, for instance in the form of crucial legal guarantees, significant public goods such as education and infrastructure, and is to act as negotiatior with and acquisitor of resources from supranational levels of governance (in a general sense, see Crouch and Streeck, 1997). In the case of the Central and

Eastern European economies, the state is often paradoxically empowered by the regional policy of the EU, in that in the prior absence of the regional level in these states, the central states have been pushed to create a regional dimension, as well as to control and implement regional restructuring and policy making (cf. Bruszt, 2007). While initially states were bypassed in the European Commission's emphasis on 'partnership' with subnational, that is, local and regional, authorities, states seem to have been able to regain important 'gatekeeping' powers in the context of regional policy (Allen, 2005).

1.6 Supranational level

The importance of the supranational level for regional and local economies in the transformation societies becomes clear in terms of the variegated impact of the European integration project on the transformation process. The importance of the EU for economic transformation and restructuring in general, and for local and regional development in particular, becomes evident in a twofold way: as an ex ante anchor in the enlargement process providing a reference model, a market, political and technical support and related conditionality (in particular, the so-called Copenhagen criteria); and in the regional policy of the EU that focuses on convergence and cohesion, the countering of regional disparities between European regions, and the inducement of competitiveness, economic growth, innovation and employment.

The 'return to Europe' of these societies has, to a significant degree, consisted of complying with the conditionality of membership stipulated by the EU in its enlargement strategy, which included the need for the adoption of the EU's *acquis communautaire*. This conditionality also comprised more specific conditions related to regionalization and the capacity to comply with the standards of regional policy, which as such was a highly significant part of the enlargement process. The *acquis*, and in particular chapter 21 on regional policy, can be said to include a particular 'model' of decentralized subnational governance and 'partnership', even though the particular perceptions of this model and emphases on levels of ultimate responsibility can differ over time and with regard to the actors involved (Hughes *et al.*, 2004: 528). The preparation of the accession countries for future EU funding was facilitated by European support in the form of, first, the so-called PHARE programme, and, later, also through the ISPA and SAPARD programmes.

While the pre-accession process and its logic of conditionality focused the preparation of the candidate states for membership, the regional policy is part of the overall EU instrumentarium of active policies to affect on the European economy. In this, the regional policy is clearly one of the policy fields of the EU (together with agricultural policy) where the new Member States expected important financial transfers to take place. The prominence given to the notion of 'Europe of the regions' in European economic policy making in the 1990s, and the resulting re-evaluation of the role of the Structural Funds and regional policy making, have contributed to a decisive regional twist in the European strategy to enhance competitiveness and innovative potential in the European economy (Bruszt, 2007: 1) and have made possible taking advantage of the many and important local idiosyncrasies (agglomeration of resources, knowledge, skills) that characterize Europe. The initial rationale for regional policy at the end of the 1980s was to mitigate the effects of the Internal Market and to prepare states for the EMU (Armstrong, 2007) and to attenuate asymmetric shocks from monetary unification and macro-policies (Buti and Sapir, 1999). During the 1990s, the regional policy gained an extra dimension in that it is clearly understood to be one of the main instruments to promote economic growth and competitiveness in Europe, since the early 2000s to be in line with the Lisbon and Gothenburg agendas.

This renewed attention for the regional level in economic integration, together with the 'transmitted' EU model of regional governance through conditionality, has profoundly affected the role of subnational regions in the transition economies. The 'Europeanization' of the new Member States consists partly in the moving away from what had been in some countries an extremely centralized and statist economy or to give economic rationale to previously regionally decentralized economies and societies, to the revalorization of regions, and the redistribution of decision-making power and competences to regional and local governments (cf. Dieringer and Lindstrom, 2002).

The impact of Europeanization is evident in the run-up to the membership of the transformation countries. First of all, the so-called Copenhagen criteria that formed the broad benchmarks for the Commission's assessment of the application countries' readiness to join the EU-induced reforms of subnational administrative systems on the basis of the *acquis communautaire* (Bruszt, 2007: 2). Secondly, the prospect of financial redistribution through the EU's Cohesion Policy, including the so-called Structural and Cohesion Funds, induced the prospective Member States to reform subnational structures in order to be eligible for these redistributional policies.[3] Major reforms have, for instance, been undertaken by Poland and Hungary in order to improve the quality of subnational governments, and also to enhance the capacity to receive regional funding by increasing the size of subnational regions to make them compatible with EU standards (Allen, 2005: 234; Hughes *et al.*, 2004).

A major part of the EU's regional policy consists of the so-called Structural Funds. During the period of the third multi-annual budget (2000–2006), and, more generally, during most of the pre-accession process, the EU focused in its regional policy on three types of regions that were eligible to Structural Funds, based on three main policy objectives: less favoured regions, regions in industrial decline, and rural and agricultural regions.[4] During the period of the fourth multi-annual budget (2007–2013), regional policy has been redefined and focuses on the priorities of convergence (similar to the former Objective 1, covering regions with a GDP less than 75 per cent of the EU average), competitiveness and employment (replacing Objectives 2 and 3, focusing both on regional restructuring and human capital), and territorial cooperation (cross-border and transnational cooperation) (Allen, 2005).

It has been argued that, rather than imposing a singular model of EU regionalization on the new Member States, the regional policy has been adapted to national political institutional arrangements. Therefore, its adoption by the New Member States might be expected to have had a variegated impact on regional governance and empowerment, especially since the implementation of assistance was mostly the responsibility of Member States, as stipulated in chapter 21 of the *acquis* dealing with regional policy (Hughes *et al.* 2004).

1.7 Diversity in capitalist trajectories

The convergence thesis regarding the emergence of capitalism and the forms of governance in Central and Eastern Europe can be contradicted in quite a number of ways, not only in terms of qualitative differences between new and old member countries (as, for instance, visible in differences in social welfare regimes, see Keune, 2006), but also on the ground of intra-regional diversity (see Bachtler, Downes, and Gorzelak, 2000). As King and Szelenyi (2005) have argued, the transition trajectories of building capitalism and restructuring the economy have not been the same throughout the region. Significant differences can be identified, among others, by looking at the different kinds of political and economic elites involved, the emerging types of capitalism, the role of foreign capital in economic transformation and the dynamics of accumulation, the importance of forms of political capitalism and clientelism, the relation between market and non-market forms of coordination, the structure of the economy, and the role of the state and local governments (cf. King and Szelenyi, 2005: 213; see also Bachtler, Downes and Gorzelak, 2000: 3; Lane and Myant, 2007). According to King and Szelenyi, the difference between forms of 'capitalism from without' and 'capitalism from above' coincides with a regional distinction between East-Central, and Eastern and South-Eastern Europe.[5]

Regarding macro-level transformations, the 'varieties of capitalism' literature has not yet classified the emerging capitalist systems in Central and Eastern Europe, and does not seem to understand the theoretical model as being in need of correction because of them. This is partly because these systems are in a way understood to be in a situation of liminality, that is, in between one system and the other. The theory of varieties of capitalism therefore seems to predict that the emerging capitalisms fit one or the other of the types of capitalism that have been identified in the world of advanced capitalism (most prominently the Anglo-Saxon model and the continental European model – cf. Berger and Dore, 1996; Dore, 2000). Current divergence is then mainly treated as transitory (Cernat, 2006). The assumptions are that Central and Eastern European capitalisms will converge to existing models because of external pressures through globalization and Europeanization, and that capitalisms in the region, if they are to be efficient and successful, need to adopt one or the other model. This also means that the possibility of globalization and Europeanization leading to divergence rather than convergence is not considered (cf. Hay, 2004).

The assumption of dual or co-convergence (to either a liberal market model or a social market economy) excludes the emergence of hybrid and original forms, or peripheral types of capitalist systems. It is here that a separate debate on the emerging capitalisms in Central and Eastern European countries (CEECs) has added substantially to the understanding of different, novel forms of capitalism. A number of approaches in the field of 'transition studies' has contradicted assumptions of convergence on the basis of: (1) the idea of path dependence, i.e., the expectation that past legacies shape the construction of contemporary institutions, therefore leading to novel outcomes or 'bricolage' (see especially Stark, 1990; Dallago, 1996, Stark and Bruszt, 1998); and (2) the proposition that the role of the primary capitalist actors in the transition region is different from advanced economies, therefore indicating a significant – but possibly transitory – difference in the emerging capitalist order (see Eyal *et al.*, 1998; King and Szelenyi, 2005).

In a recent contribution by King and Szelenyi (2005), three ideal-types of transition capitalism are identified: liberal capitalism, hybrid capitalism and patrimonial capitalism. Despite the convincing arguments mentioned above against assumptions of convergence and a-historicism of neoliberal approaches, and the well-argued attempts to reconstruct alternative trajectories in the construction of capitalism, both seem to operate with an overly restrictive understanding of the outcome of the transformation process, while neglecting potential constructions and dynamics that do not fall into their respective *teloi* of transition (a network society in the case of Stark and Bruszt, a managerial-technocratic project in the case of Eyal *et al.*) (see Blokker, 2005). Other experiences are then either considered to be beyond the scope of analysis, or become instances of 'involution' rather than transition. King and Szelenyi, for instance, argue that Hungarian capitalism has developed into a form of 'capitalism from without', with potential to 'upgrade' to liberal capitalism (convergence), while Romania represents a form of 'patrimonial capitalism', which is characterized by a 'vicious circle of declining state capacity and market withdrawal' (involution) (2005: 220).

One might conclude from this that CEECs are 'locked into' particular trajectories, from which it is nearly impossible to escape. But national designations of capitalism often forego the transformative capacities of agency as well as the importance of subnational diversity – that is, regional and local economies that might deviate from the 'national model', create linkages with external actors, and potentially introduce change that might affect the whole system. In contrast, we seek to challenge homogeneous understandings of varieties of capitalism and strong assumptions of convergence. It is necessary to create a bridge between the approaches that explain varieties of capitalism on a national level and those that point to the increasing importance of the territory in economic development and the creation of local production systems. Our approach emphasizes the possibility of subnational divergence and innovation by means of the potential circumvention of pressures for convergence by local actors. In this, it builds on neoclassical sociology (path dependency; innovation through recombination; actor-centred institutionalism), as well as on the local development literature, as it has been developed with regard to Western Europe (see, e.g., Crouch *et al.*, 2001; Garofoli, 2002; Piore and Sabel, 1984; Scott and Storper, 1992) and Eastern Europe (Grabher and Stark, 1997; Pickles and Smith, 1998). We propose to avoid the determinism and implicit convergence theses immanent in the former and the too optimistic interpretations of autonomous local development in (some of) the latter.

1.8 An interpretive approach to local development

If one accepts the premise that modern capitalist systems necessarily differ from each other (as in neoclassical sociology and comparative economics), one needs to carefully analyse in what qualitative difference between systems consists. Differences are based on different (combinations of) institutional ways of regulating and coordinating the economy (cf. Polanyi, 1985; see also Fligstein, 2001). Such coordinating mechanisms can be defined as 'modes of governance'. In principle, five modes of governance can be identified: market, state, hierarchy, community, and association (Boyer and Hollingsworth, 1997; Crouch *et al.*, 2001; Crouch, 2005). As different forms of capitalism combine a variety of ways of coordinating the economy, based on various degrees of involvement of political and economic actors, modes of governance can be an effective device for researching varieties of emerging capitalisms in transformation societies.

However, a purely institutional analysis of differences tends to be descriptive and can therefore only give a partial picture of (emerging) differences between systems. In particular, institutional definitions of difference have the tendency to presuppose either the prevalence of one or another proven model of capitalism (Hall and Soskice, 2001) or assume that past legacies will constitute the present through combinations of old and new institutions (Stark and Bruszt, 1998; Dobry, 2000). In this, they risk underestimating how such combinations are mediated by social and political actors, how innovative (constellations of) actors can induce rapid change, and how such change is the result of the (temporary) settlement of conflict.

Basically, three local developmental strategies can be identified: (a) marketization; (b) local community/context-building; and (c) insulation. Strategies of transformation and economic development can be identified in terms of their promotion of combinations of modes of governance (market, state, community). Crouch and Trigilia (2001) developed three dimensions of interaction to study different forms of governance: endogeneity/exogeneity (agency), substance/procedure (content) and formality/informality (implementation). These three dimensions are both useful to identify existing institutional models of governance in a region/locality, and to analyse the formulation/construction of developmental strategies by elites.

By relating these local strategies to national capitalist systems and local systems and their legacies, it is possible to indicate to what extent local elites are constrained by national (and transnational) institutions and pressures, and to what extent they can deviate, and possibly innovate and influence bottom-up processes. Local diversity in constructing capitalism is then understood as a possible indication of structural subnational diversity, the construction of hybrid models of capitalism (based on distinct combinations of modes of governance, which need not necessarily to be complementary), and possibly even of more widespread change. By focusing on local governance, it is possible to analyse to what extent actors have been constrained to reproduce different models of capitalism during most of the 1990s and arguably the early 2000s in economic transformation.

1.8.1 Overview of the book

The focus of the remainder of the book is twofold. In the first section, the book theoretically and comparatively researches the distinct nature of subnational differences within Central and Eastern Europe. It challenges the idea that the economic growth that the new Member States experienced in the run-up to and after accession to the European Union (EU) creates convergence across the board. Rather the contrary is argued – that is, that regional and local differences have widened since 1989. In almost all the post-communist countries a substantial share of economic activity is concentrated in the capital regions, which often also have the highest GDP per capita, and in other regional centres. Other regions, however, in particular rural and de-industrialized areas, suffer from high rates of unemployment, experience the out-migration of young and well-educated people, and have difficulties in adapting to the market economy and stimulating economic growth. This part of the book offers both innovative approaches for the analysis of regional and local development and a wide comparative and up-to-date analysis of regional and local socioeconomic disparities in Central and Eastern Europe, which are the result of complex processes, related to past legacies, available resources, (local and national) policy strategies, ungoverned market processes, investment patterns, and European and global integration.

In the first chapter, Aleksander Surdej offers an original account of the different time horizons related to different processes of local development. He argues that in the early globalization debate it seemed that local economies were the major victims of a global economy increasingly dominated by footloose multinational corporations and flows of capital, but that now it is acknowledged that, first of all, the impact of globalization on local economies is less significant in certain respects, and, secondly, that local economies can offer local social and cultural factors that are extremely important for successful economic activity. This means that increasingly 'soft', cultural factors are considered to be important for local development as well as general economic activity, but, and here Surdej's chapter is most original, such cultural factors often operate and emerge in a different time horizon than those of instant business calculations and managerial decisions. And, most significant for the topic of this book – regional disparities and local development – the crucial, soft factors of local economies that are most important in contributing to the development of 'local collective competition goods' that in turn attract significant external investors and firms are primarily provided by local governments and other actors.

In the second chapter, Grzegorz Gorzelak relates regional developmental disparities to a long-term perspective of the economic position of the region in the European context. He argues for a strong thesis that holds that it is only with the collapse of communist regimes that several centuries of economic backwardness of the East-Central European region can potentially be overcome, in particular in the context of the European integration project. But Gorzelak's depiction of a heritage of peripherality shared equally throughout the region does not lead him to draw one-sidedly pessimistic and deterministic conclusions regarding the region's future, nor make him argue for a homogenized treatment of the impact of this legacy on the region. In empirical terms, he points to the very different trajectories that countries have undertaken since 1989, ranging from 'leaders' to 'winners' to 'losers' and 'laggards'. In theoretical terms, he argues against the search for a singular solution for all nations and regions engaged in development, and in favour of a diversified approach in which the differences of the categories defined earlier are acknowledged explicitly. In a discussion of EU Structural and Cohesion Policy, this leads him to conclude – in a rather provocative manner – that regional policies should not so much follow a principle of 'equalization' in which all regions have equal access to funding, but rather to an adherence to the principle of functionality, focusing on those regions that are able to adapt to current global standards of capitalism.

In Chiara Guglielmetti's contribution (chapter 3), the European dimension to local development is the focal point. The chapter analyzes the process which led to the present structure of the EU's regional and Cohesion Policy, the role played by the different stakeholders and the evolution and rethinking of policy rationale recently undertaken by the European Commission, in the perspective of the accession of ten Central and Eastern European Countries. She asks how much and in what direction the recent Eastern Enlargement will condition European Union Cohesion Policy tenets, which features of European Cohesion

Policy have been addressed by the wide revision process that has taken place, and to what extent the EU budget's structure and process is efficient and consistent with cohesion policy aims. The chapter addresses the aforementioned questions, arguing for the necessity of maintaining both the allocative and the distributive function of EU regional policy, and stressing the value-added role of the EU in fostering a more even and balanced regional and local development.

In chapter 4 on Poland, Grzegorz W. Kolodko argues that while it is often assumed that Poland is one of the frontrunners in economic transformation, such a reading should be treated with caution. The proportion of people marginalized by social exclusion in post-socialist transforming economies – including Poland – has increased markedly in the past two decades. In this, it should be acknowledged that there are important national and subnational disparities, but that the situation differs from country to country and, within each specific country, from region to region. Following the economic transformation and growth starting in 1990, and despite sustained attempts at decentralization and the stimulation of local developmental polities, regional and social disparities in Poland have increased significantly. It can, however, at the same time be argued that Poland has been relatively successful in its economic transformation, leading Kolodko ultimately into arguing that '[t]here is no doubt that later on Poland has handled the challenges of the great transformation better in many respects than other countries'. Hence, after almost 20 years of an ongoing post-socialist transformation towards a democratic polity, a market economy and civil society, there are, according to Kolodko, a number of significant lessons that other countries, especially the so-called emerging markets, can learn from the Polish experience, at both the national and subnational levels.

In his chapter on labour market developments (chapter 5), Peter Huber analyses regional labour market problems in the 27 Member States of the EU, using disaggregated data on regional employment, unemployment and participation rates. His main question is whether accession changed disparities in regional labour market conditions and to what degree the structure of employment, unemployment and participation rates in the 12 new Member States differs from the original 15 members. He finds that aggregate labour market disparities are comparable between the two country groups, but that there are important structural differences. He explains the latter by referring to five important factors that account for a large part of the structural differences: overall unemployment in a region; female employment and participation rates; youth employment and participation rates; the employment rates of prime age males; and the participation and employment rates of the elderly. By means of cluster analysis, it is suggested that regions in the new Member States are most similar in structural labour market characteristics to many German and French NUTS 2 regions. In addition, regression analysis suggests that the correlates of aggregate regional employment and unemployment rates between the two groups do not differ dramatically, but that there may be some differences with respect to employment rates of individual demographic groups. Huber concludes that significant differences between old and new Member States particularly pertain to long-term unemployment shares as well as lower employment and participation rates of males, as well as higher youth unemployment rates in the recently acceded countries (for an elaborate discussion of the latter point, see Blokker and Dallago, 2008). At the same time, differences within the region are variegated, and no simplistic East–West distinctions seem to hold true. Here, national institutions and regional determinants play a significant role.

In chapter 6, Pavlinek analyses the gradual and selective, but definite (re-)integration of the Central and Eastern European economies into the wider European and global economies. From the start of this process of reintegration and redirection of trade flows, a strong emphasis was placed by actors that are both internal and external to the region on the inflow of FDI as a major factor in the restructuring of the post-communist economies, and in the stimulation of economic development. The effects of FDI are, in particular, visible at the company and enterprise level, by contributing to the transfer of technology and knowledge, the restructuring of organizations, the training of workers, the transfer of management know-how and practices, and new strategies for production and distribution. Despite the major inflow of FDI in the Central and Eastern European region since the early 1990s, its level is relatively low compared to the inflow in advanced economies in the wider European and global context. Furthermore, FDI inflow and its effects have been highly uneven in the region, both sectorally and geographically speaking. Pavlinek argues that the inflow of FDI does not, moreover, necessarily lead to positive and long-term beneficial effects on regional development. Of particular importance is the attraction of high value-added types of investment, attracted in particular by an educated and skilled labour force. Especially metropolitan areas are, however, able to attract this type of investment, inducing further regional disparities within countries. A similar argument is made regarding the embedment of foreign firms, which tends to be higher in more developed regions, therefore contributing to an increase in regional polarization.

In the second section, the book comes down to the level of subnational localities to analyze – through a substantial number of case studies in the region – regional and local institutional set-ups and strategies of local development. Local development is often seen as being centred around the start-up of new enterprises and the development of local contexts, thus stimulating job-creation and entrepreneurial opportunities. However, so it is argued in the book, the development of small and medium-sized enterprises (SMEs) does not necessarily lead to 'catch-up' economic growth. Differences in performance need to be related to historical trajectories, existing resources, and local development strategies. In addition, multiple levels need to be considered, as local economies are not self-sufficient but participating in a multi-level interplay of governance. The second section confronts distinct case studies focusing on Poland, Hungary, Romania and Croatia in the light of the above-mentioned factors.

Ruttkay's chapter on Hungary (chapter 7) gives a detailed overview of the regional and local institutional and legal changes since the early days of post-communist transformation. In this contribution Ruttkay focuses on the legal institutionalization (including the relevant constitutional and statutory laws), institutional restructuring and public duties, and economic management and planning that together constitute the regional and local level of government and governance. After an analysis of the main points of political contention and institutional dilemmas regarding the development of regional and local structures, Ruttkay discusses the prospects for local policy making, particularly in respect of social and economic policy making. According to her, the main problems include the lack of local finance and a clear demarcation of national and local and regional responsibilities. Progress in decentralization is continuing in Hungary, but at a slow pace, and various institutional structures, including so-called micro-regions, tend to overlap. Ruttkay therefore calls for a rationalization of local and regional structures.

Anna Gasior-Niemiec's in-depth account of the transformation of subnational government in Poland since the early 1990s (chapter 8) provides significant insights into the emergence, structure, and quality of regional and local governance in the new EU Member States. Gasior-Niemiec argues that while the Europeanization of Polish public discourse has been successfully permeated by ideas of local and 'good governance', decentralization, and the mobilization of endogenous resources, the actual practices are lagging behind. Three rationales can account for a paradoxical situation of both central and regional governments in the implementation of the Structural Funds in the period 2004–6: the normative pressure of the EU model of good governance; the political importance and strength of regional governments; and the nature of the regional development arena. Gasior-Niemiec illustrates her argument with a discussion of the ERDF/ESF monitoring and steering committees that were implemented in the post-accession period. She concludes that even if these committees were to incorporate the logic of new modes of governance that operate on the basis of 'soft' methods rather than legal means, in reality the impact of social partners on policy-making processes is disappointing. Equally, the transition from government to governance seems to date not to have led to the expected results and a successful implementation of a new mode of governance in Poland.

Ionita shows in his contribution on Romania (chapter 9) how Romanian local public and private actors have in the past few years been strongly influenced by the process of EU integration, in both a direct and an indirect sense. Pre-accession funds have contributed to an increased quantity and quality of fixed capital investment in certain industrial sectors where SMEs are predominant, while local and regional governments gained additional resources for the much-needed public infrastructure. Indirectly, the general framework of economic stability created by the prospect of EU accession bolstered growth and encouraged foreign greenfield investments, while the rules for EU funds acted as a disciplinary mechanism and a stimulus for the adoption of new management techniques in both SMEs and the public administration. By contrast, according to Ionita, the impact of public programmes aimed at investing in human resources is more uncertain, because, traditionally, local and regional governments have little role to play in this policy area, and as a result few tools to implement generous strategies. Ionita argues, moreover, that the gradual integration of Romania into the EU led to a dramatic decline in the level of unemployment, forcing even the central employment agencies to rethink their mission. In the programmatic areas where the natural absorption of funds has been low, undesirable supply-driven effects of projects are already becoming visible. What is more, a certain duality in the public administration tends to appear between policy areas and departments that are eligible to run EU projects (investments, HR, etc.) and those that are not: the former offer better payment and more exciting career opportunities, and thus strip the latter of resources and expertise that is, in any event, in increasingly scarce supply. All of these changes, either triggered directly by the process of accession or influenced by the broader macroeconomic and demographic developments, have affected the Romanian regions unevenly, advancing as a 'wave' from West towards East.

In the final chapter (chapter 10), which analyses the prospective Member State Croatia, Ivo Bićanić and Vedrana Pribičević critically assess the idea that there has recently been a major increase in regional inequality in Croatia, that some regions increasingly lag behind, and that spatial divergence is increasing in the Croatian economy. According to Bićanić and Pribičević, regional disparities and divergence should be related to the combined effect of four shocks to which the economy has been exposed since 1989. The shocks in question are transformation, independence, war and integration. An additional factor is whether or not areas are eligible for redistributive transfers and how such transfers have changed over time. The authors approach the issue by discussing two particular aspects of spatial inequality. The first is internal and concerns the inequality and development gradient of Croatia's regions. The second is external and concerns Croatia's position vis-à-vis the European development gradient. The authors conclude that while it is true that during the past 16 years Croatian regions have faced enormous instability, in general the inequality of regions in per capita terms has remained virtually unchanged during the period. That said, the inequality of regional gross income has increased and the position of the economy in the European context has worsened. The main explanation the authors give for the relative continuity during the period of exposure to shocks is by referring to dramatic changes in population (such as internal shifts, emigration and immigration).

Notes

1. In this introduction as elsewhere in the book, the terms 'regional', 'municipal' and 'local' are used, sometimes interchangeably, to identify the subnational level of territories and processes.
2. A view strongly influenced by the apparent success stories of industrial clusters in Western Europe and also referred to as 'new regionalism' (see, among others, Macleod, 2001).
3. See for the recent redefinition of the EU's Cohesion Policy, EC 2007 and chapter 3 in this book.
4. EU definitions distinguish Objective 1 (regions 'lagging behind'), Objective 2 (regions experiencing 'industrial decline'), and Objective 5b (rural and agricultural regions) (cf. Cappelen *et al.*, 2003). Objective 1 regions comprised regions that have a GDP per capita level that is lower than 75 per cent of the EU average. The Objective 1 regions are of great importance for the new Member States in that most of their regions, with the exception of a number of capital cities and urban areas such as Prague and Bratislava, are clearly falling within the definition of 'less favoured regions'. The effect of the Structural Funds is expected to be a convergence in terms of GDP levels between

regions in Europe and an increase in regional administrative capacity (cf. EC, 2007).

5. Lane (2007) argues that two major types of capitalism are developing in the former state socialist countries: a type similar to the continental type of market capitalism (similar to what Hall and Soskice indicate by coordinated market capitalism) and a hybrid state/market uncoordinated capitalism. While the former can be found in the new Member States of the EU, the latter applies to, for instance, Russia and the Ukraine. Lane places particular emphasis on the higher state involvement in the economy (in respect to the West) in both these models (Lane 2007: 34–5).

References

Abrham, J. (2007) 'Regional Differentiation of the New Member States of the European Union', CAP Working Paper, September.

Allen, D. (2005) 'Cohesion and the Structural Funds', in H. Wallace et al. (eds), *Policy-Making in the European Union*, Fifth Edition, Oxford University Press, pp. 213–42.

Amin, A. and J. Tomaney (1995) *Behind the Myth of European Union: Prospects for Cohesion*, London and New York: Routledge.

Amin, A. and J. Hausner (1997) *Beyond Market and Hierarchy: Interactive Governance and Social Complexity*, Cheltenham, UK and Lyme, NH: Edward Elgar.

Andreff, Wladimir (1996) *Les multinationales globales*, Paris: Ed. La Découverte

Armstrong, H. (2007) 'Regional Policy', in A. El-Agraa (ed.), *The European Union. Economics and Policies*, 8th edition, Cambridge: Cambridge University Press, pp. 421–40.

Bachtler, J., R. Downes and G. Gorzelak (eds) (2000) *Transition, Cohesion and Regional Policy in Central and Eastern Europe*, Aldershot, UK and Burlington, USA: Ashgate.

Bateman M. (2000) 'Neo-Liberalism, SME Development and the Role of Business Support Centres in the Transition Economies of Central and Eastern Europe', *Small Business Economics* 14, 275–9.

Berger, Suzanne and Ronald Dore (eds) (1996) *National diversity and global capitalism*, Ithaca, NY: Cornell University Press

Blokker, P. (2005) 'Post-Communist Modernization, Transition Studies, and Diversity in Europe', *European Journal of Social Theory* 8(4), 503–25.

Blokker, P. and B. Dallago (eds) (2008) *Youth Entrepreneurship and Local Development in Central and Eastern Europe*, Aldershot: Ashgate.

Boyer, R. and J.R. Hollingsworth (eds) (1997) *Contemporary Capitalism: the Embeddedness of Institutions*, Cambridge and New York: Cambridge University Press.

Bruszt, L. (2005) 'Governing Subnational/regional Institutional Change: Evolution of Regional (Subnational Developmental Regimes – Challenges for Institution-building in the CEE Countries and Subnational Institutional Experimentation', NEWGOV (available at: http://www.eu-newgov.org/database/DELIV/D15D01_Evolution_of_Regional_development_Regimes.pdf).

Bruszt, L. (2007) 'Multi-Level Governance – The Eastern Versions. Emerging Patterns of Regional Developmental Governance in the New Member States', SPS Working Paper 2007/13, Florence: European University Institute.

Buti, M. and A. Sapir (eds) (1999) *La politica economica nell'Unione economica e monetaria europea*, Bologna: Il Mulino.

Cappelen, A., Fulvio Castellacci, Jan Fagerberg and Bart Verspagen (2003), 'The Impact of EU Regional Support on Growth and Convergence in the European Union', *Journal of Common Market Studies* 41(4), 621–44.

Cernat, L. (2006) *Europeanization: Varieties of Capitalism and Economic Performance in Central and Eastern Europe*, Basingstoke and New York: Palgrave.

Crouch, C., P. Le Galès, C. Trigilia and H. Voelzkow (2001) *Local Production Systems in Europe: Rise or Demise?*, Oxford and New York: Oxford University Press.

Crouch, C., P. Le Galès, C. Trigilia and H. Voelzkow (2004) *Changing Governance of Local Economies: Responses of European Local Production Systems*, Oxford and New York: Oxford University Press.

Crouch, C. (2005) *Capitalist Diversity and Change: Recombinant Governance and Institutional Entrepreneurs*, Oxford and New York: Oxford University Press.

Crouch, C. and C. Trigilia (2001) 'Conclusions: Still Local Economies in Global Capitalism?', in C. Crouch et al., *Changing Governance of Local Economies: Responses of European Local Production Systems*, Oxford and New York: Oxford University Press, pp. 212–37.

Crouch, C. and W. Streeck (1997) *Political Economy of Modern Capitalism: Mapping Convergence and Diversity*, London and Thousand Oaks, CA: Sage.

Dallago, Bruno (1996) 'Between Spontaneity and Economic Engineering: Path Dependence in the Process of Economic Transition', in *Economic Developments and Reforms in Cooperation Partner Countries: The Social and Human Dimension*, Brussels: NATO, pp. 73–86.

Dallago, Bruno (2008) 'The Budget Constraint in the Governance of Organizations', *Corporate Ownership and Control*, June 2008, 5(4), 219–32.

Dallago, B. and R.J. McIntyre (2003) *Small and Medium Enterprises in Transitional Economies*, Basingstoke: Palgrave Macmillan.

Dieringer, J. and N. Lindstrom (2002) 'The Europeanization of Regions in EU-Applicant Countries. A Comparative Analysis of Hungary, Poland, Romania and Slovenia', paper for the 7th EACES Conference in Forli, June.

Djankov, S. et al. (2003) 'The New Comparative Economics' by Djankov, Simeon, Edward L. Glaeser, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, *Journal of Comparative Economics* 31(4), 595–619.

Dobry, M. (2000) 'Paths, Choices, Outcomes, and Uncertainty: Elements for a Critique of Transological Reasoning', in M. Dobry (ed.), *Democratic and Capitalist Transitions in Eastern Europe: Lessons for the Social Sciences*, Dordrecht, Boston and London: Kluwer, pp. 49–70.

Dore, Ronald (2000) *Stock Market Capitalism, Welfare Capitalism: Japan and Germany versus the Anglo-Saxons*, Oxford: Oxford University Press.

European Commission (2007) *Growing Regions, Growing Europe: Fourth Report on Economic and Social Cohesion*, Luxembourg: European Commission.

Eyal, Gil, Ivan Szelenyi and Eleanor Townsley (1998) *Making Capitalism without Capitalists: Class Formation and Elite Struggles in Post-Communist Central Europe*, London: Verso.

Fligstein, N. (2001) *The Archiecture of Markets: An Economic Sociology of Twenty-First-Century Capitalist Societies*, Princeton and Oxford: Princeton University Press.

Garofoli, G. (2002) 'Local Development in Europe: Theoretical Models and International Comparisons', *European Urban and Regional Studies*, 9(3), 225–39.

Gasior-Niemiec, A. (2007) 'Civil Society and New Modes of Governance in Poland', *Polish Sociological Review*, 1(157), 65–85.

Grabher, G. and D. Stark (1997) *Restructuring Networks in Post-socialism: Legacies, Linkages, and Localities*, Oxford/New York: Oxford University Press.

Hall, Peter and David Soskice (eds) (2001) *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, Oxford: Oxford University Press.

Hardy, J. (2004) 'Rebuilding Local Governance in Post-communist Economies: the Case of Wroclaw', *European Urban and Regional Studies* 11(4), 303–20.

Hardy, J. and A. Smith (2004) 'Governing Regions, Governing Transformations: Firms, Institutions and Regional Change in Post-Soviet East-Central Europe', in A. Wood and D. Valler (eds), *Governing Local and Regional Economies. Institutions, Politics and Economic Development*, Aldershot: Ashgate, pp. 147–76.

Hay, C. (2004) 'Common Trajectories, Variable Paces, Divergent Outcomes? Models of European Capitalism under Conditions of Complex Economic Interdependence', *Review of International Political Economy*, 11(2), 231–262.

Hughes, J. G. Sasse and C. Gordon (2004) 'Conditionality and Compliance in the EU's Eastward Enlargement: Regional Policy and the Reform of Subnational Government', *JCMS* 42(3), 523–51.

Jessop, B. (1994) 'The Transition to Post-fordism and the Schumpeterian Workfare State', in B. Loader and R. Burrows (eds), *Towards a Post-Fordist Welfare State?*, London: Routledge, pp. 13–38.

Keating, M. (2003) 'Territorial Restructuring and European Integration', in M. Keating and J. Hughes (eds), *The Regional Challenge in Central and Eastern Europe: Territorial Restructuring and European Integration*, Brussels and New York: P.I.E.-Peter Lang, pp. 9–20.

Keune, M., J.P. Kiss and A. Toth (2004) 'Innovation, Actors and Institutions: Change and Continuity in Local Development Policy in Two Hungarian Regions', *International Journal of Urban and Regional Research* 28(3), 568–600.

Keune, M. and J. Nemes Nagy (2001) *Local Development, Institutions and Conflicts in Post-socialist Hungary*, Budapest: International Labour Office.

Keune, M. (2006), The European Social Model and Enlargement', in M. Jepsen and A. Serrano (eds.) *Unwrapping the European Social Model*, Bristol: Policy Press, pp. 167–88.

King, L. and I. Szelenyi (2005) 'Post-Communist Economic Systems', in N. Smelser and R. Swedberg (eds), *The Handbook of Economic Sociology*, 2nd edition, Princeton University Press, pp. 205–32.

Kornai, János (1980) *Economics of Shortage*, Amsterdam: North-Holland.

Kornai, János (1992) *The Socialist System*, Princeton: Princeton University Press.

Lane, D. (2007) ' Post-State Socialism: A Diversity of Capitalisms', in D. Lane and M. Myant (eds), *Varieties of Capitalism in Post-Communist Countries*, Basingstoke: Palgrave Macmillan, pp. 13–39.

Lane, D. and M. Myant (eds) (2007) *Varieties of Capitalism in Post-Communist Countries*, Basinstoke: Palgrave Macmillan.

Lazonick, William (2008) 'Entrepreneurial Ventures and the Developmental State. Lessons from the Advanced Economies', Discussion Paper No. 2008/01, Helsinki: UNU-WIDER.

Le Galès, P. and H. Voelzkow (2001) 'Introduction: The Governance of Local Economies', in C. Crouch et al. (eds), *Local Production Systems in Europe: Rise or Demise?'*, Oxford: Oxford University Press, pp. 3–24.

Macleod, G. (2001) 'New Regionalism Reconsidered: Globalization and the Remaking of Political Economic Space', *International Journal of Urban and Regional Research* 25(4), 804–29.

Nelson R.R. and S.G. Winter (1982) *An Evolutionary Theory of Economic Change*. Cambridge, MA: The Belknap Press of Harvard University.

Pickles, J. and A. Smith (1998) *Theorising Transition: The Political Economy of Post-communist Transformations*, London: Routledge.

Piore, M. J. and C. F. Sabel (1984) *The Second Industrial Divide: Possibilities for Prosperity*, New York: Basic Books.

Polanyi, K. (1985), *The Great Transformation*, Boston: Beacon Press, [1985] c.1944.

Poplawska, E. (2002) 'The New Constitutional Principle of Subsidiarity and "the Diminishing State" in Poland', *Journal of Constitutional Law in Eastern and Central Europe*, 9(1), 51–95.

Sapir Report (2004) *An Agenda for a Growing Europe: The Sapir Report*, Oxford: Oxford University Press.

Schmidt, V. (2002) *The Futures of European Capitalism*, Oxford and New York: Oxford University Press.

Scott A. and M. Storper (1992) 'Industrialisation and Regional Development', in A. Scott and M. Storper (eds), *Pathways to Industrialisation and Regional Development*, London and New York: Routledge.

Smith, A. and A. Swain (1998) 'Restructuring and Institutionalising Capitalisms: the Micro-foundations of Transformation in Eastern and Central Europe', in J. Pickles and A. Smith (eds), *Theorising Transition: The Political Economy of Post-communist Transformations*, London: Routledge, pp. 25–53.

Stark, D. (1990) 'Privatisation in Hungary. From Plan to Market or from Plan to Clan', *East European Politics and Societies* 4(3), 351–92.

Stark, David and Laszlo Bruszt (1998) *Postsocialist Pathways: Transforming Politics and Property in East Central Europe*, Cambridge: Cambridge University Press.

This page intentionally left blank

Part I
Regional Diversity in Central and Eastern Europe

This page intentionally left blank

1
Time Horizons and the Institutional Underpinnings of Local Development

Aleksander Surdej

Introduction

In recent decades growing economic openness and rapid technological changes have seemed to undermine the capacity of the state, and of public authorities in general, to modify the course of economic development as the increasing mobility of capital, the increased size of trade flows, the importance of transnational corporations and the speed of technological developments have sources and consequences that outflank the jurisdiction of any single state.

But with the changes in economic structures and the rise of the service economy there has been a growing recognition that: (i) mobile factors of economic development have smaller weight for an overall well-being of the society than had been believed; and (ii) mobile factors of production are attracted not only by cost advantages, but also by local social and cultural factors.

The increased recognition of the role of soft factors of economic development is related to the discovery that the structure of the modern economy is dominated by services and that a large share of services is not traded internationally. Thus, if the forces of globalization shape the provision of financial or business services (such as back-office services), they have almost no influence on the organization or on the provision of personal or social services. However, the efficiency of domestic services influences the efficiency of the whole economy and also its international competitiveness.

Furthermore, this efficiency is to a large extent determined locally as such services as transportation, health and social care are substantially financed, regulated and provided by local governments.

This chapter will offer a short review of the current theory and a discussion of the most important factors influencing the quality of locally provided public goods and balancing temporal dimensions of local development.

1.1 Temporal tensions of local development

It should be noticed that various factors of local economic development act at different speeds and have differentiated temporal consequences. In the perspective that is taken in this analysis it is important to distinguish between three different types of factors: (i) those factors which are constant, that is to say which cannot be modified – such as, for example, geographical location; (ii) those factors which will change in the long run, but where the change is not controlled by governments as it is, to a large extent, the result of spontaneous processes; and (iii) those factors which are fully modifiable by programmed public action.

Against this background it is important to ask whether and when there might appear to be negative interaction between different temporal processes. One obvious eventuality is that unchanging or slowly changing factors determine and limit the range of intentional changes which is feasible in the short run. This phenomenon has been studied under the name of path dependence, that is the dependence of current developments on the peculiarities of the past trajectory. In principle, 'path dependence' might be considered to be a neutral, descriptive category. However, it is frequently associated with negative judgements as if the constraining power of the past over the present was to block only positive changes. Thus, in the context of postsocialist transformations the term 'path dependency' has usually served to explain why the policies of seemingly well-intentioned reformers might have led to bad social outcomes.

Less frequently researchers notice that 'path dependence' might be a positive term indicating that existing practices and institutions inject stability in the social system and make it less prone to destabilizing changes.

If obviously long-term processes reduce the feasibility of some policy choices, it is also true that short-term decisions have significant impacts (both positive and negative) on long-term processes. It is especially interesting to identify and analyze the possibility that decisions made under the short-term pressures of current circumstances destroy assets which could have been a stable basis of long-term development. Is this theoretical possibility realistic? We can easily imagine that a local government trying to reduce the level of unemployment attracts external investors by offering them land that has a potentially high recreational value. In this example short-term benefits undermine the fruition of long-term possibilities. This dilemma is a rather common one as the empirical research shows that governments, be they national or local, are often forced to make such intertemporal trade-offs sacrificing long-term prospects for the benefits of current budgetary or political convenience.

In Table 1.1 we make an attempt to systemize development dilemmas by linking factors of development with the time horizon in which they tend to operate and seeing whether and how local governments can influence them.

The focus on a short-term perspective seen most often in the statements of public managers stresses the importance of constraints to local developments such as insufficient budgetary revenues or burdensome administrative procedures (like stringent public procurement regulations). From this perspective it might seem that the size of budget, the level of investments and managerial abilities are the predominant factors of local development. Yet the analysis from a longer perspective leads to different conclusions. According to this view, the fundamental issues of local economic development consist of 'the difficulties in altering the institutional framework from one geared to confronting the physical environment to one capable of dealing with modern human environment' (North, 2005, p. 7). In other words, institutions – the rules of human behaviour – are the main factor behind modern economic development.

Table 1.1 Approaches to local development according to time horizon

Time horizon (in years)	**Factors**	**Local government actions**
10–100	**TILT** – Tradition, Identity, Loyalty, Trust	Gradualist, transparent and patient policies
1–10	**LOC** – Leadership, Organization, Cooperation	Stable leadership, opening for citizen participation
0–1	**BIM** – Budget, Investments, Management	Tusk oriented budgets, multiyear planning, public private partnership

Source: Own elaboration inspired by Williamson (2000).

Institutions, according to Douglass North (1990), are the rules of social interactions and their economic role is to induce people either to be productive or redistributive, active or passive, innovative or conservatory. Institutions ensure that human interactions are characterized by a greater degree of stability, making economic exchanges and social transactions more predictable and thus expanding the scope of potentially beneficial cooperation.

Although the progress of social sciences has helped to understand the nature and functions of institutions, it has not equipped them with instruments to design them as institutions are formed from extremely complex webs of rules and they are not suitable for policy manipulations. Thus, for instance, the recognition of the great significance of the judicial system and law enforcement does not automatically lead to ideas about how to reform these areas.

Contemporary social research has highlighted the importance of trust in economic development (see, for instance, Fukuyama, 1995) and made some analytical progress by identifying trust-inducing factors and the economic consequences of the presence or absence of trust (Kornai and Rose-Ackerman, 2004). It has been discovered that trust is a precondition for the transition from personal exchange to impersonal exchange. Thus, trust broadens the geographical and social range of actors who become involved in mutually advantageous exchanges and by this trust serves the expansion of markets. Other positive effects of high trust come from the reduction of the costs of control and the diminution of enforcement costs. We have learned that trust is easier to generate in small groups of actors that interact repeatedly, while in large groups composed of haphazardly transacting actors trust becomes problematic and cannot be assumed as a natural state of things. In such groups it becomes important to 'formalize' trust in procedures and institutions than to rely on informal trust rooted in interpersonal relations.

High levels of social trust enhance loyalty. Loyalty in turn is an indicator of commitment to places or people. Thus, loyalty lengthens the time perspective during which people perceive or even calculate advantages and disadvantages, benefits and costs of living in certain localities and cooperating in certain groups. Widespread loyalty might be a stable social equilibrium, although people are free to move in search of better life chances. We might think of loyalty as being a result of the choice between the benefits of staying in a locality (for instance, the psychological benefits of being at home) and the costs of not moving (such as sacrificing expected higher income). The balance of costs and benefits is dependent, among others, on the ratio (and sociodemographic composition) between those who stay and those who move. As there is an increase in the proportion of those who emigrate, the payoff to loyalty decreases, but the change does not seem to be a linear one. Loyalty thus slows down the outflows of people in times of crisis and creates anchors for the rebirth of local development.

Until recently, identity and other symbolic resources have been neglected by economic and management literature. Modern theories of motivation in economics and management tend to recognize the contribution of such soft factors in stark contrast to the earlier literature which placed an almost exclusive stress on the importance of financial incentives. Identity has been discovered by Akerlof and Kranton to be an important economic resource since ‘employees may have identities that lead them to behave more or less in concert with the goals of their organizations. With such an identity, workers are willing to put in high effort rather than low effort with little wage variation’ (Akerlof and Kranton, 2005). On the other hand, management literature recognizes that limited observability of actions is one of the main motivational problems (Roberts, 2004: 125). The fact that people (employees, citizens) can hide a part of their actions from the scrutiny of employers or authorities creates problems that cannot be solved either by formal contracts or by reputation. These motivational problems are, however, reduced if people’s identities prevent them from shirking or reducing their efforts.

Tradition is not an unambiguous term. It is often used in a dichotomy to indicate the opposition between tradition and modernity. Tradition tends to be associated with religious fundamentalism and, in this sense, is judged to be incompatible with the requirements of a modern economy. Thus, modern economies were thought to function increasingly in terms of secular consideration and thus to marginalize the values espoused by religious people. Studies of religion were concerned with its decline, while studies of economic life were able to ignore religion. The newer view emphasizes the continuing presence of religion in societies characterized by very different kinds of economic relationships. Religion varies and changes qualitatively, but remains a powerful force that must be considered by very different kinds of economic relationships (Wuthnow, 2005: 608).

Today, tradition, including its religious dimension, can no longer be associated negatively with economic development (Harrison and Huntington, 2000). Tradition interacts with modern economies in a complex and changing way and tradition’s positive contribution to economic development seems to stem from the sense of identity and cultural embedment it grants to people.

Table 1.2 Cultural barriers to local development: when certain aspects of TILTs become liabilities

Factor	Type of pathologies
Trust	cronyism; nepotism, 'amoral familism'
Identity	intolerance of differences
Loyalty	lack of openness
Tradition	blind conservatism

Source: Own elaboration.

Trust, identity, loyalty and tradition (TILT) might be considered assets in certain conditions facilitating local development. But, in other circumstances, they might display characteristics which have a negative effect upon economic and social development (Trigilia, 2001) (Table 1.2). Thus, for instance, trust might have detrimental effects if it cements the circles of cronies acting together in order to extort public money or restrict competition. Strong family ties might lead to discrimination against other people, if such families control public offices or public expenditure. Strong identity, in turn, might generate intolerance or neglect of foreign inventions or innovations simply because they are generated by others. Loyalty, although it prevents mass exit in hard times, might lead to the lack of openness and thus it might reduce the amount of beneficial exchanges with others. Similarly tradition can degenerate into blind conservatism and instead of selectively protecting the valuable, it defends the unworthy.

It should be recognized that the role of trust, identity, loyalty and tradition is contingent and depends upon unique historical circumstances. Contemporary social research has drawn a complex picture of interdependencies between factors influencing local development, and it has confirmed the centrality of institutions in managing the uncertainties characterizing a social environment. Institutions, of course, are human products, but not necessarily the product of human design. This often-used statement correctly indicates that public policies might not be able to shape institutional conditions in order to achieve greater economic efficiency and to increase social welfare. This thesis is especially true, when we consider human capacity to modify institutional setup in the short run.

Institutions place a number of constraints on the search for short-term policy solutions. Solving short-term policy problems requires organizing and leading collectivities by creating a shared vision of goals to be achieved, mobilizing cooperation among key actors and making this cooperation durable by placing it in appropriate organizational forms.

A positive link between longer time perspective and medium time horizon seems more apparent. Communities with stronger identities encounter fewer problems in stable cooperation and its leaders are more likely to transform tradition into a shared vision of the community's future. In addition, a tradition of grassroots cooperation favours the diversity of organizational forms which is taken by such a cooperation. There seems to be less tension in public–private partnerships as there is less distrust about the terms of such partnerships and more confidence that such a partnership has not been captured by special interests or used to exploit some private actors to the benefit of others.

Local development also depends on the quality of *ongoing* political and economic processes. When examining the functioning of local government one should stress the importance of budget size and structure – that is, the importance of allocation of public funds. The structure of the budget reflects the decisions about the types and volumes of local public goods and public services that are provided. But the budget is only a part of total investments made in a given locality. Thus, it is important to see to what extent the budget has been used as a lever to increase the total investments made in a given community. Although local development is predominantly a product of spontaneous processes, special responsibility stays with those local government administrators who possess resources (including administrative means) to support, modify and orientate local development. Such resources are scarce. Thus, they have to be used efficiently and in line with local development priorities. Economists stress the importance of efficiency, often overemphasizing its static nature. Yet the criteria of static efficiency are often applied to single policy decisions conceived as autonomous policy choices. This is not entirely satisfactory since we should consider efficiency to be a result of a series of policy choices and actions. In such a case it seems more appropriate to speak about the criteria for dynamic efficiency, which in turn depends upon the capacity to read and shape people's preferences and to find their collective expression in goals set and choices made. Dynamic efficiency cannot be properly understood outside formal procedures and informal patterns of cooperation, that is without due regard to the state of existing institutions (see Table 1.3).

Table 1.3 indicates the basic differences between static and dynamic efficiency. It also shows the possibility of differentiated relationships between processes with different time horizons and by this between static and dynamic efficiency. In principle, it can happen that measures

Table 1.3 Types of efficiency in local government

	Static efficiency	**Dynamic efficiency**
Goals	Short-term optimization, (budgetary savings, time saving etc.)	Long-term development (development smoothing, choice broadening, protecting non-market values)
Instruments	technical feasibility analysis, public providers and market actors	commitment, credibility, reputation
Constraints	existing financial and human resources, administrative procedures	institutions, informal cooperation patterns

Source: Own elaboration.

satisfying the criteria of static efficiency enhance dynamic efficiency. Yet, in other contexts there might exist a trade-off between static and dynamic efficiency. The situation in which there is a static/dynamic efficiency trade-off needs to be identified, but such a diagnosis needs to be done in specific historical and spatial circumstances.

The possibility of trade-offs between policies and factors acting according to different time horizons is not only of theoretical interest, but also has some practical policy relevance. Thus, while recognizing the existence of short- or medium-term determinants of local development, one can see that certain weaknesses of a given locality, which stem for instance from its peripheral location or poor infrastructure, can be overcome by targeted investments in infrastructure. But, looking from a longer perspective it would be simplistic to suggest that the state of infrastructure is the main factor differentiating local development possibilities. A longer-term perspective should not be used to justify policy immobility, but it should help to prevent rushed decisions, which might undermine what might otherwise be the source of long-term local strength – that which has a chance to achieve fruition in a more distant future.

1.2 Time perspective and the criteria for an institutional choice

The coming of the post-industrial era has brought an end to development policy ideas according to which successful local development depends upon the region's capacity to attract large-scale public or private investments. Although such investments, if properly connected with the context of the local economy, still have a role to play in stimulating economic development, it has been recognized that contemporary development increasingly depends upon dispersed (and often networked) forms of economic and social activities. The factors (institutions, policies) which activate dispersed resources, encourage and support mutually beneficial exchanges, induce cooperation and reduce destructive conflicts might produce positive cumulative effects that could outweigh the importance of large investment projects.

Local development actors and policies have to cultivate those factors which enhance cooperation and support the long-term orientation of economic activities. This factor is especially important for SMEs which tend to operate locally and for their existence and efficiency need 'all kinds of inputs which are supplied locally and which might be called 'local collective competition goods' (Crouch, Le Galès, Trigilia and Voelzkow, 2001).

It is important to notice that local development might suffer if it is affected by 'boom and bust' phenomena generating instability in living conditions. This means that local development becomes more stable if it is generated by numerous local SMEs, which balance the risks of relying on large-scale, capital-intensive, but isolated investment projects coming from outside. By now it has also become evident that large-scale development projects do not always generate the necessary spillover effects.

Institutions as 'soft' factors of local development have gained in importance due to the fact that governments in developed countries have recognized that development in a post-industrial, service or knowledge-based economy cannot be efficiently promoted by an exclusive reliance on external intervention. The discussion so far can be summarized in Figure 1.1, which represents the triangle of local development.

Using this triangle we can formulate *the local development trilemma* (LDT) as a challenge to balance processes which operate according to different time horizons. The LDT might be summarized in the following statement: how to build institutions which at the same time are efficient in maintaining trust, identity, loyalty and tradition (TILT), that is long-term factors of local economic development, while assuring leadership, organization and cooperation (LOC), that is medium-term factors of economic development, and being efficient in budget and investment management (BIM), that is short-term factors of local development.

LDT can be reformulated in such a way as to be able to identify local public goods which have to be provided in order to solve this

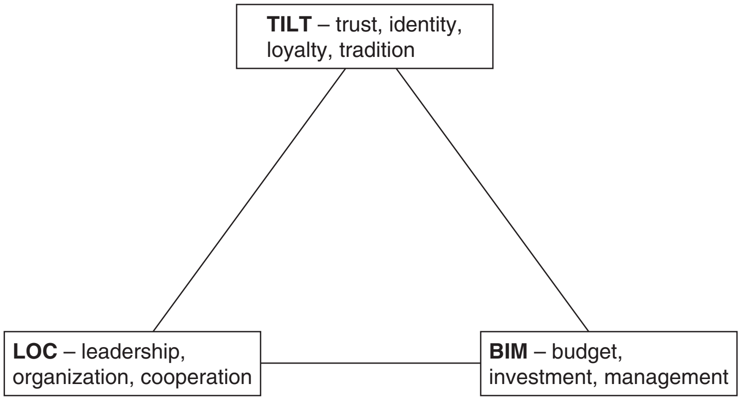


Figure 1.1 Triangle of local institutions design
Source: Own elaboration.

Table 1.4 Examples of local public goods (LPG)

TILT-related LPG	LOC-related LPG	BIM-related LPG
Good social communication and open local debate	Strong local political associations	Competent local administration
Active cultural institutions (e.g. local museum)	Strong local cultural associations	Dense network of business support institutions
High-quality educational institutions	Existing local traditions of mutual help	Light administration with little red tape
Producers and products with high regional identification	Culture of cooperation and consensus orientation of local leaders	Spending transparency/ no corruption

Source: Own elaboration.

trilemma – that is, to be able to support stable, intertemporally balanced, local development. Such a tentative list of local public goods looks as shown in Table 1.4.

The idea that the provision of right amount and right composition of local public goods is essential for local development is not an absolutely new one, but only in recent studies have researchers such as Amin (1999) made an empirical confirmation of the existence of the link between regions' prosperity and the efficiency of its public institutions in providing local public goods and in supplying collective services. There are also good theoretical reasons to think that other characteristics of local civic life, such as respect for individual's initiative and the culture of reciprocity and trust, create favourable conditions for local economic development by reducing the costs of social anomy, marginalization and criminality.

Although the phenomenon of economic globalization highlights the de-territorialization of businesses, it appears that a territorially isolated firm can hardly be competitive, but, more importantly, it might not have been created in a territorial vacuum without the existence of supporting institutions and encouraging social environment. Metaphorically speaking, it may be suggested not that 'enterprises create the business environment', but rather that 'the business environment creates enterprises'.

It might seem paradoxical that economic globalization has to some extent increased the importance of territorial factors, including local tradition and identity. We can achieve a better understanding of the nature of this apparent paradox, if we consider 'collective identity' in terms of a kind of brand, which might have substantial 'pecuniary' value. Local identity, like all broadly recognized and highly valued brands, signals high quality, increases the level of customers' loyalty and thus permits the owners to 'charge a higher price'. But, unlike brands typical of products markets the concept of 'territorial identity as a brand' indicates the capacity to attract highly valued activities and people, and an ability to focus activities on long-term development goals and not just the capacity to increase market shares or to penetrate new markets.

Although we find strong arguments to insist on the importance of institutional factors for local development, it is difficult to make an empirical validation of these theoretical claims. For now we should be satisfied with the statement that theoretical analysis enables us to formulate plausible arguments.

1.3 Conclusions

Culture matters for economic development – as stated by the title of a collection of brilliant essays edited by Lawrence E. Harrison and Samuel P. Huntington (Harrison and Huntington, 2000). This thesis has often been read as an invitation to search for solutions for the development of the least developed countries. But, what if culture matters everywhere? In a broader sense it seems true that attractive local cultures and place offering space for attractive ways of life act as a selection mechanism attracting migrants and, in turn, bringing indispensable innovations and dynamism to the local economic and social systems otherwise threatened by immobility.

Institutions as rules embodying cultural values and shaping patterns of social interactions can be seen to be *either* an obstacle to change *or* the vehicle for change depending upon several auxilliary circumstances. Yet, without trust, shared identity and strong local traditions, which facilitate loyalty to the territory, stable local development – that is, development which balances the desire for economic development with the need of social cohesion and territorial solidarity – might be simply unattainable.

References

Amin, Ash (1999) 'An Institutionalist Perspective on Regional Economic Development', *International Journal of Urban and Regional Research*, 23(2), 365–78.

Akerlof, George A. and Rachel E. Kranton (2005) 'Identity and Economics of Organizations', *Journal of Economic Perspectives*, 19(1), 9–32.

Crouch, C., P. Le Galès, C. Trigilia and H. Voelzkow (2001) *Local Productions Systems in Europe: Rise or Demise*, Oxford: Oxford University Press.

Fukuyama, Francis (1995) *Trust: the Social Virtues and the Creation of Prosperity*, London: Penguin Books.

Harrison, Lawrence E. and Samuel P. Huntington (eds) (2000) *Culture Matters: How Values Shape Human Progress*, New York: Basic Books.

Kornai, Janos and Susan Rose-Ackerman (eds) (2004) *Building a Trustworthy State in Post-Socialist Transition*, Palgrave Macmillan.

Meyer-Stamer, J. (1996) Konkurencyjność systemowa (System's competition), in Gospodarka Narodowa, no. 3.

Matusiak, Krzysztof B., Edward Stawaszand Aleksandr Jewtuchowicz (2001) *Zewnetrzne determinany rozwoju innowacyjnych firm*, Lodz.

Nee, Victor (2005) 'The New Institutionalisms in Economics and Sociology', in Neil J. Smelser and Richard Swedberg (eds), *The Handbook of Economic Sociology*, New York and Oxford: Sage.

North, Douglass C. (1990) *Institutions, Institutional Change and Economic Performance*. Cambridge: Cambridge University Press.

North, Douglass C. (2005) *Understanding the Process of Economic Change*, Princeton, NJ: Princeton University Press.

Rallet, Alain and André Torre (eds) (1995) *Économie industrielle et économie spatiale*, Paris: Economica.

Roberts, John (2004) *The Modern Firm: Organizational Design for Performance and Growth*, Oxford: Oxford University Press.

Trigilia, Carlo (2001) 'Social Capital and Local Development', *European Journal of Social Theory*, 4, 427–42.

Williamson, Oliver E. (2000) 'Taking Stock, Looking Ahead', *Journal of Economic Literature*, 38(3), 595–613.

Wuthnow, Robert (2005) 'New Directions in the Study of Religion and Economic Life', in Neil J. Smelser and Richard Swedberg (eds), *The Handbook of Economic Sociology*, New York and Oxford: Sage.

2

Regional Development in Central and Eastern Europe

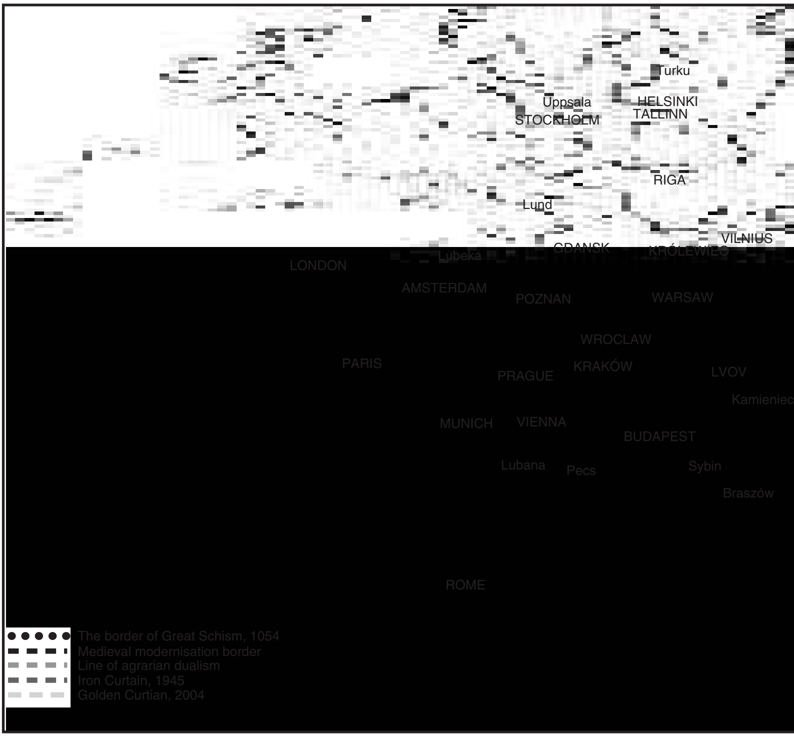
Grzegorz Gorzelak

2.1 Some historical background

For almost one thousand years, Central and Eastern Europe (CEE)[1] has been a periphery of the continent. Moreover, over the course of history its peripherality has become deeper and more pronounced. In fact, it is only in recent years that the historical factors have worked in favour of this region.

The first factor that affected a vast part of CEE was the Great Schism of 1054, which completed the division of Christianity into Western (Catholic, later subdivided into Catholic and – generally speaking – Protestant) and Eastern (Orthodox). However, the division that followed along what is generally known as Huntington's fault line (Huntington, 1997) was not only limited to religion. It also had a strong bearing on political culture and institutional development. As Pipes (1992) indicates, the societies living east of this frontier did not fully develop the institution of ownership until the mid-eighteenth century, a fact which – as Pipes argued – did not allow them to create a democratic system similar to that known in Western Europe. We may say that this event started the cultural division of Europe (see Map 2.1). As Fernand Braudel writes: 'the fact that the world and civilization of Russia were sucked into the orbit of Byzantium from the tenth century onwards helped to distinguish Eastern from Western Europe' (Braudel, 1993: 532).

The second important line of East–West division was constituted by the late medieval modernization that took place in the thirteenth and fourteenth centuries (Braudel, 1993; Gorzelak and Jałowiecki, 2002). The line Stockholm–Gdańsk–Kraków–Budapest–Pecs was a barrier for innovations that were arriving from the West: chartering towns according



Map 2.1 The eastern-western split of Europe

to the Magdeburg and Lübeck laws, Romanesque style in architecture, Catholic cloisters, new agricultural technologies (although the three-year crop rotation system was also practised in Germany and Poland), universities (the three oldest universities in Central Europe were those at Prague, Kraków and Pecs, all of them founded around the mid-fourteenth century). The line mentioned above can be labelled as the spatial division of Europe, separating its materially better and more developed part from that characterized by a less intense use of space, a smaller number of cities, fewer cultural and intellectual facilities and obsolete technologies.

This agrarian dualism has shaped the economic face of Europe since the sixteenth century. The Elbe River began to separate the western part – which accelerated its evolution to capitalism and manufacturing – from its eastern part – which turned back to feudalism and agriculture. The geographical discoveries of the New World triggered inflation that was proceeding eastwards from Spain and Portugal. In the mid-sixteenth century, a unit of grain was priced at around 134 monetary units in Spain, around 100 in Germany and the Netherlands and only 34 in Poland. No wonder therefore that East European landlords abandoned the early reforms of shifting from serfdom to monetary rent[2] and increased the semi-slavery system in order to develop the production of grain through increasing their agricultural land which – cultivated by free labour – allowed them to maximize their incomes from exporting grain to the West.[3] Braudel describes this in the following way: 'As the sixteenth century ended, there was established throughout these regions [in Eastern and Central Europe] … what historians more and more tend to call "the second serfdom". The peasants were enmeshed once more in a seigniorial regime, this time worse than that of the past' (Braudel, 1993, p. 318).

This led to an unprecedented development of gentry (in Poland they accounted for as much as 10 per cent of the total population) and growth of its wealth which was then translated into political power, at the expense of the powers of the kings. Towns were deprived of labour since serfdom kept potential manufacturers in villages. As a result, the demand of the gentry for manufactured goods could not be satisfied by domestic production, and was instead met by suppliers in Germany, the Netherlands and the British Isles. Thus, the economic gains from the export of food products did not translate into sustainable growth in the Eastern European economies – on the contrary, they led to the region's economic obsolescence and growing backwardness. Let us once again quote Braudel: 'This system, which in the East continued until the ninetieth century, was no doubt largely responsible for the extra backwardness of these areas by comparison to the West' (Braudel, 1993, p. 319).

We had to wait nearly four centuries – until after the end of the Second World War – to witness the next separation of Central and Eastern Europe from the western part of the continent. It is no coincidence that this division followed the line of the economic divide from the sixteenth century. With a small allowance for eastern Austria, the Iron Curtain separated the more developed Western Europe that remained democratic and could undergo post-industrial restructuring in the 1970s and 1980s from the less developed one, which, under the regime of communism and, later, of 'real socialism', pursued the traditional resource-based development paradigm until its end – that is, until 1989.

In 2004, another momentous change happened – Central Europe became reconnected to the western part of the continent. Once again, the historical traditions took their toll: the 'Golden Curtain' almost exactly reproduced the divide produced by the Great Schism, with the effect that the territories which had for centuries been within Russia itself or under Russian domination, and communist for at least three generations, were outside the integrated Europe.

In conclusion: Central and Eastern Europe has, for a thousand years, been a peripheral and underdeveloped part of the continent, with low levels of material wealth, obsolete social and economic structures and weak (west of the Huntington line) or authoritarian (east of this line) political systems. The twentieth century exacerbated this backwardness, since CEE was isolated from the economic, organizational and technological advances which occurred in the West. However, the expansion of the European Union brought great opportunities for Central Europe which – while still being a periphery – increased its ties with the core of the continent. Eastern Europe has been excluded from this system, which may further increase its level of structural peripheralization.

2.2 The post-socialist trajectories

There can be little doubt that the post-socialist restructuring of this region was a long and painful process. It was also a differentiated process, since individual post-socialist countries adopted diverse patterns in their emergence from their history of centrally planned economies and authoritarian political systems. Their restructuring trajectories are presented in Figure 2.1.

As can be seen, all of the countries have followed a J-curve pattern (see Bradshaw, Stenning, 2001; cf. Figure 2.1), in which the first stage of restructuring implies a decline of the overall output, which then enables the economies under restructuring to achieve an ability to grow in the new circumstances (the Schumpeterian pattern of 'creative destruction' can be brought into consideration here).

The countries' trajectories can be generalized as follows:

1. The deeper the initial decline, the higher the rate of growth that can be achieved in the growth stage, and the sooner this stage will occur.
2. Only a few countries have enjoyed a stable, positive growth, and several of them suffered periods of stagnation, if not decline (Poland was in the stagnation phase in 1989–2001, before becoming the first economy in the region to enter the path of positive growth – which happened in mid-2002).
3. Those countries which did not have a deep phase of decline in the initial period of transformation (including most of the post-Soviet republics and Russia) experienced the most severe problems and the

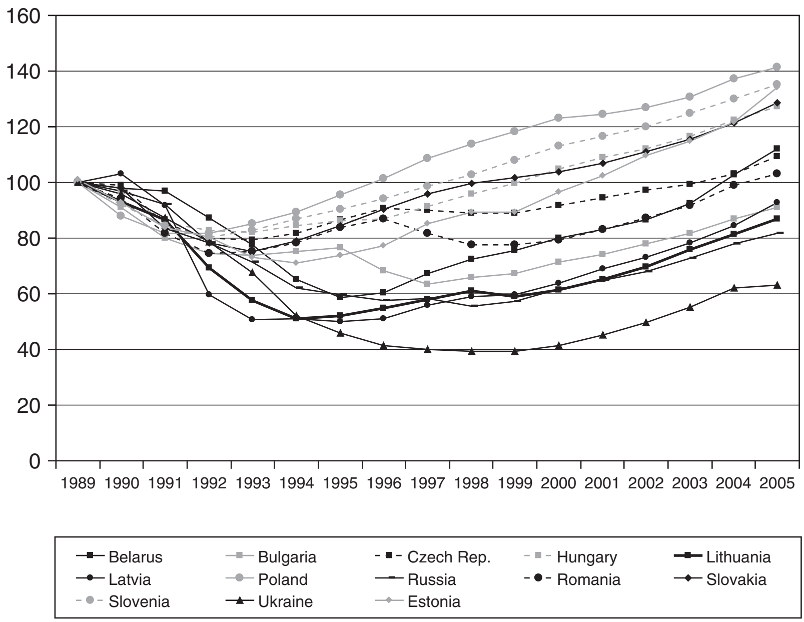


Figure 2.1 GDP growth of selected post-socialist countries, 1990–2005
Source: Based on Table 2.1.

most rapid decline in the later stages, and some of them do not seem to have experienced a stable recovery.

4. All post-socialist countries lost in comparison with older members of the OECD, which demonstrates that even 16 years after the beginning of the restructuring process they have not closed the growth gap which was created by the initial decline (some even compare it to the Great Depression of the 1930s; see Buckley and Mini, 2000).

Figure 2.1 also shows that the countries' performance can be grouped into four different categories:

1. *The leaders* – Poland, Slovenia, Slovakia, Estonia and Hungary – which managed to surpass the initial 1989 level by one-third or more. These countries have been pursuing relatively stable paths of growth, with some slowdowns, but without actual recessions.
2. *The strong followers* – the Czech Republic, Romania, and (surprisingly) Belarus[4] – constitute the second group of countries which were able

to achieve the pre-transformation levels. Their growth was unstable, with some acceleration during the last period.

3. *The strugglers*: four countries – Lithuania, Latvia, Russia and Bulgaria – were not able to return to their 1989 levels, which was due to their suffering a very steep decline at the beginning of the transformation period. The Russian case is a specific one, since its recovery and strong growth stemmed from high prices for oil and gas which accounted for two-thirds of Russian exports. This strong reliance on simple raw materials gives rise to serious doubts concerning the future competitiveness of the Russian economy.
4. Ukraine stands as a *lonely loser*, being the country that has experienced the most acute problems in emerging from the recession. After a long period of decline, it encountered a phase of fast growth, which was due to the increased demand for traditional industrial products. However, the most recent data show that this dynamics has been lost. One should note that the real situation of this country may be not that bad because it has an exceptionally high share of hidden economy (estimated at 50 per cent of the GDP).[5]

2.3 Some hypotheses on the nature of regional development

Most of the theoretical considerations related to the theory of development – both national and regional – tackle the main question: what factors should be triggered in order to accelerate the level of less developed entities (countries or regions) so that they would be able to catch up with the more developed ones and the overall level would be more equalized. This principle – of equalizing the differences in the levels of development – is also at the core of the traditional regional policies of both national and supra-national agencies.

This question is not that simple, however, since a tremendous variety of developmental paths have been adopted by nations, countries, regions, cities and localities, and indicating one neat solution of all cases is virtually impossible.

The theoretical foundations of regional development are extensive and diverse. Particular theories stress different aspects of regional development, usually rooted in more general theoretical approaches to socioeconomic development on the supraregional level – of countries and groups of countries. In most of these theories, particular factors of regional development such as physical environment ('geographical determinism' theories), technology, labour, capital, infrastructure (theories related to location advantages; growth theories); institutions (public choice; institutional economy), relations with the outside world (economic base theory) are emphasized as the factors of utmost importance. This usually leads to the selection of a rather narrow set of measures and instruments by the regional policies, which – being based upon a particular theoretical approach – tend to concentrate only on selected factors of regional development (for the most recent review of several theoretical approaches, see Pike, Rodriguez-Pose and Tomaney, 2006).

In a general perspective, the endogenous factors of development are much more important than the exogenous ones. History (see, for example, Davies, 1996; also Landes, 1998), and especially the current model of development – in which global competitive advantage can be achieved mainly through innovativeness and technological progress – provide a strong argument supporting this statement.

The competitiveness of a territorial socioeconomic system (a country or region) is influenced by the match between its internal socioeconomic-institutional structures and the current pattern of socioeconomic development (Gorzelak, 2004). Along with the changes in the model of development, the location attractiveness and competitiveness of regions is also changing (now these features have become global, see one of the best publications on globalization by Scholte, 2005).

Individual territorial systems react differently to these changes. Only those which can prepare for them well in advance and those which can adapt their internal structures to the foreseen external patterns are able to take full advantage of the positive congruence between their features and the (changing) model of development. Others, unable to adapt, may lose their previous position or will remain in a state of relative underdevelopment.

Only territorial systems that are well adapted to the current model of development can make efficient use of the external impulses such as capital investment or public assistance. Those systems which are not well adapted to the general patterns of development are unattractive for external investment; they also use external public assistance for current social purposes rather than to create foundations for stable and durable growth.

The reactions to the changing socioeconomic and geographical environment may result in the emergence of the four following types of territorial systems:

(a) *The leaders*, i.e. those who were strong in the previous conditions and have been able to maintain their leading position; external impulses are utilized to advance restructuring and further increase the potential for development. The core metropolitan areas are a good example in this process;

(b) *The winners* – those who have gained as a result of the changing environment; the only regions belonging to this group are those which were able to prepare themselves in advance to the changing conditions, since only these regions could take advantage of external impulses. Among the areas to be included in this group are some regions of the US South, Ireland, and Bavaria after the Second World War.
(c) *The losers* – those who have been unable to complete the necessary restructuring process. This group contains several old industrial regions as well as some post-Soviet republics, which entered the path of growth only after a ten-year delay. The past decade might suggest that Japan could also – to some extent – be included in this category;
(d) *The laggards* – those who could not achieve a high level of development either before or after the change in the external conditions, since they have a low level of adaptability and responsiveness to external factors. These are the cases where regional policies have failed – Central Appalachia (see Isserman, 1996), Mezzogiorno, south-western Spain, and the most recent and most dramatic example of the former GDR – this list is perhaps the longest of the four types listed. External assistance is often squandered on useless investments and projects, while dependency and rent-seeking attitudes flourish. As has been demonstrated by the most recent evaluation of such policies conducted within the European Union (see, for example, Boldrin and Canova, 2001; Braunerhjelm et al., 2000; Sapir et al., 2003; Rodriguez-Pose and Fratesi, 2004), this approach is most prone to lead to social redistribution, and does not create secure foundations for growth.

In the following we shall examine these four cases in relation to the regions of the new EU Member States in more detail.

2.4 The regional dimensions of transformation

The Central and Eastern European countries are internally differentiated. However, the regional differences within the new Member States seem to be similar to those existing within the 'old' EU-15. This is demonstrated clearly in Table 2.1.

As can be seen, while in the Western European countries the span between the highest and the lowest developed regions decreased over the period 1998–2003,[6] in all post-socialist countries – with the exception of the Czech Republic – this difference increased.

Table 2.1 Regional differences in GDP per inhabitant, 1998–2003

Countries	**Number of regions**	**Highest : lowest ratio**	
		1998	**2003**
France (continental)	22	2.1 : 1	2.0 : 1
Germany	41	2.9 : 1	2.6 : 1
Italy	20	2.4 : 1	2.3 : 1
Spain	17	2.1 : 1	2.0 : 1
United Kingdom	37	3.9 : 1	3.7 : 1
Czech Republic	8	2.6 : 1	2.6 : 1
Hungary	7	2.2 : 1	2.5 : 1
Poland	16	2.0 : 1	2.2 : 1
Romania	8	1.8 : 1	2.1 : 1
Slovakia	4	2.5 : 1	2.9 : 3

Source: EUROSTAT.

The regional differentiation of GDP per inhabitant in Central and Eastern European countries – the ten new Member States – is presented in Figure 2.2. In all of the countries, the metropolitan cores – in most cases along with the region that directly surrounds them – display the highest levels of economic development. In most countries, the eastern regions are less developed, something which is especially true in the case of the four Visegrad countries (the Czech Republic, Hungary, Poland and Slovakia).

The metropolitan regions have attained levels of GDP per inhabitant which are equal to, or – in the case of the national capitals – higher than the current EU average. These regions enjoy a diversified and relatively modern socioeconomic structure, which allows them to develop rapidly growing sectors such as specialized services and also to attract foreign direct investment. In ESPON (2004), the category of MEGA (Metropolitan European Growth Area) was created to denote the urban cores which display not only a quantitative dimension ('mass'), but also qualitative features such as competitiveness, innovativeness and connectivity. In the new Member States, 19 such MEGAs were delineated, eight of which are located in Poland (the country with the highest index of polycentricity).

In the least developed regions of the new Member States the per capita GDP is four or five times lower than the EU average. These regions are dominated by agriculture (particularly in Romania and Poland), with few industries and an underdeveloped service sector. They also lack

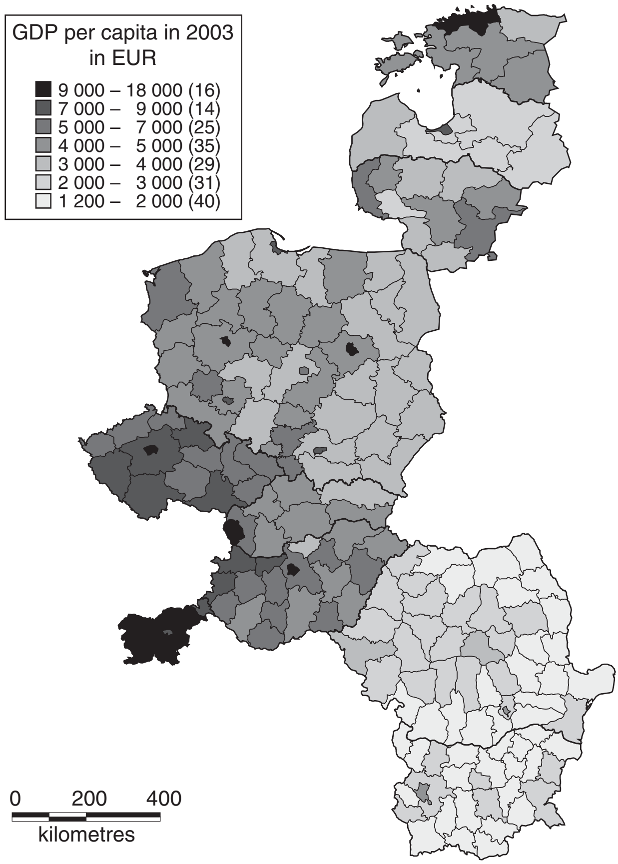


Figure 2.2 GDP per inhabitant in NUTS3 of new Member States, 2003, PPS
Source: EUROSTAT. Prepared by M. Smętkowski.

several of the factors which are considered as crucial for the present model of development: quality infrastructure, qualifications and skills of the labour force, innovative companies, efficient institutions, R&D potential, attractive living conditions.

Figure 2.3 presents the absolute regional dynamics of GDP in the new Member States, and Figure 2.4 relative (that is, compared to national averages) rates of growth of GDP in particular regions. As can be seen, regional differentiation is growing in all of the new Member States. The metropolitan cores – or, if not the cores themselves, the regions that

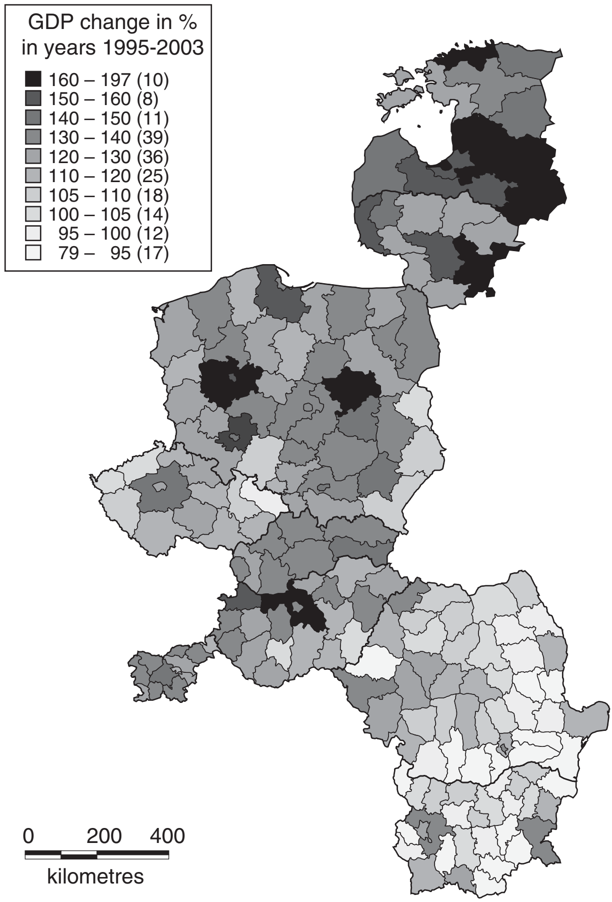


Figure 2.3 Growth of GDP in NUTS3 of new Member States, PPS
Source: EUROSTAT. *for Romania 1995–1998 based on estimations. Prepared by M. Smętkowski.

surround them, which reflect the process of rapid suburbanization – are increasing the gap between them and the rest of the NUTS3 units in all 10 Central and Eastern European countries.

Several poorer regions – notably in the East or along the state borders – have been growing at a much slower pace than the richer ones. 29 NUTS3 regions in Central and Eastern Europe noted a decline in absolute numbers during the period 1995–2003, which is a sign of permanent marginalization.

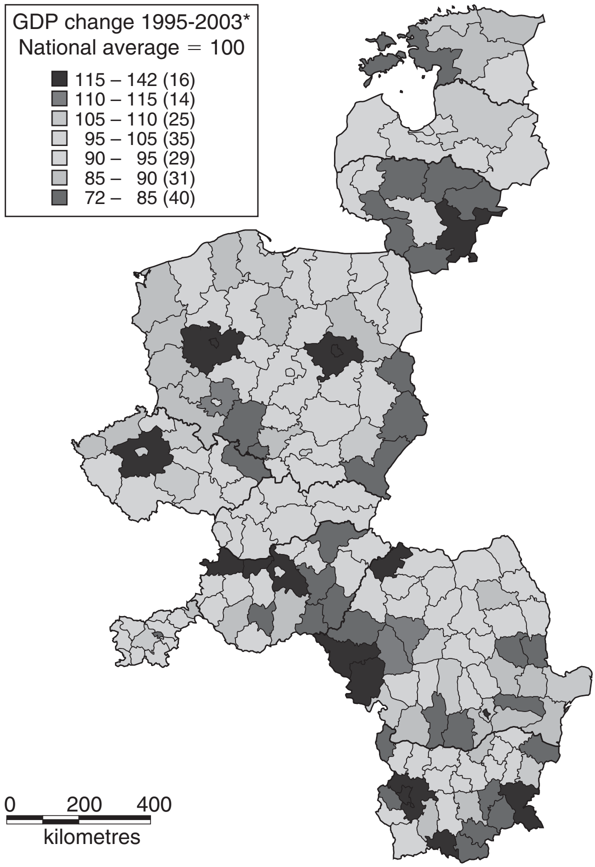


Figure 2.4 Relative growth of GDP in NUTS3 of new Member States, PPS
Source: EUROSTAT. For Romania 1998–2003. Prepared by: M. Smętkowski.

This should not be seen as a surprise. CEE countries are 'laboratories of change', where processes similar to those that occur in more stable socioeconomic territorial systems are put into motion in a more sensitive and sophisticated manner. If regional divergence is a generally observed phenomenon across Europe, then in the region of CEE, which has undergone a process of rapid restructuring, this divergence should be more strongly pronounced. As Pike, Rodriguez-Pose and Tomaney (2006, p. 8) correctly write '… traditional industrial regions, agricultural areas and

Table 2.2 Regional reactions to the post-socialist transformation

		Reaction to transformation	
		Positive	**Negative**
Position in the socialist economy	good	**LEADERS** *positive continuity* Metropolises and capitals *Diversified economy, skilled labour, good infrastructure and rich institutions*	**LOSERS** *negative discontinuity* Industrial regions *Specialised industry, derelict land, biased qualifications*
	bad	**WINNERS** *positive discontinuity* Tourist & re-industrialised regions *External demand*	**LAGGARDS** *negative continuity* Rural, peripheral *Poorly accessible, obsolete structures, low qualifications*

regions without a clear comparative advantage are finding it difficult to capture new markets, and their companies are often losing share in their own traditional markets …'. Exactly the same phenomenon – but on a much greater scale – could be observed in the European post-socialist countries.

The current differences in the levels of regional development are the outcomes of the previous situation and the process of recent change. With reference to the four types of response to changes in the post-socialist transformation, we can offer a simple typology of regional transformation trajectories (Table 2.2).

1. *The leaders* – the metropolitan regions – in socialist (industrial) times were the strongest nodes of the territorial systems in CEE. They have gone through the process of restructuring, of which deindustrialization was the major phenomenon. However, as a result of their diversified socioeconomic structures and high levels of connectivity, they were able to offer the best location conditions for the most dynamic sector – internationally connected services (financial, managerial, tourist, scientific, etc.) and high-quality commerce. The personal incomes are the highest here, and the standard of living is also the highest. Suburban rings are growing even faster due to the

rapid suburbanization of residential areas inhabited by the middle and upper classes – because they were delayed for decades under the socialist system.

2. *The losers* are those old industrial centres which, in some cases, attained an even more important role in the socialist economy than the big cities stripped of their heavy industry. These industrial regions had a double profile: on the one hand they were heavily urbanized, but on the other the industrial heritage did suppress this urban profile. Their economies were diversified enough to produce conditions that were attractive to the promotion of new economic activities (services and modern industry), mostly due to poor living conditions, the low qualifications of the labour force and the overburdened infrastructure. As a result, the restructuring has been a lengthy process, and only recently have some such industrial cities been able to enter the growth path and develop the branches characteristic the metropolitan profile.
3. *The winners* are those few regions that possessed potentials which were overlooked during the socialist, industrial pattern of development, but which turned out to be in demand in an open, competitive economy. These are principally the tourist regions that sooner (as in the Baltic Republics and the Visegrad countries) or later (like in the Balkans) assumed the roles of major attractions for domestic and foreign tourists. In addition, some of the regions in which re-industrialization has occurred (often as the result of the inflow of foreign capital) have been doing pretty well. A few border localities were able to gain from their border location, often due to illegal type of economic activities. However, in general the border location has not as yet become an advantage and still remains an impediment to growth (which is clearly pronounced at least in the four Visegrad countries).
4. *The laggards* are – in most countries – the eastern regions and the border regions. These tend to be less developed and lack major urban centres. This structural underdevelopment dates back to the already mentioned twelfth-century century line which ran from Stockholm down through Gdansk and then along the Vistula River to Kraków, proceeding further south through Budapest and along the Danube to Pecs and Zadar, and which divides Central Europe into two parts – with the prevailing western and eastern influences. The regional propensity to post-socialist transformation in the Visegrad countries is also differentiated along this line, with a higher ability to cope with the new challenges observable in the western parts of these countries, and lower in their eastern parts.

2.5 The regional policies

The new Member States have been embraced by the Cohesion Policy of the European Union. The Structural Funds and the Cohesion Funds are the most important instruments of this policy. In the period from 2007 to 2013, the 10 CEE countries will receive almost €160 billion in the form of structural assistance.

It is still an open question as to how these funds will be used. During the past few years, there has been mounting criticism of the traditional approaches to regional policy – which were based mostly on infrastructure and business support financed in the least developed regions – which has not led to the achievements of the goals of these policies (see Bachtler and Gorzelak, 2007).

In their influential report, Boldrin and Canova (2001) indicated that 'neither convergence nor divergence [wa]s taking place within the European Union ... most regions [we]re growing in a fairly uniform rate irrespective of their initial conditions' and that the 'regional policies had a smaller impact on the growth of less developed regions than the business cycle, since these regions grow faster during expansions and slower during recessions. They concluded that 'regional and structural policies serve mostly a redistribution purpose, motivated by the nature of the political equilibrium (...). They have little relationship with fostering economic growth.'

In the work of Sapir et al. (2003), the traditional Cohesion Policy of the EU was criticized from the point of view of directing resources to economically less efficient sectors and regions, which prevents the European Union from keeping up in the competition race against the US and Japan (the Far East countries were not – at that time – considered to be the main growth area in the global economy). The conclusions of this report pointed to the need for the redirection of funds from CAP and the traditionally oriented Cohesion Policy to innovations and R&D. Although this report was criticized for being prepared to satisfy the demand of the net payers to the EU budget, one cannot dismiss its analytical section which indicated the obsolescence of policies that had been maintained for decades within the EU in the conditions of a rapidly changing world.

The article by Rodriguez-Pose and Fratesi (2004) was the next step in this line of reasoning (these arguments have recently been strengthened and reiterated in Pike, Rodriguez-Pose and Tomaney, 2006). Following a thorough econometrical analysis of the regional data from 15 Member States over a considerable period of time, the authors indicated that the capacity of Structural Funds to deliver sustainable growth in lagging regions was doubtful since the strategies in these regions were skewed to infrastructure and business support that had a negligible effect on the growth in Objective 1 regions. They argued that the agricultural intervention was more social rather than developmental in character, leading even to a negative effect on growth, and that only funds directed to education and human capital could have a positive medium-term effect on growth. They concluded by stating that in the long run, the traditional approach may actually be harmful to lagging regions through causing their competitiveness to fall – although it cannot be ruled out that the Structural Funds might not have allowed for further growth of regional differentiation.

The final hypothesis on the negative effects for long-term competitiveness of Structural Funds was recently substantiated by the paper published by Ederveen, de Groot and Nahuis (2006). Analysing data in five-year periods for the period 1960–1995 for 13 EU countries, they came to the conclusion that the European support as such did not improve the countries' growth performance since it may only enhance growth in countries with the 'right' institutions. This means that the European policy to promote regional growth is only conditionally effective. The funds should first and foremost be allocated to institution building. Once the institutions are of a sufficient quality, the funds may be effective in stimulating (catching up) growth. Empirical data indicate that in some cases EU support may reduce the rate of growth (contrary to the findings from the HERMIN model). This happens in countries with less developed market economy institutions, higher levels of corruption and which are not sufficiently 'open' to economic contacts with the outside world. This argument was also applied to the new Member States, and the results of econometrical analyses show that the traditional approaches to regional development in these countries may decrease their rate of growth, since these countries do not have properly developed institutions, corruption is relatively high and protective policies are still in place.

The above mentioned publications represent just a small fraction of the literature devoted to the (critical) evaluation of regional policies, conducted in individual countries and across the EU as a whole. Most of them indicate an inadequacy of policies biased towards the 'equalization' principle realized at the expense of the 'efficiency' approach. As a result, one can observe some attempts to reform the traditional approaches. The Community Strategic Guidelines of 5 July 2005 should be wholeheartedly welcomed as a first step in the development of these reforms. In this document, we read that 'investing in areas of high growth potential' and 'investing in the drivers of growth and employment' should be the new framework for the reformed Cohesion Policy which should, in turn, be increasingly adjusted to bring it in line with the goals of the Lisbon Agenda.

A further step should be taken, which will involve the review and re-formulation of the Cohesion concept. Economic Cohesion should be understood as creating conditions for efficient co-operation between economic agents within the EU and improving the openness to the outside world through bringing about a reduction in transactional costs and promoting a supportive business environment; by contrast, the aim of Social Cohesion should be to enhance horizontal and vertical social mobility through facilitating opportunities for education, training and professional advancement.

The third component of cohesion – Territorial Cohesion – should be liberated from its equalizing orientation and should be understood in functional terms – this is, as such a spatial arrangement of the European territory that enables and supports the achievement of social and economic cohesion. This could be carried out by such means as removing transportation barriers (constructing motorways not everywhere, but where they are needed), connecting major nodes of European space – metropolitan centres between themselves and these nodes with their regional hinterlands, developing networks of educational and research institutions and between R&D and businesses. This new approach to cohesion is very much in line with the ideas of the Lisbon Agenda and the already mentioned Community guidelines.

One may still doubt whether or not these messages have been internalized in the new Member States. The equalization principles still dominate the regional policies implemented in most of these countries. For example, although in Poland the principles of equity-oriented regional policies have been officially abandoned, when it comes to addressing the EU assistance the poorer regions receive the highest shares of these funds: for example, the regionalized part of the future EU assistance for Poland is set at 2.4 per cent of the regional GDP in the poorest regions, and 0.6 per cent of the GDP in the metropolitan ones.

As already stated in this chapter, the new Member States have been offered a great opportunity to accelerate their development through being integrated into European structures. These countries may make use of this opportunity in different ways. Following the traditional patterns of regional policies will obstruct the process of catching up. Only progressive, brave and modern approaches are likely to result in the achievement of long-term national and regional competitiveness.

2.6 Conclusions

By joining the European Union, the new Member States have completed their post-socialist transformation (Kornai, 2006). They have constructed most of the institutional infrastructure characteristic of a democratic political system and an open market economy. Privatization – even if it is still incomplete – has been seriously advanced. The openness of their economies has resulted in a massive inflow of foreign capital (mostly from other EU countries) and the almost free movement of goods, services, people and capital (although some restrictions have remained – such as the limited access to labour markets).

These processes have had – and will continue to have – a strong bearing on the regional patterns of development of the CEE countries. One can even suggest that the new Member States demonstrate the spatial and regional processes in a more acute, crystalline form, which is manifested in the fact that the divergence of regional patterns of growth is stronger than in Western Europe; in economic terms, metropolises are accelerating away from other regions, and the peripheral regions bordering non-EU countries are declining more quickly.

Should – and, if yes, can – the regional policies of the CEE countries attempt to reverse these trends? Different countries provide a variety of answers – at least to the first question. For example, in Poland the overall direction of economic growth seems to prevail over any attempts to equalize the level of regional development, also because it has been acknowledged that the latter task is, in fact, unachievable. In most of these countries, the importance of metropolitan units has also been considered to be a major factor in strengthening their positions in the competitive global economy.

The regional policies of the new Member States will be conducted within the framework of the EU Cohesion Policy. How this policy will be reformed, and what meaning will be assigned to the new official term of 'Territorial Cohesion', is still a matter for future discussion. One can only hope that the convergence-driven cohesion will be replaced by an interpretation according to which 'coherent' means 'functionally effective' (see Bachtler and Gorzelak, 2007). The debate has just begun.

Notes

1. By Central and Eastern Europe, I understand that part of the European continent that was under the political and economic influence of the Soviet Union (or a part of it). One should remember that this term is relative – for the inhabitants of the Iberian Peninsula, Germany is Central Europe, Poland is Eastern Europe and whatever is located east of Poland is usually not considered as Europe at all.
2. Referring to the peasants in Western Europe, the French historian Henri Pirenne used to say 'we were free by the twelfth century'. Quoted after Braudel (1993, p. 317).
3. Serfdom was abolished in Prussia in 1807, in Austria in 1848 and in Russia in 1861.
4. It is not clear if the output of the Belarusian economy is of a structure and quality that can be compared to the those of the open economies, so the pure quantitative data – even if correct – can be misleading.
5. This factor plays a role in all post-socialist countries.
6. This does not mean that we observe within-country convergence in the EU15. As other studies reveal (Rodriguez-Pose and Fratesi, 2004), the regional divergence in the case in most of the 'old' EU. This divergence is, however, more strongly pronounced in the new Member States.

References

Bachtler, J. and G. Gorzelak (2007) 'Reforming EU Cohesion Policy. A Reappraisal of the Performance of the Structural Funds', *Policy Studies* 28(4), 309–26.

Boldrin, M. and F. Canova (2001) 'Europe's Regions: Income Disparities and Regional Policies', *Economic Policy,* London: CEPR

Braudel, F. (1993) *A History of Civilizations*, London: Penguin Books.

Braunerhjelm, P., R. Faini, V. Norman, F. Ruane and P. Seabright (2000) *Integration and the Regions of Europe: How the Right Policies Can Prevent Polarization*, London: CEPR

Buckley, R.M. and F. Mini (2000) *From Commissars to Mayors: Cities in the Transition Economies*, Washington DC: The World Bank.

Davies, N. (1996) *Europe: A History*, Oxford: Oxford University Press.

ESPON (2004) *Potentials for Polycentric Development in Europe,* Project 1.1.1, Final Report, http://www.espon.eu/mmp/online/website/content/projects/259/648/index_EN.html.

Ederveen, S., H.L.F. de Groot and R. Nahuis (2006) 'Fertile Soil for Structural Funds? A Panel Data Analysis of the Conditional Effectiveness of European Cohesion Policy', *Kyklos* 59(1), 17–42.

Gorzelak, G. (2004) 'The Poverty and Wealth of Regions (Assumptions, Hypotheses, Examples)', in H. Karl and P. Rollet (eds), *Employment and Regional*

Development Policy. Market Efficiency Versus Policy Intervention, 'Studies in Spatial Development', No. 5, Hanover: DATAR-ARL, pp. 101–22.

Gorzelak, G. and B. Jałowiecki (2002) 'European Boundaries: Unity or Division of the Continent?', *Regional Studies* 36(4), 409–19.

Huntington, S. (1997) *The Clash of Civilizations and the Remaking of World Order*, New York: Touchstone.

Isserman, A. (1996) *Socio-Economic Review of Appalachia*, Washington: ARC.

Kornai, J. (2006) 'The Great Transformation of Central Eastern Europe: Success and Disappointment', *Economics of Transition* 14(2), 207–44.

Landes, D.S. (1998) *The Wealth and Poverty of Nations*, New York: W.W. Norton.

Pike, A., A. Rodriguez-Pose and J. Tomaney (2006) *Local and Regional Development*, London and New York: Routledge.

Pipes, R. (1992) *Property and Freedom*, New York: Random House Inc.

Rodriguez-Pose, A. and U. Fratesi (2004) 'Between Development and Social Policies: The Impact of European Structural Funds in Objective 1 Regions', *Regional Studies* 38(1), 97–113.

Sapir, A. et. al. (2003) *An Agenda for a Growing Europe: Making the EU Economic System Deliver.* Report of an Independent High-Level Study Group established on the initiative of the President of the European Commission, http://www.euractiv.com/ndbtext/innovation/sapirreport.pdf.

Scholte, J.A. (2005) *Globalization: A Critical Introduction*, New York: Palgrave Macmillan.

World Bank (2000) *From Commissars to Mayors: Poverty and Cities in Transition Economies*, Washington DC.

3

Local Development in a European Union Perspective: Cohesion and Regional Policies in Central and Eastern Europe

Chiara Guglielmetti

Introduction

Cohesion Policy is a structural European policy which has the purpose of pursuing allocative and redistributive objectives and whose declared rationale was, from the very beginning, financial solidarity, integration and convergence[1] between Member States as a means of balanced, general and more even development.

From the perspective of the accession of ten Central and Eastern European Countries (CEEC), this chapter analyzes the process which led to the present structure of EU regional and cohesion policy, the role played by the different stakeholders and the evolution and the rethinking of policy rationale recently undertaken by the European Commission.

How much and in what direction will the recent Eastern Enlargements condition European Union cohesion policy tenets? Which features of European cohesion policy have been addressed by the wide revision process that has taken place? To what extent is the EU budget structure and process efficient and consistent with cohesion policy aims?

The chapter addresses the aforementioned questions, arguing the necessity of maintaining both the distributive and the allocative function of EU regional policy and stressing the value-added role of the EU in fostering a more even and balanced regional and local development.

EU Cohesion Policy has recently been faced with a number of substantial challenges, which are leading to significant changes in its actors and role. Following the 2004 and 2007 Enlargements, regional disparities within the European Union have been changing in both quantitative and qualitative terms. The accession of Central and Eastern European countries (CEEC) has substantially widened the 'prosperity gap' among EU regions. Most of the new Member States are post-Soviet countries, with specific institutional, economic, social, historical and cultural legacies. And yet the institutional and economic peculiarities of the transition have led to significantly increased differences within Central and Eastern Europe, making the stakeholders of Cohesion Policy even more heterogeneous and highly controversial. On one hand, it leads to the necessity of restructuring Cohesion Policy tenets, while, on the other, it leads to an even more urgent requirement for policies aimed at harmonizing local development.

In the early years of the European Economic Community (EEC), institutional, political, economic and strategic reasons led to a sort of *division of labour between national and European rulers* (Ferrera, 2005), with social policy firmly in the hands of the Member States. Until the Single European Act (SEA, 1986), the aims of European policy were market liberalization and the free circulation of people, goods and services. Therefore, economic and social cohesion only became an explicit European objective after 1986.

The aim of the first section is to analyze the major steps that have led to the actual structure of EU regional policy, particularly with regards to the following three questions.

Which processes have led to present-day European regional policy and who are the principal institutions and actors involved? To what extent have the aims of Cohesion Policy been changing according to new challenges and new actors? Has Cohesion Policy been able to respond effectively to the increasing demand coming from the regions, in terms of both policy processes and policy outcomes? The section takes into consideration the role played, since the very beginning of regional policy development, by those countries – Member States or Accession Countries – eligible for cohesion policies. The interplay between changing actors has caused stop and start processes. Analyzing these processes may help to explain recent policy decisions that have significantly affected the new Member States.[2]

Section 3.2 addresses the 2007–2013 programming in the perspective of the new CEE Members and of the accession countries. And, furthermore, the section deals with the European budget process. This issue is of great relevance in the ongoing debate on Enlargement and regional policy. According to the Interinstitutional Agreement concluded in June 2006, a wide process of restructuring the EU budget has been undertaken, which greatly affects cohesion policy as it is the premier policy of the EU in terms of both expenditure and coverage. Not only the *full,* *wide-ranging review* that is being pursued encompasses *all aspects of EU spending and of resources*, but it also involves the role of cohesion policy, its rationale and objectives.

Section 3.3 concludes, dealing with the process of rethinking Cohesion Policy tenets recently undertaken by the European Commission, addressing the concept of cohesion and regional policies and highlighting declared objectives as well as the aims actually pursued. The section addresses those features which make Cohesion Policy particularly complex and, at the same time, highly relevant in new Member States. Even though economic, social and political contexts vary significantly in CEEC both nationally and regionally, it is possible to single out common issues that warrant attention.

3.1 The evolution of Cohesion and Regional Policy in the EU: the emergence of the spatial dimension

There are several reasons, albeit not necessarily mutually consistent, for the initial absence of any commitment to the reduction of social and economic regional disparities in the policies of the EEC.

First, a gradual and sector-by-sector approach was adopted to pursue the European political project. According to functionalist theory (Haas, 1958, 1964), robustly advocated by Jean Monnet and Robert Schuman, the construction of the Single Market and cooperation in selected functional areas – such as atomic energy, coal and steel – were supposed to lead to deeper and wider integration between the Member States through a spillover effect.

Secondly, the Treaties of Paris and Rome were initially conceived as International Treaties, whereas social policies were generally regarded as being domestic national responsibilities. And, thirdly, there was a high perception of the risk of market rules being hampered by the provision of European funds. Even though the Treaty of Rome promotes *the harmonious development* (article 2), as well as the reduction of *the differences existing between the various regions and the backwardness of the less favoured regions* (Preamble), they are nevertheless regarded more as consequences of the Single Market than as objectives *per se*. The Single Market and the EMU were supposed to lead to positive social outcomes such as increased employment, social protection, an improvement in the quality of life, solidarity between Member States and social and economic cohesion (articles 2 and 136.3 EC Treaty) in a sort of trickle-down process towards the *égalisation dans le progrès*.

Within this context, Member State sovereignty over social protection systems was seen as an effective counterbalance to the shocks deriving from the introduction of the Single European Market (the Spaak and Ohlin reports of the 1950s). A form of compromise (Milward, 2000; Ferrera, 2005) was reached between the constitution of the EEC and the role of the Member States in social protection as well as in tackling internal disparities.[3]

In the highly controversial process that has led to current Cohesion Policy it is possible to highlight three aspects which are particularly relevant.

Firstly, there was a gradual shift from a national, vertical and sectoral approach to regional policies, conceived as budgetary transfer, towards a broader European, multi-level strategy targeted on less developed regions.

Secondly, the Enlargements have played an important role in shaping this process. On one hand, they changed the economic and social conditions that were faced by regional policy, bringing into the EU countries with social and economic conditions significantly below the EU average. On the other, the so-called 'cohesion countries' have often been critical bargaining actors, which have strongly contributed to determine political outcomes.

Thirdly, this process has given a role to the regional level of government, making territory a crucial dimension in development strategy. In parallel, the territorial dimension was pivotal in strengthening the role of the principle of social and economic cohesion in European policy.

During the 1960s the institutions responsible for tackling regional development were the European Investment Bank (EIB) and two European Structural Funds (SF) – the European Social Fund (ESF) and the European Agricultural Guidance and Guarantee Fund (EAGGF). However, it was only at the end of the 1960s that the Commission (1969, 1970) first addressed the issues of a European regional policy and of the European Regional Development Fund (ERDF), created at the Council of Paris in 1974. In this first phase the role of the Community was completely subsidiary to domestic development policies through the supply of financial resources delivered through the General Directorate for Regional Policy and Cohesion (DGXVI) to the national administrative systems. The principal actors were national both in respect to policy planning, which was an intergovernmental process, and to implementation instruments, while the Commission did not have the authority to verify Member State expenditure or project feasibility. As the focus was national, the approach was sectoral and vertical. The objective was the industrialization of the entire national territory, with no concern for local specificity. The funds were distributed according to a system of national quotas.

The debate about the Europeanization of regional policy was extremely controversial (George, 1994). The Commission's proposal for a more incisive role for the Community was challenged by the majority of the national governments. In this context,[4] the role of Italy and Ireland was decisive both in the Council of Paris and in the 1979 reform, in which the amount of the funds was increased and 5 per cent of the funds were earmarked for Community projects, leaving them outside the quota system. This notwithstanding, during this first phase there were only a few truly 'European' projects: pilot and experimental integrated projects (Integrated Development Operations and Integrated Mediterranean Projects, 1986). The rationale behind the launching of the latter was to counterbalance the negative impact on Italy, France and Greece of the recent Enlargement to Portugal and Spain (1986). As Leonardi (2005) states, these first attempts at integrating regional policies at a European level were made when Antonio Giolitti (1979–84) and Gregorios Varfis (1984–89) were Commissioners at DG XVI, demonstrating the significant role played by Italy and Greece in the development of this process.

It is only after 1988 that a truly European regional policy can be identified. The SEA (1986) introduced, as core Community aims (art. 158), socioeconomic cohesion and Structural Policies targeted at less developed regions, establishing SF and the EBI (159 TUE) as the fundamental instruments of Cohesion Policy. The five Council Regulations established norms for and regulated coordination between SF and financial instruments. Then, the Brussels European Council (1988) reached an agreement on Delors I, a package of measures that allowed the finalizing of the SF and Common Agricultural Policy (CAP) reforms.

The reforms focused on policy objectives, principles and the planning process involved in changing the role and the identity of the actors, leading to the Europeanization of regional policies. The responsibilities for rule-making, the allocation system and the implementation phase were shifted on to the Community. On one hand the Enlargement of the European Community (EC) to Southern European countries, which were lagging behind in terms of economic development, and, on the other, the perspective of the completion of the Single Market and Single Currency, for the first time, brought the issue of economic imbalances and social inequalities to the forefront of the debate. The effects of the Single Market are taken into consideration in a number of studies and reports, such as the *White Paper on the Single Market* (1985), the Commission's study *One Market/One Money* (1987), the *Cecchini Report* (1987) and the *Padoa–Schioppa Report* (1987). The Community regional policy was seen as a *conditio sine qua non* to avoid the possible adverse repercussions of the Single Market and the Economic and Monetary Union (EMU). It, therefore, had a twofold aim: (i) to be a 'shock absorber' (Leonardi, 2005) to counterbalance Single Market impacts; and (ii) to foster the regions that were lagging behind.

An analysis of the fundamental European policy principles that would become the basis of Cohesion Policy from that point in time, and of the European objectives (see Table 3.2), would clearly show a shift from a national and sectoral approach to a territorial and integrated approach. In particular, two aspects can be outlined: the emergence of a new class of actors, i.e. regional institutions, and the explicit recognition, at a European level, of the importance of the territorial dimension. Objectives 1, 2 and 5b were specifically targeted at regions. According to the first principle, i.e. concentration, projects are focused on specific regions. The Commission thus starts to differentiate and directly address intra-national regions on the basis of their specific economic and social characteristics (SEA, art. 130c).

The reform introduced the principle of integrated planning between the Commission, the Member States and the Regions. Structural Funds were delivered on the basis of a multi-annual budget according to the Community Support Framework (CSF). Their amount was doubled and their structure simplified. An allocation system based on regional eligibility criteria established by the Community took the place of the quota system. Coherently, the Eurostat system of classification was adopted, in order to identify different levels of subnational geographical aggregation.[5] A system of partnership between the Commission and Member State representatives was established. In those countries in which an effective regional level of government was established, the SF allocation system was at both the national and regional levels.

Thus, the 1988 reforms paved the way for the multi-level governance of regional policies, providing space for the so-called third level of governance. The role of Cohesion Policy in favouring the emergence of different levels of governance, allowing subnational tiers to acquire a role, is widely recognized by scholars (see, inter alia, Ferrera, 2005; Leonardi, 1995, 2005; Morata, 2002). A deliberate European strategy aimed at strengthening regional involvement in economic and social Cohesion Policy is identifiable, in particular where employment and social exclusion are concerned. In addition to the increasing involvement of the third level of government in Cohesion Policy, Ferrera (2005) described two other ways through which the process of European regionalization of

Table 3.1 Principal interregional associations tackling social policy with CEE members

Association	**Foundation year**	**Members**
Council of European Municipalities and Regions (CEMR)	1951	37 European countries
Association of European Border Regions	1971	CEMR; AER; Conference of Peripheral Maritime Regions of Europe (CRPM); Eurocities
Alpe Adria	1978	Austria, Croatia, Germany, Hungary, Italy, Slovenia
Assembly of European Regions (AER)	1985	260 member regions from 33 countries; 13 interregional member organizations
Eurocities	1986	120 cities; 15 associated members
European network of cities and regions for the social economy (Reves)	1998	16 countries

social policies has taken place: interregional or transregional association, whose membership is multinational, engaged in social policies and in new solutions for welfare (cfr. Table 3.1; Ferrera, 2005; Conzelman, 1995; Ansell, Parsone and Darden, 1997; Deschouwer et al., 2003) and increasing institutional and financial links between these kinds of associations and EU institutions (i.e. INTERREG and EURES programmes).

The fourth principle places the Community as one of the actors in a multi-level network and not as a substitute for Member States. The Commission was entitled to earmark part of the resources to finance Community Initiatives (CI) and territorial and sectoral projects according to Commission guidelines. The effects of the CI was twofold: on one hand, the power of the Commission in regional policy increased substantially; on the other, the focus on the regional dimension and transregional cooperation reinforced the regional level of government, fostering new approaches to local development.

The process which led to the creation in 1993 of the Cohesion Fund is paradigmatic. It was clearly conceived as a form of compensation for those countries that were likely to benefit less from membership of the EMU. The aim was to support national governments to align their

Table 3.2 The regional policy architecture

Objectives			Financial instruments	Objectives	Financial instruments
1989–93	**1994–99**	**2000–2006**		**2007–2013**	
1. Promoting Development and Structural Adjustment of the regions 'lagging behind'	1. Promoting Development and Structural Adjustment of regions whose development is lagging behind	1. Regions lagging behind in development terms Cohesion Fund	ERDF, ESF, EAGGF-Guarantee/ Guidance FIFG, Cohesion Fund	1.Convergence	ESDF ESF Cohesion Fund
2. Converting regions, frontier regions or parts of regions seriously affected by industrial decline	2. Converting regions seriously affected by industrial change	2. Economic and social conversion zones	ERDF ESF	2. Regional competitive-ness and employment	ERDF ESF
3. Combating long-term unemployment	3. Combating long-term unemployment and facilitating integration into employment	3. Training systems and employment policies	ESF	3. European territorial cooperation	ERDF
4. Facilitating occupational integration of young people	4. Facilitating the adaptation of workers to industrial changes and changes in production systems				

5a. Adjustment of agricultural structures	5a. Adjustment of agricultural structures and fisheries sector		
5b. Facilitating the development of rural areas	5b. Facilitating the development and structural adjustment of rural areas		
	6. Promoting development of regions with an extremely low population density		
	Interreg II; URBAN	Interreg III; URBAN II; EQUAL; Leader +; Rural Development and restructuring of the fishing sector beyond Objective 1	ERDF, ESF, FIFG, EAGGF-Guidance/ Guarantee

budgets with Maastricht convergence criteria. As a matter of fact, the provision of the Cohesion Fund in the Treaty of Maastricht was finally made thanks to the threat of a veto by Spain and to the intervention of the cohesion country coalition.

Through CI, the Commission engaged in fostering interregional and transnational networks and development strategy. The policy priorities were human resources, unemployment and social exclusion, industrial changes and structural adjustments, rural development. Interreg II, Urban and Leader II initiatives were undertaken. The latter adopted an endogenous perspective, focusing on local potentialities and on multi-actor partnerships. The Committee of Regions (COR), foreseen by the Treaty of Maastricht and created in 1994, permitted the Regions to be represented and to participate directly in European policy making.

The so-called Lisbon Strategy (2000) opened the way to a new coordination between European reforms in the market of goods, services and capital and national employment and social policies which, being national responsibilities, were coordinated within the institutional framework of the open method of coordination (OMC). Soft regulation provided cooperation at national, regional and local levels, as well as processes of peer review and benchmarking.

For the first time the coordination between national social policies was regarded explicitly as an objective worth pursuing at a European level. A new perspective was launched which was based on possible and expected connections between growth, social cohesion and employment within a specifically European social model. There were changes in both the relevance and the position of social cohesion in EU policy objectives: social cohesion became an objective *per se*, a factor contributing to competitiveness. The original Lisbon Strategy was therefore aimed at pursuing a wide range of policy objectives: competitiveness, through liberalization and structural reforms, innovation, full employment, sustainable growth, social cohesion and, from 2001, environmental sustainability. The Welfare State, a specific European *sociopolitical construction* (Ferrera, 2004, 2005), was conceived as a typical feature of European states that was worthy of preservation and this represented a new shift of perspective (Pizzuti, 2006).

The Berlin European Council (1999) established the programming for the period 2000–2006. Regional policy architecture had therefore to be adopted taking into account substantial political, economic and institutional changes. The EMU was launched in 1999. Five years later, the most relevant EU Enlargement process took place, bringing into the European Union eight countries from CEE, alongside Cyprus and Malta.

A substantial realignment of the allocation of the resources had therefore to be faced, leading to the 'statistical effect': regions which had met the eligibility criteria in EU-15 would not meet the criteria in EU-25, as the average GDP decreased. Part of the budget had to be spent for the pre-accession activities of the candidate countries.

The level of resourcing was increased by 25 per cent and the structure of the policy was simplified, reducing the objectives to: the structural adjustment of regions lagging behind in terms of development (objective 1); the economic and social conversion of region in need of structural changes (objective 2); and the creation of training systems and implementation of employment policies (objective 3). The Council allocated €47 billion for financial support to the 10 applicant countries through the PHARE programme and the Instrument for Structural Policies for Pre-Accession (ISPA). Agenda 2000 changed ISPA from a demand-driven to an accession-driven programme and posed as priority institution building and structural change.

The principle of concentration was strengthened in territorial and financial terms, as well as in terms of the objectives pursued. Decentralization, procedure simplification and efficiency (the 4 per cent performance reserve) were pursued explicitly.

One step forward in the Lisbon Strategy occurred in 2000: the OMC was applied to social policy (the Nice Summit) and a set of multidimensional structural indicators was established in order to monitor national policy outcomes within the framework of a *management by objectives approach* (Ferrera, 2004, 2005; Atkinson, 2003; de la Porte and Pochet, 2004; Scharpf, 1997, 2002). Nevertheless, the poor results achieved led to a significant revision of the Lisbon Strategy undertaken in 2005. Social and economic data referring to the first five years were appreciably lower relative to the fixed threshold in terms of values of poverty, long-term unemployment and early school leaving.

The rethinking involved policy aims, through the shelving of one of the three tenets of the original strategy, namely social cohesion, as well as governance procedures. The relaunch established a new *label*, focussing on the areas of growth and employment. The objectives were to make Europe a more attractive place in which to invest and work, to enhance knowledge and innovation as engines of growth and to shape policies allowing businesses to create more – and better – jobs. The council also established a benchmark of 60 per cent of the resources for convergence objectives and 75 per cent of the resources for the regional competitiveness and employment objectives to pursue the Lisbon Strategy (*fléchage Lisbonne*).

The role of social objectives in the Lisbon Strategy has been debated widely. Even though the 2005 and the 2006/2007 Spring European Council Presidency Conclusions reaffirmed the commitment to the reduction of poverty and social exclusion, the decoupling between the objectives of growth and social cohesion cannot be disregarded.

3.2 Cohesion and regional policy, 2007–2013

The fourth round of Cohesion Policy programming has been significantly influenced by three events which took place between 2004 and 2007 – that is, the two Eastern Enlargements and the relaunching of the Lisbon process. The accession of 10 CEEC has appreciably decreased the GDP per capita of the EU causing the so-called 'statistical effect', thus leading to potential conflicts between 'old' and 'new' Structural Fund beneficiaries.

Furthermore, the process of rethinking the future of cohesion policy[6] and the reforming process of the structure of the EU budget are likely to exert a powerful influence on the implementation of the 2007–2013 programming period. The fourth round is therefore rooted in a new and changing environment, in which the modified composition of actors, beneficiaries and contributors may not only be pivotal in determining political outcomes in the budget reform process, but also become the driver for the definition of cohesion policy objectives.

The financial framework for the years 2007–2013 (see Figure 3.1) was established by the European Council in December 2005 for a total amount of €308 billion (2004 prices) – €347 billion at current prices – earmarked for regional and cohesion policy; Structural Fund regulation, which introduced substantial modifications, was adopted in 2006, when the Interinstitutional Agreement was also reached. The Commission's proposal was approved with a substantial reduction in the amount of resources, which varied between the proposed 1.24 per cent of the EU GNI, to the 1.045 per cent proposed by the EU Council (2005) and the 1.048 per cent in the Interinstitutional Agreement.

Notwithstanding the fact that the EU budget represents quite a small portion of national GNI, the budget procedure is characterized by a highly complex process in which substantial attention is paid to the definition of side-payments to Member States in order to adjust their net position. For instance, it was the agreement reached by the Council to review the EU budget in 2008–2009 that broke the deadlock caused by the CAP decision and by the position of the United Kingdom. This process mirrors a controversial situation, in which it has become increasingly

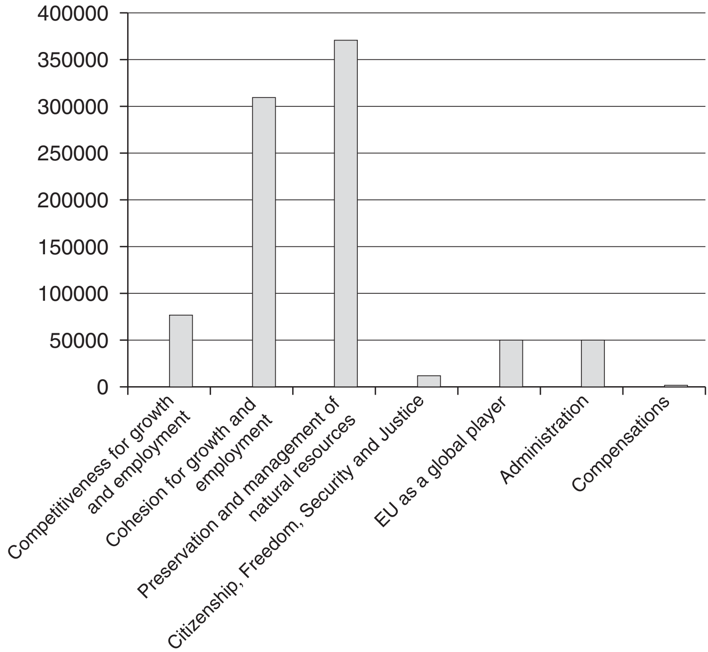


Figure 3.1 Financial framework for 2007–2013
Source: Data from Financial Framework (revised) (2008/29/EC).

difficult to counterbalance national interests with the nature of the public good which EU policies should acquire – the so-called *common pool problem*.

In fact, EU finances have different revenue sources: custom duties and agricultural levies ('traditional own resources'), levies on national Value Added Tax (VAT) receipts and Member State contributions according to their GNI ('fourth resources'). The latter covers more than three-quarters of the budget, while the 'traditional own resources' – the core of the process in the early years of the EC, when the main purpose of a community budget was to finance CAP – are becoming less relevant.[7] Making the Member State contributions the main source of funding has led the budget political agreement into a highly controversial arena. One widely accepted hypothesis is that national interest becomes the driving force in the budget bargaining process, through *the inflation of rebates and special provisions and the neglect of policies on a European public good type* (Sapir, 2004; Osterloh, Heinemann and Mohl, 2008a, 2008b), contributing strongly to the determination of the allocation of the funds, and sometimes leading to biased outcomes (Mrak and Rant, 2007; De Broek and Hemming, 2008).

Even though the role of the Parliament has been increasing significantly as a result of the Treaties of Luxembourg (1970) and Brussels (1975) as far as expenditure regulation is concerned, revenues remain substantially a Member State decision.

The question at the core of the reform process (European Commission, 2007c) is therefore whether or not it is possible to enhance the production of public goods by reforming the revenue sources of the EU, being the budget currently conceived as a cross-compensation between Member States. In particular, the introduction of an EU tax has been proposed (Begg, 2007).

As a matter of fact, the links of this process to Cohesion Policy are deep and twofold. Cohesion Policy has become a major expense within the EU budget, and it would therefore be significantly influenced by modification of both processes and expenditure size. In turn, after the Eastward Enlargements, the distributive features of cohesion policy are likely to slow down the budget bargaining process, characterized by a strong links between EU and national budgets.

3.2.1 Cohesion Policy objectives

As far as Cohesion Policy Financial Resources Allocation is concerned (see Figure 3.2), in the programming for 2007–2013 the number of the objectives has been reduced to three: convergence, regional competitiveness and employment, and European territorial cooperation. The former Community Initiatives are now incorporated in the three objectives. Considering the resource allocation by objectives, as shown in Table 3.3, the reorganization of the financial framework leads to a significant concentration of resources in Objective 1: 77.4 per cent of funds are allocated for the current Objective 1 area, which also includes Cohesion Funds, and 4.02 per cent is earmarked for the phasing-out areas.

Regional competitiveness and employment replace the 2000–2006 objectives 2 and 3, shifting the focus onto the regions (NUTS 1 or NUTS 2) rather than on micro-zoning as before.

The ERDF finances the third objective, whose role is to reinforce the other two. Policy areas covered by this objective are the promotion of small and medium-sized enterprises (SMEs), urban, rural and coastal development and the establishment of economic networks.

European territorial cooperation in areas related to economic and social cohesion will be pursued by the European Grouping of Territorial Cooperation.

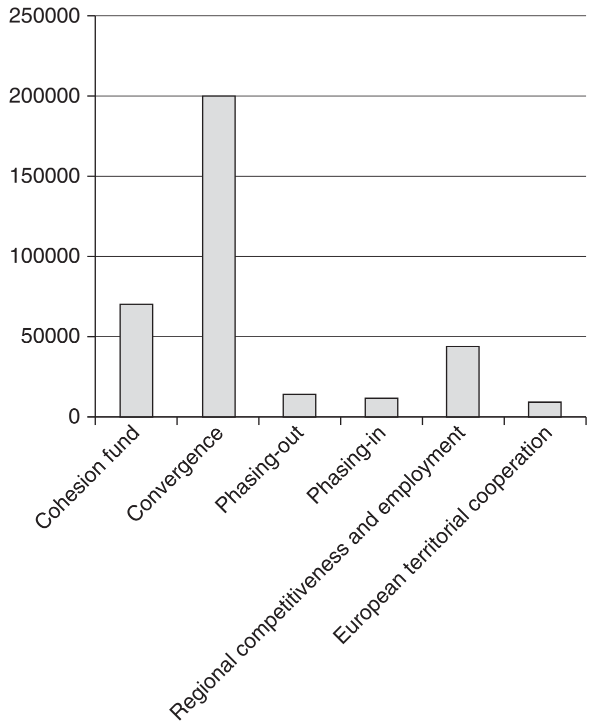


Figure 3.2 Cohesion Policy financial resources allocation
Source: Data from European Commission.

The reorganization of the objectives is grounded on a twofold basis: the necessity to simplify and clarify policy architecture and to concentrate resources on the Lisbon Partnership for Growth and Jobs, according to Commission Guidelines and to *fléchage Lisbonne*.

The aims of convergence are to foster growth and employment in those regions and Member States which are worse off in relation to specific eligibility criteria. Particular attention is paid to the development of an innovation- and knowledge-based society, environmental sustainability, administrative efficiency and an increased capacity to adapt to changing socioeconomic conditions.

As far as the convergence objective is concerned, ERDF priorities are fostering entrepreneurship and innovation and environmental sustainability. Particular attention is paid to the development of SMEs, namely of clusters of enterprises, networks and public–private partnership,

Table 3.3 Indicative allocation by Member States, 2007–2013 (current prices, € million), data from European Commission

Country	**Convergence**			**Regional competitiveness and employment**		**European territorial cooperation**	**Total**
	Cohesion Fund	**Convergence**	**Phasing Out**	**Phasing In**	**Reg. competitiveness and employment**		
Max. co-financing (exceptions Annex 3)	**85%**	**between 75% and 85%**		**between 50% and 85%**		**between 75% and 85%**	
Bulgaria	2,283	4,391				179	6,853
Czech Republic	8,819	17,064			419	389	26,692
Estonia	1,152	2,252				52	3,456
Latvia	1,540	2,991				90	4,620
Lithuania	2,305	4,470				109	6,885
Hungary	8,642	14,248		2,031		386	25,307
Poland	22,176	44,377				731	67,284
Romania	6,552	12,661				455	19,668
Slovenia	1,412	2,689				104	4,205
Slovakia	3,899	7,013			449	227	11,588
Other Member States	10,797	87,167	13,955	9,377	42,687	5,554	16,9539
Total and percentage (approx.)	69,577; 20.03%	199,323; 57.37%	13,955 ; 4.02%	11,408; 3.28%	43,555 ;12.54%	8,723; 2.51%	347,410

reflecting the increasing interest in systems capable of fostering and reinforcing innovation and expertise exchange between private enterprises of different sizes, research centres and universities and the public sectors (OECD, 2008a,b,c). As a matter of fact, the priorities of investments in transport, information society and tourism, especially sustainable tourism, are connected to the two priorities.

Entrepreneurship and SMEs are also at the forefront of regional competitiveness, employment and European territorial cooperation.

The ESF now has to focus on promoting innovation, employment, transnational and interregional cooperation. Within the competitiveness and employment strategy, enhancing employment opportunities is a means to overcome poverty and spatial disparities and achieve social inclusion (article 2).

Strategic follow-up was introduced, in order to strengthen the consistency with the Lisbon Strategy. Three new programmes have been introduced in order to support and enhance investments, in a perspective of cooperation between the Commission, the EIB and the European Bank for Reconstruction and Development. Jasper (Joint Assistance in Supporting Projects in European Regions) is meant to assist Member States in preparing quality projects; Jeremie (Joint European Resources for Micro to Medium Enterprises) is a programme which improves access to finance for SMEs and the development of micro-credit; finally, Jessica (Joint European Support for Sustainable Investment in City Areas) is a programme which supports sustainable and recyclable urban investment and development in cities.

As Table 3.4 shows, all of the CEE Member States are eligible for convergence, either for the entire territory or for specific regions, thus leading to a substantial realignment of beneficiaries. Regional data on per capita GDP in pps and on GDP growth rates show serious and deeply rooted structural regional imbalances. The available data on labour market at the regional level mirror this situation, showing high levels of disparity in the rates of regional unemployment and employment by sector. Regional disparities are also reflected in the data on the level of education. In this respect the Czech Republic is a paradigmatic case, going from 157.1 per cent per capita GDP in Praha to 59.8 per cent in Středni Morava, 61.1 per cent in Moravskoslezsko and 60.7 per cent in Severozápad. The average annual change in GDP growth is 3.8 per cent in the capital city compared to 1.2 per cent in Moravskoslezsko and 0.3 per cent in Severozápad. 15.7 per cent of people aged between 25 and 64 have a low educational attainment in Severozápad compared to 4.5 per cent in Praha. The unemployment rate is 13.9 per cent in Moravskoslezsko, 13.5 per cent in Severozápad and 3.5 per cent in Praha (data 2005).[8]

Table 3.4 Regions and Member States eligible for Cohesion Policy objective

	Convergence		Regional competitiveness and employment		European territorial cooperation		
Country	**Regions eligible for the convergence objective**	**Cohesion Fund financing**	**Regions**	**Transitional support "phasing in"**	**cross-border cooperation**	**transnational cooperation**	**Interregional cooperation, setting up networks exchanges of experience**
Bulgaria	All the territory	yes	The EU Regions which are not eligible for the convergence objective or for the transitional support of the regional competitiveness and employment "phasing in" objective		NUTS3 level Regions, along all the land-based internal borders and some external borders, along maritime borders separated by a maximum distance of 150 km*	All the regions. Commission, in consultation with Member States, has identified 13 cooperation zones*	All the EU Regions
Czech Republic	Střední Čechy, Jihozápad, Severozápad, Severovýchod, Jihovýchod, Střední Morava, Moravskoslezsko						
Estonia	All the territory						
Hungary	Közép-Dunántúl, Nyugat-Dunántúl, Dél-Dunántúl, Észak-Magyarország, Észak-Alföld, Dél-Alföld			Közép-Magyarország			
Latvia	All the territory						
Lithuania	All the territory						
Poland	All the territory						
Romania	All the territory						
Slovakia	Západné Slovensko, Stredné Slovensko, Východné Slovensko						
Slovenia	All the territory						

Source: Data from the European Commission.
*List defined in decision 31/10/2006.

The convergence objective has both regional and national (Cohesion Funds) eligibility criteria: regions whose GDP is less than 75 per cent and Member States whose GNI is less than 90 per cent of the EU-27 average are eligible. The transitional funds supporting regions and Member States which would have been eligible without the so-called statistical effect (phasing out) will gradually decrease.

3.2.2 Funds and administrative rationalization and the role of the Member States

It is possible to identify a clear trend towards funds and administrative rationalization. The aim seems to be not only to diminish administrative and regulatory burdens, but also to increase the influence and the autonomy of the Member States.

The rule 'one programme for one fund' has been introduced. Cohesion Policy is now based on three funds with the same programming and management rules: the ERDF, the ESF and the Cohesion Fund, whose primary objectives consist of developing trans-European transport networks and environmental issues. It still remains the unique fund subject to the macroeconomic conditions established during the CSF 2000–2006, which involves the possibility of partial or total suspension in case of excessive government deficit with no adoption of corrective measures. The constraints have become tighter because suspension will concern the whole programme and not just projects as before. This can be seen as a counterbalance to the stronger power of the Member States, as Commission appraisals are only requested in the case of major Cohesion Fund projects.

National competences in terms of project definition and implementation have increased substantially in comparison to the past. The Commission has taken on more a role of coordination through the elaboration of guidelines within which Member States and Regions are requested to define national and regional objectives. In line with this shift, the objectives of the Structural and Cohesion Funds are declared explicitly. ERDF expenditure and eligibility rules are now national. The allocation procedure of the ESF is also based on national criteria, within a Legal European Framework which defines expenditures that are not eligible.

The National Strategic Reference Framework (NSRF) replaces the CSF and the Single Programming Documents (Council, 2006). The substantial difference between the former and the latter testifies to the growing national influence on policy planning. While CSF was a management instrument, the NSRF is a programming instrument in which national and regional socioeconomic features, policy priorities and key implementation elements are set. The provision of the NSFR is aimed at simplifying strategy and concentrating resources to fewer and clearer objectives. Flexibility has also substantially increased in the implementation phase (Operational Programmes), giving more autonomy to the national and regional levels.

Subsidiarity is strengthened, in order to simplify national evaluation, monitoring and bureaucratic obligations,[9] which are thus appreciably decreased, in line with the newly introduced principle of proportionality. The rationale is to connect obligations and amount of funds allocated by the Community. A set of indicators to measure programmes has been defined, along with obligations in terms of evaluation, report and management (art. 13.1).

The principle of additionality is also reinforced. Within the convergence objective, European funds must co-finance, rather than replace, public expenditures. The 2007–2013 round introduces a financial corrective mechanism, in case the principle has not been respected in order to counterbalance the increased role of the Member States.

Three new programmes have been presented by Member States to cope with the establishment of networks and the exchange of experiences: (i) Interact, with the aim of supporting cooperation programme management as well as organization management; (ii) Urbact, a thematic city network; and (iii) the European spatial planning observation network (Espon), an observation network for spatial planning. The growing interest of the Community in spatial planning, testified to by increased financial support to Espon for 2007–2013, seems to represent an indication of the increased attention paid by the Commission to the concepts of territorial disparities and, consequently, to the importance of local, endogenous development which needs to calibrate means according to specific geographical, social, cultural, historical features and endowments of resources.

Another policy in line with this perspective is the provision of a national performance reserve and the strengthening of the principle of partnership. The former consists in the possibility of establishing, at a national level, a performance reserve up to 3 per cent of the allocation for each objective in order to enhance flexibility in responding to local and sector-based crises. Partnership is reinforced in order to include civil society, non-governmental organizations, environmental partners, and organizations promoting gender equality in the programming, implementing and managing stages of the process.

The role of the Member States, which increased significantly in terms of planning, implementation, evaluation and monitoring phases, can be seen as an answer to the growing diversity within the EU and as a counterbalance to the statistical effect. The trend of a re-nationalization of regional and Cohesion Policy, however, disregards important factors which should be taken into consideration and will be discussed in the next section. The nature of the public good embedded in convergence is not sufficiently perceived in the EU. One serious obstacle to this is the difficulty of evaluating and measuring convergence outcomes. As Bachtler and Mendez (2007) highlight, European Cohesion Policy has been criticized harshly by scholars with respect to both the role of the different levels of government and also the effectiveness of the policy itself.

To date the analysis of the effectiveness of actions undertaken and consistency with objectives has not yielded any conclusive answers (Kaljulaid, 2008; Uustal, 2008), leaving open questions about the extent to which Cohesion Policy has succeeded in fostering more even development, convergence and integration (Leonardi, 2005).

3.2.3 Institution building and pre-accession assistance in Central and Eastern Europe

The strategy for supporting applicant countries – that is, Croatia, the former Yugoslav Republic of Macedonia and Turkey – and the countries engaged in the path to accession has been rationalized and simplified. A single instrument, the Instrument of Pre-Accession Countries (IPA), has replaced PHARE, ISPA, Sapard, CARDS and the pre-accession financial assistance for Turkey programmes. The financial framework is spread over several years and is revised on an annual basis. Regional development (in particular in relation to transport and environmental issues), rural development and human capital development are the focuses of IPA. Institutional capacity building remains the key issue in supporting Applicant Countries (particularly relevant in relation to these objectives have been the Twinning projects) as well as in helping Member States to improve the capacity of national, regional and local administration. The fundamental scope of ESF assistance within the framework of the Convergence objective is the *strengthening of institutional capacity and the efficiency of public administration and public services at national, regional and local level* (art. 3, c.2). Partnership between public and private, private and private and between public, private and the third sector is another fundamental issue that is emphasized by the new ESF regulation.

As a matter of fact, as far as regional policy is concerned, with the breakdown of the previous order, new Member States are actually experiencing a sort of dual transition (Brusis, 2000): on the one hand, there has been the institutionalization of a market economy environment; on the other, a concept of 'endogenous' development has replaced the equalization-oriented concept of regional policy.

Planning, management and the implementation of Cohesion Policy are based on multi-level governance in which the competence and the role of the national and the regional tiers are often not clearly defined. Fostering institution building and state bureaucracy modernization, fighting corruption and enhancing administrative efficiency are therefore a *conditio sine qua non* in the effort to effectively implement Cohesion Policy in new Member States, which are still suffering from serious institutional weaknesses.

Subnational administrative tiers have often only been recently established (see Box 1), there is therefore an urgent necessity to enhance administrative capacity to cope with regional development policies. Since 1999 UNDP Regional Reports on Europe and the CIS have been stressing the fact that *economic growth through market driven policies were pursued to the relative neglect of institutional reform* (UNDP, 1999). The majority of the New Member States have undertaken territorial reorganizations and administrative reforms during the transition and the accession period in order to better meet EU requirements.

In this respect, it is crucial to define a long-term policy framework in order to avoid the risk of undermining learning processes, stability of processes and networks. Notwithstanding that Cohesion Policy has a regional focus, there is evidence that shows the necessity to calibrate the opportunity to decentralize on a case by case basis. As outlined in the LSE-UNDP *Development and Transition* issue 2006 'in countries whose poor regions face severe development challenges and possess limited fiscal resources and administrative capacity, central governments must take a lead role. Centralized structural fund programming and management may be needed to ensure the effective implementation of priority programmes'.

Box 3.1 The administrative organization of CEE new Member States and Applicant Countries

In 1999 **Bulgaria** was divided into 28 *oblasti* (regions, NUTS1) and 287 *obštini* (comuni, NUTS3). Until 1987 the country was organized as 28 autonomous districts, the *okrăzi*, geographically similar to the present *oblasti*. From 1987 to 1999 there were 9 *oblasti*, before 76 *okresy* (districts) including 3 'statutory cities', which remain today as territorial divisions and seats for administrative branches.

Since 2000 the **Czech Republic** has been divided into 14 regions (13 *kraje* and Prague) which have some political and economic autonomy.

Estonia is divided into 15 *Maakonnad* (counties). The ancient administrative division was re-established in 1990. Each county is made up of *omavalitsus* (municipality), or *linn* (urban municipality), which are divided into *linnaosad* (districts) and *vald* (rural municipality).

Hungary is divided into 19 *megyék* (counties, NUTS3), 23 *megyei jogú városok* ('urban counties', towns with extended power but dependent on the county) and Budapest. The counties are made up of 173 *kistérségek* (sub-regions). Since 1996, the counties and the City of Budapest have been classified into 7 statistical regions (NUTS2) for statistical and policy purposes.

Latvia is divided into 26 *rajoni* (districts), 7 *lielpilsētas* (cities) and 5 planning regions.

Lithuania established its administrative organization in 1994 and in 2000 introduced some modification in order to meet EU requirements. It is divided into 10 *Apskritys* (counties), 60 *savivaldybés* (municipalities) and more than 500 *seniūnijos* (elderates).

Since 1999 **Poland** has been divided into 16 *województwa* (administrative regions, created in 1920), with mainly administrative functions. Each *województwo* is made up of 379 *powiat*. The third administrative level is made up of 2478 *gminas* (municipalities).

Since 2003 **Romania** has been divided into 41 *judeţe* (districts) and 1 municipality.

Slovakia is divided into 8 *kraje* (counties), with a certain degree of autonomy since 2002. Each *kraj* is made up of 79 districts, which are made of *obec* (municipalities), in turn made up of *katastrálne územie*. *Kraje* and *obec* are self-governing entities and Unit of State administration. Since 2004 district offices were replaced by Circuit Offices, which are responsible for several districts and are the units taken into account for statistics.

Slovenia is divided into 8 regions.

Since 1990 **Croatia** has been divided into 20 *županija* (counties) and Zagreb.

Since 2004 the **Former Yugoslav Republic of Macedonia** has been divided into 85 *opštini* (municipalities). From 1996 to 2004 the country was divided into 123 municipalities. Before 1996 there were 34 administrative districts.

Table 3.5 Structural Funds absorption rates, 2000–2006 (funds paid/funds decided)

Czech Republic	33.35%
Estonia	51.51%
Latvia	34.24%
Lithuania	36.77%
Hungary	50.00%
Poland	38.37%
Slovenia	52.32%
Slovak Republic	36.68%

Source: European Commission (2007d).

In the financial framework for the period 2007–2013 €2 billion has been earmarked for interventions in New Member States and in the convergence regions of Greece, Italy and France.[10] An effective Structural Funds absorption capacity not only requires the acquisition of the regulatory framework, but also needs cooperative partnership between central governments, municipalities, private and third sectors and NGOs (European Commission, 2008; UNDP, 2006; Brusis, 2000). As Table 3.5 shows, absorption capacity strongly needs to be developed in post-socialist New Members. The Czech Republic, with the lowest absorption rate (33.35 per cent), has shown difficulties, particularly in respect of objective 3. Latvia and Lithuania are also part of the slowest group. Estonia, Hungary and Slovenia show the highest rates. Particularly relevant is the Slovenian performance, attesting at a rate of 52.32 per cent. The best performers in the EU are Germany (75 per cent), Spain (75.11 per cent), Ireland (82.80 per cent), Austria (79.99 per cent) and Portugal (75.54 per cent).

3.3 Allocation and redistribution: territorial and social dimensions of Cohesion Policy

The reform processes in governance and policy architecture which have recently been undertaken[11] and the developments of the European Cohesion Policy over the past decades reflect the effort to modify policies and procedures to meet a changing environment, to tackle new challenges and, in particular, to respond to recent Eastern Enlargements and new global imbalances.

Leaving aside the latter, several pivotal questions arise in our perspective which are closely connected to each other and overlap, at least partly. Firstly, it has been debated which would be the better target of Cohesion

Policy, in particular whether it is worthwhile to allocate resources at a national or regional level and whether it is more effective to allocate resources widely rather than to concentrate funds on strategic regions in order to fuel growth where major potential is located. Secondly, even though the so-called 'excellence or equity dilemma' (Begg, 2008) has been a constant and pressing issue in the Cohesion Policy debate, it has nevertheless never been so much at the forefront. The question is connected to the redefinition of the objectives of Cohesion Policy, to the nexus between regional and Cohesion Policy and the Lisbon Process and to the reshaping of the Social European Model. Lastly, the highly political value embedded in the concept of social and economic cohesion should not be disregarded.

The common ground which underlies these questions seems to be twofold: on one hand, the necessity of maintaining regions as pivotal interlocutors in EU cohesion policies, on the other the importance of strengthening the social dimension of regional policy.

The question of the re-nationalization of Cohesion Policy is part of a wider debate on policy tenets which has been going on since 2000 in the perspective of the 2004 Enlargement. There have been quite serious differences in respect of the positions relating to the merits of policy solutions between net contributors, the 'cohesion countries' and Community Intitutions, namely the Commission, upheld by the Parliament, the COR and the European Economic and Social Committee (Deutsch Institut für Wirtschafsforshuung, 2002; European Commission, 2001, 2002, 2003; Sapir *et al.*, 2003).

Even a brief outline of the economic and social conditions in the new Member States from Central and Eastern Europe shows growing disparities within countries. Analyses and forecasts show favourable economic growth scenarios. The Czech Republic, Hungary, Poland and Slovakia are the leading group, while Romania and Bulgaria are lagging behind. However, despite the data that suggest that there has been an increase in per capita income pps, the variance of income at the regional level is increasing significantly. Data on the disparities between leading regions, namely capital regions and western border regions, and regions which are lagging behind testify to a deep polarization that is rooted in geographical, economic, political and historical reasons which constitutes a common pattern in the CEEC. As the Espon (2003) report stresses, *a common problem is the weakness of the urban systems to support polycentric urban growth*. The distance to the single Global Integration Zone of EU-15 seems to play a pivotal role in regional development dynamics (Espon, 2003; Melhbye, 2000). In those countries which participate in the European trade space there is a striking disparity, with a clear prominence being given to the areas that are geographically and economically connected to the economically vital nodes of the EU. This leads, on one side, to the re-emergence of regional interests that extend across national borders and to the so-called municipal capitalism. Some of these regions, in axial extension of the Global Integration Zone of the EU-15, are likely to shape new axes of interest.

On the other hand, this spatial structure leads to cumulative causations which need to be dealt with. In this respect, at an aggregated level institutional and economic reforms and EU membership have increased the flow of investments in Eastern Europe. The amount of inward FDI has risen from US$24.1 billion in a world total of US$491.8 billion in 1997 to US$105.9 billion in a global total of US$1,335.1 billion, representing a rise from 4.9 per cent to 7.9 per cent of the world total. Romania and Poland were among the leading recipients of new FDI projects in both 2005 and 2006, accounting respectively for 2.5 per cent in 2005 and 3.06 per cent in 2006 (Romania) and 2.59 per cent in 2005 and 2.74 per cent in 2006 (Poland) share in world total (data from the Economist Intelligence Unit).

But, notwithstanding that the flow of inward FDIs to the regions has become considerable, with Estonia, Hungary and the Czech Republic being at the forefront, the flow has been highly concentrated in capital regions or in specific areas. Consequently, due to the polarization of the investments, the role of inward FDIs in fostering economic and social cohesion should not be overemphasized.

What is required urgently is a strategy grounded on the enhancement of local development, which is based on the fostering of endogenous endowments of resources and on making use of local opportunities, taking account of idiosyncratic trajectories. However, to be sustainable local and regional development cannot be conceived as an isolated, self-sufficient process. On the contrary, stronger links and communication networks need to be constructed and reinforced at local, regional, national and international levels.

Even though the 2004 and 2007 Enlargements have presented a major challenge to Cohesion Policy, it is precisely the policy areas of cohesion and sustainability that will allow the EU to make use of those opportunities that have arisen from Eastward Enlargements within the perspective of a local development strategy. Alesina, Angeloni and Etro (2001a,b; 2005) have stressed how the increased number of preferences in a larger union can make the harmonization of policies more complex and can even lead to negative effects, highlighting the necessity for the supranational level to focus on policies whose implementation and planning at an upper level can have an added value in respect of the national level. The added value of a European regional and Cohesion Policy relies on the stimulation of local development while simultaneously coordinating strategies and creating valuable spatial and economic connections. This is even truer when referred to CEEC, where institutional and policy capabilities are still at a difficult stage of development.

The area of intervention of regional policies tends moreover to overlap areas covered by SMEs and entrepreneurship, labour market and social policies. The stimulating role of the Community seems to be important in policy areas in which the experience of new Member States is recent and the commitment in terms of level of expenditure is appreciably lower than the EU27 average.[12]

As noted in recent studies (see, inter alia, Maarteen de Vet, 2008; Tarschys, 2008), from its very inception Cohesion Policy has been a polysemic concept, designed to tackle a variety of economic and social objectives, that are often quite vague in terms of definition and certainly very difficult to measure accurately. This has led the debate to address Cohesion Policy as an 'omnibus policy', a sort of budget chapter in which to inject new concerns (Tarschys, 2008). Politically, there has been a clear shift towards a convergence of funds to fewer, clearer aims. In addition to this process, since the relaunch of the Lisbon Strategy in 2005, it is possible to identify a further, parallel tendency. Notwithstanding declarations of the European Council have repeatedly cited greater social cohesion and the fight against poverty and social exclusion as fundamental objectives of the Lisbon Strategy, it cannot be disregarded that the label of Lisbon II did not include social cohesion, pursuing a decoupling between growth and employment on one side and the social dimension not directly connected with the labour market on the other (Pizzuti, 2005). This process is likely to seriously threaten what Atkinson defined as the 'lasting contribution' of the Lisbon European Council (2000) and of that of Laeken – that is, the '… coupling of "greater social cohesion" with the economic objectives that had dominated the EU agenda of the previous decade. This reflected the feeling of many people that the social dimension of Europe deserves greater priority' (Atkinson, 2003).

In parallel, the *fléchage Lisbonne* has concentrated the major part of regional and Cohesion Funds on Lisbon objectives, shifting the focus of Cohesion Policy strongly onto the Partnership for Growth and Jobs. The connection is strengthened by the links established in 2007–2013 programming between the NPR and NSRF. This tendency has been confirmed by the absence of social cohesion or social inclusion objectives in the Commission Staff Working Paper (2006) aimed at defining the NRP's guidelines[13] and by the synthesis report of the EU Network of Independent Experts on Social Exclusion regarding the second semester 2006 (Begg, Marlier, 2007), as well as by the absence of the aim of cohesion in the Commission Integrated Guidelines (2006).

The redistributive aim of Cohesion Policy is the subject of considerable debate, at both the political and academic levels, which seems to threaten the social policy dimension. Connected to this tendency is the proposal, advocated by scholars and politicians, to concentrate resources on high potential growth regions rather than on regions that are viewed as 'lagging behind'. Since the pre-accession phase, subnational distributional issues have been conceived of as a secondary issue (Drevet, 2000) that could be dealt with at the national level. And yet there seems to be a striking necessity to maintain both the distributive and the allocative functions of Cohesion Policy in order to tackle cumulative causation.

Moreover, within the growth, competitiveness and employment objectives, high priority is given in 2007–2013 programming to policies aimed at sustaining and fostering entrepreneurship and the development of SMEs. The purpose of more effectively designing these types of policies is emerging strongly in international organizations and also national and local governments. Often, at both political and academic levels, these policies are regarded as contrasting with social policy, in the sense that development is based less *on redistribution and more on enhancement of regional and individual capabilities* (Heidenreich, 2003). Entrepreneurial SMEs can be a fundamental driver of economic and social development as well as an effective means of fighting poverty. The contrast between entrepreneurship policy and social commitments has recently been challenged by an important branch of research into entrepreneurship and the business environment (Kauffmann Foundation, 2007). In contrast to other institutions, such as the World Bank, which exclusively stress the importance of policies aimed at reducing regulatory and administrative burdens, the Kauffman Foundation highlights the relevance of health and social protection and of policies aimed at reducing income, educational and social inequalities in shaping a business friendly environment and fostering innovation.

As outlined by Atkinson (2003), to conceive economic and social policies as necessarily integrated does not automatically imply any complementarity between policies for social inclusion and policies for growth and competitiveness. Conflicts can arise and can be solved by tackling these aspects in an explicit fashion.

Moreover the highly controversial nature of Cohesion Policy reflects its 'political value', the message of a deeper and tighter EU naturally embedded in it, as well as the difficult relationship developed in these respects with the new Member States in the CEE region. On the one hand, the behaviour of the New Member States has been twofold, showing the difference between politicians supporting regional policies as an important counterbalance to the institutionalization of a market economy and politicians who considered regional policies to be an obstacle to change. In the Czech Republic and Poland the latter position initially prevailed, and was revised as a result of the harsh increase in unemployment rates caused by structural change. On the other, the response of CEEC to the process of the constitutionalization of the EU has been controversial.[14] This process is likely to make it complex, in the short term, to deal with a policy which *sends a clear signal to prospective Member States that this is an achieved model, that it is part and parcel of European civilization and that it must be endorsed as an ambition by all those applying for membership* (Vandenbroucke, 2002).

3.4 Structural Fund regulation

Regulation (EC) No. 1080/2006 of the European Parliament and of the Council of 5 July 2006 on the European Regional Development Fund and repealing Regulation (EC) No 1783/1999.

Regulation (EC) No. 1081/2006 of the European Parliament and of the Council of 5 July 2006 on the European Social Fund and repealing Regulation (EC) No 1784/1999.

Council Regulation (EC) No. 1083/2006 of 11 July 2006 laying down general provisions for the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999.

Council Regulation (EC) No. 1084/2006 of 11 July 2006 establishing a Cohesion Fund and repealing Regulation (EC) No 1164/94.

Council Regulation (EC) No. 1085/2006 of 17 July 2006 establishing an Instrument for Pre-Accession Assistance (IPA).

Council Regulation (EC, Euratom) No. 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the EC.

Notes

1. According to the definitions given by Leonardi (1995, 2005), cohesion is the political objective, while convergence and integration are the processes

through which cohesion can be reached. Convergence is the decreasing of the gaps between different countries or regions in social and economic indicators, while integration refers to the process of institution building and to the adoption of new rules of the game.

2. The chapter deals with the ten new CEE Members and with Croatia and the Republic of Macedonia, two accession countries.
3. An approach that Gilpin (1987, 2001) labelled as *Smith abroad and Keynes at home* and Krasner described as a compromise between *interdependence sovereignty* and *Westphalian sovereignty* (Krasner, 1999).
4. Italy and Ireland threatened to boycott the Council if the ERDF was not created, while the 1979 reform was partly conceived as a counterbalance to the entrance of Italy and Ireland into the European Monetary System-EMS (1979).
5. In the early 1980s, Eurostat developed a single European system of territorial classification, the Nomenclature of Territorial Units for Statistics (NUTS), a five-level hierarchical classification made up of three regional and two local levels.
6. The recent debate launched by the European Commission testifies to the growing awareness of political institutions, as well as of the other policy stakeholders, of the necessity of rethinking cohesion policy tenets. The first round of public consultation took place between September 2007 and January 2008. It was launched at the Fourth Cohesion Forum (September 2007) and further developed by the EU Council at an informal ministerial meeting (Azores, November 2007). The second round began in April 2008 with a conference on the future of cohesion policy, held in Maribor (Slovenia) under the Slovenian Presidency.
7. This process can be considered in contrast with the art. 269.1 TEC, which since 1970 prescribes that *without prejudice of other revenue, the budget shall be financed wholly from own resources*, modifying the original procedure which was based on mandatory national contributions established on the basis of economic and political criteria or, in the case of ESF, on the basis of national contribution capability, in order to enhance Community independence from the national level.
8. The Commission 'Fourth Reports on Cohesion Policy' provides regional data on demography, GDP, GDP growth, employment and education for all EU-27 countries except for Latvia and Lithuania.
9. The bodies responsible for management, follow-up and control are now a management authority, a certification authority, an auditing authority and a follow-up committee for each OP.
10. The aims are enhancing e-government, better regulation, easier business creation, effective management of public policies and improving services provided to citizens and businesses, including the reinforcement of the judiciary (e.g. Bulgaria, Slovenia, Poland) (European Commission, 2008).
11. The European Employment Strategy was launched in 1997; the Lisbon Strategy was launched in 2000 and revised five years later, within which the OMC was implemented. Presently, a wide range of revision processes are underway which concern policy objectives, governance and budget procedures.
12. In 2005 labour market policy expenditure amounted to 0.49 per cent of GDP in the Czech Republic, 0.19 per cent in Estonia, 0.34 per cent in Lithuania, 0.68 per cent in Hungary, 0.73 per cent in Bulgaria, 0.54 per cent in Latvia,

1.22 per cent in Poland, 0.49 per cent in Romania, 0.61 per cent in Slovakia, 0.60 per cent in Slovenia compared to a EU27 average of 2.11 per cent and a EU15 average of 2.20 per cent (data Eurostat).

Also as far as social protection expenditure is concerned, Eurostat data show significantly different levels of expenditures. In 2005 social protection expenditure accounted for 27.2 per cent of GDP in EU-27 and 27.8 per cent in EU-15. The country with the lowest expenditure rate was Latvia, with 12.4 per cent of GDP. The Czech Republic expended 19.1 per cent, Estonia 12.5 per cent, Lithuania 13.2 per cent, Hungary 21.9 per cent, Poland 29.6 per cent, Romania 14.2 per cent, Slovakia 12.9 per cent, Bulgaria 16.1 per cent and Slovenia 23.4 per cent.

13. In this respect, the 2007 Spring European Council highlighted that 'the common social objectives of the Member States should be better taken into account within the Lisbon agenda ... in order to ensure the continuing support for European Integration by the Union's citizens'.
14. The Constitution has been ratified in Hungary, Lithuania (2004), Bulgaria, Latvia, Romania, Slovenia, Slovakia (2005), Estonia (2006). The process of ratification of the Constitutions has been delayed and then abandoned in the Czech Republic and Poland.

References

Alesina, A., I. Angeloni and F. Etro (2001a) *The Political Economy of International Unions*, Harvard Institute of Economic Research Working Paper no. 1939.

Alesina, A., I. Angeloni and F. Etro (2001b) *Institutional Rules for Federations*, Harvard Institute of Economic Research Working Paper no. 1940.

Alesina, A., I. Angeloni and F. Etro (2005) 'International Unions', *American Economic Review*, 95(3), 602–15.

Alesina, A., I. Angeloni and L. Schuhknecht (2005) 'What Does the European Union Do?', *Public Choice*, 23, 275–319.

Ansell, C.T., C.A. Parsons and K.A. Darden (1997) 'Dual Networks in European Regional Development Policy', *Journal of Common Market Studie*s, 35(3), 347–75.

Atkinson, A.B. (2003) 'Social Inclusion and the European Union', in J.H.H. Weiler, I. Begg and J. Peterson (eds), *Integration in an Expanding European Union: Reassessing the Fundamentals*, Oxford and Malden, MA: Blackwell.

Atkinson, A.B., B. Cantillon, E. Marlier and B. Nolan (2002) *Social Indicators: the EU and Social Inclusion*, Oxford: Oxford University Press.

Bachtler J. and C. Mendez (2007) 'Who Governs EU Cohesion Policy? Deconstructing the Reforms of the Structural Funds', *Journal of Common Market Studies*, 45(3), 535–64.

Begg, I. (2006) *Lisbon Relaunched: What Has Changed? Is It Working Better?*, Special CEPS Report, Brussels: Centre for European Policy Studies.

Begg, I. (2007) *Lisbon II, Two Years On: An Assessment of the Partnership for Growth and Jobs*. *Special CEPS Report*, Brussles: Centre for European Policy Studies (CEPS).

Begg, I. (2008) *Economic Governance in an Enlarged Euro Area*, European Economy Economic Papers, 311, Brussels.

Begg, I. and E. Marlier (2007) *Social Inclusion 2006: Second Semester Report. Independent Overview Based on National Report of Independent Experts*, Brussels: EU Network of Independent Experts on Social Inclusion.

Brusis, M. (2000) *Institution Building for Regional Development: A Comparison of Bulgaria, the Czech Republic, Estonia, Hungary, Poland and Slovakia*, CAP working papers (available on the internet at http://www.cap.uni-muenchen.de/download/2000/RPintroduction.PDF).

Commission (1969) 'Memorandum sur la Politique Régionale dans la Communauté', *Bulletin des Communautés Européennes*, suppl.3/69, Brussels.

Commission (1970) *Rapport sur les Problèmes Régionaux dans la Communauté Élargie*, COM (73), Bruxelles.

Committee for the Study of Economic and Monetary Union (1989) *Report on economic and monetary union in the European Community*, Luxembourg: Office for Official Publications of the European Communities.

Conzelman, Thomas (1995) 'Networking and the Politics of EU Regional Policy: Lessons from North Rhine-Westphalia, Nord-Pas and North West England', *Regional and Federal Studies*, 5.

Dallago, B. and G. Pegoretti (1995) *Integration and Disintegration in European Economies*, Aldershot and Brookfield, VT: Dartmouth.

De Broeck, M. and R. Hemming (2008) *Transparency of the EU Budget*, contribution presented to the Conference on 'Public Finances in the EU', Bureau of European Policy Advisers of the European Commission, Brussels, 3 and 4 April (available on the Internet at http://ec.europa.eu/dgs/policy_advisers/docs/program_en.pdf).

De la Porte, Pochet (2004) 'The European Employment Strategy: Existing Research and Remaining Questions', *Journal of European Social Policy*, 14, 71–8.

Delors, J. (1989) 'Regional Implications of Economic and Monetary Integration', in CEC, *Report of Economic and Monetary Union in the European Community*, Luxembourg: Office of Official Publications of the European Community, pp. 81–9.

Deschouwer, K., M. Keating and J. Loughlin (2003) *Culture, Institutions and Economic Development: a Study of Eight European Regions*, Cheltenham and Northampton, MA: Edward Elgar.

Deutsch Institut für Wirtschafsforshuung (2002) *How to Finance Eastern Enlargements of the EU*, DIW discussion paper no. 287, Berlin: DIW.

Drevet, J.F. (2000) 'Une Europe rassemblée ou intégrée?', *Futuribles*, 259, 23–36.

European Anti-Poverty Network (2007) *Making Lisbon Deliver for People Experiencing Poverty: EAPN Response to 2006 Implementation Reports on the National Reform Programs*, Brussels: EAPN.

European Commission (2001) *Enlarging Solidarity, Uniting Europe. Second Report on Economic and Social Cohesion*, Brussels.

European Commission (2002) *Report of the High Level Group on Industrial Relations and Change in the European Union*, Brussels: DG EMPL.

European Commission (2003) *Communication from the Commission. Second Progress Report on Economic and Social Cohesion, COM(2003), 34 final*, Brussels.

European Commission (2005) *Working Together for Growth and Jobs: A New Start for the Lisbon Strategy. Communication to the Spring European Council from President Barroso in Agreement with Vice-President Verheugen*, COM (2005) 24, Brussels, 2 February.

European Commission (2006a) *Evaluation of the Open Method of Coordination for Social Protection and Social Inclusion*, SEC (2006) 345, Brussels.
European Commission (2006b) *EU Budget 2006 Financial Report*, Luxembourg.
European Commission (2006c) *Working Together for Growth and Jobs: Further Steps in Implementing the revised Lisbon Strategy*, Commission Staff Working Paper
European Commission (2007a) *Towards Common Principles of Flexicurity: More and Better Jobs through Flexicurity and Security*, COM (2007) 359, Brussels.
European Commission (2007b) *Growing Regions, Growing Europe: 4**th** Report on Economic and Social Cohesion*, Belgium.
European Commission (2007c) *Reforming the Budget, Changing Europe*, communication SEC(2007) 1188 final, Brussels.
European Commission (2007d) Report from the Commission. 18th Annual Report on Implementation of the Structural Funds (2006),COM(2007), 676 final, Brussels.
European Commission (2008) Fifth Progress Report on Economic and Social Cohesion. Growing Regions, Growing Europe, COM(2008), 371 final, Belgium.
European Communities (2007) *Cohesion Policy 2007–13: Commentaries and Official Texts*, Luxembourg: Office for Official Publications of the European Communities.
European Council (2000) *Presidency Conclusions of the Lisbon European Council*, SN 100/00, 23–4 March.
European Council (2005) *European Union Financial Perspectives 2007–13 – United Kingdom Presidency Proposal* (FINAL) (19/12/05), 15915/05, CADREFIN 268, Brussels.
European Council (2006) Council Decision of 6 October 2006 on Community strategic guidelines on cohesion (2006/702/EC), Official Journal of the European Union 21/10/2006, L 291/11.
European Economic and Social Committee (2006) *Implementation of the Lisbon Strategy: Summary Report for the European Council (23 and 24 March 2006)*, Brussels: CESE 1468/2005.
Economist Intelligence Unit (2008) *World Investment Prospects to 2011, Foreign Direct Investment and the Challenge of Political Risk*, available on the Internet at www.eiu.com.
Espon (2003) *Particular Effects of Enlargement of the EU and Beyond on the Polycentric Spatial Tissue with Special Attention on Discontinuities and Barriers. Second Interim Report*, available on the Internet at www.espon.eu.
European Parliament (2007) Working Document on the 2007–2013 Multiannual Financial Framework Review: First Reflections, Reimer Böge, Chairman, Committee on Budgets, Brussels.
European Union (2006) *Interinstitutional Agreement Between the European Parliament, the Council and the Commission on Budgetary Discipline and Sound Financial Management*, (2006/C 139/01), Official Journal of the European Communities.
Eurostat (2008) *Enterprise Births, Survival and Deaths – Employment Effects*, Statistics in Focus 44/2008 (available on the internet at http://epp.eurostat.ec.europa.eu/portal/page).
Eurostat (2008) *Expenditures on Labour Market Policies, 2005*, Statistics in Focus 45/2008 (available on the internet at http://epp.eurostat.ec.europa.eu/portal/page).

Eurostat (2008) *Social Protection in the European Union*, Statistics in Focus 46/2008 (available on the internet at http://epp.eurostat.ec.europa.eu/portal/page).

Ferrera, M. (2004) *The Futures of European Welfare States*, Oxford: Oxford University Press.

Ferrera, M. (2005) *The Boundaries of Welfare: European Integration and the New Spatial Politics of Social Protection*, Oxford: Oxford University Press.

Geddes, M. (2000) 'Tackling Social Exclusion in the European Union? The Limits to the New Orthodoxy of Local Partnership', *International Journal of Urban and Regional Research*, 24(4), 782–800.

George, S. (1994) *Politics and Policy Making in the European Union*, Oxford: Oxford University Press.

Gilpin, R. (1987) *The Political Economy of International Relations*, Princeton, NJ: Princeton University Press.

Gilpin, R. (2001) *Global Political Economy: Understanding the International Economic Order*, Princeton, NJ: Princeton University Press.

Haas, E.B. (1958) *The Uniting of Europe*, Stanford, CA: Stanford University Press.

Haas, E.B. (1964) *Beyond the Nation-State: Functionalism and International Organization*, Stanford, CA: Stanford University Press.

Haas, E.B. (1970) 'The Study of Regional Integration: Reflections on the Joy and Anguish of Pretheorizing', in Leon N. Lindberg and Stuart A. Scheingold (eds), *Regional Integration: Theory and Research*, Cambridge, MA: Harvard University Press.

Heidenreich, M. (2003) '*Regional Inequalities in the Enlarged Europe',* Journal of European Social Policy, 13(4), 313–33.

Heidenreich, M. and C. Wunder (2008) 'Patterns of Regional Inequality in the Enlarged Europe', *European Sociological Review*, 24(1), 19–36.

Kaljulaid, K. (2008) *Putting Cohesion Policy into Order*, contribution presented at the Conference on the Future of Cohesion Policy, 7 and 8 April, Maribor, Slovenia (available on the internet at http://www.svlr.gov.si/en/slovenian_presidency_of_the_council_of_the_eu/events/conference_on_the_future_of_cohesion_policy/).

Kauffman Foundation (2007) *On the Road to an Entrepreneurial Economy: A Research and Policy Guide. Version 2.0*, available on the Internet at www.kauffman.org.

Krasner, S.D. (1999) *Sovereignity: Organized Hypocrisy*, Princeton, NJ: Princeton University Press.

Leonardi, R. (1995) *Convergence, Cohesion and Integration in the European Union*, London: Macmillan.

Leonardi, R. (2005) *Cohesion Policy in the European Union*, Basingstoke and New York: Palgrave Macmillan.

Milward, A.S. (2000) *The European Rescue of the Nation-State*, London: Routledge.

Morata, F. (2002) 'La politica di coesione', in S. Fabbrini and F. Morata, *L'Unione Europea*. Le politiche pubbliche, Bari: Laterza, pp. 111–39.

Mrak, M. and V. Rant (2007) *Financial Perspectives 2007–2013: Domination of National Interests*, EU-Consent EU-Budget Working Paper No. 1 (available on the internet at http://www.eu-consent.net/library/papers/EU-Budget_wp1.pdf).

OECD (2008) *OECD Framework for the Evaluation of SME and Entrepreneurship Policies and Programmes*, Paris: OECD.

OECD (2008) *Business Cluster: promoting Enterprise in Central and Eastern Europe*, Paris: OECD.

Osterloh, S., F. Heinemann and P. Mohl (2008a) *The EU Tax Revisited: Should There Be One? And Will Be There One?*, EU-consent EU Budget Working Paper No. 6.

Osterloh, S., F. Heinemann and P. Mohl (2008b) *EU Budget Reform Options and the Common Pool Problem*, paper prepared for the Conference on Public Finances in the EU, Brussels.

Overturf, S.F. (1986) *The Economic Principles of European Integration*, New York: Praeger.

Pizzuti, F.R. (ed.) (2006) *Rapporto sullo Stato Sociale 2006. Welfare State e Crescita Economica*, Novara: Dipartimento di Economia Pubblica, Università di Roma "La Sapienza" e CRISS, UTET.

Sapir, A. (2004) *An Agenda for a Growing Europe: The Sapir Report*, Oxford University Press, Oxford, 2004 (co-authored with Philippe Aghion, Giuseppe Bertola, Martin Hellwig, Jean Pisani-Ferry, Dariusz Rosati, José Viñals, Helen Wallace and Marco Buti, Mario Nava and Peter M. Smith).

Scharpf, F.W. (1997) *The Problem Solving Capacity of Multi-Level Governance*, Florence: Robert Schuman Center, European University Institute.

Scharpf, F.W. (2002) 'The European Social Model: Coping with the Challenges of Diversity', in J.H.H. Weiler, I. Beggand and J. Peterson (eds), *Integration in an Expanding European Union: Reassessing the Fundamentals*, Oxford and Malden, MA: Blackwell.

Sharpe, L.J. (1993) *The Rise of Mesogovernment in Europe*, London: Sage Publications.

Tabellini, G. (2003) *Principles of Policymaking in the European Union: an Economic Perspective*, CESifo Economic Studies No. 49 (I), 75–102.

Tarschys, D. (2008) *Maximising What? On the Multiple Objectives of EU Cohesion Policy*, contribution presented at the Conference on the Future of Cohesion Policy, 7–8 April, Maribor, Slovenia (available on the internet at http://www.svlr.gov.si/en/slovenian_presidency_of_the_council_of_the_eu/events/conference_on_the_future_of_cohesion_policy/).

Telò, M. (2002) 'Governance and Government in the EU: OMC', in M.J. Rodriguez (ed.), *The New Knowledge Economy in Europe*, Cheltenham: Edward Elgar.

UNDP (1999) *Transition 1999: The Human Cost of Transition, Human Security in South East Europe*, UNDP Regional Report.

UNDP (2006) *Partnerships in Structural and Cohesion Funds Planning and Absorption: A Comparative Review of the Practices of Selected EU Member States and Lessons Learned for Bulgaria*, Sofia: UNDP.

Uustal, K. (2008) 'For a More Effective Policy for Cohesion', contribution presented at the Conference on the Future of Cohesion Policy, 7 and 8 April, Maribor, Slovenia (available on the internet at http://www.svlr.gov.si/en/slovenian_presidency_of_the_council_of_the_eu/events/conference_on_the_future_of_cohesion_policy/).

Vandenbroucke, F. (2002) 'Foreword', in A.B. Atkinson, B. Cantillon, E. Marlier and B. Nolan (eds), *Social Indicators: the EU and Social Inclusion*, Oxford: Oxford University Press.

Vet, J.M. de (2008) *A Changing Rationale for Structural Funds? Reflections on Past, Present and Future*, contribution presented at the Conference on the Future of Cohesion Policy, 7–8 April, Maribor, Slovenia. Available on the internet at http://www.svlr.gov.si/en/slovenian_presidency_of_the_council_of_the_eu/events/conference_on_the_future_of_cohesion_policy/Mehlbye, P. (2000) 'Global Integration Zones – Neighboring Metropolitan Regions in Metropolitan Clusters', in *Informationen zur Ramentwicklung*. Special issue. Europäische Metropolregionen, 11/12, 755–62.

Weise, C., J. Bachtler, R. Downes, I. McMasterand K. Toepel (2001) *The Impact of EU Enlargement on Cohesion*, European Commission Tender No. PO/00-1/RegioA4, available on http://ec.europa.eu/regional_policy/sources/docgener/studies/pdf/enlarge.pdf.

Zeitlin, J. (2007) *Strengthening the Social Dimension of the Lisbon Strategy*, La Follette School Working Paper No. 2007–022 (available on the internet at http://www.lafollette.wisc.edu/publications/workingpapers/).

Zeitlin, J. (2007) *A Decade of Innovation in EU Governance: The European Employment Strategy, the Open Method of Coordination, and the Lisbon Strategy,* La Follette School Working Paper No. 2007–031 (available on the internet at http://www.lafollette.wisc.edu/publications/workingpapers/).

4

Poland's Great Transformation and the Lessons to be Learnt[1]

Grzegorz W. Kolodko

It is widely assumed by commentators that the post-socialist transformation started in Poland. This is true, but only to a certain extent. Although it was indeed in Poland in the 1980s that various processes contributing to this dramatic change gained the greatest momentum, things were not stationary in the other countries of Central and Eastern Europe. The winds of change were also blowing in Hungary and the former Czechoslovakia. But it is true that Poland acted as a trailblazer and was the first to implement many of these changes, which was not an easy thing to do.

Another widespread assumption is that the post-socialist transformation was set in motion in 1989, when – first in Poland and then, through a chain reaction engulfing the entire region – 'real socialism collapsed' or, as others would prefer to put it, 'communism was defeated'. Is it thus to be understood that the previous system, which had been prevalent for several decades in this part of Europe and also across the vast expanses of Asia, simply *collapsed* through its inability to adapt to the changing internal and external conditions – not just economic, cultural and political, but also technological – or was it, rather, *defeated*, and if so, by whom: by internal forces alone, or as the result of external pressure? This is a separate question which remains controversial.

Perhaps History will provide an unambiguous answer, although I doubt it. For real socialism *did* collapse and *was* also defeated. The one does not necessarily rule out the other. What is, on the other hand, an unquestionable fact for us is that History sees that very year – 1989 – as a turning point on the path of mankind. Even if it was not the actual beginning of that great change, whose roots could be traced back to earlier reforms – particularly those implemented in Poland, Hungary, and also the former Yugoslavia – it did mark a major shift.

This *great post-socialist shift* consisted in abandoning the earlier efforts to reform the old system (Kolodko and Nuti 1997; Kornai 2001). The attempts to increase the international competitiveness of the economy and to give real socialism a more 'human face' had failed. As a result the foundations of the old system were overturned in a fairly radical manner. Rather than continuing to 'reform' something that had proven to be barely capable of reform, efforts were made to reject the old system and construct a new one in its place. This time it was to take the form of a capitalist market economy. Likewise, to be sure, with a 'human face'.

This is a process which has been ongoing for more than a decade and a half, during which time post-socialist countries have experienced many fluctuations, the latter, sadly, prevailing. Excluding China, the greatest economic success story in the modern world (Lin, Cai and Li, 2003), as well as Vietnam, which followed in China's footsteps, in the majority of the 27 countries of Central and Eastern Europe and the former Soviet Union, with more than 400 million inhabitants, the output and consumption levels achieved in 2004 remained lower than they had been 15 years earlier. International statistics demonstrate unequivocally that the *proportion of people marginalized by social exclusion in post-socialist transforming economies has markedly increased* (Kolodko 2000b; Stiglitz 2002).

Obviously, the situation in this region differs from country to country and, within each specific country, from region to region. Even in a country such as Poland, per capita GDP in the richest region is much higher than in the poorest ones. Among the key factors of a region's success defined by the European Commission are: the structure of the economic activity, the concentration of employment, the skills of the workforce and its educational level, regional accessibility and physical infrastructure, innovative activity, and institutional capacity (European Commission, 2000). Other important explanatory variables include the geography of the region and the volumes and structure of regional foreign trade.

Before the administrative reforms and until 1998, Poland was divided into 49 departments, or voivodships (*wojewodztwa*). In 1999 decentralization reform introduced a new structure of local and regional self-governments, giving them full responsibility for regional economic development. The administrative map of Poland is shown in Map 4.1. Consequently, 16 large NUTS 2 regions (voivodships) were formed with the primary objective of creating an effective and rational structures for the governing of a modern nation. Poland's public administration structure was defined by the Constitution and appropriate legislative acts. The

Map 4.1 Map of the Polish regions

new territorial division and the structure of the authorities has accepted a concept of administrative structure that has been applied in other European countries of comparative population and size.

The intention of the reform was to carry out both the further decentralization of power and to build up the necessary skills connected with an appropriate position in the public finances system. Finally, by introducing a three-level country territorial division, a policy of self-government at the *powiat* and *voivodship* level was created. Such an approach led to a separation of powers between government and self-government administration. The public finance system, based upon increasing the share of the territorial self-government in the level of overall public spending, has been changed. Despite these changes, regions received insufficient financial resources, and many of the responsibilities which might have been transferred to this level of administration remained under the control of the central administration.

On the international scale, such differences within post-socialist countries are even greater. This is a consequence of both the legacy of the past – including that of the centrally planned socialist economy – and, in particular, the course taken by the transformation of the system over the past two decades. Some countries have performed better than others – with Poland almost always included among the list of the most successful.

The largest regions are Mazowieckie, Wielkopolskie and Zachodniopomorskie. In terms of population the most populated regions are Mazowieckie, where Warsaw is located (5.1 million inhabitants) and Slaskie (4.9 million inhabitants). The smallest region is the western region of Lubuskie (1 millon inhabitants).

Following the economic transformation and the revival of economic growth in the early 1990s, regional and social disparities in Poland have increased significantly. However, as is shown in Table 4.1, in per capita terms regional differentiation in Poland is relatively low and is less than is to be found, for example, in countries such as Italy or Spain. The per capita GDP ratio of the poorest (Lubelskie) and richest (Mazowieckie) region is 1:2.2. The poorest regions are situated in the eastern part of the country: Lubelskie, Podkarpackie, Podlaskie, Warminsko-Mazurskie and Swietokrzyskie. Relatively advantaged or disadvantaged regions in Poland have been identified in the work of Gorzelak (1999; chapter 2 in this book), and grouped into four categories:

- *leaders*: regions displaying positive continuity and development potential as urban centres, tourist regions;
- *winners*: regions being able to achieve positive discontinuity with dynamic and fast growth enjoying an advantage of the German and Austrian markets (regions located in the western part of Poland);
- *losers*: regions faced with negative discontinuity having the concentrations of old, obsolete industries;
- *laggers*: regions with negative continuity, being not able to overcome their peripheral location, mostly situated in the eastern parts of the country. (Gorzelak, 1999)

The fact that the capital region (Mazowieckie) is the wealthiest in Poland is a pattern that is common to every country in CE Europe. As such, it constitutes a significant concentration of both economic and political activity. Other Polish regions having a development level above the national average are Slaskie and Wielkopolskie.

In Central and Eastern Europe the old-industrial regions have been the most badly affected by the process of economic transition. In Poland this concerns primarily the Slaskie region which was the driver of economic activity during the socialist era and inherited the highest concentration

Table 4.1 GDP per capita by region in 2000 as a percentage of the average

	Area (km^2)	**Population ('000s)**	**Population density (persons per km^2)**	**Share of GDP (Poland = 100%)**	**GDP per capita (Poland = 100%)**
Poland	**312,679**	**38,125**	**122**	**100.0**	**100.0**
Dolnoslaskie	19,947	2,882	145	7.8	103.3
Kujawsko-Pomorskie	17,972	2,066	115	4.7	87.2
Lubelskie	25,122	2,173	86	3.9	68.3
Lubuskie	13,988	1,009	72	2.4	90.2
Lodzkie	18,219	2,566	141	6.2	91.8
Malopolskie	15,183	3,271	215	7.3	85.3
Mazowieckie	35,558	5,172	145	21.4	158.4
Opolskie	9,412	1,042	111	2.3	82.8
Podkarpackie	17,845	2,098	118	3.8	69.0
Podlaskie	20,187	1,196	59	2.3	74.0
Pomorskie	18,310	2,204	120	5.7	98.2
Slaskie	12,334	4,669	379	13.3	107.9
Swietokrzyskie	11,710	1,280	109	2.5	74.8
Warminsko-Mazurskie	24,173	1,427	59	2.9	76.5
Wielkopolskie	29,827	3,379	113	9.4	106.9
Zachodniopomorskie	22,892	1,693	74	4.1	92.8

Source: Modified from 'Construction sector in Poland – H2 2007', PMR Publications, October 2007.

of old industries (Gorzelak and Jakowiecki, 2000). The other most economically disadvantaged regions (Podlaskie, Lubelskie and Podkarpackie) are located in the eastern part of the country: they have a comparatively unfavourable geographical location and their economies are dominated by agriculture (European Commission, 2001).

The areas of poverty and destitution have also expanded, and in some countries life expectancy has also dropped. Income disparities have increased everywhere, sometimes sharply, although once again this has varied from region to region. In the majority of societies of the post-Soviet region and the Balkans, the Human Development Index (HDI), as assessed under the United Nations Development Program (UNDP), is now lower than at the beginning of the transformation period.

As stressed earlier, however, the situation not uniform. Poland is a country which is characterized by growing regional disparities. In the transition period some regions have managed to adapt to the new social and economic circumstances and have become leaders of economic growth, whereas other regions, located in the eastern part of the country, did not succeed in keeping up with the new conditions. In general, regions lagging behind comprise 34.1 per cent of the whole population and 30 per cent of Polish territory (Lobatch, 2004).

Those regions close to large settlements can develop rapidly and thereby rectify their previous disadvantages in respect of income, unemployment and migration. These regions can draw on large stocks of skilled labour and can participate in technical progress. From the other side, the regions facing development problems and lagging behind the mainstream of socioeconomic improvement are principally rural regions that are peripheral to large conurbations and regions with old industries (Barjak, 2000).

The relative autonomy of the Polish regions has already led to differences in the quality of management, the use of regional potential and general economic development; this makes some of them more successful and influential than others. The central government's regional policy has not been explicitly balancing decentralization of the responsibility for economic development with the government intervention primarily by using subsidies and state aid (Gorzelak, 2000).

In addition to the Gini coefficient, two other general measures often used to estimate income inequality are the Theil index and the ratio of regional and national median incomes. The Theil index (see Table 4.2), which allows one to estimate the contribution of each voivodship to total income inequality, has the advantage of being additive across different subgroups or regions in the country (Cowell, 2000: 109).

Table 4.2 Spatial decomposition of income inequality at the subnational level, 1999

Poland 1999	**Disposable income per head (PPS)**	**(%)**	**Population (1000)**	**(%)**	**N**	**Theil value (%)**	**MLD* value (%)**
Wielkopolskie	6,464	9.4	3,363	8.7	2,656	0.3288 (17.0)	0.1978 (11.2)
Mazowieckie	7,034	15.4	5,075	13.1	4,055	0.2190 (18.6)	0.1939 (16.5)
Zachodniopomorskie	5,984	4.5	1,735	4.5	1,320	0.2064 (5.1)	0.1683 (4.9)
Opolskie	5,890	2.8	1,083	2.8	836	0.2053 (3.1)	0.1817 (3.3)
Kujawsko-Pomorskie	5,832	5.3	2,100	5.4	1,723	0.1876 (5.5)	0.1643 (5.8)
Pomorskie	5,956	5.7	2,202	5.7	1,680	0.1652 (5.2)	0.1505 (5.6)
Swietokrzyskie	5,135	2.9	1,321	3.4	959	0.1617 (2.6)	0.1564 (3.5)
Warminsko-Mazurskie	5,063	3.2	1,469	3.8	1,330	0.1590 (2.8)	0.1460 (3.6)
Lubelskie	5,522	5.3	2,230	5.8	1,780	0.1560 (4.6)	0.1576 (5.9)
Łódzkie	6,098	7.0	2,638	6.8	2,661	0.1553 (6.0)	0.1435 (6.4)
Podlaskie	5,574	2.9	1,221	3.2	883	0.1542 (2.5)	0.1509 (3.1)
Małopolskie	5,847	8.2	3,238	8.4	2,307	0.1435 (6.5)	0.1395 (7.6)
Dolnoslaskie	5,833	7.5	2,971	7.7	2,482	0.1431 (5.9)	0.1434 (7.1)
Podkarpackie	5,210	4.8	2,130	5.5	1,588	0.1270 (3.4)	0.1225 (4.4)
Lubuskie	5,695	2.5	1,024	2.7	889	0.1151 (1.6)	0.1106 (1.9)
Lubelskie	5,973	12.5	4,840	12.5	4,226	0.1096 (7.5)	0.1054 (8.6)
Between	/	/	/	/	0.0039	2.1	0.0012 (0.8)
Together	5,980	100.0	38,640	100,0	31,375	0.1816 (100.0)	0.1542 (100.0)

Source: Hoffmeister (2006).
*MLD is mean logarithmic deviation

With regard to the regional concentration of total GDP, as much as 20 per cent of national GDP is concentrated in the capital region around Warsaw, the richest region in Poland, with only 13 per cent of the population (Heshmati, 2004). Disparities of income distribution are closely connected with disparities in the level of regional development.

Table 4.2 shows that income inequality occurring within the regions explains about 98 per cent of the Theil index and 99 per cent of the MLD. Incomes are most unequally distributed in the regions of Warsaw (Mazowieckie) and Poznan (Wielkopolskie), which represent the major poles of economic growth and development. The high level of inequality in Zachodniopomorskie is the result of high FDI inflow in the Szczecin region, while other parts of the region lag behind (Hoffmeister, 2006).

Leaving miracles where they belong, it is nevertheless a legitimate question to ask *whether or not Poland is an economically successful country*. Determining the answer to this question depends upon what is chosen to measure the success. After 19 years of transformation, per capita GDP is about 70 percent higher. This does not represent enormous progress, not only in comparison with China, but also *vis-à-vis* Western Europe or the United States, that is, the richest countries, which have, on average, developed faster in those years, leaving Poland and other post-socialist countries even further behind. However, it is the largest increase recorded by any of the transforming economies. In this respect Poland has achieved more than any other country in the region – at least for the time being, as it will only be possible to speak of a true success (or lack thereof) after a longer period. A final judgment can only be passed from the perspective of generations.

There is no doubt, however, that in many – but, sure enough, not all – respects, *Poland has handled the challenges of the great transformation better than other countries*. This merits reflection and scrutiny and invites comparisons across time and space. Much has been said about it thus far, while many other things remain to be uncovered. But even a cursory analysis of the special case of Poland shows that its better macroeconomic indicators result from two factors.

The first was the fact that Poland experienced the *shortest duration of the transformational recession among all countries*. It lasted for only three years – from mid-1989 till mid-1992 – whereas in the extreme case of Ukraine, it evolved into a *great transformational depression* which lasted for a whole decade. This was a consequence not so much of a sound strategy at the outset of the Polish transformation, which was missing as a result of the insane idea of a 'shock therapy', as of the positive effects of the market reforms that had already been implemented during the days of socialism (Kolodko 2000a; Baka 2004). And this is the first lesson that follows from the Polish experience of the times of dramatic change.

LESSON ONE

Economic reforms that increase the flexibility of markets and at least partially contribute towards the building of institutions necessary for the efficient functioning and development of a market economy at both central and local level always come in handy when a bolder and more profound structural shift is subsequently made. Even if certain reasons – for instance, of a political or cultural nature – prevent changing too much at one go, it makes sense to change things little by little, for in time this is likely to bring about the desired results. This is not to say that these partial reforms will gain due recognition later on. Most likely they will not, but that does not change the fact that they did take place and will prove helpful for long-term development. Politically speaking, someone sows and someone else reaps the political benefits, but the most important thing is the gain for society, economy and state.

The past two decades have been a heterogeneous period in terms of not only the dynamics of growth, but also the distribution of its fruits (Tanzi, Chu and Gupta 1999) and *institution building* (World Bank 2002), which allowed growth to occur in Poland earlier than elsewhere. The years in question can be divided into four distinct episodes:

1. The initial *'shock without therapy' in 1989–93*, when a largely overshot stabilization policy, disregard for market-economy institution building, excessive and over rapid trade liberalization and a neglect of the growth-stimulating functions of the state pushed the cost of the transformation well beyond the unavoidable minimum (which was also mentioned in the official documents), while the effects fell considerably below what was expected (and attainable). The actions that led to *sub-optimal effects at an excessive cost were in blatant violation of the basic rules of pragmatism and rationality*. Consequently, the scale of the transformational recession was much larger than would have been the case had the government pursued an appropriate policy; unemployment reached massive proportions; inflation proved impossible to bring down to single digits and a structural budget deficit began to mount.
2. *'Strategy for Poland' in 1994–7*, when the economic institutions became substantially strengthened – allowing Poland to become associated with the European Union in 1994 and to join the OECD in 1996 – and, most importantly, the economy entered a fast-growth path thanks to an appropriate policy of structural reform and development. During

those four years, per capita GDP grew at an average rate of 6.4 per cent a year, achieving a cumulative increase of as much as 28 per cent, which is truly impressive, compared to the overall 40 per cent growth in the 15 post-socialist years. As a result of formerly centrally planned economic system in Poland (and in all CEE countries) its growth and development is connected with rising inequality.

The increase of income disparities was curbed, as reflected by the Gini coefficient, which in 1996–7 was at the level of 33 points. Income inequality has increased continuously and in 2002 the Gini coefficient for consumption inequality was 0.28 (higher than in other CEEC countries (World Bank, 2002).[2] Income inequality is higher in the capital city Warsaw than within the country (country Gini = 0.274; Warsaw Gini = 0.289).

There is a lesson to be learned from the 'Strategy for Poland' episode:

LESSON TWO

Only a proper mix of two policies – a system change policy and a development policy oriented towards the accumulation and efficient allocation of capital at both the central and the local level – offers an opportunity for rapid economic growth. The neglect of either of these components precludes good results. Apart from Poland, this is amply demonstrated in a negative sense by the Russian case and in a positive sense by China.

3. The period of *overcooling the economy in 1998–2001*. Indeed, the word 'overkilling' would be equally apt, as the growth rate fell from more than 7 per cent during the last quarters of the implementation of the 'Strategy for Poland' to a stagnant 0.2 per cent in the 4th quarter of 2001. Such was the result of a doctrinaire approach to financial policy, viewed mostly in instrumental terms, as a tool to suppress inflation and to reduce the current account deficit.

Such a policy could not have brought the expected stabilizing effects, while inevitably causing destruction in the real sphere by hampering growth and aggravating the unemployment problem. (Table 4.3 shows the increase of unemployment in Poland.) Unfortunately, unemployment in Poland is not only a result of the transition phase to the market economy; but also a long-lasting phenomenon caused by the mentality of the people and the lack of services needed. In September 2004 the total unemployment was officially estimated at around 19 per cent, with

Table 4.3 Unemployment in Poland

	1990	1991	1992	1993	1994	1995	1996	2002*
Total	1126.1	2155.6	2509.3	2889.6	2838	2628.8	2359.5	3113
Men	552.4	1021.5	1170.5	1382.3	1343	1180.2	983.9	1486
Women	573.7	1134.1	1338.8	1507.3	1495	1448.6	1375.6	1627
Unemployment rate	6.3	11.8	13.6	16.4	16	14.9	13.6	17.6

(*) Data according to Polish Statistical Office from the third quarter of 2002. Some unofficial data suggest higher unemplyment level (19.8 per cent).
As a source for the data 1991–1996 was used http://www.ilo.org/public/english/employment/strat/publ/etp20.htm according to Year Books of Statistics, data of National Labour Office.

more than 3.2 million people registered as jobless. The highest unemployment rates are in the northern and western *voirodships*, with the highest unemployment rate being in the region of Warmińsko-Mazurskie (29.2 per cent), Lubuskie (25.2 per cent) and Zachodniopomorskie (25 per cent). In Mazowieckie (13.6 per cent) and Małopolskie (14.3 per cent), the unemployment rate is the lowest. Large cities have relatively low unemployment rates, reaching the level of 5.8 per cent in Warsaw, 6.3 per cent in Poznan, 7.7 per cent in Katowice, 9.3 per cent in Gdynia and 9.8 per cent in Rzeszów. The wave of massive job losses is over, but employment is still declining in small enterprises (Gardawski 2002).

In terms of unemployment, there are three major vulnerable groups: young people, women and uneducated people in the age range 30–54. The group in the range 30–54, which experiences the longest periods of unemployment, is characterized by low mobility, a lack of appropriate education, a passive attitude and a rigidity of skills.

According to GUS, long-term unemployment is increasing in Poland. Around 40.4 per cent of those who were not employed at the end of 1998 had not worked for more than 12 months, while 23.4 per cent had been out of work for more than 24 months. At the end of 2000, these figures were 44.7 per cent and 24.4 per cent respectively, while at the end of 2001 they had risen to 48.4 per cent and 27.7 per cent (Gardawski 2002).

High unemployment, associated with negative labour market developments, affects the following groups in particular (Towalski 2003):

- over 895,000 *young people* in the 18–24 age group were unemployed in 2002;

- *women* were the largest group among the unemployed. More than 1.6 million women were registered as unemployed, constituting more than 51 per cent of the unemployed workforce;
- 2.4 million *people with lower vocational skills and unskilled workers* accounted for 74.8 per cent of registered unemployment.

There are also some specific Polish features of unemployment:

- *Agricultural overpopulation*: Northern and eastern regions of Poland experienced the highest levels of unemployment as a result of the traditional domination of the farming industry and insufficient industrial development and unfavourable demographic structure – dominated by older people.
- *The legacy of state-run agricultural farms*: people in northern and western Poland have been working in so-called PGR – *Panstwowe Gospodarstwo Rolne*, (similar to Russian *kolkhoz*), which received high government subsidies and were very inefficient.
- *Change in the industrial structure after a fall of the socialist system*, following the former dependency upon other Eastern European countries, especially the former Soviet Union.
- *Domination of one type of industry*: some regions in Poland were dominated by only one type of industry (such as heavy industry in the western part of the country, textiles in Lodz, and the shipyards in Gdansk). Following the disruption of such an industry, structural unemployment had a strong effect upon individual regions.

Hence the next lesson.

LESSON THREE

Confusing means and ends in economic policy backfires, increasing the social costs of development and decreasing its attainable scale. This sin was rampant not only in Poland and was not restricted to specific periods: mixing up policy goals and instruments is a widespread phenomenon in the modern world (seen, in particular, in the erroneous advice furnished by the International Monetary Fund and, worse still, its misguided practices). As the means become glorified, they sometimes come to be perceived as ultimate goals, as was the case in Poland in the late 1990s, driving the economy to stagnation. That effect occurred despite the progress in institution building, privatization efforts, decentralization and the ongoing process of opening up the economy.

4. The *return to the path of rapid development and integration with the European Union in 2002–4* marks a fourth period, differing from the

> previous ones in terms of the characteristics and dynamics of changes in the system and in the real world. A key role has been played therein by two factors of a programmatic nature: (i) profound reorganization attempts in the area of public finance, aimed at adjusting the system to the capacities of the state and requirements of a modern market economy, on the one hand; and (ii) European integration on the other. The principal policy document in this field was the 'Public Finance Recovery Program' (PNFR 2003), in which both the far-reaching restructuring of the public finance system, and the EU accession process were viewed in instrumental terms. Its main task – to restore rapid growth – has been fulfilled. The rate of GDP growth rose rapidly from 0.5 per cent in early 2002 to 6.5 per cent in the first half of 2004.[3]

It thus becomes apparent that the *success of the Polish transformation in 1989–2004 is made up of a peculiar mixture of fluctuations*. In this context, the catastrophic performance towards the end of the 1990s, in the real and the financial spheres alike, gives one pause for thought. After all, the boom of 1994–7 – the years of the 'Strategy for Poland' – might have continued, but did not. In a different perspective, after the needless and harmful overcooling of the economy in 1998–2001, the economic misery of those years might have continued to this day, but did not, either.

What do such profound changes in growth dynamics depend upon? Surely, no significant external shocks occurred to account for the great acceleration of 1994–7 or for the great deceleration of 1998–2001. The impact on the Polish economy of the Russian crisis of 1998–2001 was many times less serious than the Polish and foreign propaganda would have it in those days (some reminiscences of that way of thinking still linger on); likewise no other subsequent external shock (this time of a positive nature) occurred to drive the economy forward.

In fact, during the four-year period 1994–7, the Russian economy was in a much poorer shape than in the next four years, 1998–2001, and yet no responsible person would have invoked this 'argument' to explain why things were not even better. On the other hand, in 1998–2001, the need was felt to explain away many things – namely, the above-mentioned *economic policy errors*. These observations give rise to our next conclusion:

LESSON FOUR

At the time of a great systemic transformation – in which the liberalization and the opening up of the economy go hand in hand with its integration into *the global system – institution building, that is, the creation of new rules of the market economic game and a legal and organizational framework for their implementation, including the activation of local human and social resources, is of fundamental importance (North 1997 and 2002; Kolodko 2000a; Stiglitz 1998). But policy is also vital. Ever-improving institutions do not by themselves entail – at least not in the short-term perspective – an ever-improving policy. The latter may be, alas, steadily deteriorating, for it also depends upon other factors, such as the economic doctrine, the dominant political set-up and the skills (or their lack) of those who run the economic policy at both central and local levels. Institutions matter, but so does policy.*

This is a situation which did indeed occur in Poland: despite the obvious institutional progress – which also occurred in connection with EU integration – there was a deterioration in economic policy. Its particularly weak point was the poor coordination between fiscal and monetary policy, as well as between those related to industry and trade. Tight monetary policy was a result of unexpected fiscal relaxation followed by uncertain fiscal policy. The factors contributing to the lack of coordination include inflationary pressures, a large external debt, the central bank's aspirations to independence and also some political problems. Combined with increased government expenditures, such a sub-optimal policy mix hampered economic growth in Poland (Rozkrut, 2002).

It only became possible to change this, partly, in mid-2002. It is small wonder then that soon afterwards the economy re-entered the path of more rapid growth. This does not mean, however, that it will automatically stick to this path, as this will depend upon the quality of the economic policy, which is an area characterized by the emergence of new threats.

One would be hard-pressed to give an example of an economic success based on investing other people's savings. Only in a handful of special cases did foreign investments – especially direct ones, which in the modern world and the global economy are a principal vehicle promoting technology transfer, management quality improvement, the development of marketing abilities and a pro-export orientation in the economy – play a significant (but still not decisive) role in financing economic expansion. Such was the case in Ireland, which made strategic use of the incoming stream of investment, much from the Irish Diaspora in the United States. Foreign direct investment also played a significant role in the accelerated growth in the south-east of China. Generally, however, *foreign investments only play a supplementary role vis-à-vis domestic savings*.

Table 4.4 FDI stocks in Central and Eastern Europe – Spring 2001 (US$ billion)

	1990	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**
Poland	0.1	0.4	1.4	2.3	3.8	7.8	11.5	14.6	22.5	28.0	37.0
Czech Rep.	0	0.6	2.9	3.6	4.5	7.1	8.5	9.8	12.5	17.5	21.5
Hungary	0.6	2.1	3.6	5.6	7.1	11.9	15.0	16.1	17.5	19.3	21.1
Slovakia	na	na	na	0.5	0.8	1.1	1.4	1.6	2.0	2.1	3.4

Source: Business Central Europe (2001), Vienna Institute for International Economic Studies (2001).

By having low capital costs, an inexpensive labour force, good market access, a large domestic market, historical links with the West, and also proximity to the EU and Central and Eastern Europe, Poland is a very attractive destination for foreign investors and has become one of the most attractive markets in Central Europe (Table 4.4).

The regional distribution of FDI reflects the increasing economic polarization in Poland (Table 4.5). The most favoured location is Warsaw, with 649 investments worth over $1 million. The majority of FDIs are located in the western regions of Poland in large urban agglomerations such as Katowice (333), Poznan (269), Wroclaw (218), Gdansk (176), Kraków (151) and Lódz (150) (Michalak, 2001).

It makes sense to count on the influx of foreign capital, but one should beware of making overly optimistic projections in this area. This is another lesson that emerges from the experience of the post-socialist Poland – not only for the Poles, but also for other 'emerging markets'.

LESSON FIVE

The main source of development financing in all types of so-called emerging markets has been and is domestic capital accumulation. Therefore, its formation should be given the priority it requires in macroeconomic policy and in the system of microeconomic incentives. What is important, in particular, is the appropriate design of the financial – both fiscal and monetary – policy, which has a significant effect upon the marginal propensity to save and thus has a fundamental influence on the overall rate of capital accumulation and the investment level and its dynamics. The active role of local governments and local financial market agents is of particular significance and importance. One can count on others only to a limited degree. It is best to count on oneself.

This should not be interpreted as an argument against attempts to attract as much foreign capital as possible (or, to use the correct

Table 4.5 Regional distribution of FDI in Poland (number of locations)

	Voivodship	**1998**	**1999**	**2000**
1	Mazowieckie (Warsaw)	449	483	649
2	Slaskie (Katowice)	231	268	333
3	Wielkopolskie (Poznan)	216	231	269
4	Dolnoslaskie (Wroclaw)	153	166	218
5	Pomorskie (Gdansk)	139	146	176
6	Malopolskie (Kraków)	101	111	151
7	Lodzkie (Lódz)	109	118	150
8	Kujawsko-Pomorskie (Bydgoszcz)	76	81	104
9	Zachodniopomorskie (Szczecin)	72	77	101
10	Lubelskie (Lublin)	48	56	62
11	Podkarpackie (Rzeszów)	48	50	61
12	Warminsko-Mazurskie (Olsztyn)	43	46	55
13	Swietokrzyskie (Kielce)	44	45	52
14	Lubuskie (Zielona Góra)	40	43	52
15	Opolskie (Opole)	35	36	41
16	Podlaskie (Bialyslok)	30	31	39

Source: PAIZ (1999, 2000, 2001).

globalization parlance, capital from other parts of the increasingly integrated world economy). However, such efforts should not pursue capital at any price. The experience of Poland (among other countries) serves as a dramatic reminder that the influx of foreign capital, if it is not properly controlled, may lead to excessive dependency on that capital (particularly in the financial services sector), which is not always beneficial for long-term growth. The resulting dependency levels are sometimes referred to as *dependent capitalism*.

Poland stands out as one of the few countries in the world to have received a *vast infusion of external capital during a very difficult period, crucial for the success of the entire market transformation*. It took a highly peculiar form of forbearance from taking action that would otherwise necessitate a severe outflow of capital from Poland in connection with the repayment of a large foreign debt. However, in view of the political circumstances, half of Poland's debt was cancelled – subject to some tough conditions, which were satisfied. Few cases like this have ever occurred worldwide.

One should nevertheless hope that their number will increase. *Poor countries should persevere in their efforts to obtain the cancellation of the unrecoverable portion (which may, in some cases, be the full amount) of their debt to rich countries*. They ought to keep trying until they succeed, as succeed they must. Only the imprudence, greed and shortsightedness of the richer countries prevent this from happening. And when it does happen, the capital flow from more developed to poorer economies will increase. However – and this is yet another significant lesson from Poland – debt cancellation must be combined with sound structural reforms, effective anti-corruption measures and an adequate macroeconomic policy. Debt reduction is sometimes simply inevitable, if a country is unable anyway to pay off its external liabilities. But it only makes economic sense if the consequences of the earlier economic policy errors (excessive debt) are removed along with their causes (faulty policy).

Politicians of the world have united. Not workers – as someone postulated a long time ago – but, of all people, politicians. At least when it comes to shifting the responsibility for their errors onto others, including – interestingly – other countries and *their* governments. This can be seen, for instance, in the powerful United States, whose trade deficit, structural though it is, is being blamed – by the US Administration – on China and its policy of adopting a fixed exchange rate for the yuan, which, as it happens, has been pegged for many years to the US dollar. Less surprisingly, this trend also occurs in most poorer countries, such as Mali, where the mounting difficulties are attributed (not without reason on this occasion) to the discriminatory trade practices of the stronger partners from better-developed parts of the world, who subsidize their farmers (and voters), thus suppressing the price of cotton – a commodity of fundamental importance for many countries trying to break out of the vicious circle of poverty.

The countries of post-socialist transformation, including Poland, are no different. *Blaming one's own problems on others has become even easier now that the technological, commercial and financial links between various national economies are stronger than ever before*. It is thus simpler – or so it seems to those who engage in such practices – to push the responsibility for the outcomes of one's own incompetence onto 'foreign influence and interests'. In Poland, such a reaction was widespread in the aftermath of the erroneous and harmful policy after 1998, which led to an overcooling of the economy. The consequences of these errors were explained away by references to the Russian crisis, which in reality affected Poland only to a minimum degree, since trade with Russia was only of marginal importance to Russia.

Later on – and this tendency is certain to continue – blame for various hardships, which are always present in the economy, was placed at the door of the European Union, although this organization obviously offers the new Member States more than it receives in return. This is not meant to conceal the fact that, in the course of the integration process, the post-socialist accession countries could have obtained more at a lower cost – alas, they failed to take advantage of this opportunity during the accession negotiations. There is a lesson to be learnt here by all of the countries applying for accession to the EU in the future.

The general conclusion from all this is as follows: *globalization, which is an objectively inevitable process, presents to national economies new, additional opportunities and chances, but also additional risks and threats* (Kolodko 2002).

The two go together. But 'together' does not mean 'in a one-to-one proportion'. The additional benefits (those which would not have arisen save for globalization) may well outweigh the additional costs. But, unfortunately, the reverse is also possible. The whole point is to make apt use of these interrelations in the national strategy of socioeconomic development. And this is yet another lesson to be learnt by all the emerging economies from all corners of the ever more strongly interconnected world, as they keep opening up to broad external contacts.

LESSON SIX

Globalization creates additional development opportunities and additional development threats to everyone (Stiglitz 2002), down to the local level. Therefore, the art of economic policy-making consists today in the apt handling of the dilemmas that crop up under the new circumstances. The mini-max rule should be followed: minimize threats, maximize opportunities – or, more precisely, reduce the inevitable costs of participation in the global economic game and increase the benefits thereof for agents at all levels.

The Polish case is highly illustrative in this context. The reduction of the foreign debt by half; *the structural shift in the geographic distribution of foreign trade towards the most highly developed economies, abounding in free capital resources (potentially allocable in Poland) and modern* (likewise absorbable) technologies; the influx of a sizable stream of foreign direct investments that reinforce the desired microeconomic restructuring and boost the international competitiveness of enterprises; finally, integration with the European Union – these are just the most significant benefits that Poland has skillfully taken advantage of.

On the other hand, *the exorbitant price paid by Poland for the inflows of short-term speculative capital* during some episodes of its opening up to the world has been (and still is) an additional cost to pay. Too bad, indeed, the price is so steep, but the guilty party is not globalization or capital (greedy by its very nature and 'speculative' by definition), but an *erroneous policy of the central bank* (NBP), whose dismal handling of internal interest rates creates international rate differentials that amount to inviting 'foreign speculative capital' to wreak havoc in Poland.

This entails losses in the order of billions of dollars, which would be perfectly avoidable. There are countries which have solved this problem, in a variety of ways, including Chile or Malaysia, to say nothing of China and India. *The Polish experience thus indicates not only the right and proper course of action, but also things to steer clear of.* It is best to avoid errors that someone has already committed at some place and time.

These would include those which occurred, for instance, in Poland at the beginning and then again towards the end of the 1990s. The momentous changes in Poland at the turn of the twentieth century also teach us quite a few lessons that lie on the borderline between economics and politics. This is a compulsory curriculum for all, since everyone has to learn the hard way the interrelationships described above. Even so, it would be unreasonable not to examine the experiences of others. The Poles have learned a great deal, too, analyzing other 'interesting cases' (although, perhaps, not *as* interesting as the case of Poland – the most fascinating of all), but some persons in charge of the government could have done better in this respect. In particular, each of the four stages of the Polish transformation of 1989–2004 enumerated above demonstrates that in order to attain economic success, *it is necessary to combine a technocratic and a social approach*.

Economic policy requires a great deal of professionalism. When 'everything depends on everything else', it is very difficult to state competently what really depends on what in the tangle of events. One needs to understand this and make use of extensive professional knowledge and technocratic ability to manage huge resources and capital streams.

But this is not sufficient. An economy does not consist solely of financial and material resources and streams. It is also – indeed, mainly – composed of social capital – that is, people and the relationships that unite them (or divide them, as the case may be). Therefore, political activity in the field of economy inevitably entails an involvement in the sphere of social relationships, especially those which arise through economic interaction. In economic policy, 'to be right' in the technocratic sense is not enough. One also has to be right in social terms (Sen 2000).

This means that the *principal social groups should have a general understanding of the governmental intentions that lie behind its financial, industrial, commercial, regional or investment policies*. Furthermore, even if these groups do not actively support measures that are intended to put the government programme into practice, they should at least give their passive consent for their implementation. Otherwise, the politicians – *qua* technocrats – may still be right (for instance, when trying to reduce the scope of tax exemptions or to verify the system of social transfers), but society may also be right to reject their ideas. A situation when both sides are right is likely to stir controversy for all. And when both sides stubbornly stick to their respective rights, an open political and social conflict ensues.

LESSON SEVEN

Economic policy is simultaneously a technocratic and social endeavour. The neglect of either of these aspects automatically decreases the effectiveness of the policy. It is not enough that narrow circles of experts know what to do: this knowledge must be shared by broad circles of society at both national and local levels, although it then becomes a different knowledge. Therefore, the best results in economic policy are provided by an appropriate mix of financial and social engineering, technocratic macroeconomic governance and genuine social dialogue, professional pragmatism and social sensitivity.

The past two decades of market transformation in Poland and its intermittent fluctuations indicate clearly that the economy was doing better when the two above-mentioned approaches were combined consistently. Any deficiency in this respect had a bad effect on the effectiveness of the economic policy. How is this effectiveness measured? The answer follows from one of our lessons, admonishing us not to confuse means and ends: the appropriate measure is invariably the socioeconomic dynamics – the pace of financially, economically, socially and ecologically sustainable growth. In those periods when we made sure our homework was done, growth was faster – and vice versa. Obviously, the actor to learn the most from these experiences was Poland – although, regrettably, not all Poles. After all, fools are never in short supply. And whereas the Polish transformation has indeed been largely successful, this success was largely concentrated in successful regions and there was most certainly no such thing as a Polish miracle. For there are no miracles. Not even in Poland.

Notes

1. I thank Ms Joanna Rybacka-Barisic for her support in researching data and information on local institutions and development.

2. http://lnweb18.worldbank.org/eca/eca.nsf/Countries/Poland/86749F6E07E142D085256C250062D889?OpenDocument.
3. However, due to too restrictive monetary policy of the central bank (NBP), on the one hand, and discouraging capital formation and productivity growth politics during the election year, it has slowed down again, to about 4 per cent in the first half of 2005.

References

Baka, Władysław (2004) *Economic Ideas of the 'Round Table' After Fifteen Years. Lessons for the Future*, No. 54 (May), Transformation, Integration and Globalization Economic Research at the Leon Kozminski Academy of Entrepreneurship and Management, Warsaw (www.tiger.edu.pl).

Barjak, F. (2000) 'Differences in the Economic Capability of Regions – A Typology of East Germany and Poland', American Cairo – Economics and Political Sciences, revised.

Cowell, F. A. (2000) 'Measurement of Inequality', in A.B. Atkinson and F. Bourguignon (eds), *Handbook of Income Distribution*, vol. 1 (Handbooks in Economics, vol. 16), Amsterdam: Elsevier.

European Commission (2000) *Covergence Report 2000*, Brussels: European Commission. Home page: http://europa.eu.int/comm/economy_finance.

European Commission (2001) *Second Report on Economic and Social Cohesion*, http://www.Inforegio.cec.eu.int/wbdoc/docoffic/official/report2.

European Commission (2006) 'Directorate-General for Regional Policy, *Study on FDI and regional development, Final report*, Report by Copenhagen Economics in cooperation with Professor Magnus Blomström, 22 December.

Gardavski, J. (2002) 'The Dynamics of Unemployment from 1990 to 2002', http://www.eurofound.europa.eu/eiro/2002/10/word/pl0210110fpl.doc (accessed 2 April 2008).

Gorzelak, G. (1999) 'Regional Policies and Regional Capacity-Building in Poland' in M. Brusis. Central and Eastern Europe on the Way to the European Union: Regional Policy-Making in Bulgaria, the Czech Republic, Estonia, Hungary, Poland and Slovakia, Centrum für Angewandte Politikforschinung, www.cap.uni-uenchen.de/ download/RP.pdf.

Gorzelak, G. and M. Jakowiecki (2000) *Strategie polskich regionow w procesie integracji europejskiej (Strategies of Polish regions in the process of European integration)*, EUROREG working paper, www.euroreg.uw.edu/publications.

Heshmati, Almas (2004) 'Regional Income Inequality in Selected Large Countries', Forschungsinstitut zur Zukunft der Arbeit Institute for the Study of Labor.

Hoffmeister, O. (2006) 'Inequality of Incomes on both sides of the Odra: The Contribution of the Regional Division,' Luxembourg Income Study Working Paper Series, Working Paper No. 439.

Kolodko, Grzegorz W. (2000a) *From Shock to Therapy. Political Economy of Postsocialist Transformation*, Oxford and New York: Oxford University Press.

Kolodko, Grzegorz W. (2000b) *Post-Communist Transition: The Thorny Road*, Rochester, NY and Woodbridge, UK: University of Rochester Press.

Kolodko, Grzegorz W. (2002) *Globalization and Catching-up in Transition Economies*, Rochester, NY and Woodbridge, Suffolk, UK: University of Rochester Press.

Kolodko, Grzegorz W. (2003) *Structural Reform and Economic Growth in 2002–2003: The Opening and Closing Balance*, TIGER – Transformation, Integration and Globalization Economic Research, Leon Kozminski Academy of Entrepreneurship and Management (WSPiZ), Warsaw (www.tiger.edu.pl/english/aktualnosci/report_en.pdf).

Kolodko, Grzegorz W. and D. Mario Nuti (1997) *The Polish Alternative: Old Myths, Hard Facts and New Strategies in the Successful Transformation of the Polish Economy*, Research for Action, 33, Helsinki: The United Nations University World Institute for Development Economics Research (WIDER) (www.tiger.edu.pl/kolodko/working/wider/wider_1997.pdf).

Kornai, Janos (2001), *The Role of the State in a Post-socialist Economy*, Distinguished Lectures Series, No. 6, Leon Kozminski Academy of Entrepreneurship and Management, Warsaw (www.tiger.edu.pl/publikacje/dist/kornai.pdf).

Lin, Justyn Yifu, Fang Cai and Zhou Li (2003) *The China Miracle: Development Strategy and Economic Reform*, Hong Kong: The Chinese University Press.

Lobatch, Andrei I. (2004) 'EU Membership and Growing Regional Disparities: Poland's Strategy Options to Optimise Structural Transfers from the Union', 12th NISPAcee Annual Conference 'Central and Eastern European Countries Inside and Outside the European Union: Avoiding a New Divide'.

Michalak, W.Z. (2001) 'Retail in Poland: An Assessment of Changing Market and Foreign Investment Conditions', 24(3), Toronto: Ryerson University, Centre for the Study of Commercial Activity.

North, Douglass C. (1997) *The Contribution of the New Institutional Economics to an Understanding of the Transition Problem*, WIDER Annual Lectures, 1 (March), Helsinki: The United Nations University World Institute for Development Economics Research (WIDER) (www.wider.unu.edu/publications/publications.htm).

North, Douglass C. (2002) *Understanding Economic Change and Economic Growth*, Distinguished Lectures Series, No. 7, Leon Kozminski Academy of Entrepreneurship and Management, Warsaw (www.tiger.edu.pl/publikacje/dist/nortg.pdf).

Paci, P., M.J. Sasin and J. Verbeek 'Economic Growth, Income Distribution and Poverty in Poland during Transition', http://siteresources.worldbank.org/INTISPMA/Resources/Training-Events-and-Materials/paci_sasin_verbeek_prw.pdf.

PNFR (2003) *Public Finance Recovery Program*, Rada Ministrów, Warszawa, 3 June (www.tiger.edu.pl/english/aktualnosci/Program_en.pdf).

Rozkrut (2002) 'The Monetary and Fiscal Policy Mix in Poland', BIS Papers No 20, http://www.bis.org/publ/bppdf/bispap20t.pdf (accessed 2 April 2008).

Sen, Amartya (2000) *Development as Freedom*, New York: Alfred A. Knopf.

Stiglitz, Joseph E. (1998) *More Instruments and Broader Goals: Moving Towards the Post-Washington Consensus,* WIDER Annual Lectures, 2 (January), Helsinki: The United Nations University World Institute for Development Economics Research (WIDER), (www.wider.unu.edu/events/annuell1998.pdf).

Stiglitz, Joseph E. (2002) *Globalization and Its Discontents*, New York and London: W.W. Norton & Company.

Tanzi, Vito, Ke-young Chu and Sanjeev Gupta (eds) (1999) *Economic Policy and Equity*, Washington, DC: International Monetary Fund.

Towalski, R. (2003) 'Unemployment in 2002', http://www.eurofound.europa.eu/eiro/2003/07/word/pl0307107fpl.doc (accessed on 2 April 2008).

Walsh, P.P. (2000) 'Regional Unemployment in Poland: A Legacy of Central Planning', Discussion Paper 91, LICOS – Centre for Transition Economics, Leuven: Catholic University of Leuven.

World Bank (2002) *Building Institutions for Markets: World Development Report 2002*, Washington, DC: World Bank.

5

Regional Labour Market Disparities in an Enlarged European Union

Peter Huber

5.1 Introduction

Among the many important steps to European integration over the course of the past two decades, the two waves of accession of the Central and Eastern European countries (CEEC) to the European Union (EU) in 2004 and 2006 were undoubtedly among the most intensely debated. It was anticipated that these enlargements, which involved a total of 12 countries with a population of over 100 million inhabitants and a GDP of over €1,300 billion, would present major challenges both to the 12 new Member States (NMS12) and to those countries that were already members (the EU15). In particular, on the side of the NMS12 the implementation of the *acquis communautaire* (Burda, 1998), eligibility for EU Structural Funds (Boldrin and Canova, 2001), potential membership in the European monetary union (Gros, 2000) and the benefits from the liberties guaranteed in the European Economic Area (Belke and Hebler, 2001) were discussed. On the side of the EU15, by contrast, the hopes for increased levels of growth caused by further integration existed alongside fears related to potential migration and increased competitive pressures (Boeri and Brücker, 2000).

In addition, the accession of the NMS12, as pointed out recently by Caroleo and Pastore (2007), also changed the economic and political geography of the EU, raising a number of normative and analytical issues. The CEEC among the NMS12 have only recently emerged from a phase of massive industrial and institutional restructuring, which raises renewed analytical interest in the consequences of structural change for regional labour markets (Caroleo and Pastore, 2007) and on the capability of European regional labour markets to adjust to region-specific shocks

(Gacs and Huber, 2005; Bornhorst and Commander, 2006). On the policy side, by contrast, the fact that the NMS12 are largely composed of lagging regions has shifted the allocation of EU Structural Funds towards these countries. This raises the issues of whether or not these funds are an adequate instrument to enhance regional development in these countries and also which regional policies are best suited to the combating of regional labour market problems.

Any attempt to address these issues requires a clear picture of the relevant differences and similarities in regional labour market problems in the different parts of the EU. Thus, a number of recent contributions have focused on analysing regional labour market problems in the EU (see, inter alia, Overmann and Puga, 2002; Perugini and Signorelli, 2004). However, only a few contributions have focused on regional labour market problems across the whole of the EU27. Furthermore, most of these studies focus only on aggregate indicators such as the unemployment rate, without giving consideration to the substantial differences in the structure of employment, unemployment and participation in the regions of the EU27.

This chapter analyses regional data on employment, unemployment and participation rates for 258 NUTS2 regions of the EU27 disaggregated by gender and ten-year age groups. We add to the literature by taking a broad view of the regional labour market situation. While our aims are primarily descriptive, we believe that this will provide a more comprehensive view of regional labour market disparities in the EU27 than is currently available. Following a short survey of the literature, which is used to formulate our hypotheses, section 5.3 presents data and a descriptive analysis at both the national and regional levels. Section 5.4 then presents the results of a principal component analysis conducted on disaggregated labour market indicators, following which section 5.5 uses these results to analyse differences between the EU15 and the NMS12 on the basis of a discriminant and a cluster analysis. Section 5.6 uses regression analysis to determine to what degree the correlates of the different labour market outcomes vary between the EU15 and the NMS12. Section 5.7 concludes by presenting issues for future research.

5.2 Literature survey

The background to this chapter is shaped by three distinct, but interrelated strands of literature on regional labour market problems in the EU27. The first relates to regional developments in transition economies (see Ferrangina, 2005, 2007; Huber, 2007 for surveys), to which the majority of the NMS12 belong. This literature stresses the relationship between structural change and regional development. For instance, in recent surveys Ferragina (2005, 2007) argue that optimal speed of transition (OST) theory (see Aghion and Blanchard, 1994; Boeri, 2000) offers two explanations for the high and persistent disparities in the levels of regional unemployment. The first holds that regional unemployment disparities arise from different equilibrium outcomes with high unemployment rate regions experiencing similar labour market flows as low unemployment regions in all periods, but early transition and little correlation between measures of restructuring and regional unemployment. The second suggests that regional disparities reflect different speeds of restructuring. In this case, high unemployment regions have high worker flow rates throughout the transition period and there is a high level of correlation between regional unemployment and restructuring measures. From their literature survey Ferragina and Pastore (2007) conclude that the evidence favours interpretations where persistent unemployment rate disparities reflect differences in the speed of restructuring.

Huber (2007) finds that regional disparities increased in almost all transition countries during the early years of transition, that the regional distribution of labour market indicators has been relatively stable and that there is some indication of regions diverging into two groups: a small group of prosperous regions and a larger group of poorer regions. When focusing on the long-run determinants of regional differentiation in terms of unemployment and GDP he suggests specifically that capital cities and regions closer to EU borders have experienced higher growth and lower rates of unemployment. By contrast, the spillovers within countries tend to be small. Regions located closer to capital cities do not profit from their vicinity to these regions to the same extent as in many mature market economies. Finally, when reviewing the literature on regional labour market adjustment he finds that hopes for regional labour market disparities to diminish through the traditional channels of migration, wage flexibility and capital mobility are bleak and that the regional labour markets in the transition countries may be considered to be as inflexible as those in the old EU countries.

This literature thus suggests that as a result of more intensive industrial restructuring regional labour market problems in the CEEC among the NMS12 may be of a different nature to those found in the EU15. This applies to both the demographic as well as the regional structure of employment, unemployment and participation. One could, for instance, hypothesize that with respect to the demographic structure male workers should have worse labour market outcomes in the NMS12 than in the

EU15, since they were most strongly affected by declines in the level of industrial employment. In addition, long-term unemployment should be a more serious problem on account of a high mismatch component in unemployment, resulting from structural changes. Furthermore, the structure of regional labour market problems should be more closely related to the industrial structure and the structural change of regions in the NMS12. In addition, enlargement may have changed the EU-wide distribution of regional labour market problems, which may require a new focus of EU-wide labour market policies.

The second strand of literature related to the arguments in this chapter is on regional labour market disparities in mature market economies. This research has used a variety of methods to determine which labour supply and demand issues as well as institutional factors shape regional labour market outcomes. In a recent survey Elhorst (2003) categorizes this literature and defines a set of variables which should be included in any analysis of regional differences in unemployment. In addition, he also documents the scarcity of research that focuses on regional labour market disparities from a European perspective. Most contributions covered by Elhorst (2003) focus on case studies of either one or at most a handful of countries, and only two of the 41 studies can actually claim to be representative of the EU as a whole (although even these studies cover only the EU12). While this lack of comparative work continues, recent years have seen the experience of a few studies with a more European focus. Of these Overmann and Puga (2002) use non-parametric and parametric techniques to show that regional unemployment rate disparities in the EU are highly persistent. Furthermore, they find that high unemployment regions in the EU are geographically clustered, with country borders having only a small impact on the relative performance of a region and the labour market situation of neighbouring regions having a large impact. Perugini and Signorelli (2007), in a study that focuses on the EU15 in the period between 1997 and 2006, find high persistence but also a small tendency for the sigma convergence of employment, unemployment and long-term unemployment rates. Their results suggest that regions with low employment rates have high long-term unemployment rates, low population density and low per capita incomes. By contrast, high unemployment and long-term unemployment regions have a low population density and low per capita incomes. Elhorst and Zeilstra (2007), using data from 11 EU countries, find substantial heterogeneity of coefficients across countries when regressing regional unemployment rates on indicators that are deemed to be important in their explanation.

Most of these studies also analyse the effects of labour market institutions on regional labour market outcomes. Perugini and Signorelli (2007) find that active labour market policies reduce the levels of regional and long-term unemployment rates but that they have no effect on employment rates. By contrast, higher tax wedges and increased product market regulation increase unemployment and reduce employment rates and expenditure on passive labour market policies increases the employment rate but reduces both the unemployment and long-term-unemployment rate. Elhorst and Zeilstra (2007) find that higher tax wedges and higher unemployment benefits increase regional unemployment rates, while higher levels of centralization of wage bargaining reduce them. The only papers we are aware of that use data on new Member States besides data from the EU15 are Longhi, Nijkamp and Traistaru (2005) and Perugini and Signorelli (2004). Longhi, Nijkamp and Traistaru (2005) use data at NUTS1 level from 1995 to 2001 and focus on the role of bargaining institutions and sectoral specialization. They find that specialization increases regional unemployment rate disparities most in countries with intermediate and decentralized collective bargaining institutions. Perugini and Signorelli (2004), by contrast, focus on the NUTS2 level and concentrate on analysing convergence in employment rates for the period from 1993 to 2003. They find beta divergence for the NMS but a mild tendency of convergence for the EU15.

These contributions thus suggest that as well as regional factors, national institutions also play an important role in shaping regional labour market disparities in the EU. Again this can be used to formulate hypotheses with implications for both the regional and the demographic structure of labour markets. With respect to the former, regional disparities should be larger for those demographic groups where institutions most strongly affect the labour market outcomes (that is, the young, the older and, potentially, women). With respect to the latter – to the degree that institutions are national – employment, unemployment and participation rates of regions within the same country should be more homogenous than between countries and this higher homogeneity should be highest for the labour market groups most strongly affected by labour market institutions.

Finally, a third strand of literature, to which we relate primarily in terms of the methodology it employs, uses explorative data analysis to identify regional types in the EU. Again this literature has followed a wide set of methods and objectives. Regional labour market typologies exist both for the CEEC among the NMS12 (e.g. Scarpetta and Huber, 1995) as well as for individual CEECs (e.g. Fazekas, 1996) and for the EU (e.g. Wiese *et al.*, 2001). For this literature too, there is a lack of results for the entire EU27. The early contributions (Scarpetta and Huber, 1995; Wiese *et al.*, 2001) focus exclusively on the CEEC of the NMS12 or the EU and, in some cases, use regional breakdowns that are no longer relevant. To the best of our knowledge the only exception to this is Aumayr (2007). She classifies the 12 NUTS3 regions of the EU 25 into 14 region types according to their industrial specialization, productivity and accessibility. She finds that only some of these region types show regional convergence and that lower steady-state incomes can be expected mostly in peripheral regions.

5.3 Data and descriptive analysis

From the above discussion it can be seen that the recent literature offers a number of hypotheses relating to both the regional and the demographic structure of regional labour market problems in the EU27. In our discussion of these hypotheses we use data from Eurostat on 258 NUTS2 regions[1] of the EU 27 on employment and participation rates by gender and age groups from 2004 to 2006. To augment our data with information on unemployment, we calculate the unemployment rate for each of these groups by using the definition $\mathrm{ur}_{\mathrm{ijkt}} = (1 - \mathrm{er}_{\mathrm{ijkt}}/\mathrm{pr}_{\mathrm{ijkt}}) * 100$ (see Perugini and Signorelli, 2007) with er_{ijkt} being the employment rate of region i, age group j, gender k and time period t, $\mathrm{pr}_{\mathrm{ijkt}}$ being the participation rate of the same subgroup and $\mathrm{ur}_{\mathrm{ijkt}}$ the unemployment rate. We thus have data on gender-specific employment, unemployment and participation rates for the following age ranges: 15–24 years, 25–34 years, 35–44 years, 45–54 years and 55–64 years. Including the total employment, participation and unemployment rates by age group and in aggregate we end up with 18 indicators of the labour market situation, to which we add the share of long-term unemployment in total unemployment.[2] In comparison with other researchers, therefore, we make use of a larger number of indicators.[3] This reflects our particular aim of focusing on regional disparities in the structure of labour market outcomes.

5.3.1 National differences in the labour market situation

Table 5.1 displays national employment, unemployment and participation rates as well as the national share of long-term unemployment in total unemployment for the years 2004 and 2006. In particular, in the year 2006 the EU27 experienced positive labour market developments, with employment rates increasing in almost all countries and

Table 5.1 Development of national employment, unemployment and participation rates and shares of long-term unemployment in the EU27, 2004 and 2006 (in %)

	Employment rate		**Unemployment rate**		**Participation rate**		**Share of long-term unemployment**	
	2004	**2006**	**2004**	**2006**	**2004**	**2006**	**2004**	**2006**
				EU 15				
Austria	55.7	57.3	4.9	4.8	58.6	60.2	27.5	27.4
Belgium	48.1	48.7	8.4	8.3	52.5	53.1	49.0	51.2
Germany	50.8	53.2	10.7	10.1	56.9	59.2	51.8	56.4
Denmark	62.4	63.4	5.5	3.8	66.0	65.9	21.5	20.8
Spain	49.6	52.7	11.0	8.5	55.7	57.6	32.0	21.7
Finland	55.2	56.3	8.8	7.7	60.5	61.0	24.0	25.2
France	50.6	50.6	9.6	9.5	56.0	55.9	41.9	43.7
Greece	47.6	48.6	10.5	9.0	53.2	53.4	53.1	54.3
Ireland	58.0	60.2	4.6	4.4	60.8	63.0	34.9	32.3
Italy	45.5	45.8	8.1	6.9	49.5	49.2	49.2	49.6
Luxembourg	52.2	52.4	5.1	4.7	55.0	55.0	21.0	29.5
Netherlands	61.9	62.8	4.5	3.8	64.8	65.3	34.2	43.1
Portugal	57.8	57.7	6.8	7.7	62.0	62.5	44.3	50.2
Sweden	65.0	65.9	6.5	7.1	69.5	70.9	19.3	15.2
UK	59.0	59.1	4.7	5.3	61.9	62.4	20.6	22.4
				NMS 12				
Bulgaria	43.8	46.7	11.9	9.0	49.7	51.3	59.5	55.7
Cyprus	60.3	60.7	4.3	4.4	63.0	63.5	28.0	19.3
Czech Republic	54.2	55.0	8.3	7.3	59.1	59.3	51.0	54.2
Estonia	53.0	56.8	9.7	6.0	58.7	60.4	52.2	48.2
Hungary	46.6	46.8	6.2	7.5	49.7	50.6	44.0	45.1
Lithuania	50.7	52.7	11.4	5.7	57.2	55.9	51.2	44.3
Latvia	51.9	55.3	10.4	6.9	57.9	59.4	43.8	36.2
Malta	46.0	46.7	7.3	7.3	49.6	50.4	46.8	40.2
Poland	44.3	49.6	19.0	13.9	54.7	57.6	54.0	56.3
Romania	50.3	51.0	8.0	7.3	54.7	55.0	58.9	57.8
Slovakia	49.2	51.2	18.1	13.4	60.1	59.1	64.7	76.3
Slovenia	55.2	55.8	6.4	5.9	59.0	59.3	51.5	49.3

Source: Eurostat, own calculations.

unemployment rates declining. Furthermore, there is also substantial heterogeneity in labour market conditions among the EU27. In 2006 the country with the highest employment rate was Sweden (65.9 per cent) and the country with the lowest was Italy (45.8 per cent). Sweden was also the country with the highest participation rate (70.9 per cent) and Italy again had the lowest (49.2 per cent). Poland (with 13.9 per cent) and Slovakia (13.4 per cent), despite strong declines, were outliers with respect to unemployment rates, while the Netherlands and Denmark were the countries with the lowest levels of unemployment (3.8 per cent each). Finally, the share of long-term unemployed in total unemployment was highest (and increased from 2004 to 2006) in Slovakia (76 per cent) and lowest in Sweden (15.5 per cent).

However, explanations which assume that this heterogeneity is due solely to differences between the NMS12 and the EU15 seem to be too simple. Employment and participation rates in the NMS12 are well within the range of the EU15, although they tend to be towards the lower end of the distribution. The highest employment and participation rates among the CEEC of the NMS12 are found in Estonia (56.8 per cent and 60.4 per cent, respectively), figures which mean that it ranks ninth in the EU27. The two CEE countries with the lowest employment rates of the NMS12 are Bulgaria and Hungary (with 46.7 per cent and 50.6 per cent, respectively), but these still both rank higher than Italy. With some qualifications the same applies to unemployment rates. Here, with the exceptions of Poland and Slovakia, most of the CEEC rank in the middle of the unemployment rate distribution among the EU27. The data, however, confirm that restructuring has had an important impact on the structure of unemployment in the NMS12. The share of long-term unemployed in total unemployment differs most clearly between the EU15 and the NMS12. With respect to this four of the NMS12 (Romania, Bulgaria, Slovakia and Poland) lead the EU27 and all of the NMS12 are ranked in the upper two-thirds of the distribution.

In order to focus on the more medium-term labour market situation in the EU27, for the remainder of this chapter, we make exclusive use of (unweighted) averages of the indicators considered for the years 2004 to 2006. Figure 5.1 displays the average employment rate at the national level, with the NMS12 represented by dotted lines and the EU15 by full lines. Again this figure displays the substantial heterogeneity among the EU27. In addition, it also highlights the stronger impact of industrial decline in the NMS over the past decade. In comparison to the EU15 the NMS12 have particularly low employment rates among the prime working age males (that is, those aged 25 to 54 years), while employment rates of females and the older tend to be more in line with the EU15.[4]

5.3.2 Regional indicators

Descriptive statistics at the national level thus suggest some differences between the NMS12 and EU15. We are, however, more interested in the situation relating to regional labour markets. Two questions that arise

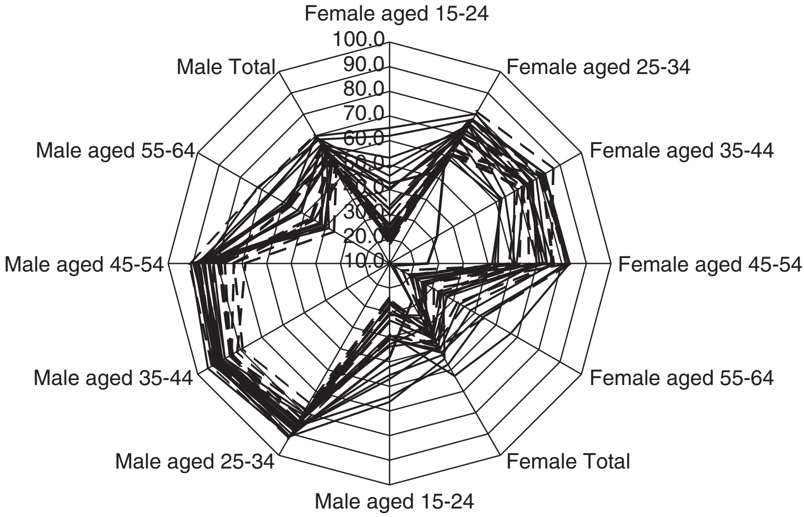


Figure 5.1 National employment rates by age group and gender, 2004–2006
Source: Eurostat, own calculations, dotted lines – NMS 12 countries, full lines – EU15 countries, Figure reports (unweighted) average values for the years 2004 to 2006.

in this respect are whether accession of the NMS12 has changed the overall distribution in the EU27 relative to the EU15 and whether or not the distribution differs among individual subgroups. In Table 5.2 we consider the size of regional disparities (measured by the coefficient of variation) for all indicators analysed for both the EU15 and the NMS12. According to these results, regional disparities in aggregate employment, unemployment and participation rates are only slightly higher in the EU15 than in the NMS12, despite the EU15 being composed of a much larger number of regions (203 relative to 55). This suggests that aggregate regional disparities between the EU15 and the NMS12 are by and large comparable.

Table 5.2, however, also suggests more sizeable differences of regional disparities in both the EU15 and NMS 12 with respect to the employment, participation and unemployment rates of individual demographic groups. Regional disparities in participation and employment rates in both the EU15 and NMS12 are around two or three times as high as the average at the two ends of the age distribution (i.e. for the young and the old) and higher for females than for males. The same applies to unemployment rates. Here regional disparities are larger for females than for

Table 5.2 Coefficient of variation of employment, participation and unemployment rates by gender, age and country group (averages 2004–2006)

Gender	Age 15–24	Age 25–34	Age 35–44	Age 45–54	Age 55–64	All age groups
			Employment rate			
			EU 27			
Female	0.42	0.13	0.12	0.17	0.36	0.18
Male	0.32	0.07	0.06	0.08	0.22	0.10
Total	0.36	0.09	0.07	0.10	0.26	0.12
			EU15			
Female	0.38	0.13	0.13	0.17	0.33	0.18
Male	0.27	0.07	0.05	0.05	0.20	0.09
Total	0.32	0.09	0.07	0.08	0.24	0.12
			NMS 12			
Female	0.22	0.10	0.11	0.17	0.39	0.12
Male	0.20	0.08	0.07	0.10	0.24	0.11
Total	0.21	0.07	0.07	0.12	0.28	0.10
			Participation rate			
			EU 27			
Female	0.33	0.09	0.11	0.16	0.35	0.14
Male	0.25	0.04	0.03	0.06	0.21	0.07
Total	0.28	0.06	0.06	0.09	0.25	0.10
			EU15			
Female	0.29	0.09	0.11	0.16	0.32	0.15
Male	0.22	0.04	0.02	0.04	0.20	0.07
Total	0.25	0.06	0.05	0.08	0.23	0.10
			NMS 12			
Female	0.17	0.09	0.10	0.15	0.37	0.10
Male	0.15	0.05	0.04	0.08	0.22	0.08
Total	0.16	0.05	0.06	0.10	0.26	0.08
			Unemployment rate			
			EU 27			
Female	0.55	0.59	0.57	0.62	0.83	0.54
Male	0.45	0.55	0.63	0.73	0.76	0.55
Total	0.46	0.53	0.56	0.66	0.77	0.51
			EU15			
Female	0.57	0.63	0.58	0.62	0.88	0.54
Male	0.41	0.56	0.64	0.76	0.82	0.53
Total	0.45	0.54	0.55	0.66	0.84	0.49
			NMS 12			
Female	0.41	0.47	0.50	0.52	0.66	0.48
Male	0.37	0.47	0.47	0.50	0.55	0.46
Total	0.38	0.46	0.47	0.50	0.57	0.46

Table 5.2 (Continued)

	Share of long-term unemployed
EU 27	0.38
EU 15	0.40
NMS12	0.18

Source: Eurostat, own calculations. Table reports coefficient of variation of (unweighted) average values for the years 2004 to 2006.

males and increasing in age (i.e. higher than the average by a factor of 1.5 for the oldest age group). Thus, regional labour market disparities among both the EU15 and NMS12 suggest substantial differences in the behaviour of the labour market for women, the young and the older, where in particular for the latter two groups (national) institutional differences may play an important role in shaping regional labour market performance.

Finally, the impact of the NMS12 on EU27-wide disparities in employment, unemployment and participation rates seems to be limited, since coefficients of variation change hardly at all relative to the EU15 when considering the EU27. This finding contrasts starkly with results in respect of GDP and suggests that differences in employment, participation and unemployment rates between the NMS12 and the EU15 are no longer large enough to cause extreme increases in EU27 disparities.[5]

5.4 The differentiation of regional labour market problems in the EU: A principal components analysis

Thus our analysis so far suggests substantial variance in the structure of regional labour market problems in the EU27. Conducting the analysis on the full set of 19 indicators used in this chapter, however, leads to difficulties in the interpretation of the results. Thus to uncover the factors underlying heterogeneity, we conducted a factor analysis, in which we included the employment, unemployment and participation rates for males and females by age group as well as the share of long-term unemployed.[6] From this analysis we obtain five significant factors (Table 5.3). These account for 88 per cent of the total variance in our data. Furthermore, the five significant factors have relatively intuitive interpretations:

Factor 1 explains 45 per cent of the variance and is high where unemployment rates (irrespective of the demographic group) and long-term

Table 5.3 Factor loadings and descriptive statistics for factors identified in the factor analysis

	Factor 1	Factor 2	Factor 3	Factor 4	Factor 5
			Employment rates		
			Females		
Aged 15–24	−0.17	0.26	**0.88**	0.10	0.28
Aged 25–34	−0.27	**0.69**	**0.50**	0.19	0.01
Aged 35–44	−0.14	**0.95**	0.15	0.05	0.08
Aged 45–54	−0.13	**0.87**	0.17	0.04	**0.33**
Aged 55–64	−0.19	**0.41**	0.20	−0.03	**0.83**
			Males		
Aged 15–24	−0.24	0.13	**0.89**	0.20	0.22
Aged 25–34	**−0.68**	0.23	**0.30**	0.37	0.01
Aged 35–44	**−0.66**	0.03	0.13	**0.69**	0.05
Aged 45–54	**−0.58**	0.01	0.18	**0.72**	0.23
Aged 55–64	−0.28	−0.04	0.29	0.20	**0.83**
			Participation rates		
			Females		
Aged 15–24	−0.10	0.19	**0.88**	0.07	0.32
Aged 25–34	0.06	**0.65**	**0.34**	0.23	−0.05
Aged 35–44	0.23	**0.93**	0.00	0.05	0.02
Aged 45–54	0.17	**0.89**	0.12	0.05	0.28
Aged 55–64	−0.04	**0.44**	0.22	0.00	**0.82**
			Males		
Aged 15–24	−0.10	0.10	**0.91**	0.11	0.26
Aged 25–34	−0.18	0.25	0.17	**0.42**	−0.07
Aged 35–44	−0.01	0.12	0.05	**0.92**	−0.03
Aged 45–54	−0.05	0.13	0.20	**0.89**	0.26
Aged 55–64	−0.06	0.01	0.32	0.22	**0.86**
			Unemployment rates		
			Females		
Aged 15–24	**0.32**	**−0.51**	**−0.64**	−0.21	−0.08
Aged 25–34	**0.59**	**−0.51**	**−0.52**	−0.05	−0.06
Aged 35–44	**0.77**	**−0.39**	**−0.37**	−0.03	−0.12
Aged 45–54	**0.90**	−0.13	−0.20	−0.01	−0.18
Aged 55–64	**0.92**	0.11	0.05	0.15	−0.06
			Males		
Aged 15–24	**0.53**	−0.21	**−0.53**	**−0.48**	−0.06
Aged 25–34	**0.86**	−0.15	**−0.30**	−0.23	−0.07
Aged 35–44	**0.92**	0.04	−0.15	−0.26	−0.10
Aged 45–54	**0.93**	0.14	−0.09	−0.20	−0.09
Aged 55–64	**0.95**	0.17	0.03	−0.03	−0.02

Table 5.3 (Continued)

			Long term unemployment		
Total	**0.58**	−0.09	**−0.45**	0.02	**−0.32**
			Descriptives		
Lambda	14.0	5.8	2.9	2.7	1.9
Expl. variance	45.1	18.8	9.5	8.6	6.0

Source: Eurostat, own calculations, bold figures highlight factor loadings in excess of 0.3, Lambda = eigenvalue of associated factor.

unemployment is high, while employment rates are low. This factor is thus closely associated with the overall unemployment and employment situation within a region. The second factor explains a further 19 per cent of the variance and is associated with high female employment and participation rates, while the third factor, which explains about 10 per cent of the variance, is high for regions with high youth employment and participation rates, low youth unemployment rates and low long-term unemployment. It thus measures the labour market situation of youths. The fourth factor, contributing another 9 per cent to the total variance, is particularly high in regions where participation and employment rates of prime age males (i.e. those aged between 25 and 45) are high and the male youth unemployment rate is low. This factor is thus associated with the labour market situation of (prime aged) males. The fifth factor finally, is associated with high participation and employment rates of the elder (i.e. those older than 54).

The results of a regression of these factors on aggregate labour market indicators (total employment, unemployment and participation rates) in Table 5.4 are indicative of the explanatory power of structural explanations of regional employment, unemployment and participation rate disparities in the EU. Together, the five significant factors explain between 80 and 90 per cent of the variance in aggregate employment, unemployment and participation rates.[7] Factor 1 is negatively correlated with the aggregate regional employment and participation rates and highly positively correlated with the regional unemployment rates. By contrast, all other factors are positively and significantly correlated with total regional employment and participation rates but negatively correlated with unemployment rates. The highest marginal effects on aggregate employment rates are found for factor 3. Here an increase of one standard deviation is associated with a ceteris paribus increase

Table 5.4 Regression results for regional employment, unemployment and participation rates

	Employment rate		Participation rate		Unemployment rate	
	B	**S.E.**	**B**	**S.E.**	**B**	**S.E.**
Factor 1	−2.60***	0.13	−0.32**	0.15	3.98***	0.02
Factor 2	3.04***	0.13	2.87***	0.15	−0.88***	0.02
Factor 3	3.34***	0.13	2.77***	0.15	−1.38***	0.02
Factor 4	1.16***	0.13	0.75***	0.15	−0.91***	0.02
Factor 5	2.82***	0.13	2.71***	0.15	−0.49***	0.02
Factor 6	1.02***	0.13	1.43***	0.15	0.52***	0.02
Constant	52.32***	0.13	57.18***	0.15	8.66***	0.02
R2	0.87		0.76		0.97	

Source: Eurostat, own calculations, B – coefficient estimates, S.E. – Standard Error, *** (**) (*) signify significance at the 1 (5) (10)% level, respectively.

in the employment rate of 3.3 percentage points. Factor 2 has the strongest impact on regional participation rates with a one standard deviation increase increasing the participation rate by 2.9 percentage points. Finally, Factor 1 has the strongest impact on regional unemployment rates. A standard deviation increase in this factor increases regional unemployment by 4 percentage points.

Factors 1, 2 and 5 also have a strong impact on regional employment rates, while factors 3 and 5 have a strong impact on regional participation rates. By contrast, the marginal effects of factor 4 are the smallest. This suggests that high unemployment rate regions in the EU27 (i.e. regions with a high score of factor 1) are also regions with low employment and participation rates, while regions with a good labour market situation for females, young and the elderly (i.e. high factor scores for factors 2, 3 and 5) also have high aggregate employment and participation rates, but low unemployment rates.

Furthermore, the geographical dispersion in these factors reconfirms the descriptive analysis given in section 5.3. Low unemployment rate regions (i.e. regions with a low score of factor 1) are located principally in Austria, the Czech Republic, the UK and northern Italy, while the high unemployment regions are to be found in Poland, Slovakia, Germany and southern Italy. By contrast, many southern European regions have low female employment rates (i.e. low scores for factor 2) and northern European regions have high female labour market participation rates.

The NMS12 regions but also many French regions have a low score for factor 3, which suggests that youth labour market problems are important. High scores in terms of factor 3 – indicating a favourable youth labour market situation – are attained in Germany, the UK and Austria. Similarly high scores of factor 4 (indicating a favourable labour market situation of males) are primarily obtained in Austria, Northern Italy and Germany, while the NMS have very low scores in this respect. In addition, regions with a good labour market situation for the elder (high score of factor 5) are primarily in Northern Europe, while Northern Italy, Austria and many of the NMS12 record low scores.

5.5 Do the new Member States differ from the EU15?

5.5.1 ANOVA results

A further question we set out to address is to what extent NMS12 regions differ from the EU15 in their labour market outcomes. A number of pre-accession studies find that national labour market outcomes in the CEEC do not differ dramatically from those seen in the EU15. For instance, Knogler (2001) concludes that in 1998 the CEEC did not perform worse than many EU15 countries in respect of most indicators and also that it outperformed most of the EU15 with respect to gender differences in terms of both unemployment and employment rates. Similarly, Huber (2003) concludes that most indicators of labour market development in the NMS12 are within the ranges observed in the EU15. With regional data we are able to test these hypotheses more formally. We conduct a series of ANOVA tests of the hypothesis that average employment, unemployment and participation rates in the NMS12 do not differ significantly from the EU15 for each of the indicators or for the five principal components derived in the last section. Furthermore, since there is also substantial heterogeneity among both EU27 and also NMS12 countries we ran regressions of regional indicators on a set of country dummies to examine how much of the regional variation can be explained by national differences.

The results shown in Table 5.5 suggest that the average unemployment rates in NMS12 regions were significantly higher for almost all subgroups whereas the employment and participation rates were lower. The only exception to this is the participation rate of prime aged females (that is, those aged between 35 and 54 years), which is significantly higher in the NMS12. When, however, conducting the same analysis on factor scores we find significant differences between the NMS12 and the EU15 only with respect to factors 2 to 5 (that is, those most strongly associated with the labour market situation of the females, young, males and the elderly). Thus in particular the structure of regional labour markets differs between the NMS12 and the EU15, where – as has already been found in the descriptive analysis – the NMS12 have a significantly worse situation with respect to the labour market situation of males, young and elderly (factors 3, 4 and 5), but on average perform better with respect to females (factor 2).

The results, however, also suggest that for most indicators, regression models, in which regional employment, unemployment and participation rates are regressed on a dummy for regions in the NMS12, explain only a very small part of the variation. In general, the R^2 values of these regressions (columns labelled EU-R2 in Table 5.5) explain less than 10 per cent of the variance. The only case where a dummy for the NMS12 explains more than 15 per cent of the regional variance is with respect to factors 3 and 4 (that is, factors associated with the youth and the male labour market) of the principal components analysis. While in particular this last result confirms some of our hypothesis with respect to the potential differences in the labour market situation between the NMS12 and EU15, we conclude that simple East–West explanations of regional differences in labour market conditions have only a low explicative power and are not able to explain the large variance in regional labour market indicators within the EU27.

National explanations seem to be more important. The R^2 values of running regressions on national dummies (the columns labelled N-R2 in Table 5.5) indicate that for most subgroups more than 40 per cent of the variance of individual indicators and also more than 50 per cent of the variance in factor scores can be explained by national dummies. Thus national (institutional) factors are of primary importance when considering regional labour market disparities in the EU27. Furthermore, for the participation and employment rates of the young and the older workers more than 80 per cent of the variation can be explained by national dummies and R^2 values of national dummies are highest for factors 3 and 5 (i.e. those associated with the labour market situation of the young and the elder). Thus, as expected, national factors are most important in explaining regional labour market disparities in labour market segments that may be considered most strongly affected by national institutions.

5.5.2 Cluster analysis

While differences between the NMS12 and the EU15 are clearly significant, national differences seem to be more important, in particular when considering the labour market situation of the young and the old. These

Table 5.5 Results of Anova tests for differences in regional employment, unemployment and participation rates by age and gender

	EU 15	NMS 12	EU27	Sign	EU-R2	N-R2	EU 15	NMS 12	EU27	Sign	EU-R2	N-R2	EU 15	NMS 12	EU27	Sign	EU-R2	N-R2
	Unemployment rate						Participation rate						Employment Rate					
Females																		
15–24	20.1	25.2	21.2	***	0.03	0.57	44.9	28.9	41.6	***	0.22	0.89	37.1	21.5	33.9	***	0.18	0.87
25–34	10.6	13.0	11.1	**	0.02	0.51	49.9	47.2	49.3	**	0.02	0.75	43.4	27.6	40.1	***	0.23	0.8
35–44	8.3	10.5	8.8	***	0.03	0.49	76.8	72.5	75.9	***	0.05	0.42	40.3	24.6	37.0	***	0.21	0.85
45–54	6.8	10.1	7.5	***	0.07	0.54	77.8	81.8	78.6	***	0.03	0.58	45.3	41.4	44.5	***	0.04	0.71
55–64	5.9	6.6	6.0		0.003	0.54	72.6	74.4	72.9		0.004	0.75	61.0	56.0	60.0	***	0.1	0.62
All ages	9.7	12.2	10.2	***	0.03	0.52	81.6	78.9	81.0	**	0.02	0.65	2.5	4.0	2.8	***	0.02	0.52
Males																		
15–24	17.2	25.4	18.9	***	0.13	0.45	2.4	4.0	2.8	***	0.04	0.52	69.0	62.9	67.7	***	0.06	0.43
25–34	8.2	10.4	8.6	**	0.03	0.45	51.7	37.1	48.6	***	0.22	0.83	84.4	81.6	83.8	***	0.03	0.38
35–44	5.7	8.5	6.3	***	0.07	0.48	65.9	62.9	65.3	***	0.06	0.68	76.7	72.4	75.8	***	0.05	0.35
45–54	5.4	9.2	6.2	***	0.11	0.54	91.8	91.1	91.7		0.004	0.42	71.5	73.1	71.9		0.005	0.5
55–64	5.8	7.9	6.3	***	0.03	0.55	94.4	91.8	93.9	***	0.09	0.48	89.1	84.0	88.0	***	0.13	0.38
All ages	7.5	10.9	8.2	***	0.08	0.49	47.4	37.6	45.3	***	0.12	0.82	6.2	7.8	6.5	**	0.01	0.61
Total																		
15–24	18.4	25.3	19.9	***	0.08	0.51	57.2	49.1	55.5	***	0.08	0.78	67.7	67.0	67.6		0.001	0.71
25–34	9.2	11.6	9.7	***	0.03	0.47	6.2	7.9	6.6	**	0.02	0.61	85.7	75.9	83.7	***	0.3	0.52
35–44	6.8	9.4	7.3	***	0.06	0.47	48.4	33.0	45.2	***	0.22	0.88	76.7	71.4	75.6	***	0.08	0.56
45–54	5.9	9.6	6.7	***	0.11	0.56	57.7	54.7	57.1	***	0.05	0.72	35.6	25.8	33.5	***	0.11	0.79
55–64	5.8	7.4	6.1	**	0.02	0.58	84.3	81.9	83.8	***	0.03	0.38	53.9	45.5	52.1	***	0.08	0.74
All ages	8.4	11.5	9.0	***	0.07	0.48	4.1	5.5	4.4	**	0.02	0.57	4.0	5.4	4.3	**	0.02	0.57
								Aggregate Indicators										
LTU													37.5	53.6	40.8	***	0.16	0.71
Factor1													0.22	−0.06	0.00	*	0.01	0.57
Factor 2													0.28	−0.08	0.00	**	0.02	0.60
Factor 3													−0.79	0.21	0.00	***	0.17	0.87
Factor 4													−0.81	0.22	0.00	***	0.18	0.69
Factor 5													−0.47	0.13	0.00	***	0.06	0.74

Source: Eurostat, own calculations, table is based on average values for the years 2004 to 2006, Columns labelled Sign report the significance of a dummy variable for NMS12 member states with *** (**) (*) signifying significance at the 1 (5) (10)% level respectively, columns labelled EU-R2 report the R^2 value of this regression, columns labelled N-R2 report the R^2 values of a regression on national dummies, other columns report (unweighted) means for the respective subgroup, LTU = share of long term unemployed in total employment.

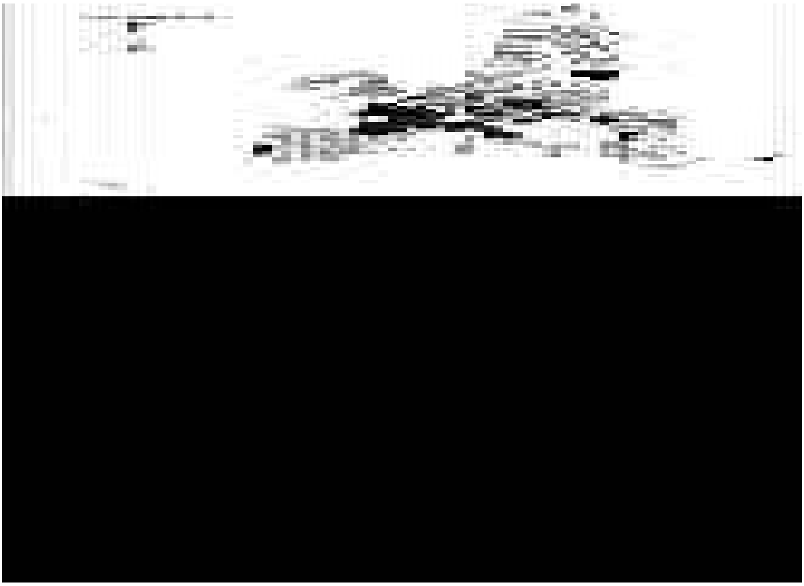


Figure 5.2 Cluster membership of European NUTS2 regions
Source: Eurostat, own calculations.

findings, however, tend to mask the substantial heterogeneity within both the EU15 and NMS12. A potential shortcoming of the above analysis is that there may be a number of regions characterized by similar labour market problems located in different countries. To analyse this issue we performed a cluster analysis using the factor scores of the principal components of the previous section as cluster variables. Furthermore, we use correlation coefficients as distance measures and average within group linkage to define groups. To decide on the number of clusters reported we look at the distance between the two merged clusters. We settled on a total of five groups to avoid studying an excessive amount of groups. Tables 5.6 and 5.7 display the characteristics of the members of these groups; Figure 5.2 shows the geographical location of cluster members.

The findings suggest that the CEEC among the NMS12 are not characterized by completely different regional labour market problems than the EU15. The cluster in which most of the NMS12 regions can be found is cluster 2, which is marked by high scores of factor 1, the lowest average employment and participation rates and the highest total unemployment rates among all clusters. Furthermore, in terms of the structure of

Table 5.6 Group means and summary statistics of clusters (aggregate indicators)

	Cluster 1	**Cluster 2**	**Cluster 3**	**Cluster 4**	**Cluster 5**
			Employment rate		
Female	51.0	41.0	45.5	36.5	52.8
Male	67.0	53.3	60.7	59.6	64.7
Total	58.8	46.9	52.8	47.8	58.5
			Participation rate		
Female	53.9	48.1	49.2	42.0	55.8
Male	70.0	62.0	64.4	64.3	68.7
Total	61.8	54.8	56.5	52.9	62.0
			Unemployment rate		
Female	5.4	14.6	7.5	13.6	5.4
Male	4.3	14.0	5.8	7.4	5.9
Total	4.8	14.3	6.6	9.8	5.6
Share of long-term unemployment	33.7	54.7	41.1	42.8	25.1
			Number of regions from…		
NMS		31	17	1	6
EU27	25	32	48	47	53

Source: Eurostat, own calculations.

employment, unemployment and participation rates this cluster has the highest unemployment rates and relatively low employment rates for most groups, while participation rates are more in line with the average. In addition to regions of the NMS12 in Poland, Slovakia and Eastern Hungary this cluster draws its membership from 32 EU15 regions, which are mostly located in Germany and France. Thus these regions are the most comparable to NMS12 regions.

Further clusters where NMS regions are represented to a significant degree are clusters 3 and 5. The Czech as well as some Western Hungarian and Slovak regions are grouped into cluster 3. This comprises the low unemployment rate regions in Northern Italy, Southern Germany and France. It has aggregate employment and participation rates in the middle ranges of the EU27 and also achieves average performance with respect to the demographic structure of employment, unemployment and participation rates. Cluster 5, by contrast, which also encompasses some Romanian regions and two Baltic countries, may otherwise be considered a cluster of the northern labour markets of Sweden, Denmark

Table 5.7 Group means of clusters (disaggregate indicators)

	Females					**Males**				
Age	15–24	25–34	35–44	45–54	55–64	15–24	25–34	35–44	45–54	55–64
					Employment rate					
Cluster 1	55.4	77.5	76.2	70.4	29.1	60.6	90.2	92.1	87.9	50.9
Cluster 2	26.4	64.2	71.8	66.1	26.9	31.3	77.6	81.9	74.8	41.7
Cluster 3	29.0	72.1	77.4	72.7	31.5	36.4	87.5	91.8	87.6	47.9
Cluster 4	26.5	59.4	60.3	53.8	28.1	36.5	82.6	90.0	86.7	56.1
Cluster 5	46.9	73.0	76.2	75.5	49.1	50.2	86.7	88.8	85.0	63.9
					Participation rate					
Cluster 1	61.0	81.6	80.1	73.5	30.3	66.2	94.1	95.3	91.0	53.0
Cluster 2	35.1	75.7	82.6	75.6	30.8	42.2	90.4	92.4	85.1	47.8
Cluster 3	34.7	78.5	82.8	77.2	33.3	42.7	93.3	96.0	91.6	50.4
Cluster 4	36.0	70.4	68.1	58.6	30.0	44.5	90.9	95.2	90.9	59.2
Cluster 5	53.8	77.4	79.6	78.2	50.5	59.0	91.7	92.5	88.4	66.6
					Unemployment rate					
Cluster 1	9.6	5.1	4.8	4.3	3.7	8.5	4.2	3.4	3.4	3.9
Cluster 2	26.1	15	12.8	12.4	11.4	26.4	14.2	11.3	12	12.1
Cluster 3	16.9	8.2	6.5	5.7	4.9	14.9	6.2	4.4	4.4	4.6
Cluster 4	28.9	16.3	11.8	8.4	6.1	18.9	9.2	5.4	4.6	5.3
Cluster 5	13.6	5.7	4.3	3.5	2.7	15.5	5.5	4.0	3.9	4.1

Source: Eurostat, own calculations.

and the UK. This cluster has the second lowest unemployment rates and high employment and participation rates. In addition, in this instance the employment rate of the older and (to a lesser degree) of women is particularly high.

In consequence, our analysis suggests that southern European labour markets, which have often been viewed as those most comparable to the NMS12 on account of their high unemployment rates, may not be the best comparison group. The southern European regions of Italy, Spain and Greece are placed in cluster 4. Of the NMS12 only Malta belongs to this cluster. This cluster is also characterized by high unemployment rates, high shares of long-term unemployment and low participation and employment rates. However, it differs in terms of cluster 2 by high levels of gender difference in terms of employment, unemployment and participation rates. Finally, a cluster where none of the NMS12 regions are grouped is cluster 1 which collects the low unemployment regions of primarily Austria and the Netherlands. Here in addition to low unemployment rates both low youth unemployment rates and low participation rates on the part of the older population prevail.

5.6 Regression analysis

One final hypothesis we want to address is that regional labour market problems may be correlated with different variables in different parts of Europe. In particular, we hypothesized that as a result of the higher levels of industrial restructuring in the CEEC among the NMS12, industrial structure and structural change may be more important correlates of regional labour market outcomes in the NMS12. In this section we will use regression analysis to address this issue. In his survey Elhorst (2003) suggests that the variables most often found to be significant determinants of the regional unemployment rate are: the age structure of the population, the educational attainment of the population, the participation rate, employment growth, the share of persons living in the public rental sector, social security and minimum wage levels, amenities, wages, productivity, vacancy rates, market potential as well as the national unemployment rates and the share of long-term unemployed. Of these we were able to obtain (from EUROSTAT sources): the share of less educated (i.e. ISCED levels below 2) and the share of the highly educated (ISCED 5 or higher) in active age population, the share of the population aged 25 or older in active aged population, indicators of the structure of employment,[8] an indicator of structural change,[9] total employment growth in the period 2004–06, average wages (compensation per employee), productivity (GDP at PPP per employee), the share of long-term unemployed and the participation rate. In addition, we also include country fixed effects to account for national institutions (such as the generosity of social security system, minimum wages and national labour market regulations) as well as the national labour market situation (such as national unemployment rates).

Table 5.8 presents the results of regressing the 2004 to 2006 average of (the log of) these indicators on the average (log of the) aggregate regional unemployment rate for the same time period. The second column presents results for the full sample, while columns 3 and 4 present results for the NMS12 and the EU15 and the remaining columns report results for each of the five clusters. A number of results can be highlighted. First R^2 values are above 0.80; relative to the ANOVA results of section 5.4 this represents an improvement of 30 percentage points. Thus, aside from national factors, regional developments are also an important determinant of the regional labour market situation. Secondly, when considering the significant variables, in the EU27, EU15 and NMS samples the share of long-term unemployed, the share of the active aged population above 25, sectoral employment shares and participation rates are the significant correlates of regional unemployment rates. Among these variables a higher share of over 25 year olds and higher participation rates have the strongest negative impact, while a higher share of the long-term unemployed increases regional unemployment rates. Sectoral employment shares, by contrast, are only on the margin of significance or not robust. Only the share of construction in employment unambiguously increases regional unemployment rates, which is probably due to higher seasonal unemployment in regions with a high share of construction employment.

Thirdly, the results suggest that there are only a few differences in the correlates of unemployment rates between EU15 and NMS12. The only variable for which coefficient estimates for the EU15 and NMS12 sample differ significantly is the indicator of sectoral structural change. Here point estimates suggest a small positive impact in the NMS12, but a negative one in the EU15. Both coefficients are, however, individually insignificant. Thus our hypothesis that initial industrial structure and structural change have a stronger impact on the regional labour market situation in the NMS12 and EU15 finds limited support. Differences in the determinants of regional unemployment rates among the clusters defined in the last section, by contrast, seem to be slightly larger. In particular for cluster five (that is, the cluster of southern European regions) educational attainment and wages are a significantly more important determinant of the regional unemployment rate than elsewhere and for cluster 4 (that is, the northern European labour markets) educational attainment is more important.

As a further experiment we also regressed the (log of the) aggregate regional employment rate on the same set of variables. Results of this regression (in Table 5.9) largely accord with those for unemployment rates. Aside from national determinants, regional factors are also an important determinant of regional employment rates. The R^2 values in this specification are by 20 percentage points higher than those in the model of section 5.4, where only national dummies were included. The share of long-term unemployed, participation rates and the share of the population older than 25 in the total active population are the most important determinants of employment rates, with parameters (as expected) oppositely signed to those for unemployment rates. In addition, here too differences for the NMS and the EU15 pertain only to the impact of structural change on the employment rate (which is negative but insignificant in the case of the NMS12 and positive but insignificant in the case of the EU15) and education and wages seem to have a significant impact only in cluster 5 (that is, the southern European labour

Table 5.8 Regression results for regional unemployment rates

	All	NMS	EU15	Cluster 1	Cluster 2	Cluster 3	Cluster 4	Cluster 5
Ln(low education	0.074	0.278	−0.086	−0.637	0.111(0.030)	0.580*	0.400	−0.956***
share)	(0.111)	(0.200)	(0.141)	(0.649)		(0.288)	(0.250)	(0.323)
Ln(high education	−0.096	−0.303	−0.078	−2.488	0.488	−0.070	−0.762***	−0.728*
share)	(0.171)	(0.339)	(0.197)	(1.657)	(0.297)	(0.324)	(0.268)	(0.388)
Ln(share of	−2.890***	−4.520*	−4.473***	−4.543	−2.268	−0.100	0.534	−1.741
population above 25)	1.216	(2.426)	(1.358)	(7.818)	(2.011)	(2.200)	(2.098)	(2.380)
Ln(agricultural	−0.126***	−0.130	−0.077	−0.462	−0.264***	−0.025	−0.040	−0.093*
employment share)	0.048	(0.097)	(0.051)	(0.261)	(0.058)	(0.065)	(0.066)	(0.050)
Ln(other service	0.409*	0.972*	0.443*	1.065	1.055***	0.406	0.277	−0.528
employment share)	0.209	(0.538)	(0.231)	(1.149)	(0.360)	(0.271)	(0.273)	(0.504)
Ln(construction	0.258**	0.392*	0.346**	−0.156	0.247*	−0.317	0.197	0.447**
employment share)	0.111	(0.229)	(0.142)	(0.430)	(0.138)	(0.243)	(0.254)	(0.191)
Ln(trade & restaurants	0.121	0.040	0.240	−0.133	0.327	0.022	0.214	−0.552
employment share)	0.195	(0.421)	(0.222)	(1.021)	(0.349)	(0.249)	(0.293)	(0.335)
Ln(financial & real est.	0.122	−0.070	0.280*	0.702	−0.554**	0.225	0.248	0.169
employment share)	0.122	(0.187)	(0.146)	(0.564)	(0.202)	(0.215)	(0.264)	(0.173)

Ln(employment	−0.219	1.084	−0.371	−2.080	0.164	0.234	−1.244	0.568
growth)	0.429	(1.001)	(0.509)	(4.093)	(0.635)	(0.680)	(1.027)	(0.896)
Ln(structural change)	−0.039	**0.097**	−0.044	−0.160	0.003	0.022	−0.075*	−0.061
	0.032	(0.064)	(0.037)	(0.136)	(0.039)	(0.093)	(0.043)	(0.077)
Ln(productivity)	−0.071	−0.151	−0.235	−0.171	0.417	−0.775	−0.356	−1.465**
	0.305	(0.911)	(0.337)	(0.792)	(0.454)	(0.667)	(0.400)	(0.628)
Ln(wages)	−0.339	−0.104	0.065	−0.166	−0.555	0.373	0.361	1.651***
	0.351	(1.061)	(0.416)	(1.028)	(0.466)	(0.741)	(0.668)	(0.551)
Ln(long term	0.850***	0.887***	0.797***	0.439	0.601**	0.589***	0.488***	0.450***
unemployment share	0.130	(0.311)	(0.129)	(0.423)	(0.237)	(0.206)	(0.140)	(0.151)
Ln(aggregate	−1.147**	−1.723*	−1.400**	−0.559	1.262*	−1.461	−1.483	−1.139
participation rate)	0.499	(0.992)	(0.575)	(2.597)	(0.702)	(0.992)	(0.643)	(0.745)
	257	55	202	25	60	65	48	55
No. observations								
R2	0.83	0.93	0.81	0.91	0.89	0.87	0.83	0.88

Source: Eurostat, own calculations, dependent variable: ln(unemployment rate), values in brackets are heteroskedasticity robust standard errors, *** (**) (*) signify significance at the 1 (5) (10)% level respectively, bold figures report a significant (at the 5% level) difference of coefficient estimates between the NMS12 and the EU15, regression includes country dummies, which are not reported.

Table 5.9 Regression results for regional employment rates

	All	NMS12	EU15	Cluster 1	Cluster 2	Cluster 3	Cluster 4	Cluster 5
Ln(low education	0.001	–0.035	0.021	0.031	–0.004	–0.045	–0.039	0.058***
share)	(0.014)	(0.028)	(0.017)	(0.034)	(0.018)	(0.032)	(0.035)	(0.019)
Ln(high education	0.007	0.009	0.001	0.141	–0.061	0.019	0.086**	0.039*
share)	(0.019)	(0.043)	(0.022)	(0.088)	(0.053)	(0.027)	(0.034)	(0.023)
Ln(share of	0.280*	0.561*	0.478***	0.217	0.400	0.014	0.079	0.027
population above 25)	(0.147)	(0.321)	(0.163)	(0.379)	(0.363)	(0.167)	(0.275)	(0.148)
Ln(agricultural	0.011**	0.028**	0.003	0.024	0.044***	0.001	0.002	0.003
employment share)	(0.005)	(0.013)	(0.005)	(0.014)	(0.011)	(0.005)	(0.008)	(0.003)
Ln(other service	–0.061**	–0.178**	–0.062**	–0.058	–0.193***	–0.050**	–0.041	0.045
employment share)	(0.024)	(0.076)	(0.026)	(0.062)	(0.064)	(0.021)	(0.035)	(0.028)
Ln(construction	–0.038***	–0.074**	–0.047***	0.004	–0.046**	0.026	–0.023	–0.029**
employment share)	(0.012)	(0.031)	(0.015)	(0.021)	(0.022)	(0.017)	(0.035)	(0.011)
Ln(trade & restaurants	–0.021	0.009	–0.035	0.002	–0.066	–0.007	–0.011	0.036
employment share)	(0.019)	(0.049)	(0.021)	(0.056)	(0.060)	(0.019)	(0.041)	(0.020)
Ln(financial & real est.	–0.001	0.037	–0.022	–0.042	0.083**	–0.015	–0.025	–0.012
employment share)	(0.013)	(0.025)	(0.015)	(0.035)	(0.036)	(0.017)	(0.033)	(0.010)

Ln(employment	0.015	−0.089	0.018	0.034	−0.043	−0.002	0.156	−0.050
growth)	(0.055)	(0.173)	(0.059)	(0.219)	(0.121)	(0.052)	(0.129)	(0.051)
Ln(structural change)	0.005	**−0.007**	0.005	0.008	0.000	−0.002	0.009	0.004
	(0.004)	(0.008)	(0.004)	(0.008)	(0.007)	(0.007)	(0.005)	(0.004)
Ln(productivity)	0.011	−0.123	0.043	0.001	−0.064	0.050	0.041	0.087**
	(0.031)	(0.089)	(0.033)	(0.041)	(0.074)	(0.049)	(0.052)	(0.039)
Ln(wages)	0.025	0.162	−0.038	0.002	0.093	−0.036	−0.067	−0.102***
	(0.035)	(0.108)	(0.039)	(0.056)	(0.078)	(0.058)	(0.094)	(0.034)
Ln(long term	−0.074***	−0.108**	−0.066***	−0.024	−0.095***	−0.043**	−0.044**	−0.021**
unemployment share)	(0.014)	(0.040)	(0.013)	(0.022)	(0.041)	(0.017)	(0.017)	(0.008)
Ln(aggregate	1.053***	1.060**	1.087***	1.041***	0.775***	1.046	1.174***	1.106***
participation rate)	(0.055)	(0.135)	(0.062)	(0.139)	(0.121)	(0.081)	(0.085)	(0.043)
	257	55	202	25	60	65	48	59
No. of observations								
R2	0.970	0.980	0.960	0.980	0.940	0.980	0.980	0.980

Source: Eurostat, own calculations, dependent variable: ln(employment rate), values in brackets are heteroskedasticity robust standard errors, *** (**) (*) signify significance at the 1 (5) (10)% level respectively, bold figures report a significant (at the 5% level) difference of coefficient estimates between the NMS12 and the EU15, regression includes country dummies, which are not reported.

markets) and education is more important in cluster 4 (that is northern Europe).

Finally, Tables 5.A1 to 5.A4 in the Appendix present results for the employment and unemployment rates of the young (15–24 year olds), the older (55–64 year olds) as well as males and females as dependent variables. While the results for unemployment rates (Tables 5.A1 and 5.A2) are quite similar to those for aggregate unemployment rates, for employment rates (Tables 5.A3 and 5.A4) we find some variation. In particular, educational attainment is a more important determinant for the participation rates of all groups (where, interestingly, the coefficients are oppositely signed for young and the older) and differences in the correlates of male regional employment rates between the NMS12 and the EU15 are more significant than for aggregate employment rates (with – as hypothesized – sectoral employment shares being more important in the NMS).

Thus we conclude that in addition to national factors explaining regional unemployment rates, regional correlates (of which the most important are the age structure of the population, long-term unemployment, participation and sectoral employment shares) contribute a substantial part to the explanation for differences in aggregate regional employment and unemployment rates in the EU27, and that differences in these correlates between the EU15 and the NMS12 – with the potential exception of the impact of structural change – are mostly insignificant, but that there may be some differences between clusters, in particular when considering the cluster of southern European labour markets. Finally, there may also be more significant differences in the correlates of the structure of regional employment rates between the EU15 and the NMS12 in particular for male employment rates.

5.7 Conclusions

In this chapter we argue that the literature on regional labour market development leads to a number of hypotheses with respect to the regional and demographic structure of labour market problems in an enlarged EU. We also argue that these factors are linked and present evidence which indicates that it is important to consider the structure of regional labour market problems. We find that regional disparities in employment, unemployment and participation rates are of a different order of magnitude for individual labour market groups than for the overall aggregates and that a factor analysis based on indicators of the structure of regional employment, unemployment and participation rates can explain between 80 per cent and more than 90 per cent of the variance in aggregate employment, unemployment and participation rates in the EU27.

In addition, we find significant differences between the NMS12 and the EU15. In particular, both national and regional data indicate that the NMS12 have higher long-term unemployment shares as well as lower employment and participation rates of males and higher youth unemployment rates than the EU15. However, we also show that simple East–West explanations of regional labour market disparities can rarely explain more than 10 per cent of the EU-wide variance in the 19 regional labour market indicators considered and that both the results of cluster and factor analyses suggest substantial similarities between the labour markets of individual NMS12 and EU15 regions. In particular, the labour markets of Poland and Slovakia are most directly comparable to the high unemployment regions of northern and eastern Germany but that they have less in common with the southern European labour markets. We also find that in contrast to income differentials, regional disparities in labour market indicators have not increased dramatically within the EU27 as the result of enlargement and that the distribution of regional labour market indicators has also shown no visible shift.

We also find that the national differences are important (and more so than East–West differences) in offering an explanation of regional labour market disparities in the EU15. For most of the indicators used in this chapter, national dummies can explain more than 40 per cent of the total regional variance in the EU27. Our results also corroborate the hypotheses that national factors are more important for the young and the older and that for these groups regional disparities within the EU are largest. At the same time, however, when regressing regional unemployment and employment rates on a number of variables found to be significant in the literature, we find that regional variables such as the share of long-term unemployed, the share of the older active aged population, the sectoral employment share and the participation rate, are significantly correlated with regional labour market differences even after controlling for national differences. Finally, our regression results provide only little evidence that the determinants of aggregate regional employment and unemployment rates differ starkly between the NMS12 and the EU15, but indicate that educational attainment and wages are more important in the southern European labour markets and that differences between the EU15 and the NMS12 are larger when considering the structure of employment, where the later applies in particular to male employment rates.

In sum, our results suggest that disparities in regional labour market problems in the EU27 are shaped by the interaction between national factors such as institutions and regional determinants and furthermore that these factorshave a variety of effects on labour market groups. We would thus suggest that future research, which sets out to determine in more detail how different interactions between national institutions and regional determinants impact differentially on regional labour markets, would be particularly rewarding in any attempt to secure a more complete picture of regional labour market disparities in the EU27. Furthermore, such research could also focus more strongly on the causes of regional disparities for individual demographic groups. Our results suggest that the labour market for youths and the older could be of particular interest in this respect. In addition, one element that is missing from our analysis are differences in the labour market situation of persons with different qualifications. Thus a detailed analysis of regional differences in the labour market situation for different skill groups is also left to future research.

Notes

1. We exclude the French overseas territories and the Spanish regions of Ceuta and Melila due to missing data problems and indicators for those aged 65 and older due to the low reliability of these data. NUTS2 data is used due to the pivotal role of these regions for EU regional policy and its use in many regional labour market studies for the EU (Taylor and Bradley, 1997; Basile and Schioppa, 2002; Overmann and Puga, 2002; Boldrin and Canova, 2001).
2. This is not available on a disaggregation by age and gender but included none the less on account of its primary importance for the assessment of the overall labour market situation.
3. Mosley and Mayer (1999), benchmark the labour market situation in the EU using the unemployment rate, the male and female unemployment rates as well as both the share of long-term unemployed and the youth unemployment rate, on the grounds that these are closely related to the goal structure of the European Employment Strategy. Amendola, Caroleo and Coppola (2006) use population density as well as activity, employment, long-term unemployment rates and sectoral employment shares.
4. Similar analysis for participation rates shows that these differ from the EU 15 in the NMS12 primarily due to the participation of prime age males. With respect to unemployment the high unemployment countries of the NMS12 are burdened by high youth unemployment rates.
5. Since Overmann and Puga (2002) stress that issues of regional disparities should be analysed by looking at the complete distribution of indicators, we also conducted kernel density estimates for each of the indicators used. Participation rates are left skewed, implying a large share of regions with above

average and a small share with below average participation rates. For males, the employment rate distribution is bimodal, with bimodality more pronounced for the young and the older. Unemployment rates are skewed to the right both in the EU27 and the EU 15 with a small 'bump' to the right of the mean The distribution of employment, unemployment and participation rates, however, does not differ dramatically between EU27 and the EU15.

6. We excluded overall male and female as well as total employment, unemployment and participation rates by age group to avoid multicollinearity among indicators.
7. Note that these aggregate indicators were not included in the factor analysis and that factor scores are orthogonal with mean zero and unit standard deviation, by definition. A unit increase in a factor is thus equivalent to a standard deviation increase.
8. These are the share of employees in agriculture (NACE A&B), construction (NACE F), Wholesale trade and restaurants (NACE G,H & I), financial intermediation and real estate (J and K) and other services (NACE L to Q).
9. This is measured as the sum of absolute employment share changes in the period 2004 to 2006 across the sectors mentioned.

References

Aghion, Philipe and Oliver J. Blanchard (1994) 'On the Speed of Transition in Central Europe', *NBER Macroeconomics Annual 1994*, Cambridge, MA: NBER, pp. 283–320.

Amendola, Adalgiso, Floro Ernesto Caroleo and Gianluigi Coppola (2006) 'Regional Disparities in Europe', in F. E. Caroleo and S. Destafinis (eds), *The European Labour Market: Regional Dimensions*, Heidelberg: Physica Verlag, pp. 9–32.

Aumayr, Christine M. (2007) 'European Region Types in EU-25', *European Journal of Comparative Economics*, 4(1), 109–47.

Basile, Roberto, K. Padoa and F. Schioppa (2002) 'Unemployment Dynamics of the "Mezzogiornos of Europe": Lessons for the Mezzogiorno of Italy', CEPR Discussion Papers 3594, London: CEPR.

Belke, Ansgar and Martin Hebler (2002) *EU – Osterweiterung, Euro und Arbeitsmärkte*, Munich and Vienna: R. Oldenburg.

Boeri, Tito (2000) *Structural Change, Welfare Systems, and Labour Reallocation, Lessons from the Transition of Formerly Planned Economies*, New York: Oxford University Press.

Boeri, Tito and Herbert Brücker (eds) (2000) *The Impact of Eastern Enlargement on Employment and Wages in the EU Member States*, European Integration Consortium, Berlin: Deutsches Institut für Wirtschaftsforschung (DIW).

Boldrin, Michele and Fabio Canova (2001) 'Europe's Regions', *Economic Policy*, April, 205–53.

Bornhorst, F. and Simon Commander (2006) 'Regional Unemployment and its Persistence in Transition Countries', *The Economics of Transition*, 14(2), 269–88.

Burda, Michael (1998) 'The Consequences of EU – Enlargement for Central and Eastern European Labour Markets', CEPR Discussion Paper No. 1881, London: CEPR.

Caroleo, Floro Ernesto and Francesco Pastore (2007) 'A New Regional Geography of Europe? The Labour Market Impact of the EU Enlargements', IZA Discussion Paper 2620, Bonn: IZA.

Elhorst, J. Paul (2003) 'The Mystery of Regional Unemployment Differentials: Theoretical and Empirical Explanations', *Journal of Economic Surveys*, 709–48.

Elhorst, J. Paul and Annette S. Zeilstra (2007) 'Labour Force Participation Rates at the Regional and National Levels of the European Union: An Integrated Analysis', *Papers in Regional Science*, 17(5), 525–49.

Fazekas, Karoly (1996) 'Types of Microregions, Dispersion and Local Employment Development in Hungary', *Eastern European Economics*, 34(3), 3–48.

Ferragina, A.M. and F. Pastore (2005) 'Regional Unemployment in the OST-Literature', in F.E. Caroleo and S. Destefanis (eds), *The European Labour Market – Regional Dimensions*, Heidelberg and New York: Physika, pp. 33–87.

Ferragina A.M. and F. Pastore (2007) 'Mind the Gap Unemployment in the New EU Regions', *Journal of Economic Surveys*, 22(1), 73–113.

Gacs, Vera and Peter Huber (2005) 'Quantity Adjustments in the Regional Labour Markets of EU Candidate Countries', *Papers in Regional Science*, 542–58.

Gros, Daniel (2000) 'EMU, the Euro and Enlargement', manuscript, CEPS, Brussels.

Huber, Peter (2003) 'What Can we Learn about Labour Market Adjustment in the Candidate Countries from Literature?', in K. Aiginger and G. Hutschenreiter (eds), *Economic Policy Issues for the Next Decade*, Boston: Kluwer, pp. 155–86.

Huber, Peter (2007) 'Regional Labour Market Developments in Transition: a Survey of the Empirical Literature', *European Journal of Comparative Economics*, 4(2), 263–98.

Knogler, Michael (2001) *Die Arbeitsmärkte der Beitrittskandidaten vor dem Hintergrund der EU-Osterweiterung*, Osteuropa Institut München, Working Papers No. 228.

Longhi, Simonetta, Peter Nijkamp and Iulia Traistaru (2005) 'Is Sectoral Diversification a Solution to Unemployment? Evidence from EU Regions', *Kyklos*, 58(4), 591–610.

Mosley, Hugh and Antje Mayer (1999) 'Benchmarking National Labour Market Performance: A Radar Chart Approach', WZB Discussion Paper FS I 99–202.

Overmann, Henry G. and Diego Puga (2002) 'Unemployment Clusters across Europe's Regions and Countries', *Economic Policy*, 17(4), 117–47.

Pench, Lucio R., Paolo Sestito and Elisabetta Frontini (1999) *Some Unpleasant Arithmetics of Regional Unemployment in the EU. Are there any lessons for EMU?*, European Commission, Forward Studies Unit, Working Paper.

Perugini, Cristiano and Marcello Signorelli (2004) 'Employment Performance and Convergence in the European Countries and Regions', *European Journal of Comparative Economics*, 1(2), 243–78.

Perugini, Cristiano and Marcello Signorelli (2007) 'Labour Market Performance Differentials and Dynamics in EU-15 Countries and Regions', *European Journal of Comparative Economics*, 4(2), 209–62.

Scarpetta, Stefano and Peter Huber (1995) 'Regional Economic Structures and Unemployment in Central and Eastern Europe: An Attempt to Identify Common Patterns', in S. Scarpetta and A. Wörgötter (eds), *The Regional Dimension of Unemployment in Transition Economies*, Paris: OECD.

Taylor, Jim and Steve Bradley (1997) 'Unemployment in Europe: A Comparative Analysis of Regional Disparities in Germany, Italy and the UK', *Kyklos*, 50(2), 221–45.

Wiese, Christian, John Bachtler, Ruth Downes, Irenen McMaster and Kathleen Toepel (2001) *The Impact of EU Enlargement on Cohesion*, Berlin and Glasgow: DIW – German Institute for Economic Research and EPRC European Policies Research Centre, March.

Appendix

Table 5.A1 Regression results for regional unemployment rates

	ALL	NMS	EU15	Cluster 1	Cluster 2	Cluster 3	Cluster 4	Cluster 5
	Dependent variable: unemployment rate of the 15–24 year olds							
Ln(low education share)	0.140*	0.342**	0.056	−0.514	0.084	0.364	−0.064	−0.671**
	(0.084)	(0.150)	0.119	(0.829)	(0.080)	(0.219)	(0.297)	(0.275)
Ln(high education share)	−0.049	−0.005	−0.014	−2.389	0.088	−0.027	−0.776***	−0.540*
	(0.137)	(0.278)	0.160	(2.172)	(0.221)	(0.299)	(0.249)	(0.311)
Ln(share of population above 25)	−1.478	−5.409***	−2.187**	−0.747	−2.579	−0.542	1.568	0.836
	(0.934)	(1.799)	1.077	(10.024)	(1.661)	(1.750)	(2.450)	(2.299)
Ln(agricultural employment share)	−0.113***	−0.160*	−0.078	−0.485	−0.194***	−0.070	−0.016	−0.113***
	(0.042)	(0.084)	0.047	(0.278)	(0.039)	(0.077)	(0.072)	(0.035)
Ln(other service employment share)	0.461**	0.582	0.534***	1.745	1.073***	0.550**	0.246	−0.084
	(0.178)	(0.421)	0.195	(1.344)	(0.299)	(0.241)	(0.307)	(0.435)
Ln(construction employment share)	0.047	0.317*	0.067	0.038	0.086	−0.282	0.122	0.181
	(0.096)	(0.175)	0.120	(0.650)	(0.119)	(0.202)	(0.198)	(0.164)
Ln(trade & restaurants employment share)	0.039	−0.113	0.139	−0.096	0.014	−0.182	0.289	−0.488**
	(0.160)	(0.338)	0.173	(1.101)	(0.288)	(0.229)	(0.221)	(0.234)
Ln(financial & real est. employment share)	0.188*	−0.012	0.279**	0.620	−0.273	0.429**	−0.151	0.151
	(0.101)	(0.148)	0.119	(0.587)	(0.175)	(0.204)	(0.222)	(0.135)
Ln(employment growth)	0.243	1.346	0.091	−1.164	0.730	0.068	0.438	0.737
	(0.354)	(0.811)	0.423	(5.050)	(0.471)	(0.526)	(1.267)	(1.116)
Ln(structural change)	−0.022	**0.100***	**−0.031**	−0.192	−0.017	0.017	−0.110**	0.001
	(0.031)	(0.055)	0.036	(0.147)	(0.037)	(0.090)	(0.043)	(0.068)
Ln(productivity)	−0.298	−0.853	−0.357	−0.334	0.411	−0.904	−0.705**	−1.690***
	(0.249)	(0.696)	0.269	(0.970)	(0.414)	(0.666)	(0.325)	(0.527)
Ln(wages)	−0.268	0.514	−0.071	−0.416	−0.606	−0.079	1.004*	1.651***
	(0.301)	(0.830)	0.361	(1.263)	(0.398)	(0.832)	(0.521)	(0.440)

Ln(long-term	0.701***	0.849***	0.652***	0.161	0.603***	0.560***	0.443**	0.330**
unemployment share)	(0.116)	(0.255)	0.119	(0.490)	(0.150)	(0.178)	(0.181)	(0.153)
Ln(aggregate	−1.175***	−2.551***	−1.242**	0.633	0.885	−1.528*	−1.154*	−0.766
participation rate)	(0.429)	(0.794)	0.502	(2.871)	(0.783)	(0.820)	(0.638)	(0.771)
No. observations	257	55	202	25	60	65	48	59
R2	0.86	0.94	0.85	0.89	0.95	0.88	0.93	0.91
	Dependent variable: unemployment rate of the 55–64 year olds							
Ln(low education	−0.167	0.079	−0.315*	−0.436	−0.401**	0.174	0.515	−1.177
share)	(0.149)	(0.315)	(0.188)	(0.833)	(0.165)	(0.530)	(0.458)	(0.884)
Ln(high education	−0.303	−0.522	−0.368	−2.068	0.073	−0.389	−1.504***	−1.461
share)	(0.246)	(0.518)	(0.302)	(2.178)	(0.365)	(0.580)	(0.523)	(0.867)
Ln(share of	0.823	3.900	−1.524	−1.462	5.080	1.838	−0.738	−2.729
population above 25)	(2.159)	(5.845)	(2.588)	(10.108)	(3.968)	(3.179)	(3.561)	(4.961)
Ln(agricultural	−0.142***	−0.199	−0.100*	−0.427	−0.327***	−0.178	−0.148	0.072
employment share)	(0.054)	(0.184)	(0.058)	(0.273)	(0.085)	(0.128)	(0.101)	(0.097)
Ln(other service	−0.072	0.974	−0.114	0.744	1.112	−0.348	0.662	−0.290
employment share)	(0.345)	(0.774)	(0.380)	(1.311)	(0.556)	(0.482)	(0.466)	(1.118)
Ln(construction	0.480***	0.583	0.543**	0.126	0.413	−0.113	0.502	0.773*
employment share)	(0.178)	(0.475)	(0.228)	(0.492)	(0.260)	(0.308)	(0.536)	(0.450)
Ln(trade & restaurants	0.298	0.002	0.270	−0.129	0.140	0.238	0.127	−0.792
employment share)	(0.331)	(0.973)	(0.387)	(1.124)	(0.576)	(0.416)	(0.549)	(0.793)
Ln(financial & real est.	0.253	−0.214	0.460	0.604	−0.558	−0.112	0.403	0.920*
employment share)	(0.215)	(0.365)	(0.265)	(0.683)	(0.337)	(0.347)	(0.495)	(0.501)
Ln(employment	−0.006	0.314	−0.010	−2.181	−0.496	0.397	−2.188	3.969
growth)	(0.709)	(1.742)	(0.875)	(4.740)	(0.955)	(1.344)	(1.902)	(2.213)

(Continued)

Table 5.A1 (Continued)

	ALL	**NMS**	**EU15**	**Cluster 1**	**Cluster 2**	**Cluster 3**	**Cluster 4**	**Cluster 5**
Ln(structural change)	−0.102	0.090	−0.121**	−0.181	0.070	−0.099	−0.139	−0.140
	(0.052)	(0.151)	(0.058)	(0.155)	(0.077)	(0.145)	(0.084)	(0.148)
Ln(productivity)	0.171	0.070	0.131	−0.858	0.645	−0.226	−0.158	−1.579
	(0.470)	(1.529)	(0.530)	(1.071)	(0.658)	(1.117)	(0.779)	(1.515)
Ln(wages)	−0.449	0.002	−0.251	0.580	−0.657	0.678	0.890	1.718
	(0.507)	(1.794)	(0.602)	(1.425)	(0.737)	(1.162)	(1.332)	(1.426)
Ln(long-term	0.853***	0.891*	0.817**	1.017*	0.578	0.242	0.349	0.476
unemployment share)	(0.186)	(0.507)	(0.208)	(0.491)	(0.394)	(0.374)	(0.245)	(0.285)
Ln(aggregate	−0.967	−0.293	−1.326	0.805	2.467**	−3.427*	−1.609	−1.603
participation rate)	(0.753)	(1.734)	(0.888)	(3.005)	(1.094)	(1.725)	(1.073)	(1.695)
No. observations	257	55	202	25	60	65	48	59
R2	0.82	0.86	0.75	0.98	0.9	0.86	0.8	0.67

Source: Eurostat, own calculations, dependent variable: ln(unemployment rate), values in brackets are heteroskedasticity robust standard errors, *** (**) (*) signify significance at the 1 (5) (10)% level respectively, bold figures report a significant (at the 5% level) difference of coefficient estimates between the NMS12 and the EU15, regression includes country dummies, which are not reported.

Table 5.A2 Regression results for regional male and female unemployment rates

	ALL	NMS	EU15	Cluster 1	Cluster 2	Cluster 3	Cluster 4	Cluster 5
				Dependent variable: Female unemployment rate				
Ln(low education share)	0.089	0.289	−0.025	−1.002	−0.077	0.472	0.351**	−0.662*
	(0.116)	(0.212)	(0.158)	(0.589)	(0.121)	(0.305)	(0.170)	(0.385)
Ln(high education share)	−0.037	−0.392	0.050	−3.007*	0.357	−0.047	−0.572**	−0.624
	(0.176)	(0.376)	(0.202)	(1.520)	(0.285)	(0.361)	(0.226)	(0.456)
Ln(share of population above 25)	−2.943**	−4.077	−4.626***	−5.476	−1.331	−1.004	−1.452	0.498
	(1.193)	(2.693)	(1.332)	(5.694)	(2.388)	(2.346)	(1.514)	(3.172)
Ln(agricultural employment share)	−0.097	−0.086	−0.056	−0.436	−0.236***	0.005	−0.042	−0.039
	(0.052)	(0.104)	(0.058)	(0.239)	(0.064)	(0.065)	(0.052)	(0.068)
Ln(other service employment share)	0.264	0.431	0.317	0.907	0.927**	0.351	0.185	−0.675
	(0.200)	(0.581)	(0.222)	(1.024)	(0.362)	(0.297)	(0.227)	(0.631)
Ln(construction employment share)	0.317***	0.374	0.367**	−0.064	0.334**	−0.211	0.215	0.487*
	(0.120)	(0.245)	(0.152)	(0.397)	(0.155)	(0.258)	(0.205)	(0.240)
Ln(trade & restaurants employment share)	0.125	0.324	0.192	0.122	0.398	0.114	0.242	−0.530
	(0.185)	(0.422)	(0.200)	(0.825)	(0.374)	(0.266)	(0.219)	(0.405)
Ln(financial & real est. employment share)	0.127	−0.002	0.259	0.626	−0.601***	0.253	0.115	0.302
	(0.132)	(0.209)	(0.157)	(0.469)	(0.205)	(0.232)	(0.211)	(0.193)
Ln(employment growth)	0.011	1.046	−0.080	−1.183	−0.174	0.484	−1.208	−0.211
	(0.457)	(0.966)	(0.570)	(3.783)	(0.603)	(0.695)	(0.883)	(1.219)
Ln(structural change)	−0.018	0.090	−0.018	−0.243*	−0.014	0.030	−0.024	−0.046
	(0.033)	(0.063)	(0.040)	(0.121)	(0.049)	(0.095)	(0.037)	(0.101)
Ln(productivity)	−0.150	−0.580	−0.286	−0.424	0.299	−0.698	−0.273	−2.161***
	(0.315)	(1.079)	(0.343)	(0.631)	(0.523)	(0.740)	(0.306)	(0.667)
Ln(wages)	−0.237	0.446	0.073	0.017	−0.347	0.228	0.304	2.425***
	(0.355)	(1.199)	(0.433)	(0.901)	(0.571)	(0.719)	(0.482)	(0.546)

(*Continued*)

Table 5.A2 (Continued)

	ALL	**NMS**	**EU15**	**Cluster 1**	**Cluster 2**	**Cluster 3**	**Cluster 4**	**Cluster 5**
Ln(long-term	0.764***	0.716**	0.704***	0.548	0.498*	0.631***	0.471***	0.240
unemployment share	(0.142)	(0.324)	(0.144)	(0.348)	(0.269)	(0.206)	(0.108)	(0.196)
Ln(aggregate	−1.375***	−2.411**	−1.548**	0.470	1.766**	−1.716	−2.036***	−1.286
participation rate)	(0.511)	(1.007)	(0.600)	(2.480)	(0.741)	(1.073)	(0.469)	(0.862)
No. observations	257	55	202	25	60	65	48	59
R2	0.85	0.93	0.84	0.88	0.92	0.79	0.940	0.860
			Dependent variable: male unemployment rate					
Ln(low education	0.103	0.281	−0.092	−0.097	0.0696	0.692**	0.4873	−1.14***
share)	(0.12)	(0.206)	(0.145)	(0.7305)	(0.120)	(0.310)	(0.409)	(0.331)
Ln(high education	−0.09	−0.186	−0.127	−1.473	0.626*	−0.077	−0.973***	−0.758*
share)	(0.188)	(0.325)	(0.22)	(1.8398)	(0.330)	(0.358)	(0.392)	(0.391)
Ln(share of	−3.043***	−5.151	−4.583***	−3.026	−3.038	0.650	2.236	−2.973
population above 25)	(1.406)	(2.701)	(1.578)	(9.9209)	(1.920)	(2.198)	(3.233)	(2.351)
Ln(agricultural	−0.159***	−0.173*	−0.100*	−0.42	−0.290***	−0.072	−0.047	−0.147***
employment share)	(0.048)	(0.098)	(0.051)	(0.2818)	(0.060)	(0.080)	(0.105)	(0.046)
Ln(other service	0.515**	1.459**	0.534**	1.1501	1.150***	0.4442	0.295	−0.449
employment share)	(0.237)	(0.538)	(0.257)	(1.2499)	(0.385)	(0.278)	(0.399)	(0.465)
Ln(construction	0.245**	0.420*	0.375***	−0.127	0.176	−0.412*	0.286	0.4265**
employment share)	(0.119)	(0.238)	(0.151)	(0.4323)	(0.140)	(0.2374)	(0.351)	(0.180)
Ln(trade & restaurants	0.127	−0.189	0.297	−0.151	0.2771	−0.057	0.189	−0.637*
employment share)	(0.227)	(0.462)	(0.266)	(1.2555)	(0.373)	(0.262)	(0.437)	(0.320)
Ln(financial & real est.	0.124	−0.116	0.312***	0.7289	−0.519**	0.1982	0.365	0.044
employment share)	(0.129)	(0.193)	(0.155)	(0.6863)	(0.222)	(0.228)	(0.382)	(0.185)
Ln(employment	−0.544	1.172	−0.793	−2.695	0.444	−0.052	−1.523	1.088
growth)	(0.492)	(1.111)	(0.557)	(4.472)	(0.7119)	(0.703)	(1.507)	(0.842)

Ln(structural change)	−0.057	0.103	−0.065	−0.076	0.017	0.0307	−0.136*	−0.082
	(0.038)	(0.072)	(0.042)	(0.155)	(0.040)	(0.095)	(0.071)	(0.077)
Ln(productivity)	−0.009	0.271	−0.206	0.103	0.471	−0.867	−0.374	−0.963
	(0.333)	(0.825)	(0.371)	(0.990)	(0.456)	(0.681)	(0.575)	(0.656)
Ln(wages)	−0.433	−0.675	0.073	−0.443	−0.698	0.507	0.515	1.090*
	(0.382)	(1.003)	(0.446)	(1.239)	(0.430)	(0.819)	(0.979)	(0.602)
Ln(long term	0.905***	1.055***	0.858***	0.3161	0.658***	0.525**	0.510**	0.552***
unemployment share	(0.136)	(0.311)	(0.135)	(0.524)	(0.233)	(0.221)	(0.208)	(0.138)
Ln(aggregate	−1.012*	−1.174	−1.324***	−1.632	0.853	−1.158	−0.938	−1.046
participation rate)	(0.549)	(1.025)	(0.625)	(2.730)	(0.735)	(1.026)	(0.994)	(0.747)
	257	55	202	25	60	65	48	59
No. observations								
R2	0.81	0.93	0.78	0.92	0.87	0.91	0.73	0.88

Source: Eurostat, own calculations, dependent variable: ln(unemployment rate), values in brackets are heteroskedasticity robust standard errors, *** (**) (*) signify significance at the 1 (5) (10)% level respectively, bold figures report a significant (at the 5% level) difference of coefficient estimates between the NMS12 and the EU15, regression includes country dummies, which are not reported.

Table 5.A3 Regression results for regional employment rates of youths and older

	ALL	NMS	EU15	Cluster 1	Cluster 2	Cluster 3	Cluster 4	Cluster 5
	Dependent Variable: Employment rate of the 15–24 year olds							
Ln(low education share)	−0.192***	−0.229***	−0.181***	0.222	−0.153***	−0.197	−0.158	−0.093
	(0.037)	(0.070)	(0.046)	(0.152)	(0.043)	(0.133)	(0.196)	(0.126)
Ln(high education share)	−0.262***	−0.313***	−0.268***	0.555	−0.177	−0.323*	−0.166	−0.143
	(0.063)	(0.131)	(0.078)	(0.445)	(0.106)	(0.182)	(0.148)	(0.126)
Ln(share of population above 25)	−1.180***	−0.077	−0.852	2.712	−2.685***	−0.527	−4.844***	−1.102
	(0.557)	(1.161)	(0.675)	(1.666)	(0.857)	(1.287)	(1.552)	(0.836)
Ln(agricultural employment share)	0.028*	0.117***	0.005	0.085	0.069***	0.017	−0.038	0.053***
	(0.016)	(0.033)	(0.017)	(0.063)	(0.022)	(0.033)	(0.030)	(0.016)
Ln(other service employment share)	−0.243***	−0.150	−0.285***	−0.409	−0.336**	−0.454***	−0.218	−0.003
	(0.064)	(0.269)	(0.068)	(0.275)	(0.148)	(0.151)	(0.174)	(0.141)
Ln(construction employment share)	−0.009	−0.090	−0.035	−0.006	−0.067	0.179	−0.351**	0.044
	(0.050)	(0.121)	(0.060)	(0.117)	(0.089)	(0.123)	(0.136)	(0.066)
Ln(trade & restaurants employment share)	0.075	0.253	0.016	−0.247	0.054	0.141	0.098	0.238
	(0.077)	(0.163)	(0.086)	(0.224)	(0.193)	(0.172)	(0.208)	(0.090)
Ln(financial & real est. employment share)	−0.011	0.101	−0.079	−0.315*	0.287**	−0.091	−0.057	0.025
	(0.043)	(0.089)	(0.049)	(0.146)	(0.118)	(0.107)	(0.172)	(0.045)
Ln(employment growth)	−0.055	**−0.808**	0.149	0.541	−0.402	0.057	0.534	−0.281
	(0.171)	(0.489)	(0.193)	(1.020)	(0.271)	(0.298)	(0.511)	(0.309)
Ln(structural change)	0.009	−0.002	0.000	0.019	0.016	0.005	0.067	−0.046**
	(0.016)	(0.027)	(0.019)	(0.038)	(0.024)	(0.039)	(0.037)	(0.022)
Ln(productivity)	0.125	0.345	0.167	0.071	0.070	0.142	0.280	−0.066
	(0.107)	(0.542)	(0.113)	(0.185)	(0.292)	(0.380)	(0.239)	(0.169)
Ln(wages)	0.015	−0.162	−0.098	−0.004	−0.144	0.206	−0.181	0.003
	(0.132)	(0.578)	(0.151)	(0.315)	(0.297)	(0.424)	(0.442)	(0.159)

Ln(long-term	−0.210***	−0.204*	−0.210***	−0.164	−0.190*	−0.172*	−0.173*	−0.133***
unemployment share	(0.039)	(0.116)	(0.042)	(0.081)	(0.096)	(0.086)	(0.096)	(0.044)
Ln(aggregate	0.946***	1.457***	0.921***	0.688	0.210	0.278	0.300	0.872***
participation rate)	(0.155)	(0.432)	(0.184)	(0.718)	(0.284)	(0.494)	(0.637)	(0.228)
No. observations	257	55	202	25	60	65	48	59
R2	0.95	0.93	0.94	0.98	0.97	0.91	0.96	0.97
Dependent Variable: Employment rate of the 55–64 year old								
Ln(low education	0.273***	0.178	0.290***	0.054	0.198***	0.364*	−0.086	0.357**
share)	(0.041)	(0.122)	(0.050)	(0.188)	(0.064)	(0.182)	(0.133)	(0.133)
Ln(high education	0.379***	0.250	0.365***	−0.388	0.470***	0.618***	0.042	0.173
share)	(0.077)	(0.175)	(0.081)	(0.556)	(0.102)	(0.214)	(0.187)	(0.131)
Ln(share of	−1.045*	**−3.267**	0.188	−0.679	−0.368	−2.698**	1.429	0.363
population above 25)	(0.571)	(1.720)	(0.602)	(1.861)	(1.242)	(1.087)	(1.050)	(0.978)
Ln(agricultural	0.049***	0.066	0.035**	−0.043	0.127***	0.049	0.070**	0.009
employment share)	(0.016)	(0.057)	(0.015)	(0.071)	(0.027)	(0.042)	(0.034)	(0.019)
Ln(other service	−0.005	−0.074	−0.008	0.516	−0.463***	0.347**	0.050	0.077
employment share)	(0.082)	(0.350)	(0.081)	(0.370)	(0.161)	(0.144)	(0.187)	(0.146)
Ln(construction	−0.100**	−0.265	−0.073	−0.055	−0.033	−0.161	−0.012	−0.111
employment share)	(0.050)	(0.155)	(0.050)	(0.160)	(0.082)	(0.092)	(0.153)	(0.070)
Ln(trade & restaurants	0.000	−0.210	0.085	0.235	−0.253	0.060	−0.173	−0.065
employment share)	(0.080)	(0.249)	(0.074)	(0.222)	(0.212)	(0.146)	(0.143)	(0.121)
Ln(financial & real est.	0.048	0.040	0.009	0.014	−0.058	−0.009	−0.022	−0.003
employment share)	(0.050)	(0.120)	(0.052)	(0.181)	(0.108)	(0.101)	(0.150)	(0.059)
Ln(employment	−0.295	0.308	−0.366	−2.524	−0.168	0.098	−0.525	−0.647
growth)	(0.195)	(0.453)	(0.209)	(1.448)	(0.283)	(0.378)	(0.566)	(0.408)

(Continued)

Table 5.A3 (Continued)

	ALL	NMS	EU15	Cluster 1	Cluster 2	Cluster 3	Cluster 4	Cluster 5
Ln(structural change)	0.017	–0.041	0.022	0.023	–0.033	–0.015	–0.029	0.048
	(0.018)	(0.038)	(0.018)	(0.048)	(0.031)	(0.042)	(0.034)	(0.034)
Ln(productivity)	0.182	0.258	0.145	0.135	0.011	0.425	0.167	0.429
	(0.123)	(0.682)	(0.102)	(0.204)	(0.284)	(0.423)	(0.204)	(0.273)
Ln(wages)	–0.176	0.051	–0.187	0.069	0.399	–0.498	–0.248	–0.423*
	(0.134)	(0.773)	(0.114)	(0.388)	(0.298)	(0.413)	(0.351)	(0.247)
Ln(long-term	–0.062	–0.157	–0.060	–0.019	–0.138	0.030	–0.155*	–0.135**
unemployment share	(0.043)	(0.215)	(0.040)	(0.084)	(0.146)	(0.094)	(0.078)	(0.057)
Ln(aggregate	1.027***	1.754***	0.924***	2.431	0.611**	1.082**	1.050**	1.301***
participation rate)	(0.170)	(0.614)	(0.177)	(1.066)	(0.272)	(0.500)	(0.454)	(0.254)
No. observations	257	55	202	25	60	65	48	59
R2	0.89	0.93	0.89	0.98	0.93	0.92	0.84	0.92

Source: Eurostat, own calculations, dependent variable: ln(employment rate), values in brackets are heteroskedasticity robust standard errors, *** (**) (*) signify significance at the 1 (5) (10)% level respectively, bold figures report a significant (at the 5% level) difference of coefficient estimates between the NMS12 and the EU15, regression includes country dummies, which are not reported.

Table 5.A4 Regression results for regional male and female employment rates

	ALL	NMS	EU15	Cluster 1	Cluster 2	Cluster 3	Cluster 4	Cluster 5
			Dependent Variable: Female employment rate					
Ln(low education share)	−0.108***	−0.076*	−0.117***	0.020	−0.024	−0.091**	−0.206***	−0.050
	(0.021)	(0.039)	(0.029)	(0.034)	(0.023)	(0.035)	(0.071)	(0.059)
Ln(high education share)	0.088***	**0.020**	0.134***	0.072	−0.013	−0.011	−0.028	0.045
	(0.032)	(0.057)	(0.037)	(0.108)	(0.057)	(0.049)	(0.076)	(0.055)
Ln(share of population above 25)	0.917***	0.269	1.272	0.919	−0.045	0.337	1.446	−0.658
	(0.259)	(0.529)	(0.278)	(0.500)	(0.470)	(0.359)	(0.514)	(0.376)
Ln(agricultural employment share)	0.004	0.016	−0.003	0.033	0.039	0.003	0.016	−0.002
	(0.008)	(0.020)	(0.009)	(0.013)	(0.012)	(0.010)	(0.015)	(0.008)
Ln(other service employment share)	−0.017	−0.069	−0.037	0.002	−0.132*	−0.009	−0.022	0.093
	(0.031)	(0.120)	(0.032)	(0.056)	(0.067)	(0.041)	(0.073)	(0.070)
Ln(construction employment share)	−0.102***	−0.152***	−0.094***	−0.008	−0.093***	0.006	−0.069	−0.096***
	(0.021)	(0.047)	(0.026)	(0.028)	(0.031)	(0.033)	(0.054)	(0.034)
Ln(trade & restaurants employment share)	−0.045	−0.031	−0.046	−0.062	−0.087	−0.021	−0.052	0.036
	(0.032)	(0.073)	(0.033)	(0.049)	(0.078)	(0.034)	(0.052)	(0.053)
Ln(financial & real est. employment share)	−0.017	0.033	−0.039	−0.021	0.111	−0.021	−0.033	−0.027
	(0.022)	(0.036)	(0.026)	(0.028)	(0.041)	(0.031)	(0.057)	(0.022)
Ln(employment growth)	0.050	0.006	0.076	−0.037	0.140	0.013	0.377	0.037
	(0.099)	(0.170)	(0.116)	(0.181)	(0.130)	(0.117)	(0.243)	(0.141)
Ln(structural change)	0.004	−0.004	0.000	0.009	0.005	−0.001	−0.012	0.006
	(0.006)	(0.013)	(0.006)	(0.007)	(0.013)	(0.010)	(0.010)	(0.011)
Ln(productivity)	−0.002	−0.133	0.033	0.065	0.028	0.014	−0.048	0.158*
	(0.053)	(0.144)	(0.059)	(0.033)	(0.110)	(0.090)	(0.087)	(0.085)
Ln(wages)	0.004	0.106	−0.034	0.005	−0.073	0.006	−0.061	−0.203**
	(0.058)	(0.170)	(0.069)	(0.064)	(0.115)	(0.081)	(0.127)	(0.081)

(Continued)

Table 5.A4 (Continued)

	ALL	NMS	EU15	Cluster 1	Cluster 2	Cluster 3	Cluster 4	Cluster 5
	Dependent Variable: Female employment rate							
Ln(long-term	−0.072***	−0.079	−0.059***	−0.053	−0.002	−0.027	−0.055	0.001
unemployment share	(0.019)	(0.061)	(0.019)	(0.020)	(0.051)	(0.027)	(0.038)	(0.022)
Ln(aggregate	1.522***	1.378***	1.524***	1.260***	0.831***	1.404**	1.894***	1.349***
participation rate)	(0.090)	(0.208)	(0.100)	(0.166)	(0.137)	(0.149)	(0.201)	(0.104)
No. observations	257	55	202	25	60	65	48	59
R2	0.96	0.96	0.97	0.98	0.94	0.97	0.98	0.98
	Dependent Variable: Male employment rate							
Ln(low education	−0.068***	**−0.002**	−0.106***	0.037	0.011	−0.006	0.035	−0.149***
share)	(0.017)	(0.026)	(0.022)	(0.056)	(0.021)	(0.030)	(0.047)	(0.036)
Ln(high education	0.053**	0.001	0.072***	0.192	−0.104	0.046	0.142***	0.107***
share)	(0.023)	(0.043)	(0.028)	(0.160)	(0.064)	(0.029)	(0.047)	(0.031)
Ln(share of	−0.060	**0.881*** **	0.016	−0.286	0.792	−0.302	−0.794	0.535**
population above 25)	(0.184)	(0.312)	(0.204)	(0.793)	(0.452)	(0.179)	(0.309)	(0.203)
Ln(agricultural	0.015**	**0.036*** **	0.005	0.015	0.048***	0.001	−0.007	0.008**
employment share)	(0.006)	(0.011)	(0.007)	(0.022)	(0.011)	(0.008)	(0.011)	(0.004)
Ln(other service	−0.085***	**−0.279*** **	−0.070	−0.094	−0.251***	−0.069**	−0.053	0.009
employment share)	(0.032)	(0.060)	(0.036)	(0.113)	(0.076)	(0.028)	(0.045)	(0.029)
Ln(construction	0.000	−0.014	−0.027	0.010	−0.009	0.031	−0.002	0.028
employment share)	(0.014)	(0.026)	(0.018)	(0.041)	(0.026)	(0.019)	(0.036)	(0.019)
Ln(trade & restaurants	−0.007	0.042	−0.035	0.042	−0.042	0.002	0.010	0.038
employment share)	(0.024)	(0.057)	(0.026)	(0.104)	(0.081)	(0.025)	(0.045)	(0.023)
Ln(financial & real est.	0.012	**0.046* **	−0.011	−0.057	0.064	−0.009	−0.005	0.005
employment share)	(0.015)	(0.023)	(0.017)	(0.067)	(0.046)	(0.019)	(0.034)	(0.012)
Ln(employment	−0.004	−0.176	−0.018	0.095	−0.201	0.003	0.027	−0.138*
growth)	(0.063)	(0.209)	(0.062)	(0.363)	(0.152)	(0.082)	(0.147)	(0.080)

Ln(structural change)	0.008*	−0.009	0.010**	0.007	−0.002	−0.002	0.022***	0.004
	(0.004)	(0.007)	(0.004)	(0.014)	(0.008)	(0.009)	(0.006)	(0.006)
Ln(productivity)	0.021	−0.135	0.056	−0.058	−0.139	0.075	0.079	0.055
	(0.039)	(0.089)	(0.042)	(0.071)	(0.113)	(0.057)	(0.067)	(0.048)
Ln(wages)	0.043	**0.225*****	−0.046	0.007	0.228**	−0.063	−0.079	−0.044
	(0.043)	(0.102)	(0.047)	(0.102)	(0.105)	(0.068)	(0.104)	(0.050)
Ln(long-term	−0.074***	**−0.127*****	−0.069***	−0.006	−0.161***	−0.053**	−0.039	−0.037***
unemployment share)	(0.016)	(0.031)	(0.016)	(0.039)	(0.043)	(0.024)	(0.024)	(0.011)
Ln(aggregate	0.728***	0.783***	0.786***	0.852***	0.705***	0.740***	0.690***	0.888***
participation rate)	(0.073)	(0.109)	(0.080)	(0.253)	(0.153)	(0.106)	(0.133)	(0.051)
No. observations	257	55	202	25	60	65	48	59
R2	0.92	0.97	0.91	0.98	0.89	0.97	0.96	0.98

Source: Eurostat, own calculations, dependent variable: ln(employment rate), values in brackets are heteroskedasticity robust standard errors, *** (**) (*) signify significance at the 1 (5) (10)% level respectively, bold figures report a significant (at the 5% level) difference of coefficient estimates between the NMS12 and the EU15, regression includes country dummies, which are not reported.

6
Regional Development Effects of Foreign Direct Investment in Central and Eastern Europe

Petr Pavlínek

6.1 Introduction

Following the disintegration of the state socialist political economic system in Central and Eastern Europe (CEE) in the late 1980s and early 1990s, the region was gradually and selectively reintegrated into the periphery of the European economy. This reintegration first took the form of trade, which was liberalized and quickly redirected from the predominantly intra-Council for Mutual Economic Assistance (CMEA) trade to East–West trade. Gradually, CEE was also integrated selectively into the European production and producer services networks. This process was spearheaded by transnational corporations (TNCs) that quickly recognized two basic potential advantages of investing and producing in CEE: its substantial market potential (more than 330 million consumers) and its low production costs. In particular, CEE has a low-cost (given its productivity level), but also relatively skilled and educated labour force, which could be employed in export-oriented manufacturing to supply the Western European markets, in addition to supplying the domestic markets in CEE. In the 2000s, these two advantages were supplemented by the third major advantage in the form of the European Union (EU) membership which was extended to Central and Baltic Europe in 2004 and to Romania and Bulgaria in 2007. Furthermore, CEE has benefited from its geographical proximity to Western European markets which results in low transportation costs of delivering goods to the Western European markets and of supplying CEE manufacturing operations with materials and components from Western Europe (WE). Geographical proximity also increases the ability of CEE-based manufacturers to react quickly to changes in demand in WE as it shortens the time between orders and the delivery of final products to WE. Not surprisingly, since 1990 CEE countries have invested heavily in improving transportation links – especially highway and railway links – with WE.

At the beginning of the economic transformation of CEE, economists and politicians stressed the importance of large FDI inflows for its success, for the future successful economic development of CEE, and for the integration of CEE into the European and global economy (Dunning, 1993a; EBRD, 1993; Papp, 1996; Gorzelak, 1996; Benáček and Zemplinerová, 1997; Michalak, 1993; Csáki, 1995; Ozawa, 2000; Lankes and Stern, 1997). TNCs invested US$477 billion in CEE between 1990 and 2006 (UNCTAD, 2007), and, as a result, FDI has certainly played an important role in the economic transformation of the region. In particular, its effects were most profound at the company and enterprise level. FDI has resulted typically in the rapid and profound restructuring of foreign invested enterprises (FIEs – joint ventures and foreign-owned companies), including, among others, organizational restructuring, technology transfer, worker training, the transfer of western management structures and practices, and new production strategies and organization. It is also usually the case that such an influx of production capital and the transfers of western factory regimes and technology will result in rapid increases in the quality and competitiveness of produced goods, improvements in productivity and an expansion of production and sales by FIEs, both domestically and abroad (for example, Estrin *et al.*, 2000, 1997; Dyker, 1999, 2001; Bell, 1997; Sharp and Barz, 1997; Hunya, 2000a, 2000b; Zloch-Christy, 1995; Hamar, 1999; Pavlínek, 2002a).

The objective of this chapter is to examine the effects of FDI on local and regional development in CEE and is organized in three sections. The second part of the chapter concentrates on the geographical unevenness of FDI in CEE at the national and subnational levels, respectively, which has important implications for regional development. It also offers a brief discussion of the uneven distribution of FDI across different economic sectors. The third part considers the regional and local development effects of FDI in CEE. The fourth part employs a 'global production networks' (GPN) perspective to regional development to suggest how CEE regions and localities can succeed in an increasingly globalized economy. Basic findings are summarized in the Conclusion.

6.2 The uneven nature of FDI in CEE

FDI in general is typified by spatial concentration and uneven distribution at all levels: from the global level through international and the

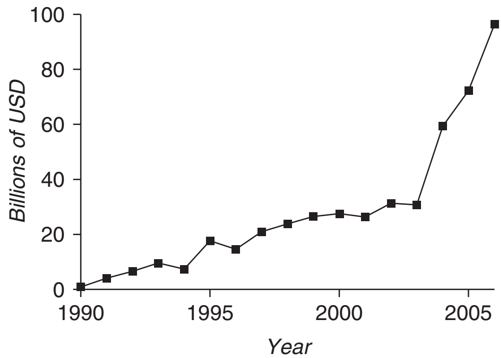


Figure 6.1 Annual FDI inflows to CEE, 1990–2006
Source: Calculated from data published in UNCTAD (2007).

national to the subnational scale (for example, UNCTAD 2007). It should not be surprising, therefore, that one of the basic traits of FDI in CEE is its spatial unevenness at various scales. FDI inflows, outflows and stocks are highly uneven at the European scale; they are uneven at the national scale within CEE; and they are uneven at subnational scales of the individual CEE countries. FDI inflows to CEE have increased dramatically, especially since 2004. However, the total of US$477 billion of inward FDI inflows attracted to CEE between 1990 and 2006 (Figure 6.1) still represents only 9.9 per cent of total inward FDI inflows invested in Europe as a whole during this period, although CEE accounts for 45.3 per cent of Europe's population. Thus, despite an increase in annual FDI inflows to CEE (Figure 6.1) and the rising share of CEE on annual inward FDI to Europe as a whole (Figure 6.2), the overall inward FDI in CEE has been low in the European context. Consequently, one would expect weaker local and regional development effects of FDI in CEE compared with WE. However, because of the lower level of economic development and the smaller size of CEE economies compared to WE economies, the overall relative importance of FDI for CEE economies is much greater than would be suggested by the total FDI inflows. One way to look at the relative importance of FDI for host economies is to measure inward FDI stock as a percentage of the gross domestic product (GDP) of a host country, region or economy. In 2006, inward FDI stock as a percentage of GDP for CEE as a whole reached 31 per cent – compared with 38 per cent for Europe as a whole and 38 per cent for the EU25.

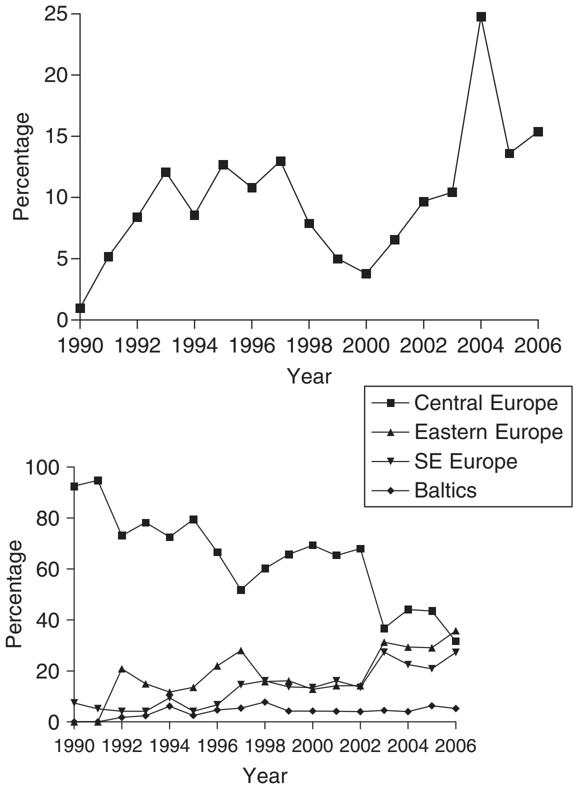


Figure 6.2 The share of annual FDI inflows to CEE on the the total FDI inflows to Europe between 1990 and 2006 (top) and the share of CEE regions on total annual FDI inflows to CEE, 1990–2006
Source: Calculated from data published in UNCTAD (2007).

6.2.1 Uneven distribution of FDI at the national scale in CEE

The distribution of annual FDI inflows within the CEE countries has been very uneven (Table 6.1, Figure 6.2). Although annual FDI inflows fluctuate significantly, it is possible to recognize long-term trends at the level of the individual international regions within CEE. Between 1990 and 2002, Central Europe (Czechia, Hungary, Poland, Slovakia and Slovenia) dominated FDI inflows into CEE, receiving two-thirds (67.4 per cent) of the total. Central Europe benefited from its relatively close proximity to WE, its much lower wages compared to WE, its relatively high level of political stability, and also its anticipated membership of the EU.

Table 6.1 The percentage share of individual regions on annual FDI inflows to CEE, 1990–2006

	Central Europe	Eastern Europe	SE Europe	Baltics	Total
1990	92.5	0.0	7.5	0.0	100.0
1991	94.8	0.0	5.2	0.0	100.0
1992	73.1	20.9	4.2	1.8	100.0
1993	78.3	15.0	4.2	2.5	100.0
1994	72.6	11.7	9.5	6.2	100.0
1995	79.5	13.7	4.2	2.6	100.0
1996	66.6	22.0	6.7	4.7	100.0
1997	51.9	28.1	14.6	5.4	100.0
1998	60.2	15.9	16.2	7.8	100.0
1999	65.7	16.2	13.8	4.3	100.0
2000	69.4	12.9	13.4	4.3	100.0
2001	65.4	14.2	16.2	4.2	100.0
2002	68.1	14.3	13.6	4.0	100.0
2003	36.8	31.3	27.4	4.6	100.0
2004	44.1	29.4	22.5	4.0	100.0
2005	43.5	29.1	20.9	6.4	100.0
2006	31.6	35.8	27.3	5.3	100.0
1990–2006	51.7	24.7	18.8	4.9	100.0

Source: Calculated from data in UNCTAD (2007).

However, its share of the annual FDI inflows to CEE dropped after 2002 by almost 30 per cent to 38.4 per cent of the total between 2002 and 2006 as the share of both Eastern Europe (Belarus, Moldova, Ukraine and Russia) and South-Eastern Europe (Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania, Macedonia, Serbia and Montenegro) increased. In the case of Eastern Europe, the economic recovery in Russia and Ukraine resulted in the increased annual FDI inflows, especially in the form of market-capture and resource-seeking investments. The share of Eastern Europe thus grew to more than one-third of the CEE total (35.8 per cent) by 2006. In the case of South-Eastern Europe, its increased share between 2002 and 2006 reflected the dramatically increased annual FDI inflows to Romania and Bulgaria related to their EU membership in 2007, a number of large privatizations, and low labour costs compared not only with WE, but also with Central Europe. As a result, the share of South-Eastern Europe of the total annual FDI inflows to CEE increased to more than 20 per cent between 2003 and 2006, reaching 27.3 per cent in 2006.

Overall, Central Europe had 45.4 per cent of CEE's inward FDI stock as of 2006, compared to 33.5 per cent in Eastern Europe, 16.4 per cent in South-Eastern Europe and 4.7 per cent in the Baltic states (Estonia,

Table 6.2 Regional distribution of FDI stock and FDI stock per capita in CEE in 2006

	FDI stock (US$)	**%**	**Population (millions)**	**FDI stock per capita (US$)**
Central Europe	300,615	45.4	65.9	4,562
Baltic states	31,135	4.7	7.0	4,448
South-East Europe	108,374	16.4	53.4	2,029
Eastern Europe	221,480	33.5	204.1	1,085
CEE total	661,604	100.0	330.4	2,002

Source: Calculated from data in UNCTAD (2007).

Latvia, Lithuania) (Table 6.2). When measured by FDI stock per capita as of 2006, there is a clear difference between Central Europe (US$3,602) and the Baltic states (US$3,360) on one side and South-Eastern Europe (US$1,059) and Eastern Europe (US$751) on the other, although these differences have been decreasing in line with the recent increase in FDI inflows to South-Eastern and Eastern Europe. These regional differences in total inward FDI inflows and inward FDI stocks have also been partially reflected in regional differences in the relative importance of FDI for domestic economies in different parts of CEE. However, the recent increase in FDI inflows to South-Eastern and Eastern Europe lowered the differences between these parts of CEE and Central and Baltic Europe that were pronounced in the 1990s. In 2006, inward FDI stock, as a percentage of GDP, was 43.6 per cent for Central Europe, 46.8 per cent for the Baltic states, 42.0 per cent for South-Eastern Europe and 19.8 per cent for Eastern Europe (UNCTAD, 2007).

Thus, despite the recent changes in the regional distribution of annual inward FDI inflows and the decrease in regional differences in annual FDI inflows, the distribution of FDI stock continues to be very uneven across CEE (Table 6.3) with very large differences in FDI stock per capita among the CEE countries (Table 6.4).

6.2.2 Uneven distribution of FDI at subnational scales in CEE

Tables 6.4 and 6.5 suggest substantial differences in the overall economic effects of FDI at the national scale in CEE. This unevenness in the distribution of FDI is even more pronounced at subnational levels. FDI is typically attracted to the existing economic clusters to benefit from external economies of scale such as markets, existing pools of

Table 6.3 Inward FDI stock in CEE countries, 2006

	FDI stock (US$ million)	**%**
Russia	197,682	29.8
Poland	103,616	15.6
Hungary	81,760	12.3
Czechia	77,460	11.7
Romania	41,001	6.2
Slovakia	30,327	4.6
Croatia	26,812	4.0
Ukraine	22,514	3.4
Bulgaria	20,707	3.1
Estonia	12,664	1.9
Serbia and Montenegro	11,385	1.7
Lithuania	10,939	1.6
Latvia	7,532	1.1
Slovenia	7,452	1.1
Bosnia and Herzegovina	4,748	0.7
Belarus	2,734	0.4
Macedonia	2,437	0.4
Moldova	1,284	0.2
Albania	1,284	0.2
CEE total	664,338	100.0

Source: UNCTAD (2007).

qualified labour, factors of production, suppliers, infrastructure, institutions and innovative capabilities (UNCTAD, 2001). Since more developed and more industrialized regions attracted higher volumes of FDI than less developed and less industrialized regions after 1990, FDI thus contributed to uneven development and regional polarization in CEE (for example, J. Kiss, 2001; Tomeš and Hampl, 1999; Domański, 2001a, 2001b; Pavlínek, 2004). In Central Europe, such areas are historically located in western rather than eastern regions of their respective countries. The western part of Czechia (Bohemia), northwestern Hungary, western Slovakia and lower and upper Silesia in Poland are all examples of this phenomenon. Thus, FDI contributed to the reproduction of existing regional disparities both between western and eastern regions and between metropolitan and peripheral areas of the respective CEE countries.

Historically, the largest FDI inflows in CEE have gone either to capital cities, which are usually the largest cities in their nations, or to other large urban areas, especially in service-related activities, such as banking, other financial services and trade-related services. Bratislava, Budapest,

Table 6.4 Inward FDI stock per capita in CEE countries, 2006

Estonia	9,741
Hungary	8,095
Czechia	7,520
Croatia	6,094
Slovakia	5,616
Slovenia	3,726
Latvia	3,275
Lithuania	3,217
Poland	2,720
Bulgaria	2,689
Romania	1,898
Russia	1,389
Macedonia	1,219
Bosnia and Herzegovina	1,217
Serbia and Montenegro	1,127
Ukraine	481
Albania	401
Moldova	321
Belarus	282

Source: UNCTAD (2007).

Ljubljana, Prague, Tallinn, Riga and Vilnius are all examples of capital cities that, with their surrounding regions, attracted disproportionately large volumes of FDI. For example, with 53.7 per cent of the total FDI stock in Czechia as of 31 December 2005, Prague attracted more FDI than the rest of Czechia put together. Prague, together with Central Bohemia (which surrounds Prague), accounted for 64.4 per cent of the FDI stock in Czechia (CNB, 2007) (Table 6.6). The unevenness in the FDI distribution is much greater at the district (NUTS 4) level. Prague 1, the historic district of Prague and one of its 15 administrative districts accounted for 19.5 per cent of the total FDI stock in Czechia as of 31 December 2005, which is the same share as the bottom 64 Czech districts (out of a total of 76 Czech districts and 15 subdivisions of Prague for which the FDI data are collected). This high concentration of inward FDI stock in Prague 1 could be explained by the fact that this historical and commercial centre of Prague has been the location of choice for the headquarters of banks, other financial institutions and also many other foreign-owned companies operating in Czechia. Top ten districts accounted for 57.9 per cent of the total Czech FDI stock while the bottom ten districts accounted for 0.65 per cent (Table 6.7). Interestingly, three

Table 6.5 Inward FDI stock as a percentage of gross domestic product in 2006

Estonia	77.2
Hungary	73.0
Bulgaria	65.8
Croatia	63.5
Slovakia	55.0
Czechia	54.8
Bosnia and Herzegovina	41.7
Moldova	39.6
Macedonia	39.0
Latvia	37.5
Lithuania	36.7
Romania	33.6
Serbia and Montenegro	32.0
Poland	30.6
Ukraine	21.1
Russia	20.2
Slovenia	20.0
Albania	14.6
Belarus	7.4
CEE total	31.0

Source: UNCTAD (2007).

districts of Prague (Prague 14, 15 and 11) are listed among the bottom ten Czech districts in terms of FDI stocks. Prague 11 has the lowest FDI stock of any Czech district, suggesting an extreme degree of unevenness in the distribution of FDI stock within Prague itself. Unfortunately, the existing data do not reveal to what extent this high degree of FDI stock concentration in parts of Prague is real and to what extent it is a statistical illusion caused by the fact that FDI stock is statistically recorded according to the location of company headquarters, which might be in Prague, while its investment and economic activities are carried out elsewhere in Czechia.

A similar situation exists in other CEE countries. For example, Budapest has dominated FDI inflows to Hungary since the early 1990s. In 2006, it accounted for 59.3 per cent of the number of FIEs, 61.9 per cent of owners' equity of FIEs, and 54.2 per cent of invested FDI by FIEs. The share of Budapest with its surrounding region (Central Hungary) was higher than two-thirds of the total for Hungary in these categories (Table 6.8). Other measures of FDI, such as employment in FIEs or the total annual sales

Table 6.6 Regional distribution of FDI stock in Czechia at the NUTS 3 level as of 31 December 2005

	FDI stock (US$ billion)	**%**
Prague	32.6	53.7
Central Bohemia	6.5	10.7
Moravia-Silesia	3.6	6.0
Ústí nad Labem	2.5	4.2
South Moravia	2.4	4.0
South Bohemia	2.3	3.8
Plzeň	2.0	3.3
Liberec	1.9	3.1
Pardubice	1.5	2.4
Vysočina	1.4	2.4
Zlín	1.2	2.0
Olomouc	1.1	1.9
Hradec Králové	1.0	1.6
Karlovy Vary	0.7	1.1
Total	60.7	100.0

Source: CNB (2007).

Table 6.7 Top ten Czech districts (including Prague's districts) (NUTS 4 level) according to FDI stock and their share of Czechia as a whole as of 31 December 2005

	FDI stock (US$ billion)	**% of Czechia as a whole**
Praha 1	11.9	19.5
Praha 3	4.5	7.4
Praha 10	3.3	5.4
Mladá Boleslav	2.7	4.5
Praha 2	2.6	4.3
Praha 4	2.4	4.0
Praha 9	2.1	3.5
Praha 5	2.1	3.4
České Budějovice	1.8	2.9
Ostrava-město	1.8	2.9
Total	35.1	57.9

Source: CNB (2007).

by FIEs, suggest a similar regional distribution, although with a slightly lower degree of concentration in Budapest (Table 6.9 and 6.10).

In Slovakia at the end of 2006 the Bratislava region accounted for two-thirds of FDI stock. The Bratislava region hosted 98.6 per cent of inward

Table 6.8 Regional distribution of FDI according to the NUTS 3 regions in FIEs with at least 10 per cent of foreign ownership in Hungary as of 2006

	Number of FIEs	**%**	**Owners' equity of FIEs (bn HUF)**	**%**	**FDI by FIEs (bn HUF)**	**%**
Budapest	14,339	59.3	11,076.8	61.9	7,533.4	54.2
Pest	2,060	8.5	2,085.1	11.7	1,987.5	14.3
Fejér	366	1.5	569.3	3.2	514.3	3.7
Komárom-Esztergom	592	2.4	456.1	2.5	445.6	3.2
Veszprém	587	2.4	175.3	1.0	164.8	1.2
Györ-Moson-Sopron	1,085	4.5	1,112.8	6.2	1,084.4	7.8
Vas	667	2.8	420.3	2.3	416.2	3.0
Zala	632	2.6	62.6	0.3	54.7	0.4
Baranya	531	2.2	54.2	0.3	44.9	0.3
Somogy	427	1.8	117.0	0.7	110.4	0.8
Tolna	255	1.1	16.2	0.1	14.0	0.1
Borsod-Abaúj-Zemplén	308	1.3	366.4	2.0	260.1	1.9
Heves	207	0.9	178.2	1.0	159.2	1.1
Nógrád	108	0.4	67.6	0.4	49.8	0.4
Hajdú-Bihar	234	1.0	255.8	1.4	242.3	1.7
Jász-Nagykun-Szolnok	180	0.7	182.0	1.0	179.3	1.3
Szabolcs-Szatmár-Bereg	324	1.3	81.7	0.5	76.3	0.5
Bács-Kiskun	568	2.3	89.0	0.5	78.6	0.6
Békés	166	0.7	64.8	0.4	46.8	0.3
Csongrád	540	2.2	192.5	1.1	182.9	1.3
Other undistributable	0	0.0	265.7	1.5	265.7	1.9
Hungary total	24,176	100.0	17,889.4	100.0	13,911.2	100.0

Source: HCSO (2008), courtesy of Anna Meskó.

Table 6.9 Regional distribution of FDI according to the NUTS 2 regions in FIEs with at least 10 per cent of foreign ownership in Hungary as of 2006

Region	**Number of FIEs**	**%**	**Owners' equity of FIEs (bn HUF)**	**%**	**FDI by FIEs (bn HUF)**	**%**
Central Hungary	16,399	67.8	13,162.0	73.6	9,520.9	68.4
Central Transdanubia	1,545	6.4	1,200.8	6.7	1,124.7	8.1
Western Transdanubia	2,384	9.9	1,595.6	8.9	1,555.2	11.2
Southern Transdanubia	1,213	5.0	187.4	1.0	169.3	1.2
Northern Hungary	623	2.6	612.2	3.4	469.1	3.4
Northern Great Plain	738	3.1	519.5	2.9	497.9	3.6
Southern Great Plain	1,274	5.3	346.3	1.9	308.3	2.2
Other undistributable	0	0.0	265.7	1.5	265.7	1.9
Hungary total	24,176	100.0	17,889.5	100.0	13,911.3	100.0

Source: HCSO (2008), courtesy of Anna Meskó.

Table 6.10 Regional distribution of sales and employment of FIEs with at least 10 per cent of foreign ownership according to the NUTS 2 regions in Hungary in 2005

Region	**Sales of FIEs (bn HUF)**	**%**	**Average number of employees of FIEs**	**%**
Central Hungary	16,777,343	61.4	319,722	52.9
Central Transdanubia	3,965,101	14.5	79,495	13.2
Western Transdanubia	2,436,324	8.9	64,597	10.7
Southern Transdanubia	713,331	2.6	36,024	6.0
Northern Hungary	1,675,631	6.1	43,097	7.1
Northern Great Plain	965,489	3.5	28,794	4.8
Southern Great Plain	774,258	2.8	32,381	5.4
Hungary total	27,307,477	100.0	604,110	100.0

Source: HCSO (2008).

Table 6.11 Regional distribution of FDI stock in Slovakia as of 31 December 2006

Region	**Enterprise sector**		**Financial sector**		**Total**	
	US$ billion	**%**	**US$ billion**	**%**	**US$ billion**	**%**
Bratislava	9.8	61.7	2.5	98.6	12.3	66.8
Trnava	1.0	6.2	0.0	0.0	1.0	5.4
Trenčín	0.9	5.6	0.0	0.0	0.9	4.8
Nitra	0.7	4.3	0.0	0.0	0.7	3.7
Žilina	1.3	8.3	0.0	1.4	1.4	7.3
Banská Bystrica	0.5	3.0	0.0	0.0	0.5	2.6
Prešov	0.3	1.9	0.0	0.0	0.3	1.6
Košice	1.4	9.0	0.0	0.0	1.4	7.8
Total	15.9	100.0	2.5	100.0	18.4	100.0

Source: NBS (2007: 67).

FDI stock in the financial sector and 61.7 per cent in the enterprise sector (NBS, 2007; Table 6.11).

Of course, this disproportionate concentration of FDI inflows and stocks into capital cities and the surrounding metropolitan regions is not limited to CEE, but is widespread elsewhere in Europe and indeed throughout the world. For example, in the case of Austria, Vienna accounts for 57 per cent of the Austrian inward FDI stock, 57 per cent of all foreign affiliates and 51 per cent of the employees of all foreign affiliates in the country. Similar examples of high inward FDI concentrations in capital cities and other metropolitan areas can be found in both developed and developing countries such as France, Sweden, Japan, Thailand, Brazil and Mexico (UNCTAD, 2001: 59–64).

Although capital cities and large urban areas have been less favoured by investors in manufacturing in CEE because of their relatively high wages in comparison to the rest of the country, foreign investors still tend to favour metropolitan and already developed areas over peripheral regions for investment because of the external scale economies and the other advantages listed above (Domański, 2001a, 2001b; Pavlínek, 2004). However, this concentration of FDI in metropolitan areas has often led to labour shortages and wage increases that have driven foreign investors increasingly into more peripheral regions, especially those investing in simple labour-intensive manufacturing processes. For example, Pavlínek and Janák (2007) show, in the example of the Czech supplier network of Škoda Auto, that labour shortages and high labour costs in the metropolitan and traditional automotive manufacturing regions of Czechia have driven foreign investors to invest in the simple, labour-intensive manufacturing of automotive components in more peripheral regions that had not been historical areas for the production of automotive components. Therefore, rising wages and increasing labour shortages in metropolitan regions are likely to lead to increasing investment in peripheral regions, especially in low-skill labour-intensive manufacturing.

What all this means in terms of regional development in CEE is that there has been relatively little FDI invested in non-metropolitan, underdeveloped or peripheral regions. As mentioned above, FDI has tended to reinforce the pre-existing regional imbalances in CEE, and it has contributed to the widening gap between the more prosperous metropolitan and other historically more industrialized and developed regions on the one hand and less developed, peripheral regions that have fallen further behind during the period of post-socialist economic transformation on the other. As such, to date, FDI has generally not been an efficient vehicle for spreading economic prosperity and success to underdeveloped and peripheral regions of CEE. However, some important exceptions to this generalization do exist. CEE governments have tried to influence the location decisions of foreign investors and to attract FDI to the less developed regions or the industrial areas that experienced structural problems and manufacturing collapse after 1989. In general, the government-financed development and modernization of the infrastructure is aimed at making peripheral and lagging regions more accessible for foreign investors. Secondly, the governments are encouraging foreign investors to invest in particular areas through FDI and industrial policies in the form of regionally targeted investment incentives. Thus, the Hungarian government, for example, has attempted to attract foreign investors to southern and eastern Hungary, which attracted very low FDI inflows in the 1990s compared to central and northwestern Hungary. It is planning and financing the construction of highways that will link southern and eastern Hungary with Budapest, hoping that the increased accessibility of these regions combined with favourable labour market conditions (lower wages and higher unemployment rates) and targeted investment incentives (such as ten-year tax holidays for investments exceeding US$4.3 million as opposed to US$13 million in the rest of the country) will make them more attractive for foreign investors (Barta and Kukely, 2007). Similar governmental policies aimed at attracting FDI into lagging and/or economically depressed regions exist in other CEE countries.

6.2.3 Uneven sectoral distribution of FDI

In addition to the geographical unevenness of FDI, it is also important to consider its uneven sectoral distribution. In general, FDI in CEE has tended to concentrate on particular economic sectors, such as the passenger car industry and the electronics industry in the manufacturing sector or in banking and other financial services. These targeted sectors have undergone profound transformations triggered by large FDI inflows and the corresponding inflows of know-how and technology transfers from advanced western countries. In those cases, where the pre-existing supplier networks have been transformed through FDI and successful domestic companies have succeeded to remain part of them, the entire supplier networks have benefited from strong spillover effects (such as in the case of the Škoda supplier network in Czechia) (for example, Pavlínek, 2003). Consequently, the regions in which these networks are concentrated (such as the Mladá Boleslav cluster in Czechia) benefited from large inflows of FDI and increasing agglomeration economies, and from the spillover effects from FIEs to local domestic-owned enterprises (see Pavlínek and Janák, 2007). At the same time, however, FDI was almost non-existent in the traditional backbones of state socialist industry in the 1990s, such as the steel industry, heavy machinery industry, chemicals, coal mining, coke and refinery, that continued to employ large numbers of workers, had excess capacities, and were in dire need of extensive restructuring/modernization (Głębocki and Rogacki, 2002; Zemplinerová, 1998). The regions in which these industries are concentrated have seen little FDI and have been struggling economically. There are vast differences between a relatively small number of successful and profitable FIEs that employ a relatively small number of workers but drive countries' exports and the rest of the struggling domestic industry, which employs the vast majority of workers. The sectoral concentration of FDI has therefore contributed to the development of a 'dual economy' in CEE (see, for example, Hunya, 2000b; Hamar, 1999; Mejstřík, 1999; Kapoor, 2000; Mišun and Tomšík, 2002; Benáček, 2000; Pavlínek, 2004; Barta and Kukely, 2007).

6.3 The regional and local development effects of FDI

When considering the regional and local development effects of FDI, it is important to remember that FDI is first and foremost a profit-seeking behaviour. As such, the profit-seeking strategies of foreign investors do not necessarily have to coincide with the long-term economic interests and well-being of the particular regions and localities in which they are making their investment. The challenge of regional and local development is to design such strategies that would couple profit-seeking behaviour of foreign investors with positive regional and local development strategies and outcomes in areas in which FDI is made. Such a strategy, which can meet the needs of TNCs and, at the same time, exploit the positive regional development potential of FDI is the basis for a successful regional and local development based on or involving FDI.

The second important consideration is to recognize a great variety of different types of FDI and a large diversity of FIEs in all possible respects with various effects on individual companies, regions and national economies. It means that any overarching generalizations about FDI's regional development effects are both difficult and dangerous to make. In other words, the same volume of FDI invested in two different locations or regions may have very different impacts on their economy depending upon the number of factors, including the nature of the economic activity, its size, its employment effects (whether it is labour intensive or capital intensive), its backward and forward linkages with domestic firms, the economic sector (which largely determines the wage level) and so on.

The third important consideration, related to the previous point, is the fact that it is not only the overall volume of FDI in a country or region but also the structure of that investment that determine its overall economic effects.

Fourthly, it is important to recognize the differences between the immediate or short-term regional economic effects of FDI and its potential long-term regional development effects. While the immediate positive effects of FDI may be considerable at the company level and for local economies, the long-term economic effects of FDI in the host countries are less clear. Typically, short-term positive economic effects are significant at the level of enterprises. In CEE, foreign acquisitions and joint ventures (JVs) with domestic companies often saved or stabilized struggling domestic enterprises. The inflow of investment capital, new technologies and foreign know-how typically improved the competitive position of FIEs, which meant stabilizing or even increasing employment. The positive employment effects are especially obvious in cases of greenfield investment. However, in many cases, foreign takeover also resulted in significant job losses and the downsizing of production as new owners or foreign partners restructured and rationalized production (for example, Smith and Ferenčíková, 1998; Hardy, 1998). Local communities may benefit from social services provided by FIEs, although the extent and nature of such services and sponsorship of local communities differ considerably from company to company (2005 interviews and field notes). Moreover, the creation of new jobs in greenfield factories may have negative consequences for the existing local companies by attracting their skilled and semi-skilled workers. These workers may have been trained by local enterprises. It has been argued that FDI may suppress or even destroy those local firms that are unable to compete with economically strong FIEs supported by government investment incentives. It may also suppress the development of new indigenous enterprises (Foley *et al.*, 1996; Dicken, 2003; Hardy, 1998). Long-term regional development effects of FDI depend upon a number of factors, including the stability of FDI, type of jobs created by FIEs, the extent of backward and forward linkages with domestic enterprises, and the diffusion of knowledge and skills from FIEs to domestic firms. For example, there is a substantial difference between the foreign investor committed to a particular investment location and demonstrating this through the forging of strong links with domestic enterprises, educating and training its labour force and participating in local social life and activities and the investor who is a typical footloose investor in search of a low-cost location offering mainly low-skilled, low-paid assembly jobs and with absolutely no interest in engaging in long-term cooperation with regional and local institutions.

Finally, therefore, it is important to recognize that FDI can have both positive and negative regional and local development effects (Table 6.12).

Table 6.12 Potential positive and negative effects of FDI in host countries at the enterprise, local and regional scales

Potential positive effects of FDI	Potential negative effects of FDI
enterprise level: • continued and expanded production • increased labour productivity • access to investment capital • access to worldwide sale and distribution networks • transfer of western technology and know-how • improved competitiveness • increased R&D *local and regional economy:* • saving of existing jobs and creation of new jobs • increased wages • growth of real income • increased tax base • increased exports • labour training • provision of social services to local communities • spillovers to local and regional economy • increased opportunities for local companies to supply foreign-owned companies • diffusion of knowledge, new patterns of behaviour, business relationships, work organization and so on	*enterprise level:* • labour shedding • disinvestment and downsizing of production • transfer of R&D abroad *local and regional economy:* • local dependency on foreign capital • external control of local economies • attracting skilled and semi-skilled workers from local companies • suppression or destruction of local firms unable to compete with FIEs supported by generous governmental investment incentives and benefiting from transfer pricing • suppression of the development of new indigenous enterprises • deskilling • regional specialization in low-skilled labour-intensive production • development of 'dual economy' • branch plant syndrome • instability of western investment • repatriation of profits abroad

Source: Pavlínek (2004).

Thus, the goal of local and regional economic development strategies is to maximize potential positive effects of FDI while, at the same time, minimizing its potential negative effects on the local and regional economy.

There are several important areas of potential regional development effects of FDI. These include employment effects, the linkages of FIEs with local companies (mainly in the form of supply linkages), technology effects (the extent of technology transfer from FIEs to domestic firms), and industrial structure and entrepreneurship effects (the effects on the competitive position of existing domestic enterprises and on the formation of new indigenous firms) (Dicken, 2003: 280). In general, these regional and local development effects of FDI depend upon a number of factors outlined above. The first is the mode of entry (whether FDI results in the construction of a new greenfield facility, a joint venture formed with an existing domestic company or the acquisition of an existing domestic enterprise) with greenfield investments more likely resulting in the creation of new employment opportunities, adding to the host country's (region's) stock of productive capacity, and potentially creating new economic opportunities for domestic suppliers than acquisitions and joint ventures. The second is the reason for the FDI – that is, whether it is a market-seeking, resource-seeking or efficiency seeking type of investment. The third important factor concerns the operational attributes of the enterprise, such as the type of industry involved, the size (scale) of operations, the type of technology used, and the extent of the enterprise's integration into the structure of its parent company (Dicken, 2003: 278–9).

The territorial embeddedness of FIEs (the extent of linkages of FIEs with domestic companies) depends upon three interrelated factors: the particular strategy of TNC and the role of a particular FIE in that strategy; the characteristics of the host economy; and the amount of time since the investment was originally made (Dicken, 2003: 288–9). In terms of linkages between FIEs and domestic firms, more developed regions generally have a better chance of benefitting from FDI than do less developed regions because firms in more developed regions operate in more competitive and more demanding business environments. As such, they are typically better positioned to satisfy foreign investors' demands for sophistication and quality of parts they produce and are thus better positioned to secure supplier contracts with FIEs (for example Pavlínek, 2004).

What then have been the regional and local development effects of FDI in CEE, in addition to its very uneven geographical and sectoral nature? Spillover effects from foreign-owned to domestic companies are considered to be a major benefit of FDI for host economies enhancing the dynamism and competitiveness of the domestic enterprises (for example, UNCTAD, 2001: 127). However, empirical research focusing on FDI spillover effects to the domestic economy in CEE has so far found them to be weak and statistically insignificant. In the case of Czechia, for example, Jarolím (2000) rejected his hypothesis that foreign presence was having a positive effect on the productivity growth of domestically owned firms because he found FDI spillover effects to be statistically insignificant. Similarly, Djankov and Hoekman (2000) found a statistically insignificant spillover effect of FIEs on domestic industrial firms in Czechia between 1992 and 1996. The authors cite the short study period as an explananation for the lack of spillover effects and suggest that know-how spillovers require a certain minimal level of technological capacity and effort on the part of domestic firms to be absorbed. Kinoshita (2001) also found spillovers from FIEs to be insignificant for Czech manufacturing firms. The empirical research in other CEE countries yielded similar results. Konings (2000), for example, found no evidence of positive spillover effects of FDI to domestic firms in Bulgaria, Romania and Poland. He found negative spillover effects in Bulgaria and Romania, while there were no spillovers to domestic firms in Poland. One might argue that the main reason for these statistical results was the short period of time since the establishment of the vast majority of FIEs in CEE. However, these findings are less surprising when compared with the empirical studies from less developed countries such as Morocco (Haddad and Harrison, 1993) and Venezuela (Aitken and Harrison, 1999). These studies found either statistically insignificant or negative spillover effects from foreign to domestic companies in terms of the impact of FDI on the growth in productivity of domestic companies. At the very least, the empirical research does not support the overly optimistic views of FDI effects on domestic industry. At the same time, because of their dominant position in the local labour market, FIEs may have a detrimental effect on local companies by attracting their skilled and semi-skilled workers (Pavlínek, 2004: 58–9; Domański, 2003: 104).

Another important concern relates to the stability of foreign investment. Many foreign investors are 'footloose', especially in those cases in which the cost of production has been the decisive location factor and in which there are either no or very weak linkages with local firms. These investors can relocate their operations if there are better opportunities to make profits elsewhere. This is the case in particular when wages and overall production costs increase in CEE countries or when the investor is facing economic difficulties at home (Pavlínek, 1998; Nicholls *et al.*, 1998). There have already been a number of examples of TNCs moving their production away from CEE to cheaper locations following only a few years of operation (see Pavlínek, 2004: 55–6). The likelihood of foreign investors being 'tied down' to a particular location increases with the formation of strong supplier links with domestic companies and other FIEs in the region. The increased local integration of foreign investors thus tends to increase the stability of FDI and should therefore be one of the strategies encouraged by regional development policies.

6.4 FDI, globalization and regional development: a global production networks perspective

One of the most important questions in respect of FDI and regional development in CEE is therefore to understand the potential effects of FDI and economic globalization on regional economies and to be able to develop regional development strategies that would maximize the chances of a particular region benefiting from FDI and from the opportunities generated by economic globalization. In other words, the central concern of local development strategies revolves around the questions of how local companies can achieve and maintain a competitive advantage in the increasingly globalized economy; how these processes affect the quantity and quality of local jobs; and how local and regional development strategies can effectively support local enterprises in reaching and maintaining their competitive position (Palpacuer and Parisotto, 2003: 98).

The global produciton networks (GPN) perspective on regional development is a recent conceptual perspective that seems to be particularly relevant in this context (see Coe *et al.*, 2004; Henderson *et al.*, 2002; Palpacuer and Parisotto, 2003). This perspective draws on global commodity/value chains (GCCs/GVCs) approaches to economic development formulated in the 1990s (for example Gereffi, 2001, 1994) to understand the organizational structures of the production networks of TNCs and the effects of these networks on the national economic development of less developed countries. Indeed, the GCCs/GVCs approaches have been principally concerned with the implications of GCCs/GVCs for national development while largely ignoring their effects at the regional and local levels. Thus, although a 'territoriality' has been identified as one of four main dimensions of GCCs (Gereffi, 1994: 96–7), the geography of GCCs has remained underdeveloped and undertheorized in the GCCs/GVCs approaches (Dicken *et al.*, 2001: 99–100). In contrast, the GPN approach recognizes the centrality of the 'territoriality' of production networks in any analysis of regional and local development effects of GPNs (Henderson *et al.*, 2002: 446). In particular, the issues of value production, enhancement and retention, and also the relations of power within production networks have been identified as crucial issues that determine the regional development outcomes of production networks (Coe *et al.*, 2004; Henderson *et al.*, 2002; Smith *et al.*, 2002; Smith, 2003) and thus, by extension, the regional development outcomes of FDI.

According to the GNP approach, regional development requires the simultaneous presence of three preconditions (Coe *et al.*, 2004: 470–1): (1) the existence of economies of scale and scope within specific regions in the form of highly localized concentrations of specific knowledge, skills and expertise; (2) the existence of external scale economies in the form of localization economies within global production networks (such as the development and existence of a variety of different high value-added activities within a region based upon learning and cooperation within a region); and (3) the appropriate structure of regional institutions able to attract and maintain global production networks. The GPN approach argues that regional development ultimately depends upon 'the dynamic "strategic coupling" of global production networks and regional assets' and its ability to 'stimulate processes of value creation, enhancement and capture' ('value' in the sense of various forms of economic rent) (Coe *et al.*, 2004: 471). Value creation can take different forms such as value creation through the labour process, particular product or process technologies, know-how transfer and collective learning, organization attributes, trade policy and branding (ibid.: 473). Different regions may create value through different forms of economic rent. As Coe *et al.* (2004: 474) argue, the creation of value and its retention within the region is crucial for regional development. The value created in a region which is transferred out of the region in the form of profit repatriation does not contribute to the regional development potential of a particular investment.

Regional institutions can play an important role in value enhancement, which is defined as 'knowledge and technology transfer and industrial upgrading' (Coe *et al.*, 2004: 474), by, for example, investment in the development of infrastructure and in human resources. Value enhancement thus takes place through skills and technology transfer from foreign-owned to local companies. It depends to a large extent upon the formation of backward and forward linkages between foreign-owned and local companies through which the skill and technology transfer takes place. Regional institutions are equally important in ensuring value capture to benefit the region. Value capture can be achieved through the reinvestment of profits in the region where profit was created in the form of investments in local subsidiaries and/or suppliers by local firms. The foreign ownership of local companies results in their external control. Therefore, the fate of regions with high levels of FDI depends to a large extent upon decisions, fortunes and misfortunes of TNCs that are based outside the region (Pavlínek, 1998, 2004). For the region and regional institutions, the challenge is to maintain the competitiveness that made the region attractive for the initial investment in the first place through bargaining with local firms to reinvest in the region in order to, for example, upgrade the local workforce. This, in turn, may benefit future development in the region by developing specific skills that could attract further investments. For example, in 1991 the initial investment by German Volkswagen in the Czech automaker Škoda saved Škoda from bankruptcy, but it did not necessarily secure its long-term development and future expansion. Škoda's successful development, especially in the second half of the 1990s and in the 2000s, was based upon much larger investment than originally planned in which the Czech government played an important role, for example, by offering additional investment incentives to Škoda to invest in Czechia rather than investing abroad (see Pavlínek, 2008 for details).

Regional development is thus driven by the 'interactive complementarity and coupling effects between localized growth factors and the strategic needs of trans-national actors' (Coe *et al.*, 2004: 474). Coe *et al.* (2004: 474) argue that 'regional assets can become an advantage for regional development *only if* they fit the strategic needs of a global production network' (emphasis in the original). Thus, the relatively skilled and cheap CEE labour force has only become an advantage for CEE in the context of its geographical proximity to WE markets and free trade within the EU and the opportunities this situation has created for TNCs to reduce production costs and remain competitive (or gain a competitive advantage) in the WE market. The regional (and local) arms of state institutions play an important role in enhancing and exploiting this complementarity and coupling effects because they promote regional advantages (assets) (such as the promotion of the regional advantage embodied in skilled and educated labour force through high-quality training and education system which then attracts the location of value-added activities or the promotion of start-ups and supplier networks and so on). The role of the state is also important in regulating labour and labour organizations. Possibilities to employ flexible labour strategies and 'lean' production methods by foreign TNCs, that would often be impossible to adopt in WE because of union resistance or existing labour legislation, played an important role in the investment decisions and the development of the passenger car industry in CEE in the 1990s (see Pavlínek, 2002b for details). The cooperation between state institutions and labour organizations in increasing the level of labour skills and the flexibility of local labour markets increases the attractiveness of the region to foreign investors. Adversarial relationships between the state and labour may therefore work against the interest of the regional economy by decreasing the attractiveness of the region to TNCs (Coe *et al.*, 2004, p. 472).

What does it all mean? As suggested above, the regional economic effects of FDI depend upon a variety of issues. In order for regional development to be successful, the basic role of regional institutions (including the regional and local arms of state institutions) is to promote local and regional assets and advantages in order to attract value-added activities to the region. These regional assets become relevant only if they fit the strategic needs of TNCs that want to exploit these region-specific assets through their investments in the region (Coe *et al.*, 2004, p. 476). Although there are different forms of economic rent, as stated above, it has been argued that, at least at the global scale, labour and its quality in terms of skills and knowledge embodied in labour has become the most important location-specific factor attracting FDI (Dicken, 2003, p. 210). The access to a high-quality (highly educated and highly skilled) labour force is a crucial factor in attracting high-value added activities, including FDI in R&D. Therefore, one of the most important strategies for countries and regions to attract high value-added activities is training the high quality and highly skilled labour force.

Many CEE countries such as Czechia and Slovakia want to reduce their reliance on the type of low-cost, low-skilled labour-intensive manufacturing that became very important in securing FDI in the second half of the 1990s and early 2000s. They want to move towards attracting a high-value added and technology-intensive style of production. However, both foreign investors and domestic firms increasingly complain about the lack of qualified workers which was perceived to be an important asset of these counties in the 1990s. Ironically, many investors have praised the state socialist system of vocational schools which produced the highly skilled labour force in these countries (2005 company interviews). However, the system of vocational training disintegrated in the early 1990s and was not adequately replaced with a new system that would fulfill the same functions. As a result, both foreign and domestic firms have increasingly found it more difficult to find qualified and skilled workers for their manufacturing operations in Czechia and Slovakia (2005 company interviews). Investors argue that the contemporary education system, with its emphasis on grammar schools, does not meet the needs of foreign investors in manufacturing. State and regional institutions therefore failed to build on the asset of skilled manufacturing labour inherited from the period of state socialism, and this inherited advantage has been gradually undermined in Czechia and Slovakia. This may force TNCs to look elsewhere for skilled manufacturing labour.

In addition to skilled labour, the key determinants of FDI location increasingly include advanced infrastructure, supply networks and support institutions and state-of-the-art logistics because TNCs are looking for investment locations that will contribute to enhance their efficiency and flexibility and thus improve their overall levels of competitiveness (UNCTAD, 2001). State and regional institutions can actively promote such regional assets in order to increase their attractiveness for high-quality FDI.

6.5 Conclusion

Despite the dramatic increase in FDI inflows to CEE since 1990, they have remained relatively low in the overall European and global context. Nevertheless, FDI has played an increasingly important role in the CEE economies, and its economic significance will certainly increase further in the future. However, FDI effects have so far been very uneven both sectorally and geographically.

Foreign investment and the foreign ownership of local companies do not automatically translate into positive long-term regional development. Among other things, the regional development effects of FDI depend upon the type of economic activities pursued by TNCs in a particular region and their value creation, enhancement and capture potential. In general, the location of high value-added activities has a much greater regional development potential than the location of low value-added activities. An educated and skilled labour force is an important region-specific asset that attracts a high value-added type of investment. Since high value-added activities are more likely to be located in metropolitan rather than peripheral regions, FDI's regional development effects tend to be stronger and more positive in regions that have already been developed. It should not be surprising therefore that FDI in CEE has contributed to the existing levels of regional inequality and polarization not only in terms of vast differences in the volume of FDI invested between metropolitan and peripheral regions, but also in terms of differences in the value creation potential of FDI between metropolitan and peripheral regions. Similarly, the degree of embeddedness of foreign companies in local and regional economies, especially in the form of backward (supplier) linkages with local domestic companies, is important for the potential of value enhancement. Foreign investors with poorly or non-existent supplier links in the region have a very low potential in value enhancement in the region, and, therefore, they have limited regional development effects. As argued above, domestic firms operating in more developed regions are generally more likely to satisfy the needs of TNCs as competent suppliers than domestic firms located in less developed regions. Thus, more developed regions are more likely to benefit from value enhancement and its positive regional development effects than peripheral regions, further contributing to uneven development and regional polarization in CEE.

Acknowledgement

This chapter was prepared with the financial support of the Research Program No. MSM 0021620831 sponsored by the Ministry of Education, Youth and Sport of the Czech Republic.

References

Aitken, B. J. and A. E. Harrison (1999) 'Do Domestic Firms Benefit from Direct Foreign Investment? Evidence from Venezuela', *American Economic Review* 89, 605–18.

Barta, G. and G. Kukely (2007) 'The Role of Foreign Direct Investments in Hungary's Regional Development', *Moravian Geographical Reports*, 15(2), 2–12.

Bell, M. (1997) 'Technology Transfer to Transition Countries: Are There Lessons from the Experience of the Post-war Industrializing Countries?', in D. A. Dyker (ed.), *The Technology of Transition: Science and Technology Policies for Transition Countries*, Budapest: Central European University Press, pp. 63–94.

Benáček, V. (2000) 'Přímé zahraniční investice v české ekonomice' (Foreign direct investment in the Czech economy), *Politická ekonomie*, 48(1), 7–24.

Benáček, V. and A. Zemplinerová (1997) 'Foreign direct investment in the Czech manufacturing sector', *Prague Economic Papers* 6, 141–55.

CNB (2007) *Přímé zahraniční investice 2005* (Foreign Direct Investment 2005), Prague: Czech National Bank.

Coe N. M., M. Hess, H. W.-C. Yeung, P. Dicken and J. Henderson (2004) "'Globalizing" Regional Development: a Global Production Networks Perspective', *Transactions of the Institute of British Geographers*, New Series 29, 468–84.

Csáki, G. (1995) 'Foreign Direct Investments in Hungary', in I. Zloch-Christy (ed.), *Privatization and Foreign Investments in Eastern Europe*, Westport, CT and London: Praeger, pp. 107–29.

Dicken, P. (2003) *Global Shift: Reshaping the Global Economic Map in the 21st Century*, 4th edn, New York and London: Guilford.

Dicken, P., P.F. Kelly, K. Olds and H.W.-C. Yeung (2001) 'Chains and Networks, Territories and Scales: Towards a Relational Framework for Analyzing the Global Economy', *Global Networks* 1, 89–112.

Djankov, S. and B. Hoekman (2000) 'Foreign Investment and Productivity Growth in Czech Enterprises', *World Bank Economic Review* 14(1), 49–64.

Domański, B. (2001a) *Kapitałzagraniczny w prezmyśle Polski: Prawidłowości rozmieszczenia, uwarunkowania i skutki* (Foreign capital in the Polish Industry: Regularities of distribution, conditions and outcomes), Kraków: Instytut Geografii i Gospodarki Przestrzennej Uniwersytetu Jagiellońskiego.
Domański, B. (2001b) 'Poland: Labour and the Relocation of Manufacturing from the EU', in G. Gradev (ed.), *CEE Countries in EU Companies' Strategies of Industrial Restructuring and Relocation*, Brussels: European Trade Union Institute, pp. 21–49.
Domański, B. (2003) 'Industrial Change and Foreign Direct Investment in the Postsocialist Economy: The Case of Poland', *European Urban and Regional Studies* 10(2), 99–118.
Dunning, J. (1993a) 'The Prospects for Foreign Direct Investment in Eastern Europe', in P. Artisien, M. Rojec and M. Svetličič (eds), *Foreign Investment in Central and Eastern Europe*, New York: St. Martin's Press, pp. 16–33.
Dyker, D. A. (1999) 'Foreign Direct Investment in Transition Countries: a Global Perspective', in D. A. Dyker (ed.), *Foreign Direct Investment and Technology Transfer in the Former Soviet Union*, Cheltenham: Edward Elgar, pp. 8–26.
Dyker, D.A. (2001) 'The Dynamic Impact on the Central-Eastern European Economies of Accession to the European Union: Social Capability and Technology Absorption', *Europe–Asia Studies* 53, 1001–21.
EBRD (1993) *EBRD Economic Review: Annual Economic Outlook*, September, London: European Bank for Reconstruction and Development.
Estrin, S., K. Hughes and S. Todd (1997) *Foreign Direct Investment in Central and Eastern Europe: Multinationals in Transition*, London and Washington: Pinter.
Estrin, S., X. Richet and J. C. Brada (eds) (2000) *Foreign Direct Investment in Central Eastern Europe: Case Studies of Firms in Transition*, Armonk, NY and London: M. E. Sharpe.
Foley, P., J. Hutchinson, B. Herban and G. Tait (1996) 'The Impact of Toyota on Derbyshire's Local Economy and Labour Market', *Tijdschrift voor Economische en Sociale Geografie* 87, 19–31.
Gereffi, G. (1994) 'The Organization of Buyer-Driven Global Commodity Chains: How U.S. Retailers Shape Overseas Production Networks', in G. Gereffi and M. Korzeniewicz (eds), *Commodity Chains and Global Capitalism*, Westport, CT: Greenwood Press, pp. 95–122.
Gereffi, G. (2001) 'Shifting Governance Structures in Global Commodity Chains, With Special Reference to the Internet', *American Behavioral Scientist* 44, 1616–37.
Głębocki, B. and H. Rogacki (2002) 'Regions of Growth and Stagnation in Poland: Changes in Agriculture, Industry and International Markets', *European Urban and Regional Studies*, 9, 53–9.
Gorzelak, G. (1996) *The Regional Dimension of Transformation in Central Europe*, London: Jessica Kingsley Publishers.
Haddad, M. and A. Harrison (1993) 'Are There Positive Spillovers from Direct Foreign Investment? Evidence from Panel Data for Morocco', *Journal of Development Economics* 42, 51–74.
Hamar, J. (1999) 'Regional Effects of FDI Inflows in Hungary', *Acta Oeconomica* 50, 169–90.
Hardy, J. (1998) 'Cathedrals in the Desert? Transnationals, Corporate Strategy and Locality in Wrocław', *Regional Studies* 32, 639–52.

HCSO (2008) *Regional Data of Enterprises with Foreign Direct Investment*, Budapest: Hungarian Central Statistical Office (courtesy of Anna Meskó).

Henderson, J., P. Dicken, M. Hess, N. Coe and H. W.-C. Yeung (2002) 'Global Production Networks and the Analysis of Economic Development', *Review of International Political Economy* 9, 436–64.

Hunya, G. (2000a) 'Central Europe Catching-up Through FDI?', in G. Hunya (ed.), *Integration Through Foreign Direct Investment: Making Central European Industries Competitive*, Cheltenham and Northampton, MA: Edward Elgar, pp. 8–27.

Hunya, G. (2000b) *International Competitiveness Impacts of FDI in CEECs,* WIIW Research Report No. 268, Vienna: The Vienna Institute for International Economic Studies.

Jarolím, M. (2000) 'Zahraniční investice a produktivita firem' (Foreign investment and productivity of firms), *Finance a úvěr* 9, 478–87.

Kapoor, M. (2000) 'Fatal Split', *Business Central Europe* 8, December.

Kinoshita, Y. (2001) *R&D and Technology Spillovers through FDI: Innovation and Absorptive Capacity*, Discussion Paper, 2775, London: Centre for Economic policy Research.

Kiss, J.P. (2001) 'Industrial Mass Production and Regional Differentiation in Hungary', *European Urban and Regional Studies* 8, 321–8.

Konings, J. (2000) *The Effects of Direct Foreign Investment on Domestic Firms: Evidence from Firm Level Panel Data in Emerging Economies*, Discussion Paper 2586, London: Centre for Economic Policy Research.

Lankes, H. P. and N. Stern (1997) *Capital Flows to Eastern Europe and the Former Soviet Union*, EBRD Working Paper No. 27, London: EBRD.

Mejstřík, M. (1999) 'The Restructuring after Privatization in the Czech Republic', *Prague Economic Papers* 8, 233–60.

Michalak, W. Z. (1993) 'Foreign Direct Investment and Joint Ventures in East-Central Europe: a Geographical Perspective', *Environment and Planning A* 25, 1573–91.

Mišun, J. and V. Tomšík (2002) 'Foreign Direct Investment in Central Europe – Does it Crowd in Domestic Investment?', *Prague Economic Papers* 11(1), 57–66.

NBS (2007) *Menový prehl'ad* (Monetary Survey), December, Bratislava: National Bank of Slovakia.

Nicholls, A., M. Kapoor and J. Cook (1998) 'Friendly Invaders', *Business Central Europe* 6(51), 43–54.

Ozawa, T. (2000) 'Foreword', in G. Hunya (ed.), *Integration Through Foreign Direct Investment: Making Central European Industries Competitive*, Cheltenham and Northampton: Edward Elgar, pp. xii–xiv.

Palpacuer, F. and A. Parisotto (2003) 'Global Production And Local Jobs: Can Global Enterprise Networks Be Used As Levers For Local Development?', *Global Networks,* 3(2), 97–120.

Papp, B. (1996) 'The Next Step', *Business Central Europe* 3(27), 35–46.

Pavlínek, P. (1998) 'Foreign Direct Investment in the Czech Republic', *The Professional Geographer* 50(1), 371–85.

Pavlínek, P. (2002a) 'The Role of Foreign Direct Investment in the Privatization and Restructuring of the Czech Motor Industry', *Post-Communist Economies*, 14(3), 360–79.

Pavlínek, P. (2002b) 'Transformation of Central and East European Passenger Car Industry: Selective Peripheral Integration through Foreign Direct Investment', *Environment and Planning A* 34(9), 1685–709.

Pavlínek, P. (2003) 'Transformation of the Czech Automotive Components Industry through Foreign Direct Investment', *Eurasian Geography and Economics* 44(3), 184–209.

Pavlínek, P. (2004) 'Regional Development Implications of Foreign Direct Investment in Central Europe', *European Urban and Regional Studies* 11(1), 47–70.

Pavlínek, P. (2008) *A Successful Transformation? Restructuring of the Czech Automobile Industry*, Heidelberg and New York: Physica-Verlag.

Pavlínek, P. and L. Janák (2007) 'Regional Restructuring of the Škoda Auto Supplier Network in the Czech Republic', *European Urban and Regional Studies* 14(2), 133–155.

Sharp, M. and M. Barz (1997) 'Multinational Companies and the Transfer of New Technological Capabilities in Central and Eastern Europe and the Former Soviet Union', in D. A. Dyker (ed.), *The Technology of Transition: Science and Technology Policies for Transition Countries*, Budapest: Central European University Press, pp. 95–125.

Smith A. (2003) 'Power Relations, Industrial Clusters, and Regional Transformations: Pan-European Integration and Outward Processing in the Slovak Clothing Industry', *Economic Geography* 79, 17–40.

Smith, A. and S. Ferenčíková (1998) 'Inward Investment, Regional Transformations and Uneven Development in Eastern and Central Europe: Enterprise Case-studies from Slovakia', *European Urban and Regional Studies* 5, 155–73.

Smith, A., A. Rainnie, M. Dunford, J. Hardy, R. Hudson and D. Sadler (2002) 'Networks of Value, Commodities and Regions: Reworking Divisions of Labour in Macro-regional Economies', *Progress in Human Geography* 26, 41–63.

Tomeš, J. and M. Hampl (1999) 'The Development of Regional Differentiation in Eastern Central European Countries During the Transformation Era', in M. Hampl et al., *Geography of Societal Transformation in the Czech Republic*, Prague: Charles University, Department of Social Geography and Regional Development, pp. 131–151.

UNCTAD (2001) *World Investment Report 2001: Promoting Linkages*, New York and Geneva: United Nations.

UNCTAD (2007) *World Investment Report 2007: Transnational Corporations, Extractive Industries and Development*, New York and Geneva: United Nations.

Zemplinerová, A. (1998) 'Impact of Foreign Direct Investment on the Restructuring and Growth in Manufacturing', *Prague Economic Papers* 7, 329–45.

Zloch-Christy, I. (ed.) (1995) *Privatization and Foreign Investments in Eastern Europe*, Westport, CT: Praeger.

This page intentionally left blank

Part II
European Integration, Regional Disparities and Developmental Strategies in New and Prospective Member States

This page intentionally left blank

7

Local Development and Local Government in Hungary: Challenges for a New Local Policy

Éva Ruttkay

Introduction

This chapter deals with current problems in Hungarian local government, which have generally been overlooked by the existing theoretical literature. These basic problems, however, result in impairments in practical terms. First of all, some basic information on the system of Hungarian local government and regional development will be given; this will be followed by an analysis of the topical issues which connect the two.

Before our discussion of the main issues, it is necessary to make some general comments in relation to several Eastern European traits, including those evident during the period of the Hungarian transition. The time range of the transition cannot by any means be regarded as historical, yet some specific correspondence can be made.

The historical framework of this transition was determined by the following:

1. In Eastern Europe, including Hungary, the increased pace of political and social changes took place in a world political order that was changing rapidly: the process took place in the course of detachment from the Soviet Union, which was becoming unstable and losing ground. The approximately 13–14 years of unstable geopolitical conditions lasted until the country joined the European Union (EU) in 2004. The act of joining the organization of the EU (and NATO) placed Hungary in a precise geopolitical situation. A single, but not underestimable burden was that at the beginning of the transition,

the presence of the Soviet army played a decisive role. It constituted a very real drawback, for while the great transitions and restructurings had already gone through in world politics, Eastern European historical experiences restrained the political elites in all respects.

2. At the beginning of the transition, the whole of the political elite was driven from office. Essentially, the political elite from the period prior to 1945 had disappeared and its descendants also became marginalized. The 'old' elite and the 'new', ambitious elite essentially emerged from the same social class and shared identical educational and socialization experiences. The prominent members of the 'old' elite had graduated from the same schools as the 'new' ones, were neighbours of one another, and, moreover, often worked in the same places. This was not a society of six levels – it was a society of, at most, two levels. The aspirations and motivations of the ambitious political elite were also evident. It was decisive that in contrast to former Hungarian historical 'traditions', there was no external 'dominant' force on which either side could have called (that is, people were not put into power by foreign governments or institutions).
3. In the way of thinking of the newly established political elite, a deep mark was made, apart from their identical education, by the quality and outcomes of their training. In Hungary, while qualifications are of a traditionally high level, because of the unusual social structure, the complete political elite did not, for example, have – and still does not have – leading personalities who have a broader historical or geographical vision.
4. In addition to the rather provincial attitude of mind and vision, the political elite's mindset was determined by the traditions of pragmatic policy carried on from 1948 – and especially 1956 – which had well-identifiable elements such as a fear of mass politics, the absolute superiority of daily short-term survival techniques, the lack of a consequent and well-grounded inner prospect, the strong habit and the functioning of centralization. All of these are showing their effects even to date. Moreover, it is assumed that it will take generations for this situation to change.
5. Civil society in Hungary is still weak and is unable to resist the centres of power. That is, although the two sides of the political elite monitor one another, there is very little independent civic control. Local policy is also in a special situation, for it is usually dependent on national policy, or an imprint of national policy, without having any 'independent' local control over national affairs.

6. One consequence of the 'peaceful' transition was that the functioning bureaucracy remained in place. The reform steps of the transition were carried out in a different attitude, but with loyalty and professionalism, and with this, transition itself became, over the course of the past few years, irreversible.

This chapter will restrict itself to a relatively narrow survey. But the margins, events and factual achievements were – and still are – affected by the all of the factors mentioned above. A brief review will be given of the two-decade evolution of Hungarian regional and settlement development, exploring its main nodes and developmental dilemmas. (See Table 7.A1.) Neither regional nor settlement development was independent from the political transition of the country: significant institutional and legal transformations are among the milestones. One further factor was the economic transition of this period, which on several occasions affected the actual development processes, the quantitative and numerable achievements. In addition to analysing the general picture and the main process-forming tendencies, several unique attributes will also be highlighted.

Subsequently, and closer to the subject of the title, it must be emphasized that the political transition had a significant effect upon the sphere of local government, and that the principal elements of the transition had been lain down at the very beginning of the reform process. The institutional formation and reformation of regional development was based on the existing administrative and political structure and did not erase it. At the same time, almost since the formation of the system, the whole of the period has been characterized by a need to rethink, to induce progress and to strive for new reforms. In practical terms, the implementation of the latter has been blocked, a development that is strengthened by the framework given by the political structure created in 1989. Namely, the characteristic of the voting system[1] is one of the most important factors concerned. Another barrier to developments in the political and administrative sphere is the so-called 'two-thirds law'[2] codified in the constitution. For example, certain laws belong to this sphere, such as the laws related to the structure of the electoral system and as a consequence, politicians have had to cooperate closely. Thus, for example, while the case of transforming the public administration is almost continuously at issue, its actual transition process advances only by small steps.

Focussing on settlement and regional development, the primary motivations of the reforms were as follows:

- Strengthening democracy (citizens' right to deliverance, etc.).
- Extending decentralization.
- Modernization (on the level of means and institutes: institutional reshaping, e-administration, etc.).
- Strengthening spatial and social cohesion (compensating among regions, decreasing differences caused by differentiation of settlements, etc.).

In respect of the issues of democracy and decentralization, the relationship between national and local policy in Hungary is still one of the least well defined. This fact entails conflicts in itself, not least because local policy independence and margins are not acknowledged, and it is rather frequent that local policy interests fall victim to national-level policy. In this chapter, we will give some viewpoints regarding the traits and situation of this relationship.

The phases and the milestones of the transition process estimated from 1989 can be grouped around the following main principles:

- Legal framework.
- Institutional restructuring.
- Economic framework.

First, and speaking in broad terms, we will highlight a number of settlement-level problems, offering a description and a brief analysis of the major developments since 1989. We will then offer a survey of the transition process of regional planning. This order is confirmed by the chronological order cited above.

I. Panorama of the transitional process of local governments in Hungary

Overview of the transition process from the point of view of local democracy

Basic information about the settlement and local government system

The Hungarian structure of settlements determines the local government structure, and is not homogeneous in relation to the number of inhabitants. In demographic terms, 1,673 settlements (that is, more than half of the total number) have populations of less than 1,000. At the same time, in Budapest and in the eight largest cities lives nearly one-third of the total population. (See Table 7.A2.)

At this point we will not offer a detailed analysis of the differences in the settlement system; however, a small remark regarding the so-called 'small settlements problem' will be made. These small settlements focus on all types of problems which are attributable to the disadvantages of social and economic transition. Older – usually retired – people, many with no schooling, constitute the great majority of the inhabitants of small settlements. Moreover, at times the majority of inhabitants of these settlements belong to the Roma/gipsy minorities. These factors jointly make the small settlement problem almost equal to the problem of poverty, lack of education, unemployment and, at times, delinquency. Generally, this problem can be more severe in the east or southeast part of the country than, for example, in Budapest, or in the west, in the Transdanubium. (See Table 7.A3.)

Almost two decades ago the system of Hungarian local authorities underwent a radical change. In 1990, in place of the former councils, new local governments were established through democratic and fair elections. The constitution of the Republic of Hungary defines the right to have a local government as a fundamental right of eligible voters collectively: 'Eligible voters of communities, cities, the capital with its districts and the counties have the right to local government. Local government refers to independent, democratic management of local affairs and the exercise of local public authority in the interests of the local population'.

In Hungary, there are the following types of local governments:

a. Settlement local governments
   - Village local governments (2,908 units)
   - City/Town local governments (217 units; 22 of them are cities with county rank)
   - Capital district local governments (23 units)
   - Capital local government (1 unit)

b. County (*megye*)/medium level/local governments (19 units)

In 1990, one of the most significant aspects of the transition was considered to be that *every settlement in the country became a unit of local government*. It was considered to be a great step forward – i.e., the reinforcement of democracy and self-government. This demand is perhaps surprising from a Western European perspective, but people wanted to get rid of forced unifications and only the principle 'every settlement has its own local government' seemed to guarantee the necessary autonomy. For this reason the number of units almost doubled in the period between 1990 and 1991. Some years later, this fact has proved a burden for the effectiveness of settlement development.

From the administrative point of view, the system is not so divided. Only relatively large settlements have an independent authority office. Smaller settlements operate common district offices which are called the 'offices of the district notary'. There are almost 500 of these offices and around 1,400 settlements are attached to them. Furthermore, the independence of these settlements is real, for every settlement has its own representative body. The Act of Local Government of these bodies is a result of local referendum. Decisions can be made, albeit with some exceptions – such as, for example, the assessment of local taxes.

The legal status and fundamental rights of village local governments and city/town local governments are substantially similar, but their tasks can differ depending upon the circumstances. As part of their duties, they must provide safe drinking water, kindergarten education, primary school instruction and education, basic health and social welfare provisions, local public road maintenance, and must also ensure the enforcement of the rights of national and ethnical minorities, and other similar social policies. The role and responsibility of cities/towns had been increased in this domain, because they have to undertake many duties – for example, secondary education or hospital provision – not only for their own habitants but also for the habitants of villages who are in their agglomeration zones.

Self-governments were established and are still functioning in the 19 territorial units of the country: counties (*megye*) represent the middle level of local government. But, when compared with the former regime, the diminution of this medium level can be observed clearly. County (*megyei*) local government is not over-present in villages and cities. Its money distribution function between settlement organs was terminated; it has lost its medium-level functions in state public administration, and its function has been limited to the maintenance of certain medical, educational, cultural and other public utilities. The town with county rank is not a part of the county; in its own territory it fulfils tasks of the ground level and medium level of local government in the same way.

The organization and operation of the capital's local government has its own distinct attributes. One-fifth of the country's population lives in the capital, where the central organs of legislation, government and jurisdiction are located, along with other organizations which have a nationwide sphere of authority. The primary provisions remain the responsibility of the district local government, but in affairs concerning the whole capital, decisions are made at the level of the capital.

Activities of local governments providing public services

One of the most important tasks of local governments is to improve the standard of those public services that it provides for citizens. The minimal sphere of services – the compulsory duties mentioned above – is determined by acts of parliament.[3] In addition, local governments may voluntarily – depending upon the claims on citizens and on the size and capacity of the local government – undertake any kind of task that is not strictly prohibited by law.

The decrease in the scope of voluntary tasks is a general tendency. To date legal regulations have delegated approximately 3,700 duties and powers to local authorities and municipal organizations. In the field of voluntary task management, due to the lack of adequate resources, municipalities often transfer regional tasks and institutions to county (*megyei*) authorities (for example, institutions of secondary education, hospitals). These transfers constitute part of the shortage of operational resources of the local authorities of smaller settlements for the budget of the counties. Thus, the lack of resources increases in county authorities. The shortcomings of the financial regulation system restrain the efficient provision of regional duties. The professional conditions determining the quality of task management become increasingly severe.

According to the Act on Local Authorities, parliament has to secure the financial resources for local governments to meet their statutory duties in relation to the provision of services and it also has to determine the mode and proportion of the budgetary contribution. Thus, the Act guarantees the operational capacity of local authorities.

County (*megyei*) local governments provide services with regional characteristics, covering a larger part of the territory or the whole county. Moreover, two or more local governments can also provide the same services together. There is a possibility to maintain definite institutions (such as schools and hospitals) in a shared way, or to make shared investments (for solid waste or sewage collection and disposal, and other related activities). It is to be hoped that in the wake of the Local Government Associations Law passed a few years ago, and of government financial incentives, local governments will make more widespread use of the opportunities that may arise from the different methods of intermunicipal cooperation.

The main problem is the lack of definition of the quality of services. Therefore, the prescription of law for providing services is somewhat ambiguous in practice. On the other hand, better-provided services are based on former traditions.

From this chapter's point of view it must be emphasized that the promotion of the local economy does not belong directly to the duties of local government. Sometimes professionals have an energetic discussion on this matter, but in the end, the concept of 'entrepreneurial local authority' is not accepted.

The economic management of local governments: the place and role of local authorities in the national economy

The possibilities, freedom and limits of economic management of local governments are based on articles included in the Hungarian Constitution. Accordingly, the local representative body may exercise rights of ownership on the assets of local government, independently manage local government revenues and may function in an entrepreneurial manner at its own liability. It shall be entitled to its own revenues for attending to the duties of local government as prescribed by law. A local representative body shall determine the types and rates of local taxes in accordance with the framework established by law.

The proportion of municipal expenditure within the GDP best characterizes the economic role and influence of local authorities in the management of public services. The proportion of municipal expenditure in the gross expenditure of the national budget was 13.2 per cent by 2004. (See Table 7.A4.)

At the beginning of the 1990s, the local authorities represented a relatively larger part of the gross domestic product of the national economy and of the whole of the state budget than in the years after 2000. Despite the fact that the role of local governments in the national economy is increasing constantly, their tasks are extended and the effects of their economic management determine the living standards of citizens, the decreasing share of local authorities is a characteristic of current trends.

The possibility of creating local government property was established by the modification of the Constitution at the end of the 1980s. Approximately one-quarter of national property serves as the property of local governments. Unfortunately, it is distributed very disproportionately across the nation. A large part of local government property cannot be disposed through sale. The transfer of some property groups (such as gas and electricity public utilities) into local government property has made little progress during recent years. As a result, there have been animated discussions between the central executive power of state and local governments, which have been often finalized at the expense, or in spite of, local government interests.

For a variety of reasons (the lack of specialists and of an entrepreneurial mentality, no guarantees in the field of propositions and in securities of public funds, and so on), a large number of local governments, having used enterprise possibilities, have been unable to augment financial resources as much as called for. On the one hand, many local governments found themselves in a very unfavourable financial situation. On the other hand, numerous settlements – particularly a large proportion of the above-mentioned small villages – were not able to ensure the fundamental supplies for their citizens.

One special characteristic of the local government financing system is that, on a country-wide average only, about one-quarter of local government revenues comes from the local government's own revenues (local taxes assessed and levied by the settlement's local government; profits, dividends, interest and rents resulting from its own activities, from undertakings, and from the yield of the local government property, etc.).

Three-quarters of revenues[4] come from the allocation of state funds. The high (and increasing) weight of grants means that local governments are in close connection with the central budget, and that fact determines their thinking about democracy.

The institutional system of regional development

The institutional system of regional development – not least because of the political constraints discussed in the introduction – was built primarily on the already existing local governmental and political structure. The Regional Developmental Act enacted in 1996 is considered to be a milestone. In addition to its innovative elements, as early as the time of its inception it bore the marks of constraint: from a practical point of view, it was a combination of administrative and local governmental institutions, far from and barely effecting the constituents' will, mainly because of multiple transmissions. The institutional system's main elements consist of different levels of development councils and the attached executive institutes (agencies). Although since the adoption of the Regional Development Act, many changes have been made in the institutional system (changes in the composition of councils, the establishment of the so-called micro-regional structure, etc.), but in essential points, in the main structure, little has changed.

Consequently, the institutional system of regional development did not actually become an indicator of independent regional interests, or the centre of local policy. The degree of decentralization is still simply theoretical – a highly distanced aim rather than a real option.

The Regional Development Act created a two-level council system: county (*megyei*) councils and regional councils. However, these are not in hierarchical connection with each other. They are subservient and inferior to the national budget. Dividable funds are estimated through specific techniques and methods, based on given systems and programmes.

The dividable funds are allocated centrally by the national parliament for both types of councils, and the change in these figures show the degree of decentralization. On the whole, however, the main concept follows the principle of equality; the actual rate of differentiations by the degree of underdevelopment is low and its effect is hardly traceable.

Over the course of the past ten years, the change in the composition of councils at different levels was frequent (almost yearly). But the main concept has remained unaltered: the determinate purport of the central government is constant in both county and regional councils. Change was brought about by the modification in the composition of local representatives. A novelty is that on councils the representatives of the central government are often local political actors. Real decentralization is also questioned, in that besides the reduction of county-level administration and policy, the regional level is held to be virtual: regions are units made up of counties and their only task is to coordinate the distribution of development funds. The creation of regions follows existing administrative boundaries, thus true regional coordinating roles are restricted to opportunities following from their adjacency.

II. The process of administrative reform

The main motivations of reforms

The Hungarian administrative reform is a permanent part of the programmes of the different governments that have been elected since 1989.

The reasons for the reforms are as follows:

- The consequences of the accession to the European Union, and establishing its compatibility with the Principles of the European Administrational Area.
- The promotion of human rights and citizen rights defined in the Constitution, the decreasing of gaps in territorial development, the provision for equality of access of citizens to services of general interest.

- Making up for the political, legal and administrative deficiencies of the administrative system created following the political changes in 1989 and the need to create a representative and administrative middle level.

Recently, the main areas of the administrative reforms have been:

- There is a need to create micro-regions in order to achieve an improvement in the quality of the public services provided to citizens. The principal characteristic of the Hungarian local government system is the existence of authorities for a small population and an underdeveloped economy. These settlements have a relatively high level of responsibility; however, due to the non-differentiated nature of municipal powers they are unable to perform the majority of their tasks at an acceptable professional and efficient level. The strengthening of local authority co-operation is needed to improve the living standards of citizens and to prevent unreasonable social and territorial inequality. The possible solution for this problem is the promotion of regional relations and the creation of micro-regions.
- In order to increase the role of regions, the middle level of the administrative and local government system needs to become increasingly efficient. This territorial reform is one aspect of the administrative reforms. Presently, the seven statistical regions are mainly responsible for territorial development. The aim is that, apart from territorial development, regions become the most important actors of economic development, planning and co-ordination as well as the recipients of Structural Funds. The creation of local authority regions is part of the administrative reform. The creation of regional local authorities presupposes extensive measures in decentralization such as transferring the tasks and powers of ministries and other central administrative bodies to regions.
- Finally, the administrative reform is also a financial question, for the reform would affect the central and the municipal budgets so that tasks and costs would balance.

In 2004, the Hungarian Parliament passed a bill, the Law on Multi-Purpose Micro-Regional Associations of Local Authorities, which laid down detailed rules concerning the creation, the structure and the operation of the voluntary multi-purpose, micro-regional associations of local authorities (LAU 1 level according to the European Union classification).

The law calls for the creation of 168 territorial development statistical micro-regions. The multi-purpose micro-regional associations have to be formed within the borders of a predetermined territory. At the beginning of 2006, such consortia had been established in 118 micro-regions, and in 90 of these, all of the municipalities have joined the consortium.

The bodies of representatives of the settlements of a given micro-region decide about the creation of the association in a written agreement. In one micro-region only one association may be created. Micro-regions comprise a group of neighbouring settlements having one or more centres and strong functional relations that make it possible for them to cater for micro-regional tasks. The creation of the micro-region system may be defined around three functions: municipal public services, the territorial development function, and the state administrative function.

The association may participate in the harmonized development and territorial development of the micro-regions, may take up the provision, the development and the organization of public services, as well as the joint maintenance of institutions. The association undertakes the tasks and powers that are assigned to it by its members.

Below, without a further detailed review of the functioning of the institutional system, we will highlight some specific problems.

Local policy and local partnership: debates and the prospect of progress

The main pillars of the debates

The problems often cited in connection with the Hungarian local authority system have two fundamental features. These problems have rather long roots; one part of these problems can plainly be imputed to objective circumstances, and another part to the principles of the reforms made. Networks between Strata and former administrative conventions should be defined as objective circumstances. Among the reform's principles the precept '*one settlement, one local government*' was regarded as the fundamental value of democracy, although today many see it as a restraint.

- The other frequently quoted problem is the quantity of tasks and their state subsidy. Multiple threads connect local governments and the state budget. The direct allocation from, or money flow, through the central budget is a decisive factor in the management of local governments. The tasks and the number of the connecting normative subsidies are sometimes incapable of review. From time to time efforts are taken to reduce the number of so-called normative (per head) subsidies, but these efforts all end in failure. At the time of writing local governments could only massively vindicate one method to increase their independent revenues, which is the privatization of assets. This is why the proportion of local governmental assets has decreased and the process is slowly coming to an end.

- There is another problem, which may only be of substantial interest to administrative professionals, scholars and certain politicians. Two basic questions are central: the first is the rational dimension of the local governmental level on which advantages and disadvantages could be argued for and against, while the second one is the question of the development of administrative levels. In Hungary, the medium level of administration that is the level between settlement and national level is the county (*megye*). However, for a number of reasons (the issue of allocating EU resources, as well as that of the rational increases in economies of scale), the development of the regional system is constantly on the agenda. This development process is sometimes on the move, but sometimes languishes. Real inner demand does not give real dynamism and grounding to the process, for the economic advancement of the country is strongly diversified. Differences throughout the 1990s have not been reduced but have instead increased. The replacement – or partial replacement – of county administration with regional administration (and self-governments of regions) is therefore always affected by current political factors.

Dimensions and options for changes of local policy

The conventional prospects of local policy were based on the following. Regarding political factors, emphasis must be placed on the characteristics of the Hungarian election system, to the extent that it affects the development of local policy.

- One characteristic arises from the peculiarities of the parliamentary poll system. The Hungarian poll system is mixed, which means that candidates gain mandates from votes in both local electoral districts and national or party lists. In the Hungarian Parliament, of the 386 seats, 176 are filled in accordance with votes for candidates in local individual constituencies. The remaining seats are filled by virtue

of votes given on party lists, less traceable to voters. This system maintains the weight of individual districts, the significance of territorial representation.
- Another peculiarity is the proximity between the parliamentary and local government elections, which are separated by no more than six months. In the five electoral periods there have been a variety of outcomes in terms of the expression of party preferences. Thus, a local governmental and a parliamentary majority could be in opposition; and thus it could even be that though differences in party preferences were rather small, they were significant.
- Therefore, it has become the subject of debate, or even libel, what concerns the identity or difference in orientation of the central government and the local government. Concurrence is presented as an advantageous condition in local policy, whilst contrast is considered to be a disadvantage.

It is the opinion of the author that the characteristics of the Hungarian poll map must be taken into consideration in any development of local policy, for it has certain clearly identifiable features and tendencies. (See Table 7.A5.)

- There are no regional parties; all parties are organized on a nationwide basis.
- Party preferences in every settlement include right-wing and left-wing candidates, which means that there are no settlements which can be labelled as ‘one religion’, or ‘one colour’. Consequently, there can be no differences between settlements as a result of the mayor’s political preferences.
- One characteristic is that in those settlements with populations of less than 10,000 inhabitants, there are almost only ‘independent’ (i.e. independent from parties) candidates, or at least, candidates representing themselves as independents going for elections. In settlements with smaller populations, residents dislike candidates supported by parties; the society of settlements ‘traditionally’ controls public characters. With a population over 10,000, only candidates with a factional reference can participate in the elections, for then social control is based on the connection with parties.
- An additional peculiarity is that the local political elite and the state-wide political elite are implicated in both local and rational politics. A large number of local political characters also serve in the national parliament. There is a stream of persons ‘worn out’ in the field of

> central politics who continue their public activity at local levels of politics. For example, in the 2006 Parliamentary elections, 123 candidates who had already been successful in local elections were again elected to office.

Relatively little change occurred in the framework of local governmental policy within settlements.

Local referendum and popular initiative

Local referendum and popular initiative are rarely applied forms in the exercise of local governmental rights. They should be used in the case of significant questions in relation to the local community as a whole. The aim of the institution of the local referendum is to allow voters to make decisions about the most significant questions of the settlement; following this, the municipal bodies and the elected body of representatives promote and represent this majority decision. Through popular initiative, all matters belonging to its scope of powers may be presented before the body of representatives. The object of the popular initiative is that the body of representatives makes a decision in relation to the initiated matter. The body of representatives may only begin the discussion of the initiated matter if it truly belongs to its sphere of power.

Forums of public will

Local authorities have to hold a public hearing on an annual basis. In the course of public auditions, representatives of social and other organizations, and citizens, direct their questions and proposals of common interest to the body of representatives. The leading representatives of the local authority of settlements, especially of settlements with a larger population, hold town-district meetings to listen to the opinion of the citizens. In the communes, the body of representatives may present the key questions affecting the life of the communes before the village meeting in order to get to know the viewpoint of citizens. The village meeting is not a decisive forum. However, based on the Act on Local Authorities, village meetings may exceptionally become decisive forums in the communities of a population of less than 500 people.

The course of popular initiatives and local referenda fluctuate year by year. It is rare for them to stall, or in spite of ostensible ‘mass demand’ became invalid because people do not participate in voting. In the seven-year period between 1999 and 2006, a total of 183 local popular initiatives reached the actual referendum status, which means 6 per cent of all Hungarian local governments. One-third of these were legally valid and successful, meaning that an appropriate number of people participated and voted for the same cause. (See Tables 7.A6 and 7.A7.)

Nevertheless, the types of local objectives which are the subject of popular initiatives tend to be fairly similar. The most frequent cause is (and this for one-third of successful referenda) the spur for territory-organizing matters: the citizen's opinion is required about settlement contraction and partition, or belonging to another settlement or county.

Citizens are not greatly or emotionally moved by environmental protection matters, but by establishments serving environmental protection: citizens protest strongly against landfills, sewage treatment plants and other similar facilities to be placed near residential areas. The greatest social opposition is based upon either solving or withholding the establishment of such facilities. Protests are made against industries considered to be pollutant. One-quarter of referenda are initiated in these areas.

The location, establishment and cessation of public institutions trigger strong emotions and popular initiatives. In particular, citizens resent the closure of schools near residential areas. In the mapping of citizen opinion about the establishment of communal utilities overtures are made by local governments. Citizen motions stand behind the protection of collective property and its detainment from privatization. In a recently studied period of just seven years there were 16 such referenda.

The citizen's evaluation of settlement integration plans conventionally consist in prescriptions. Thus all plans formally go through the citizen filter before being passed to the delegate body of the local government. Nonetheless – probably because the contents and display of these plans are not clear enough to citizens and few people choose to interpret them – often through formal conciliation and by chance, after the acceptance of the plans their meaning becomes clear. An already accepted plan is often required to be modified at a later date, and this can cause important problems.

A concrete example: the measure which, in principle, would have approved the regional utility of solid refuse disposal, which was not subsidized by the European Union Cohesion Fund, was rejected through citizen opposition. In this affair, a utility was obstructed after being already accepted and scheduled in the settlement development plan and the National Physical Plan. After wanting to construct the establishment at all costs, the original proposers went through all possible steps, but ultimately failed. Maybe the twentieth settlement's government was induced to authorize the execution in its borders.

The possibility of popular initiative has a considerable impact upon local governments' local policy, for even in the case of it being unsuccessful, the opinion and adjudication of the citizens must be taken in account. All of this has a significant impact upon the framework of partnership.

III. The prospects for local policy

New challenges after joining the European Union

Non-obligatory tasks have provided a wide range of opportunities to local governments in terms of the formation of policy in respect of possibilities and local demand. Such specific ‘sector’ local politics include local social policy and local economic policy. Local social policy deals with the issues of sexual or other types of discrimination, and the possibilities of advancement, while local economic policy focuses on the alleviation of subsistence conditions, or actively participates in improving employment, workplaces and local tax policies, and so on.

As mentioned above, the depth and set of instruments in forming the local economic policy is controversial. Practically, much newer elements did not surface, for the already known set works.

Over the past 15 years, a peculiar problem has evolved in Hungary in relation to the system of resources and objectives of regional and settlement development. A distinct misconception is alive in both fields: on the levels of central, regional or county as well as that of local governance. One cause of this is, for example, the dispersal and misconception of central-ministerial level tasks. Among the traditional objectives of regional development have been, for example, support in establishing industrial parks. This task belonged in the past 15 years principally to the Economic Ministry, embodying ministerial direction and holding subsidies in hand. It apparently puts the principle of region into practice, but operates with organizational independence and the targets of subsidies are not local government.

There exists a sort of disorder in the interpretation of regional planning. However, such matters are probably not solely related to Hungary. Some discussion of these matters is given below.

In advisements on different levels of regional development, at present, tenders serving settlement aims are called for and evaluated, while true, traditionally meant objectives of regional development are relatively neglected.

This problem can be demonstrated by showing what kind of objectives for regional and settlement development were appointed within the National Development Plan allocating European Union funds. The so-called Regional Operative Program sets out goals and applications.

The Operational Program for Regional Development (OPRD) is one of five operative programs linked to the First National Development Plan. These are as follows:

- ECOP – designed to stimulate *economic competitiveness*,
- EIOP – promoting *environmental* investments,
- ARDOP – operational in the *agricultural* field,
- HRDOP – directed towards developing *human resources* and training,
- OPRD (Hungarian abbreviation, ROP) – which serves to promote *regional development* and the territorial structural transformation of Hungary, adjusted to EU regional policy.

OPRD (*Operational Programme of Regional Development*) contains the following purposes or measures:

- Tourism
  The emphasis is on developing tourist attractions, visitor access to and facilities in Hungary's national parks, World Heritage sites, historical town centres are improved; mansions, castles and museums are developed for tourist purposes, and cycle paths are built. Also, by improving tourist reception capacity through the redevelopment of hotels, pensions, resort houses and apartments.
- Road reconstruction
  Minor and side roads are redeveloped by state and local authorities in order to improve access to disadvantaged regions and micro-regions. This measure also includes improving the conditions of public transport.
- Urban rehabilitation
  By rehabilitating decaying, outmoded urban areas largely populated by disadvantaged sections of society, the living conditions of local residents are improved.
- Development of nursery schools and primary schools
  By implementing developments in nursery schools and primary schools, not only the technical condition of buildings is improved but tutorial aids and equipment are also upgraded.
- Training, employment
  The primary objective of measures designed to support local employment initiatives and strengthen cooperation between institutions of higher education and local players is to improve the employment situation in the regions and retain graduates in the regions.

In comparison, the most important objectives of regional operative programmes in the period from 2006 to 2013 include the following interventions which should move us towards a balanced approach towards regional development:

- A co-operative and competitive urban network based primarily on the establishment of developmental poles.
- A renewal of the countryside, involving the integrated and sustainable development of villages and rural areas.
- A realignment of backward regions, meaning the implementation of complex realignment programmes.
- The sustainable development of the region of Lake Balaton, and additionally the regions of the rivers Danube and Tisza.

These interventions are included in seven regional operational programmes: South Great Plain OP, South Transdanubia OP, North Great Plain OP, North Hungary OP, Central Transdanubia OP, Central Hungary OP, West Pannon OP. (See Table 7.A8.)

It can be seen that today the management of efforts to achieve development objectives has been centralized decisively, falling within the coordination of the ministry concerned. The latter include coordination of regional developments in the overall decision-making process. Generally, settlement objectives appeared within the regional operative programme, in such a way that the majority of them do not even demand collaboration between settlements. In general, one settlement or local government applied with one or, at most, two projects. However, apart from a few projects, the execution of the project did not require the cooperation of partnerships within settlements. It is obvious that local governments have applied for the attainment of important settlement objectives. Tasks belong to their competencies through legal authorization.

The problem is the following: real economic advances cannot be achieved by applications under the competency of local governments. Surface differences in the painting and decorating of schools can indeed be decreased by small reconstruction programmes. Painting and decorating provides for local employment and, obviously, improves local living conditions. By the same token, the settlement itself becomes more competitive, but this does not address the root causes of the problem. Thus, the small reconstruction programme stimulates local income and production capability, but in this does not solve the causes of lack of development nor has a long-term effect.

In practical terms, with the lack of true institutional modification and real decentralization, development in the next seven-year period will yield a structure similar to the present one.

In this author's opinion, the definition of regional and settlement development must be reconsidered. Can regional development be approached and operated only amidst the aspects and competency frames of the local government settlements? Do settlement-level approximations add up to the traditional regional policy's system of objectives and set of means? In other words: can regional policy at a national scale be made by means of settlement development?

The answer is evidently, no. The vital question is, the basics must be rethought: What is meant by regional development policy? What are its objectives? What means does it have in the changing world? How can regional policy and settlement development policy be connected rationally?

An additional problem is that under the present state of development and with existing problems, the local government's opportunities to utilize the traditional settlement and local governmental instruments are reduced, e.g. collecting local tax, granting free space to enterprises, thereby promoting settlement. The reduction of local governmental assets and releasing revenues narrows the opportunities of the local government. With the shortage of local incomes, even the decorating of a public nursery becomes problematic.

In addition to the problems in the operation of local economic policy, the efforts made for improving social policy are unacceptable. In Hungary, the fight against ethnic segregation must be mentioned. It can have serious implications for the course of a settlement's development. Intellectual barriers must also be noted: over the course of the past twenty years little has changed in this regard. Some typical examples of the directors of local governments are:

- In favour of poll maximization: conflicts are downplayed in order to raise local government revenues.
- Solutions are expected from 'above' and, simultaneously the critique is that little money is given by the central government to solve local problems, norms are inadequate, etc.

It seems that these problems in relation to the intellectual approach adopted can only be resolved when the current policy makers have been replaced.

Framework of local policy and partnership

The most important factor in the formation of local policy is the relationship between the central government and the individual local governments. The representative tendency in connection with this relationship is decentralization. It can be indicated that although the process is slow, progress does still occur. This progress, characterized by detours and withdrawals, has an effect on every single aspect of local policy. In the relationship of the central and local government to date, the central function has been largely dominant. Apart from probable self-restraint, the clinging to traditions of centralized governance in Eastern Europe has resulted in decentralization making only slow progress. Efforts to avoid waste and to reduce the use of resources lead to slow progress in the area of financial decentralization.

One conceivable field of local policy is settlement cooperation. In respect of this issue progress has been secured by the development of multi-purpose associations in micro-regions. However, a number of questions concerning the roles of micro-regions still remain unanswered, for these constructions can in no way substitute for the system of larger local governments, and as a middle level would make the system unclear and overcomplicated.

Another important field of local policy is the network of connections within settlements, which run along multiple lines. These are partly centred on the cooperation methods of enterprises, and profit and non-profit oriented organizations working in the settlements. An increasing emphasis is placed on the question of dealing with residents as partners. Little has been done in the conditioning of these matters in the period under consideration. The local referenda, which were arranged primarily in relation to questions on the autonomy of settlements and urban parts or matters of urban development, generally came through with meagre attendance. One single exception was civil protest against pollution and local or regional environmental contamination problems (sequential residential protest against refuse landfills, disposal areas). These often showed, however, that communications between the local government and citizens were unsuccessful and inadequate. This lack, however, may have a remarkably harmful effect on the operations of local control:

- The local information flow lags well behind modern technical possibilities and true demands in every settlement, including Budapest. Local media is scant and powerless, in spite of the fact that the toolkit of the local information flow is widely broadened with electronic media gaining ground. All forms of local information flow in Hungary are badly underdeveloped. Its role in public policy is indeed still small. The lack of local media causes impairment in the proper function of local society control, even in the cases of settlement or regional development programmes.

This situation can be explained through a single illustration, that of the existence of settlements on the Internet. Of the 19 Hungarian counties, only five settlements have a website, while in some counties provision virtually covers only cities. In the whole country, 60% of the country's settlements have indicated the Internet either independently or in an associate form. Yet this still does not mean that there is any kind of intense local information stream in connection with the presence of the Internet. In 90% of these cases, we can speak of scarcely visited, barely informative websites; in this sense, their presence is simply a formality.[5]

- The widening of European Union programmes demands an innovative approach to partnership building and functioning. Especially in the case of some programmes, patent connections should have been developed, whether successful or not. This shows that severe effort must be made in favour of progress.

Summary

On the whole, it appears that because the administrative realignment remains unresolved, regional planning in Hungary, which by the 1990s had already developed a strongly deformed vision and system of means, risks becoming even more complicated. In a peculiar way, joining the European Union has made the situation even worse.

In the interpretation of local policy a paradigm shift is needed: a rational connection must be found to competitive aims and to innovative policy. It is indispensable for local policy to adapt adequate socio-political goals – for example, the fight against segregation, objectives concerning the equal opportunity of sexes, and other such issues.

Notes

1. See details later.
2. These bills require a two-thirds majority vote from the members of the Hungarian Parliament.
3. Duties of local authorities can be divided to two categories:

Obligatory duties:
The majority of local task provisions are under the exclusive authority of local governments of settlements. The county local governments only cater for public services of a larger volume and of a regional character.
The **obligatory duties** of local authorities are for example:

- Cultural and educational tasks;
- Health and social welfare tasks;
- Communal provision tasks;
- Water management tasks;
- Traffic management;
- Territorial development tasks;
- Environment and nature protection,
- Housing management tasks;
- Local fire protection tasks;
- Local duties of public security.

Voluntary tasks:
As stated above, apart from obligatory tasks (depending on local needs and the municipal economic capacities) local authorities may also take up voluntary tasks. Opportunities and the property situation of local authorities with the general aggravation of the conditions of economic management influences the number and the sphere of voluntary duties taken up by municipalities as well as their quality of management.

4. E.g. from central taxes assigned, from normative budgetary contribution, from target subsidies for socially prioritized targets and claimed by local governments, for earmarked subsidies to selected local governments for the realization of certain investment projects with high costs, etc.
5. The National Association of Hungarian Settlements makes surveys each year on the quality of settlement websites and evaluates them by unific standards.

References

Ágh, A., Á. Rózsás and G. Zongor (2005) *Europeanization and Regionalization in Hungary*, Budapest: Önkor Press.

Ágh, A. and A. Ferencz (eds) (2006) *Deepening and Widening in an Enlarged Europe: The Impact of the Eastern Enlargement, 'Together for Europe'*, Budapest: Research Centre of the Hungarian Academy of Sciences.

Baldersheim, H., M. Illner and H. Wollmann (eds) (2003) *Local Democracy in Post-Communist Europe*, Wiesbaden: VS Verlag Urban and Regional Research International.

Berg, R. and N. Rao (eds) (2005) *Transforming Political Leadership in Local Government*, Basingstoke: Palgrave.

Bloomfield, J. (2006) *Counselling, Cajoling or Coordinating: Central Governments' Policy Approaches toward Local Government on the Issues of Performance and Cost-Effectiveness*, Brussels: CCRE/CEMR.

Bódi, F. and A.Fekete (2005) 'Ideas About Settlement Development and Local Government Lobbying', *A Falu* **20**(4), 76.

Considine, M. and S. Giguere (2008) *The Theory and Practice of Local Governance and Economic Development*, Basingstoke: Palgrave.

Coulson, A. and A. Campbell (eds) (2006) 'Local Government in Central and Eastern Europe', *Local Government Studies*, **32**(5) (November), special edition.

Council of Europe (1985) *European Charter of Local Self-Government*. Strasbourg, France, October.

Council of Europe (2005) 'Effective Democratic Governance at Local and Regional Levels', Budapest, Open Society Institute (reports by Gérard Marcou and Ken Davey on the Stability Pact countries of South-East Europe).

Dafflon, B. (2002) *Local Public Finance in Europe*, Cheltenham: Edward Elgar.

Dallago, B. and I. Iwasaki (2007) *Corporate Restructuring and Governance in Transition Economies*, Basingstoke: Palgrave.

Denters, B. and L. Rose (eds) (2005) *Comparing Local Governance Trends and Developments*, Basingstoke: Palgrave.

Dexia (2002) *Les finances locales dans les 15 pays de l'Union européenne*, 2e édition – version abrégée.

Dexia (2002) *Local Finance in 11 Countries of Central, Eastern and Baltic Europe*.

Dexia (2003) *Local Finance in the 10 Countries Joining the European Union in 2004*.

Dexia (2004) *Les finances locales dans l'Europe à 25* [Local finances in the Europe of the 25], Paris: Dexia Editions.

Dexia (2005) Local Governments in the World Basic Facts on 82 selected Countries.

Ehtisham, A. and V. Tanzi (eds) (2002) *Managing Fiscal Decentralization*. London: Routledge.

Hambleton, R., H.V. Savitch and M. Stewart (2002) *Globalism and Local Democracy: Challenge and Change in Europe and North America* Basingstoke: Palgrave.

Horváth, T.M. (2000) 'Municipal Autonomy and Intergovernmental Relations: The Hungarian Case', in Erik Amnå and Stig Montin (eds), *Towards a New Concept of Local Self-Government? Local Government Development in Comparative Perspective*, Oslo: Fagbogsforlaget, pp 46–72.

Kemp, R.L. (ed.) (2007) *Economic Development in Local Government: A Handbook for Public Officials and Citizens*, Jefferson, NC: McFarland and Company, inc.

Kersting, N. and A. Vetter (eds) (2003) *Reforming Local Government in Europe. Closing the Gap between Democracy and Efficiency*, Wiesbaden: VS Verlag 'Urban and Regional Research International'.

Marcou, G. (2002) Les structures régionales dans les pays candidats et leur compatibilité avec les fonds structurels (Europe centrale et orientale) [Regional structures in the applicant countries and their compatibility with the structural funds (central and eastern Europe)]. 'Rapport au Parlement européen' [Report to the European Parliament], Luxembourg, Parlement européen, Direction générale des Etudes, STOA 105 FR, September.

Marcou, G. and I. Verebelyi (eds) (1993) *New Trends in Local Government in Western and Eastern Europe*, Brussels: International Institute of Administrative Science.

Miller W. L., M. Dickson and G. Stoker (2000) *Models of Local Governance Public Opinion and Political Theory in Britain* Basingstoke: Palgrave.

'New Hungary' Development Plan (2007) *National Strategic Reference Framework of Hungary 2007–2013*, Budapest: Office of National Development.

National Development Concept (2005) Budapest: Office of National Development.

National Spatial Development Concept (2005) Budapest: Office of National Regional Development.
Oláh, M. (1996) A helyi elit szerepe a kelet-közép-európai új demokráciák önkormányzati életében. [The role of the local elit in the life of local self governments in the Easter-central european democracies] In: Átépítés. Közigazgatás – területfejlesztés – városmarketing. Szerk. Agg Zoltán. [Közzéteszi a] Veszprémi Megyei Önkormányzat Közigazgatási és Informatikai Szolgáltató Irodája. [Veszprém], Comitatus, pp. 215–44.
Rhodes, R.A.W., P. 't Hart and M. Noordegraaf (eds) (2007) *Observing Government Elites Up Close and Personal*, Basingstoke: Palgrave.
Rodden, J., G. Eskeland and J. Litvack (2003) *Fiscal Decentralization and the Challenge of Hard Budget Constraints*. Cambridge, MA: MIT Press.
Ruttkay, E. (2004) 'Democracy – Decentralization – Fiscal decentralization' *Comitatus*, **14**, 6–18.
Ruttkay, E. (2007) 'Local Policy, Local Development – Mile Stone', *Comitatus*, **17**, 24–36.
Steiner, E. and I. Darázs (2005) *The Characteristics of the Hungarian Local Authority System and the Municipal Economic Management*, Budapest: Önkorpress.
Stoker, G. (1991) *The Politics of Local Government*, 2nd edition, Basingstoke: Palgrave.
Szücs, S. and L. Strömberg (eds) (2006) *Local Elites, Political Capital and Democratic Development. Governing Leaders in Seven European Countries*, Wiesbaden: VS Verlag 'Urban and Regional Research International.
Travers, T. (2005) *International Comparisons of Local Government Finance: Propositions and Analysis*, London School of Economics and Political Science.
UCLG (2007) *Decentralization and Local Democracy in the World*, First UCLG Global Report, Barcelona.

Websites

www.magyarorszag.hu
www.toosz.hu
www.localinfo.hu
www.valasztas.hu
www.localdemocracy.org
www.frdl.org.pl
www.cities-localgovernments.org
www.logincee.org

Table 7.A1 Trends of regional development, 1995–2005

Counties, (megye), regions	**Regional GDP per capita (Hungary = 100)**					
	1995	**1997**	**1999**	**2001**	**2003**	**2005**
Budapest	183.6	191.1	196.1	200.5	202.7	213.4
Pest	72.6	77.5	80.3	87.3	89.7	89.2
Central Hungary	145.7	151.0	153.6	157.3	158.2	163.2
Fejér	99.7	118.1	115.2	104.2	95.3	95.6
Komárom-Esztergom	86.6	86.2	82.4	93.2	106.8	114.2
Veszprém	84.6	80.6	80.9	84.2	79.3	74.7
Central Transdanubia	90.9	96.5	94.4	94.4	93.3	94.0
Györ-Moson-Sopron	108.5	109.1	130.2	121.1	120.7	111.1
Vas	106.8	114.6	118.3	102.0	106.2	94.6
Zala	91.3	90.5	88.8	87.4	93.8	85.5
Western Transdanubia	102.8	105.0	114.6	105.9	108.9	99.2
Baranya	79.7	79.8	78.0	74.9	74.9	72.5
Somogy	75.9	69.8	68.3	70.6	69.6	65.7
Tolna	91.5	83.2	87.9	80.5	71.9	69.1
Southern Transdanubia	81.4	77.2	77.2	74.8	72.4	69.4
Borsod-Abaúj-Zemplén	75.4	68.7	66.2	63.4	63.2	68.7
Heves	74.5	72.2	72.3	74.2	74.7	69.9
Nógrád	59.2	52.4	54.4	55.5	54.8	50.5
Northern Hungary	72.4	66.8	65.7	64.8	64.7	65.9
Hajdú-Bihar	77.5	76.1	71.4	75.1	76.7	74.2
Jász-Nagykun-Szolnok	77.0	74.7	67.0	70.8	66.3	62.1
Szabolcs-Szatmár-Bereg	60.2	57.1	53.8	56.5	57.1	54.7
Northern Great Plain	70.9	68.6	63.6	66.9	66.5	63.6
Bács-Kiskun	78.3	72.5	69.1	69.3	68.4	67.0
Békés	77.7	71.1	67.4	65.7	61.9	59.5
Csongrád	92.6	88.7	85.1	79.7	78.4	76.3
Southern Great Plain	82.6	77.2	73.6	71.5	69.6	67.8

Source: CSO Hungary.

Table 7.A2 Distribution of settlements according to population size, 2002

Settlement size category	Number	% of all settlements	Population	% of total population
>499	1,021	34.10	277,089	2.70
500–999	687	32.00	502,018	4.90
1000–1999	643	21.00	926,097	9.10
2000–4999	505	10.10	1,521,117	15.00
5000–9999	136	1.80	947,165	9.30
10000<	144	1.00	5,967,876	58.80
Total	3,135	100.00	10,142,362	100.00

Source: Területi Statisztikai Évkönyv, KSH, Budapest, 2002.

Table 7.A3 Income steps by settlement categories, 2000

Settlement population size category (head)	Total taxed income per head (thousand Ft)	Total income per one taxpayer (Ft)
0–499	198	191
500–999	224	223
1,000–1,999	647	239
2,000–4,999	674	253
5,000–9,999	699	274
10,000–19,999	750	315
20,000–49,999	808	353
50,000–99,999	880	433
100,000–1,000,000	886	403
1,000,000<	1186	536
Country total	860	336

Source: Own calculations according to data of Finace Ministry of Hungary.

Table 7.A4 Expenses of local governments in the percentage of GDP between 1990 and 2004 (%)

Year	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
Expenses together*	13.9	15	16.9	16.9	17.2	14.4	13.2	13.4	13.4	12.8	12.5	12.8	13.7	13.8	13.2
Operational expenses	11.1	11.9	13	13	12.3	11	10.3	10.1	9.7	9.7	9.3	9.5	10.1	10.4	9.9
Development expenses	2.5	2.5	3.3	3.1	3.9	2.5	2.1	2.6	2.8	2.3	2.4	2.6	2.9	2.3	2.2
Social and sociopolitical expenses	0.3	0.5	0.6	0.8	1	0.9	0.8	0.7	0.9	0.8	0.7	0.6	0.6	0.6	0.6

Source: Ministry of Finance published in 'Tizenöt év a magyar demokrácia szolgálatában'. Önkormányzati tükör 1990–2005. BM
*Expenses inGFS system

Table 7.A5 Settlement size and balloting preferences, 2002

Settlement population size category	Distribution of votes by parties (%)				Participation ratio
Heads	MSZP*	FIDESZ*	SZDSZ*	Other parties	
0–499	33.97	53.56	3.18	9.28	72.08
500–999	36.58	50.81	3.12	9.48	68.24
1.000–1.999	38.80	47.84	3.43	9.93	66.13
2.000–4.999	40.16	45.71	3.80	10.33	65.00
5.000–9.999	41.56	43.37	4.28	10.80	65.70
10.000–19.999	42.43	41.91	4.84	10.83	69.65
20.000–49.999	43.49	39.64	5.77	11.11	70.74
50.000–99.999	44.24	38.87	6.27	10.62	74.23
100.000–1.000.000	44.14	40.50	5.00	10.36	72.99
1.000.000–	44.12	31.58	9.56	14.75	77.52
Total	42.05	41.07	5.57	11.30	70.53

Source: Own calculations using data of National Election Office **Abbreviations*: MSZP: Hungarian Socialist Party, FIDESZ: FIDESZ Hungarian Fidesz – Hungarian Civic Union, SZDSZ: Hungarian Liberal Party.

Table 7.A6 Number of popular initiatives in the period 1999–2006

Year of referendum	Successful	Cancelled	Total
1999	17	0	17
2000	8	16	24
2001	9	3	12
2002	3	5	8
2003	12	23	35
2004	11	39	50
2005	10	9	19
2006	7	11	18
Total	77	106	183

Source: Own calculations based on data of Hungarian Election Office, for given years.

Table 7.A7 Objectives of popular initiatives in the 1999–2006 period

Objectives	**Years**							
	1999	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Environmental protection	1							
Environmental protection establishment	5	6	1	2	8	1	3	1
Industrial facility		1	1	1	2	5		7
Affairs of institutions or the community	2	2	1		8	16	2	1
Territory organization (public administrational changes)	8	6	7	4	13	9	11	3
Communal development	1	4				8		
Property affairs, privatisation		3	1		4	3	1	4
Physical plan or modification of physical plan		2	1	1		8	2	2
Altogether	17	24	12	8	35	50	19	18

Source: Own calculations based on data of Hungarian Election Office for given years.

Table 7.A8 Indicative financial allocation plan of the operational programmes

Operational programmes	**Million EUR, current prices**	**Distribution (%)**
Economic Development OP	2,497	10,01
Transport OP	6,223	24,97
Social Infrastructure OP	1,949	7,82
Environment and Energy OP	4,179	16,77
Regional OP's		
West Pannon OP	464	1,86
Central Transdanubia OP	508	2,04
South Transdanubia OP	705	2,83
South Great Plain OP	749	3,00
North Great Plain OP	975	3,91
North Hungary OP	904	3,63
Central Hungary OP	191	7,67
7 regions total	622	24,94
Implementation OP	315	1,26
State Reform Op	120	0,48
Technical assistance	342	13,74
NHDP in total	***2,492***	***100,00***
from which:		
ERDF in total	1,250	50,76
CF in total	8,642	34,68
ESF in total	3,629	28,69

Source: National Development Plan 2007–2013.

8

Local Government in the Process of Transformation

Anna Gąsior-Niemiec

Introduction

The current phase of the transformation of subnational government in Poland has been in progress since 1990. In its chronological dimension the process has been marked by three major events: the 1990 reform establishing territorial self-government at the municipal level; the 1999 reform establishing district- and region-level self-government; and – last but not least – Poland's accession to the European Union in 2004. The three events have been accompanied by large-scale institution building and an introduction of novel legal frameworks. In addition to the legal-institutional changes, the progressive transformation of subnational government in Poland has, however, also encompassed several other dimensions, including modes of policy making, patterns of agency, and public discourse.

Far from simple linearity, the transformation could, nonetheless, be described in terms of two major stages: the first involving *reforms of government*, whereas the second marked an attempt to *move from government to governance*. Chronologically overlapping to an extent, both stages may be characterized as still not being fully completed. The decentralization of government, especially at the regional level, has been stalled at the point where regional governments need to acquire more autonomy in the sphere of policy making backed by adequate financial powers. The project of governing the subnational space shared by public administration and civil society has only been initiated. While it has successfully permeated public discourse in Poland, its implementation in practice has so far been evaluated in an ambivalent way.

The present chapter is concerned in particular with the second of the aforementioned stages of the transformation occurring in Poland, i.e. with the attempted turn from government to governance. It is claimed that the introduction of new modes of governance in the country has mostly been a result of Europeanization affecting public discourse, the behaviour of elites, institutional structures, and procedures (cf. Grabbe, 1999, 2001; Radaelli, 2002; Gąsior-Niemiec, 2003). While attempts to install new governance arrangements in Poland might be traced back to at least the mid-1990s, they have become more pronounced since the accession year of 2004. The structuring of the field of actors involved in local and regional development policy has been one of the most clear-cut instances of this process. Other pronounced instances might be found in the arena of (progressively regionalized) social policy, whereas in a cross-cutting perspective, the process is most easily understood from the vantage point of institutional development of civil society *qua* social partners.

This chapter contains five sections: the introduction is followed by a brief discussion of the concept of new modes of governance as defined by students of European integration which is linked to a selective overview of some 'good governance' examples that have been instituted in Poland to date. These are mostly related to the EU programmes, funds and policies. Indicating the arena of the European Regional Development Fund as the case to be further analyzed, the next part of the chapter contains a brief outline of the present shape of territorial self-government in Poland highlighting the self-government's position vis-à-vis the European incentives, on the one hand, and vis-à-vis domestic civil society – on the other.

The bulk of the analysis, dedicated to the currently most recognized instance of new modes of governance, is focused on the monitoring and steering committees established for the 2004–2006 Structural Funds programming period within the framework of the Integrated Operational Programme of Regional Development (*Zintegrowany Program Operacyjny Rozwoju Regionalnego* – ZPORR, utilizing the ERDF and ESF resources). The analysis and evaluation of the committees are based primarily on opinions and recommendations voiced by representatives of social partners and representatives of local self-governments (being both part of *and* actual or potential beneficiaries of the decisions taken by the committees). The opinions expressed here and the recommendations that are provided serve as a starting point for proposing a more encompassing interpretation of the apparent failure of the committees, especially at the regional level. General conclusions follow the analyses and interpretations.

New modes of governance

The stage of progressing transformation of local government in Poland which has been labelled in the introduction as an attempted transition from *government* to *governance* is to be viewed as an integral part of the governance turn that has been attributed to the European Union (cf. European Commission, 2003; Gąsior-Niemiec, 2007b). The innovative concept of the European construction as a multi-level governance system or that of a networked polity have been progressively translated into and/or reflected by developments taking place in a variety of policy areas and tiers of political authority (cf. Hooghe, 1996; Kohler-Koch, 2002).

The idea of 'good governance' entailing shared responsibilities, overlapping competencies and pooled resources has reverberated particularly strongly at local and regional levels across the European Union (cf. Adshead, 2002). It has been supported by promoters of the new regional development paradigm focused on the mobilization of endogenous potential and has also been warmly received by subnational actors, seeing in it a way to empowerment. With the launching of the social and civic dialogue as new EU priorities, the icon of good governance earned ardent support on part of civil society organizations as well (cf. Koźlicka, 2006).

Good governance describes a general tendency to forgo a traditional top-down steering of the social and economic processes in favour of new institutional arrangements encouraging flatter and less formal hierarchies, and a move to establish heterarchies rather than purely political monopolies to govern particular areas of social life. In an attempt to interpret the foundations and patterns of the governance turn, students of European integration have focused in particular on the notion of new modes of governance (NMG) (cf. Kohler-Koch, 2002; Börzel *et al.*, 2005). This has involved the publication of several conceptual papers as well as typologies of the phenomenon which have been supported and illuminated by a wealth of theoretical and empirical research (cf. NoE CONNEX at www.connex.org and NewGov IP at www. eu-newgov.org).

In a paper devoted to an overview of the definitions and approaches to NMG, Börzel *et al.* (2005: 6 and ff) offer a succinct umbrella definition, specifying that new modes of governance entail specifically formatted processes of making/implementing of collectively binding decisions. This specificity is manifest in the *voluntary compliance* of actors involved with the decisions made, irrespective of the degree to which the processes are embedded in legislation. Moreover, the processes entailing policy formulation and/or implementation involve, on a regular basis, *private actors*, representing both the for-profit sector (business) and not-for-profit organizations (NGOs).

Apart from an enhanced access of different categories of actors to a variety of public arenas, the new modes of governance in their ideal-typical form have then been characterized as institutional arrangements that are much less hierarchical than conventional bureaucracies, operating through horizontal rather than vertical linkages, relying on flexible rather than rigid forms of coordination and co-operation, involving ongoing negotiations, mutual learning and persuasion rather than legal enforcement and command on the part of the multitude of (public and private) members included in networks which form the NMG's ideal-typical organizational basis (cf. Mayntz, 2002; Börzel *et al.*, 2005). Not unexpectedly, the successful operation of NMG has been claimed to be to a significant degree dependent upon shared values, informal rules, and other soft resources, such as social capital (ibid.).

Thus conceived, new modes of governance are either explicitly or implicitly assumed to contribute to greater inclusiveness, accountability and efficiency of the policy-making/implementation. They are also claimed to be more useful and effective in creating and safeguarding common and public goods than either market or hierarchy (cf. Héritier, 2002). Furthermore, apart from an assumption that NMG should result in the lowering of transaction costs, it might be surmised that owing to their 'soft' texture, involving shared norms, negotiated goals, and co-operative linkages, they could be particularly called for in those arenas/cases in which there is a need to balance diverging interests, to provide some leverage to a weaker party, and/or to build a broader social consensus around an issue of common interest.

A scrutiny of the European Union's institutional and financial incentives, which is offered in particular to its Member States, allows us to indicate several such arenas/cases, notably featuring regional policy and social policy. The introduction of NMG within these arenas has been most strongly underpinned by the principles of *partnership, pact* and *dialogue*. The premise of partnership has, for instance, been inscribed as one of the leading principles in the operation of the European Regional Development Fund, whereas the principle of pact has been more typical of instruments designed to implement the European Social Fund (social pacts, territorial pacts, employment pacts, etc.). The principle of dialogue has found its most significant expression in the institutionalization of tripartite social dialogue committees (public administration/employers/employees) and the more recent institutionalization of civic dialogue platforms (public administration/business and professional associations/civic society organizations) (cf. Koźlicka, 2006).

The principles and NMG arrangements have actually been promoted by the EU not only in its Member States, but also within the candidate countries. From the mid-1990s onwards Poland has constituted a vivid example of the tendency to promote and install the logic of NMG in selected arenas/settings. As early as the mid-1990s the PHARE-financed Local Initiatives Programme and STRUDER Programme aimed to create local partnerships oriented towards the activation of endogenous developmental capacities, which was to exceed the narrowly conceived sphere of local government (cf. Drążkiewicz, Gęsicka and Szczucki, 1995; Kozak, 1998). PHARE (2000, 2001) and ESF supported the successive waves of projects aimed at the creation of local employment pacts, while PHARE, ESF and other streams of EU funding have been used throughout this decade to support the creation of tripartite committees (at the central and then the regional levels) as well as to assist the institutionalization and capacity building of civil society organizations to play the role of partners to local/regional governments (cf. Marody and Wilkin, 2002: 71–116; Zalewski, 2005).

Although those initiatives have also garnered support from other foreign institutions (such as the OECD, USAID and the World Bank), the EU incentives must be acknowledged to be the most consistent and persistent – which might, for instance, be evidenced by the recurrent encouragement offered to projects aimed at the establishment of local employment pacts – an NMG formula that has more often than not been a conspicuous failure in most regions of the country. The more recent instances of EU-driven attempts to graft NMG in Poland may include the ESF financed regional pacts (cf. Wejcman, 2004), local partnership programmes (cf. Wejcman, 2008) as well as public consultation programmes related to government-drafted strategies of development (cf. Napiontek and Fałkowski, 2006).

It appears that the consultation programmes have been most firmly rooted in the normative discourse on NMG, openly stating that their goal was to 'create' social partners and integrate them in the country's policy-making and policy-implementation processes (Napiontek and Fałkowski, 2006: 9, 16–17; Hausner, 2007: 310–16). Albeit initiated and managed by the central government, the consultations had a special regional bent owing to the fact that the bulk of the pro-developmental activities and funding has been related to Poland's participation in the European Regional Development Fund (ERDF) and the European Social Fund. The actual implementation of the funds at the subnational level called for means mustering awareness and support on part of the local and regional actors.

Promoting the slogan of good governance, the programme thus served to introduce the idea of transition from government to governance as a manner to mobilize and involve all regional and local actors in pro-developmental activities. Central-government designed institutional arrangements for the ERDF and ESF programming and implementation were to give 'voice' to the subnational actors, stimulate cross-sector and cross-tier 'synergies', and ensure the actors' 'voluntary compliance' – quite in accordance with the characteristics of NMG offered in the theory (cf. Börzel *et al.*, 2005).

Even though the regionalized consultations on the National Development Plan have eventually proved to be both futile (the successive cabinet has rejected the NDP) and were frequently evaluated as only lip-service paid by the politicians and the administration under the pressure being exerted by the EU (Napiontek and Fałkowski, 2006: 11), they have both signalled *that* the central government was aware of the growing importance of the subnational level as a negotiated policy-making/implementation arena and signalled *to* all of the subnational actors (territorial self-governments, business and professional associations, and non-governmental organizations) that they are invited to participate more actively in the policy-making/implementation processes.

The public consultation programmes could actually be seen as a delayed attempt to legitimize the already introduced NMG institutional arrangements, which were related to the 2004–06 Structural Funds programming period. Even though the ERDF during that period was programmed centrally in Poland and implemented in all of the 16 regions *via* a single Integrated Operational Programme of Regional Development (ZPORR), the institutional arrangements created for ZPORR did, nonetheless, largely comply with the European governance trend. This was reflected predominantly in the institutionalization of the principle of vertical and horizontal partnership.

The principle was doubly safeguarded in the 2004–2006 ZPORR institutional arrangements, namely both at the central *and* subnational level ZPORR monitoring and steering committees had been established. The committees – which will be analysed in greater detail further in the chapter – formally provided for an inclusion of regional and local self-governments as well as of economic and social partners in the regional development policy making and implementation in Poland. Seeking to explain the apparently paradoxical nature of the first round of the

Structural Funds implementation in the country – i.e. both centralist and regionally anchored – one may point to three different rationales.

The first could be related to the normative pressure of the EU model of good governance, openly recognized by Polish political and administrative elites (cf. Hausner, 2007; Grosse and Kolarska-Bobińska, 2008). The second may be linked to some domestic factors of which the relative political strength, bargaining power, and high aspirations of the regional tier of government in Poland seem decisive. The features make it difficult for the central government to bypass the subnational political elites completely in policy making, especially that regional (and to a lesser extent local) political elites are directly connected with national political parties.

The third rationale could be related to the nature of the regional development arena as it has emerged both in the wake of Polish decentralization and in terms of EU regional and social policies (cf. Gorzelak, 2004, 2007; Rodriguez-Pose and Fratesi, 2004). Given the predominance of the paradigm of endogenous development and consistent emphasis on social cohesion alongside the stress put on competitiveness, this policy arena seems indeed predestined to a form of new modes of governance as a result of which the largely antagonistic objectives (as well as values and interests underlying them) might be reconciled, while diverse endogenous resources mobilized and integrated (cf. Gąsior-Niemiec, 2007a). The role of an animator of the governance arrangements in the arena of local and regional development was ascribed to central government, while the role of their operator was to be shared between the central and regional tiers of government, inclusive of economic and social partners.

Mapping territorial government in Poland

In terms of territorial government the Republic of Poland is currently covered by a three-tier system, consisting of the municipal (commune – *gmina*), county (district – *powiat*) and regional (voivodship, province – *województwo*) levels. The municipal level and the county level are served by public administration constituted solely by directly elected bodies of local self-governments. The regional level is served by two-forked administrative structures, attached, respectively, to directly elected bodies of local self-government (the Council, the Marshal and his/her Office) and to the central government-appointed regional governor (the Voivod and his/her Office). The general tendency, beginning in 1990 – the year in which the genuine municipal-level territorial self-government was reinstituted in post-communist Poland – has been to broaden the scope of the responsibilities resting with the particular tiers of territorial government (cf. Swianiewicz *et al.*, 2005; Kowalczyk, 2006).

The progressive transfer of administrative competencies from the central to the local level has, to a certain extent, been followed by the strengthening of the local political agency *sensu stricto*. This process is best exemplified by the change in the status of local leadership whereby since 2002 the leaders of the municipal governing bodies – *wójt* (the village head), *burmistrz* (the town head), and *prezydent* (the city head) – have been elected directly and have enjoyed leverage over the respective councils (cf. Swianiewicz and Klimska, 2003). These two processes have not, however, been accompanied by an adequate transfer of financial powers from the central to the subnational (especially the regional) level. This shortcoming may to, a large extent, be held responsible for the clearly visible subordination of the local and regional development strategies towards the European Union priorities – the EU funds have become the major component of the local governments' financial provisions for pro-developmental activities (cf. Hausner, 2001; Szlachta, 2001; Grosse, 2004).

The functioning of Polish territorial self-government is thus crucially dependent upon the financial transfers from the two centres – the national one and the supranational one. By necessity it is also permeated by the political logic currently dominating in the two centres. The impact of the national political logic is manifested primarily in the strong influence of the national political parties on the structures and operations of local self-governments – the influence increases dramatically from the municipal to the regional level. The impact of the supranational (and international) logic is primarily manifest in the already mentioned choice of developmental priorities. It is, however, also reflected in some other aspects of local politics and policies, which included the grafting of several innovative governing and managing practices ('best practices') (cf. Swianiewicz and Klimska, 2003; cf. also Grabbe, 1999, 2001). Finally, the supranational logic works, as already mentioned, through attempts to re-elaborate the relationship between subnational political bodies and civil society organizations (cf. Marody and Wilkin, 2002; Gliński, Lewenstein and Siciński, 2004).

The functioning of the local government in Poland is therefore circumscribed by a rather complex interplay of different logics underwritten by often-divergent goals, values and interests. This interplay is particularly complicated at the regional level whose construction vis-à-vis the supranational, the national, and the local tiers of government is quite ambivalent. In addition, a gap caused by very weak interdependencies seems to exist between the regional political bodies and their potential economic and social partners. The complexity and ambivalence have been clearly demonstrated within the framework of the programming and implementation of the 2004–2006 EU Structural Funds.

Because of the space limitations in this chapter, at this stage we will offer only a brief specification of some of the major sources of complexity and ambivalence currently inscribed in the functioning of regional-level local government in Poland:

- Firstly, we will point to the double political structure of the tier – the Council/the Marshal/Office and the Voivod/Office – which often requires forging a cross-political party consensus, which is not an easy task in view of the deep political cleavages and the concomitant antagonistic Polish political culture.
- Secondly, we will point to the paradoxical status of the regional tier – burdened with overall responsibility for regional development and lacking adequate financial provisions to carry out the related tasks.
- Thirdly, we will point to the institutional discontinuity existing between the regional tier and the other two (municipal and county) tiers. The latter being actually autonomous in relation to the regional tier makes the tasks of the regional administration aimed at coordinating a variety of local developmental priorities and activities and at gearing them towards a regional synergy quite arduous.
- Fourthly, we will mention the growing expectations – backed by both formal and informal requirements – faced by the regional tier of subnational government to consult and share decision-making not only with municipal and county self-governments but also with representatives of civil society at large.

All of those sources of complexity and ambivalence need to be brought to light in the context of analyses that focus on the experience of the 2004–2006 ERDF in Poland with a particular emphasis being placed on the evaluation of the then novel institutional arrangement – the monitoring and steering committees – introduced in an attempt to foster the transition from government to 'good governance'.

The 2004–2006 ERDF programming experience in Poland

The 2004–2006 programming period marks an important threshold in the institutionalization of Polish regional (development) policy with a focus on changes and innovations affecting the area of local government.

As mentioned, by and large, the provisions and operations carried out during this period may be interpreted as a large-scale experiment in installing the logic of the new modes of governance in the arena of local and regional development in the country. The logic resided, *inter alia*, in legal provisions for the creation of organized, special-purpose policy networks to manage the programming and implementation of the ERDF, including representatives of the three main categories of stakeholders – representing public administration, business and civil society (not-for-profit) organizations.

The networks known by their official names of monitoring and steering committees were established in Poland in a manner congruent with the EC Directive No. 1260 of 1999. Their establishment was, however, also strongly underpinned by the ever more widespread discourse on the necessity to follow the EU discourse on governance (European Commission, 2003), to introduce a model of public–private partnerships, and to allow for an increased inclusion of civil society actors in public policy-making processes. Policy recommendations by eminent Polish experts, civil society representatives, and top politicians clearly evidence the connection (cf. Marody and Hausner, 2000; Hausner, 2001b, 2007; Szomburg, 2003; Luft and Wygnański, 2006; Gęsicka, 2006; Napiontek and Fałkowski, 2006).

The steering and monitoring committees were established for all of the operational programmes elaborated within the frameworks of strategies to implement the National Development Plan, the Community Support Framework and the EU Structural Funds at both the central and regional levels. The main legal framework for the establishment and functioning of the committees was adopted in 2004 together with the *Ustawa o Narodowym Planie Rozwoju* (Law on the National Development Plan) of 20 April 2004 and put into operation as of 8 June 2004 (cf. Dz.U. z 2004 r., nr 116, poz. 1206). The monitoring and steering committees constituted an integral part of the whole regional (development) policy 2004 legislation package.

Monitoring committees were conceived of as independent, opinion-giving and consultative bodies to support those institutions managing each of the operational programmes. These institutions included relevant ministries, such as the Ministry of Regional Development, the Ministry of Economy, the Ministry of Agriculture, the Ministry of Labour and so on, depending upon the policy scope covered by the programmes. The task of the committees was to monitor, evaluate and recommend changes and modifications of objectives, priorities, allocation strategies and volumes of support as well as modes of management and implementation of the respective programmes and the related funds. Each of the committees was presided over by the representative of the relevant managing institution (*Ustawa* ..., 2004).

The decisions and recommendations of the committees were not envisaged as being legally binding. However, the committees' status, scope and composition – as specified in the 2004 law – seemed to institute them as an important policy forum to operate through soft methods such as opinion-giving and recommendations based on negotiation, persuasion, learning and the mutual adjustment of the members. Precisely, this is the logic of operation identified as typical of new modes of governance, making them different from the traditional, statist forms of policy making which rely on legal means of enforcement (cf. Börzel *et al.*, 2005). Bearing in mind the inclusion in the committees of economic and social partners alongside central and regional administration and local self-governments, indeed a crucial channel for giving shape to regional (development) policy seemed to have been created in the post-accession Poland (cf. Szomburg, 2003; Luft and Wygnański, 2006; Gęsicka, 2006; Hausner, 2007).

Similar remarks can be made in respect of the steering committees. They might even be seen as all the more significant from the point of view of economic and social stakeholders if we realize that steering committees had been made co-responsible for the evaluation, selection and recommendation of developmental projects submitted by all entitled entities with the aim of securing financial support from a particular fund within the framework of a particular operational programme. Thus, the steering committees could indeed act as the most essential forum in reflecting the move from government to governance, within which the diverging interests of the different categories of regional stakeholders were to be revealed, confronted and reconciled, ensuring that regional public interest remained a priority.

On the other hand, the steering committees might also have been expected to function as a battleground in which different groups of actors attempted to establish predominance, which would then be reflected in project recommendations issued by the committees. The dominant role of territorial governments was marked by law, but not exempt from challenge and/or overruling by the other stakeholders. In addition, it could have been expected that the actual relationship between the economic and social dimensions of regional (development) policy might be one of the main issues to be negotiated within the framework of the committees – providing a particularly strong incentive for the political, economic and social actors to enter into persuasion and bargaining. Attempts at a redefinition of the role of the local government, as well as that of social partners, as *part of a wider governance* arrangement were thus to be expected.

Considering these expectations, a closer scrutiny of the law-stipulated principles of the constitution, composition and modes of operation of the committees seems vital from the point of view of the attempted (EU-induced) transition from government to governance in Poland. What is even more important, however, is the gaining of an insight into the actual functioning of the committees. In particular, it seems of interest to see which partners were invited to participate in them and in what manner, including in terms of their status, competences, skills and goals. In addition, it appears crucial to investigate what was their expected and actual role in the committees and thus their impact on regional (development) policy making in the country. On the other hand, it is equally interesting to investigate the way in which the new governance arrangements were perceived by representatives of local governments. Finally, it is important to note what changes were advocated by the different parties and which were actually introduced in the revised construction of the institutional framework to programme and implement the 2007–2013 Structural Funds package.

The 2004 *Law on the National Development Plan* stipulated that monitoring and steering committees were to be established by the Managing Institution at the central level and by the Voivod (the state-appointed governor of the region) or the Marshall (elected head of the region) at the regional level. The law ensured that ultimately the initiative to form this type of policy network and to control it was left to the central administration. The coordination of meetings and proceedings was entrusted to a representative of a managing institution, who presided over each of the committees (*Ustawa* …, 2004). Each of the committees was to be composed as follows: one-third should be representatives of the state administration, one-third should be representatives of the regional and local self-governing administration; and one-third of representatives should be social and economic partners (*Ustawa* …, 2004).

Let us now make a closer examination of the category of social and economic actors who were, by law, designated as members of the committees. The category of social and economic partners was defined by the 2004 law as comprising representatives of four basic groups of stakeholders: organizations of employers, organizations of employees, non-governmental organizations, and representatives of academic milieus. Representatives of these groups were granted the status of permanent members of the committees and were invited to participate in their proceedings on an equal footing with the remaining categories of actors (ibid.). Notably, participation in the proceedings of the committees was not remunerated (with the obvious exception of public administration representatives), which might have been – and indeed was – perceived as a certain barrier by non-administration committee members (cf. Chodor, 2005: 70).

Another interesting issue concerned the procedures regarding the selection of the representatives of social and economic partners to become members of particular committees. Analyses indicate that these procedures were only loosely described by the 2004 law and remained rather vague, allowing for discretionary decisions by representatives of public administration aided by arbitrarily selected representatives of the other stakeholders' groups during the selection process (*Ustawa …*, 2004). On the one hand, this might be seen as a sign of flexibility by their nature inscribed in policy networks and NMG in general. On the other hand, however, the representativeness, credibility and accountability of the economic and social actors invited to take part in the proceedings of the committees had been undermined (cf. Gąsior-Niemiec and Gliński, 2007).

At the regional level procedures for the selection of social partners to monitoring and steering committees were initially altogether lacking. Following protests by some civil society actors and a subsequent ministerial directive, varying procedures were introduced gradually in every region. On the whole, the region-level procedures were regarded as being far less formalized but also much less transparent than those obtaining at the central level (Chodor, 2005: 10). This perception was reflected in both experts' and stakeholders' opinions claiming that the composition of the monitoring and steering committees at the regional level was much more vulnerable both to discretionary powers of the public administration officers and open to political clientelism (cf. Skotnicka-Illasiewicz, 2006: 13–15). The prevalence of such opinions must have given rise to the emerging problem of the stakeholders' compliance with the committees' decisions. The opinions reflected also eroding trust towards the committees among the stakeholders and the public (cf. Gąsior-Niemiec and Gliński, 2007; Dworakowska *et al.*, 2006, 2007).

The compliance and trust were eroded further when information, opinions and gossip related to the actual functioning of the committees began to be revealed to the public. The high expectations brought about by the emphasis placed on the principle of partnership, the idea of shared decision making, and the supposed increase in the level of social control (in the interest of effectiveness and fairness) over political processes apparently was not borne out by the reality. Surprisingly, the disappointment was voiced by all of the parties participating in the new governance settings. Experts, representatives of territorial self-governments, officers of the state administration and representatives of the social partners spoke more or less openly of the failure of the committee structure (cf. Chodor, 2005; Czartoryska and Wejcman, 2006; Dworakowska *et al.*, 2006, 2007; Napiontek and Fałkowski, 2006). The severe criticism was addressed in particular at the region-level steering committees.

The tenor of the criticism is well reflected in results of several case studies carried out with a view to capturing the reception of the novel governance arrangements among particular categories of actors. Particularly revealing results have been obtained by research conducted with a view to evaluating the first experience of monitoring and steering committees from the point of view of social partners (cf. Chodor, 2005; Gąsior-Niemiec, 2007a) and by research focused on the evaluation of the experience from the point of view of local self-governments (cf. Dworakowska *et al.*, 2006, 2007). In addition to pointing out several of the structural weaknesses of the NMG formula as it had been applied in Poland, the results of the surveys are, first of all, indicative of a huge gap between the expectations bred by the introduction of the committees and the perceived *manner* and *effects* of their functioning. In my opinion, they also evidence a double misunderstanding: this related to the nature of the institutional instruments such as the NMG arrangements, and that of the nature of policy-making process itself.

The ERDF monitoring and steering committees – a perspective of social partners[1]

The national-level Monitoring Committee for the 2004–2006 programming period of the ERDF (ZPORR) was established by motion of the Ministry of Economy, Labour and Social Policy in 2004 with the aim of opinion-giving and recommending Supplement to the Programme and changes proposed to it, evaluating annual reports, final reports of the Programme, proposals of changes in the Programme, including changes and shifts in allocation between activities. The Committee's aim was also to monitor periodically progress in reaching milestone objectives as regards particular aims of the Programme which were defined in the Integrated Operational Programme of Regional Development and Supplement to the Programme (Chodor, 2005, 23; *Ustawa …*, 2004).

Its proceedings were for the most part coordinated by the Ministry of Regional Development which was created in 2005 and took over the role of the main institution managing the programme.

The Committee included seven representatives of the Polish NGO sector. These were delegated by research and development and academic milieus, local democracy-oriented NGOs, charity and social work-oriented NGOs, minority, youth and religious organizations, ecological NGOs, grassroots local self-government, and the milieu of organizations which constitute so-called 'soft' (entrepreneurship and innovation) supporting infrastructure. It could be mentioned that the balance in the social partner representation was, in general, tipped towards so-called Third Sector oligarchs – that is, the most powerful, rich and professional organizations (cf. Gąsior-Niemiec and Gliński, 2006). All of the oligarchs not only enjoy a high profile at the central level but also have strong regional representations. They do not, however, enjoy a status of a legitimate Third Sector (branch) representative. Nevertheless, in general, the composition of the social partner segment of the central level Committee might be interpreted as indicative of a conscious attempt to balance the NGO representation in terms of fields of expertise, branch rank, type of resources (and political correctness).

As far as the actual proceedings of the Committee, during the period of January–November 2005 when the reported study was conducted (Chodor, 2005), the committee was convened on six occasions. The attendance of the social partners varied but, in general, deteriorated over time. Towards the end of the period only the representatives of Caritas and Bractwo Młodzieży Prawosławnej were in regular attendance, while the other NGO representatives appeared either once or not at all. The level of active participation throughout the studied period was very low and, again, it deteriorated over the course of time, especially when compared with the growing active involvement of other committee members (Chodor, 2005: 82).

Judging from the evidence, such as the minutes of the committee's sessions, in total the social partners took the floor only six times during the period under research, the majority of which took place during the initial meetings. For instance, the grassroots local self-government representative (Krajowe Stowarzyszenie Sołtysów) took the floor, asking for clarification as to the criteria for classifying NGO financial resources as public resources. The Federacja Stowarzyszeń Naukowo-Technicznych NOT representative successfully proposed changes to be introduced to an academic scholarship scheme in order to ensure that both university students and high school students were entitled to take advantage of it (ibid.: 23–4). At the end of the first year of the committee's operation, the social partners' participation must, in general, be classified as extremely passive in view of the official records and almost totally inconsequential in terms of an ambition to shape the regional (development) policy programme.

Let us now offer a brief overview of the activity of selected regional steering and monitoring committees established within the framework of the same 2004–2006 ERDF (ZPORR) Programme. To repeat, the regional committees came into being by motion of regional executive boards and/or regional governors. The basic aim of the committees was to evaluate the projects filed for EU co-financing within the given region and to recommend some of them for funding. It needs to be mentioned that prior to evaluation by the committees, the projects were evaluated by panels of experts in order to rank the projects according to formal and technical criteria, such as their goodness of fit with priorities set in the given regional development strategy and/or National Development Plan, their technical feasibility and potential contribution to the development of the region, congruence with needs of regional economy, and so on.

Therefore, it might be surmised that the process of evaluation and recommendation by the regional steering committees could be interpreted as consciously designed to serve additional, non-technical purposes. The committee members could, for instance, attempt to change the expert ranking of projects arguing for and against it on grounds such as projects' contribution to a long-term regional interest, their beneficial/detrimental social effects, their innovative potential, etc. We should then reasonably expect that the committees became sites of political struggle, bargaining, persuasion, mutual learning and adaptation where also the voice of social partners would be heard. This, however, seemed not to be the case.

Even though the regional committees convened sessions at least twice as frequently as the central level committees, the NGO representatives were generally only slightly more active at the regional level than they were at the central level, in terms of attendance and voicing opinions, filing postulates, etc. (Chodor, 2005: 24–5; RKM, 2005 a, b, c, d; RKS, 2005a, b, c, d). Namely, there was only minor evidence that in the framework of some regional monitoring and/or steering committees the participating social partners did indeed attempt to introduce changes in the allocation schemes and/or ranking of projects to be funded by the ERDF (ZPORR) operational programme. Moreover, in many cases the proposed changes, even when supported by the whole committee (that is, negotiated within the policy forum), were subsequently disregarded or annulled under pressure from the representatives of public administration (cf. Bojarski, 2005; Chodor, 2005: 64–9; RKM, 2005 a, b, c, d; RKS, 2005a, b, c, d). By comparison, other categories of committee members, including economic partners, appeared to be several times more active than the social partners – representatives of the non-governmental sector (cf. ibid.).

Looking for ways in which to explain the less than satisfactory level of participation of social partners in the exemplary NMG settings in Poland, we will now turn to the opinions that some of the NGO representatives voiced in respect of the functioning of the analysed committees and their role within them. In general, it must be stressed that the newly positioned social partners seem to appreciate the opportunity and see it in terms of a step forward on the way to empowering civil society in Poland. Nevertheless, they rather consistently highlight several weaknesses inherent in the institutional formula and its operation. Furthermore, they also express some doubts concerning their own capacity to perform this institutional role.

On the one hand, the monitoring and steering committees, especially at the regional level, were often seen by the interviewed social partners as 'fig leaves' or 'voting machines' intended to simply legitimize decisions which have already been taken somewhere else by the regional politicians (Chodor, 2005: 65 and ff; Skotnicka-Illasiewicz, 2006: 13–15, 22–3). The voice of social partners was said not to be blocked literally; rather it was disregarded, taken into account selectively, and occasionally just overruled without any deliberation. Moreover, in many cases if any deliberation did take place, it was perceived as too formalized and misdirected towards technicalities and administrative issues instead of tackling issues such as social costs, public benefit, and the short- and long-term effects of projects (ibid.).

On the other hand, many shortcomings were also identified on the part of the NGO representatives themselves. The interviewees often felt that they lacked the expertise necessary to deal with the committees' agenda. They also admitted that the majority of NGO representatives tended to be passive or interested only in narrow issues related to the direct interest of their organizations or the organizations' clients. In addition, they felt that the voice of NGO representatives in the committees could be more effective if it came not from single organizations but rather from a coalition. Moreover, they hinted at questionable representativeness of the NGO representatives, which – alongside the absence of expertise – acted very much to the detriment of the social partners' perception by the other members of the committees and necessarily reduced their influence on the decisions made by the bodies (ibid.).

Finally, it is worth emphasizing significant doubts which were expressed by the social partners in respect of their role in new governance structures such as committees. The majority of NGO representatives proved to be unclear whether or not they should play the role of technical/policy experts – for which they admitted a lack of the appropriate skills – or rather function as guardians of a common good, 'pangs of conscience' to remind the other partners constantly about 'social costs' and civic and moral obligations involved in the policy-making processes (Chodor, 2005: 63–4). On the whole, they also appeared to be deeply frustrated by the fact that the committees did not function according to more clearly and rigidly prescribed procedures. In addition, they seemed deeply disappointed by the fact that ultimate decisions about what projects to include in the financial framework of the ERDF (ZPORR) in the given regions had been *political*, i.e. taken by regional political bodies (the Marshall/Office and the Governor/Office), i.e. and reflecting the preferences of the currently ruling political forces. The overall recommendation issued by the NGO sector representatives concerned the *abolition* of the formula of the regional steering committee (cf. Czartoryska and Wejcman, 2006; Dworakowska *et al.*, 2006, 2007), which actually did occur during the 2007–2013 programming period.

The ERDF monitoring and steering committees – a perspective of territorial self-governments

A series of surveys (cf. Dworakowska *et al.*, 2006, 2007) conducted among the representatives of territorial self-governments (at the municipal and county level) has in turn generated some data relating to the evaluation of the 2004–2006 NMG arrangement by the actors who also simultaneously fell into two categories: (i) participants in the monitoring and steering committees; and (ii) actual/potential beneficiaries of the committees' decisions. The surveys were focused primarily on the issue of transparency of the new institutional arrangements and procedures to programme and implement EU Structural Funds. By admitting 'free opinions' from the respondents, the surveys have actually produced a much more encompassing picture of the views that the representatives of the local government have in respect of the attempted transition from government to governance in Poland, investigated in this chapter.

The surveyed commune- and district-level territorial self-governments were generally sceptical about the ability of the regional steering committees to improve the effectiveness and transparency of the Structural Funds programming and implementation in Poland (Dworakowska *et al.*, 2007, passim). The respondents believed that too many actors have been included in the decision-making processes. On the other hand, they were critical of the fact that ultimately decisions could be subject to change by regional political bodies, which – in their view – undermined the idea of expert and social control over decision-making (ibid.). Distrust has been expressed by the respondents not only regarding the 'neutrality' of the political bodies in the decision-making processes but also regarding their (supposed) hidden influence on the choice of experts and social partners included in the regional steering committees (Dworakowska *et al.*, 2007).

The recommendations advanced by the surveyed representatives of the territorial self-governments urged the abolition of the formula of regional steering committees. Moreover, they stressed the need to limit political dimension of the decision making in favour of extensive reliance on technical expertise – provided by *external* experts. On the other hand, the recommendations included a call to strengthen the social control over the programming and implementation of Structural Funds – contrary to the NMG formula which has facilitated the actual inclusion of social partners in decision making, the advocated solution was to decrease the number of decision makers while increasing their accountability. One of the preferred options in this regard was to make it a legal requirement for decision makers to issue a detailed public justification of the decisions taken (ibid.; cf. also Czartoryska and Wejcman, 2006, *passim*).

These views, largely sharing the ambivalence expressed by the representatives of social partners, conform even more clearly with the already presented hypothesis pointing to the persistence of a double misunderstanding as regards the nature of the NMG and the nature of the policy-making process. Namely, in the eyes of the stakeholders, the NMG arrangements – most notably the regional steering committees – apparently did not contribute either to greater consensus or to higher efficiency in the sphere of the policy-making processes at the regional level in Poland. On the contrary, they have been evaluated as decreasing the level of transparency and accountability while increasing the level of arbitrariness and politicization of decision making. To an extent these views substantiate the doubts and scepticism expressed by experts as regards the overall effectiveness of the introduction of NMG in Poland, and other new Enlargement countries (cf. Grosse and Kolarska-Bobińska, 2008; *NewGov*, 2008).

Conclusion

In the light of the existing evidence, to date the attempted transition from government to governance in Poland, exemplified by the evaluation of the 2004–2006 ERDF/ESF (ZPORR) monitoring and steering committees, seems not to have produced the expected added policy value. The participation and impact of the social partners on the outcomes of the policy processes are of marginal importance. As a result of both external blockages and internal structural weaknesses, social partners appear neither truly capable of, nor very keen on, exerting an impact on the functioning of the committees and using them to take part in either the (re)shaping of principles, objectives, instruments or, at least, influencing the project selection and allocation processes.

In summary, when we consider the point of view of new modes of governance and the role played by social partners, the experience of the first round of the implementation of the ERDF in Poland could be viewed as disappointing. The social partners may be said to be misplaced within the new governance arrangements. Their misplacement is, to an extent, due to the internal weaknesses of the milieu they represent. However, the deficient legal provisions for their inclusion in the committees weigh heavily on the misplacement. The deficiencies are clearly manifest in the selection criteria used to co-opt social partners, lacking clarity as to their role in the policy networks, and last, but not least, in an ambiguous sitting of the committees within a larger political context.

From the point of view of local territorial self-governments (at the commune and district levels), the attempted transition from government to governance at the regional level in Poland has also apparently failed. The expectations of increased neutrality (i.e. de-politicization), transparency and effectiveness of the decision-making processes in regions have been largely frustrated. The move to increase co-operation and compliance through a process of inclusion has not been legitimized. Instead of the supposed benefits inscribed in the expansion of the regional development policy-making arena and its reorientation towards informal negotiation and bargaining, a feeling of distrust towards regional political institutions has grown, and a call to eradicate (as much as possible) politics from the policy arena has been voiced. A recommendation to restrict rather than to enlarge the policy-making arena has been also stressed, accompanied by an introduction of more formal and more law-regulated procedures to take and to justify decisions. In other words, the opinions have pointed towards a preference for government rather than governance at the regional level. However, the emerging paradoxical conception of government – politically neutral and relying on technical experts – might seem on the one hand indicative of the overall frustration with political culture in Poland, while on the other hand they reflect distant echoes of the (indeed) de-politicized methodology of NMG.

This final interpretation would appear to point to the relative success of the normative discourse of good governance in the country whose tenor has apparently gained ground with stakeholders at the subnational level – this is why they demand 'social control', expertise, transparency and accountability. However, the actual attempt to move from government to governance appears to have encountered several barriers, of which the most important still appear to be the weak levels of legitimacy of regional institutions, the low levels of trust in principles of public deliberation, and ill prepared and façade institutionalization of NMG (cf. Szomburg, 2003; Zalewski, 2005; Luft, Wygnański, 2006; Grosse and Kolarska-Bobińska, 2008).

Note

1. This part of the chapter is based on an earlier paper by Gąsior-Niemiec (2007a).

References

Adshead, M. (2002) *Developing European Regions: Comparative Governance, Policy Networks and European Integration*, Burlington, VT: Ashgate Publishing Company.

Börzel, T.A., S. Guttenbrunner and S. Seper (2005) 'Conceptualizing New Modes of Governance in EU Enlargement', a NewGov IP file (retrieved from www.eu-newgov.org).

Bojarski, L. (2005) 'W Urzędzie Marszałkowskim przyklepano skandaliczny podziałpieniędzy z UE', *Rzeczpospolita*, 22 April (retrieved from an electronic archive at www.rzeczpospolita.pl).

Chodor, J. (2005) 'Raport z monitoringu działalności przedstawicieli organizacji pozarządowych w Komitetach Monitorujących i Sterujących', Warsaw: Ogólnopolska Federacja Organizacji Pozarządowych.

Czartoryska, M. and Z. Wejcman (2006) *Jak skutecznie działać w komitecie monitorującym ZPORR 2004–2006. Poradnik dla przedstawicieli organizacji pozarządowych*, Warsaw: Fundacja Rozwoju Demokracji Lokalnej).

Drążkiewicz, J., G. Gęsicka and J. Szczucki (eds) (1995) *Inicjatywy lokalne: polskie doświadczenia*, Warsaw: Fundusz Współpracy.

Dworakowska, A. *et al*. (2006) Raport 'Przejrzyste fundusze strukturalne', Warsaw: Instytut Ekonomii Środowiska, CEE Watch.

Dworakowska, A. *et al*. (2007) Raport 'Przejrzyste fundusze strukturalne', Warszawa: Instytut Ekonomii Środowiska, CEE Watch, Fundacja Batorego.

European Commission (2003) *White Paper on Governance* (http://europa.eu.int/comm/governance/index_en.htm).

Gąsior-Niemiec, A. (2003a) *Europeanization and Myth-making: (New) Regionalism in Poland*. PhD dissertation, Warsaw: IFiS PAN.

Gąsior-Niemiec, A. (2007a) 'Civil Society and New Modes of Governance in Poland' *Polish Sociological Review* 1(157), 65–85.

Gąsior-Niemiec, A. (2007b) 'The New Regionalism in Europe – An Outline of the Problematic' in P. Jakubowska, A. Kukliński and P. Żuber (eds), *The Future of the European Regions*, Warsaw: Ministry of Regional Development, pp. 353–73.

Gąsior-Niemiec, A. and P. Gliński (2007) 'Polish Traditions of Self-organization, Social Capital and the Challenge of Europeanisation', in F. Adam (ed.), *Social Capital and Governance: Old and New Members in Comparison*, Münster: LIT Verlag, pp. 223–52.

Gęsicka, G. (2006). 'Strategia uzgadniania rozwoju', *Rzeczpospolita*, 15 May.

Gliński, P., B. Lewenstein and A. Siciński (eds) (2004) *Samoorganizacja społeczeństwa polskiego: III sektor i wspólnoty lokalne w jednoczącej się Europie*, Warsaw: IFIS PAN.

Gorzelak, G. (2004) 'Polska polityka regionalna – cele, uwarunkowania, instytucje, instrumenty', in T.G. Grosse (ed.), *Polska wobec nowej polityki spójności Unii Europejskiej* (Warsaw: Instytut Spraw Publicznych), pp. 247–60.

Gorzelak, G. (2007) 'Rozwój – region – polityka' in G. Gorzelak and A. Tucholska (eds) *Rozwój, region, przestrzeń*, Warsaw: Ministerstwo Rozwoju Regionalnego, Centrum Europejskich Studiów Regionalnych i Lokalnych UW EUROREG, pp. 179–214.

Gorzelak, G. and A. Tucholska (eds) (2007) *Rozwój, region, przestrzeń*, Warsaw: Ministerstwo Rozwoju Regionalnego, Centrum Europejskich Studiów Regionalnych i Lokalnych UW EUROREG.

Grabbe, H. (1999) 'A Partnership for Accession? The Implications of EU Conditionality for the Central and Eastern European Applicants', European University Institute WP RSC no. 99/12.

Grabbe, H. (2001) 'How Does Europeanization Affect CEE Governance? Conditionality, Diffusion and Diversity', *Journal of European Public Policy* 8(6), 1013–31.

Grosse, T.G. (ed.) (2004) *Polska wobec nowej polityki spójności Unii Europejskiej*. (Warszawa: Instytut Spraw Publicznych).

Grosse, T.G. and L. Kolarska-Bobińska (2008) 'New Modes of Governance in New Member States', *NewGov Policy Brief no. 25* (accessed 15 April 2008 at http://www.eu-newgov.org/database/PUBLIC/Policy_Briefs/NEWGOV_Policy_Brief_no25.pdf).

Hausner, J. (2001a) 'Modele polityki regionalnej w Polsce'. *Studia Regionalne i Lokalne*, 1(15), 5–24.

Hausner, J. (2001b) 'Dialog to klucz do rządzenia', wywiad A. Fandrejewskiej, K. Sadłowskiej z ministrem Jerzym Hausnerem', *Rzeczpospolita*, 2 November (retrieved from an electronic archive at www.rzeczpospolita.pl).

Hausner, J. (2007) 'Narodowy Plan Rozwoju (2007–2013) jako narzędzie społecznej zmiany', in G. Gorzelak and A. Tucholska (eds), *Rozwój, region, przestrzeń*, Warsaw: Ministerstwo Rozwoju Regionalnego, Centrum Europejskich Studiów Regionalnych i Lokalnych UW EUROREG, pp. 309–18.

Hausner, J. and M. Marody (eds) (2000) *Jakość rządzenia. Polska bliżej Unii Europejskiej?* EU-monitoring IV, Kraków: Friedrich Ebert Stiftung, MSAEP.

Héritier, A. (ed.) (2002) *Common Goods: Reinventing European and International Governance*, Lanham, Boulder, New York and London: Rowman & Littlefield Publishers, inc.

Hooghe, L. (ed.) (1996) *Cohesion Policy and European Integration: Building Multi-Level Governance*, Oxford: Oxford University Press.

Kohler-Koch, B. (2002) 'European Networks and Ideas: Changing National Policies?', *EioP*, 6(6) (http://eiop.or.at/eiop/texte/2002-006a.htm).

Kowalczyk, A. (2006) 'Local Government in Poland', *Local Governments in Central and Eastern Europe* (www.lgi-osi.hu), 217–53.

Kozak, M. and A. Pyszkowski (eds) (1999) *Pilotażowy program rozwoju regionalnego Phare-STRUDER*: *doświadczenia, efekty, inspiracje*, Warsaw: Polska Agencja Rozwoju Regionalnego.

Koźlicka, R. (2006) 'Współpraca organizacji pozarządowych z instytucjami Unii Europejskiej: prowadzenie dialogu społecznego', in Stowarzyszenie na Rzecz Forum Inicjatyw Pozarządowych, *Dialog obywatelski w procesie integracji obywatelskiej*, Warsaw: Stowarzyszenie na Rzecz Forum Inicjatyw Pozarządowych, pp. 4–17.

Lewenstein, B. and H. Palska (2004) 'Organizacje pozarządowe na scenie publicznej Polski okresu transformacji: dynamika rozwojowa i relacje z władzą – analiza badań jakościowych', in P. Gliński, B. Lewenstein and A. Siciński (eds), *Samoorganizacja społeczeństwa polskiego: III sektor i wspólnoty lokalne w jednoczącej się Europie*, Warsaw: IFIS PAN, pp. 80–106.

Luft, B. and J. Wygnanski (2006) 'Szukanie kapitału społecznego', *Rzeczpospolita*, 24 July.

Narodowa Strategia Integracji Społecznej dla Polski (2004) (Warsaw: Zespół Zadaniowy ds. Reintegracji Społecznej, Ministerstwo Polityki Społecznej).

Narodowy Plan Rozwoju 2004–2006. Dokument przyjęty przez Radę Ministrów w dniu 11 lutego 2003 r. (Warsaw: Ministerstwo Gospodarki, Pracy i Polityki Społecznej).

Marody, M. and J. Wilkin (eds) (2002) *The Vagaries of Institution Building: Poland's Adjustment to the European Union*. EU-monitoring VI, Kraków: Friedrich Ebert Stiftung, MSAP AE.

Mayntz, R. (2002) 'Common Goods and Governence', in A. Héritier (ed.), *Common Goods: Reinventing European and International Governance*, Lanham, Boulder, New York and London: Rowman & Littlefield Publishers, inc.).

Napiontek, O. and M. Fałkowski 'Civic Dialogue in Poland – Consultations of the Draft of the National Development Plan 2007–2013' (www.eu-newgov.org).

NewGov (2008) 'Call for Participation: Civil Society, New Modes of Governance and Enlargement' (Free University Berlin, 8–10 May).

Radaelli, C.M. (2000) 'Whither Europeanization? Concept Stretching and Substantive Change', *EIoP* 4(8) (http://eiop.or.at/eiop/texte/2000-008a.htm).

RKM (2005a) 'Analiza aktywności członków Mazowieckiego Komitetu Monitorującego Kontrakt Wojewódzki' (an interim research report based on the minutes of the committee sessions, compiled by J. Chodor, OFOP, Warsaw).

RKM (2005b) 'Analiza aktywności członków Podlaskiego Komitetu Monitorującego Kontrakt Wojewódzki' (an interim research report based on the minutes of the committee sessions, compiled by J. Chodor, OFOP, Warsaw).

RKM (2005c) 'Analiza aktywności członków Świętokrzyskiego Komitetu Monitorującego Kontrakt Wojewódzki' (an interim research report based on the minutes of the committee sessions, compiled by J. Chodor, OFOP, Warsaw).

RKM (2005d) 'Analiza aktywności członków Wielkopolskiego Komitetu Monitorującego Kontrakt Wojewódzki' (an interim research report based on the minutes of the committee sessions, compiled by J. Chodor, OFOP, Warsaw).

RKS (2005a) 'Analiza aktywności członków Mazowieckiego Komitetu Sterującego' (an interim research report based on the minutes of the committee sessions, compiled by J. Chodor, OFOP, Warsaw).

RKS (2005b) 'Analiza aktywności członków Podlaskiego Komitetu Sterującego' (an interim research report based on the minutes of the committee sessions, compiled by J. Chodor, OFOP, Warsaw).

RKS (2005c) 'Analiza aktywności członków Świętokrzyskiego Komitetu Sterującego' (an interim research report based on the minutes of the committee sessions, compiled by J. Chodor, OFOP, Warsaw).

RKS (2005d) 'Analiza aktywności członków Wielkopolskiego Komitetu Sterującego' (an interim research report based on the minutes of the committee sessions, compiled by J. Chodor, OFOP, Warsaw).

Rodriguez-Pose, A. and U. Fratesi (2004) 'Między rozwojem a polityką społeczną – europejskie fundusze strukturalne w regionach celu 1', *Studia Regionalne i Lokalne*, 3(17), 5–32.

Skotnicka-Illasiewicz, E. (z zespołem) (2006) 'Polityka regionalna UE jako element strategii rozwoju lokalnego i regionalnego' – raport z badania zrealizowanego przez agencję badawczą SMG/KRC dla Departamentu Analiz i Strategii UKIE, Warsaw: MillwardBrown SMG/KRC.

Swianiewicz, P. (2006) 'Poland – The Development of Subnational Governments 1990–1998' (www. eu-newgov.org).

Swianiewicz, P. *et al.* (2006) 'Partnership-based development institutions supporting regional development–Developments in the 1990s', Newgov-15-D2-Regional Development Regimes Poland (accessed 20 March 2007 at http://www.eu-newgov.org/database/DELIV/D15D02b_Regional_Development_Regimes_Poland.pdf).

Swianiewicz, P. and U. Klimska (2003) 'Kto rządzi gminą i jak? Lokalni liderzy polityczni w teorii i praktyce samorządów w Polsce', *Studia Regionalne i Lokalne*, 4(14), 15–40.

Szlachta, J. (2001) 'Polityka regionalna w Polsce w perspektywie integracji z Unią Europejską', *Studia Regionalne i Lokalne*, 1(5), 26–40.

Szomburg, J. (2003) 'Upublicznić politykę państwa', *Rzeczpospolita*, 2 January.

Ustawa z 25 czerwca 1998 r o samorządzie województwa. DZ.U. nr 91, poz. 576.

Ustawa z 26 listopada 1998 r o finansach publicznych. Dz.U. nr 155, poz. 1014.

Ustawa z dnia 20 kwietnia o Narodowym Planie Rozwoju (Dz.U. nr 116, poz. 1206).

Wejcman, Z. (2008) *Raport z programu 'Lokalne Partnerstwa'* (www.boris.org).

Wejcman, Z. (2004) *Pakty regionalne jako instrument dialogu społecznego* (Warsaw: SPLOT).

Zalewski, D. (ed.) (2005) *Dialog społeczny na poziomie regionalnym. Ocena szans rozwoju*. (Warsaw: Friedrich Ebert Stiftung, Przedstawicielstwo w Polsce, IPiSS).

Zintegrowany Program Operacyjny Rozwoju Regionalnego 2004–2006 (2003) (Warsaw).

Other websites consulted

www.bkkk-cofund.org.pl
www.funduszestrukturalne.gov.pl
www.mazowieckie.gov.pl
http://www.ofop.engo.pl/
www.podkarpackie.gov.pl
www.wielkopolskie.gov.pl
www.ukie.gov.pl
http://www.zporr.gov.pl

9
How to Avoid the '*Mezzogiorno* Syndrome': The Golden Burden of EU Funds in the Romanian Regions

Sorin Ioniţă

9.1 Introduction

Travelling across Europe, one is sometimes left with the impression that the discrepancies in the level of development, still noticeable to the naked eye in spite of the decades of Cohesion Policy, are harder to explain with econometric or spatial models than by watching the Italian neorealist movies of the 1940–50s. If true, this is the best illustration of the notion of *path dependency*: a vicious circle in which past underdevelopment creates conditions for its own perpetuation. In countries like Italy, this is known as the '*Mezzogiorno* problem', but if we move one level up, the question can be rephrased: how many *Mezzogiorno*s does the EU have?

Eastern Germany after unification is often considered, like the Italian south, to be a region with intractable problems, and sometimes parts of Portugal, Spain or Greece are placed in the same box. Depending upon the yardstick used, one could include almost every one of the new Member States; or, alternatively, at least the eastern halves of Poland and Slovakia, plus the area east of Middle Danube (historically, outside the old Roman *limes*). An even more interesting challenge is to identify how many such regions actually exist *within* each country. This means territorial units that are not only poorer on average, but were also poorer in the past, and where recent public interventions, by the national states or the EU, have failed to produce the expected impact.

This issue is crucial, since the 'Mezzogiorno syndrome' is not only about being below a certain level (for example, the 75 per cent GDP per capita of the Union's average, which makes a region eligible for Cohesion funds at NUTS II level). It is much more: a resilient situation of dependency, rooted in the local economic and social networks. Here, when assistance funds flow in from the outside, the demand for services responds normally by increasing. However, since the local supply is limited and rigid, for various historical and cultural reasons, the inputs also have to be provided from outside, and thus the level of dependency of the whole area is reinforced. When a modern factory is built, part of the specialized labour has to be shipped from elsewhere at high costs, because of the local scarcity of this type of resource. When a new highway finally arrives, it does not bring with it much development; on the contrary, locals use the easier access to flee, and the younger and more mobile are the first to do so, leaving the home region worse off.

As a new EU member, Romania as a whole is trying hard to avoid becoming one of Europe's problem regions, trapped in a developmental dead end. Nevertheless, inside Romania there are areas threatened by the *Mezzogiorno* syndrome. This chapter aims to show that this is indeed the case, and to discuss how the situation should be conceptualized in order to respond with appropriate policies, having in mind the substantial resources earmarked for the country in the Structural and Rural Development Funds.

9.2 Regional development: policy or destiny?

In Romania the transition to market and democracy was more difficult and traumatic than in other CEE states, as a result of the secular legacy of underdevelopment and the severe socioeconomic distortions inherited from a communist regime which was more brutal and autarchic than most of the others in the region. The attempts to distribute more or less evenly the industries and wealth across the whole territory of the country, an explicit policy guided from Bucharest for many decades before 1990, led to perverse effects: an over-investment in prestige projects and an under-investment in basic infrastructure and maintenance; 'white elephants' – poorly planned and unsustainable industrial projects, decided for purely political reasons. As a result, many mono-industrial towns or micro-zones were created, which relied on a single large company or industry branch for their entire socioeconomic life, in the middle of an otherwise backward sub-region. A complex network of cross-subsidies between industries and regions made it impossible to judge what was – and what was not – economically viable.

Beneath the surface of the formal socialist economy, portrayed as modern and booming, the social structure of deep Romania has endured in many places in a more or less unaltered form. First and foremost, the hard core of autarchic peasant households engaged in strip-farming has survived. Paradoxically, they were even reinforced as a viable economic structure during the long decades of mismanagement and food shortages. This semi-survival, traditional agriculture on small plots was practiced by the members of agro cooperatives alongside – or at the expense of – the official state agriculture. But also by a large proportion of the new industrial workers, who were in fact semi-urbanized peasant commuters, more attached to their land and garden than the factory that paid their nominal salaries. As a result, Romania has entered the EU in 2007 with an estimated number of 4.4 million agro exploitations ('farms'), of which only about one-third have registered so far for financial support under CAP. Of the rest, a simple number are simply too small and undercapitalized, and therefore fall off the radar screen of any conceivable European policy. These aging rural dwellings, insulated from the monetized economy, are unevenly distributed across the eight Romanian development regions (NUTS II), predominating in the South and East of the country.

The economic restructuring with partial deindustrialization after 1990 was an inevitable phase during which some of these distortions and overinvestments were eliminated, especially those in heavy industry. After almost two decades of transition and ten years of approaching the EU on fast-forward, a number of conclusions are discernible regarding the relative potential of development in the Romanian regions. In a tentative summary of the factors that determine their wealth and dynamism, to be proven with data in the following sections, one can say that:

- Old, historic disparities in development could not be erased by the massive efforts and investments, lasting decades, under Communism. The regime only managed to create an appearance of social homogeneity and some unsustainable economic insertions which disappeared as soon as the protecting glass case was removed.
- The divergence between regions after 1990, which was especially apparent during economic booms (the rich ones grow faster than the poor ones in good years, and decline less during recessions[1]) is therefore to a large extent a reflection of the historical patterns prevalent under Communism, and even before.
- Apart from the inherited development and its prerequisites, additional factors influencing regional growth seem to be playing a role today: geographical location (the closer to the western border, the better,

but this overlaps by and large with the historical patterns); and easy access (the cases of Bucharest, or the city-harbour of Constanţa on the Black Sea).

- Demographics will play an increasingly important role, in a way that is completely new for Romania, reproducing trends that occurred after the Second World War in some parts of Western Europe. First, the country shares with most of the Union a general population decline. Secondly, this ageing process is very pronounced in some parts of our rural society, especially in the vast plains of Southern Romania, which will probably lead to depopulation and a complete change of the agricultural economy in a few decades. From an economic point of view such a process makes sense, but many social problems will have to be solved along the way, and many temporary palliatives will have to be applied to ease the pains of change at such a breakneck pace.

All of these factors are exogenous to governance and lead to the pessimistic conclusion that, ultimately, the patterns of development in Romania are largely predetermined. The same conclusion was drawn by researchers in other countries that more or less share Romania's problems, such as Poland.[2] There are no traceable success stories of policy interventions that managed to change these patterns before 1990, and such success stories are even less likely to appear after the collapse of Communism, when the scope and instruments of social and economic intervention were reduced substantially. Currently there is a hope, shared by many decision makers and public administrators, to spread the development more evenly with the help of large infrastructure projects, financed mainly through the EU. However, such expectations should not be played up excessively: the theory of planting highways in backward regions in order to generate development leads to poor investment strategies in cost–benefit terms, and is in general honoured more in rhetoric than in reality. What we observe on the ground is that, when infrastructure projects are successful, this is the case because they are prioritized in order to serve economic activities where they already exist and are constrained by the insufficient transportation and utility networks.

This is a well-known problem that goes to the very core principles of the development theory: development as a phenomenon is complex and elusive, difficult to trigger top-down by government policies, even well intended. It resembles a living body easy to destroy but hard to regenerate from scratch. Creating a favourable environment for it is one thing the governments can do, and here comes the orthodox package of competitiveness, functional bureaucracy, low corruption and stable institutions.

But this, more often than not, is a subject of nationwide strategies, rather than region-specific ones, and even in this respect, things are easier said than done. In Romania the general policy framework and the business environment are determined largely at the national level, so there is little that a mayor or county councillor from a poor region can currently do to push things in the right direction. (The converse is not true, however: they can do a lot of harm if they choose to; therefore useful advice would be to avoid wrong-headed local policies that kill the little growth that is happening naturally in a specific community.) All in all, development appears easier to tackle as an object of measurement and evaluation than as a policy target for decision makers.

On the other hand, working against this deterministic view, the truly historical novelty in this part of the world is the process of EU integration. There before in the history of this region has there been such a consistent and institutionalized foreign intervention, with technical, financial and political components, with the declared aim of modernization and development. The *crescendo* of assistance in the last decade reaches a climax two or three years after a country becomes a full member: in the case of Romania, around 2009–10, with grants totalling up to €200 per capita annually, which as a percentage of GDP surpasses the level of assistance available to Western Europe after the war through the Marshall Plan. If there is something that can alter the old patterns of regional development, probably this is it. Which does not mean that things run on automatic pilot once a country joins the Union and money starts flowing in even larger quantities. For every Ireland which has used its EU funding intelligently, shaping itself up and becoming a modern country, there are counter-examples that did not, burying them in projects with low impact and reinforcing the closed traditional society.

Another important variable to be considered is the opening of the European borders for Romanian citizens in 2002. This was arguably one of the most significant changes for ordinary Romanians in the decade and a half of transition,[3] with an impact that is still hard to quantify. The massive circulatory migration between Romania and Western Europe over the course of the past five years has brought into the country more money than the official assistance provided through EU pre-accession instruments. Since the emigration pool is very diverse in terms of skills and community of origin, with the poor rural sector in the eastern part of Romania being well represented, the benefits from this migration are relatively evenly distributed by social category and region. In turn, this contributes to a more even geographical distribution of freshly added resources, thus moderating the general trend of regional divergence in the buoyant years mentioned above. On the other hand, the outflow of workers, which experienced a peak in 2003–05, has created a very tight local labour market and, increasingly, severe labour shortages in some regions and professions. But at least in this respect, and for the time being, the Romanian regions are spared one of the typical Mezzogiorno problems: high unemployment.

9.3 Current trends

As mentioned, GDP per capita has steadily risen in Romania in real terms since the EU accession negotiations began in 1998–99, but this happened unevenly across the eight development regions (Figure 9.1).[4] Region 8 (a special one, including only the capital city of Bucharest and the surrounding small county) benefited most, followed by the western parts of the country and Constanţa county (on the Black Sea, pushing up the average in the South East region). Since 1998, Region 8 has doubled its GDP/cap in euro terms, which is a remarkable achievement: at PPP it is catching up rapidly with the Euro-wide average. Wages have followed the same trend, though less pronounced: salaries in NW and the Central region are not as high as the GDP level in these parts would predict, and this gap may be explained in many ways, from the concentration

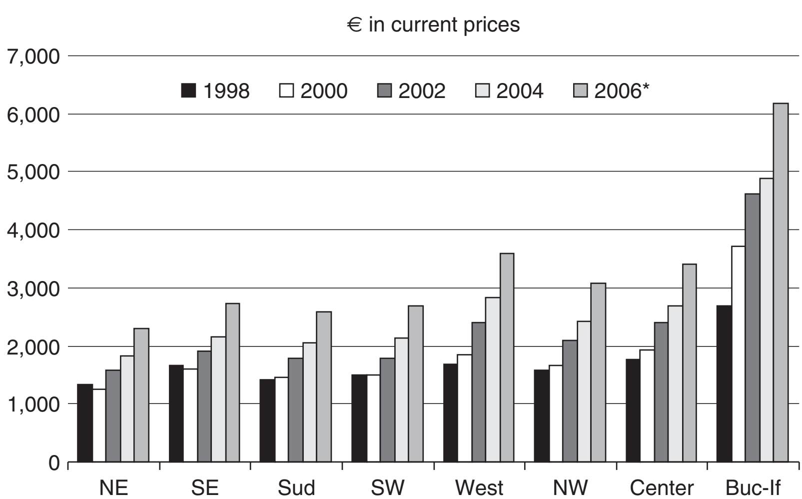


Figure 9.1 GDP/cap in the NUTS2 regions (€ in current prices)
Source: Statistical yearbook, INSSE, 2006

of the declining state mining sector in SW, to the variable share of the underground economy across regions.

Demographics reflect the changing socioeconomic conditions in Romania during the period of transition. There is a general decline in the level of population, which is nothing new, and is the result of falling birthrates and emigration. This latter factor plays an uncertain role in the long term, however: a large proportion of those who left to work in the EU will return, as their heavy investments in land and houses back home predict, and so the effect will be temporary; however, if many of them settle down for good in Western Europe, statistics will register a substantial one-off drop in population in the early years of the decade. In any case, data show that:

- The poorer northern and eastern are currently more affected by the outflow of people, these being areas of the highest external and internal emigration;
- There was a reverse in the general, historical trend in urbanization during the transition, especially between 1994 and 2000, as many urban dwellers moved (back) to villages. This was part of a subsistence strategy employed by blue-collar workers who were faced by massive industrial restructuring. Things look as if the forced urbanization under Communism led to a backlash immediately after the regime fell. This stage is over by now and the long-term urbanization trend has resumed lately.

The ageing of the population is apparent especially in the rural south and south west, where it is close to Western European levels. Since younger people still around in these villages and small towns are strongly attracted by the adjacent Region 8 – and first and foremost by the city of Bucharest – a gradual depopulation of these areas is likely to take place in future. Economically, this makes sense, as the consolidation of land and agro economic activities is a necessity, especially in the Romanian Plain, where the current pattern of strip-farming on small plots is not sustainable in the long run. But the changes will be accompanied by social problems which will need to be tackled with vision, determination and resources. The recent policy of life annuities for old peasants in exchange for land that has been put in place by the Ministry of Agriculture and agreed with the EU may address this problem if it is properly implemented. On the other hand, it has the potential to accelerate the uprooting of traditional communities.

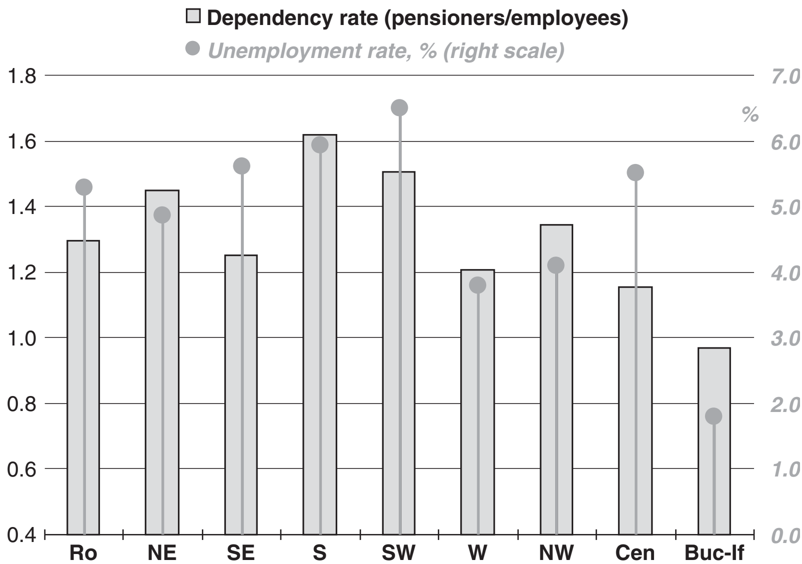


Figure 9.2 Social problems by region, 2005
Source: Territorial statistical yearbook, INSSE, 2006.

Unsurprisingly, the differential in ageing trends is also reflected in the social dependency rate, which varies from region to region. Again, the southern parts record the highest pensioners/employee ratios (Figure 9.2). Demographics and industrial decline have contributed to this, as successive Romanian governments have been happy to camouflage the under-employment of people with low qualifications through early retirement and migration to villages. The absolute level of unemployment is quite low for a country supposed to be undergoing massive economic and labour reallocations (Figure 9.2), but the numbers do not account for the fact that many individuals of working age are under-employed subsistence 'farmers', keeping themselves busy round the clock on their tiny plots and gardens, at a very low rate of productivity.

The future does not look much rosier, for the current distribution of labour by sectors (Figure 9.3) and the stock of human capital are not favourable to sustained development. The whole country should look more like Region 8 in order to come closer to the EU occupation structure. But this will not happen in the near future, as a result of social rigidities, which make it difficult for older and unskilled people in villages to respond to market signals, and the relatively high costs (financial

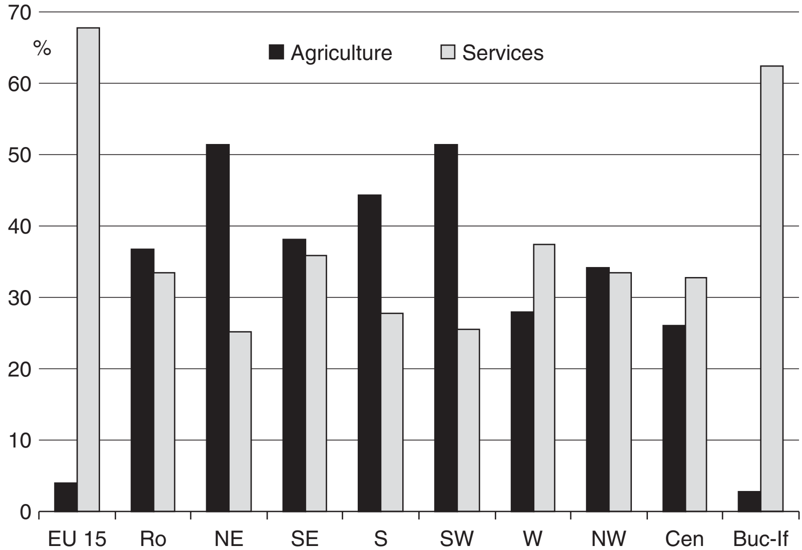


Figure 9.3 Structure of labour by sectors and regions, 2003
Source: Territorial statistical yearbook, INSSE, 2006.

and emotional) of relocation from one part of the country to another. In general, the decline of the occupation in agriculture after 2000, even in the least advanced counties, has not released labour for industry and services, but was most likely the effect of natural decline of population, emigration and a steep increase in occupation in the public administration (Figure 9.4). In these 'Romanian *Mezzogiorno* regions' it is possible that the EU assistance remain without the desired effect, since it is not clear whether or not these communities have enough resources, energy and expertise in the private sector to make effective use of it.

The effects of the international migration of people of active age, and the increased demand for workforce, especially in the western regions of Romania and in Bucharest (Figure 9.5), predict an ever tighter labour market in the future, with shortages in almost all skill and qualification groups.[5] Companies and the public sector are increasingly outbidding each other for good employees, or try to move the little manpower available from other parts into the western regions or big cities. The chances are high that in a few years the tight labour market would have generalized at the country level, spreading into the poorer regions too. The upside of the situation may be the continuation of the current trend of

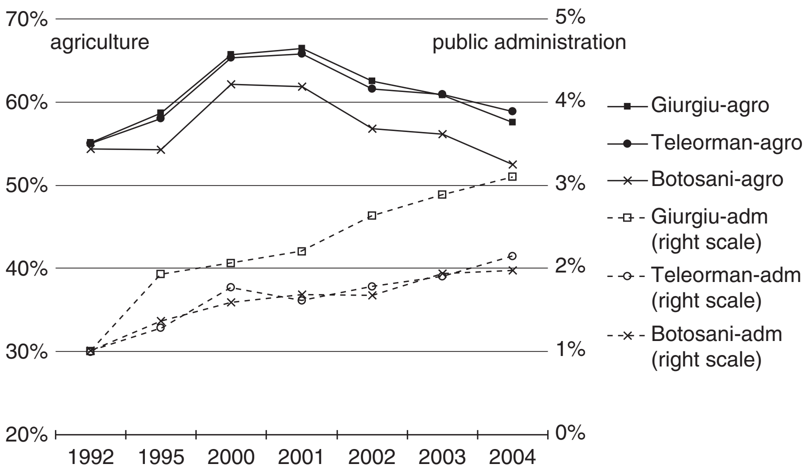


Figure 9.4 Agriculture and public administration, as % of total employment, three Romanian '*Mezzogiorno* counties' (South and North-East)
Source: Territorial statistical yearbook, INSSE, 2006.

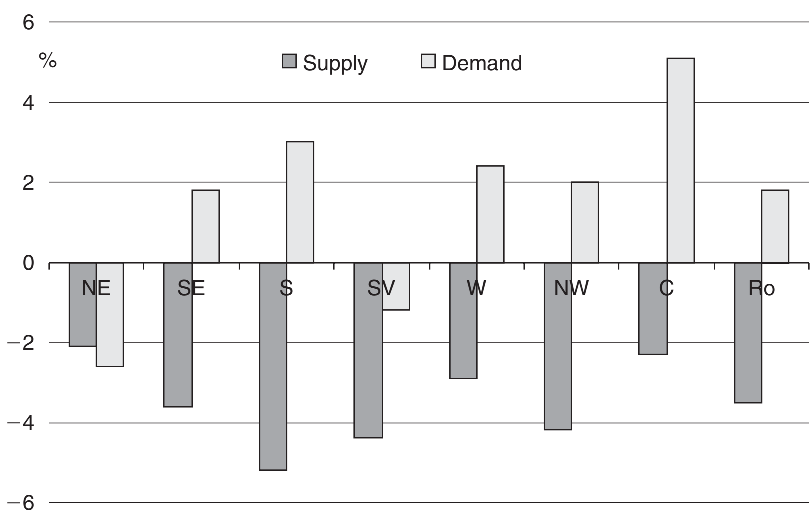


Figure 9.5 Labour force supply and demand by region, forecast for 2005–2013
Source: Regional labour market supply: forecast 2013, The National Research. Institute for Labour and Social Protection, Bucharest, 2005.

development with low unemployment and rising salaries, which have already doubled in euro terms between 2001 and 2005 as a national average, and almost doubled again between 2005 and 2007, pushing companies up the added-value ladder and freeing human resources from labour-intensive industries. The downside is that the wave of development and economic modernization sweeping Romania from West to East looks poised to replace the old regional cleavages with a new one: urban–rural, in which disparities are likely to grow quickly, especially in the relatively poorer southern and eastern parts, as cities and their immediate surroundings pick up with the rest of the country and leave the 'deep rural Romania' behind.

9.4 Current patterns of development and EU assistance

To summarize the complex dynamics of regional development in Romania, two broad determinants are discernible that have shaped the pace and direction of change over the past decade, and will probably continue to do so. As said, they reproduce well the historical lines of change and modernization, this being a process '*a la longue durée*' (Figure 9.6).

A. First, the *progressing wave model*, advancing from West to East at a pace of about 30–40 km per year. If we accept this simplified but highly

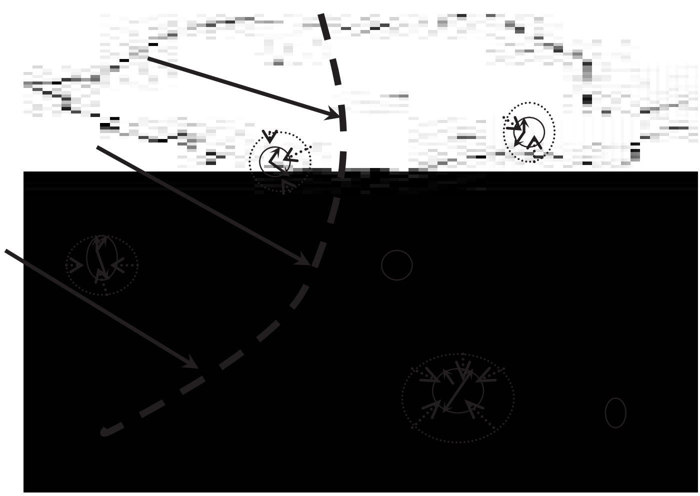


Figure 9.6 The two vectors of regional development: the West–East tidal wave; and the opposing diffusion-draining effects of large cities

visual description, take as the starting point the Austrian border, and the initial moment the late 1980s, when Hungary launched its pro-market reforms, the sustained growth of the western parts of Romania in recent years fits well this model of a progressing wave of development.

B. Secondly, the *polycentric diffusion pattern*, where administrative modernization, economic diversification and better opportunities, all reflected in a higher land price, spread around from a small number of cities with good transportation connections, and which are large enough to sustain a vibrant social life necessary to attract and retain a critical mass of professionals and investors. In many ways, these cities are better linked with the network of global metropoleis than with their immediate hinterland, especially when an international airport exists in their vicinity. For instance, in terms of institutional distance, Timişoara and Bucharest are closer to Brussels than to the small neighboring towns of Oraviţa or Caracal, respectively.

These two vectors of development may work in conjunction, but also, sometimes, cancel each other's effects. For example, better access through new transportation networks brought in by the progressing wave may paradoxically shorten the radius of development around the urban development poles. Instead of diffusion, what we observe is a draining of resources by the large city from its hinterland, a phenomenon already noted in other parts of the post-communist world.[6] In Bucharest, for instance, the development momentum is felt within a radius of about 20–25 km around the capital, and accurately reflected in the price of land, whereas the area within a 50–100 km radius is characterized by a draining of resources, which tend to be concentrated in the regional centre. Businesses relocate in order to benefit from the network effects of the capital, while the better commuting possibilities allow labour to travel from further away. This kind of influence may be temporary, but where it exists it is strongly felt and may take a long time to wear off. Bucharest, which resembles the above-mentioned Warsaw as a large metropolis in the middle of a relatively backward region, arguably creates the same kind of effect in the adjacent, relatively poor counties.

With the increase in the volume and complexity of EU assistance over the next few years, the question arises: what will be the impact of these large programmes on the existing, natural patterns of regional development shown in Figure 9.6? By tradition, the focus of the EU regional policy has been primarily the poorer regions, which were regarded as legitimate targets of a massive redistributive effort. This approach has been increasingly criticized in recent years for its inconsistent goals and equalitarian logic. In a way, we could even speak of an anthropomorphic fallacy of the regional policy: if human individuals are regarded, following Kant, as goals in themselves, a vision that justifies a certain level of social redistribution at the expense of growth, in the same way the territorial administrative units of Europe (such as NUTS 2) are conceived as moral entities which must be 'aided' and 'lifted out of poverty' through redistribution. However, this parallel is dubious, precisely because too much focus on regions and their components can miss the more complex social dynamics of individuals, who have their own goals and plans about how to accede to prosperity, and who should be the ultimate unit of analysis. Secondly, even with such a policy in place, critics say, there is no discernible reduction in regional disparities at the broader EU level, while in the countries where disparities have decreased, it is not clear to what extent this is directly attributable to the EU regional policy.

Most famously, the Sapir Report commissioned by the Commission and published in 2003 has argued these points forcefully and has made a strong case for increasing Europe's competitiveness. Another study, by economists at Ecofin Council, draws the same conclusion: that the twin goals of competitiveness and convergence pursued by the Structural Funds may be at odds with one another. Therefore, one can choose to pursue cohesion understood in a narrow sense, which is the one that prevails in practice; or, alternatively, it is possible to opt for maximizing the total efficiency and growth of the society, and accept some degree of inequality, as long as everybody is better off in absolute terms.[7] As the regional disparities in the new Member States may continue to increase after accession, at least in some larger countries, balancing the two goals will increasingly become a hot political issue, influencing the discussion about decentralization and national development policies in general.

The Romanian government has set as its explicit goal to employ the six Sectoral Operational Programmes (SOP) agreed with the EU in order to sustain the nationwide development process and close the gap with the rest of the EU. Over the same period, it has decided to use the seventh (the Regional Operational Program, ROP) to reduce the disparities between Romania's NUTS 2 regions. Thus, the authorities intend to trigger a two-tier motion, transposing into national policy the EU-wide objective of convergence on several levels. Since the equalizing ROP amounts to only about 14–15 per cent of total EU assistance in Romania, it would seem that the Romanian government has adopted a pro-growth scenario.

However, on closer examination this is far from certain. It is unlikely that this clear-cut and rational concept will be put into practice without numerous and tacit adjustments at the margins, which may finally lead to substantial alterations. For example, even in SOPs a set of indicative allocation rules were included, mostly following pressures from local government, to make sure that in one way or another each region – and, probably, county – will 'get their share' of funds. This is simply a local reflection of the current ambiguity about the notion of convergence in EU circles: does it mean simply a redistribution of resources with the aim of achieving relatively equal inputs (resources); or a more sophisticated meaning can be accepted ('functional cohesion') which assumes that regions or sub-regions will continue to play different roles in the economy, with poles and peripheries, and this arrangement is acceptable as long as everyone is better-off tomorrow than today (the 'rising wave' model)? This unsolved dilemma, never addressed explicitly in the national debate, will continue to haunt Romania's politics and administration for a long time to come.

If a clear commitment is not made for one or the other scenario, and the policy mix is going to result in hesitation and muddle, a number of other institutional factors which are already present may in fact reinforce the existing development patterns, consolidating the trend of historical path dependence described at the beginning of this chapter. Institutional capacity problems in particular have become severe in recent years. The main problems in running EU assistance at all government levels are related to the actual implementation of individual projects. Poor management and scarce expertise are two recurrent themes in the discussion. Consultants, engineers and architects are in short supply in many parts of the country, especially in the rural areas, while any project above a certain threshold requires a certified expert. The shortage of human resources can sometimes lead the project beneficiaries to cut corners and try to do as much as possible with the limited resources available locally, and as a result they run into problems of incompatibility and conflicts of interest.

In addition, most public administrators in Romania still do not realize what project management means, and tend to focus exclusively on the calendar of physical works when preparing a project. They are not planning ahead properly for stages of the project such as the issuing of licenses and permits, the renewal of tenders, legal problems with the contractor, dealing with utility providers, and so on. This results in delays which are more likely to happen in less developed and urbanized regions, where the pool of expertise in project management and consulting is limited even in the private sector. In general, the New Public Management – with cross-sectoral goals, performance indicators, strict deadlines, evaluation and feedback – represents a difficult challenge in Romania, but especially in its *Mezzogiorno* regions.

The sustainability of the infrastructure projects may be an issue, but it is still too early to judge this. According to the regulations for rural infrastructure projects, for example, beneficiaries are checked on during the five years after completion to determine whether or not they are fulfilling the contract requirements for operating and maintaining the investment properly. There are signs that in a number of cases – especially roads – the cost and management of maintenance operations place a significant burden upon poor rural local governments, so the investment gradually runs down. If such cases proliferate, they may have an indirect effect on the overall absorption rate in the long run, as the central authorities will tend to tighten the criteria for awarding project grants. Again, this is more likely than not to reinforce the current territorial wealth distribution.

One easy way to increase the absorption rate of EU funds on business promotion has been to establish business incubators and technology parks. Around two dozen of these function in Romania at the time of writing, many of them having been developed with PHARE funds, and more proposals are likely to come in the next programme cycles. However, even if they were implemented reasonably well from the point of view of the initial physical investment, their long-term effectiveness is in many cases questionable. Reportedly, only a few came anywhere near to covering their operational costs, with the rest remaining practically empty. There is no coincidence that the few successful examples are located in the west and north west regions, or near large university centres, which confirms the dual direction of development mentioned at the beginning of this section. Those implanted outside the areas with the right economic and social conditions are unlikely to trigger growth, remaining proverbial cathedrals in the desert.[8]

9.5 Conclusion: the danger of creating dependence

In view of all of the above, a viable option for the Romanian authorities during the European budget cycle 2007–2013 is to consider efficiency to be the main goal, instead of the mechanical understanding of cohesion as the equal distribution of funds across a territory. There are two reasons why this strategy is better than the alternative, or a politically balanced combination of them: first, it ensures an overall high rate of growth and the more rapid modernization of the country; secondly, it avoids the creation or perpetuation of dependency in the Romanian sub-regions where there is already a predisposition towards it. Regional disparities are not extremely high in Romania compared with other EU countries, and as a result the political pressure for equalization should not be very high.

The idea of betting on winners has clear advantages. First, those regions that benefit from one or other of the natural development drives in Figure 9.6 already have a comparative advantage, so their entrepreneurs will be able to compete better on the Single European Market. Secondly, these regions and growth poles have a better capacity to use EU funding more effectively. This does not mean that honest efforts are not made by the Romanian authorities in less developed parts of the country to improve their communities. On the contrary: currently there are no discernible variations in output performance (funds absorption rate) by region, while the stage of institutional preparation for Structural Funds (procedures, accreditation, etc.) has been relatively even across the country in recent years. The point is that the final impact in society (outcome) over the long term is likely to be more pronounced in other regions, at a similar level of public effort to push up the absorption rates, simply because the productivity of the capital invested may be lower in the *Mezzogiorno* areas.

Although these ideas should be treated simply for what they are, that is, simple predictions based on the pre-accession experience, the polarizing variant of the effects of EU assistance still appears to more plausible than the equalizing one. The situation is, as we have already mentioned, rather common and acceptable, if the Pareto criterion is satisfied (with everybody becoming better off in absolute terms). It can also be found in many regions of the world, including Western Europe, where the gaps between the most and the least developed regions have also been growing.

However, the governments and regional authorities can still take some steps to support growth, beyond crossing their fingers and praying that one of the natural vectors of development will extend its influence in their parts. For example, the current Sectoral Development Programs should not be politically broken down according to area and locality, in an attempt to provide equal shares to everyone. Public schemes aimed at increasing competitiveness should target the generators of growth, and these sources of development are not evenly distributed across the territory. In the same vein, there is a risk that funds tend to be pumped excessively into programmes where the impact is hard to measure, but there is anecdotal evidence that such effects are minimal. ‘Soft’ and complex areas such as investment in the human resources or research should be approached with extreme care, especially in the post-communist world, where budget rent seeking and inefficiencies are well entrenched in the state education–training–research network.

Simpler and cheaper steps could be taken instead, which are often ignored, at a great cost for the development perspective. For instance, many administrative barriers were in place until 2007, when the country joined the EU, against the integration of the major Romanian cities into international and regional networks. Crossing the border into Bulgaria, only 60 km away from Bucharest, was costly in terms of fees and waiting time, and therefore the citizens of both countries avoided travel across the border. This was unfortunate, because a few years ago a draft action plan prepared by the Bucharest City Council with the help of an international consultancy pointed out that Bucharest had all of the conditions necessary to become the business hub and the airport of choice for 1.5–2 million inhabitants from northern Bulgaria, as Vienna is for Western Slovakia. In the process more economic opportunities could have been created for those poorer counties that surrounded the capital. The natural flows of people and goods after January 2007 seem indeed to vindicate the conclusions of the consultants, as the EU accession forced the two countries to remove every bureaucratic obstacle from the border points, but this positive result was reached largely by default, without the contribution of authorities, and the impact is still smaller than it should be due to the lack of regional infrastructure and development plans prepared in advance.

One of the policy domains in which the shortage of knowledge, experience and manpower is felt most acutely is the area of urban and regional rehabilitation projects. These are probably the most complex type of interventions eligible for EU funds during the 2007–13 cycle, combining aspects of legislation, local economy, welfare policy and urbanization. Such projects, if successful, can have a dramatic impact on local communities, much more than a shiny new road nearby, changing the whole dynamics of local development, and making (again) parts of cities or regions attractive through post-industrial reconversion. However, the expertise for running such demanding schemes is almost nonexistent at present, and there is just one small project funded by EU and completed by the end of 2007. Proper management of the larger interventions currently on the agenda, such as the rehabilitation of a number of historical city centres, including that of Bucharest, will represent the real test.

Regional disparities are visible not only in terms of the endowment with resources and infrastructure, but also in the capacity to maintain this stock of fixed capital. The current institutional arrangements create skewed incentives which encourage a relentless drive for new public investments at both local and regional levels, but much weaker stimulants to properly maintain the new assets. The more public infrastructure will be built across Romania, the more expensive it will be in terms of its operation. Without careful planning these costs will be difficult to cover from the local budgets, especially in poorer regions. Since the EU does not provide funds for such routine activities, and the tradition in the Romanian bureaucracy is to overlook the costs of maintenance, there is a strong possibility that the nation will be left, once again, with expensive and dilapidated cathedrals in the desert, which will contribute little to the reduction of regional disparities.

To give another example, decision makers will have hard choices to make regarding some types of investments aimed at reducing territorial disparities. New rural infrastructure in areas with rapid depopulation is unlikely to reverse the demographic trend, as young people will continue to leave, especially if there is a big city no more than 100–150 km away. No matter what development experts may say, or what the government does, in twenty years from now Romania cannot possibly have the same share of 32 percent of the population occupied in agriculture – and about a third of these in inefficient, subsistence farming – as there is no other EU member with this type of social structure.

Another risk that is already apparent is that the public authorities may be tempted to mimic elusive and poorly understood Western European development models. The current discussions, based on a superficial analysis of the 'Irish model', represent just such an example of lack on information as to why some countries have benefited more than others from their accession to the EU. For instance, how important for Ireland were the pre-existing good and competitive education system, the large English-speaking diaspora, the country's location, or the low-tax, balanced-budget policies pursued by the government, which were partly against – rather than in line with – the prevailing views in Brussels at that time. Arguably, these elements contributed at least as much to the country's spectacular growth after accession as the Structural Funds themselves. Apart from relentless growth-oriented policies, which would set Romania on a collision course with the more socially inclined old EU members, it is not clear exactly what the country can easily copy from the Irish model.

Public policies sometimes fall prey to intellectual fads or lobby groups that push for this or that economic sector, regarded as more strategic than others, with detrimental effects. Among the 293 NUTS 2 regions of Europe, there are exceptions – those not having among their priorities to become an IT hub, to pioneer some sort of e-government or promote tourism (classic, cultural, agro, eco, etc.) in order to capitalize on their natural beauty and strategic location. In reality, it is very difficult to predict what the future is going to bring in terms of comparative advantages.

Public authorities can usually speed up growth and modernization if they consistently encourage the following: (i) the most efficient economic activities, with neutral policies; and (ii) good fundamental and applied research, where the latter is measured by the accepted international standards of the profession.

Finally, ultimate success or failure must be judged in terms of the broader picture. As long as the whole country grows and the wave of development lifts all of the boats, although some more than others, there is no reason to panic. Being below the national average on some indicators does not necessarily mean the *Mezzogiorno* disease, but being simultaneously poor and dependent, yes.

Notes

1. Which is not the case when we compare countries.
2. A good overview is given in G. Gorzelak (2006) 'Poland's Regional Policy and Disparities in the Polish Space', *Regional and Local Studies Journal*, special annual issue, RSA-Polish section and Warsaw University.
3. Or ever, as some may argue: even before Communism, when borders were in principle open, it was the intellectual and business elites who travelled abroad, and not so much ordinary people.
4. Romania has only two tiers of local government: 3,160 municipalities with directly elected councils and mayors; and 41 counties (NUTS 3 level) with elected councils. The eight NUTS 2 regions created in 1998, to reproduce the EU territorial structure, are technically only associations of counties, run each of them by a collegiate Regional Development Council (RDC) where the county council presidents meet periodically to take decisions. In this sense, these virtual regions are actually subordinated to the counties, have no budget of their own and no executive organs. In each region a Development Agency (RDA) was also created in 1998, reporting to the RDC, with the mission to assist it with local strategies and carry out the EU programmes decided at the centre. In conclusion, like Hungary and unlike Poland, Romania chose to keep its old fragmented politico-administrative structure and avoid the creation of the third tier of local governance – the regions. Regional development strategies tend to be rather centralized, with the parameters of policies and programmes decided uniformly at the national level and only the technical implementation delegated to RDAs.
5. *Regional Labor Market Supply: Forecast 2013*, The National Research Institute for Labor and Social Protection, Bucharest, 2005.
6. Gorzelak (2006), see note 2.
7. Thus satisfying the condition for a Pareto improvement.
8. Like a high-tech industrial park built in a medium-sized city in North-Eastern Romania, where there is no university centre large enough to produce the necessary pool of specialists.

10
Multiple Shocks and Changes in the Development Gradient of Croatia's Regions

Ivo Bićanić and Vedrana Pribičević

Introduction

Over the course of the past two decades Croatia has experienced four large political and economic shocks. The first was the transformation which resulted in self-managing socialism being replaced by a capitalist system. This process began in Croatia in 1989 (while Croatia was still part of Yugoslavia) and many argue it is not yet completely finished. The second shock was independence: Croatia was one of the seven new states eventually spawned by the break-up of Yugoslavia in 1991. The third shock was the Homeland war during which Croatia's independence was contested and successfully defended in the second of the Four Wars of the Yugoslav Succession. The Homeland war (the name it is given in Croatia) lasted four years – from 1991 to 1995. The fourth shock started with the EU integration process. Croatia signed the Pact on Stability and Accession in 2001, it became a candidate country in 2004 and the process accelerated when membership negotiations started in 2005. Of course, these shocks were not purely external (indeed, only one, the war, was external). The generation of these shocks – and most certainly their form – was primarily a result of internal political economy developments and domestic policy choices that were taken in a given setting and path dependency. To a somewhat lesser (but far from insignificant) extent they were imposed externally through various forms of conditionality. However, in each case the shock came quickly, defined a clear point of discontinuity and had a very strong influence on every aspect of Croatian society. Furthermore, each one had far-reaching consequences and had an important influence on the path dependency of the countries concerned. In this sense, it is justified to describe them as shocks. For the majority of these two decades Croatia was exposed to the simultaneous influence of more than one shock and thus faced their cumulative influence and effects. For example, the simultaneous effects of the transformation, independence and war in the early 1990s fundamentally determined the kind of capitalism that developed in Croatia. Currently (at the beginning of the twenty-first century) it is experiencing the cumulative effects of two shocks: transformation and integration. The latter's influence should, arguably, be felt for a long time and have an even greater effect than any previous shock.

Taken in isolation each of these shocks would have exerted a profound influence on all aspects of Croatian society and especially the economy; taken together, their effects are likely to be cumulative, with a number of far-reaching consequences. Among the consequences the spatial effect of the shocks stands out. This is because each shock involves important spatial asymmetries. The transformation – with its redressing of the effect of socialist economic and industrial policies and external liberalization, the war – through destruction in the areas of active fighting and induced population movements, independence – through new borders and transport costs and, finally, integration – through new spatial barriers and real and nominal convergence – have all led to pronounced asymmetric spatial effects. Indeed, it would be justified to expect that these asymmetries could have had cumulative effects that would lead finally to a new distribution and a likely increase in spatial inequality. This has certainly been the common intuitive perception that led to a 'stylized fact' about the Croatian economy. This 'stylized fact' states that as a result of the shocks outlined above Croatia has recently experienced a major increase in the levels of regional inequality. Not only have some regions increasingly lagged, but the level of spatial divergence is still increasing, the regional development gradient changing and these processes are expected to continue (certainly into the medium term and very likely beyond). This claim is often based more on intuitive grounds than on substantial evidence and has been made in such diverse national and international sources as Čavrak (2003), Nacionalno vijeće za konkurentnost (2003), EC Delegation to Croatia (2004) or UNDP (2002). An even stronger formulation of this 'stylized fact' is offered in Puljiz and Maleković (2007) who point to a dramatic rise in levels of inequality since the beginning of the century.

This chapter discusses two aspects of Croatia's regional inequality. The first, central topic is the validity of the stylized fact in the context of thirty years of regional inequalities. It is found that it does not seem to fit the facts particularly well. The second concerns internal redistribution and changes in eligibility of the less developed regions for regional development funds and finds that the scope has changed little over the thirty-year span. These points are discussed in the chapter's five sections. The first section discusses the main aspects of the initial, pre-shock (1989) spatial inequality. The second is concerned with current (2008) spatial inequality. The third section offers a calculation of long-term (thirty-year) changes in Croatia's spatial inequality and the validity of the 'stylized fact'. The fourth section discusses eligibility for regional development funds. The final section offers some conclusions.

10.1 The initial, pre-shock regional development gradient

The initial spatial differences prevailing when the first shock (the transformation) began in 1989 are a legacy of almost 50 years of socialist development. These initial conditions have two aspects: the first, simpler aspect concerns the initial values of the relevant regional variables while the second, more complex aspect refers to the path dependency they generated. The 50 years of socialist development cannot be discussed in any detail in this chapter so only the most important aspects will be mentioned: for a discussion of the former see Bogunović (1991) and some aspects of the latter Franičević and Bićanić (2007).

Over the course of the 50 years of postwar socialist development (in Yugoslavia) Croatia has been transformed from a typically undeveloped economy in 1945 into an upper-medium income economy by 1989 (as defined by the World Bank). As elsewhere the development process led to profound social and structural changes that are best illustrated by changes in levels of urbanization, industrialization and deagrarianization as well as rising educational levels and living standards. Comparing the values for 1961, 1991 and 2001 (these dates were chosen because they are population census years, but they underestimate the full intensity of the experience) shows Croatian levels of illiteracy fell from 12.9 per cent in 1961 to 3 per cent in 1991 and 1.8 per cent in 2001. The share of agricultural population fell from 43.9 per cent in 1961 to 9.1 per cent in 1991 and 5.5 per cent in 2001 while the share of agriculture in social product decreased from 23 per cent in 1961 to 9 per cent in 1991 (in 2001 its share in GDP was 7.4 per cent). At the same time, between 1961 and 1987 aggregate social product and per capita social product (both in constant 1972 prices) increased by 3 and 2.8 times respectively. The levels of employment in non-agricultural occupations increased from 816,000 in 1963 to a maximum of 1,520,000 in 1988, while employment in industry and mining over the same period increased from 323,000 to 567,000. The population of the capital city, Zagreb, increased during the period from 460,000 in 1961 to 934,000 in 1991.

This dynamic development varied across regions: the levels of regional inequality in some periods decreased and in others increased in spite of regional development policies (discussed in section 10.4). During the 1971–1980 period there was significant convergence but during the other times divergence or stagnation (see Bogunović 1991). The regional inequality calculated in section 10.3 and illustrated by Tables 10.2 and 10.3 shows a significant reduction of spatial inequality in the 17-year period between 1971 and 1988 when measured in terms of both aggregate social product and per capita social product. The cumulative effect of this development included major population movements. The two main migrations concerned, first, the migration from less developed regions into cities and, second, 'temporary' emigration abroad (as 'gastarbeiters'). There was an above-average population increase in the communes around and in the major cities, Zagreb, Split, Rijeka and Osijek. There was a positive but below-average increase in Sisak and Varaždin and a decrease in predominantly rural Karlovac, Bjelovar and Gospić (each of these 'names' actually refers to one of the nine Associations of communes plus Zagreb into which Croatia was divided). Throughout the period the traditional emigration regions were the Istrian hinterland, the Adriatic islands, Lika, the Dalmatian hinterland, Kordun, Banija and western Slavonija (that is, the less developed regions of Croatia) (see Bogunović, 1991; and Wertheimer-Baletić, 1999). Emigration began with the liberalization of the visa regime in the mid-1960s and in 1981 there were more than half a million Croatian 'gastarbeiters' in Western Europe and Scandinavia (in contrast to previous waves, this emigration was not trans-oceanic).

In addition to the usual spatial changes linked to development and reflected by the effects of urbanization, industrialization and de-agrarianization Croatian regional inequalities were also under the strong influence of some of the canons of socialist development policies. In view of later events, the two that stand out in this respect concern the consequences of the bias towards industry and tourism. The specifics of socialist industrial development relevant for later shocks (transformation and integration and – albeit to a much lesser degree – independence) concerns the strong bias towards industrialization. This bias was reflected in the emergence of large vertically integrated firms and mono-employment towns (due to other aspects of socialism this also meant the local unity of political and economic power with all that this entails in non-democratic regimes). In Croatia the most notable examples of medium-sized mono-employment towns are Sisak (the 'archetype' example of socialist development: 'black metallurgy', i.e. iron and steel and a refinery), Karlovac (metal processing), Šibenik (aluminium), Slavonski Brod (metal processing), Western Srijem (shoe production), Varaždin (textiles) as well as Pula and Trogir (shipbuilding). In addition to these medium-sized cities there were many smaller towns with perhaps an even more pronounced mono-employment. Each of the large cities based their economy on a couple of large vertically integrated firms. The results of this bias to industry is indicated by the fact that in 1988 industrial employment was 570,000 (36 per cent of total employment) whereas by 2006 it had fallen to 266,000 (25 per cent of total employment). Given later developments, another aspect of socialist development with an important regional aspect must also be mentioned. It concerns Croatian shipbuilding. During the socialist period five large shipyards were built in Croatia (at this time every Yugoslav shipyard of any size was in Croatia) which for a short period became the world's fifth largest producer. In a socialist economy characterized by regulated foreign trade, an artificial exchange rate, a bias towards heavy industry and the extensive subsidization of production costs shipbuilding – which involves the production of large units of high value – offers an ideal export sector. The second important development policy shift for Croatia was the liberalization of travel – one of the results of the 1965 Socio-economic Reforms. On the one hand this permitted emigration and the emergence of the 'gastarbeiter', but on the other it also permitted the development of tourism. The importance of the former has been commented on earlier in this chapter; the importance of the latter was crucial to the development of the Croatian economy. There was a major shift of investments into tourism along the whole length of the Adriatic coast. This constituted a major shift of economic activity and since more than 85 per cent of the coast is located within Croatia it received the majority of the benefits. In 1964 there were 17.3 million tourist overnight stays; by 1988 there were 67.3 million overnight stays and tourism and catering accounted for 6 per cent of the nation's social product.

In the period up to 1991 Croatia was a Yugoslav republic. Within the wider frame of Yugoslavia Croatia as a whole was unquestionably the second most developed republic. During the period between 1955 and 1987 Croatia's economy grew at below the Yugoslav average; however, due to population changes in per capita terms it improved its relative position so that its per capita social product rose from 122 per cent to 127 per cent of the national average (see SZS, 1989). However, during the whole period in Yugoslavia regional inequalities increased as the less developed regions fell behind (especially Kosovo) and the most developed (Slovenia) drew away (see SZS, 1989). With these changes in mind while Croatia improved its position relative to the rest of Yugoslavia it lagged increasingly far behind the most developed republic, Slovenia. In 1955 and 1987 Croatian per capita social product was, respectively, only 70 per cent and 63 per cent of Slovenia's per capita social product. Croatia's spatial heterogeneity meant that it had less developed regions. Croatia's less developed regions were not eligible for federal support after 1965. In 1965 the system of supporting less developed areas changed from support to communes to support to larger units so federal funds went only to the republics of Bosnia and Herzegovina, Macedonia and Montenegro and the Autonomous province of Kosovo. As a result form then onwards any support for Croatia's less developed regions was a matter of internal redistribution. In the late 1980s a new and more complex formula for determining the status of less developed republics and Kosovo was designed. If this criteria is applied to communes out of the 512 communes in Yugoslavia 190 were less developed and of those 27 were in Croatia, see Sirotković (1990).

At the end of the 1980s (and before the beginning of the transformation in Croatia in 1989) the cumulative experience of almost 50 years of socialist regional development had led to the administrative division of Croatia into 105 communes (in 1980 there were 113 and in 1987 the number increased to 115). These communes were then grouped into ten association of communes, each centred on an urban agglomeration and the City of Zagreb. This structure was introduced in 1974 and survived until 1990. Both communes and their associations were administrative and statistical rather than economic units and some of the association of communes straddled what would have been more than one economic region. The only attempt during its entire history when regions were defined as economic entities was in 1966 for the needs of the Social Plan of Croatia 1966–70 (the plan coincided with the 1965 Social-economic Reform, a major effort to reform the socialist system; see Sirotković and Stipetić 1984). In this attempt Croatia was divided into four economic regions (the Panonian plane, Central Croatia, North coast and Lika and Dalmatia).

10.2 The current regional development gradient

At the time of writing (in 2008) the current regional differences are a result of the cumulative effects of the four shocks outlined in the introduction to this chapter. Two of these, independence and war, are unquestionably completed, even though the 'ripple effects' of the latter are still being experienced. The completion of another shock, the transformation, is unclear. The transformation is over if measured by irreversibly established capitalism and a return to a secular growth path, but it is incomplete if measured against the stability of the new political economy and the transformation-induced restructuring of the real sector. Furthermore, given the magnitude of the change it involved its 'ripple effects' will still be apparent for some time to come. One shock, EU integration, is certainly only in its earliest phase and will certainly last for a considerable period into the future. As a result, the current regional differences are unstable and are very likely to change in the years to come.

The data on current regional inequality are based primarily on data collected at the county level. Currently (since 1992), Croatia is administratively divided into 20 counties plus the capital city of Zagreb (which together now form NUTS3 level regions). These units represent regional government and are statistical units, but not economic regions. In addition, there are local units of self-government. In 2006 there were 126 cities (determined by population census) and 429 communes and as a separate entity the city of Zagreb (see Ministry of Finance, 2007). The numbers vary from year to year as a result of both demographic changes and gerrymandering. As of 2007 Croatia has been divided into three NUTS2 regions (the government had initially suggested five regions, but it later accepted the EU's recommendation of three). The regrouping of counties and Zagreb into NUTS3 regions is apparent from the figures in Table 10.1. Even though this division is closer to the economists' understanding of economic regions there are still features that do not make them economic units. As a result of the recent date of the changes very few statistics have been recalculated along the lines of the new NUTS2 boundaries, but with more intense EU integration in the future this will undoubtedly change. This makes it difficult to establish a consistent regional development policy. The responsibilities of counties and local self-government units are defined by the 'general clause' (according to which everything not expressly given to the central government remains in regions) and 'delegated scope of activities' (in which the centre can delegate some activities to regions, but they are under a high degree of central supervision). Fiscal decentralization, which started in 2001, makes it difficult for regions (with the exception of Zagreb) to achieve any major independence. For example, the aggregate share of counties, towns and communes in GDP in 2005 was 9 per cent, but their income

Table 10.1 Variety among Croatian counties, 2005

Counties	**Share of population (%)**	**Share of territory (%)**	**Population density (inhabitants per km^2)**	**Share of GDP(%)**	**Level of education(% of people with higher education)**	**GDP per capita EUR**	**NUTS 2 Classification GDP per capita EUR**
City of Zagreb	17.56	0.79	1127.60	32.35	38.00	12908	
Zagreb County	6.98	3.49	101.20	5.59	4.30	5446	
Krapina-Zagorje	3.21	1.48	109.60	2.30	1.33	5172	HR 01 North-western Croatia 9050
Varazdin	4.16	1.94	146.40	3.45	2.61	5928	
Koprivnica-Krizevci	2.80	1.99	71.20	2.52	1.47	6452	
Medimurje	2.67	0.90	149.60	2.02	1.23	5323	
Bjelovar-Bilogora	3.00	3.01	50.40	2.12	1.50	5149	
Virovitica-Podravina	2.10	2.31	46.10	1.39	0.93	4803	
Pozega-Slavonia	1.93	2.08	47.10	1.30	0.96	4834	
Slavonski Brod-Posavina	3.98	2.32	87.10	2.12	2.08	3785	HR 02 Middle and Eastern Croatia 4865
Osijek-Baranja	7.45	4.74	79.50	5.54	5.92	5313	
Vukovar-Sirmium	4.61	2.80	83.40	2.58	2.24	4028	
Karlovac	3.20	4.14	39.10	2.34	2.10	5335	
Sisak-Moslavina	4.18	5.10	41.50	3.18	2.50	5525	
Primorje-Gorski kotar	6.88	4.09	85.10	8.17	9.00	8376	
Lika-Senj	1.21	6.10	10.00	1.06	0.60	6363	
Zadar	3.65	4.16	41.40	2.99	3.07	5526	
Sibenik-Knin	2.54	3.40	37.80	1.93	1.83	5299	HR 03 Adriatic Croatia 6709
Split-Dalmatia	10.45	5.17	102.10	8.24	11.13	5395	
Istria	4.65	3.21	73.40	6.15	4.40	9126	
Dubrovnik-Neretva	2.77	2.03	68.90	2.64	2.85	6615	

Sources: Statistical Yearbook of Croatia, various years and Državni (2008).

was 6 per cent. When one adds tax policy and that the proportions allocated to central and local governments are variable and determined by a strong, centralized national government then it is clear that true fiscal decentralization still has a long way to go in Croatia (for a exhaustive analysis of this issue see Bajo, 2007).

Table 10.1 provides some statistics relating to the income differences between economic regions in Croatia. Indeed, Puljiz and Maleković (2007) claim that the variety among Croatian counties is larger than that met in many European economies. Foreign authors offer mixed opinions on this point. Some stress the large internal heterogeneity (see UNDP, 2007; EC, 2004) while others do not see it as a special feature (see World Bank, 2007). In addition to the heterogeneity among counties the data clearly show the dominance of the capital city Zagreb, i.e. strong metropolitization. In 2003 Zagreb accounted for 38 per cent of all employees, and 36 per cent of all Croatian entrepreneurs; Zagreb registered firms produced about 50 per cent of firm revenue and exported about 45 per cent of national exports; finally, 45 per cent of all Croatian banks have headquarters in Zagreb and they control 62 per cent of banking capital. All this from a population share of only 17.5 per cent Zagreb accounts for 31.5 per cent of all university graduates. The list of statistics showing the dominance of Zagreb could continue. This dominance is somewhat misleading in terms of GDP since some firms had plants located elsewhere, but statistically their revenue is added to that of Zagreb. Puljiz and Maleković (2007) estimate Zagreb GDP to contribute 31.5 per cent of Croatia's national GDP. Once Zagreb is excluded from the data the differences among regions become significantly smaller.

The current heterogeneity of regions is also a result of large recent movements of population. As a result, most border counties saw reductions in population, with the Lika-Senj County losing most – by 2001 it had lost 35 per cent of its 1991 population census inhabitants, whereas Šibenik-Knin county lost 23 per cent and Sisak-Moslavina 21 per cent. By contrast, the two counties that saw the greatest population gains were Zagreb and Istra, 13 per cent and 4.2 per cent respectively. As a result the capital, Zagreb, increased its share in Croatia's population from 14.2 per cent in 1971 to 16.3 per cent in 2001. In the period 1990–2006 these population movements were largely induced by the Four Wars of the Yugoslav Succession, especially the one in Croatia (the 'Homeland War') and Bosnia and Herzegovina. In Croatia, the areas of conflict were the border regions that were also the poorest areas of the country often inhabited by Serbs that were a minority nationally but a majority in those areas. The first type of population movement was that of displaced persons in the early 1990s involving movements into Croatian cities and the northwest. Over time much of this migration became permanent, e.g. the actual population of the metropolitan area of Zagreb increased by over 10 per cent in five years. The second type of movement involved two kinds of refugees. The first and larger group in the mid-1990s was the emigration of Serbs from the occupied areas of Croatia (Serbs from other parts of Croatia were not involved) into Serbia and parts of Bosnia and Herzegovina. They emigrated during the final military campaigns of the Homeland war from border areas with local Serb majorities that were also rural, and had always been among the least developed parts of the country. A small number of them, mostly the aged, subsequently returned. The second and smaller one was the immigration of Croats from Bosnia and Herzegovina into Croatia. All of these shifts involve major changes in population demographics and composition that is reflected in the data.

Another feature of the current regional inequalities is the distinct demise of the socialist mono-employer towns in Croatia. Following the de-industrialization and the period (albeit incomplete) of economic restructuring, none of them remain. Perhaps the best-documented example of this phenomenon is Sisak (see Brajčić, 2005). In 1990 the level of employment in the town's steel mill was 13,396; by 2003 it stood at only 1,637. Similarly, in Šibenik the aluminium industry, which had employed more than 8,000 in 1989, has been scaled back – now only a small processing plant employing 1,600 remains; and Slavonski Brod's metal processing plant employment fell from over 17,000 in 1989 to 4,800 in 2006. The change has certainly influenced the economic fortunes of the towns and surrounding areas that relied on these large vertically integrated socialist firms, none of which have managed to maintain even a shadow of their former position in any part of Croatia. Furthermore, their demise has not spawned new entrepreneurial activity (as had been hoped for under the initial transformation paradigm); but instead led to a decline often involving negative cumulative causality (Sisak and the Homeland war, Šibenik and tourism, etc.). The fate of other mono-industrial towns is similar and the only exception has been in the area of shipbuilding – a sector that remains both state-owned and heavily subsidized (although EU conditionality may lead it to a similar fate in 2009).

In spite of the spatial heterogeneity of Croatia in the period after 1991 the regional and spatial aspects of the Croatian economy were not under the spotlight until recently. The EU was an extremely important agent in resuscitating Croatia's interest in regional development. Its previous lack of interest was, to a large extent, politically motivated (the Serb minorities inhabit most of the least developed regions and one of the reasons

Croatia was an international pariah during the 1990s was because of its refusal to face the complexity of its regional problems). Two CARDS programmes, especially CARDS 2002 Strategy for Capacity building for Regional Development, were ground-breaking (see EC, 2004). Regional-related interest of other international organizations added to this (see, for example, UNDP, 2002, 2007; and World Bank, 2007). One equally important stimulus came from EU negotiations and the conditionality that they involved. These required Croatia to develop a regional policy and regional statistics and to define NUTS2 regions within set deadlines. As a result, numerous Croatian government institutions and civil servants started to pay serious attention to regional issues. This external stimuli and internal lack of knowledge also led to local economists showing an interest in regional issues (see, for example, Botrić, 2003; Lovrinčević et al., 2004; Puljiz and Maleković, 2007; Puljiz, 2006; Nestić and Vecchi, 2007; and Kavklar et al., 2007). EU support has also come not only through conditionality but also in the funding of local government projects. CARDS projects have committed €48 million for regionally related projects.

Even though the interest of local economists in regionally related research topics has increased in recent years the most comprehensive analyses were published by local offices of international organizations (which included a substantial amount of local input). The World Bank (2007) made a detailed study of regional differences in incomes and poverty and other aspects of living standards in Croatia in the period after 2000. Their database was the micro data from the 2003 Household Consumption Survey which was recalculated for five regions. Even though the report contains much useful data the possibilities for comparability are relatively low since it divides Croatia into five regions (as compared with the local division of 20 counties plus Zagreb and the EU division into 3 NUTS2 regions). The report concludes that for the five regions Croatian regional income inequalities are high, but not exceptional and that while overall poverty levels are relatively low (11 per cent), the level of regional variation is high (between 3 and 20 per cent). They also conclude that formal (taxes and transfers) and informal redistributive efforts lead to a significant reduction in the levels of regional heterogeneity. For example, the ratio of highest and lowest GDP per capita in the five regions is 2.2, but it falls to 1.43 for primary income and it further falls to 1.16 for expenditure (see World Bank, 2007: 38). Another useful study about current regional inequality was carried out by the UNDP (2007). Their work was based on micro data from the standard questionnaire of the European Quality of Life Survey that was applied to Croatia in

2006. Because they used a standard survey, the results are comparable to those found in other EU member countries. The study includes a wealth of data from the standardized survey that is calculated at the national level and disaggregated to the county level. This study fits into the general framework of other studies recognizing large heterogeneity with one important exception. The study finds that the Southern Adriatic counties are towards the top end of the distribution with regard to quality of life and expectations and not, as was commonly held, at the bottom end. This result is probably best explained by timing, the 'stylized' view of Dalmatia in the bottom end was true during the Homeland war and the collapse of tourism. However, since the year 2000 tourism has taken off and the results of the economic boom are apparent in the 2006 data.

EU conditionality also required the adoption of a regional development strategy. However, the closest Croatia has come to such a regional development strategy was the publication of a proposal (see Ministarstvo, 2006). The writing of this document was an example of EU conditionality and the fact it had not been adopted by early 2009 demonstrates a clear lack of political will. This lack is clear from the document itself, which is couched in very vague terms. It only offers a general outline of an institutional structure aimed at achieving regional development. It proposes the adoption of a law to cover all aspects of regional development, and a council that was intended to include representatives of all stakeholders and county development agencies. At the policy level it proposes the establishment of regional consultancy centres, support for SMEs and entrepreneurship in general, and support for rural development. In addition, it also places a strong emphasis on human capital and local partnerships.

10.3 Secular changes in regional inequality

Given these shocks and the mentioned 'stylized fact' it may be interesting to consider secular changes of regional inequality in Croatia. Inequality was measured using the two most commonly used inequality measures, namely the Gini coefficient and the Theil index, for three periods spanning thirty years. The first period was from 1971 to 1973 (the actual regional structure was established in 1974, but the data was recalculated only as far back as 1971 – earlier data recalculated along the 1974 regional borders does not exist) and reflects socialist Croatia's experience of high growth rates during this period. The second period is 1985–1988 – the socialist crisis era, and also the middle of the thirty-year span. The third period is from 2001 to 2003 and is known as the period of 'mature transformation'. The first and third periods were determined by the availability of data, namely 1971 is the first year of data collection and 2001 is the first post-1990 year with available data. The middle period was chosen to provide two equal 15-year periods. To eliminate the effect of short-term policies and shocks (present in 1971 and in 2001), three-year averages were taken.

The two inequality measures chosen for the study the Gini coefficient and the Theil index (see Cowell, 2000), satisfy the main required characteristics for inequality measures (except that the Gini is not directly decomposable while the Theil index has no fixed range). The formulae of the Gini coefficient and the Theil index were adapted for the available data: ungrouped data with every data point representing one unit (each of the 20 counties plus Zagreb) and the average for the whole distribution was known as were the weights for each point (the share in income and population was known). The original data for the first two periods came from various issues of the Statistical Yearbook of Croatia and for the third from a special publication of the Državni Zavod za statistiku (2008).

The Gini coefficient is the most commonly used formula for measuring inequality. It has a clear intuitive meaning with a maximum value of 1 for extreme inequality and 0 for egalitarian distributions. The higher the value of the Gini coefficient the higher the level of inequality. The Theil index is a measure derived from a general entropy inequality measure by assuming specific values for parameters. The higher the values of the Theil index the higher the level of inequality. Its drawback is that it has a less intuitive meaning since there is no fixed maximum value, making comparability difficult; however, it does have the advantage of decomposability. Since the maximum for the Theil index depends upon the number of observations and since in this case there were always 21 observations the Theil index could be used.

Because of major changes in boundaries over the course of the thirty-year period the changes in regional inequality levels could not be calculated directly. The first change came in 1974 when commune boundaries for 105 communes (in 1980 the number increased to 113 and in 987 to 115) were determined, together with the introduction of ten associations of communes and the city of Zagreb as a separate unit. The second change in regional boundaries was in 1992, which saw the adoption of a completely new approach to spatial boundaries. This approach established 549 communes and cities as well as twenty counties, with Zagreb again being a separate unit. To create the thirty-year series the data had to be recalculated. Since the accuracy of inequality measurements depends upon the number of statistical points, and if more points are used then the measurements are more reliable, it seemed a good idea to recalculate the data for the whole period for boundaries of the 20 counties and the city of Zagreb. This could be done because the new 1992 division followed the pre-1992 commune's boundaries – that is, it split communes into smaller ones, thereby increasing the number of units from 115 plus Zagreb to 549 plus Zagreb. However, the fragmentation left old commune boundaries intact (that is, no new commune straddled the old commune boundary). As a result, a comparable set of data was derived by recalculating the pre-1992 data for 115 communes according to post-1992 regional (county) boundaries. In this way a comparable data set for the three periods could be derived.

While comparability could be achieved through the recalculation of boundaries it was impossible to achieve complete comparability concerning the income variable. Socialist social accounting (i.e. the pre-1990 national accounts) used the measure of gross material product (GMP) and thus calculated the social product and national income. The data for the first two periods thus refer to social product. For the post-1990 period only UN SNA national accounts were used to calculate GDP. The difference is in the way services and the private sector was included and it is estimated that GMP methodology underestimated GDP income by around 10–15 per cent. The regional GDPs for the period 2001–2004 were calculated in 2005 using EUROSTAT methodology (by this time Croatia had already signed the Stability and Accession Pact and was obliged to implement EUROSTAT methodology) and EU membership negotiations were under way. However, the pre-1990 GMP data were not recalculated to post-1990 GDP standards. Since inequality measures are scalar values measuring distributions it appears that the mistake is tolerable.

Measures are taken of two aspects of regional inequality. The first is the distribution of aggregate county income – the results of the inequality measurement are in Table 10.2. The second is the distribution of county average per capita income and the results of the measured inequality levels are in Table 10.3. The second measure should eliminate the effect of population changes and show the shifts in regional distribution of economic activity as well as the inequalities. These simple measures were chosen out of necessity. Other studies have made use of more complex measures: for example, a development index was used in the 1980s; Lovrinčević et al. (2004) offer another way of ranking; and Puljiz (2006) constructs a complex index. However, these indices could not be recalculated for the entire thirty-year period. In addition, it is worth

Table 10.2 Inequality of county GDP in Croatia

Year	**Gini index**	**Three year average Gini index**	**Theil index**	**Three year average Theil index**	**Maximum/ minimum**	**Three year average Max./Min.**
1971	0.4627	0.4551	0.1869	0.1782	23.1878	22.7006
1972	0.4639		0.1829		27.2998	
1973	0.4389		0.1649		17.6143	
1986	0.4389	0.4332	0.1687	0.1644	20.6342	21.1431
1987	0.4381		0.1681		21.5661	
1988	0.4225		0.1564		21.2289	
2001	0.4632	0.4646	0.2020	0.2031	31.9103	28.5278
2002	0.4611		0.1998		28.1712	
2003	0.4694		0.2073		25.5018	

Source: Author's calculation based on data from Statistical Yearbook of Croatia, various years.

Table 10.3 Inequality of county per capita GDP in Croatia

Year	**Gini index**	**Three year average Gini index**	**Theil index**	**Three year average Theil index**	**Maximum/ Minimum**	**Three year average Max./Min.**
1971	0.1815	0.1857	0.0250	0.0257	3.2425	3.2759
1972	0.2126		0.0326		3.9822	
1973	0.1628		0.0194		2.6029	
1986	0.1569	0.1537	0.0196	0.0185	3.8239	2.9075
1987	0.1464		0.0173		2.3934	
1988	0.1578		0.0186		2.5051	
2001	0.1460	0.1453	0.0174	0.0175	3.0405	3.0515
2002	0.1412		0.0164		2.9976	
2003	0.1486		0.0186		3.1163	

Source: Author's calculation based on data from Statistical Yearbook of Croatia, various years.

remembering Krugman's (1996) discussion of the small differences generated by more complex indices and straightforward per capita income.

All of the inequality measures indicate the two kinds of changes that have taken place during the 30-year period. The inequality measures for aggregate income (social product in the first two periods, gross domestic product for the third) show a decrease during the first 15 years, followed by an increase. The changes are such that the final Ginis are only 3 per cent higher than the initial ones and the final Theil index is 14 per cent higher, but the ratio of maximum to minimum values has increased significantly. The values for the middle of the period are in all cases lower so that there is a 'U'-shaped change, which describes the reductions during the first 15 years and the increases during the second period. This increase is in line with the 'stylized fact' and indicates that the inequality of the size of Croatian counties has increased over these years.

There were major population shifts during the second period. County per capita income should permit a comparison from which the population changes have been eliminated. The per capita inequality measurements do not show the 'U'-shaped change. Instead, over the course of the entire thirty-year period there is a steady fall in the levels of regional per capita income inequality. The exception is the ratio of highest and lowest per capital income which does exhibit the 'U' shape, but its final values are lower than the initial ones and the rising part of the 'U' is not pronounced. This difference can be explained by the mentioned population shifts and the failure of policies to keep the population in the regions of emigration. More interesting results concern the second period. There is a small decrease in the inequality of per capita income, but an increase in the level of regional income inequality. Again, population shifts, especially from the poorest areas, could account for these changes. What is important is that the stylized fact regarding inequality of per capita income does not seem to stand up.

Changes in inequality measurements conceal changes in ranks. Going beyond the inequality measures may indicate some changes in the ranking. While the overall inequality change shows a consistent increase in aggregate inequality and a decrease in per capita income inequality there are shifts in terms of the ranking of the individual regions. Of the 21 regions (20 counties plus Zagreb), the ranking of eight remained stable. Of these four were among the more developed, two in the middle and two were in the bottom end of the distribution throughout the entire period under consideration. An equal number of counties, four in each case, improve their position or increase their lag. These shifts occur in the lower and middle end of the distribution and do not seem to affect the top end. There are changes in the rankings of only five regions. These regions are to be found at the bottom end of the distribution. This kind of structure would seem to indicate a two-tier Croatia, a stable top end of the distribution with changes and dynamics in the middle and lower end with none of these joining the top end.

10.4 Regional redistribution and the support for less developed regions

During the majority of the thirty-year period (the exception was in the period 1991–2002) there was an elaborate system of redistribution to the less developed regions of Croatia. In addition to being the basic unit of local government communes were important as basic units of spatial redistribution.

Socialism had an in-built egalitarian bias, one of whose aspects was a policy of redistribution to less developed regions. Initially (until 1965) all redistribution was managed at the federal level. During socialism Croatia, as the second most developed republic and also the second largest, made the biggest single contributions to these redistributions. Until 1961 this redistribution to less developed regions was regulated by the federal government. Between 1961 and 1965 there was a dual system with funds for Croatia's less developed regions coming from federal and republic (i.e. Croatian) sources. After 1965 redistribution to the less developed parts of Croatia were solely under the jurisdiction of Croatia. The redistribution to the less developed republics and the autonomous province of Kosovo remained a federal policy: at its highest point Croatia contributed 1.94 per cent of its social product to the federal fund, but after 1987 the share fell to 1.56 per cent (see Sirotković, 1990). The redistribution among Croatian regions was managed by a republican fund that was established in 1966. The funds income came from the republican budget and also directly from firms. After 1981 (and thus in 1989) the total republican funds' income was 0.5 per cent of the non-private sector social product (of which 0.42 per cent came from the republic budget and the other 0.08 per cent from firms' 'voluntary' contributions). The fund disbursed its income to less developed regions according to predetermined priorities that changed over time (alternating between infrastructural priorities and improving existing capital resources). The areas eligible for support and the priorities were determined by five-year plans. The less developed regions existing in 1989 were determined in the Social plan for the period 1986–1990. Two criteria were used. One was the development criteria (a composite index was calculated) and the second one was by administrative decree (that is, political criteria were used for those not passing the first test). The changes in eligibility and coverage are given in Table 10.4.

Following the achievement of independence in 1991 a completely new system of territorial redistribution was established in 1996 before being amended in 2002 to become the system as we find it today. State regional

Table 10.4 Changes in ranking and development gradient of Croatian regions

	1971–1973	1986–1988	2001–2003	Average
Zagreb County	15	7	17	13, ∩oscillates
Krapina-Zagorje	11	20	15	15, U oscillates
Sisak-Moslavina	8	9	10	9, →stable
Karlovac	9	14	8	10, U oscillates
Varazdin	12	10	5	9, ↑improves
Koprivnica-Krizevci	10	19	3	11, U oscillates
Bjelovar-Bilogora	13	13	13	13, →stable
Primorje-Gorski kotar	2	3	3	3, →stable
Lika-Senj	19	21	7	15, ↑improves
Virovitica-Podravina	20	16	11	15, ↓lags
Pozega-Slavonia	19	17	18	18, →stable
Slavonski Brod-Posavina	14	18	20	17, ↓lags
Zadar	16	8	14	13, U oscillates
Osijek-Baranja	6	6	12	8, ↓ lags
Sibenik-Knin	17	15	19	17, →stable
Vukovar-Sirmium	7	12	21	14, ↓ lags
Split-Dalmatia	5	5	16	9, ↓lags
Istria	4	1	2	2, →stable
Dubrovnik-Neretva	3	3	5	4, →stable
Medimurje	21	11	9	14, ↑ improves
City of Zagreb	1	2	1	1, →stable

Source: Author's calculations.

redistribution is based upon two criteria and there were three kinds of recipient regions (communes, parts of cities and Vukovar as a special recipient area). The first two kinds of recipient areas were those occupied in the 1991–1995 Homeland war or those that had suffered damage during the war. These are jointly referred to as Areas of Special State Concern (commonly referred to as ASSC). The third kind of less developed regions eligible for support is composed of Hilly and Mountainous areas (referred to as HMA) and some Adriatic islands. Thus, in addition to a purely development task common to all economies in the Croatian case the regions eligible for support were also involved in tackling many other socially very sensitive issues, including matters such as the return of refugees, Serb minority issues, and dealing with problems of displaced persons. Financially, these regions are supported in four distinct ways: (1) Through tax breaks that provide smaller profit taxes for firms and larger income tax rebates for citizens. (2) Through aid (for example, the Fund for Regional Development established in 2002 aids local units whose income is below 65 per cent of the national average) that is used

Table 10.5 Intra-Croatian redistribution of income

Local self-government units eligible for financial support				
	Number of less developed administrative units	**Share in Croatia**		
		Of all communes	**Area,**	**Population**
1966–1970*	16 communes	15.5	18.9	10.0
1971–1975*	46 communes	43.8	44.3	29.8
1976–1980*	27 communes	25.7	29.3	16.3
1981–1985*	28 communes	25.7	30.6	14.6
1986–1990*	30 communes	28.6	32.0	15.7
2001–2003**	180 communes and cities	32.8	30.6	14.6
Size of funds for financing eligible less developed areas				
	Share in Income		**Share in general govt**	
1986/1990*	0.5% of social product		n.a..	
2002***	0.28% of GDP		0.6%	

Source: *Bogunović (1991), **Institute for International Relations (2005) and ***Ministry of Finance (2004).

principally for infrastructural investments and subsidies (determined yearly to finance 'minimum standards' of public services). (3) Through institutional support (for example, support for industrial zones, access to funds, and so on). (4) Through direct support for entrepreneurs in these areas. This will involve subsidized credits and bank guarantees (the first is given by the development bank, HBOR and the second by the agency for small enterprises, HAMAG, both within their otherwise wider mandate have special programmes for ASSC areas). Prior to the establishment of the fund in 2002 but in the period from independence in 1990 to 2001 there was no institutionalized regional policy.

It is interesting to compare the inclusion rate of the two systems as reflected in Table 10.5. The aggregate population and area eligible for funds shows a remarkable consistency. Regardless of the system and regardless of the application of different criteria the eligibility changed little. When the areas are compared there is a difference. The system until 1990 supported larger units and more compact areas. The current system, with its three different categories, supports much smaller units strewn throughout the whole country. One point that is clearly visible is that there is a considerable overlap and that over the course of the period the less developed areas have not experienced much change – almost no area has joined the 'developed' club.

10.5 Concluding remarks

During the almost forty-year period considered in this chapter Croatian regions have experienced two quite different sub-periods. The first was a relatively stable period but during the second the Croatia and its regions were exposed to four substantial shocks (transformation, independence, war and EU integration), each of which had spatially asymmetric effects. As a result, it is quite understandable that over the course of the past two decades Croatian regions have faced instability, leading to the development of a 'stylized' fact about significantly rising and changing regional inequality. This instability is reflected in the changes of measured inequality of regional income over a thirty-year period (1971–2003). The changes were 'U' shaped, indicating a fall during the first sub-period and a rise during the second one. The inequality of regions per capita displays a completely different dynamic and has decreased steadily over the thirty-year period. Such changes of the latter variable, which is a better indicator of economic welfare, does not support the 'stylized fact' about the rise of Croatian spatial inequality. The main explanation of the difference during the period of exposure to shocks is given by the dramatic changes in population (internal shifts, emigration and immigration). These population shifts were under the influence of all four shocks and their analytical unbundling has not yet been undertaken. In the thirty-year period all of the support for Croatia's less developed regions has been carried out through the policy of internal redistribution. In spite of large differences during the thirty-year period the eligibility of less developed regions for these redistribution resources has changed little in respect of area and population. On a more disaggregated view in spite of growth, change and efforts over the thirty-year period none of the less developed regions has 'joined' the developed regions. In this sense, Croatian spatial inequalities seem stable in the sense of a 'two-tier' structure with little change in the upper tail and in the lower tail dynamics that do not upset the two-tier structure.

References

Bajo, Ante (2007) 'Fiscal decentralizacija' (Fiscal decentralization) in Ott Katarina (ed.), *Javne financije u Hrvatskoj,* 3 (Public finance in Croatia 3), Zagreb: Institut za javne financije, pp. 53–75.

Bogunović, Aleksandar (1991) *Regionalna ekonomika* (Regional economics), Zagreb: Narodne novine.

Botrić, Valerija (2003) 'Regionalni aspekti nezaposlenosti u Hrvastskoj' (The regional aspect of Croatian unemployment) *Privredna kretanja i ekonomska politika*, 95/2003, 27–45.

Brajčić, Zdenko (2005) 'Razvoj metalurgije i njezin utjecaj na urbanu preobrazbu i stambenu izgradnju Siska' (The development of metallurgy and its influence on the transformation of Sisak urban development), *Geoadria* 10(2), 211–28.

Čavrak, Vladimir (2003) 'Regionalni razvoj i regionalna politika Hrvatske' (Regional development and regional policy in Croatia) in Ivo Družić (ed.), *Hrvatski gospodarski razvoj*, Zagreb: Politička kultura.

Cowell, Frank (2000) 'Measurement of Inequality', in Anthony Atkinson and Francois Bourguignon (eds), *Handbook of Income Distribution*, Amsterdam: North-Holland Elsevier, pp. 87–166.

EC Delegation to Croatia (2004) *Strategy for Capacity Building for Regional Development, Analysis of Regional Development in Croatia* CARDS 2002 Programme for Croatia, Zagreb

Franičević, Vojmir and Ivo Bićanić (2007) 'EU Accession and Croatia's Two Economic Goals: Modern Economic Growth and Modern Regulated Capitalism', *Journal of Southeast European and Black Sea Studies* 7(4), 637–63.

Institute for International Relations (2005) *New Approach in Development Level Assessment and Categoriazation of Territorial Units*, Zagreb: IMO.

Kavklar, Alenka, Darja Boršič and Ivo Bićanić (2007) 'Estimating Determinants of Unemployment Spells in Croatia', *Proceedings 9th International Symposium on Operational Research in Slovenia*, Univerza u Ljubljana, Ljubljana.

Krugman, Paul (1996) 'Cycles of Conventional Wisdom on Economic Development', *International Affairs* 72, 717–32.

Lovrinčević, Željko, Davor Mikulić and Davor Budak Davor (2004) 'Područja od posebne državne skrbi u Hrvatskoj – rezlike u regionalnoj razvijenosti i demografsko-obrazovne karakteristike' (Areas of special state concern in Croatia – differences in regional development and demographic and educational characteristics), *Ekonomski pregled* 55(3–4), 389–411.

Ministry of Finance (2004) *Godišnje Izvješće 2003 (Annual Report for 2003)*, Zagreb: Ministarstvo financija.

Ministry of Finance (2007) *Annual Report of the Ministry of Finance for 2006*, Zagreb: Ministry of Finance.

Ministarstvo mora, prometa, turizma i razvoja (2006) Nacionalna strategija regionalnog razvoja, radna verzija (National strategy for regional development, draft version), Ministarstvo mora, prometa, turizma i razvoja, Zagreb at www.mmtpr.hr and http://www.strategija.hr/lgs.axd?t=16&id=208.

Nacionalno vijeće za konkurentnost (2003) *Godišnje izvješče o konkurentnosti Hrvatske 2002* (Annual report on Croatian Competitiveness 2002), Nacionalno vijeće za konkurentnost, Zagreb.

Nestić, Daniel and Giovanni Vecchi (2007) 'Regional Poverty in Croatia', in I. Lovrinčević (ed.), *Social Policy ands Regional Development, Proceedings*, Zagreb: EIZ and FES, pp. 65–90.

Puljiz, J. (2006) 'Proposal for New Development Categorisation of Regional and Local Units in Croatia', *Croatian International Relations Review* 12(44/45), 125–39.

Puljiz, Jakša and Sanja Maleković (2007) 'Regional Income and Unemployment Disparities in Croatia', *Conference Proceedings 7th International Conference Enterprise in Transition*, Split: University of Split.

Sirotković, Jakov (1990) *Ekonomski razvoj Jugoslavija – od prosperiteta do krize* (Economic development of Croatia – from prosperity to crises), Zagreb: Narodne novine.

Sirotković, Jakov and Vladimir Stipetić (eds) (1984) *Ekonomika Jugoslavije* (Economics of Yugoslavia), Zagreb: Informator.

UNDP (2002) *Human Development Report for Croatia*, Zagreb: UNDP.

UNDP (2007) *Kvaliteta života u Hrvatskoj Regionalne nejednakosti* (Quality of life in Croatia – Regional inequalities), Zagreb: UNDP Croatia.

Werheimer-Baletić, Alica (1999) Demografija i rast (Demographics and growth), Zagreb: MATE.

World Bank (2007) *Ocjena životnog standarda Prvi dio: Promicanje socijalne uključenosti i regionslne jednakosti* (Croatia Living Standard Assessment, Part I: promoting social inclusion and regional equity), WP 37992, Zagreb: World Bank.

Data

Državni Zavod za Statistiku (2008) 'Bruto domaći proizvod za Republiku Hrvatsku i Županije 2005' (GDP for the Republic of Croatia and counties in 2005), *Priopćenje* 45(12).

Državni Zavod za Statistiku RH (various years) *Statistički ljetopis RH* (Statistical Yearbook of the Republic of Croatia).

Savezni zavod za statistiku (1989) *Jugoslavija 1918–1988* (Yugoslavia 1918–1988), Belgrade: Savezni zavod za statistiku.

Zavod za statistiku Socialističke Republike Hrvatske (various years) *Statistički godišnjak SRH* (Statistical Yearbook of the Socialist Republic of Croatia).

Index

Accession 11, 12, 18, 19, 22, 63, 73, 74, 83, 84, 111, 116, 122, 130, 206, 258, 269, 272, 286
Acquis communautaire 2, 11, 12, 122
Administrative districts 85, 173
Administrative structure 101, 234, 271
Agrarian dualism 44
Agricultural overpopulation 110
Allocation 5, 37, 67, 68, 76, 77, 78, 81, 82, 86, 108, 123, 205, 208, 227, 243, 247, 260, 266
Anglo-Saxon model 14
Annual FDI inflows 168, 169, 170, 171

Budget
  Cohesion policy 89
  County 203
  Cross compensation 76
  Current budget 33
  EU budget 13, 18, 57, 64, 68, 74, 75, 76, 91, 267
  Local 270
  Maastricht convergence criteria 69
  Management 39
  Municipal 207
  National 204–6
  Pre-accession activities 72
  Republican 289
  Savings 38
  Size 33, 37
  State 5, 7, 208
  Structural deficit 107
  Soft budget constraint 9
  Transfer 65
Budget cycle 267
Bulgaria
  Administrative organization 84
  Employment 129
  EU membership 166
  FDI inflow 170, 184
  GDP growth 47
  Lagger 48, 87

Capitalist trajectories 3, 4, 13
Central and Eastern Europe (CEE)
  Capitalism 14
  Definition 61
  Differentiation 50, 51
  FDI 166, 167
  Governance 13
  Industrial regions 102
  Interregional associations 69
  Labour market 139
  Output levels 100
  Periphery 43, 47
  Pre-accession assistance 57, 83
  Prosperity gap 63
  Regional disparities 8, 53
  Role of state 5, 10
  Trajectories 15
Civil society 5, 19, 82, 228, 229, 230, 232, 235, 236, 237, 240, 244
Council for Mutual Economic Assistance (CMEA) 166
Co-financing 243
Cohesion countries 66, 87
Cohesion Fund 12, 57, 69, 70, 76, 77, 78, 79, 80, 81, 89, 91, 212, 254
Cohesion Policy 12, 18, 57, 59, 63, 66, 67, 73, 76, 86, 253
  Phasing in 77, 78, 80
  Phasing out 76, 77, 78, 79
Common Agricultural Policy (CAP) 57, 67, 74, 255
Communes 211, 275, 277, 278, 285
Community Support Framework (CSF) 68, 237
Competitiveness 6, 8, 10, 11, 12, 13, 31, 48, 49, 51, 58, 60, 70, 72, 73, 75, 76, 77, 78, 79, 80, 90, 100, 116, 167, 182, 183, 187, 189, 214, 234, 256, 265, 268

Conditionality 11, 12, 272, 282, 283, 284
Constitution 91, 93, 100, 199, 201, 204, 206, 239
Convergence 1, 3, 11, 13, 14, 15, 57, 60, 63, 70, 73, 76, 77, 78, 79, 80, 82, 83, 85, 91, 92, 125, 126, 127, 265, 266, 273, 275
Convergence criteria 69
Councils 201, 205, 206, 215, 235, 271
Counties 22, 85, 188, 201, 202, 203, 206, 218, 261, 262, 264, 269, 271, 278, 279, 280, 281, 283
Croatia
  Applicant country 83
  Counties 280
  Development gradient 279
  FDI inflow 170, 172, 173, 174
  Interregional associations 69
  Mono-employment towns 276
  Regional inequality 274, 278, 284, 287, 288
  Regional structure 85, 278
  Shocks 272
  Stability and Accession Pact 286
Cross-border 13, 80
Crouch, C. 10, 16, 39
Cultural barriers 36

Dallago, B. 1, 6, 14, 20
Decentralization 1, 19, 21, 73, 100, 101, 104, 111, 200, 205, 206, 207, 216, 217, 228, 234, 265, 278, 279
Democracy 200, 201, 205, 208, 242, 254
Development gradient 272, 273, 274, 277
Dialogue 118, 230, 231, 232
Dirigisme 1
Divergence 14, 15, 22, 54, 57, 126, 255, 257, 273, 275
Domestic savings 113,
Dual economy 180, 182
Dynamics
  Accumulation 13
  Growth 48, 107, 111
  Regional 52, 87, 263, 269
  Socioeconomic 118

Efficiency 31, 32, 36, 37, 38, 58, 73, 77, 83, 84, 183, 189, 231, 246, 265, 267
Emerging markets 19, 113
Employment
  Cohesion policy 78, 80
  Competitiveness 13, 76, 90
  Data 154–65
  ERDF/ESF 70, 75, 79
  FDI 180
  FIEs 174, 177, 181
  Growth 59, 89
  Industrial 125, 275
  Innovation 11
  Mono-employment 276
  Non-agricultural occupations 274
  Pacts 231, 232
  Participation 127–31
  Policies 72, 73, 213–15
  Regional 135–41, 144
  Single Market 65
  Small enterprises 109
  Social exclusion 68
  Structure 123, 124
  Success region 100
  Youth 134 276
Endogenous factors 49
Enlargement, *see EU enlargement*
EU regional policy 18, 64, 150, 214, 264, 265
EU enlargement xi, 72
  Copenhagen criteria 11, 12
Europe of the Regions 12
European budget 64, 267
European Commission 11, 18, 64, 75, 92, 100, 230, 237,
European Economic Area 122
European Regional Development Fund (ERDF) 66, 91, 229, 231, 232
European Social Fund (ESF) 66, 70, 71, 79, 81, 83, 92, 227, 229, 232, 233
European Structural Funds (SF) 66, 207, 229, 233, 234, 236, 237, 245, 246, 265, 268, 270

Europeanization 12, 14, 21, 66, 67, 229
Exogenous factors 49, 256

Foreign Direct Investment (FDI) 2, 88, 106, 113, 114, 167–90
Foreign Invested Enterprises (FIEs) 167, 174–84
Firm level 6
Fiscal decentralization 278, 279
Fléchage Lisbonne 73, 76, 89,
see also Lisbon Strategy
Flexibility 6, 8, 81, 82, 107, 124, 187, 189, 240
Fordism 7
Fordist-Keynesian model 5
Functional cohesion 266

Global commodity/value chains (GCCs/GVCs) 185
Gini coefficient 104, 108, 284, 285
Global production networks 167, 185, 186
Globalization 2, 3, 5, 10, 14, 31, 41, 49, 114, 116, 117, 185
Good governance 21, 229, 230, 233, 234, 23, 248

Hall, P. 3, 16, 23
Human Development Index (HDI) 104
Hungary
  Constitution 201
  Employment 129
  FDI inflow 88
  FDI stock 113, 172, 173, 174,
  GDP growth 47
  Leader 47, 87
  Local governments structure 201
  Reforms 12
  Regional development 222
  Regional structure 85
  Structural Funds 86

Identity 33, 35, 36, 39, 40, 41, 42
International Financial Institutions (IFIs) 9
Industrial zones 291
Inequality 104, 105, 106, 108, 189, 207, 273, 274, 275, 278, 283, 284–88
Institution building 58, 73, 83, 84, 107, 111, 112, 228
Integrated Operational Programme of Regional Development 229, 233, 241
Integration 9, 11, 12, 17, 18, 20, 22, 23, 65, 87, 88, 111, 112, 116, 117, 122, 167, 184, 212, 229, 230, 257, 269, 272, 273, 275, 278
Intertemporal (policy) trade offs 33, 38
Instrument for Structural
Policies for Pre-Accession (ISPA) 11, 73, 83

Kornai, J. 5, 9, 34, 60

Labour force participation 123–38, 140–3, 148
Labour market disparities 149, 150
Labour markets 8, 60, 122, 124, 126, 129, 137, 140, 141, 143, 148, 149, 150, 188
Laggards/Laggers 50, 55, 56, 102
Leaders 47, 49, 55, 102, 104
Liberal Market Model 3, 14
Lisbon Strategy 72, 73, 79, 89
Local Democracy 200, 242
Local Government 32, 33, 37, 38, 90, 114, 197, 199, 200–13, 215, 217
Local public goods 37, 39, 40, 41
Losers 50, 55, 56, 102
Loyalty 33–6, 39, 40, 41, 42

Macleod, G. 2, 4, 5, 6, 23
Market economy 1, 17, 58, 60, 83, 91, 100, 107, 108, 111
Metropolitan regions 51, 55, 177, 178
Mezzogiorno problem 253, 258
Micro-regions 21, 207, 208, 214, 217
Migration 23, 104, 122, 124, 257, 259, 260, 261, 275, 276, 281, 288

Modernization 43, 84, 178, 179, 200, 257, 263, 264, 267, 271
Modes of governance 4, 16, 229, 230, 234, 237, 238, 247
Mono-employment 275, 276
Multi-level governance 68, 83, 230
Multinational Corporations (MNCs) 9

National Development Plan 214, 233, 237, 239, 243
National dummies 136, 137, 138, 143, 149
Networked polity 230
New Modes of Governance (NMG) 230, 231, 234, 237, 238
New Public Management 266
NUTS 2 regions 19, 100, 176, 177, 265, 270, 271

Obligatory duties 219

Pact 231, 232
  On Stability and Accession (SAA) 272, 286
Participation rates 123, 126–30, 132–41, 143, 148, 150, 151
Partnerships 37, 72, 215, 232, 237, 284
PHARE 11, 37, 73, 83, 232, 267
Phasing in 77, 78, 80
Phasing out 76, 77, 78, 79
Political elites 234
Poland
  Crop rotation system 44
  Disparities 102, 104, 113, 253
  Employment 128
  Equity 59, 102
  EU assistance 59
  FDI 172, 173, 174, 184
  GDP 100
  Gentry 45
  Governance 229, 232, 235, 239
  Labour Market 149
  Leaders 47, 87, 88, 99, 102
  MEGAs 51
  Reforms 12, 99
  Regional structure 85, 100, 233, 234
  Stagnation 46
  Strategy for Poland 107, 108, 111
  Subnational government 228, 230, 232
  Transformation 99, 106
  Unemployment 108, 109, 129, 135
Polycentricity 51, 87, 264
Post-Fordism 1
Post-socialist transformation 19, 55, 56, 60, 99, 115
Pre-accession 11, 13, 22, 72, 73, 83, 90, 91, 257, 268
Progressing wave model 263
Public services 37, 83, 203, 204, 207, 208, 219, 291

R&D 8, 9, 52, 57, 59, 182, 188
Redistribution 12, 50, 57, 86, 90, 265, 266, 274, 277, 289, 290, 292
Referenda 211, 212, 217
Regional competitiveness 60, 70, 73, 76, 77, 78, 80
Regional development
  Administrative capacity 84
  Differences 55
  Disparities 18, 106
  Dynamics 263
  ERDF 91
  EU 11, 83, 87, 257, 264, 271
  FDI 167, 168, 178, 180, 181, 185–9, 282–4
  Gradient 273–5
  Growth 60
  Institutions 66, 199, 205, 206
  Labour market 142
  Linkages 88
  Local government 197, 291
  Policy 214, 215, 216, 218, 229–37, 241–3, 278
  Socialist 277
  Statistical data 8
  Structural change 124
  Structural Funds 123
  Theory 48, 49

Traditional approaches 58
Traditional objectives 213
Trends 222
Regional disparities 2, 8, 11, 18, 63, 6, 79, 104, 124, 126, 127, 130, 148, 149, 150, 172, 265, 267, 269, 270
Regional diversity xi, 2, 13
Regional labour markets 122, 124, 129, 137, 150
Regional networks 269
Regional policy, *see EU Regional policy*
Regional restructuring 11, 13
Regionalism 1, 23
Regionalization 9, 11, 13, 68
Romania
Continuity 255
Demographics 256, 259
Development 256
EU membership 166, 255, 257
Effects FDI 184
FDI inflows 170
FDI stock 172, 173, 174
GDP growth 47
Mezzogiorno syndrome 254, 261, 262, 267
Migration 257
Modernization 263
NUTS 2 regions 265
Patrimonial capitalism 15
Policy framework 257
Regional development 51, 263
Regional structure 85
Sectoral Operational Programmes (SOP) 265
Strong follower 47, 87
Transition 254
Unemployment 258, 260

SAPARD 11, 83
Sapir Report 4, 265
Sectoral concentration 180
Sectoral Operational Programmes 265
Settlement 199–203, 205, 207–13, 215–19
Shock therapy 10, 106
Shocks 272, 273, 284
Shortage economy 5
Small and Medium-Sized Enterprises (SMEs) 8, 39, 76, 77, 79, 89, 90, 284
Slovakia
Employment 128, 129
FDI inflow 169, 172, 173, 174, 177
FDI stock 113
GDP growth 47
Labour market 149
Leader 47, 87
Regional differences 51
Regional structure 85
Social market economy 14
Social plan 277, 290
Social policy 64, 69, 73, 90, 213, 216, 229, 231, 241
Socialist economy 55, 56, 102, 255, 276
Soskice, D. 3, 16, 23
Spatial heterogeneity 277, 282
Stakeholders 6, 7, 18, 63, 92, 237, 238–40, 246, 248, 284
State
Allocative function 5, 205
Areas of Special State Concern 290
Budget 5, 7, 204, 208
Central planning 5
Declining capacity 15, 31
Distributive role 5, 290
Labour 187
Legitimacy crisis 10
Macro-economic agent 4
Modes of governance 16
Public Administration 202
Regional distribution 290
Restructuring 5, 9, 10, 11, 111
State aid 104
State bureaucracy 84
State-ownership 110, 282
Transformation 5, 10
Welfare state 72
Strategy for Poland 107, 108, 111
Structural Funds, *see European Structural Funds*
Szelenyi, I. 3, 13, 14, 15

Tax
  Base 182
  Breaks 291
  EU tax 76
  Exemptions 118
  Holidays 179
  Local 202, 204, 205, 213, 216, 219
  Policy 279
  Value Added Tax (VAT) 74
  Wedges 126
Territorial
  Embeddedness 183
  Self-government 101, 228, 229, 233–5, 241, 245, 246
Transnational Corporations (TNCs) 166, 167, 180, 184, 185, 187–90
Transformational depression 106
Trigilia, C. 16, 36, 39
Trust 33, 36, 39, 40–2
  Detrimental 36
  Distrust 37, 246
  Eroding 240
  Inducing factors 34
  Informal 34
  Low Levels 248

Unemployment
  High rate 17,107, 109, 124, 179, 258
  Increase 91
  Local government 33
  Long-term 73, 125
  Low rate 263
  Policy 69, 70
  Rate 123, 260
  Regional 79, 124–48
United Nations Development Program (UNDP) 104
Urbanization 269, 274, 275
  Forced 259
  Reverse 259
  Suburbanization 53, 56

Varieties of Capitalism 3, 14, 15
Vertical integration 7, 275, 276, 282
Voivodships 100
Voluntary compliance 230, 233
Voluntary tasks 203, 219

Washington consensus 2
Winners 50, 55, 102, 268